Credit Union National Association
CUNA

NCUA Budget Briefing

Mike Schenk, Chief Economist
October 17, 2018

Good morning. I'm CUNA Chief Economist Mike Schenk – and I appreciate the opportunity to share some observations on the NCUA budget process, the budget itself and the agency's strategic direction implicit in the proposed budget. As you know, CUNA represents America's credit unions and their over 110 million members.

First, we'd like to again thank NCUA leadership for continued improvement in the budget process.

CUNA stood alone in advocating for these improvements – and – to your credit - the process (under the leadership of Chairman McWatters and Board Member Metsger) HAS been more transparent, more inclusive and the budget materials are easier to understand.

Most importantly, direct linkage to the agency's strategic plan is more clearly communicated and the budget is more obviously rationalized.

Providing budget details and justifications in advance, holding this open briefing session, and soliciting feedback as the NCUA has done is good public policy and improves government transparency. We thank NCUA leadership for focusing on improvements to the budget process and for making it more inclusive.

Our review of the Budget Justification and related documents confirms that NCUA continues to head in the right direction with right-sizing the budget, reducing staffing and providing credit unions with fewer regulatory and supervisory impediments to serving members.

The NCUA's proposed 2019 operating budget totals $304.4 million, which represents a $1.7 million (0.6%) increase relative to the 2018 board-approved budget. The proposed budget increase compares favorably to both increases in headline inflation (reflected in a 2.3% increase in the consumer price index in the year ending September 2018) and to increases in credit union operating expenses which reflect a median increase of 4.7% during the year ending June 2018.

CUNA has urged the NCUA to decrease staffing and to reign-in fast-growing compensation outlays. Employee pay and benefits account for nearly three-quarters of the agency's proposed budget and individually they are the two largest groups of expenditures.

The NCUA Board has been receptive to CUNA's view and has proposed a variety of changes that impact the budget through reorganization and needed updates to the examination process.

These changes will lower the agency's authorized staffing level from a peak of 1,269 authorized FTEs in 2015 to 1,178 in the 2019 budget, a decline of 91 FTEs or approximately 7%. Budgeted staffing for 2019 is ten FTEs lower than 2018 (or nearly 1%).

Looking forward, we continue to believe that credit unions can and should play a more distinct, supportive and useful role in the agency's merit pay process.

In the past we've noted that examiners spend a large percentage of their time interacting with the credit unions they supervise. However, feedback from credit unions on the performance of individual examiners – to the extent it is collected at all - is obtained in a generally random fashion. The only formal feedback mechanism available is through the examination appeals process - but credit unions are loath to use that process mostly due to fear of retribution and a perception that the process is largely ineffective.

For this reason, CUNA maintains interest in the agency funding an independent third-party review of field examiners, both as an unbiased method to provide data on field examination consistency across the regions, as well as to help identify areas of success and improvement, which would help direct efficient use of agency training and merit resources.

With its keen interest in staffing issues (and related costs), CUNA previously urged the NCUA to study the composition of the Regions to explore possibilities for significant cost savings.

The NCUA's willingness to deliver on this proposal is clearly reflected in this budget – and the action you took on this front resulted in an over 20% decline in facilities costs relative to the prior year budget. Further, we applaud the anticipated additional savings from lease terminations in 2021 once Eastern Region personnel are co-located in the NCUA-owned central office building.

One important note related to these changes: CUNA argued for and fully supported *both* the Agency's reduction in the size of the Asset Management and Assistance Center and the associated realignment of supporting functions to their central office counterparts. However, we again urge NCUA to provide more AMAC budget detail given the keen interest in this function often expressed by CUNA membership.

The budget clearly supports the NCUA's strategic plan focus on implementation of a more flexible examination schedule, including extended cycles up to 20 months, and virtual examinations with remote monitoring.

NCUA's commitment to modernization in this area, as demonstrated by increasing leverage of technology resources as a long-term cost savings is both innovative and laudable among financial regulators. We appreciate that balancing the value in reduced staff travel and remote assessment with the value in having on-site examiners to develop relationships and insight in the field is a delicate challenge.

As we've said in the past, we think that investments in time and money are well spent in modernizing NCUA's examination process as this makes for a more efficient NCUA staff.

NCUA has already made progress by implementing the 18-month examination cycle and planning for examinations with remote components.

Of course, the recently enacted Economic Growth, Regulatory Relief, and Consumer Protection Act (S. 2155) was designed to soften the pendulum blow which was the Dodd Frank Wall Street Reform and Consumer Protection Act of 2010 for community financial institutions, and CUNA strongly supported the legislation.

As you know, included in Section 210 of the law is a provision that amended the Federal Deposit Insurance Act to increase the asset limit below which depository banks are eligible for an 18-month examination cycle (rather than a 12-month examination cycle) from $1 billion in assets to $3 billion in assets. The federal banking agencies have issued an interim final rule to implement this provision, giving banks holding under $3 billion in assets an examination only once every 18 months, leaving credit unions on an uneven playing field. Credit unions, however, remain eligible for an 18-month examination cycle only if their asset level is below $1 billion. This regulatory disparity now serves as a comparative advantage for community banks.

