June 24, 2019 **VIA E-MAIL ONLY: regcomments@ncua.gov**

Gerard Poliquin, Secretary of the Board
NATIONAL CREDIT UNION ADMINISTRATION
1775 Duke Street
Alexandria, Virginia 22314-3428

Re: Patelco Credit Union—Comments on Advance Notice of Proposed Rulemaking: Compensation in Connection with Loans to Members and Lines of Credit to Members

Dear Mr. Poliquin and the NCUA Board:

Patelco Credit Union thanks the Board for raising § 701.21(c)(8) in the course of its regulatory reviews. Patelco is a California chartered and federally insured credit union originally formed in 1936 to serve Pacific Telephone and Telegraph Company employees; we now serve employer groups, communities in the San Francisco Bay area, Sacramento area, and Central Valley, and associational groups. With nearly $7 billion in assets, our operation requires talented personnel. Keeping those people requires nuanced incentives. Paying employees competitively with what they can receive at banks, non-bank lenders, and other types of institutions is necessary to success. So we believe this matter, and the topic of incentive compensation in general, is a necessary area for regulatory consideration and reform.

We support the Agenda's recommendation to "provide flexibility with respect to senior executive compensation plans that incorporate lending as part of a broad and balanced set of organizational goals and performance measures." It is counterintuitive that "overall financial performance" could not be based on a number of individual measures that equate to overall performance. Loan performance as an individual measure, along with loan quality, profitability, efficiency, member experience, and other measures, would create a better set of incentives particularly when balanced with ROI and/or net worth quality.

Because of the preference of sophisticated operations for flexibility, we believe that credit unions should have flexible options so long as those options are within a reasonable risk management framework. Patelco supports the NCUA pursuing a regulatory framework more in line with the Interagency Proposed Rule on Incentive Compensation and less like § 701.21(c)(8), particularly for executives. The NCUA can and should maintain blanket conflict of interest prohibitions for volunteers (directors and Credit Committee or Supervisory Committee members), but the same blanket type of methodology does not allow for credit unions to keep up with the times and adequately compete.

With these general comments in mind, we turn to the specific feedback requests from the Board:

- *Is there a single industry standard or methodology for developing executive compensation plans? Are there multiple standards or methodologies for credit unions of different asset sizes?*

  We are not aware of any single industry methodology, but a basic general thought process proceeds as: What is our general philosophy on total compensation; base salary and bonus, deferred compensation, other perks, and other compensation plans; What is competitive for this position considering total rewards in the market; What will be relatively comparable with similarly situated executives already here; What are comparable executives payed at similarly situated institutions; What are this executive's employment horizons like here (and generally until retirement)? The answers to what plans and levels of compensation are appropriate depends on the institution.

- *Are the terms and conditions of executive compensation plans developed by credit unions themselves or are the plans crafted by third-party vendors?*

  We develop compensation plans internally and through consultation with independent third party advisors, depending on the circumstance and the prominence of the position. CEO compensation, for example, makes sense to be developed with input from third party advisors and consultants, as the Board of Directors is not in the business of doing the work of compensation studies. For other executives, compensation plans can be developed with input from search firms and consultants, or can be developed through consultation, coordination and collaboration with the CEO. An institution's human resources department is often a partner for all departments in the creation and tracking of incentive plans.

- *What do these plans look like? Are there specific formulas employed to determine terms and conditions? If so, what are the formulas?*

  For retirement plans, amounts are based on the desired target compensation, the retirement horizon, tax planning, and other various variables. These are not necessarily formula based, though once retirement or deferred compensation plans are selected, the math specific to that type of plan and vesting schedule flows naturally from the various elements.

  For bonuses, formulas are used to calculate achievement of performance goals and corresponding bonus awards. Separate goals are generally set for organizational and individual performance, and then bonuses are often dependent on meeting or exceeding those threshold goals. Based on performance levels, bonuses vary.

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- *Is the current structure of § 701.21(c)(8), namely a broad prohibition with specific exceptions, the best format for regulating this area?*

  We do not believe a broad prohibition with specific exceptions is ideal in this area. For employees, the prohibition-and-exception format is extremely confusing, as it lends itself to wonder about regulatory views on internal controls, governance, and pay in general. For executive compensation, the more narrow exception leaves out the details that would actually go into providing incentives to these employees.

- *Do commenters prefer a bright line test for permissible compensation to regulations that make a more holistic evaluation of individual compensation plans and the incentives they provide? Is a bright line test even possible in this highly fact determinative area? If so, where is that line?*

  We would prefer a more holistic evaluation of compensation plans in line with risk, rather than bright line tests. Indeed, apart from certain limits, such as senior management and certain key risk-takers having limits of 150% or 125% of target payouts (as reflected in the Interagency Proposed Rule on Incentive Compensation), bright line tests are likely not possible for employee compensation. This includes compensation for senior executives.

- *Are current credit union compensation plans similar to, and competitive with, those provided at other financial institutions? If not, how do they differ and what, if anything, in the NCUA's regulations contributes to those differences?*

  Credit union compensation plans are steadily growing to resemble those possible at other financial institutions. However, credit unions cannot offer stock options or similar types of compensation. Credit unions also cannot offer retirement plans that would have payouts over a number of years—Internal Revenue Code § 457(f) makes it so that entire amounts are taxable as soon as they vest. This tax code creates the large payouts for executives upon retirement. The Tax Cuts and Jobs Act makes worse this division by creating an excise tax for payments over $1 million. The combination of these laws creates an inherently uncompetitive situation for credit unions. It is important that the NCUA not create further roadblocks to competitive pay.

  The NCUA does currently contribute to some of the uncompetitive nature of credit union pay, as § 701.21(c)(8) prevents credit unions from pursuing pay for loan producers or innovators on an incentive basis. Senior managers who are highly involved in creating channels for the secondary market or other highly lucrative fields expect incentive pay to be a major part of their package. This tool is not available to us. We believe it should be available to us in order to compete with other types of lenders for key talent.

- *What limitations, if any, are necessary to prevent individuals from being incentivized to take inappropriate risks that endanger their credit unions? What authorities do credit unions need to enable them to compete for talented executives?*

  We do not believe limitations are necessary, but process is. Expectations and guidelines would make it so that credit unions could design appropriate safeguards by position. Such expectations could include that credit unions include metrics that are quality/risk related, and not just production related, but we also believe that exceptions should be possible to those expectations when supported by reasonable business cases. Expectations for examiners that would focus on risk management, rather than narrow looks at plan documents, would further assist.

- *To what extent should the NCUA permit loan metrics, such as loan volume, to be a part of compensation plans? How would those metrics be incorporated into the overall plan?*

  NCUA should allow such metrics to be a part of compensation plans. They should be allowed as line items in larger plans, or as standalone bonus plans.

- *Should the NCUA provide additional requirements for compensation related to a line of business that is new for the credit union or one in which the credit union lacks substantial experience or expertise?*

  No, because these can be the very items in which a credit union needs to hire skilled outside help and condition their pay on success of the venture. For developing expertise, institutions may need to improve upon their executive team, and may not yet have developed the profits to support pay expected by the target talent. A promise of pay based on success can create the possibility of future compensation without locking the institution into pay without results. Prohibiting incentive compensation for new business lines or new pay structures would slow the innovation and expertise that the credit union industry needs to remain vibrant.

Please do not hesitate to contact us if we can be of further assistance to the NCUA in crafting policy in this important area.

Sincerely,

PATELCO CREDIT UNION

Chris Allen, SVP Chief Risk Officer