September 9, 2024

Ms. Melane Conyers-Ausbrooks
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, Virginia 22314-3428

Re: Comments on Incentive-Based Compensation Proposed Rule: RIN 3133-AE48

Dear Secretary Conyers-Ausbrooks,

We are pleased to offer this Comment Letter addressing the National Credit Union Administration's ("NCUA") proposed Incentive-Based Compensation Rule (the "Proposed Rule").

Overall, the Proposed Rule is intended to address the requirements set forth in Section 956 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") and is aimed at mitigating excessive risk-taking by financial institutions through the regulation of compensation practices. Further, the rulemaking is intended to ensure that incentive-based compensation arrangements (1) do not encourage excessive risk-taking and (2) are aligned with the long-term health and stability of financial institutions. Of course, these are noble goals. As with all rulemaking, however, the devil is in the details.

This letter proceeds in four parts. First, we offer a brief description of our firm. This establishes our *bona fides* to comment on these matters – particularly, as they relate to credit unions. Next, we summarize the Proposed Rule, with an emphasis on its expected effects on our credit union clients. Third, we offer some general suggestions for improvement, echoing many of the concerns already expressed by various industry participants and advocacy groups. Finally, we offer a critique of the Proposed Rule as it is intended to apply to credit unions, emphasizing that a one size fits all approach for financial institutions fails to account for the significant idiosyncrasies in the credit union model.

About Olden Lane

Olden Lane is a boutique investment bank, dedicated exclusively to credit unions. We animate our *raison d'etre* with a stated philosophy:

> "We believe that credit unions are different.
>
> The quality of their mission, the values of key stakeholders, and the nature of their regulatory supervision vary from other financial institutions. Therefore, capital markets solutions should be carefully integrated to optimize outcomes and tailored to the unique needs of each credit union.
>
> In an ever-dynamic market environment, we work every day to ensure that our team's breadth, depth, and expertise are a real boon to our clients."

Based in Bridgewater, New Jersey, we operate a FINRA and SEC registered broker-dealer (Olden Lane Securities LLC), recognized as the leader in the market for credit union subordinated debt. Since January 2019, our firm has assisted more than 50 clients in gaining approval for subordinated debt applications worth well over $1 billion. We are proud that our subordinated debt transactions with credit union issuers include the largest, most complex and most creative structures in the market.[1] The capital we enable for our clients facilitates additional lending, often expanding credit to parts of the country that are too often underbanked.

We also operate an SEC registered investment advisor (Olden Lane Advisors LLC) that assists credit unions with capital planning, balance sheet management, and mergers and acquisition (M&A) related activities. We regularly help credit unions to identify appropriate objectives for capital and to maintain safety and soundness.

Summary of the Proposed Rule

Section 956 of Dodd-Frank mandates that federal regulators, including the Federal Deposit Insurance Corporation (FDIC), Federal Reserve Board (FRB), Office of the Comptroller of the Currency (OCC), NCUA, Federal Housing Finance Agency (FHFA), and the Securities and Exchange Commission (SEC), jointly issue regulations or guidelines to prohibit incentive-based compensation arrangements that encourage inappropriate risks. More specifically, Section 956

> "requires that the appropriate Federal regulators prohibit any types of incentive-based compensation arrangements, or any feature of any such arrangements, that the appropriate Federal regulators determine encourage inappropriate risks by a covered financial institution: (1) by providing an executive officer, employee, director, or principal shareholder of the covered financial institution with excessive compensation, fees, or

[1] For a list of our firm's significant transactions, see our website at www.oldenlane.com.

> benefits; or (2) that could lead to material financial loss to the covered financial institution."[2]

The Proposed Rule builds on a previous proposal that dates all the way back to 2016,[3] and seeks public comment on several alternatives and questions regarding its implementation. As proposed, these regulations will apply to financial institutions with $1 billion or more in assets.

The Proposed Rule includes specific prohibitions designed to make incentive-based compensation arrangements more risk-sensitive, and require the inclusion of risk adjustment of awards, deferral of payments, and forfeiture and clawback provisions in incentive-based compensation plans. Additionally, the Proposed Rule emphasizes the importance of sound governance and risk management controls to safeguard institutions from compensation practices that could lead to excessive risk-taking. Finally, recordkeeping and disclosure requirements are also included to help regulators monitor and identify potential issues.

