

Robert K. Rusch  
Associate General Counsel  
Telephone: (608) 231-7922  
E-mail: robert.rusch@cunamutual.com  
Fax: (608) 236-7922



May 27, 2011

Ms. Mary Rupp  
Secretary of the Board  
National Credit Union Administration  
1775 Duke Street  
Alexandria, VA 22314-3428

Re: Proposed Rule, Parts 741 and 751 of NCUA's Rules and Regulations,  
Incentive-Based Compensation Arrangements

Dear Ms. Rupp:

On behalf of the companies of the CUNA Mutual Group, I am pleased to provide comments on NCUA's proposed rule on incentive-based compensation arrangements. CUNA Mutual is the nation's leading provider of financial products and services to credit unions and credit union members. Specifically, in relation to this rule, CUNA Mutual makes available various executive benefit programs and several member financial products which, to some degree, may be supported by incentive-based compensation arrangements. My comments will focus on the aspects of the rule that may possibly impact these programs and services, leaving other significant aspects of the rule for others' comment.

The overall purpose of the proposed rule is admirable. Excessive compensation and incentive-based compensation which put credit unions at undue risk of material loss should be closely scrutinized and generally not permitted. These are, of course, matters of safety and soundness relative to which the authority of NCUA is very well established. As a result, it would seem these rules are intended primarily (1) to ensure credit unions give proper thought to the interplay between incentive-based compensation and safety and soundness and (2) to provide NCUA more ready information upon which to make its own safety and soundness determination or to trigger further inquiry. Again, these are admirable goals but we believe the proposed rule is too far reaching in its efforts and, unless some changes are made, will result in significant costs to credit unions with little or no attendant benefit to members or any other interested parties.

### **The Rule Should Recognize Differences in Incentive-based Compensation Plans**

Incentive-based compensation is defined as "any variable compensation that serves as an incentive for performance." This broad definition will cause a credit union to incur reporting and other operational costs for many incentive-based plans which, due to their modest value and due to the level of the employees to whom they are paid, pose no significant threat of material loss to the credit union. While NCUA has clearly attempted to minimize the reporting costs relating to such modest plans by suggesting that reporting be a "clear narrative" or "succinct," the reporting costs will still be significant, as will the costs associated with other requirements of the proposed rule, including those calling for independent monitoring and more direct, hands-on board analysis and oversight.

Many incentive-based plans are offered at dollar levels which do not require the same scrutiny as other types of more high-end incentive plans because such modest incentives are unlikely to drive persons to take inappropriate risks. For example, the payment of a \$10 referral fee or product/service enrollment bonus by a loan officer or member service representative is unlikely to involve or encourage actions which may threaten a credit union's safety and soundness. Day-to-day management oversight of these incentives should be sufficient to ensure these incentives are not having unintended consequences. Independent review and detailed board analysis, as called for by the proposed rule, add unnecessary costs which are clearly disproportionate to any possible threat to the credit union's safety and soundness.

Moreover, at least for all federal credit unions, these incentive-based plans are already closely regulated by other existing rules. For example, NCUA Rule 701.21(c)(8)(iii)(C) and Rule 721.7(b)(3) regulate incentive payments to an employee, other than a senior management employee, in connection with a loan or any incidental powers activity. Such incentives are allowed under these rules only if the board establishes written policies and internal controls in connection with such incentives and monitors compliance with such policies and controls at least annually.

Based on the above, we recommend that the proposed rule be modified as follows:

**Add the following sentence to the end of Section 751.4(a):**

**"For any incentive-based compensation arrangement which pays a Covered Person (a) less than \$[5,000.00] per year, or (b) less than [5]% of the Covered Person's salary per year, whichever is greater, a credit union must simply report, without further detail, that it makes such plans available to Covered Persons. Plans paying incentive compensation within these limits shall not otherwise be subject to the requirements of this part."**

This modification would meet the statutory requirement that all incentive-based compensation plans be reported to NCUA while also providing NCUA with information sufficient to determine whether or not such compensation is excessive or could lead to material financial loss to the credit union. This approach would also reflect a more appropriate cost/benefit balance while still achieving the purpose of the statute.

#### **Certain Forms of Executive Compensation Should Be Clearly and Specifically Exempted**

As noted in the Section-by-Section Description of the Proposed Rule, the definition of incentive-based compensation is not intended to cover compensation that is awarded solely for, and the payment of which is solely tied to, continued employment (e.g., salary). However, because the definition is written so broadly, for the sake of clarity, we believe it would be appropriate to provide a specific exception for salary and other similar forms of compensation, such as contributions to retirement plans or deferred compensation plans. Such clear exception should include illustrative examples of the most common forms of such salary-like compensation to which the rule is NOT intended to apply. This would also include compensation which is earned or credited based on continued employment (though such amounts may be subject to forfeiture in some early separation scenarios) and where the final payment of such amounts may occur at some later date (e.g., upon retirement). Within that list, we recommend the inclusion of 457(b)<sup>1</sup> and (f)<sup>2</sup> plans, 401(k) Plans<sup>3</sup>, Collateral Assignment Split Dollar Life Insurance Plans<sup>4</sup>, and Life Insurance Bonus Plans<sup>5</sup>. Specifically, we recommend that the proposed rule be modified as follows:

