Open Board Meeting April 21, 2016

Prepared Remarks of NCUA Vice Chairman Rick Metsger
On the Proposed Interagency Incentive Compensation Rule

Section 956 of the Dodd-Frank Act requires federal financial institutions regulators, including NCUA, to issue joint regulations or guidelines requiring disclosure and reporting of compensation at financial institutions with more than $1 billion in assets.

It also requires regulators to prohibit certain types of incentive-based compensation that encourages inappropriate risk taking, or which could lead to a material financial loss.

While the financial regulators have some flexibility over the structure of this proposed rule, doing nothing is not an option. In fact, Congress specifically directed the regulators to prescribe a rule or guideline no later than 90 days after the Dodd-Frank Act was signed into law, which was nearly five years ago.

Congress mandated action in this area because there were financial institutions which failed as a result of excessive risk-taking that was encouraged by incentive based compensation arrangements which rewarded senior officials based on the volume of business they generated, regardless of whether the institution subsequently made or lost money on that business.

Congress, and the American people, want senior executives at large financial institutions held accountable if their desire for personal enrichment leads to decision-making that results in material losses to the institution or our deposit insurance funds.

Now as we all know, credit unions were not a primary cause of the financial crisis. They were primarily victims, which is why the NCUA took the lead in becoming the first financial institutions regulator to sue the Wall Street Banks whose actions led to the crisis. Our aggressive actions in court have recovered more than $3.1 billion from the Wall Street Banks that did so much to hurt main street and American middle class families.

At the same time we must acknowledge that excessive incentive-based compensation has contributed to the failures of some corporate and natural person credit unions. A prime example of this problem is the failure of the Cal State 9 Credit Union – whose losses cost the Share Insurance Fund more than $170 million.

The Material Loss Review of Cal State 9 done by the NCUA's Inspector General found that, "An incentive compensation program that paid nearly $400,000 in bonuses to the credit union's CFO between 2006 and 2007 based on net income generated by the HELOC program" was one of, "…two factors that contributed significantly to Cal State 9's excessive concentration of its assets in indirect HELOCs," that eventually led to its demise.

The proposed rule before us today, and we need to remember that it is just a proposed rule not a final rule, is quite lengthy—more than 500 pages.

This is part of what happens when Congress directs seven very different federal agencies, which regulate seven different types of entities to do a joint rulemaking. The vast majority of the 500 pages are preamble explaining the basis for the rule, asking questions which the agencies want commenters to address, and explaining the slight differences between the rules for each agency. The rules, which apply to credit unions, for example, take into account the differences in the way the Internal Revenue Code treats credit unions and other financial intermediaries like banks. The actual proposed rule for credit unions, is only about 20 pages long, and like the rules for other financial intermediaries it scales the rules based on institutions' assets.

The toughest rules apply only to "Class 1" institutions with more than $250 billion in assets, and as we all know, there are no credit unions that are even close to this threshold.

The second toughest rules apply only to "Class 2" institutions with between $50 and $250 billion in assets, and again, as we all know, there is only one credit union in this category.

"Class 3" institutions are credit unions with between $1 and $50 billion in assets, and there are just over 250 credit unions in this category.

Thus more than 95% of all credit unions are totally exempt from this proposed rule. It should also be noted that the rules for "Class 3" credit unions are significantly streamlined, and are only about two pages of the proposed rule.

In order to do our part for the environment, we're only distributing the 20 pages of the proposed rule which apply to credit unions, but anyone who wants to compare them against the proposed rules for other financial intermediaries can download the full 500 plus pages from the NCUA's web site.

As staff has already described, the "light" two-page version of this rule that applies to "Class 3" credit unions with between $1 and $50 billion in assets prohibits incentive-based compensation that encourages inappropriate risk-taking that could lead to a material loss to the credit union. It requires the Board of Directors, or a board committee, to oversee and approve incentive-based compensation for senior executive officers. And, finally, it requires that credit unions maintain records on its incentive-based compensation rules for seven years.

It does NOT require credit unions to report the actual amount of compensation paid to individual senior executive officers. So state chartered credit unions, which already file Form 990 with the IRS may find this proposed rule less burdensome than the existing IRS rule.

Like most rules written by a committee, this rule is probably not perfect, nor should we live under the misconception that by itself it will prevent another meltdown. It is, however, an effort to require accountability and limit risk-taking, and in some form or another, it is required under a plain reading of Section 956 of the Dodd-Frank Act.

I look forward to the comments we will receive on the proposed rule.