VIA EMAIL: boardcomments@ncua.gov

November 20, 2017

Mr. Gerald Poliquin
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, Virginia 22314–3428

Re: **NCUA Board's Regulatory Reform Agenda, 82 Fed Reg 39702**

Dear Mr. Poliquin:

Digital Federal Credit Union (DCU) supports the agency's efforts to provide regulatory relief to credit unions and appreciates the opportunity to comment on the National Credit Union Administration (NCUA) Board's Regulatory Reform Agenda. We recognize that the review of NCUA rules by the agency's staff task force in a relatively short time frame was a considerable undertaking, and we commend their efforts in helping the Board develop a detailed list of regulatory reform issues. Our letter generally focuses on those items on the agenda of particular significance to DCU and on which the Board has not already taken final action this year.

Tier I, Board Action Within Two Years

Loan Maturity Limits

DCU welcomes the Board's review of its maturity limits on loans to one-to-four family residences and other loans. The Board is also considering combining all loan maturity limits in one section of its regulations and incorporating an agency legal opinion into its rules that clarifies troubled debt restructurings are not new loans. DCU supports these changes as well.

The Federal Credit Union Act (FCUA) generally limits loan maturities to 15 years, including member business loans (MBL), with certain exceptions such as for home purchase loans, mobile home loans, and home improvement loans. The maturity limits for MBLs secured by a one-to-four family dwelling that is not a member's primary

residence are particularly problematic as they do not allow credit unions to provide members with mortgages that are readily available from non-credit union financial institutions and the regulation restricts the sale of such loans in the secondary market. As a result, rather than being able to originate and sell these loans with 30-year maturities, we can only offer 15-year loans with a balloon payment, which is disadvantageous to the members and to DCU.

The Board cited §§701.21(f) and (g) of the FCUA among the relevant legal provisions it is keeping in mind as it considers lengthening loan maturities. We agree these provisions allow the Board some flexibility to address loan maturity limits for loans on one-to-four family non-owner occupied dwellings, and we encourage the Board to develop a proposal for comments on this issue as soon as possible.

Meanwhile, legislation is pending in Congress, S. 836 and HR 389, the Credit Union Residential Loan Parity Act, that would no longer require NCUA to classify loans on non-owner occupied one-to-four family properties as MBLs. NCUA has supported this legislation, and DCU appreciates the agency's efforts to communicate its views on the bills to Congress.

While the purpose of the legislation is to remove non-owner occupied one-to four-family loans from the coverage of the statutory MBL aggregate cap, the bills would also support NCUA permitting longer maturities for these loans since they would no longer have to be considered MBLs. This treatment would be consistent with the current MBL rule under which the agency designates some loans as 'commercial' even if they do not meet the statutory definition of an MBL. A non-owner occupied one-to-four family loan, while currently classified as an MBL, is not considered a commercial loan by NCUA. If such loans are exempted from the statutory MBL cap, the agency would have additional latitude to ensure they are categorized as residential loans. Even so, we do not think the agency has to wait for the legislation to be enacted (since that outcome is unclear) and should proceed with a proposal to allow longer loan maturities, especially for loans on one-to-four family non-owner occupied dwellings.

Compensation in Connection with Loans

DCU supports the agency's review of its rules on compensation to credit union officials in connection with lending. In particular, there are two provisions in the agency's rules that create confusion and unduly limit the ability of well managed credit unions to provide incentives for good performance, consistent with a credit union's policies and

strategic plan. For example, 12 CFR 701.21(c)(8)(iii)(B) permits bonuses and compensation to an employee but it must be based on the 'overall financial performance' of the credit union, rather than being tied to the performance of his or her department or individual function. Also, under the next provision in the FCUA 12 CFR 701.21(c)(8)(iii)(C), a bonus or incentive may be provided to an employee in connection with lending performance, but the employee cannot be a senior management official. These two provisions create confusion, when not looked at in context of the proposal, and the final rule issued when this section was previously amended.

In April of 1995, the National Credit Union Administration (NCUA) issued a proposed amendment to Section 701.21(c)(8) of the NCUA Rules and Regulations. This section addresses prohibitions from receiving incentive and outside compensation. Generally, we believe the proposed amendment was intended to address an area of ambiguity that had been difficult to address. In the supplementary information, the proposal stipulates that:

> "In the context of incentive pay, rather than outside compensation, loan processing and making credit decisions on loans are clearly activities in connection with making loans. Thus, an employee would be prohibited from receiving incentive pay for performing those activities unless covered by an exception."[1]

Additionally, as part of the supplementary information related to proposed exceptions, utilization of overall financial performance measures is discussed:

> "Exception (B) would clarify that an incentive may be paid to an employee based on the overall financial performance of the credit union, which of course depends in part on its lending activities. While it could be argued that such an incentive is not truly "in connection with" a loan made by the credit union, the Board has included the exemption to avoid confusion. The Board believes that this type of incentive presents fewer problems than does an incentive based on the performance of a single individual, as it is focused on the interests of the credit union as a whole. However, incentives based on an organization's overall performance must still be monitored closely to avoid the problems discussed above. NCUA of course reserves the right to take exception to overall performance related incentive plans for

[1] **Federal Register** / Vol. 60, No. 76 / Thursday, April 20, 1995 / Proposed Rules pg. 19690

> safety and soundness reasons, for example, and plans where incentive pay is based on asset growth with no consideration of factors such as capital and asset quality."[2]

This supplemental information related to proposed Exception (B) also acknowledges that overall financial performance "of course depends in part on lending activities". "In part" can be open to interpretation, but it seems that "in part" would suggest more than 1% of the incentive, and would be less than 100%.