General Critique of the Proposed Rule

General statements about the greed of executives offered after the failure of a financial institution or a larger market dislocation make great fodder. Not surprisingly, the Proposed Rule briefly highlights failures during the Great Financial Crisis, at Wells Fargo (2016) and at Silicon Valley Bank (2023) to bolster the case for adoption.[4] In a separate statement supporting the Proposed Rule, NCUA Chairman Todd Harper recounted the Cal State 9 Credit Union and Western Corporate Federal Credit Union failures and offered that "[g]reedy executives should not earn excessive bonuses while taxpayers foot the bill when their institutions fail."[5] And Board Member Tanya Otsuka added that "[i]f your institution fails on your watch and you still receive your incentive-based pay, I am not sure what exactly you're being incentivized to do."[6]

In our view, sweeping proclamations about excessive pay in the wake of a high-profile failure have all the feel of Monday morning quarterbacking and are often of little utility. For example, concluding that SVB managers "had a financial incentive to focus on short-term profit over sound risk management,"[7]

---

[2] Notice of Proposed Rulemaking, *Incentive-Based Compensation Arrangements*, RIN 3133-AE48, (July 18, 2024), available at https://ncua.gov/files/press-releases-news/incentive-based-compensation-arrangements.pdf.

[3] *See* Notice of Proposed Rulemaking, *Incentive-Based Compensation Arrangements*, RIN 3235-AL06, 81 FR 37670 (Jun. 10, 2016), available at https://www.federalregister.gov/documents/2016/06/10/2016-11788/incentive-based-compensation-arrangements.

[4] *See Incentive-Based Compensation Arrangements, supra* note 2, at 28.

[5] *See NCUA Chairman Todd M. Harper Statement on Proposed Interagency Rule on Incentive-Based Executive Compensation,* National Credit Union Administration (Jul. 18, 2024) (commenting that "it's an understatement to say that this rulemaking is long overdue"), available at https://ncua.gov/newsroom/speech/2024/ncua-chairman-todd-m-harper-statement-proposed-interagency-rule-incentive-based-executive.

[6] *NCUA Board Member Tanya F. Otsuka's Statement on the Executive Compensation, Section 956, Notice of Proposed Rulemaking,* National Credit Union Administration (Jul. 18, 2024), available at https://ncua.gov/newsroom/speech/2024/ncua-board-member-tanya-f-otsukas-statement-executive-compensation-section-956-notice-proposed.

[7] *See Incentive-Based Compensation Arrangements, supra* note 2, at 28.

is conclusory and it fails to strike any balance that recognizes all of the successful institutions that also pay executives handsomely based on outcomes. Moreover, in our experience, wholesale pronouncements, made with the benefit of hindsight, tend to do little to alleviate, avoid or ameliorate the next failure.

In a statement in support of the Proposed Rule, Board Member Otsuka echoed the agencies' justification, observing that "[a]t the time of its collapse, SVB had 31 unresolved supervisory warnings," and lamented that "[s]till, the CEO Greg Becker received a $1.5 million bonus as part of his 2022 compensation package that was worth about $10 million in total."[8] With the regulatory agencies unable to fully enact the proper regulatory tools more than a decade after they were prescribed by Congress, however, shouldn't they bear some responsibility for the SVB failure? And, how certain are we that SVB would not have failed if stronger incentive-based compensation rules were in place?

We concede that the Proposed Rule fulfills the NCUA's statutory obligation under Section 956 of the Dodd-Frank Act. Without the participation of the SEC and the FRB, however, the overall proposal fails to satisfy the explicit requirements of Dodd-Frank. Because Section 956 of Dodd-Frank mandates joint rulemaking by six federal financial agencies, the absence of the FRB and the SEC in the design of the instant proposal signals potential interagency disagreement or misalignment.[9] It also raises significant doubts as to whether the Proposed Rule might be finalized in anything resembling its current form. Most importantly, in a recent Client Update, the lawyers at Davis Polk summarized the significance of this defect succinctly: "[t]he Proposed Rule cannot become legally binding unless all six agencies participate in the re-proposal, and we believe that the Federal Reserve is unlikely to do so."[10]

Not surprisingly, the Proposed Rule has also sparked significant industry pushback. Organizations such as the Bank Policy Institute and the American Bankers Association have expressed concerns that it is overly prescriptive and fails to account for the comments submitted in response to the 2016 version.[11] They argue that the rule imposes a one-size-fits-all approach that limits the flexibility needed by institutions to tailor compensation practices to their specific risk profiles and activities.

