Cooperative Credit Union Association
Delaware • Massachusetts • New Hampshire • Rhode Island
Creating Cooperative Power

July 22, 2016

Gerard Poliquin
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428

Cooperative Credit Union Association, Inc. Comments on Incentive-Based Compensation Arrangements Proposed Rule
RIN 3235–AL06

BY EMAIL ONLY

Dear Secretary Poliquin:

On behalf of the member credit unions of the Cooperative Credit Union Association, Inc. ("Association"), please accept this letter relative to the National Credit Union Administration's ("NCUA") request for comments on its proposed rule on Incentive-Based Compensation Arrangements. The Association is the state trade association representing credit unions located in the states of Delaware, Massachusetts, New Hampshire and Rhode Island, serving approximately 195 credit unions which further serve approximately 3.8 million consumer members.

While the proposal of an incentive-based compensation arrangement rule is well intentioned, the Association is of the position that the proposal overreaches in its scope, and contains too much ambiguity and too many problematic provisions. As such, the Association does not support any aspect of this proposal, and requests that the respective agencies retract this proposal and reconvene to consider a potential path forward for any incentive-based compensation rule.

In preparation for the development of the present comment letter, to foster a local consensus, and in order to assist in providing thoughtful, detailed comments, the Association conducted a survey of all credit union members in order to assess the impact that this proposal would have on our local credit unions. Nearly all respondents indicated that regulations governing incentive-based compensation are unnecessary, and that credit unions which use incentive-based compensation programs already have detailed policies and procedures that have safely and effectively administered these programs without the need for additional regulatory requirements.

I. Covered Institution Levels are Too Low and Too Far-Reaching

Section 956 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") requires the National Credit Union Administration ("NCUA"), the Federal Deposit Insurance Corporation ("FDIC"), the Office of the Comptroller of the Currency ("OCC"), the Board of Governors of the Federal Reserve System, the Securities and Exchange Commissioner ("SEC"), and the Federal Housing Financing Agency ("FHFA") (collectively, "the Agencies") to jointly prescribe regulations or guidelines to prohibit incentive-based compensation arrangements that encourage inappropriate risk-taking by covered institutions.

The proposed rule applies to financial institutions that have $1 billion or more in assets. These covered institutions are divided into three tiers: Level 1, which are institutions with assets greater than or equal to $250 billion; Level 2, which are institutions with assets of greater than or equal to $50 billion and less than $250 billion; and Level 3, which are institutions with assets greater than or equal to $1 billion and less than $50 billion.

The Association notes from the outset that to date, ten member credit unions will be subject to a finalized regulation on incentive-based compensation as they fall within the Level 3 tier of covered institutions.

While this number may seem small, the Association suggests two considerations to rebut the statements made by the NCUA, in support of the proposal, that 96% of all credit unions will be exempt from any final regulation. First, this static percentage is just that, static. It does not consider credit unions that are very close to obtaining $1 billion in assets and therefore falling under the Level 3 requirements. In the Association's respective states alone, eleven credit unions have assets falling between $500,000 and $1 billion. As such, it is necessary to consider not just credit union asset size as the numbers as calculated at present, but must consider how the list of covered institutions will grow in the coming years.

Furthermore, the Association notes that provisions of Section 751.1(c)(2) which state that a credit union is not required to comply with the requirements of the level it falls under with respect to any incentive-based passed with a performance period that begins before the compliance date. While on its face this provision appears to be a grandfathering clause, this too represents too static of an application, resulting in considerable negative effects upon the institution as a business. This provision does not take into consideration the life of the plan, and the necessary development, change, and growth in terms of staff of a covered institution. A covered institution should not be forced to continue applying its compensation plan to an employee that has been with the institution, and not be able to apply that same compensation plan to a new employee. This disparity stunts the possibility of growth for covered institutions in terms of maintaining and attracting new talent, who may have a unique specialty or history for that institution, but be turned away by a better offer elsewhere.

Secondly, while a relative small percentage of credit unions will be covered as Level 3 institutions under this rule, the Association notes that the proposal contains provisions that could allow the NCUA to require Level 3 credit unions to comply with the more rigorous requirements applicable to

Level 2 institutions. Level 2 requirements can be imposed on Level 3 institutions if the agency determines that the credit union's complexity of operations or compensation practices are consistent with those of a Level 1 or Level 2 institution, based on the credit union's activities, complexity of operations, risk profile, or compensation practices.

