

Overhead Transfer Rate – 2004 Method

Introduction

In the past, NCUA reviewed and set the Overhead Transfer Rate (OTR) periodically. The last cycle resulted in 2004 being the year for reassessment. Based on the previous method, the OTR was last set at 62%. Utilizing the previous method for 2004 would have resulted in an OTR range of 68% to 76% for the NCUA Board's consideration. **The substantial increase in the projected OTR based on the previous method is due to significant increases in the amount of time examiners are reporting spent on insurance-related activities, consistent with the Risk-Focused Examination Program.**

The 2004 OTR method results in a transfer rate of 59.8%. The 2004 method differs from the previous method, which relied primarily on the examiner time survey results, by factoring in the following:

- **The value to the NCUSIF of the insurance-related work performed by state supervisory authorities (SSAs).**
- **The cost of NCUA resources and programs with different allocation factors from the examination and supervision program.**
- **The distribution of insured shares between federal credit unions and federally insured state-chartered credit unions.**
- **Operational costs charged directly to the NCUSIF.**

The 2004 method results in a more comprehensive and equitable calculation and allocation of costs. With the refined formula and ongoing time survey process, NCUA can accurately set the OTR annually. The framework is not unduly complex, thus enabling NCUA to administer it at minimal cost. The refined method's formula involves four steps, in addition to a series of calculations to determine the value of SSA work.

STEP 1 – Workload Program Regulatory-Related Activities

NCUA is both a regulator and an insurer¹. NCUA fulfills both its regulatory and NCUSIF due diligence related responsibilities via core and special programs (workload) conducted by field staff. Allocation factors for regulatory and non-regulatory activities are needed to separate and allocate the costs associated with these roles. Three components are needed to calculate the cost driver for NCUA's regulatory role:

1. The regulatory (non-insurance) related percentage of time spent on federal examination and supervision contacts (part of the core program) is based upon the **Examination Time Survey results**.

¹ In its 2001 review, Deloitte and Touche characterized NCUA's dual role as similar to a "multi-product company."

2. The regulatory-related percentage of time applied to **other² core programs and special programs³** is based on the characteristics of each program.
3. The percentages from components 1 and 2 are then applied to the **Workload Program Hours**, which represents examiner and specialized examiner time spent on various programs. This results in a weighted percentage of program hours devoted to NCUA's regulatory role.

Component 1: Examination Time Survey Results

Collection of this cycle's survey began in June 2002 and concluded at the end of May 2003. The full year's worth of survey results are as follows:

Contact Type	Total Surveys Collected	Non-insurance Related % (Regulatory)
Examination (code 10)	168	29%
Supervision (code 22)	102	26%
Total	270	29%

Component 2: Percentage of Regulatory Time Spent on Other Core Programs and Special Programs (Workload)

The following chart shows the regulatory percent determined for other core programs and special programs and the associated rationale for the determination. The programs on the chart are conducted by examiner and specialized examiner staff.

Other Core Programs	Regulatory %	Rationale for Regulatory %
State Exam and Supervision	0%	NCUA has limited regulatory responsibility for FISCUs, almost all of which is handled by state supervisory authorities. Thus, all of NCUA's activities related to examining and supervising FISCUs is non-regulatory, to address risk to the NCUSIF.
State Exam Review	0%	NCUA reviews state examinations to assess and monitor insurance risk to fulfill NCUA's fiduciary responsibility in managing the NCUSIF. Thus, all of this activity is non-regulatory.
5300 Program - FCU	29%	This function fulfills mixed roles and is closely related to the examination process. Thus, the regulatory percent for FCU examinations, as determined by the survey, is used.
5300 Program – FISCU	0%	NCUA collects and reviews call reports for FISCUs to assess and monitor insurance risk to fulfill NCUA's fiduciary responsibility in managing the NCUSIF. Thus, all of this activity is non-regulatory.

² Core programs include hours budgeted for field examiners to complete federal and state examination/supervision, state exam reviews, and the 5300 program. Other core programs include everything except federal examination or supervision program time (e.g., 5300 time, state exam time, etc.).

³ Special programs include hours budgeted for field examiners to complete fair lending exams, subject matter examiner work, agricultural lending reviews, FOM and chartering activity, capital market specialist contacts, small credit union programs, and CUSO exams.

