NASCUS
The National Association of State Credit Union Supervisors

February 20, 2024

Melane Conyers-Ausbrooks
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428

Re: NASCUS Comments on NCUA Request for Comment Regarding Overhead Transfer Rate Methodology (NCUA-2023-0142)

Dear Secretary Conyers-Ausbrooks:

The National Association of State Credit Union Supervisors (NASCUS)[1] provides the following comments on the NCUA Request for Comment Regarding Overhead Transfer Rate (OTR) Methodology.[2] NASCUS appreciates the opportunity to share our views and those of state credit union system stakeholders on this important matter. Our comments this year will include previous related comments[3] by reference regarding the OTR Methodology, but this letter will concentrate on the broad aspects of the questions posed in the NCUA request for comment and attempt to clarify the current broad concerns held by the state system regarding the transparency of the methodology, its inputs and reconcilements with actual performance and our perception of the potential inequitable treatment of FCUs and FISCUs.

NASCUS recognizes that the development and implementation of an OTR Methodology can be a complicated undertaking. This is especially true when balancing administrative efficiency against granularity and potentially diverging views of equitable apportionment. Further complicating the matter is NCUA's dual role as both the administrator of the share insurance fund as well as the administrator of the federal charter in competition with the state charter (the dual chartering system).

We commend NCUA for its continued commitment to evaluating and refining the OTR Methodology to ensure the OTR is equitable and coheres to the statutory parameters

[1] NASCUS is the professional association of the nation's forty-six state credit union regulatory agencies that charter and supervise over 1900 state credit unions. NASCUS membership includes state regulatory agencies, state chartered and federally chartered credit unions, and other important stakeholders in the state system. State-chartered credit unions hold over half of the $2.25 trillion assets in the credit union system and are proud to represent nearly half of the 140 million members. The remaining 5 states lack state-chartered credit unions.
[2] Request for Comment Regarding Overhead Transfer Rate Methodology, 88 FR 88131 (Dec. 20, 2023),
[3] NASCUS Comments on NCUA Staff Draft Budget Justification 2024 -2025 (Docket Number NCUA-2023-0117); November 21, 2023; Available at https://www.nascus.org/wp-content/uploads/2023/11/NASCUS-COMMENTS-ON-DOCKET-NCUA-2023-0117.pdf

established by the Federal Credit Union Act. In that vein, we believe strongly that NCUA should continue to publish the OTR Methodology for comment.

NCUA Should Continue to Publish OTR Methodology for Comment

NASCUS and our state credit union system stakeholders find value in the ongoing dedicated notice and comment process. It gives stakeholders an ongoing opportunity to provide input into how the OTR Methodology may be better refined. The notice and comment period serves to educate stakeholders about the OTR and NCUA's funding mechanism. Furthermore, ongoing notice and comment allows for additional stakeholders to engage in the process as they familiarize themselves with the intricacies of the OTR.

Given the importance of the OTR Methodology, and immense consequences to the funding levels of the SIF of the OTR itself, it is hard to imagine any speculative benefits of discontinuing the dedicated notice and comment outweighing the critically important value of dedicated notice and comment. Maintaining dedicated notice and comment is especially compelling given that as discussed in our comments that follow, the current OTR Methodology, although appealingly simplified, remains deficient in several critical elements.

In addition to statutory fidelity and equity between the state and federal systems, another compelling reason to ensure the OTR is properly calibrated is that every dollar transferred out of the share insurance fund (SIF) in excess of what is statutorily necessary is a dollar unavailable to cover system losses and subsequently a dollar that may be needed to replenish, or fund increased reserves[4], in the SIF by the charging of a premium.[5]

NCUA Budget Funding Sources: Requirements to Utilize Title I Examinations and Prohibition on the Discrimination of FISCUs

The Request for Comment proceeds from two erroneous premises. The first is that by granting the NCUA authority to act as both a prudential regulator of federal credit unions and as the administrator of the National Credit Union Share Insurance Fund for all federally insured credit unions, Congress envisioned an equal division of labor and an equal allocation of costs among these two responsibilities. The second is that there are only a few provisions of the Act that are relevant to how the NCUA establishes the OTR Methodology and none of those provisions meaningfully constrain NCUA's discretion. Both premises are contrary to the plain language, history and purpose of the Act.

