Filed via: regcomments@ncua.gov

May 27, 2011

Ms. Mary Rupp
Secretary to the Board
National Credit union Administration
1775 Duke Street
Alexandria, VA 22314

Dear Ms. Rupp:

Re: Comments on Notice of Proposed Rulemaking for Incentive-based Compensation Arrangements

On behalf of the California and Nevada Credit Union Leagues, I appreciate the opportunity to comment on the proposal by NCUA and other federal regulators to implement §956 of the Dodd-Frank Act, which would establish rules on incentive-based compensation practices for covered financial institutions, including credit unions. By way of background, the California and Nevada Credit Union Leagues (Leagues) are the largest state trade associations for credit unions in the United States, representing the interests of more than 400 credit unions and their 10 million members.

Summary of the Proposal and the Leagues' Position

The proposed rule would 1) require the reporting of incentive-based compensation arrangements by a covered financial institution; and 2) prohibit incentive-based compensation arrangements at a covered financial institution that provide “excessive compensation,” or that could expose the institution to “inappropriate risks that could lead to material financial loss.” The proposal would apply to credit unions with at least $1 billion in total consolidated assets that offer incentive-based compensation arrangements to executive officers, employees, or the (sole compensated) director. Additionally, the proposal imposes a requirement on credit union with assets greater than $10 billion to defer at least 50% of the annual incentive-based compensation of an executive officer over a period of no less than three years.

The Leagues recognize that these rules are mandated by the Dodd-Frank Act, and are intended to address flawed incentive compensation practices in the financial industry that were one of many factors that contributed to the recent financial crisis. However, we do not believe that credit union incentive compensation practices played any significant role in this crisis. Compared to other types of financial institutions, credit unions are exposed to a considerably limited set of financial risks. This comes from the greater statutory and regulatory limits placed on credit unions’ operational activities, lending limits, and investing powers. In other words, limited exposure to financial risk greatly reduces credit

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union risk-taking activity. So, while we appreciate that NCUA has not added significantly to the basic requirements contained in section 956 of the Dodd-Frank Act, we have concerns that in some areas of the proposal NCUA does not sufficiently recognize a distinction between credit unions' environment and focus, and the high-risk/high-reward drivers present in stock-based institutions. In addition, we believe the proposal raises questions regarding reporting and enforcement of this requirement. Our specific concerns are addressed in the balance of this letter.

Coverage of the Proposal

Compensation

In the Supplementary Information to the proposal, NCUA lists three types of compensation that would not fall within the scope of the definition of compensation. They are: 1) compensation solely tied to continued employment; 2) compensation for activities that do not involve risk-taking; and 3) compensation based solely on a covered person's fixed compensation that does not vary based on one or more performance metrics. We believe these compensation types should be included in the final rule or an appendix to the rule, rather than merely referenced in discussion of the proposed rule. Further, we believe much more clarity is needed in the rule regarding what is and isn't compensation. For example, some other compensation categories that should be excluded are:

- 457(b) Deferred Compensation Plans, 457(f) Supplemental Retirement Plans, Executive Long-Term Care Plans, and Executive Disability Plans. These are deferred compensation arrangements, retention plans, or insurance plans that have no linkage to performance, and would therefore not materially affect the ongoing operations of a credit union.

- Compensation arrangements that are awarded to all credit union staff without consideration of performance metrics of any one person, group, or department of persons.

- Variable pay plan awards based on a credit union or team of credit union employees meeting a pre-determined goal (whether quarterly, annually, etc.)

- Special recognition awards for efforts or results that are beyond expectations

The proposed definition of compensation also excludes payments consistent with §701.33 of NCUA's Rules and Regulations. This regulation permits reimbursement for 1) reasonable and proper costs incurred by covered persons in carrying out official credit union business; 2) provision of reasonable health, accident and related types of personal insurance protection; and 3) indemnification. We agree with these exclusions and thank NCUA for including them in the proposal. However, as §701.33 is only applicable to federal credit unions, we are concerned about the applicability of this exclusion to state-chartered credit unions. Are state-chartered credit unions permitted this exclusion? Further, what if state law permits for equally applicable, but not identical, benefits for state-chartered credit unions? Would those benefits not be excludable from compensation? The Leagues recommend that this reference be expanded or clarified to ensure that state-chartered credit unions are not disadvantaged by this unclear reference.

