

**DRAFT 2/15/11**

**National Credit Union Administration**

**12 CFR Chapter VII**

**Authority and Issuance**

For the reasons stated in the preamble, the National Credit Union Administration proposes to amend chapter VII of title 12 of the Code of Federal Regulations as follows:

**PART 741 – REQUIREMENTS FOR INSURANCE**

1. The authority citation for part 741 continues to read as follows:

**Authority:** 12 U.S.C. 1757, 1766, 1781-1790, and 1790d.

2. Add a new §741.225 to subpart B to read as follows:

§741.225 Incentive-Based Compensation Arrangements.

Any credit union which is insured pursuant to Title II of the Act must adhere to the requirements stated in part 751 of this chapter.

3. Add a new part 751 to subchapter A to read as follows:

**Part 751 Incentive-Based Compensation Arrangements**

751.1 Authority.

751.2 Scope and purpose.

- 751.3 Definitions.
- 751.4 Required reports to regulators.
- 751.5 Prohibitions.
- 751.6 Policies and procedures.
- 751.7 Evasion.

§751.1 Authority. This part is issued pursuant to section 956 of the Dodd-Frank Wall Street Reform and Consumer Protection (Dodd-Frank) Act (12 U.S.C. 5641).

§751.2 Scope and purpose. This part applies to any federally insured credit union or credit union eligible to make application to become an insured credit union under 12 U.S.C. 1781 with total consolidated assets of \$1 billion or more and offers incentive-based compensation arrangements to covered persons. Nothing in this part in any way limits the authority of the NCUA under other provisions of applicable law and regulations.

§751.3 Definitions.

For purposes of this part, the following definitions apply unless otherwise specified:

- (a) Board of directors means the governing body of any credit union.
- (b) Compensation means all direct and indirect payments, fees or benefits, both cash and non-cash, awarded to, granted to, or earned by or for the benefit of, any covered person in exchange for services rendered to the credit union, including, but not limited to, payments or benefits pursuant to an employment contract, compensation or benefit agreement, fee arrangement, perquisite, postemployment benefit, or other compensatory arrangement.

Consistent with Section 701.33 of this chapter, the term compensation specifically excludes reimbursement for reasonable and proper costs incurred by covered persons in carrying out official credit union business; provision of reasonable health, accident and related types of

personal insurance protection; and indemnification.

(c) Reserved

(d) Covered person means any executive officer, employee, or director of a credit union.

(e) Reserved

(f) Executive officer of a credit union means a person who holds the title or, without regard to title, salary, or compensation, performs the function of one or more of the following positions: president, chief executive officer, executive chairman, chief operating officer, chief financial officer, chief investment officer, chief legal officer, chief lending officer, chief risk officer, or head of a major business line.

(g) Incentive-based compensation means any variable compensation that serves as an incentive for performance.

(h) Reserved

(i) Total consolidated assets means the amount of total consolidated assets as of the year-end 5300 Call Report.

§751.4 Required reports to regulators.

(a) In general. A credit union must submit a report annually to, and in the format directed by, the NCUA, that describes the structure of the credit union's incentive-based compensation arrangements for covered persons and that is sufficient to allow an assessment of whether the structure or features of those arrangements provide or are likely to provide covered persons with excessive compensation, fees, or benefits to covered persons or could lead to material financial loss to the credit union.

(b) Individual compensation. A credit union is not required to report the actual compensation of particular covered persons as part of the report required by paragraph (a) of this section.