Special Programs	Regulatory %	Rationale for Regulatory %
Fair Lending Exams	100%	NCUA conducts these exams to fulfill its regulatory responsibility in this area.
Subject Matter Examiner (SME)	29%	This function fulfills mixed roles. NCUA has SMEs for both consumer compliance (regulatory) and safety and soundness (insurance) disciplines. Thus, the regulatory percent for FCU examinations, as determined by the survey, is used.
Agricultural Lending	0%	NCUA reviews agricultural lending to assess and monitor insurance risk to fulfill NCUA's fiduciary responsibility in managing the NCUSIF. Thus, all of this activity is non-regulatory.
FOM & Chartering	100%	This field work is derived from NCUA's regulatory role.
RCMS	0%	NCUA reviews capital markets issues to assess and monitor insurance risk to fulfill NCUA's fiduciary responsibility in managing the NCUSIF. Thus, all of this activity is non-regulatory.
Small Credit Union Program (SCUP)	85%	For federal credit unions, this program is derived from NCUA's regulatory role in chartering and promoting the success of FCUs. However, approximately 15% of the credit unions participating in this program (or its activities) are state-chartered.
CUSO Exams	0%	NCUA has no direct regulatory authority related to CUSOs. These reviews assess and monitor insurance risk to fulfill NCUA's fiduciary responsibility in managing the NCUSIF. Thus, all of this activity is non-regulatory.

Component 3: Workload Program

The respective results of components 1 and 2 are then applied to the Workload Program hours to calculate the weighted percent of program hours devoted to NCUA's regulatory role. Core and Special Programs make up total "productive" hours for examiner and specialized examiner staff, representing approximately 59 percent of the total workload program hours.⁴

After applying the appropriate regulatory factors for each time category, total regulatory hours equal 163,760. This represents 25 percent of total core and special program hours, the weighted percent of program hours devoted to NCUA's regulatory role.

⁴ The remaining time (40.4 percent) includes examiner development, training, meetings, administrative, and leave (i.e., overhead costs of conducting the core and special programs).

Core Programs	Estimated 2004 Workload Hours	Regulatory %	Regulatory Hours
Federal Examination	360,000	29%	104,400
Federal Supervision	103,000	26%	26,780
State Exam & Supv ⁵	65,000	0%	0
State Exam Review	10,500	0%	0
5300 Program – FCU	34,000	29%	9,860
5300 Program – FISCO	28,000	0%	0
Total Core Program	600,500	n/a	141,040
Special Programs			
Fair Lending Exams	2,500	100%	2,500
Subject Matter Examiners	3,000	29%	870
Agricultural Lending	2,000	0%	0
FOM & Chartering	1,500	100%	1,500
RCMS	11,500	0%	0
Small Credit Unions	21,000	85%	17,850
CUSO Exams	1,000	0%	0
Total Special Program	42,500	n/a	22,720
Total Core & Special Programs	643,000	n/a	163,760
Percent of NCUA's Workload Program devoted to NCUA's Regulatory Role			25%⁶

STEP 2 – Application of Allocation Factors to Financial Budget

In Step1, the regulatory allocation factor (25%) is calculated based on the weighted level of examination and supervision (core and special workload program) hours budgeted to fulfill NCUA's dual role as regulator and insurer. In Step 2, this allocation factor, along with other allocation factors, is applied to the financial budget. The regulatory allocation factor calculated in Step 1 is the appropriate driver for most of NCUA's cost centers, with the exception of the following areas:

- **Asset Management and Assistance Center (AMAC) Costs.** A regulatory allocation factor of 0% is used for AMAC's portion of the financial budget since its role is solely related to NCUA's role as insurer. AMAC's role is to "handle liquidation payouts, manage assets acquired from liquidations and assistance programs, and manage recoveries for the National Credit Union Share Insurance Fund." AMAC also provides assistance and advice pertaining to conservatorships, real estate and consumer loans, appraisals, bond claim analysis, and reconstructing accounting records.

⁵ Includes 44,000 hours for insurance reviews and 21,000 hours for supervision.

⁶ There may be some instances where the "math" shown here is off by a point due to rounding.

