Heartland
Credit Union Association

July 22, 2016

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 the 1.453 million credit union members we represent, the Heartland Credit Union Association (HCUA) appreciates the opportunity to comment on the National Credit Union Administration's (NCUA) proposed Incentive-based Compensation Rule.

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.

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.

<u>Covered Institutions</u>

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. 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. HCUA believes 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.

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.

Risks

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.

Implementation Timeframes

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 by 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.

Basic 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.

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.

As always, we appreciate the opportunity to review this issue. We will be happy to respond to any questions regarding these comments.

Sincerely,

Bradley D. Douglas

Brad Douglas
President/CEO