In reviewing exception B, the board indicated that the exception was included to avoid confusion about whether or not an incentive based on overall financial performance is considered to be in connection with a loan made by a credit union. This clarification remains consistent in the final regulation, issued later in 1995 as follows:

> "In response to the comments, and to reduce regulatory burden, the Board has determined to give member-elected boards of directors more flexibility in determining compensation policies for lending-related activities, including the use of incentive pay. Accordingly, the final rule will allow federal credit unions to pay: (1) To any employee, including a senior management employee, an incentive or bonus based on the overall financial performance of the credit union;"[3]

Additionally, the final regulation includes the following:

> "(iii) This section does not prohibit:
>
> ...
>
> (B) Payment, by a Federal credit union, of an incentive or bonus to an employee based on the credit union's overall financial performance;"[4]

While exception (B) does not specifically spell out the "including senior management" element of employees, this is clear in supplemental information provided in both the proposal and final regulation that this is the intention. Furthermore, in reviewing the final rule, we did not identify anything included within this document that discussed a concern that specifically warranted the exclusion of senior management from this exception.

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[2] **Federal Register** / Vol. 60, No. 76 / Thursday, April 20, 1995 / Proposed Rules pg. 19690

[3] **Federal Register** / Vol. 60, No. 192 / Wednesday, October 4, 1995 / Rules and Regulations pg. 51886

[4] **Federal Register** / Vol. 60, No. 192 / Wednesday, October 4, 1995 / Rules and Regulations pg. 51889

On a related but separate rule making, DCU submitted the attached comment letter in July 2016 regarding the joint regulatory proposal under the Dodd Frank Act of NCUA and the other federal financial regulators on incentive based compensation. The status of that proposal is unclear. However, while DCU does not support the proposal, if it goes forward, we urge the agency to help achieve changes that are necessary to make compliance possible, as outlined in the attachment.

Federal Credit Union Bylaws

DCU agrees that the agency's review of the bylaws for federal credit unions is warranted and in fact is long overdue. For example, on issues such as member meetings and elections in Articles III and IV, the bylaws are overly prescriptive and need to be revisited with an eye toward facilitating governance procedures. Also, it is not necessary for NCUA to provide prior approval of all bylaw changes when an after the fact notice to the appropriate NCUA regional office would suffice, particularly for changes the agency has already approved for other credit unions. In addition, the agency may subject a credit union to sanctions for failure to comply with its bylaws, although such situations are intended to be limited to material issues. While the failure of a small number of credit unions to follow their bylaws helped drive the Board to reserve the right to impose sanctions when the bylaws were changed in 2007, this approach seems overly harsh and unnecessary for most credit unions. We support a credit union working group to assist the agency in developing a proposal that would update and streamline the bylaws.

Capital Planning and Stress Testing

DCU will be filing a separate comment on the agency's proposal approved for comments last month that would not require stress testing for credit unions with up to $20 billion in assets during the first three years they have at least $10 billion in assets. While all credit unions of $10 billion or more in assets would submit capital plans each year, only credit unions with assets over $20 billion would receive a separate review of their plan. For the other covered credit unions, NCUA would address capital planning as part of the supervisory process. While these are steps in the right direction of regulatory relief for credit unions between $10 billion and $20 billion in assets, DCU is concerned about the application of the rule, including its size-based thresholds. We would like to draw the agency's attention to the U.S. Treasury Department's Office of Financial Research Viewpoint issued October 2017 that the size of a bank is insufficient to identify systemically significant institutions.

Risk Based Capital (RBC)

DCU opposed the current RBC rule and continues to question why the former rule needed to be changed. We think the Board should discard the present rule and return to the previous one, since some form of RBC is consistent with prompt corrective action under the FCUA. However, we note that regulators in the banking sector are increasingly wary of RBC and some economists are doubting its usefulness. For example, a 2013 study released by the Mercatus Center concluded RBC is not an effective predictor of bank performance.

DCU will not be directly affected by the RBC rule in the short term, but if the rule is not repealed soon, we support extending the January 2019 compliance date for covered credit unions to allow the agency to revisit the need for the rule as adopted.

If the current rule is retained, further agency consideration of the scope of the rule and the definition of a 'complex' credit union that is not so dependent on asset size as well as revisiting appropriate risk weightings would be useful in light of federal bank regulators' current review of simplified capital standards for community banks.

