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CSBS ACCREDITED 1993
NASCUS ACCREDITED 2000
CSBS/AARMR MORTGAGE ACCREDITED 2015

April 1, 2016

National Credit Union Administration
Attn: Gerard Poliquin, Secretary of the Board
1775 Duke Street
Alexandria, VA 22314-3428

Dear Board:

Thank you for this opportunity to comment on the Overhead Transfer Rate (OTR) and Federal Credit Union (FCU) Operating Fee Schedule Methodology. Since these are interrelated topics, this comment letter will serve as comment for both the OTR and the FCU Operating Fee Schedule Methodology. As the regulator of North Dakota State Chartered Credit Unions, the Department is concerned with what appears to be a systematic effort to consolidate authority over the safety and soundness of financial institutions. We recognize and respect your role as insurer of deposits and ask that you afford us that same level of respect as the chartering agency for North Dakota credit unions as well as our legally mandated role to regulate and ensure the safety and soundness of the institutions we charter. We also encourage you to respect a credit union's choice to be state or federally chartered, and not indirectly subsidize the federal charter through the OTR at the expense of all credit unions, including state chartered credit unions.

Weaknesses within the Methodology

The OTR request for comment outlines the efforts NCUA has employed to support the mechanics of the methodology. Statistics and third party audits of these mechanics have been utilized to try and support this model. Unfortunately, the assumption that all safety and soundness related rules and activities are solely insurance related is not well supported and intrinsically flawed. The result of this flawed assumption is a methodology with results that defy reason and distort the true cost to examine a federal credit union.

It appears, through the mapping of procedures and regulations, virtually all safety and soundness related examination costs are assumed to be an insurance related cost. No consideration is afforded to these costs as also a chartering related expense, and no attempt is made to allocate these costs between both the insurance and chartering function. This is a critical flaw within the assumption of the methodology.

The assumption that all safety and soundness related costs are only a cost of insurance is inconsistent with the congressional intent, the application used by states and other federal regulators, and even the application outlined within the historic context of your own regulations. Congress has long made clear safety and soundness was also a responsibility of the chartering authority, including the requirements within the Credit Union Membership Access Act (CUMAA) which requires NCUA to consult with the State Supervisory Authority (SSA) regarding prompt corrective action and member business lending (both safety and soundness provisions). Within North Dakota statutes and rules, safety and soundness concerns are thoroughly addressed. These rules include, in part, member business loans, prompt corrective action, audits, and a general safety and soundness provision. These rules are actively enforced, and most findings, exceptions, and enforcement actions issued by the Department, as a function of our role as the chartering regulator, relate to safety and soundness concerns.

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Safety and soundness is clearly an obligation of the chartering entity and the Office of the Comptroller of the Currency (OCC) is a good example of a Federal Agency with only chartering authority. This agency has a very active safety and soundness examination program, and defines safety and soundness within its mission as noted in footnote 10 of your OTR Request for Comment. Much of their expenditures are used for safety and soundness; these same expenditures have been classified as solely insurance related costs by NCUA. If these costs were only insurance related, the OCC would not incur these expenses since FDIC has the role of insurer. NCUA has actually used OCC safety and soundness material in reference in NCUA guidance and rule, including reference to the OCC's Credit Risk Handbook. If safety and soundness were not a role of the chartering entity, why would the OCC include safety and soundness it in its mission statement, and publish the safety and soundness material referenced by the NCUA?

Within your OTR Request for Comment, the reasoning appears at times to conflict with itself. On one hand, recognizing other chartering authorities such as the OCC which has clearly defined safety and soundness as part of their mission, then later within your Request for Comment, the OTR methodology assigns all safety and soundness costs solely to the insurance function.

It is noted that NCUA relies upon the work of State Supervisory Authorities (SSA) where possible to meet its obligation to monitor for safety and soundness as envisioned by congress and noted in footnote 12 of the Request for Comment. This is again an area where the Request for Comment appears to conflict with itself. As noted above, the mapping of expenses indicates that no safety and soundness related costs are allocated to the chartering function. If safety and soundness were solely an insurance activity, there would not be any safety and soundness related work product from the SSA to rely upon. The publication appears to conflict with itself noting your reliance upon SSA safety and soundness work as the chartering entity, then by assigning all safety and soundness costs for federal credit union examinations as insurance related. If safety and soundness work product exists from the SSA, then examination safety and soundness work product and expenses must also exist as part of the chartering function of federal credit unions.

The assumption within the OTR methodology that certain safety and soundness examination expenses pertain only to the insurance function conflicts with the framework of other NCUA regulations. The business loan rule, NCUA Part 723, is possibly the best example of this; the restrictions within this rule relate mostly to safety and soundness concerns. The rule has a long history of allowing for state specific regulations to replace the NCUA rule. If business loans were solely a function of insurance safety and soundness related concerns, and did not have chartering safety and soundness implications, why would past and current rules allow states to adopt their own business loan regulations? The business loan rule in particular appears to recognize that both the chartering and insurance function bear responsibility for the safety and soundness risk. Costs associated with the examination of this risk need to be allocated equally to the insurance and chartering costs associated with federal credit union examinations.

There is irony in the OTR methodology's attempts to clearly map out certain regulations as cleanly and clearly insurance function versus chartering function, without entertaining the notion certain regulations function under both. NCUA's regulations themselves are not even designed to cleanly or clearly map out the applicability between insurance and chartering regulations, much less address the question of safety and soundness as an insurance or a chartering function. NCUA, despite many requests over many years to separate the two sets of rules into distinct sections, continues to blend insurance related rules with chartering related rules. The end result continues to be confusion for the industry, consumers, and even state and federal examiners as to which rules apply to which credit unions. It is in this tangled web of regulations that OTR Examiner Time Surveys have been employed. It is highly unlikely under the current

rule construct that the OTR methodology can overcome the challenges of not only identifying rule applicability, but also assign where the safety and soundness responsibility resides.

