NASCUS
National Association of State Credit Union Supervisors

July 22, 2016

Mr. Gerard Poliquin
Secretary to the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314

Re: NASCUS Comments on Notice of Proposed Rulemaking for Incentive Based Compensation Arrangements

Dear Mr. Poliquin:

The National Association of State Credit Union Supervisors (NASCUS), the professional association of the state credit union regulatory agencies and the nation's state credit union system, submits the following comments in response to the National Credit Union Administration's (NCUA's) notice of proposed rulemaking on Parts 741 and 751, Incentive Based Compensation Arrangements. NASCUS agrees that incentive based compensation arrangements should not be structured in a manner that incentivizes inappropriate risk taking and/or lack prudent risk mitigating features. After reviewing the proposed rule, NASCUS submits the following recommendations. In so doing, we acknowledge that NCUA worked closely with its federal banking regulator peers who in turn have issued similar rules pursuant to Congressional direction. However, because NCUA's proposed rules need to be consistent, but not identical, to its federal peers, we direct our comments exclusively to NCUA.

Regulation versus Guidelines

NCUA's proposed rulemaking was prescribed by Section 956 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (DFA) which authorized federal regulators to address incentive based compensation by regulation or guidelines.[1] NASCUS appreciates that some compensation plans at some large financial entities incentivized inappropriately risky behavior, in turn contributing to the financial collapse. We believe there is a role for regulators in ensuring such compensation plans are consistent with principles of safety and soundness. However, regulatory authority related to compensation in the marketplace should be exercised judiciously.

The proposed rule would have benefitted from a discussion of the need to address incentive based compensation arrangements by regulation rather than by guidance. Congress explicitly provided regulators the option to meet the prescriptions of the DFA by guidance. If the regulators' experience with existing guidance on compensation informed the decision to adopt rulemaking, then a discussion of the shortcomings of guidance would provide stakeholders valuable context with which to evaluate the proposal.

[1] Public Law 111–203, 124 Stat. 1376 (2010).

<u>Proposed §751.1(b) Scope</u> – NCUA must clarify whether it interprets its Congressional mandate regarding incentive based compensation arrangements to cover non-federally insured credit unions.

The proposed rule defines its scope as applying to any federally insured credit union or "any credit union eligible to make an application to become an insured credit union under 12 U.S.C. 1781."[2] In addition, the scope contains an asset threshold of $1 billion.[3]

It is unclear from the text of the proposed rule what exactly is meant by a credit union "eligible to make an application" for federal share insurance. Pursuant to 12 U.S.C. 1781(a), NCUA may insure:

> (1) credit unions organized and operated according to the laws of any State, the District of Columbia, the several territories, including the trust territories, and possessions of the United States, the Panama Canal Zone, or the Commonwealth of Puerto Rico, and (2) credit unions organized and operating under the jurisdiction of the Department of Defense if such credit unions are operating in compliance with the requirements of subchapter I of this chapter and regulations issued thereunder.

In addition, the provision states that application for insurance may be made by a state credit union at any time.[4] Taken together, the provisions referenced in the proposed rule may be fairly read to define the scope of the rule to include any credit union, regardless of whether it is federally insured.

We do not believe this was NCUA's intent. NCUA should amend the provision to explicitly clarify that the rules apply only to federally insured credit unions.

However, if it is NCUA's intent to extend the rules to non-federally insured credit unions, then NCUA should include provisions codifying consultation with the prudential state regulator.

<u>Proposed §751.1(c)(2) Grandfathered plans</u> – NCUA should clarify whether a grandfathered plan may be re-enacted or extended while retaining its exempt status.

The proposed rule grandfathers existing incentive based compensation plans "with a performance period that begins before [Compliance Date as described in paragraph (c)(1) of this section]."[5] Given the contractual nature of some incentive based compensation plans, and the potential complications of retroactive application of new regulations, we support the grandfathering of existing plans. However, we seek clarification on the scope of the grandfather provision. NCUA should clarify whether an existing plan with a term certain and renewal clause may be renewed after the "Compliance Date" while retaining its grandfathered status. NCUA should further clarify whether the grandfathering of the incentive based compensation plan

[2] 81 FR 37820 (June 10, 2016).
[3] Ibid.
[4] 12 U.S.C. 1781(a)(2).
[5] 81 FR 37820 (June 10, 2016).

attaches to the plan itself or to the employees covered by the plan. In other words, would a credit union be able to add additional employees to a grandfathered plan after the "Compliance Date" or would additional employees require a separate compliant plan?

Proposed §751.6 Reservation of authority for Level 3 credit unions – NCUA should provide greater insight into both the threshold for applying Level 1 and 2 regulations to a Level 3 credit union and the process by which the NCUA Board will make the determination.

The proposed rule provides NCUA discretion to apply the more rigorous provisions applicable to Level 1 and 2 credit unions to Level 3 credit unions that have complexities and compensation practices "consistent" with those of Level 1 and 2 credit unions.[6] NASCUS understands, and agrees, that regulators often need flexibility to address outliers of a regulatory framework. However, in this case, very little in the proposed regulation establishes a framework that would allow a Level 3 credit union to understand the parameters of what might trigger application of the more advanced rules.

The proposal states that the NCUA will establish procedures to administer this provision.[7] Given the complexity and operational costs of complying with Level 1 and 2 requirements, we encourage NCUA to include in its procedures consultation with the state regulator in the case of a FISCU, and an opportunity for the credit union to rebut NCUA's initial determination that discretionary rules should be applied.

Regulating compensation practices requires vindicating legitimate supervisory concerns without unduly interfering in the free marketplace. Congress directed the federal regulators to act in this area, and in that context, the proposed approach, in general, is reasonable. However, we encourage NCUA to work with stakeholders during the revision process to ensure currently unforeseen consequences on implementation are identified, evaluated, and mitigated.

In addition, NCUA should consult with the appropriate state regulators before extending Level 1 and 2 provisions to a level 3 credit union. Given the subjective nature of the determination, and lack of concrete parameters, consultation with the state regulator will be essential in ensuring a a balanced and informed decision.

We would be pleased to discuss these comments in detail at NCUA's convenience.

Sincerely,

- signature redacted for electronic publication -

Brian Knight
Executive Vice President & General Counsel

[6] 81 FR 37822 (June 10, 2016).
[7] Ibid.