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

Re: Notice of Proposed Rulemaking for Incentive-based Compensation Arrangements - RIN 3133–AE48

Dear Mr. Poliquin:

On behalf of America's credit unions, I am writing regarding the Office of the Comptroller of the Currency (OCC), Board of Governors of the Federal Reserve System (Board), Federal Deposit Insurance Corporation (FDIC), Federal Housing Finance Agency (FHFA), National Credit Union Administration (NCUA), and U.S. Securities and Exchange Commission (SEC) (Agencies) Joint Proposed Incentive-based Compensation Arrangements Rule. The Credit Union National Association (CUNA) represents America's credit unions and their more than 100 million members.

It has been more than five years since the Agencies first proposed an incentive-based compensation rule, as required by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). In these five years, credit unions have remained healthy and continue to demonstrate safety and soundness leadership for depository institutions unmatched by for-profit institutions. Credit unions' financial strength and commitment to serving members, at the direction of their member-comprised boards of directors, is a testament to the success of the cooperative ownership model.

Unfortunately, the Dodd-Frank Act lumped financial institutions of all sizes and structures together for regulatory requirements designed to curtail the actions of a few bad actors before and during the financial crisis. These onerous requirements are found throughout the Dodd-Frank Act and continue to be reflected in the over-regulation of credit unions through new, highly prescriptive rules promulgated by the Consumer Financial Protection Bureau.

Section 956 of the Dodd-Frank Act requires the Agencies to establish rules regarding certain incentive-based compensation practices. More specifically, it covers compensation that rewards undue risk-taking on behalf of a financial institution that could lead to material losses. Unlike others in the financial marketplace, credit unions have generally not provided to employees the kinds of abusive compensation plans that are the subject of this proposal and that encouraged unmanageable risks, thereby contributing to the financial crisis. Nonetheless, the Agencies have a difficult time articulating why this rule is necessary for any financial institution, as it appears that compensation is responsible for few bank failures.

For example, the proposal's preamble discusses FDIC's incentive-based compensation reviews. Of the 518 bank failures resolved by the FDIC between 2007 and 2015, 65 involved banks with total assets of $1 billion or more that would have been covered by the proposed rule. Eighteen of these 65, or 28 percent, were identified as having some level of issues or concerns related to compensation arrangements, many of which involved incentive-based compensation. The preamble contains no such information for credit unions because we presume it would contain no evidence of incentive-based compensation leading to credit union failures. In fact, CUNA's review of NCUA's material loss reviews did not see compensation as a reason for the failure of any credit union.

Accordingly, compensation issues are not linked to many bank failures and no credit union failures. Thus, this rule should be crafted in a way that minimizes the impact on all financial institutions—especially credit unions—as it seeks to provide a solution to a problem that does not appear to exist, particularly for credit unions.

The vast majority of covered credit unions will be subject to only recordkeeping requirements and some mandatory material loss and performance measure requirements for incentive-based compensation plans. However, the proposal would provide the Agencies' staff with the authority to impose more stringent requirements on financial institutions with $10 billion or more in assets. As proposed, these overly prescriptive requirements run the risk of placing an undue burden on covered credit unions.

Scope – Covered Institutions

The Agencies are required by Section 956 of the Dodd-Frank Act to develop an incentive-based compensation rule applicable to financial institutions, including credit unions. Specifically, Section 956 prohibits certain employees of covered financial institutions from receiving excessive "compensation, fees, or benefits" that "could lead to material financial loss" to covered institutions. Covered financial institutions include those that have at least $1 billion in assets and are (i) a depository institution or its holding company, (ii) a registered broker-dealer under the 1934 Act, (iii) a credit union, (iv) an investment adviser under the Investment Advisers Act of 1940, (v) Fannie Mae, (vi) Freddie Mac, and (vii) any other financial institutions that the appropriate regulators by rule determine should be treated as a covered financial institution.

The proposed rule would apply to any covered institution with average total consolidated assets greater than or equal to $1 billion that offers incentive-based compensation to covered persons. Covered institutions would be assigned to one of three levels based on average total consolidated assets.

- Level 1 – greater than or equal to $250 billion in average total consolidated assets;
- Level 2 – greater than or equal to $50 billion and less than $250 billion in average total consolidated assets; and
- Level 3 – greater than or equal to $1 billion and less than $50 billion in average total consolidated assets.

The vast majority of covered credit unions will fall into the Level 3 category with only one credit union with enough assets to be subject to Level 2 requirements. There are also several credit unions that could be subject to Level 2 requirements at the discretion of regulators. The proposed rule gives discretion to regulators to apply Level 2 requirements to Level 3 institutions with assets greater than $10 billion.