(c) Minimum standards. The information submitted by the credit union pursuant to paragraph

(a) of this section must include the following:

- (1) A clear narrative description of the components of the credit union's incentive-based compensation arrangements applicable to covered persons and specifying the types of covered persons to which they apply;
- (2) A succinct description of the credit union's policies and procedures governing its incentive-based compensation arrangements for covered persons;
- (3) If the credit union has total consolidated assets of \$10 billion or more, an additional succinct description of incentive-based compensation policies and procedures specific to the credit union's:
  - (i) Executive officers; and
  - (ii) Other covered persons who the board of directors, or a committee thereof, of the credit union has identified and determined under §751.5(b)(3)(ii) of this part individually have the ability to expose the credit union to possible losses that are substantial in relation to the credit union's size, capital, or overall risk tolerance;
- (4) Any material changes to the credit union's incentive-based compensation arrangements and policies and procedures made since the credit union's last report submitted under paragraph (a) of this section; and
- (5) The specific reasons why the credit union believes the structure of its incentive-based compensation plan does not encourage inappropriate risks by the credit union by providing covered persons with:
  - (i) Excessive compensation; or

- (ii) Incentive-based compensation that could lead to material financial loss to the credit union.

§751.5 Prohibitions.

(a) Excessive compensation prohibition. (1) In general. A credit union must not establish or maintain any type of incentive-based compensation arrangement, or any feature of any such arrangement, that encourages inappropriate risks by the credit union by providing a covered person with excessive compensation.

(2) Standards. An incentive-based compensation arrangement provides excessive compensation when amounts paid are unreasonable or disproportionate to the services performed by a covered person, taking into consideration:

- (i) The combined value of all cash and non-cash benefits provided to the covered person;
- (ii) The compensation history of the covered person and other individuals with comparable expertise at the credit union;
- (iii) The financial condition of the credit union;
- (iv) Comparable compensation practices at comparable institutions, based upon such factors as asset size, geographic location, and the complexity of the credit union's operations and assets;
- (v) For postemployment benefits, the projected total cost and benefit to the credit union;
- (vi) Any connection between the individual and any fraudulent act or omission, breach of trust or fiduciary duty, or insider abuse with regard to the credit union; and
- (vii) Any other factors the NCUA determines to be relevant.

(b) Material financial loss prohibition. (1) Generally. A credit union must not establish or maintain any type of incentive-based compensation arrangement, or any feature of any such arrangement,

that encourage inappropriate risks by the credit union, by providing incentive-based compensation to covered persons, either individually or as part of a group of persons who are subject to the same or similar incentive-based compensation arrangements, that could lead to material financial loss to the credit union.

(2) Requirements for all credit unions. An incentive-based compensation arrangement established or maintained by a credit union for one or more covered persons does not comply with paragraph (b)(1) of this section unless it:

- (i) Balances risk and financial rewards, for example by using deferral of payments, risk adjustment of awards, reduced sensitivity to short-term performance, or longer performance periods;
- (ii) Is compatible with effective controls and risk management; and
- (iii) Is supported by strong corporate governance, including active and effective oversight by the credit union's board of directors or a committee thereof.

(3) Specific requirements for credit unions with \$10 billion or more in total consolidated assets.

- (i) Deferral required for executive officers. As part of appropriately balancing risk and financial rewards pursuant to paragraph (b)(2)(i) of this section, any incentive-based compensation arrangement for any executive officer established or maintained by a credit union that has total consolidated assets of \$10 billion or more must provide for:
  - (A) At least 50 percent of the annual incentive-based compensation of the executive officer to be deferred over a period of no less than three years, with the release of deferred amounts to occur no faster than on a pro rata basis; and

