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NAFCU | Your Direct Connection to Education, Advocacy & Advancement

May 31, 2011

Mary Rupp
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314

RE: Notice of Proposed Rulemaking for Incentive-Based Compensation Arrangements

On behalf of the National Association of Federal Credit Unions (NAFCU), the only trade association that exclusively represents the nation's federal credit unions, I am writing to provide NAFCU's comments on the advance notice of rulemaking on incentive-based compensation arrangements. NAFCU and its membership are very concerned with several aspects of the proposal. We understand the National Credit Union Administration (NCUA) is required to work jointly with other agencies on this rule. Nonetheless, there is no justification for the agency to apply certain aspects of the rule – which are clearly aimed at larger institutions – to credit unions. Simply stated, credit unions have little in common with large, multinational banks, much less the even larger investment institutions that will ultimately be covered by this rule.

NAFCU also disagrees with the scope of the rule as applied to credit unions. We are concerned with the deferred compensation scheme and are further concerned with the definitions for “covered persons” and “incentive-based compensation.” Further, the reporting requirements should be modified. Next, the agency's authority regarding what constitutes “excessive compensation” should be modified. Finally, credit union service organizations (CUSOs) should not be included in the rule

Scope of Coverage

NAFCU strongly disagrees with the agency's decision to require a portion of incentive based compensation to be deferred for institutions with more than \$10 billion in assets. Under the proposed rule, credit unions would be the *only* financial institutions (other than governments sponsored enterprises (GSEs)) with less than \$50 billion in assets that would be required to defer compensation for their executives. The agency provided no justification for this determination. It simply does not make sense that the compensation arrangements at an \$11 billion credit union should come under closer scrutiny than the compensation arrangement at a \$49 billion bank or investment firm. Indeed, the recent evidence indicates that natural person credit unions generally require less regulatory oversight than larger, more complex institutions. Accordingly, the NCUA should define “larger covered financial institution” to mean a credit union with \$50 billion or more in assets.

Deferred Compensation Scheme

NAFCU is also concerned with the deferred compensation scheme, which would require deferral of 50% of incentive-based compensation for at least three years. First, the proposal would place the same restrictions on credit unions that are placed on extremely large institutions where it is not uncommon for a small group of employees using sophisticated, proprietary trading strategies to oversee literally billions of dollars that change hands on a weekly basis. If the NCUA insists on treating employees at natural person credit unions in the same fashion that the Securities and Exchange Commission (SEC) or the Federal Reserve wishes to treat employees at the largest financial institutions in the world, it needs to supply a compelling reason to do so.

Further, the proposal will create new burdens for credit unions as the Internal Revenue Service (IRS) has a complex regulatory scheme for any deferred compensation package. NAFCU is skeptical that the potential benefits – if indeed any exist – outweigh the cost to credit unions to comply with the deferred compensation scheme and its attendant tax issues.

Definitions

NAFCU opposes the broad definition of “covered persons.” The NCUA would define the term to mean “any executive officer, employee, or director of a credit union.” Incentive-Based Compensation arrangements, 76 Fed. Reg. 21,170, 21,213 (proposed April 14, 2011) (to be codified at 12 C.F.R. pts. 741 and 751). This incredibly broad definition is indicative of the overly-broad nature of the proposed rule. The proposal is intended to minimize unnecessary risk-taking. However, the rule, in practice, can capture the incentive-based compensation arrangement of any credit union employee that has such an agreement. Consequently, the proposal will create unnecessary burdens for credit unions that are required to report incentive-based compensation arrangements for individuals who have little or no realistic possibility of creating risk issues. Accordingly, the NCUA should refine the definition to include only those individuals who actually pose a risk to the institution.

NAFCU is also concerned with the definition of “incentive-based compensation.” The term would apply to *any* variable compensation and the proposed definition of “compensation” in and of itself is extremely broad. Understandably, the agency wants to ensure credit unions do not circumvent the rule. Nonetheless, applying the rule to any variable incentive-based compensation is needlessly broad. For example, a credit union employee may receive some variable compensation based on his or her length of service at the credit union. Certainly, that is not the type of incentive-based compensation that Congress intended to be covered by the law. However, under the agency’s broad definition, such an arrangement would be covered.

The agency provides examples of certain types of compensation that would not be considered compensation in the preamble to the rule, yet fails to include those same examples in the regulation itself. If specific types of compensation are identified in the preamble as outside the scope of the rule, the agency should list those same items in the regulation itself. Similarly, NAFCU recommends the agency consider listing additional specific types of compensation that should not be considered “incentive-based compensation” under the rule. Specifically,

compensation for activities that do not involve risk taking, and compensation tied solely to an individual's continued employment should not constitute "incentive-based compensation."

Reporting Requirements

NAFCU has concerns with several aspects of the reporting requirements. First, ninety days may not be sufficient time to file the reports. Second, reports should only be required on an annual basis. Third, even annual reports may not be necessary if there have been no changes from one year to the next. Fourth, NAFCU recommends that the agency, as an alternative to the proposed requirements, allow credit unions to simply provide copies of any incentive-based compensation arrangements.