- **Office of Credit Union Development (OCUD) Costs.** A regulatory allocation factor of 100% is used for OCUD's portion of the financial budget. OCUD's role is to "foster business development of credit unions by providing the guidance and education needed for the delivery of financial services, facilitate the expansion of credit union services through the chartering of new credit unions and field of membership expansions, and coordinate efforts with third-party organizations to improve the ... successful operation of credit unions." Though there is some insurance benefit derived from the programs of this office, it is not its primary purpose and not material enough to warrant further refinement of the cost driver.
- **Office of Corporate Credit Unions (OCCU) Costs:** A regulatory allocation factor of 18% is used for OCCU's portion of the financial budget. OCCU supervises all corporate credit unions, including non-federally insured state-chartered corporate credit unions, due to the systemic risk these institutions pose. The only regulation applicable solely to corporate credit unions, Part 704 of NCUA Rules and Regulations, is designed to address insurance risk. Though this office predominantly serves a NCUSIF risk management role, the allocation factor is reflects the operating fee paid by corporate credit unions to cover costs associated with chartering activities (e.g., field of membership, mergers, etc.).
- **Office of Chief Financial Officer (OCFO) Costs:** A regulatory allocation factor of 20% is used for OCFO's portion of the financial budget. OCFO is primarily an overhead function, but does have a portion of its workload specifically devoted to accounting matters of the NCUSIF (recordkeeping, investments, etc.). The allocation factor is based on a breakdown between overhead and NCUSIF specific activities.
- **Office of Chief Information Officer (OCFO) Costs:** A regulatory allocation factor of 20% is used for OCIO's portion of the financial budget. OCIO provides overhead offices with IT support, as well as developing and supporting the systems used in the examination and supervision programs (used by both federal and state examiners). A portion of OCIO's workload is specifically devoted to issuance and support of hardware and software systems used by both NCUA and SSAs. The allocation factor is based on a breakdown between NCUA specific activities and activities supporting SSA staff.
- **Office of Human Resources (OHR) Costs:** A regulatory allocation factor of 20% is used for OHR's portion of the financial budget. OHR is an overhead function. However, the Division of Training and Development (DTD) within OHR coordinates training for both NCUA and SSA staff. Similar to OCIO, the allocation factor for OHR is based on a breakdown between NCUA specific activities and DTD activities related to SSA staff.

- **Regional Divisions of Insurance (DOI) Costs:** A regulatory cost driver of 87% is used for the DOI portion of the financial budget based on an analysis of these divisions' workload. Each of NCUA's regions has a Division of Insurance devoted to overseeing chartering, mergers, purchase and assumptions, fields of membership, credit union member complaints, account insurance, bylaw questions, credit union low income designations, and administration of the small credit union program. DOI's role is primarily regulatory, but does involve addressing NCUSIF account insurance issues, and credit union consolidations and other corporate changes involving state-chartered credit unions.

All other central office costs use the regulatory allocation factor calculated in Step 1 since they provide overhead functions (either organizationally, like the Office of Inspector General, or in terms of general staff support) or are directly related to the workload programs (e.g., Office of Examination and Insurance). Applying the allocation factors to the respective portions of the financial budget results in a cost of fulfilling NCUA's regulatory role of \$39.6 million.

Cost Area 2004 Financial Budget	Portion of Dollar Budget (millions)	Allocation Factor - Regulatory Percent	Regulatory Cost (millions)
Regions			
Divisions of Insurance	\$5.8	87%	\$5.0
All Other Region Costs	\$83.2	25%	\$20.8
Central Office			
AMAC	\$2.2	0%	\$0.0
OCUD	\$0.8	100%	\$0.8
OCCU	\$6.1	18%	\$1.1
OCFO	\$5.0	20%	\$1.0
OCIO	\$9.1	20%	\$1.8
OHR	\$6.8	20%	\$1.4
All Other Costs	\$30.9	25%	\$7.7
Total 2004 Budget	\$149.9		\$39.6

STEP 3 – Calculation of NCUSIF Costs

Step 2 computed the portion of the financial budget that applies to NCUA's regulatory role. When the regulatory portion of the financial budget is subtracted from the total budget, the result is the portion of the budget applicable to NCUA fulfilling its role in managing the NCUSIF. **However, in addition to NCUA budget costs, there are some operational costs charged directly to the NCUSIF.**⁷ These insurance costs must be factored into the total operational costs⁸ of providing NCUSIF deposit insurance, which need to be absorbed by federally insured credit unions (FICUs).