**Add the following sentence to the definition of incentive-based compensation:**

**“Incentive-based compensation does not mean salary or any other form of compensation that is awarded solely for, and the payment of which is solely tied to, continued employment including [insert product types by name or description here].”**

This recommended language tracks with a similar approach adopted in the recently adopted NCUA rule on golden parachute payments. In that rule, NCUA includes specific exceptions for certain qualified pension or retirement plans under Section 401 of the Internal Revenue Code (IRC); employee benefit plans that are permissible under § 701.19; bona fide deferred compensation plans; certain death and disability payments; certain “nondiscriminatory” severance plans; payments required by state law; and payments that the Board has determined permissible under § 750.4. See Section 750.1(f)(2) of the rule. The adoption of similar clarifying exception language would be appropriate and helpful in this proposed rule as well.

An alternative approach would be to amend the definition of incentive-based compensation to include only variable compensation that is tied to a specific financial objective or activity. It is this kind of variable compensation that can skew or otherwise adversely influence objective decision-making and ultimately will increase the risk of material financial harm to the credit union. If this approach is adopted, we would recommend the proposed rule be amended as follows:

**Change the definition of incentive-based compensation to read:**

**"Incentive-based compensation means any variable compensation tied to the attainment of specific credit union financial or operational goals."**

Lastly, we question whether compensation that is product sales-based, i.e., commissions, should be treated as incentive-based compensation. For example, dual employees and employees of state chartered credit unions with securities licenses and/or state insurance licenses typically receive compensation that is a percentage of the commissions generated by their sales activity. Such compensation would appear to fit within the definition of incentive-based compensation, yet by structuring the compensation as a percentage of the commissions received by the credit union, the credit union is actually reducing its financial risk as compared to a commitment to pay the employee a fixed salary regardless of the amount of commissions he or she produces. Commissions may make up and in fact are intended to make up a significant part of these

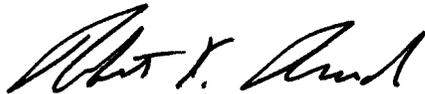
employees' annual pay. In this regard, commissions function as the equivalent of salary and should be excepted from the purview of the rule. To achieve this result, we recommend the proposed rule be modified as follows:

**Add the following sentence to the definition of incentive-based compensation:**

**“Incentive-based compensation does not mean commissions or other sales-based compensation earned upon the sale of insurance or securities products.”**

Thank you for your consideration of our comments and recommendations. Should you have any questions regarding this submission, please do not hesitate to contact me.

Sincerely,



Robert K. Rusch  
Associate General Counsel

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<sup>1</sup> 457(b) Plan is a non-qualified deferred compensation plan that allows select credit union executives to defer a specified amount of pre-tax income, subject to certain limitations. The deferred amounts, plus earnings, are paid to the executives at a later date — usually when they retire and may be in a lower tax bracket.

<sup>2</sup> 457(f) Plan is a non-qualified deferred compensation plan that allows the credit union to set aside additional pre-tax income of select executives beyond the traditional 401(k) or 457(b) plan. In a 457(f) plan, any amount can be contributed on behalf of an eligible executive as long as there is a substantial risk of forfeiture. A “substantial risk of forfeiture” is when an executive forfeits benefits if they voluntarily separate from employment prior to an agreed-upon term or date. The deferred amounts, plus earnings, are paid to the executives at a later date when the risk of forfeiture lapses — usually when they retire.

<sup>3</sup> 401(k) Plan is a qualified deferred compensation plan that allows credit union employees to defer pre-tax income, subject to certain limitations. The plan may include matching employer contributions. Plans that allow participants to direct their own investments provide a core group of investment products from which participants may choose. Otherwise, professionals hired by the credit union direct and manage the employees' investments. The deferred amounts, plus earnings, are paid to the employees at a later date — usually when they retire and are in a lower tax bracket.

<sup>4</sup> Collateral Assignment Split Dollar Life Insurance is a way to finance the purchase of a life insurance policy. In this arrangement the credit union and the executive agree to “split” both the cost (premiums) and benefits (cash-value and death benefits) of a permanent life insurance policy. The executive owns the policy and assigns certain interests in the policy to the employer as collateral for payments made by the employer as outlined in the split dollar agreement. For tax purposes, the payments are structured as loans to the executive. When policy benefits are accessed, either as death benefits or cash values, the credit union receives back the total premiums financed. The executive or the executive's beneficiary receives the balance of the policy proceeds.

<sup>5</sup> Life Insurance Bonus Plan is a premium payment arrangement where the purchase of a policy owned by the executive is paid for through discretionary bonuses by the credit union. The payments are taxable income to the executive and are reported as such through the credit union's payroll system.