The flexibility allowed by this provision calls into question the underlying validity of a tiered applicability structure. If a credit union that squarely falls into the well-defined limit of $1 billion to $50 billion in assets can be made subject to stricter regulations simply by a determination of the NCUA based on subjective judgments of a credit union's profile or activities, the tiered structure loses its legitimacy. At a minimum, such a structure fails to provide clear guidance, which is what credit unions require in order to comply.

In addition, the Association is of the position that the $1 billion threshold for Level 3 institutions is not warranted. The costs associated with the inclusion of institutions of this size outweigh any harm these individual, relatively small institutions could cause. Should the Agencies maintain a qualifying threshold for covered institutions, the measurement should begin with institutions of $10 billion in assets or more, as to be more inline with the original intent of Dodd-Frank and other agency rules, such as the Consumer Financial Protection Bureau. Also, this minimum threshold should increase over time to account for economic changes.

II. Standards Used to Determine Prohibited Practices Are Vague and Subjective

Of particular concern to the Association regarding any incentive-based compensation rule is the ambiguity and subjectivity of the standards used to determine prohibited practices. The proposed rule would prohibit arrangements that the Agencies determine encourage inappropriate risks by certain financial institutions by providing excessive compensation or that could lead to material financial loss. The text of the proposal states that "excessive compensation" is compensation, fees, and benefits that are excessive when amounts paid are unreasonable or disproportionate to the value of the services performed by a covered person, taking into account all relevant factors. The proposal lays out potential factors to be included. However, the list of factors is not exhaustive and leaves room for consideration of any other factor the agency deems relevant. In addition, "inappropriate risk taking" is not defined at all within the proposal.

While credit union employees make every attempt to comply with regulations and regulatory policies, they are limited in their ability to comply with vague requirements and standards. Individuals working for regulatory agencies will have disparate interpretations of the terms used in the proposal. While an examiner in one institution might consider one action to be an inappropriate risk, an examiner at another, similar institution may not see that same action as risky. This creates tension within the industry, and more importantly, a conflicted relationship between the regulator and its regulated entities.

NCUA needs not forget its affirmative responsibility to be consistent in the application of the policy under Dodd-Frank, and consistent with the other five entities and their application of policy to their regulated entities. As the prudential regulator of credit unions, NCUA is responsible for overseeing the safety and soundness of the industry. The Association expresses its concern over the apparent need to check off vague standards on a checklist.

Furthermore, the Association urges the Agencies to keep the intent of Dodd-Frank in mind. In the proposal's vague definition of "excessive compensation" and in consideration of the factors noted, the intent of Dodd-Frank is to consider overall compensation in terms of safety and soundness, rather than simply money across the table. These issues invite ambiguity and require the Agencies to more clearly align any final rule with the intent behind Dodd-Frank.

It is the opinion of our member credit unions that currently administer incentive-based compensation programs that credit unions are able to make these appropriate and sound business decisions. In responding to our survey, one member credit union that would be a covered Level 3 institution under the proposed rule explained how it administers its incentive-based compensation program. The program is an annual bonus program that is available to all levels of employees. The program is based upon annual goals as established by the Board of Directors, the CEO, and the senior leadership team. The annual goals have three measurable components, and they are focused on the core activities of the credit union and its members. Again, the goals are measurable and there are checks and balances that must be achieved in addition to the established goals. It is important to note that the plan has been carefully packaged and developed over time in order not to affect safety and soundness.

Other credit unions indicated similar policies. Each noted that its program is measured against specific, numerable areas and goals which relate to the credit union. Some measured criteria include business growth and volume, membership growth, active checking growth, loan growth, member satisfaction, employee engagement, and CAMEL rating, among others. Each responding credit union noted the alignment between the measureable criteria, the credit union's goals, and member service. No member credit union reported an exclusive, direct link to salary only based upon unqualified loan volume in their plan.

Member credit unions also provided examples of risk management and control functions in place to assure safe and sound compensation practices. Such examples include minimum and maximum financial soundness ratios, specific board policies to mitigate risk, monthly monitoring systems, compensation limit levels, ROA modifiers, review boards, and others. These credit unions maintain extensive documentation, including regular reports to their boards of directors and senior leadership teams, multi-level reviews of policies, and financial statements. No member credit union reported an exclusive, direct link to salary only based upon unqualified loan volume in their plan.

The Association is of the position that the current provisions of the proposed rule do not set out clear, workable standards, and that incentive-based programs should remain a business decision of the credit union, and be subject to the credit union's policies.