---

[8] *NCUA Board Member Tanya F. Otsuka's Statement on the Executive Compensation, Section 956, Notice of Proposed Rulemaking, supra,* note 6.

[9] *See* Jeffrey A. Brill, Mark Chorazak, Adam J. Cohen & Michael A. Wiseman, *The Third Attempt: Banking Agencies Revive Incentive-Based Compensation Rules for Financial Institutions,* Skadden Arps et al. (May 21, 2024), available at https://www.skadden.com/insights/publications/2024/05/the-third-attempt.

[10] *Some, but not all, required regulators re-propose incentive compensation rule under Dodd-Frank,* Davis Polk (May 9, 2024), available at https://www.davispolk.com/insights/client-update/some-not-all-required-regulators-re-propose-incentive-compensation-rule.

[11] *See, e.g. Joint Comments on Incentive-based Compensation,* American Bankers Association, Bank Policy Institute BPI, Financial Services Forum, Securities Industry and Financial Markets Association SIFMA, *(Jun. 18, 2024), available at https://www.aba.com/advocacy/policy-analysis/joint-ltr-incentive-comp; See also* Tara Payne, *Incentive Compensation Document Invalid, Even More Prescriptive Than Prior Version,* Bank Policy Institute (Jun. 18, 2024), available at https://bpi.com/incentive-compensation-document-invalid-even-more-prescriptive-than-prior-version/.

Moreover, these groups highlight that the financial services industry has evolved significantly since the original proposal, and the new rule fails to adequately address these changes.[12]

Credit Union Specific Critique of the Proposed Rule

Our chief criticism of the Proposed Rule concerns its potential application to credit unions. As our firm's Philosophy proclaims, "[w]e believe that credit unions are different." As such, we are skeptical that an appropriate rule on compensation can be properly crafted for credit unions in harmony with five distinct federal regulators responsible for the oversight of disparate organization types with various sizes, and subject to altogether different regulatory regimes and missions.

In the Proposed Rule, the NCUA estimates (based on Q3 2023 data) that 424 federally insured credit unions exceed the $1 billion asset threshold and would, therefore, be within the Proposed Rule's scope. By the NCUA's estimate, these credit unions comprise only 9% of the nation's more than 4,000 credit unions.[13] Given these numbers, any theoretical support we might have for this Proposed Rule faces a steep uphill climb.

Some might argue that the Proposed Rule aligns the NCUA's approach with other financial regulators to create a level playing field and prevent regulatory arbitrage. We see little validity to this argument, as we find little reason why the credit union compensation rules need to resemble those of banks regulated by the FDIC or the OCC, or publicly traded companies regulated by the SEC.

Besides, the NCUA has existing regulations addressing compensation matters for federally insured credit unions. Today, these regulations prohibit certain compensation practices, such as compensating employees or directors directly for loans made by the credit union.[14] Under Section 704.19, corporate credit unions are also required to provide disclosure relating to the compensation of the highest paid employees.[15]

Moreover, any discussion of extending their application to Credit Union Service Organizations (CUSOs) should be a complete non-starter. Under Section 712.2, credit union investment in CUSOs is already limited to 1% of paid-in and unimpaired capital and surplus as of the last calendar year-end financial report. Such a modest investment should, in no way, threaten the safety and soundness of the credit union, thereby eviscerating any hook for the agency to subject the CUSOs executives to a Dodd-Frank incentive compensation regime enforced by the NCUA.