⁷ Direct charges include costs associated with providing state examiners computers and training.

⁸ Credit union failure related costs (payouts to failed institution members) are not operational costs and are not included in the calculation since these losses are already allocated based on the mutual nature of the NCUSIF.

NCUA relies to the fullest extent possible on state supervisory authorities to perform much of the insurance-related supervision of federally insured state-chartered credit unions. The costs NCUA/NCUSIF *avoids* (i.e., benefits derived from the work performed by SSAs) as a result should be taken into account when determining and allocating the “total” costs of providing federal share insurance. Thus, the “total” cost of providing the NCUSIF federal share insurance includes work performed by state supervisory authorities (SSAs), valued at \$18.7 million.⁹

The calculation results in total imputed insurance costs to be absorbed by FICUs of \$131.1 million, calculated as follows:

	Millions
2004 Financial Budget	\$149.9
Regulatory Costs (see Step 2)	- \$39.6
SSA imputed Value	+ \$18.7
Direct Operational Charges to NCUSIF	+ \$2.1
Total NCUSIF Operational Costs	= \$131.1

STEP 4 – Allocation of NCUSIF Costs

The total cost to FICUs of providing NCUSIF insurance must be allocated between FCUs and FISCUs. Consistent with the mutual nature of the share insurance provided by the NCUSIF, and the allocation method for premiums and dividends, insured shares is the appropriate basis to allocate NCUSIF costs between FCUs and FISCUs. As of June 30, 2003, FCUs and FISCUs represented 55% and 45% of insured shares respectively. Thus, the allocation of costs is:

	FCU (Millions)	FISCU (Millions)
Total Cost of Providing NCUSIF Insurance	\$131.1	\$131.1
Proportional Allocation Basis	x 55%	x 45%
Total Allocated Insurance Costs	= \$72.1	= \$59.0

However, state supervisory authorities are already providing \$18.7 million worth of imputed value to the NCUSIF. Therefore, FISCUs are only responsible for absorbing \$40.3 million through the OTR (\$59.0 million minus \$18.7 million).

	Millions
Total Allocated Insurance Costs - FISCUs	\$59.0
SSA Insurance Work Imputed Value	- \$18.7
Net Cost of NCUSIF Insurance – FISCUs	= \$40.3

⁹ The calculation of the imputed SSA value is detailed in the following sections of this report.

Since FICUs are responsible for supporting \$40.3 million of the costs through the OTR, and this represents their insured shares allocation basis of 45%, the total dollar cost to be absorbed by all insured credit unions through the OTR is \$89.6 million.

FISCU Portion of NCUA Insurance Cost	\$40.3m
Divided by FISCU Proportional Allocation Basis	<u>45%</u>
Equals Dollar Amount of OTR ¹⁰	\$89.6m

Or

Dollar Amount of OTR	\$89.6m
Times FISCU Proportional Allocation Basis	<u>45%</u>
Equals FISCU Portion of NCUA Insurance Cost	\$40.3m

The OTR as a percentage of the financial budget is calculated by dividing the dollar amount of the OTR by the financial budget. This results in the OTR stated as a percentage, which is what is known as the OTR.

	Millions
Dollar Amount of OTR	\$89.6
Divided by NCUA Budget	\$149.9
Equals OTR	59.8%

¹⁰ Mathematically, the first computation must be used to arrive at the OTR dollar amount, since this amount is the unknown being solved for.