The agency should also reconsider whether a higher RBC requirement for well capitalized credit unions compared to the requirement for adequately capitalized credit unions is justified, given the language of the FCUA under prompt corrective action that conclusively precludes this result. In addition, we think NCUA should provide to credit unions any economic analysis it has conducted of the impact of the Financial Accounting Standards Board's current expected credit loss standard, which will likely compound compliance for RBC covered credit unions when it takes effect.

As noted below on the topic of 'alternative capital,' we support authority for credit unions to raise capital other than through just retained earnings. We recognize a change in the FCUA is needed to include alternative capital in net worth, but the agency does have authority to permit it for RBC purposes without a statutory amendment.

In that connection, we do not see the need to delay a review of alternative capital, which is the result that placing it in Tier II has. The agency has already issued an advance notice of proposed rule making (ANPR) on alternative capital and should move on to a proposed rule. In particular, if in the Tier I time frame the agency decides to revise instead of repealing the present RBC rule, or retains it without changes, authority for alternative capital to help covered credit unions meet RBC requirements should be approved to coincide with that decision.

Fidelity Bond Coverage

Our credit union would like to see the agency assemble a working group on this issue that includes credit unions and insurers with the objective of updating NCUA's rules to provide flexibility for credit unions to make business decisions about bond coverage, consistent with the FCUA, particularly regarding the scope of coverage and deductibles. We also think issuing an advance notice of proposed rulemaking would be useful to identify the range of issues before an actual proposal is developed.

Securitization

DCU appreciates the well reasoned legal opinion letter the agency issued in June 2017, which identifies the authority federal credit unions have under the FCUA to securitize their assets. This is an important development, and we anticipate that over time it will benefit participating credit unions by strengthening their asset/liability management capabilities and their members who will continue to have access to strong lending programs. DCU would like to work with the agency in the development of its planned guidance on securitization. Moreover, as we have suggested elsewhere in this letter, we think the agency should establish a working or advisory group that includes credit unions and securitization experts, to identify all key issues and concerns that should be addressed in the guidance.

Appraisals

DCU agrees the agency should revise its appraisal threshold, in particular for loans on one-to-four family dwellings. The agency notes that it is already working with the other federal financial regulators to raise the threshold from $250,000 to $400,000 when such loans are business loans and repayment of the borrowing is dependent on income from the business. The bank regulators allow the appraisal threshold to increase to $1 million when repayment for a real estate related business loans is not dependent on the underlying business, and we encourage NCUA to consider that approach as well.

NCUA's agenda indicates it is also considering developing its own changes to appraisal requirements, independently of the other federal financial institution regulators. DCU would support this effort if it is designed to maximize relief for various types of lending that require appraisals.

The current thresholds limit our ability to utilize more advantageous rules on appraisals from the secondary market. For example, FNMA provides appraisal waivers for some home purchase loans when there is a 20% down payment and a prior appraisal was obtained under its Collateral Underwriter program. FreddieMac has a similar approach.

Also, certain new mortgage refinancing, such as when the borrower has at least 20% equity in the home and is not receiving cash as part of the transaction no longer generally require appraisals in the secondary market.

DCU encourages the Board to consider these developments as it reviews appraisal requirements. While prudent lending can make good use of appraisals, allowing lenders more flexibility in determining when appraisals are needed could result in important regulatory relief.

Accuracy of Advertising

The Board is currently seeking comments on a proposal to reverse an onerous rule change in 2011 that presently requires credit unions to reference their federal share insurance in radio and television ads of 15 seconds or longer. The proposal would raise the threshold for the reference to 30 seconds, as it was before the 2011 amendment. DCU agrees with this change and may file a separate comment letter. We also think addressing the extent to which federal share insurance must be mentioned in social media ads would be useful. For example, the current NCUA advertising rule at 12 CFR 740 provides exceptions for when referencing federal share insurance is impractical and not required, such as on calendars, pens, pencils, and keychains. Whether that exception should include certain social media ads could be considered by the Board.

Tier II, Board Action In 3-4 Years

Loan Participations

DCU supports the agency's efforts to improve its loan participation rule such as by removing the current limit on total loans that may be purchased from one originating credit union. We do not think this provision of the loan participation rule was warranted and it limits the options selling and buying credit unions have regarding loan participation arrangements. Currently, credit unions may obtain a waiver from this provision. Likewise, a credit union may obtain a waiver from the limits on purchasing loan participations that involve one borrower. The agency should consider allowing well managed, well capitalized credit unions to set their own reasonable limits for both these restrictions.

Also, under the MBL rule, NCUA treats certain purchased loan participations as MBLs including for risk weighting under the RBC rule. If the participation involves a loan to a member of the purchasing credit union, even though the loan was originated by the selling credit union, the interest in the participation must be counted as an MBL by the purchasing credit union. We do not think this practice is justified and encourage NCUA

to reconsider it as it reviews the regulation of loan participations. Similarly, the conflict of interest provisions regarding the use of third parties to review a loan participation could be clearer as to when the third party can actually acquire an interest in the loan participation.