- (B) The adjustment of the amount required to be deferred under paragraph (b)(3)(i)(A) of this section to reflect actual losses or other measures or aspects of performance that are realized or become better known during the deferral period.
- (ii) Additional requirement for covered persons presenting particular loss exposure. As part of appropriately balancing risk and financial rewards pursuant to paragraph (b)(2)(i) of this section, if a credit union has total consolidated assets of \$10 billion or more—
- (A) The board of directors, or a committee thereof, of the credit union shall identify those covered persons (other than executive officers) who individually have the ability to expose the credit union to possible losses that are substantial in relation to the credit union’s size, capital, or overall risk tolerance;
- (B) The incentive-based compensation arrangement for any covered person identified pursuant to paragraph (b)(3)(ii)(A) of this section must be approved by the board of directors, or a committee thereof, of the credit union and such approval must be documented;
- (C) The board of directors, or committee thereof, may not approve the incentive-based compensation arrangement for any covered person identified pursuant to paragraph (b)(3)(ii)(A) of this section unless the board or committee determines that the arrangement, including the method of paying compensation under the arrangement, effectively balances the financial rewards to the covered person and the range and time horizon of risks associated with the covered person’s activities, employing appropriate methods for ensuring risk sensitivity such as deferral of

payments, risk adjustment of awards, reduced sensitivity to short-term performance, or longer performance periods; and

(D) In fulfilling its duties under paragraph (b)(3)(ii)(C) of this section, the board of directors, or committee thereof, must evaluate the overall effectiveness of the balancing methods used in the identified covered person's incentive compensation arrangements in reducing incentives for inappropriate risk taking by the identified covered person considering the methods' suitability for balancing the full range of risks presented by that covered person's activities, and the methods' ability to make payments sensitive to all the risks arising from the covered person's activities, including those that may be difficult to predict, measure, or model.

#### §751.6 Policies and procedures.

(a) In general. Any incentive-based compensation arrangement, or any feature of any such arrangement, is prohibited under section \_\_\_\_\_.5 of this part, unless adopted pursuant to policies and procedures developed and maintained by each credit union and approved by its board of directors, or a committee thereof, reasonably designed to ensure and monitor compliance with the requirements set forth in section 956 of the Dodd-Frank Act, codified at 12 U.S.C. 5641, and this part and commensurate with the size and complexity of the credit union, as well as the scope and nature of its use of incentive-based compensation.

(b) Standards. The policies and procedures must, at a minimum:

(1) Be consistent with the reporting requirements in section 751.4 of this part and prohibitions in section 751.5 of this part;



- (2) Ensure that risk-management, risk-oversight, and internal control personnel have an appropriate role in the credit union's processes for designing incentive-based compensation arrangements and for assessing their effectiveness in restraining inappropriate risk-taking;
- (3) Provide for the monitoring by a group or person independent of the covered person, where practicable in light of the credit union's size and complexity, of incentive-based compensation awards and payments, risks taken, and actual risk outcomes to determine whether incentive compensation payments for covered persons, or groups of covered persons, are reduced to reflect adverse risk outcomes or high levels of risk taken;
- (4) Provide for the credit union's board of directors, or committee thereof, to receive data and analysis from management and other sources sufficient to allow the board, or committee thereof, to assess whether the overall design and performance of the credit union's incentive-based compensation arrangements are consistent with 12 U.S.C. 5641;
- (5) Ensure that documentation of the credit union's processes for establishing, implementing, modifying, and monitoring incentive-based compensation arrangements is maintained that is sufficient to enable the NCUA to determine the credit union's compliance with 12 U.S.C. 5641 and this part;
- (6) Consistent with section 751.5(b)(3) of this part, where deferral is used in connection with an incentive-based compensation arrangement, provide for deferral of incentive-based compensation awards in amounts and for periods of time appropriate to the duties and responsibilities of the credit union's covered persons, the risks associated with those duties and responsibilities, and the size and complexity of the credit union and provide that the

deferral amounts paid are adjusted to reflect actual losses or other measures or aspects of performance that are realized or become better known during the deferral period; and

- (7) Subject any incentive-based compensation arrangement to a corporate governance framework that provides for ongoing oversight by the board of directors or a committee thereof, including the approval by the board of directors or a committee thereof of incentive-based compensation to executive officers.

§ 751.7 Evasion. A credit union is prohibited, for the purpose of evading the restrictions of this part, from doing indirectly or through or by any other person, any act or thing that it would be unlawful for such credit union to do directly under this part.