From 1934 to 1970 the Act provided for the regulation of federal credit unions, and did not include an insurance function. The Agency's supervisory responsibilities as the prudential regulator of federal credit unions included, and still include, the review of financial reports from each federal credit union at least annually. Fees paid by federal credit unions funded the costs of these supervisory activities. Supervisory fees were assessed on a graduated scale

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[4] Chairman Harper's November 2023 written testimony before the Senate Banking, Housing and Urban Affairs Committee; available at https://ncua.gov/newsroom/testimony/2023/ncua-chairman-todd-m-harpers-written-testimony-senate-banking-housing-and-urban-affairs-committee

[5] "NCUA: NCUSIF Premium May be Coming," CUtoday.info (September 17, 2020). Available at https://www.cutoday.info/Fresh-Today/NCUA-NCUSIF-Premium-May-Be-Coming.

in order to "defray [administrative, supervisory, and other expenses incurred by the Agency in carrying out the Act] as far as possible." See H. Rep. No. 91-1457, Federal Share Insurance for Credit Unions, at 26 (setting out Section 105 as it appeared as Section 6 of the original Act in 1970). The Agency was also responsible for periodic examinations of federal credit unions. Fees paid by federal credit unions funded the costs of these examinations, "giving due consideration to the time and expense incident to such examinations, and to the ability of federal credit unions to pay such fees." Id. (setting out section 106 as it appeared as Section 7 of the original Act in 1970).

In 1970, Congress designated the then-existing Act governing the Agency's role as prudential regulator for federal credit unions as Title I. Congress also added a new Title II to establish the credit union share insurance program.[6] Title II expressly recognized that the new insurance program was not being created in a vacuum, but rather was building on the existing Act. The express purpose of this approach was to take advantage of economies of scope, such that the Agency could leverage the supervisory and examination work relevant to the insurance program that was already being done as part of the NCUA's pre-existing supervisory duties. The new legislation thus provided, and the Act still provides, that "[r]eports required under Title I of this Act shall be so prepared that they can be used for share insurance purposes." Section 202(a)(5) of the Act, codified at 12 U.S.C. § 1782 (a)(5). The Act likewise provided, and still provides, that reports of state-chartered credit unions to their regulators should also be used for insurance purposes to the "maximum extent feasible." Id.

A fundamental problem with the current OTR Methodology is that it ignores this history and contravenes the plain language of the Act. The Request for Comments states "[b]ecause the NCUA acts as both prudential regulator and insurer of FCUs, its oversight of these FCUs is equally focused on the statutory requirements applicable to FCUs under Title I of the FCU Act and minimizing losses to the Share Insurance Fund under Title II of the FCU Act." Accordingly, the first of the Four Principles categorizes 50 percent of "time spent examining and supervising FCUs" as insurance-related and, thus, funds those costs via the overhead transfer, not from operating fees from federal credit unions. This result is directly contrary to the statute and the relevant history. The contemporaneous history confirms that the provisions of the Act recognized that the then-existing oversight and examination of federal credit unions was sufficient to allow them to be insured. See Sections 202(a) and 206(b) of H.R. 18870, reprinted in To Provide Insurance for Accounts in State and Federally Chartered Credit Unions, Hearings before the House Banking and Currency Comm., at 12-15, 20-21 (1970).