Finally, regarding the definition of "excessive compensation," the Leagues question the proposed adoption of all the standards found in section 39(c) of the Federal Deposit Insurance Act (FDIA). Section 956 of the Dodd-Frank Act stated that in establishing standards for compensation, federal regulators shall "take into consideration" the standards found in section 39(c) of the FDIA. It did not require the full adoption of such standards. NCUA does not provide information as to what factors were considered in proposing to implement them in full. This is especially germane given the unique structure and risk exposure of credit unions in light of other financial institutions. We request that NCUA provide additional information regarding the need for full adoption of all of these standards. Of particular concern is proposed §751.5(a)(2)(vii), which states that NCUA may decide compensation is excessive based on "any other factors the NCUA determines to be relevant." At a minimum, this standard should be revised to limit NCUA's authority to applicable law or regulation, and not "any factor" the agency feels relevant.

<u>CUSOs as Covered Financial Institutions</u>
NCUA requests comment on whether credit union service organizations (CUSOs) should be considered covered institutions under the rule. As NCUA notes, currently no CUSOs wholly owned by a federally insured credit union have total consolidated assets of $1 billion or more. The Leagues believe that CUSOs should not be covered by the rule. In general, CUSOs do not engage in the same business activities as covered financial institutions. They are not depository institutions. To subject them to coverage under the rule when most of their competition is not would be to place them at a competitive disadvantage. We believe this is not the focus and intent of the Dodd-Frank provision.

<u>Covered Persons</u>
The Leagues believe the inclusion of the term "employee" within the definition of "covered persons"—without additional qualifying language—is unnecessarily broad, and will unfairly add to a credit union's compliance and internal control program in order to avoid including employees that are not in positions to influence or affect risk-taking activities by an organization. Therefore, we recommend that the term "employees" be modified to language substantially similar to "employees whose duties have the potential to influence or encourage activities that may lead to material financial loss to a credit union."

Deferral Requirement for Larger Credit Unions

The proposal imposes a requirement on credit unions with assets greater than $10 billion to defer at least 50% of the annual incentive-based compensation of an executive officer over a period of no less than three years. The Leagues strongly object to NCUA setting the threshold for such a requirement at $10 billion when federal banking agencies and the SEC have set this threshold at $50 billion. Not only does §956 of Dodd-Frank impose no such threshold for credit unions, the imposition of a lower deferral threshold standard for credit unions imposes an arbitrary, punitive standard on institutions that have far less risk-taking exposure than those subject to the $50 billion threshold. NCUA has provided no data or rationale as to why this threshold is warranted for credit unions. Until the agency can provide such information for review and consideration, we believe the $10 billion limit should not be finalized. At the very least, this threshold should be set at the $50 billion limit applicable to banks.

Further, we believe that NCUA should permit a credit union to invest the deferred bonus to an executive officer in a prudent and responsible way. This would help accommodate the impact of inflation and the lost revenue opportunity to the individual.

Reporting and Enforcement

The proposal requires a covered credit union to submit a report annually to the NCUA describing the structure of the credit union's incentive-based compensation arrangements for covered persons. The information in the report is to be sufficient to allow an assessment of whether the structure or features of the arrangements are likely to provide covered persons with excessive compensation or could lead to material financial loss to the credit union. The proposal states that this report is to be in a format directed by NCUA. However, no report format has been proposed. While the proposal sets forth minimum standards of information to be submitted, we believe it is important to be able to review and provide comments on the actual report format that will be used.

More importantly, we are concerned about how NCUA will evaluate credit union reports for compliance with the rule's requirements. How will NCUA assess the components—and policies and procedures—of each credit union's incentive arrangement, given the limited minimum standards for reports? For example, while we do not support reporting of actual compensation information to NCUA, we note that the reports will not require such information to be included. How then will NCUA determine that incentive-based compensation at a particular credit union is excessive, unreasonable, or disproportionate? We bring this up not to suggest that compensation information should be reported, but to highlight the ambiguous, subjective nature of how this requirement, as proposed, is likely to be enforced. NCUA has not indicated whether the requirements of this rule will be included in its on-site exams of credit unions. The Leagues do not support such an approach. We believe to do so would be unnecessary and burdensome, and could elevate privacy concerns in the event that individual compensation information, or credit union proprietary information, is sought by examiners.

I appreciate your thoughtful consideration of our views and recommendations. It is clear that several changes need to be made—and questions addressed—in order to make sure this rule is a meaningful, useful, and fair implementation of the Dodd-Frank requirement. We thank the NCUA for the work done so far on this issue, and look forward to working with the agency to craft an effective and equitable rule.

Sincerely,

Diana R. Dykstra
President/CEO

cc: League Member CEOs