NAFCU is concerned that ninety days may not be sufficient time to provide the required reports. First, this will be an entirely new process for the employees tasked with filing the reports. The rule will require credit union employees to justify any incentive-based compensation arrangement. Given the sensitivity of compensation issues and the potential repercussions, employees will naturally want to spend considerable time drafting and refining the required reports. Finally, the proposal would require considerable oversight from a credit union's board of directors. The reporting requirements will require a staff outline of the process, board input, and presentation of the disclosures to the board, with additional time required for consideration, review and board approval. Given that most credit union boards meet on a monthly basis, it would be difficult to complete the process in just ninety days, particularly when the reporting process is entirely new.

Second, regardless of when the NCUA approves a final rule, reports should be required on an annual basis, and not more often than that. There seems little reason to require initial reports within ninety days of a final rule only to require another report just a few months later. Ideally, the agencies can approve the rule several months before the end of the calendar year, giving institutions sufficient time to familiarize themselves with the process, with reports due thirty to ninety days after the new year.

Third, the reporting process will provide little value in cases where there have been no changes to the incentive-based compensation scheme. Admittedly, when there have been no changes or only immaterial changes, the reporting process will be much easier. Nonetheless, requiring reports in such cases is an unnecessary waste of resources.

Finally, NAFCU recommends that the agency permit credit unions that wish to do so, to simply provide copies of any incentive-based compensation arrangement with specific salary figures redacted. This would not be a requirement but would be an alternative method that credit unions would have the option of using to comply with the reporting rules. This simple disclosure system would eliminate the regulatory burdens required under proposed § 751.4 for credit unions that wish to disclose all of their arrangement. Further, permitting reports to be filed in this way would ensure that the agency is receiving a completely transparent description of the incentive-based compensation plan.

In conclusion, more than ninety days will be required to comply with this burdensome new process. The agency should not require reporting more than once a year; even during the first year the system is in place. The NCUA should consider an exemption to the annual reporting requirements in cases where there have been no material changes to the incentive-based compensation structure. Finally, credit unions should be permitted – but not required – to satisfy the reporting requirement by simply disclosing all incentive-based compensation arrangements.

Agency Authority Regarding “Excessive” Compensation

The rule prohibits credit unions from establishing incentive-based compensation arrangements that the agency deems “excessive.” In making the determination, the NCUA proposes to examine six different specific factors. Additionally, the agency would reserve the right to add any other factor it deems relevant. *Id.* This provides the agency the authority to essentially determine, after the fact, what factors a credit union should have considered when designing its incentive-based compensation scheme. It will be difficult, if not impossible, for a credit union board of directors to determine what constitutes “excessive” compensation if the agency has the authority to add additional factors months or years later. If the agency determines it needs to consider other factors it should do so using the customary notice and comment process required under the Administrative Procedures Act.

This section also creates a serious question regarding the relationship between the reporting requirements and prohibited acts. Section 751.4(b) of the proposal specifically states that credit unions are not required to report actual individual compensation, but instead need only report the structure of the compensation packages. *Id.* However, § 751.5(a)(2) necessarily will require specific information regarding an individual’s compensation in order to determine whether the compensation is “excessive.” This leads to the obvious question; how exactly will the NCUA determine when the actual compensation – and not just the structure of the package – must be disclosed?

If the agency determines the required reports are not sufficient to provide details of the compensation package, does that trigger the right to determine “excessive” compensation under § 751.5? Will the NCUA use that authority only after problems become apparent at a credit union? If so, the agency’s authority seems to be virtually useless as it could be used, at best, to claw back excessive compensation. Will this information be required if the agency is unhappy with the results of a credit union exam? This is an incredibly important question and one which is completely ignored by the agency in the proposed rule. This issue absolutely requires clarification.

The Scope of the Rule as Applied to CUSOs

The rule should not be applied to CUSOs. First, no CUSO is currently over \$1 billion, which is the threshold for coverage under the rule. However, even if a CUSO with more than \$1 billion in assets did exist, it still should not fall under the coverage of the rule. First, CUSOs are relatively small, as evidenced by the fact that not a single CUSO would currently satisfy the \$1

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billion threshold. Second, CUSOs are extremely limited in their activities. Further, strict limits already exist regarding credit union investments in CUSOs.

Conclusion

NAFCU strongly disagrees with the agency's proposal to extend the deferred compensation provisions to all credit unions with more than \$10 billion in assets. First, there is virtually no justification for treating credit unions more strictly than other financial institutions. The deferred compensation provisions should not apply unless the credit union has more than \$50 billion in assets. Second, the definitions for "incentive-based compensation" and "covered persons" are both unduly broad and will result in unnecessary reports that have little or no bearing on risk mitigation. Third, the rule contradicts itself. First, the agency states that credit unions do not need to report actual compensation. However, in the very next section of the rule, the agency grants itself the authority to regulate compensation in a manner that necessarily requires reporting actual compensation figures. Fourth, there is absolutely no discussion of how these conflicting sections can or will be reconciled. Finally, there is no reason to subject CUSOs to this rule.

NAFCU appreciates the opportunity to comment on this proposal. As our comments above make clear, the rule is in need of serious revisions. Should you have any questions or require additional information please call me or Carrie Hunt, NAFCU's General Counsel and Vice President of Regulatory Affairs at (703) 842-2234.

Sincerely,



Fred R. Becker, Jr.
President/CEO