LAKE TRUST
CREDIT UNION

July 20, 2016

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

RE: Proposed Rulemaking for Incentive-Based Compensation Arrangements

Dear Mr. Poliquin:

I am writing on behalf of Lake Trust Credit Union, which serves 35 counties in Michigan, has 170,000 members and $1.7 billion in assets. Lake Trust appreciates the opportunity to provide comments to the National Credit Union Administration (NCUA) on the interagency proposed rulemaking for Incentive-Based Compensation (IBC) arrangements.

Let me start by saying there are several sections of the proposed rule we question not only for Lake Trust, but for the credit union industry as a whole. It is our understanding that the proposed IBC rule is intended to address the questionable behaviors that contributed to the financial crisis.

Although its been noted publicly several times before, it's important to ensure it's noted again – Credit Unions weren't responsible for the financial crisis, and the behaviors of credit union executives weren't comparable to those at the big banks. In fact, the credit union business model does not even support that type of unscrupulous behavior. As you're aware, credit union boards are composed of volunteer directors representing the members themselves, not separate shareholders interested in the high-stakes profits that perhaps instigated exorbitant risk-taking.

However, since Dodd Frank requires an inter-agency solution, and since it's highly unlikely Congress would at this time extract credit unions from the purview of this Act, Lake Trust would like to suggest that further guidance in existing practices instead of additional rule-making would accomplish the intention of Section 956.

Not only is the proposed IBC rule excessive, it is, in fact, duplicative of the existing NCUA authority, within the CAMEL Rating System, which examines compensation packages and arrangements to ensure safe and appropriate risk-taking. Additionally, many of the proposed IBC rule's points are covered and further identified in the NCUA's Examiner Guide.

The intention of the proposed IBC rule would be better addressed by updating existing examination guidance with an evaluation of the specific credit union's performance measures and risk metrics, instead of broad brushing risk assessments and promulgating costly and ambiguous rule-making.

However, if the decision is made to pursue this rule, we recommend further evaluation of the following topics:

The Design and Definition of Risk Levels:
Asset size is not always the most appropriate evaluation of risk-taking. We suggest that levels a more appropriate design would be based on a credit union's current offerings and practices, perhaps including products, business lines, and/or the degree and extent of business relationships. Providing additional criteria beyond asset size to distinguish between the levels of risk would create greater confidence in the examination process.

As the proposed rule (section 751.6) is written today, it creates great concern for credit unions, as examiners could require a credit union of our size (Level 3) to comply with some or all of the requirements of a Level 1 or Level 2 credit union based on their own definitions of complexity. The proposed rule merely suggests that a credit union's operations or compensation practices would in some way be part of that evaluation. And while the rule references that some reasonable advance warning would be provided, without objective criteria the credit union could be aware of and prepare for, it leaves the organization in a strictly reactive position, one that could create other significant risks, costs and implications. As part of a final ruling, it would be important, from our perspective, that risk criteria are identified up front as part of the design of the rule. This would allow credit unions to make safe, strong, proactive, and strategic decisions.

The Definition of "Risk-taker" and Role of the Board in reviewing Incentive Pay:
Per section 751.4(e), the proposed rule would require the Board of Directors to approve incentive-based compensation arrangements for virtually every employee in the organization, whether that be a branch employee, mortgage originator, or senior level executive.

At the very least, we believe the definition of covered person should be revised. Technically, the rule's definition would include directors and all credit union employees. We suggest, that while it's likely not intended the proposed rule would include small-dollar internal incentive programs to improve efficiency, generate small-scale innovation, or improve member loyalty, it does, in fact, include them today, and should be revised to address appropriate risk takers.

Secondly, the monitoring and approval of such incentive plans presents a governance conflict for Lake Trust. Per the governance model developed by the Lake Trust Board of Directors, they have one employee, the President & CEO. The President & CEO is then responsible for all other employees in the organization. And, while it is the practice of the President & CEO to share senior level plans for review with the Board's Executive Committee, suggesting that the Board is responsible for approving all incentive plans, from tellers to the CEO, is beyond reasonable.

Additionally, the level of skill and expertise necessary to evaluate incentive plans for the breadth of the entire organization, suggests that the Board need be more than knowledgeable in just executive compensation plans, but in employee compensation as a whole. This is a lot to ask of a volunteer board.

The Impact of Far-Reaching Deferral, Clawback and Forfeiture Requirements:
As a Level 3 credit union, per the proposed rule's definition, Lake Trust wouldn't currently be required to comply with the deferral, clawback and forfeiture requirements. However, with the ambiguous discretionary authority provided to examiners, it seems prudent to respond to the obtrusive and extensive requirements outlined in sections 751.7 a-c.

The percentages and timelines associated with deferrals (50 percent/three years for senior executives, 40 percent/three years for risk-takers), forfeitures (100 percent), and clawbacks (100 percent, no less than seven years) would create extenuating circumstances for employees who would be required to comply.

Incentive pay in organizations like Lake Trust doesn't just support the families of senior executives. It can support branch employees, commercial services employees, and mortgage originators. In the cases of these employees, we'd be talking about holding portions of their pay hostage – the part that's used for things like family vacations, taxes, and college tuitions; not elaborate spending sprees.

And, in the cases of those employees, additional risk monitoring is already in place, through Asset Liability Management practices and approvals, Commercial Credit Committee approvals, and even performance management practices which reach beyond financial metrics to member satisfaction and loyalty.

The unintended consequence this rule could create is an elimination of incentive pay and an increase to base pay, which in itself would contradict the intention of the rule in the first place – to ensure appropriate levels of risk-taking, we believe, in an effort to ensure the long-term success of the organization.

Yet – if implemented, the proposed IBC rule could do just the opposite. It would likely stagnate growth, impede talent retention and acquisition, and stifle innovation. The long-term success of credit unions like ours could be in jeopardy.

Again, in closing, we strongly believe that the proposed IBC rule is duplicative, and that additional guidance in existing authorities could better achieve the intended results without subjecting credit unions to additional costly compliance requirements.

We appreciate the opportunity to comment. Please feel free to reach out to me directly with any questions or if you'd like to discuss this further. I can be reached at dsnodgrass@laketrust.org or (517) 267-7207.

Sincerely,

David Snodgrass
President & CEO