According to recent press reports, the NCUA may propose a new rule requiring federal credit unions to provide information on executive compensation to their members. The new regime would presumably be designed to bring the disclosure of federally chartered credit unions in line with the

---

[12] *Id.*

[13] A review of Q2 2024 data, in the Callahan & Associates database, reveals 446 credit unions with assets over $1 billion, representing 9.69% of the nation's 4,600 credit unions by count.

[14] *See* 12 CFR 701.21(c)(8)(i).

[15] *See* 12 CFR 704.19. The annual disclosure must include the compensation of the three, four, or five highest-paid employees, depending on the number of full-time employees. The disclosure may also include other information, such as salary surveys, compensation information from similar credit unions, and a discussion of compensation in relation to other expenses.

detail that state-chartered credit unions regularly provide through their tax forms.[16] Today, aside from federal credit unions and religious organizations, tax-exempt organizations are required to disclose certain financial information through IRS Form 990. As we understand it, the proposal under consideration would require federal credit unions to report information about executive compensation similar to that reported in the IRS Form 990. We would generally support such a plan, as it would harmonize the available disclosure between state and federally chartered credit unions. Other than a rather tenuous interpretation holding that federally chartered credit unions are governmental instrumentalities, we see little reason for the disclosure difference. Additionally, we generally welcome any change that improves credit union accountability and transparency, without a significant regulatory burden. Our view is consistent – improving the quality of the data available on credit union activities holds the credit unions accountable and allows both consumers and communities to more accurately assess the quality of their service provider.

A Final Statement Regarding Clawbacks

Our final comment is a cautionary statement about clawbacks in general. In the period since the Great Financial Crisis, there has been an obsession with the idea of clawing back monies from executives following failures. Very generally, a clawback attempts to regain previously conferred monies or benefits following a certain triggering event, usually involving some change in circumstances.[17] The mechanism is designed to address "inequities that cannot easily be resolved by existing remedies under the law because of countervailing legal rights independently supporting such inequities."[18] By design, the clawback can be utilized even when the one being enriched can assert a preexisting legal right to the payment.[19] The application of such a regime interjects significant subjectivity and complexities, however. Moreover, these limitations warrant further study before the NCUA signs on to any regime which mandates a clawback. As this author highlighted when studying the subject as an academic:

> "the mere presence of a clawback, whether explicitly provided *ex ante* or added in an attempt at equity *ex post*, is no panacea. In fact, the clawback itself can often increase the mess, adding a layer of cost and complexity in the form of uncertainty, unpredictability, and discontinuity."[20]

---

[16] *See generally NCUA eyeing executive compensation reporting for federal credit unions,* ABA Banking Journal (Jul. 9, 2024) (citing the White House Office of Management and Budget's recently released spring regulatory agenda, which provides an overview of possible regulatory actions by federal agencies in coming months), available at https://bankingjournal.aba.com/2024/07/ncua-eyeing-executive-compensation-reporting-for-federal-credit-unions/.

[17] *See* Michael C. Macchiarola*, In the Shadow of the Omnipresent Claw: In Response to Professors Cherry & Wong*, 95 Minn. L. Rev. Headnotes 1 (2010), at 1, available at SSRN: https://ssrn.com/abstract=2909847.

[18] Miriam A. Cherry & Jarrod Wong, *Clawbacks: Prospective Contract Measures in an Era of Excessive Executive Compensation and Ponzi Schemes*, 94 MINN. L. REV. 368, 379 (2009).

[19] *See* Macchiarola, *supra* note 17, at 5.

[20] *Id.,* at 18.

Conclusion

We thank the NCUA Board and Staff for the consideration of this Comment Letter. And we are grateful for the opportunity to share our views on the proposed regulatory change. Again, given this Proposed Rule's fourteen-plus years in the making, its limited application to credit unions generally, and the successful pre-existing regime concerning compensation of credit union executives, we think the NCUA's best course of action here is to simply do nothing.

While we are dubious that we will see the adoption of any version of the Proposed Rule, we respectfully request that the NCUA give serious thought to the improvements we have summarized above if they do proceed at all.

Should you have any questions regarding our comments, please feel free to contact the undersigned at 908 432-6819 or mmacchiarola@oldenlane.com.

All the best,

/s/ Michael C. Macchiarola

Chief Executive Officer
Olden Lane Inc.