Eligible Obligations

DCU agrees with the comments in the agency's agenda that there should be no limits on the eligible obligations of the credit union's members. We also think it is a good idea to strip away requirements that are not imposed by the FCUA and to consolidate provisions regarding eligible obligations in one place in the regulations. Loan participations could benefit from that approach as well, in light of the provisions that apply to them under the MBL rule.

Alternative Capital

Consistent with our longstanding view, and as indicated above, DCU encourages the agency to develop a separate rule making on alternative capital to meet RBC requirements. We also want to acknowledge the agency's strong support for federal legislation to permit alternative capital to meet net worth requirements. We hope the agency will continue supporting such legislation and informing Congress of your views whenever appropriate, as you have in the past.

Investments and Derivatives

DCU supports a review of investment authority for federal credit unions, including removal of preapproval requirements for derivatives. We also agree that credit unions with the necessary capabilities, including expertise, to manage their investments in line with their strategic plans should have much more latitude than they do now to exercise sound business judgments in setting investment policies and implementing investment programs. A principles-based approach would suit investment regulation and compliance well for the agency and for those credit unions that have a reasonable vision and appropriate strategy for their investments as part of their overall asset liability management.

The agency has provided a detailed list of investment provisions it could review as part of its efforts to streamline its regulation. DCU agrees this list in the appendix to the agenda is a good starting point in developing an improved rule. However, as with other complex issues addressed in this letter, we encourage the agency to assemble a working group that should include credit union officials as well as investment advisors, and develop an ANPR that would help provide a solid foundation for a comprehensive

updating of the investment rule. The agency should also consider investment authority for community banks as it reviews new flexibility for credit unions in this area.

The agenda also provided a detailed list of derivative provisions in its efforts to streamline its regulations which included to "move" put-option purchases in managing increased interest-rate risk for real estate loans produced for sale on the secondary market, in 701.21(i) to 703.102(a). and "Rename" 703 Subpart B from "Derivatives Authority" to "Derivatives and Hedging Authority". We are not in favor of such changes as it adds layers of complexity, which is not the intent of the regulatory reform process. We believe the put-options pertaining to real estate loans should remain in Loans to Members regulations.

DCU would like to request the Board add an item to its Regulatory Reform Agenda, authority for credit unions to invest in mutual funds offered by Management Investment Companies (MICs). The MIC would be an entity receiving NCUA derivatives authority as opposed to numerous individual credit unions. NCUA rules and regulations could be modified to incorporate requirements for individual credit union investors utilizing any MIC issued funds with derivative authorities (policies, procedures, etc.).

The MIC would be registered under the Investment Company Act of 1940 and the Securities Act of 1933. From this perspective, the MIC would fall under the regulatory scope of the Securities Exchange Commission (SEC). The existing regulatory framework of the mutual fund industry includes considerable oversight at the time of registration, as well as frequent ongoing reporting requirements. As we understand it, this reporting includes an annual prospectus, annual & semi-annual reports and other requirements related to various changes which occur during the interim. An organizational structure would likely include:

- Board or Trustees (Responsible for fiduciary oversight)
- Management or Officers (Day to Day operations as well as SEC filing certifications)
- Compliance
- Investment adviser
- Administrative and Fund accounting agent
- Transfer agent
- Distributor
- Legal counsel
- Independent registered public accounting firm

With this approach, a credit union could invest in mutual funds that obtained derivatives authority from the NCUA. The intention is not to create a fund invested entirely in derivatives. It is intended to allow approved MICs the ability to utilize derivative tools to

manage the interest rate risk within the fund. As opposed to credit unions investing in individual securities with embedded interest rate, a credit union could utilize a fund as an alternative investment tool. Investing in such a fund would not grant any additional derivative authority to a credit union. We believe this solution could:

- increase the number of credit unions that could afford to participate and receive the benefits of derivative tools,
- provide a mechanism to allow access for credit unions with assets less than $250 million,
- reduce the cost of participating in the program,
- utilize the expertise of regulated third parties,
- provide less of a resource drain on NCUA staff, and
- retain NCUA the direct ability to set and monitor requirements of third party vendors.

A hypothetical example:

- At DCU, 10% of our investment portfolio is invested in a longer duration mutual fund that includes agency mortgage-backed securities (all investment authorized in FCUA).
- This mutual fund is governed by a MIC registered and regulated by the SEC.
- The MIC applied to and received authority to utilize specific derivative products as part of the interest rate risk management process within the fund.
- Without DCU individually applying and receiving derivative authorities from the NCUA, we would be authorized to invest in a fund that utilized derivatives (20% of our portfolio).
- Policies and other regulatory requirements to participate would be in place.
- For the remaining portion of our balance sheet, no authority to invest in derivatives would exist. DCU would have to specifically apply for and receive derivative authority as specified from NCUA.
- A new 'Level 0' as shown below would be included in the NCUA's derivative rules and regulations:

	Level 0		Level I	
Function	Support	Conduct	Support	Conduct
Asset Liability Management		X*	X	
Accounting and Reporting		X*		X
Credit Risk		X*	X	
Counterparty Exposure Management		X*		X
Collateral Management		X*		X
Liquidity Risk		X*	X	
Trade Execution		X*		X
Transaction Management		X*		X
Financial Statement Auditing		X*		X
Legal Services		X*		X

* - This only applies to the portion of the investment portfolio specifically covered under Level 0, and does not override any other limitations or requirements specified in other areas of NCUA Rules & Regulations.