The current OTR Methodology is also inconsistent with Section 203(a) of the Act, now codified (unchanged) as 12 U.S.C. § 1783(a). That provision states that the Share Insurance Fund is to be used for "making payments of insurance," "providing assistance and making expenditures . . . in connection with the liquidation or threatened liquidation of insured credit unions," and "for such administrative and other expenses incurred in carrying out the purposes of [Title II] as it may determine to be proper." This provision prohibits the Agency from charging the fund for any expenses incurred in carrying out its responsibilities under

[6] See Cong. Rec. H9562 (daily ed. Oct. 5, 1970).

Title I. The provision further makes clear that the charges can only relate to the Agency's new responsibilities under Title II. The plain language of the statute thus directly contradicts the notion that because the Agency has dual responsibilities, the costs of those responsibilities may be equally apportioned. There is, likewise, no support in the legislative history to support the notion that Congress sought to allow the Agency to shift large portions of its existing Title I regulatory and supervisory costs to the fund through the OTR Methodology.

The Request for Comment references the Agency's on-going efforts to "provide[] a higher degree of reliance on the respective state prudential regulator to perform the regulatory oversight function for FISCUs…result[ing] in the NCUA budgeting reduced resource time for FISCUs…." See Request for Comment at 88133. NASCUS commends the Agency's incremental progress on this front, but more is required to satisfy the statutory requirement to rely on this information to the "maximum extent feasible."

A second related problem with the current OTR Methodology is that it violates that statutory prohibition on discrimination against FISCUs. The Request for Comment states that there are only two statutory provisions that constrain the Agency's discretion regarding the OTR: (1) expenses charged to the fund must relate to its responsibilities under Title II, and (2) the Agency may not fund its entire budget from charges to the Share Insurance Fund. This is incorrect as a matter of law.

As amended in 1970, the Act imposes a separate legal requirement prohibiting the Agency in its administration of the Share Insurance Fund from "discriminat[ing] in any manner against State-charted credit unions and in favor of Federal credit unions." 12 U.S.C. § 1790. The current OTR Methodology unlawfully discriminates against FISCUs by forcing them to pay costs related to the Agency's supervisory responsibility over federal credit unions. FISCUs and, by extension, the dual chartering system, are prejudiced in two ways by the current OTR Methodology. First, use of Share Insurance Funds to subsidize FCU operating fees disadvantages state charters because FISCUs must pay the full cost of their operating fees to their respective state supervisory authorities. Second, excessive transfers from the Share Insurance Fund reduce the dividend amounts that would otherwise be payable to all federally insured credit unions. The current OTR Methodology is discriminatory because while an excessive OTR operates like a tax on all federally insured credit unions, only FCUs obtain the off-setting benefit in the form of reduced operating fees.

The non-discrimination provision, consistent with the text, history, and structure of the Act as a whole, requires that the Fund be charged only for those insurance-related expenses that do not overlap with regulatory and supervisory expenses the Agency would otherwise be incurring with respect to FCUs. The Agency's current practice of categorizing 50 percent of all time spent examining and supervising FCUs as well as transferring all other expenses it determines to be insurance-related to the Fund is thus contrary to law.

NCUA's Comparison to the FDIC

In the Notice's Background section, two statutory provisions limiting NCUA's discretion with respect to the OTR are identified[7] but reference to Section 1782(a)(5) is absent.

Section 1782(a)(5), while not speaking directly to the OTR methodology itself, speaks to NCUA's Title I responsibilities. Because the current OTR methodology is founded upon a principle of identifying Title I and Tittle II functions among NCUA examination and staff hours this section becomes very relevant. It reads:

> (5) Reports required under subchapter I of this chapter shall be so prepared that they can be used for share insurance purposes. To the maximum extent feasible, the Board shall use for insurance purposes reports submitted to State regulatory agencies by State-chartered credit unions.