Section 956 requires application to institutions with at least $1 billion, but does not establish other coverage criteria. To minimize the impact on credit unions, we recommend the final rule increase Level 2 coverage to institutions with at least $100 billion in assets, and that it remove the proposed ability of a regulator to impose Level 2 requirements on certain Level 3 institutions, as those enhanced requirements are unnecessary and will have little impact on credit union or bank failures. Moreover, the lack of credit union failures and relative lack of bank failures resulting from compensation arrangements demonstrates that the Agency staff should not have the authority to apply more stringent Level 2 requirements to institutions with less than $50 billion in assets.

Covered Person

The requirement to determine employees covered by the rule should rest with a credit union's board. A board has the duty to manage the credit union in the best interest of its members. Part of this proposed requirement is approving compensation for employees and setting compensation levels for senior management. The proposed rule would remove some of a board's ability to tie management pay to a credit union's board of directors.

Under the proposed rule, a "covered person" would include any employee who is an executive officer, employee, or director who receives incentive-based compensation at a covered institution. The most extensive limitations would apply to covered persons who are considered "senior executive officers" who are determined by title and function and "significant risk-takers" who are not senior executives but their positions or actions have the potential to expose a covered institution to significant risk.

Significant-Risk Taker (SRT): Under the proposed rule, a covered person at a Level 1 or Level 2 covered institution, other than a senior executive officer, would be a "significant risk-taker" if the person (i) received annual base salary and was awarded incentive-based compensation for the last calendar year that ended at least 180 days before the beginning of the performance period of which at least one-third consisted of incentive-based compensation and (ii) satisfied either the relative compensation test of two percent in annual base salary for a Level 2 institution, or the exposure test, which is the ability to commit or expose 0.5 percent or more of the net worth or total capital of a credit union. In addition, NCUA would be able to designate any covered person at a covered institution, other than a senior executive officer, as a "significant risk-taker" if that person has the ability to expose the covered institution to risks that could lead to material financial loss in relation to the institution's size, capital, or overall risk tolerance.

The salary and exposure test are too prescriptive for determining an SRT and could cause employees to become SRT's when their function or salary have no relation to excessive risk at a credit union. The 0.5 percent limitation is too low for employees at Level 2 credit unions, especially those under the $50 billion threshold that are determined to be subject to Level 2 requirements by NCUA.

Again, a credit union's board should determine which employees are SRTs, as the board is in the best place to manage overall risk for a credit union's compensation scheme. If a board determines that an employee is an SRT, then the board should be tasked with ensuring that proper controls and policies are in place to make sure that the employee is properly managed and he or she does not have the incentive or ability to expose a credit union to unnecessary risk.

Excessive Compensation

NCUA determining whether compensation is "excessive" would be comparable to the Federal Banking Agency Safety and Soundness Guidelines developed under Section 39 of the Federal Deposit Insurance Act. According to these guidelines, compensation is "excessive" if the amounts paid are unreasonable or disproportionate to, among other things, the amount, nature, quality, and scope of services performed by the covered person. Under the proposed rule, applying this standard, NCUA would consider all relevant factors when determining whether incentive-based compensation is "excessive." These include:

- The combined value of all compensation, fees, or benefits provided to a covered person;
- The compensation history of the covered person and other persons with comparable expertise;
- The financial condition of the covered institution;
- Compensation practices at comparable institutions, based upon such factors as asset size, geographic location, and the complexity of the covered institution's operations and assets;
- With respect to post-employment benefits, the projected total cost and benefit to the covered institution; and
- Any connection between the covered person and any fraud, breach of trust or fiduciary duty, or insider abuse at the covered institution.

We are concerned that credit unions will have trouble applying these standards, especially when considering the small number of credit unions that will be subject to these rules. This standard could be especially difficult when determining what is excessive compensation at a Level 2 institution or one that NCUA has determine should follow Level 2 requirements. There are very few peers for Level 2 credit unions, making comparison of institutions very difficult.

Material Financial Loss

The proposed rule would prohibit a covered credit union from establishing or maintaining an incentive-based compensation arrangement that encourages inappropriate risks by the covered credit union that could lead to material financial loss. Specifically, the proposed rule provides that covered institutions would be prohibited from providing incentive-based compensation to covered persons unless the arrangement:

- Appropriately balances risk and financial rewards;
- Is compatible with effective risk management and controls; and
- Is supported by effective governance, including active oversight by the board of directors (or a committee thereof).