As noted, the assumption that all safety and soundness related costs are only a function of the insurance function is deeply flawed. The use of this flawed assumption diminishes the usefulness of any and all statistical and third party review of the mechanics of the model. This flaw negates the effectiveness of the model as a measurement tool.

Noted within the request for comment is the statement that NCUA relies upon the work of the SSA whenever possible. This is appropriate; however, we are concerned that actual practice is becoming less and less consistent with this statement. The Department considers the working relationship with local and regional NCUA staff as strong, but more and more their actions appear to be driven by national level directives; directives which seems to undermine this working relationship and limits NCUA's reliance upon state work product. NCUA CAMEL ratings are an excellent example of this. NCUA examiners are now required to disclose NCUA specific CAMEL ratings even when identical to state ratings, detracting from the intended joint nature of these examinations. NCUA amended the regulatory definition of a troubled credit union, giving NCUA the power to unilaterally declare an institution as troubled. Both of these actions are inconsistent with NCUA's stated goal of relying upon the work of the SSA where possible, and congressional intent as noted in footnote 12 of the Request for Comment. Better adherence to this stated principle could help reduce NCUA's insurance related examination costs.

The Request for Comment attempts to support increased insurance related OTR costs by noting recent expanded authority for NCUA to focus on safeguarding the NCUSIF. The authority cited include passage of the CUMAA, interest rate risk rules, liquidity guidance, and rule modernization efforts. While a potential benefit to the industry, it is unclear how the cited modernization rules had any material impact on safety and soundness, or NCUA's safeguarding of the NCUSIF. Prior to the CUMAA, both NCUA and the Department were examining business lending programs and capital levels for safety and soundness. If anything, the CUMAA makes clear the chartering authority also bears responsibility for safety and soundness, requiring NCUA to work cooperatively with the SSA for Prompt Corrective Action and Member Business Loans. The assertion that liquidity and interest rate risk rules and guidance have enhanced NCUA authority seems to imply these are areas that were not previously regulated by NCUA. These risks have long been part of the CAMEL risk rating, and were actively regulated by both NCUA and the Department long before these rules and guidance were issued. No real increase in insurance related authority has occurred, thus there is no real justification for the sharp increase in the OTR.

While insurance related obligations have not changed, NCUA's chartering related obligations have increased substantially with the changes in consumer compliance related rules. With increased chartering obligations, it is expected that chartering related costs would <u>increase</u>. However, strangely absent from the both the OTR Request for Comment and the FCU Operating Fee Request for Comment is any real support or justification of the reason FCU operating fee rates have <u>declined</u>. Much effort is spent trying to justify increases in the OTR, but no comment is made why chartering specific rates declined. Even under the flawed assumption that safety and soundness is only an insurance related cost, the costs for chartering should not have declined. The cost to enforce consumer compliance alone should have more than offset any limited cost savings realized from rule modernization. With the flurry of consumer compliance related changes in recent years, if anything, FCU Operating Fees should have increased. The sizable decline is not well supported and defies reason.

Correcting the Weakness within the Methodology

Despite the previously noted weaknesses within the methodology, the framework can be salvaged. Much of the mechanics of the methodology, which is essentially a form of cost accounting, has been statistically

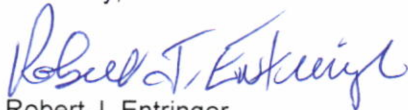
validated and reviewed by third party audit firms. Correcting the public policy related assumptions, effectively adjusting cost accounting allocations of overlapping safety and soundness expenses, to be consistent with congressional intent and the application by other state and federal regulatory agencies could make the methodology functional. Additionally, better adherence to the stated principles of relying upon SSA work product would also help strengthen the process.

The first step to correct the weakness within the methodology is to clearly separate the NCUA regulations between insurance and chartering function. Until it is clear to all parties (credit union officials, consumers, state and federal examiners) which rules are insurance related and which are only related to federal charters, it is not practical to expect accuracy in Examiner Time Surveys.

The second step to correct the weakness within the methodology is to recognize the congressional intent was for the safety and soundness responsibility to be shared equally between the chartering and insuring function. This is consistent with the framework employed by other federal banking regulators. Insurance regulatory related expenses (safety and soundness related expenses) need to be allocated on a 50/50 basis between the chartering and insurance related examination costs during FCU examinations. This cost accounting allocation essentially assigns the safety and soundness costs to both the insurance and chartering roles consistent with congressional intent and consistent with the functional application by other financial institution regulators and insurers.

Finally, hold true to your stated principle of relying upon the SSA where possible. We respect and welcome the expertise your examiners can provide during examinations. Please afford us and the credit unions we regulate the same level of respect by: relying upon SSA CAMEL evaluations and work product; limit unnecessary examinations and follow up contacts by eliminating the annual examination requirement based on asset size regardless of risk; and, afford your supervising examiners more discretion to determine IF an on-site follow up contact is necessary provided the nature of the risks do not warrant such contacts. These steps will reduce hours needed for state examination reviews, eliminate some duplication, increase the SSA Implied Value within the methodology, hold true to the congressional intent of the dual chartering system, and reduce overall examination costs to the industry.

Sincerely,



Robert J. Entringer
Commissioner
North Dakota Department of Financial Institutions

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