We think this could be an important risk management tool and recommend the Board give it full consideration.

Tier III, Board Action In 4 Years

Third Party Due Diligence

DCU is pleased the agency is considering a review of credit union due diligence requirements, which are considerable. Depending on the number and nature of third party arrangement a credit union has, due diligence compliance can be very burdensome and resource-intensive.

DCU agrees that, in general, the concept of consolidating due diligence requirements in one rule is positive but we do not think the agency should regulate how credit unions meet their due diligence obligations. Any revised due diligence rule should not be overly detailed in imposing specific requirements but should focus on allowing credit unions to determine how best to vet third party business partners and arrangements.

Preemption

DCU appreciates that operating in several states subjects institutions to a confusing array of differing state laws, unless NCUA requirements or other federal laws override them. We do not favor federal preemption for the sake of undermining consumer protections but we do think preempting state laws to facilitate credit union operations can help reduce compliance burdens and produce cost savings that are shared with members. We support the agency's view of its preemption authority and encourage the agency to consider preemption broadly while being mindful of consumer and state authority concerns.

Loan Interest Rate Ceiling

DCU encourages the Board to consider whether the federal credit union loan rate ceiling could be variable, rather than set as a fixed, temporary rate that has to be revisited at least every 18 months. We believe this is a creative approach that could result in more certainty to federal credit unions regarding future loan rate ceilings and would facilitate credit union lending and overall planning.

CUSOs

DCU supports a review of the agency's rule on credit union service organizations (CUSOs). In our view, the rule changes that took effect in January 2016 under which the agency asserted broad authority not found in the FCUA were punitive and excessive, certainly in light of the relatively low risk CUSOs pose to the credit union system. In adopting the final rule, the agency noted the various benefits CUSOs provide to credit unions and their members. Yet the current rule burdens CUSO operations and limits the capabilities of credit unions to use CUSOs to maximize their services.

For example, the rule established elaborate reporting of CUSO activities to NCUA and includes a list of high risk CUSO activities such as payroll processing that would subject a CUSO to additional requirements. These restrictions should be reconsidered as well as the need for the agency's costly CUSO Registry. In addition, the agency should consider abandoning the preapproved list of CUSO activities and permit credit unions to utilize CUSO products and services that are generally incidental to the business of a credit union.

In the past, the agency has sought statutory authority over CUSOs and other third party service providers. DCU does not support these efforts and does not think the FCUA should be amended to provide this authority to the agency. Such a change in the FCUA would mean an unnecessary expansion of the agency and higher costs to credit unions,

in addition to diverting the agency from its primary mission of supervising and regulating credit unions. We appreciate that the current NCUA Board is not pressing Congress for such authority.

Leasing

The agency's leasing rule was adopted in 2000. Although there may not be a need for numerous changes, it is appropriate that NCUA review the rule, which is overly detailed and oriented toward micromanagement. For example, the rule controls the amount of the estimated residual value a credit union may rely upon to satisfy the full payout lease requirement, which is 25% of the original cost of the leased property, unless the amount above that is guaranteed. While DCU does not currently have a leasing program, this kind of detail about the mechanics of a leasing program would be more appropriately determined by the credit union.

Central Liquidity Facility (CLF)

DCU encourages the Board to review the authority for the CLF as well as its role and function as part of its regulatory reform initiative. The CLF was designed to be an important and useful facility that provides access to liquidity for those credit unions that could demonstrate the need and repay their borrowings. Additionally, the CLF provides credit unions with a reliable resource for contingency funding needs. However, despite the role of the CLF in the past, today it has only 269 regular members and has no loans. In our view, the CLF can be a useful facility that credit unions may utilize for liquidity when interest rates begin to rise again. The agency should work with Congress to restructure the CLF, ease requirements for credit unions to be members, and extend the range of borrowing opportunities the CLF can provide.

Security Issues/Catastrophic Acts/ Records Preservation

DCU agrees with the agency that Parts 748 and 749 need to be reviewed, particularly in light of the range of security and related matters credit unions must manage. A number of experts have concluded these issues will become even more difficult to address over time. Also, some record retention requirements do not have a termination date and that should be reviewed.

We think one or more working groups should be developed to review these rules and an ANPR could be utilized to help frame the numerous issues involved in these areas.

Additional Issues

The agency has developed an ambitious agenda that if implemented in a timely manner could provide some notable regulatory relief to credit unions, particularly if modified along the lines of what DCU is recommending. We encourage the Board to incorporate our changes and comments as it proceeds with the implementation of the agenda.