As noted in the NCUA Notice[8] the NCUA determines its 50% allocation to the SIF to emulate their understanding of the FDIC practice of alternating examinations with state regulatory agencies for bank examinations. Interestingly though, despite the aforementioned requirements that federal examinations be utilized to support the SIF's responsibilities, NCUA treats FISCUs and FCUs very differently, and not in a manner similar to that of the FDIC's treatment of state-chartered banks. For evidence of this disparate treatment, NCUA has only to look at its own policies[9] which outline examination frequency requirements for FCUs no greater than 20 months from the completion date of the previous examination, but NCUA policy on FISCUs allows a "preferred" frequency of at least once every five years. Further the National Supervision Policy Manual (NSPM) states:

"*The NCUA will make every effort to conduct examinations of FISCUs jointly with the SSA, as long as the time between examinations does not exceed the NCUA's needs as insurer. Generally, the NCUA will only conduct an independent insurance review when a joint examination cannot be coordinated with the SSA. If the NCUA supervisor and SSA cannot reach an agreement regarding scheduling timeframes, the NCUA supervisor will contact the ARD. The ARD will discuss the concerns with the SSA and make necessary arrangements for a joint follow-up exam or an independent NCUA contact.*"

Even viewing of the requirements[10] for scheduling follow up reviews of problematic institutions reflects the work NCUA relies on state agencies to provide by outlining much higher asset thresholds for those reviews than that of FCUs.

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[7] NCUA Request for Comment Regarding Overhead Transfer Rate Methodology, 88 FR 88131 (Dec. 20, 2023); Footnotes 3 and 4.

[8] NCUA Request for Comment Regarding Overhead Transfer Rate Methodology, 88 FR 88132 (Dec. 20, 2023); Footnote 15

[9] NCUA National Supervision Policy Manual, pages 129 -130; available at https://ncua.gov/files/publications/guides-manuals/national-supervision-policy-manual.pdf

[10] NCUA National Supervision Policy Manual, pages 133; available at https://ncua.gov/files/publications/guides-manuals/national-supervision-policy-manual.pdf

NCUA's statutory authority, and indeed its own policy positions, represent foundational differences between the agency's dual role as a chartering regulator and deposit insurer and that of the FDIC who acts solely as an insurer. NCUA's continued emulation of this viewpoint as justification for its principles related to the OTR calculation should be reconsidered given the significant differences evident.

Impact of the State Supervisory Programs on the SIF

The 46 State and Territorial credit union supervisory agencies are the prudential regulators of nearly 2,000 state-chartered credit unions across the country, representing 68 million members and more than half of the assets in the domestic credit union system. NCUA, and the SIF, benefit tremendously from the supervisory efforts of state regulators. State supervision is primarily funded by state credit unions through fees to their respective state supervisory authorities.

Based on NCUA's published December 2022 call report data, state-chartered credit unions reported paying $94 million in state operating fees. In comparison, FCUs reported paying $109 million in operating fees to NCUA. The $94 million in SCU funding ensured robust, independent oversight throughout the country, providing over 440,000 state examination hours and resulting in more than 1,500 state generated reports. These state agency efforts were primarily focused on safety and soundness supervision benefiting the SIF as NCUA may rely on much of this work and save the direct costs of onsite examination in many FISCUs. This is precisely what Congress envisioned when it directed the SIF to rely on examinations done by states and NCUA under its Title I authority.

We raise this point because even this request for comment[11] implies very limited resources are provided through its statement that only 31.3% of the NCUA's budget is funded by FISCUs. This language underrepresents the impact of the savings afforded the NCUA budget by the application of the state related resources, despite the availability of operating fees paid by FISCUs within their 5300 system and instead provide only a mild acknowledgement that state credit unions pay a supervisory fee to their state regulator. In the narrow context of the direct funding of the NCUA budget this may be true, but it significantly misrepresents the material expenses borne by state credit unions to fund supervision, understates the significant reliance of those programs by the SIF, and presents an incomplete picture of the beneficial impact state supervisory programs have on the SIF. In response to the Notice's question on this point, we recommend NCUA's budget and OTR Notices clearly portray for stakeholders an estimation of the costs borne by FISCUs in funding the work by state regulators upon which NCUA relies. This information is essential for stakeholders to understand the true costs of administering the SIF and the efforts by the states representing direct cost savings to the SIF.