SSA IMPUTED VALUE CALCULATION

Overview

To develop an OTR that reflects the “total” cost to insured credit unions of providing NCUSIF insurance, it is important to factor in the value to the NCUSIF of the insurance-related supervision provided by state examination programs and relied upon by NCUA in managing the NCUSIF. This involves a three step process to calculate (impute) the value of the insurance work performed by SSAs. The best measure of the value to the NCUSIF of state examination programs is what it would cost NCUA to perform this work.¹¹

Step 1 – Calculate Workload

The imputed value is calculated by determining what NCUA would do, based on standards applied to federal credit unions, to meet its due diligence requirements if the SSAs were not performing the insurance-related work in FISCUs. Examination hours NCUA actually expended on FCUs in 2002 by asset size and CAMEL rating are as follows:

Table 1

2002 Average Exam Time (Hours) FCU	Assets < \$10M	\$10M - \$100M	\$100M - \$250M	\$250M - \$500M	> \$500M
CAMEL 1	45	86	162	193	295
CAMEL 2	47	93	173	214	303
CAMEL 3	51	100	188	208	303
CAMEL 4	67	119	230	0	0
CAMEL 5	84	172	0	0	0

Table 2 provides the breakdown, as of December 31, 2002, of FISCUs by CAMEL rating and asset size.

Table 2

FISCUs (#) in Each Category	Assets < \$10M	\$10M - \$100M	\$100M - \$250M	\$250M - \$500M	> \$500M
CAMEL 1	249	312	91	55	41
CAMEL 2	952	746	108	29	24
CAMEL 3	499	238	18	4	1
CAMEL 4	93	35	4	0	0
CAMEL 5	9	6	0	0	0

¹¹ The imputed value may be higher or lower than what SSAs actually spend (or collect) to conduct insurance related supervision programs NCUA relies upon. Nonetheless, the relevant factor for purposes of computing the OTR is the value to the NCUSIF derived from this work.

Multiplying the respective cells from Table 1 and Table 2 and summing the results provides the total exam hours it would take, using the same criteria as for FCUs, for NCUA to conduct exams of all FISCUs. This provides an estimate of the exam time needed if NCUA were to conduct all of the state examination work on the same basis employed for FCUs.

Table 3

	Assets < \$10M	\$10M - \$100M	\$100M - \$250M	\$250M - \$500M	> \$500M
CAMEL 1	11,205	26,832	14,742	10,615	12,095
CAMEL 2	44,744	69,378	18,684	6,206	7,272
CAMEL 3	25,449	23,800	3,384	832	303
CAMEL 4	6,231	4,165	920	0	0
CAMEL 5	756	1,032	0	0	0
Total	88,385	125,207	37,730	17,653	19,670
				Total Gross Exam Hours	288,645

However, not all examination time is used to meet NCUA’s role as insurer. Federal credit union examination survey results indicate that 71 percent of examination time is used to meet NCUA’s needs in managing risks to the NCUSIF. For consistency and fairness purposes, we apply this same distribution to FISCUs when determining the total time it would take NCUA to supervise FISCUs to meet its role as insurer. Also, well run, financially healthy FCUs are eligible for deferred exams under risk-based scheduling. The risk-based scheduling program results in a reduction of the total hours needed annually to examine FCUs, and the same standard would be applicable to FISCUs if examined by NCUA. Making these adjustments results in the following:

FISCUs	Hours
Gross FISCO Exam Hours	288,645
x Insurance Factor Based on Exam Time Survey	71%
= Total Insurance Hours w/out Risk-Based Scheduling	204,938
- Not Eligible for Deferral Hours	88,000
= Eligible for Deferral	116,938
x Adjustment for Risk-Based Scheduling	66.7%
= Annual Eligible for Deferral Hours	77,997
+ Not Eligible for Deferral Hours	88,000
+ Adjustment for Additional Supervision ¹²	9,735
= Total FISCO Hours with Risk-Based Scheduling	175,732

¹² FCUs that have their exams deferred receive some supervision in the year they do not receive an examination. NCUA applies a formula based on the size of the institution, which in the aggregate equates to about 25% of the deferred hours. Thus, this figure is calculated on the same basis by subtracting the annual deferred program hours from the eligible hours and multiplying the result by 25%.

Since NCUA’s workload program already includes 44,000 hours for examining FISCUs, these hours must be subtracted from the FISCU Hours with Risk-Based Scheduling to arrive at the net increase in hours. There also needs to be an adjustment for necessary additional supervision. NCUA’s workload program budgets 21,000 supervision hours for FISCUs. Since this supervision is typically performed jointly with SSAs, if NCUA were to conduct all of the needed supervision it would take an estimated additional 21,000 hours. Accounting for the added supervision needed and for hours already set aside to conduct FISCU exams, the calculated additional FISCU hours needed if NCUA were to do all of the work equals 152,732 hours.