In his September letter to the Agency, CUNA CEO Jim Nussle emphasized our members' concern over this disparity. Congress has already delegated authority to NCUA to set the frequency of examinations for credit unions. Given that Congress has now codified an extended examination cycle for community banking institutions—the type of insured bank depository institution most closely aligned with the credit union industry—NCUA would be well within its legal purview to exercise similar discretion for smaller credit unions.

CUNA has commented several times over the past year on the issues of electronic data modernization and on call report/profile content modernization. We appreciate the ability to do so.

We also appreciate the intent of standardized data collection is to provide a consistent and objective examination experience as well as minimize on-site examination time. Credit unions have been united in support of the examination modernization efforts undertaken by the NCUA in recent years.

However, as we described, we believe the Request for Information on data collection applies a one-size-fits-all model to data collection that may be inappropriate for smaller credit unions, given the volume, quantity, and specialization of products and services offered, as well as technology resources and infrastructure constraints.

CUNA continues to urge that any data collection efforts consider the impact that additional technology reporting and compliance would have on small credit unions' ability to serve their members, keeping in mind the lack of negotiable power wielded toward vendors, the additional record-keeping and compliance costs involved, overall automation and manual file-keeping transfer requirements unique to smaller institutions, as well as limited personnel and staffing resources.

Regarding call report/profile modernization, CUNA appreciates the agency convening working groups to address call report improvements, which allowed for significant outreach and feedback, resulting in a proposed rule that requires little alteration prior to adoption.

Still, as discussed, the modernization efforts of the quarterly call reports as well as the Automated Integrated Regulatory Examination System (AIRES) are concurrent initiatives. As a consequence, many credit unions believe that the changes will be confusing – if not overwhelming – increasing rather than decreasing initial reporting burdens. While credit unions envision at least a one-year implementation timeline would be required to comply with the call report modernization requirements, there is also recognition that compliance with the anticipated AIRES data request changes would likely require a minimum of three years for processors to develop the tools, have them adequately tested internally and externally, and fully implemented, subject to examination.

The NCUA's capital budget for 2019 is $22.0 million and reflects a continued modernization of NCUA software and hardware, which we agree is needed to meet the agency's efficiency goals.

The detailed materials in Appendix B - laying out capital expenditures links to the strategic goals, key performance metrics, and comprehensive project descriptions - are more detailed and better developed than in previous years. The changes help stakeholders better understand the agency's direction and are a welcome improvement to Budget Justification materials.

CUNA generally agrees with the NCUA's claim that the budget "reflects necessary expenditures to ensure successful execution of the agency's mission and strategic plan under the Board-approved Agency Reform Plan." We fully expect the current proposed investments in capital, systems, and technology to lead to further improvements in efficiency, lower staffing levels, and additional relief for thousands of credit unions under NCUA supervision.

Regarding safety and soundness, the strategic plan seeks to maintain a robust Share Insurance Fund (NCUSIF), including managing losses while maintaining high-quality and efficient supervision. The agency recognizes the need to provide regulatory transparency and facilitate access to credit union services, forecasting trends, targeting examinations, and effectively evaluating risks – all within varied and complex credit union asset portfolios.

That said, we applaud the agency's decision to merge the Temporary Corporate Credit Union Stabilization fund into the NCUSIF and to make the approximate $735 million equity distribution to credit unions and their members.

We support efforts to return additional monies to credit unions as soon as possible and we strongly believe the NCUA Board should, over the next several years, revert the normal operating level to its traditional 1.3% ratio.

Controlling insurance fund operating expenses is vitally important in this context.

As part of the review process several years ago, CUNA took the opportunity to again object to the fact that the National Credit Union Share Insurance Fund (NCUSIF) Overhead Transfer Rate (OTR) was at an all-time high.

We also expressed concern that the actual amounts of the total Operating Fee for Federal credit unions decreased over the previous few years, although the overall total budget for the NCUA has increased and the OTR had dramatically increased.

Since accountability and transparency are two of the values stressed in NCUA's Strategic Plan, CUNA urged the agency to adjust its funding of the OTR and the Operating Fee accordingly and to address the fact that growth in the agency's budget is often obscured through changes to the OTR.

The NCUA Board approved the current methodology for calculating the OTR at its November open meeting last year and we agree it is principles-based, simpler, more equitable and transparent. It also is in line with historical averages.

CONCLUSION

In conclusion, CUNA recognizes and applauds NCUA's improved budget process as well as most of the details of the current budget proposal.

Together, they represent a clear, positive, and significant step in the right direction as the agency works to become a leader and innovator in the financial services industry.

We again hope to see more innovation and modernization, more material reductions in the budget, and a continued focus on slowing the growth rate of expenditures.

On behalf of CUNA, thank you for the opportunity to speak to you today. I'd be happy to address any questions you may have.