One issue that is absent from the list is the establishment of the Credit Union Council. In general, DCU supports this concept and recommends the agency move forward with it. However, councils of this nature, as we all know, can be useful or mere window dressing, depending in large part on how the establishing agency treats them. We encourage the Board to commit to support the council's endeavors by developing a proposed rule for comments on how the council should be structured, its mission and role, and how it should be financed.

For example, in our view, the Board should ensure that the council is able to focus on substantive issues of concern to credit unions while affording the agency key opportunities to discuss developing material matters and possible remedies before a rule making is needed or gets underway. We also think the council should be comprised of credit union officials, but not necessarily all CEOs as including board members or certain credit union staff could be useful. In addition, the agency should use a nominating process that is published in the Federal Register to identify and select candidates for the council that would serve for specific terms.

We also recommend that NCUA consider the extent to which it could comply with the President's Executive Order issued January 30 that executive branch agencies identify two current rules for elimination whenever a new rule is proposed. While NCUA is an independent agency, we think the pairing of consideration of what rules could be discarded or reduced with the development of any new ones provides a useful agency management tool that could help contain regulatory costs for credit unions and NCUA alike.

Another recommendation that the NCUA should consider is allowing credit unions to invest in financial technology (fintech) companies. In today's technology-fueled world, credit unions should consider partnering with fintech companies although the agency's current regulations prohibit such investments. We urge the NCUA to reevaluate, in its Tier I time frame of the Regulatory Reform Agenda, its current regulations surrounding investments and CUSOs to encourage credit unions to partner with fintech companies.

A final recommendation, consistent with the Executive Order on enforcing Regulatory Reform issued February 24, 2017, is that we encourage the Board to consider

designating the General Counsel's position or other key senior agency staff position as the regulatory reform officer. In this capacity the designated officer would report to the Board and update credit unions on the agency's progress with reg relief and would help ensure NCUA's Reg Reform Agenda is implemented beyond the tenure of the current Board.

Closing

The agency surely hears from credit unions when regulatory burdens are imposed, and so DCU commends the Board for seeking comments on its proposed Regulatory Reform Agenda designed to provide relief from a number of problematic rules. We strongly encourage the Board to follow through on the promise of reg reform by implementing proposed changes as expeditiously as possible, including the revisions DCU has put forward.

In several places, DCU supports the organization of a working group to help the agency tackle some of the more complex and comprehensive issues in need of reg reform. We do not think the use of such groups and/or the use of an ANPR prior to the development of a proposal should unduly delay the agency's reg relief efforts. The groups could meet by phone in many instances and in some cases, the agency could develop surveys to be posted on its website for interested stakeholders to complete on various Reg Reform Agenda issues that could supplement or replace the need for some working groups and ANPRs. Rather than curtailing the review process, we think using the resources of the credit union system to help develop reasonable approaches particularly on key regulatory matters, will improve the process and help insure meaningful and critically needed reform is actually achieved.

Thank you again for the opportunity to comment on the agenda. If you have any questions or would like further amplification on any issue we have raised, please let me know. I would be happy to meet with agency officials or discuss these issues over the phone at (508) 804-9079.

Sincerely,

David DeWitt
Vice President Risk Management
Digital Federal Credit Union

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July 21, 2016 **VIA EMAIL ONLY: regcomments@ncua.gov**

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

Re: SW&M Comments on Notice of Proposed Rulemaking Regarding the Incentive-Based Compensation Arrangements

Dear Mr. Poliquin:

This letter is written on behalf of Styskal, Wiese & Melchione, L.L.P., a law firm located in Southern California which represents hundreds of credit unions, both state and federal, nationwide. We offer the following discussion as a comment on the Notice of Proposed Rulemaking regarding incentive-based compensation ("Proposed Rule").

In general, we understand Congress's intent in requiring the promulgation of incentive-based compensation regulations, and that the NCUA is bound to issue such rules in conjunction with the other federal financial regulators. We also agree that incentive compensation has contributed to safety and soundness problems for many financial institutions in the United States, although our observation is that this has not been a typical problem for credit unions. We are concerned with the ever-growing and more intensive reporting requirements placed on credit unions, and the growing body of regulations requiring ever-increasing time from volunteer Boards of Directors.

With respect to the Proposed Rule, we believe that certain changes or clarifications could be made to assist credit unions in complying with its provisions and to ensure that the Proposed Rule fairly effectuates Congress's intent.

1. Definition of Incentive Compensation

In proposed § 751.2(r), "Incentive-based compensation" is defined as "any variable compensation, fees, or benefits that serve as an incentive or reward for performance." While the Proposed Rule suggests that compensation that does not vary based on risk-taking activities, or compensation like 401(k) matching, would not be included in this definition, we believe that the actual language may be interpreted in two different ways, and could therefore be vague in its application. First, the definition could be read that incentive-based

Re: SW&M Comments on Notice of Proposed Rulemaking Regarding the Incentive-Based Compensation Arrangements

compensation means any variable compensation where the variable nature of the compensation serves as an incentive for performance. Second, the definition could be read that incentive-based compensation is any compensation that serves as an incentive for performance[1] where that compensation is also variable. If the second reading is applied, we believe the Proposed Rule may have significant unintended consequences.