= Total FISCU Hours with Risk-Based Scheduling	175,732
+ 2004 Budgeted Supervision Hours	21,000
- 2004 Budgeted Insurance Review Hours	44,000
Total Additional FISCU Insurance Hours Needed	152,732

Step 2 – Calculate Staff Needed Based on Workload

Step 1 computes an additional 152,732 hours if NCUA were to examine and supervise, from an insurance perspective only, all FISCUs using the same insurance-based criteria applied to FCUs. The next step is to convert these hours to the number of examiners this would require.

After adjusting for various benefits, training, and administrative time¹³, NCUA’s workload program is based on each examiner contributing 1,231 hours annually to the examination and supervision program (“productive” time for OTR computation purposes). This “productivity” ratio and the resulting “productive” hours are calculated as follows:

Estimated 2004 Core and Special Workload Program Hours	643,000
/ Total Estimated 2004 Workload Program Hours	1,095,000
= Productivity Ratio	59%
Total Work Hours in a Year Per Full Time Equivalent (FTE)	2,087
x Productivity Ratio	59%
= Productive Hours per FTE Examiner	1,231

¹³ For example, examiners (and all employees in one form or another for that matter) receive training each year, are entitled to sick and annual leave, incur travel time, have holidays off, etc.

Thus, to accomplish 152,732 hours worth of additional FISCU work, it would take 124.1 FTE Examiners calculated as follows:

Net Additional FISCU Hours Needed	152,732
/ Productive Hours per FTE Examiner	1,231
= Number of Additional FTE Examiners Needed	124.1

Adding an additional 124.1 FTE Examiners would necessitate additional staffing (and costs) in other areas. For example, additional Supervisory Examiners, Regional Office Analysts, Human Resource Personnel, facilities, etc. would be required. Based on NCUA’s staffing patterns and organizational structure, the following ratios of examiners to other positions are used to determine additional staffing needs and costs:

- Divisions of Insurance: FISCU related Division of Insurance work is already handled by existing staff and would not increase with the implementation of this program.
- Divisions of Special Actions: Any FISCU related Special Actions work, i.e., supervising problem FISCUs posing risk to the NCUSIF, is already handled by existing staff and would not increase materially with the implementation of this program.
- Central Office: With the exception of the Office of Human Resources (OHR), all other central offices are currently sufficiently scalable, and/or removed from any direct impact on workload, to absorb the additional work associated with this program.

Additional Staff Needed	Ratio Examiners to Position	FTEs Per Position
Examiners	1/1	124.1
Supervisory Examiners	1/9	13.8
Regional Office Analysts	1/20	6.2
Regional Office Directors	1/20	6.2
Other Regional Support Staff	1/15	8.3
= Number of Additional FTEs Needed		158.6

Step 3 – Calculate SSA Imputed Value

Applying the average cost per FTE to the number of additional FTEs needed results in the cost of this additional staffing. The average cost is based on the actual budget for regional offices and field staff and includes all costs, such as travel, training, facilities, consumables (e.g., supplies), in addition to salary and benefits.

Total Cost of Regions (2004 budget)	\$89,002,575
/ FTEs in Regions (2004 budget)	718.1
= Per Regional FTE Cost	\$123,942
x Number of Additional FTEs Needed	158.6
= Cost of Additional Regional Positions	\$19.7 M

With this additional staffing, there would be an impact on the workload of the Office of Human Resources (which includes the Division of Training and Development). Adding 158.6 additional staff members to NCUA would represent a 16 percent increase in staffing. Thus, a 16 percent increase in OHR's budget is projected.

In addition to increases in certain costs, there would be some areas of savings to NCUA if it conducted all of the insurance related FISCO work. There would be no need to pay for the training of state examiners, or providing SSAs with computers and other equipment. Adjusting for these costs and savings results in the imputed SSA value of \$18.7 million.

	Millions
Cost of Additional Regional Positions	\$19.7
+ Additional OHR Costs (15.0% of \$6.8 million budget)	\$1.1
- SSA Training and Equipment Cost	\$2.1
= Imputed SSA Value	\$18.7