Furthermore, performance measures would require that an incentive-based compensation arrangement be considered to appropriately balance risk and reward only if it:

- Includes both financial and non-financial measures of performance;
- Is designed to allow non-financial measures of performance to override financial measures of performance, when appropriate; and
- Is subject to adjustment to reflect actual losses, inappropriate risks taken, compliance deficiencies, or other measures or aspects of financial and non-financial compliance.

NCUA needs to provide very specific guidelines or at least the methodology that the agency will use when determining appropriate risks and performance measures. The two definitions above of material loss and performance measures appear to give NCUA staff wide latitude to review the decision-making process used in the design of an incentive-based compensation plan. Knowing how NCUA will review such plans is critical for credit unions to be able to craft plans that are compliant with the rule.

Grandfathering of Plans

NCUA needs to clarify and provide guidance on the grandfathering of plans. It is our understanding that a grandfathered plan runs until a performance period that started before the credit union became subject to the incentive-based compensation regulation expires.

Board Requirements

A credit union's board will be required to approve incentive-based compensation of senior executive officers under the proposed rule. This can be done by a board or a compensation committee. Although not necessarily burdensome, this is unnecessary as proper oversight and approval of executive level compensation is a standard board function. Less prescriptive requirements would be sufficient as the board already bears the ultimate responsibility for ensuring the provisions in this regulation are met. By including specific board requirements, examiners have the ability to scrutinize board actions as a part of the process instead of reviewing actual compliance with the rule's requirements.

Recordkeeping & Disclosure Requirements

The proposal would establish disclosure and recordkeeping requirements for Level 1 and Level 2 credit unions. For example, a covered Level 1 or Level 2 institution would be required to maintain for seven years a record of its senior executive officers and SRTs and their incentive-based compensation arrangements.

While the proposed recordkeeping and disclosure requirements appear reasonable compared to Level 1 requirements, we reiterate the apparent inappropriateness of applying these and other aspects of the proposal to credit unions, which were clearly not the primary targets of Section 956 of Dodd-Frank.

Policies & Procedural Requirements

Under the proposal, a Level 1 or Level 2 credit union would be required to develop and implement policies and procedures for its incentive-based compensation program. A number of the proposed policies and procedures appear appropriate, including those that:

- Identify and describe the role of any employees, committees, or groups authorized to make incentive-based compensation decisions;
- Require the credit union document incentive-based compensation arrangements; and
- Describe how the credit union will monitor incentive-based compensation arrangements.

We support the Agencies' objective of the proposed policies and procedural requirements, which is, at least in part, to ensure covered institutions have adequate controls in place to avoid incentive-based payment arrangements that encourage inappropriate risks or that could lead to material financial losses. However, we are concerned that some of the proposed policies and procedural requirements may be too prescriptive if applied to covered credit unions, which are often less complex than similarly-sized banks. As noted above, we ask that NCUA provide credit unions with adequate detail to understand the specific criteria agency staff will be tasked with assessing. Again, we urge NCUA to work with the Agencies to minimize the unnecessary compliance burden on credit unions, which could be achieved a number of ways, including by tailoring much of the proposal's requirements in a way that reflects the unique model of credit unions.

Conclusion

NCUA and the Agencies should strive to minimize the impact of the Dodd-Franck Act's incentive-based compensation requirements for credit unions and other community institutions. Although the majority of credit unions that are covered institutions subject to the regulation will mainly be burdened by record keeping requirements, and ensuring they can demonstrate both that their plans would not incentivize employees to take action that could lead to a material financial loss and would contain proper performance measures. This will, at minimum, require a review of record keeping requirements and a credit union's recording keeping practice. Furthermore, credit unions will also have to document whether the decision-making process and plans meet material loss and performance measure requirements.

We also remain concerned that any credit union with $10 billion or more in assets could become subject to Level 2 requirements if NCUA staff determines that its complexity or compensation practices are consistent with a Level 2 credit union. This staff authority causes uncertainty because credit unions with assets greater than or equal to $10 billion and less than $50 billion can be required to comply with Level 2 requirements by NCUA staff even though they fall well below the Level 2 asset threshold. This could lead to credit unions following Level 2 requirements out of fear that NCUA staff could require compliance with these requirements with little notice.

Thank you for the opportunity to express our views. If you have any questions about our comments, please do not hesitate to contact me.

Sincerely,

J. Lance Noggle

Lance Noggle
Senior Director of Advocacy and Counsel