For example, some executive compensation packages are not specifically "incentive" compensation, but are nonetheless variable, and may incidentally fall into the Proposed Rule under the second potential meaning above. Deferred compensation arrangements that are common among credit union executive payment packages involve payment based on formulas. These formulas may be calculated in such a way as to directly account for performance, and thus the variable nature of the compensation is itself an incentive. However, other deferred compensation arrangements where the levels are not directly based on performance may nonetheless be variable in order to account for external economic factors (e.g., interest rates, inflation, etc.).

Yet other deferred compensation formulas may indirectly be related to incentive payments. Indeed, many deferred compensation formulas are based on "total compensation" over a period of time. "Total compensation" generally includes base salary, as well as bonuses and similar incentive payments. We do not believe such formulas should be included in the definition of "incentive compensation."

We do not believe these types of variable compensation arrangements were meant to be covered by the Proposed Rule. Thus, we suggest that the NCUA clarify that the definition of "incentive-based compensation" is "any variable compensation where the variable nature of the compensation directly serves as an incentive for performance." We believe that deferred compensation formulas that are based on "total compensation" and thus only indirectly related to incentive payments should not be included in the definition.

Additionally, the Proposed Rule appears to include incentives based on both individual performance and the overall financial performance of the institution. We do not believe that compensation arrangements or incentive payments based on the overall financial performance of an institution pose safety and soundness concerns of the same type as compensation arrangements based on individual performance. The NCUA has long recognized that distinction in 12 C.F.R. § 701.21(c)(8)(iii)(B). Thus, we believe that the NCUA should examine and consider an exception to § 751.2(r) for compensation based solely on the overall financial performance of the credit union.

[1] We note that all compensation in the employment context is, essentially, an incentive for performance.

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2. Definition of Senior Executive

We strongly believe that the Proposed Rule should be tailored to minimize confusion and contradictory or misaligned standards at financial institutions. One area in which the definitions in the Proposed Rule and other NCUA regulations do not align is in the definition of "senior executive officers."

Elsewhere in the NCUA's rules and regulations, this term refers to the CEO, CFO, and "assistant CEOs" (a facts and circumstances based term which is often interpreted to mean direct reports to the CEO, or persons fulfilling job functions like an "assistant CEO"). This longstanding standard in the NCUA's rules has created confusion over the years, but has also served to ensure that people with true control over operations are not able to use that authority to the institution's detriment. It is an organizational chart based test, rather than a title based test.

For the purposes of the Proposed Rule, the agencies have included a list of "chief" positions, and noted that any individual performing the functions of such a title is a "senior executive." So, regardless of title, the person in charge of a covered institution's lending programs or investment programs will likely be considered a "senior executive officer." Many of the positions in the list are assigned farther down in organizational charts than "assistant CEOs" for many of our clients, particularly when including the "catch all" of "head of a business line."

The lack of alignment between these two sets of definitions will prove particularly problematic when credit unions attempt to draft clear compensation policies that take into account both the Proposed Rule and regulations such as § 701.21(c)(8). Having two identical terms that mean slightly different things and that would be required to be included in the same policies and procedures does not assist credit unions with compliance. We strongly believe that these definitions should be aligned in all areas of the NCUA's rules related to compensation.

In doing so, however, the NCUA should also be aware of the collateral impact of further extensions of the definitions in NCUA's existing regulations. For example, if the Proposed Rule's definition of "senior executive officer" were extended to § 721.7, then common compensation arrangements for the heads of business lines could be prohibited, whereas currently they need only be under a Board policy and subject to annual review of internal controls. Ultimately, we believe this merits repeal of or exceptions to other NCUA regulations (as discussed in additional detail below); however, at a minimum, the NCUA's examiners should be instructed in the Supplementary Information to any Final Rule as to the differences between these various definitions should they not be revised to align.

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3. Governance Considerations

   Throughout the Proposed Rule, the general tenor is that Boards of Directors should be more involved in the design and oversight of compensation plans for all levels of employees. This seems to be a part of a growing trend in financial institution regulation to involve Boards of Directors in ever-increasing operational details. We believe this trend is ultimately detrimental to the volunteer culture of credit unions. While the universal nature of the Proposed Rule may assist in diminishing differences between charters for the purposes of risk management, it also diminishes differences between charters in terms of culture and operations.

   We believe the solution for this issue would be to review the obligations for credit union Boards of Directors to ensure that each is emphasized in the regulation and accompanying Supplementary Information as requiring only high level design of potential internal control systems and outside limitations for incentive programs for non-senior management of Level 3 credit unions to be established in Board Policy and reporting.