III. Guidelines Versus Rules

Dodd-Frank allows the Agencies to create guidelines rather than a rule on incentive-based compensation arrangements. The Association suggests that guidelines will mitigate any unintended consequences such a far-reaching rule will undoubtedly have, and are the proper course of action.

This proposal is a solution in search of a problem, and, especially in the case of credit unions, a problem that credit unions had no part in. In response to the Association's survey, 86% of responding member credit unions favor guidelines over rules. The examination process, lengthy as it is, should focus on performance trends and operating ratios as a benchmark for effective management of incentive programs, rather than introduce a lengthy, far-reaching rule within a very limited period of time. One-size-fit-all-rules do not apply to credit unions, the vast majority of which are small institutions relative to the financial service industry as a whole.

The Association would also like to echo comments made by other stakeholders relative to the staggered release of each respective agencies' proposals, and the effect this approach has had on the ability to submit thorough comments. The significance of this proposal cannot be overstated. Any final rule on incentive-based compensation programs must take into consideration the comments of stakeholders under six different regulatory bodies. The effects of provisions under one agency's proposal on each other agencies' proposals and stakeholders must be taken into consideration. Despite the requirement that the six agencies act jointly to release a proposed rule, the six agencies released their respective proposals at their own pace. The NCUA was the first to release is proposal on April 21. The FHFA was the last to issue its proposal on May 16. All of the agencies committed to the comment period deadline set by the NCUA upon its issuance of is proposal, resulting in a shortened comment period not only for the stakeholders of the other agencies, but for all interested parties, as any proposal must be read in its entirety before comments can be developed.

Any final incentive-based compensation rule will have a major effect on businesses. Incentive-based compensation arrangements are critical tools in the management of financial institutions. In today's ever-evolving economy and jobs market, businesses are constantly seeking ways to attract and maintain dedicated and talented employees. Competition for these individuals is always strong. Therefore, a thoughtful, detailed, and balanced approach must be taken in the finalization of any incentive-based compensation rule. Such an approach requires time and a full opportunity to collect and review stakeholder comments. The staggered approach of the release of this proposal does not allow for the approach necessitated by such a rule.

It is without question that consequences should exist for inappropriate risk taking for personal benefit. Inappropriate incentive-based compensation programs do exist, though few and far between, and do present risk to the system. However by attempting to write a rule that applies to so many different types and sizes of institutions, this rule overreaches, and creates more negative consequences than positive outcomes. The practical problems of this rule as proposed greatly outweigh the potential benefits. A rule of this magnitude will create new compliance costs, a new and growing level of regulatory intrusion, and ultimately, diminished free market incentives for higher-level performance.

Most recently, one Association member reported that its state regulator is working with them to incorporate asset quality standards into the evaluation of an appropriate and reasonable incentive-based compensation program. The state regulator has indicated that rather than a microscopic focus on compensation level, its guidelines will focus on the quality of what is being brought in relation to the compensation program. This has been and will continue to be the approach of credit unions with any incentive-based compensation program. Safety and soundness is top priority, and every member credit union who administers these programs has documented policies that place the focus of any program on maintaining quality assets over any amount of compensation. The Association also applauds efforts by NCUA to work with credit unions and state regulators in developing a final proposal as well as to recognize sound programs developed by state credit unions working in conjunction with their state regulators.

IV. Transition Period

If, after review of all comments, the Agencies determine that the issuance of an incentive-based compensation rule similar to this proposal is timely and necessary, the Association suggests that the Agencies consider the inclusion of a transition period for compliance.

As stated in the current proposal, covered financial institutions will be required to fully comply with a final rule eighteen months after publication. The Association reminds the Agencies that as this proposal relates to compensation, it is important to consider a period of transition as individuals' salaries and benefits are involved. A sunset provision, transition or phase-in period, is suggested to allow credit unions to better manage their employee relationships. The Association notes that the proposed rule does not take into account the potential impact from any new employees who may be added to the compensation plan.

V. Conclusion

The Association expresses its appreciation to the NCUA for seeking stakeholder input into this proposed rule, and requests that the NCUA, in conjunction with the Agencies, reconsider the significant consequences this rule will have.

Thank you for your consideration of these views. The Association appreciates the opportunity to provide input and I remain available to address any questions or concerns at 732.865.4641 that you or your staff may have at your convenience.

Sincerely,

Paul Gentile

Paul C. Gentile
President/CEO

PCG/mabc/kb