Metro
Credit Union

June 15, 2016

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

Re: Comments on the Proposed Incentive Based Compensation Rule

Dear Mr. Poliquin:

Thank you for the opportunity to comment on the proposed rule. It will be more than a decade before our credit union will reach the $1 billion threshold to be covered by this rule. Nonetheless, there are so many potential problems with this rule as proposed that we feel compelled to comment.

We believe incentive based compensation without consequences for the risk of harm to the institution creates a moral hazard that was one problem contributing to the depth of the financial market collapse. Consequences should exist for inappropriate risk taking for personal benefit. We understand this proposal is mandated under Dodd-Frank as a joint rule, and we recognize the difficulties in attempting to codify the prohibition on inappropriate risk taking. However, by attempting to write a rule that applies to so many different types and sizes of institutions, this rule relies too heavily on ambiguous and subjectively interpreted terms (e.g. "inappropriate risk taking", "excessive compensation", "material financial loss"). The practical problems of this rule as proposed rule greatly outweigh the potential benefits. This rule will create enormous new compliance costs, a new and growing level of regulatory intrusion, and ultimately, diminished free market incentives for higher level performance.

The purpose of the rule is well-intended; to prevent compensation plans that incent too much risk taking to the detriment of the institution, the insurance fund, the tax payer, or the economy. A great risk of any new, well-intended rule is unintended consequences. In this case, the risk is magnified because the rule relies so heavily on subjective and ambiguous language. It is almost certain individuals working for regulatory agencies, employees of institutions, and those serving on boards will have widely disparate interpretations of the terms used in the rule, and this will create an unhealthy interaction between regulators and regulated.

Some specific concerns with the proposed rule are:

1. While we understand the NCUA is mandated to be part of a joint rule, credit unions had no impact on the financial market collapse. Forcing credit unions to be part of this proposed rule is unnecessary and will only result in additional costs with no practical benefit.
2. We are uncertain if Dodd-Frank actually requires the $1 billion minimum threshold to be subject to the rule. To the degree the NCUA or joint agencies have any discretion in setting that threshold higher, they should do so. The costs associated with the inclusion of institutions this size greatly outweigh any harm these individual, relatively small, institutions could cause. As a result, the cost is not worth the benefit. In addition, the minimum threshold should increase over time. A $1 billion institution today is far different than what a $1 billion institution will be like ten or twenty years from now. All too often, arbitrary limits, levels and thresholds set by regulation or law are not written to increase over time as organic growth occurs and result in the inclusion of and compliance costs for far more institutions than originally intended.
3. The proposed rule is full of subjective terms and definitions, such as "inappropriate risk taking". This will inherently create or exacerbate resentment and distrust between institution employees and federal regulators. Issues involving performance and compensation are intensely personal and sensitive to institution employees. Already today, not all examiners share the same views in terms of appropriate compensation. Furthermore, most strategic balance sheet decisions involve risk taking to some degree. Managing risk is what we do. What is excessive, and is that determination to be made with benefit of hindsight four years in the future? Conceding that the type of inappropriate risk taking combined with the moral hazard of excess compensation was a contributor to the extent of institutional failures, this proposed rule will almost certainly take regulatory scrutiny well past safety and soundness concerns, and into areas rightly left to business decisions in individual institutions.
4. Another problem with the entire proposed rule being full of subjectively interpreted phrases is that there is not enough guidance as to correcting the actual problem that is the stated reason for the rule. As such, the rule could be applied too broadly. One example of known behavior that justifies this type of rule was the multi-million dollar bonuses paid to risk takers for performance in a single period when the catastrophic balance sheet consequences for taking that risk may not be known until a subsequent period. No one can argue such behavior is appropriate. However, as subjectively written this rule could be used to criticize an incentive plan because a regulator simply doesn't like even though there are no real safety and soundness impacts.
5. An area of glaring potential problems is in section 751.4(b) <u>Excessive compensation,</u> as it attempts to define what excessive compensation is. For example, the very purpose of all

Incentive Based Compensation Plans is to promote behaviors the institutions desires, and that desired behavior is almost always better performance. Yet, nowhere in the "relevant factors" in determining if compensation is excessive do we find the relative performance of the institution. If the entire purpose of incentive compensation is to have higher performance, how can actually achieving higher performance not be the most relevant factor in determining what is, or isn't, excessive? Another problem is with "compensation history" at the institution. The inclusion of this determinant invites more subjectivity because instead of attempting to compare compensation to market, the rule introduces another variable to be used in comparing the institution to itself.

6. The proposed rule includes additional subjectivity concerns when it allows regulators to apply Level 1 or Level 2 requirements to a Level 3 institution. This could effectively require Level 3 institutions to fall under Level 1 or Level 2 requirements as leaders prudently attempt to mitigate further risk of retroactive rule application in compensation plan design. Ten billion dollar institutions do not impact the economy.
7. For nearly 100% of credit unions, and we suspect the vast majority of all other covered institutions, this rule is a solution in search of a problem. The Act gives regulators the ability to create guidelines rather than a rule. We believe in most cases, regulators currently recognize when the combination of risk taking and compensation is problematic. Why not give them tools to address behavior through guidelines rather than a rule with unintended consequences for institutions that never were or never will be part of the problem.
8. Currently our institution uses incentive based compensation with over 70% of our employees including "risk takers". The purpose of these plans is to promote behaviors that benefit our members and the credit union. With respect to "risk takers", incentive compensation is not paid unless results are achieved. While inappropriate risk taking can occur with or without incentive based pay, it is not difficult to monitor and identify. This proposed rule could eliminate well-functioning plans like ours. The rule would lead to increasing base compensation as institutions shift away from incentive pay. It would also increase total compensation as executives seek to make at-risk "claw back" awards in addition to rather than part of a given year's incentive based pay. As an executive, subjectively awarded compensation in the future based on third-party judgments of past decision making or uncontrollable market conditions would not be an attractive compensation plan. In the end, compensation plans would change to avoid being subject to the rule.

In summary, while we understand there were and likely still are compensation plans that encourage inappropriate risk taking, those are few and we all know them when we see them. The rule as proposed introduces a great regulatory burden and risk of unintended consequences on hundreds or thousands of institutions with compensation plans that do not encourage inappropriate risk taking. Instead of writing a rule full of ambiguous and subjectively interpreted terms, we would encourage the regulators to write simply guidelines that strongly discourage the type of plans and behaviors we all know are wrong, and then aggressively pursue individuals and institutions that violate common sense practices that harm institutions, insurance funds, or the economy.

Thank you again for the opportunity to comment on the proposed rule.

Sincerely,

Michael McDermott
President/CEO