SELCO
COMMUNITY CREDIT UNION

July 22, 2016

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

Delivered Electronically

Subject: Incentive Based Compensation Arrangements; RIN 3235-AL06

Dear Mr. Poliquin,

On Friday, June 10, 2016, the National Credit Union Administration (NCUA) board, Office of the Comptroller of the Currency, Treasury (OCC); Board of Governors of the Federal Reserve System (Board); Federal Deposit Insurance Corporation (FDIC); Federal Housing Finance Agency (FHFA); and U.S. Securities and Exchange Commission (SEC), issued a joint notice of proposed rulemaking.

SELCO Community Credit Union ("SELCO") has some concerns about the rule as proposed, but we appreciate the leadership of Chair Metsger and Board Member McWatters and their willingness to address valid concerns.

General Comments:

While SELCO recognizes that there were a few bad actors within the mortgage industry, e.g., Washington Mutual, that provided incentives for production versus quality of loans, we believe the same brush should not be used to paint the entire financial industry. As you are aware, Credit Unions were not the cause of the financial crises. Further, Credit Unions have not abused the practice of incentive-based compensation. Accordingly, we wonder why then should such burdensome rules be applied to our industry.

At credit unions, incentive-based compensation arrangements are critical tools for management. These arrangements serve several important objectives, e.g., attracting and retaining skilled staff, encouraging better performance of individuals as well as better organizational performance. At SELCO, we have a number of incentive programs rewarding individual efforts, but also the collective efforts – a true cooperative approach – linked to overall organizational performance. SELCO's incentive programs are reviewed by management, linked to score card performance and audited annually by the internal auditor. A well performing organization leads to better results for our membership and the credit union community as a whole. With the compliance burdens and associated costs heaped upon credit unions and with the low interest rate environment and competitive pressures along with attacks on interchange income and other fee reduction efforts by the CFPB, it's become critical for credit unions to be high-performing efficient organizations. We must get more with less. Incentive-based compensation is a necessary component for credit unions to be successful today and tomorrow.

Specific Concern:

The punitive nature of 751.4 (d) (3), which states:

> (d) Performance measures. An incentive-based compensation arrangement will not be considered to appropriately balance risk and reward for purposes of paragraph (c)(1) of this section unless:
> (3) Any amounts to be awarded under the arrangement are subject to adjustment to reflect actual losses, inappropriate risks taken, compliance deficiencies, or other measures or aspects of financial and non-financial performance.

As an institution with assets in excess of $1 billion, this provision is directly applicable. However, this clawback feature is punitive in nature when considering its practical affect.

Specifically, during the great recession, SELCO experienced negative income for one year. SELCO's income was affected by a number of factors, including but not limited to losses associated with home equity loans and the Corporate Stabilization Assessments. A statically significant review of those loans confirms they were within policy and were appropriately underwritten, e.g., Loan to Collateral Value of 80%. Applying this rule literally, any incentives paid to Management would be subject to clawback. Could an examiner argue after the fact there was inappropriate risks? The rule allows for "Monday Morning Quarterbacking" which removes the element of what was known at the time of the decision and, therefore, can lead to unfair results in application. While it makes sense to look back at what occurred, this approach should be softened by the realities at the time.

In the loan example above, one might argue it was reasonable to predict the market crashing by looking back after the fact, however, we believe that position would be an oversimplification considering market analysis were conducted, credit reports were reviewed, incomes were verified, etc.

The rule anticipates a required clawback of incentives in association with a year of negative income. How would application occur? Would that mean all subsequent incentives would be subject to clawback until the sum total of the one year of negative

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income has been made up dollar for dollar even if subsequent years of financial performance represents positive net income? Alternatively, would clawback of incentives be for the year of the negative income only? And, how is "actual loss" measured? Net Income, Loss on an investment, other?

Beyond the punitive nature of the rule, the rule is simply too ambiguous and subject to interpretation which will likely lead to disputes, inconsistent application and different results for similarly situated people. For example, what are "inappropriate risks"? Who gets to define that position and under what context? What of market forces? For example, say SELCO purchased a Triple A rated Bond (rated by Moody's) and it fails, was that an "inappropriate risk taken"? Should we have known that bond was going to fail? Should we not be able to rely on ratings agencies? Would this example lead to clawback? Is there an ability to appeal a decision of this nature? Who has the final say? We believe the rule lacks sufficient clarity.

As another example of ambiguity, what if an examiner finds a compliance deficiency that has nothing whatever to do with performance relative to incentives? Could the examiner require a clawback in this situation? Should there be a direct or causal link or some nexus between the compliance deficiencies, the risk and the compensation? What if the compliance deficiency had no adverse impact to performance? Would there still be a case for clawback? Finally, the last clause, "or other measures or aspects of financial and non-financial performance" is equally ambiguous and subject to interpretation and inconsistent application leading to varied results.

At a minimum, SELCO believes the rule is too ambiguous and more clarity is appropriate so as to eliminate subjectivity and inconsistent results.

Conclusion:

In conclusion, we understand the Dodd-Frank Act requires additional rule-making, however, we hope that the NCUA's commitment to improving the regulatory landscape for credit unions will lead to sensible, fair and unambiguous rules. Thank you for the opportunity to comment on this issue. We would be pleased to answer any questions you may have.

Respectfully,

Steven L. McIntire
VP, Administration & General Counsel