The OTR is the delicate balance Congress struck in Title II of the FCUA. Congress clearly intended the SIF to pay costs for its administration. However, Congress also clearly intended the SIF administration to be managed economically, relying on work NCUA was doing as the

[11] NCUA Request for Comment Regarding Overhead Transfer Rate Methodology, 88 FR 88135 (Dec. 20, 2023)

federal chartering authority and saving costs. In essence, relying on the federal regulator just as it does the state regulator.

To be clear, costs associated with administering the SIF should be allocated to the SIF. That is what Congress intended when it established the SIF. Whether driven by supervisory necessity or due diligence, the SIF must directly fund the examination of some federally insured credit unions. But the SIF's reliance on examinations funded directly by credit unions and the minimization of its expenses should also be formally acknowledged, documented and made part of the OTR setting process.

Recommendations for Strengthening SIF Governance & OTR Transparency

Properly evaluating NCUA's OTR Methodology necessitates more than an understanding of the OTR Methodology and mechanics[12], it necessitates an understanding of the underlying data applied to the methodology. In the shared interest of strengthening SIF governance and enhancing the transparency of methodology, NASCUS makes the following recommendations:

- Provide greater transparency to NCUA's underlying workload analysis in the aggregate. Providing stakeholders with more information on the aggregate distribution of supervision hours as well as hours allocated among different agency offices would enhance stakeholder understanding of the respective Title I and Title II costs.
- Reconsider the November 19, 2015, NCUA Board decision to delegate calculation and administration of the OTR to a strictly formula administration. Given the potential for misbalancing the dual chartering system, the NCUA Board should evaluate the need for equity-based adjustments.
- Provide the documentation necessary to support all underlying assumptions utilized in the OTR Methodology.
- Amend NCUA Principles 1 and 2, as appropriate based on regular review of the supporting analytics, to assure that NCUA's treatment of costs associated with FCU insurance activities and third-party vendor and CUSO risk reviews for FCUs is reasonably applied to the SIF.
- Provide NCUA reporting comparing OTR budget year estimated Title I and Title II allocated resources, including hours budgeted by the OTR Methodology versus actual hours used under each authority. Such a review should include how that comparison impacted actual transfers from the SIF and report the modified OTR based on actual performance for that fiscal year.

Closing Remarks

[12] Some NASCUS recommendations to improve the OTR Methodology, while outside of NCUA's authority, are still important to reference. The most relevant to this discussion would be the long-provided recommendation that at least one NCUA Board seat be allocated to a former state regulator to ensure the value of the state supervision program, its impact on the OTR, and indeed the SIF, is provided appropriate representation and consideration.

We encourage NCUA to continue to calibrate the OTR Methodology to ensure equitable treatment of both FCUs and FISCUs. While the current OTR Methodology marks an improvement over the previous iteration, more work is needed to ensure the reasonable distribution of expenses between NCUA's Title I and Tittle II authorities in the manner intended by Congress. The Federal Credit Union Act (FCUA) clearly contemplates that the SIF should benefit from the exam work NCUA is doing as the Title I administrator of the federal charter in a manner equitable to that of state charters. While we agree transfers from the SIF are necessary to efficiently perform NCUA's duties, all of NCUA's various formulas turn this Congressional intent on its head and shift the benefits from the SIF to the NCUA's Title I chartering functions.

Our comments herein are made in the spirit of State/Federal regulator collaboration and in support of our shared objectives to foster a vibrant dual charter system that increases consumer access to safe and sound cooperative financial institutions. NASCUS commends NCUA for the agency's continued willingness to collaborate with stakeholders to better calibrate the agency's budget and the OTR Methodology.

Sincerely,

- signature redacted for electronic publication -

John J. Kolhoff
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NASCUS