4. Section 751.6

   This Section of the Proposed Rule provides for the possibility of imposition of increased requirements for Level 3 credit unions over $10 billion in assets. While we agree that there may be scenarios where institutions with higher asset levels could be complex or systemically important enough to merit additional safety and soundness review, we disagree that § 751.6 is an appropriate method of accomplishing this goal. This is for several reasons, including:

   A. Section 751.6 does not clearly provide how re-designation or application of increased standards will be imposed initially. Are these powers to be exercised by Regional Directors? Will individual examiners in the course of an examination be permitted to wield this authority? The NCUA and the other financial regulators should provide clarity as to these initial procedures and what rights to hearings or other procedural protections are available for regulated institutions.

   B. Section 751.6 does not provide any due process rights for credit unions (or other financial institutions designated under the corollaries to 751.6) to review or appeal determinations by their regulators that they should be subject to increased Level 2 or Level 1 requirements. As elevation to a Level 2 designation (or imposition of any Level 2 or Level 1 requirements) would involve significant regulatory burden, it should not be imposed without some regulatory appeal mechanism. Indeed, without such a system established in the regulation, designation as a Level 2 institution would not even carry normal Supervisory Review Board appeal rights.

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C. Section 751.6 does not contain the standards by which regulators will determine that a financial institution will be subject to increased standards. While the Proposed Rule notes that the regulators will create those standards, it is not clear that such standards cannot be enforced prior to publication. We have concerns that this will result in development of regulations outside of the requirements of the Administrative Procedures Act, or at a minimum standards that are not subject to review and comment by the industry, concerned members, and other financial institution professionals. As the regulators have seen from the thousands of comments to the 2011 proposal, this is an area which should be subject to public review, as it has significant implications for the operations of affected institutions.

5. Additional Portions of the NCUA's Rules and Regulations

The institution of an incentive compensation rule for credit unions implies strongly that there would be individuals for whom the incentive compensation rule would apply. Looking at credit union variable compensation, however, many programs that would pose a strong safety and soundness concern are already limited by 12 C.F.R. § 701.21(c)(8), § 721.7, and § 701.23(g). Section 701.21(c)(8) prohibits credit unions from compensating employees or volunteers "in connection with any loan made by the credit union." Indeed, a recent NCUA Office of General Counsel Legal Opinion Letter extended this rule to additionally cover compensation in connection with loans not made by the credit union. Section 721.7 contains similar prohibitions for compensation based on incidental powers. Section 701.23(g) contains these prohibitions regarding the purchase and sale of eligible obligations. We are concerned that the broad prohibitions in the existing regulations and the intensive requirements under the Proposed Rule do not mesh cohesively, and believe that changes should be made to each of them to reflect the statutorily mandated scheme under the Proposed Rule.

While there are exceptions to § 701.21(c)(8), § 721.7, and § 701.23(g), the exceptions which currently allows or credit unions to implement incentive-based compensation for lower level employees in lending departments does not apply to the primary individuals covered by the Proposed Rule, namely executive officers.

Unfortunately, the existing prohibitions on incentive compensation has prevented credit unions from attracting talent. While there is an apparent attempt through the Proposed Rule to create consistent rules for financial institutions in the requirements around incentive-based compensation, credit unions will be at a significant disadvantage for attracting talent after the implementation of the Proposed Rule—credit unions will not only have the burden of significant governance requirements of the Proposed Rule, but will have them without actually being able to provide the compensation the rule was intended to guard against.

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However, we do not believe that the incentive compensation rule can (or should) completely supplant § 701.21(c)(8), § 721.7, or § 701.23(g). We agree that credit union volunteers should not be permitted to benefit from loans made by their credit union. However, we believe that employees, including senior management employees, if the incentive compensation rule applies or if a credit union agrees to be governed by the reporting requirements of the rule, should be excluded from the application of the restrictions of these subsections. In our comments to the 2011 Proposal, we suggested proposed language which would effectuate such an exception.[2]

We believe that the application of the Proposed Rule to senior management and other employees of Level 3 credit unions in place of the existing patch-work of regulations would impose sufficient requirements for internal controls, board review, and NCUA oversight to pose no greater risk to credit unions or the NCUSIF.[3] Application of the Proposed Rule rather than these subsections would also provide significant benefits to the competitiveness of credit unions in attracting personnel. Without such a change to these subsections, we believe that the Proposed Rule will prove to be duplicative at best, and at worst an intensive reporting and policy requirement which will not have any interaction with the employees for whom it was designed (i.e., executive officers who are able to expose their institutions to risk).

We thank you for the opportunity to comment on this important topic. If the NCUA has questions about our comments, we would be pleased to discuss them.

Sincerely,

STYSKAL, WIESE & MELCHIONE, LLP

Timothy I. Oppelt

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[2] Please also see our letter of August 3, 2015 to the Office of General Counsel in response to the NCUA's annual regulatory review, which suggested further revisions to § 701.21(c)(8).
[3] We would also suggest that the NCUA consider allowing credit unions under $1 billion in assets to "opt in" to compliance with Part 751 in order to gain an exemption from § 701.21(c)(8). This would permit credit unions to attract talent for lending departments and vice president roles without regard to the somewhat arbitrary $1 billion asset level. We assume that the NCUA would wish to have some written assurances from credit unions, or a formal waiver process, to obtain such an allowance.