



August 13, 2010

NCUA Proposed Rule on Golden Parachute and Indemnification Payments

Executive Summary

- The National Credit Union Administration (NCUA) Board has issued a proposed rule for comments on prohibited golden parachute and indemnification payments for all federally insured credit unions (FICUs), including both natural person and corporate credit unions.
- Under the proposed rule, FICUs, regardless of their financial condition, may not make indemnification payments to an institution-affiliated party (IAP) for legal and other professional expenses in administrative and civil proceedings by NCUA or a state regulatory agency where the IAP is assessed a civil money penalty, removed from office or made subject to a cease and desist order. IAPs are defined under section 206(r) of the Federal Credit Union Act (FCU Act) and include a committee member, director, officer, or employee of or agent for an insured credit union and certain consultants and independent contractors that have knowingly violated a law or regulation and caused a financial loss to the credit union.
- In addition, FICUs may not generally make golden parachute payments to an IAP if the FICU is: insolvent, in conservatorship, rated CAMEL 4 or 5, or in an otherwise troubled condition. A credit union that has received assistance under sections 208 or 216 of the FCU Act would be considered in a “troubled condition.”
- The final rule would apply to all new employment contracts on or after the effective date and existing contracts that are renewed or modified after the effective date.
- We know this proposal will raise a number of concerns. We are reviewing this proposal carefully with our Examination and Supervision Subcommittee.
- Comments are due to NCUA by September 7, 2010; **please submit your comments to CUNA by August 27, 2010.**
- Please e-mail your comments to Senior Vice President and Deputy General Counsel Mary Dunn at mdunn@cuna.com and Regulatory Counsel Dennis Tsang at dtsang@cuna.com. You may also contact Dennis Tsang at (800) 356-9655, ext. 6733, if you have questions. Click [here](#) to access the proposed rule.

Background

In December 2009, NCUA issued a substantially similar proposed rule that only applied to corporate credit unions, as part of a comprehensive proposal for corporate credit unions.¹ CUNA opposed the prohibition on indemnification for corporate credit union officials and noted that the agency's proposed corporate governance requirements were generally too prescriptive and in some instances, unnecessary. NCUA may have one consolidated final rule on golden parachute and indemnification issues, which would incorporate both this proposed rule and the previous proposed rule for corporate credit unions.

Under section 206(t) of the Federal Credit Union Act (FCU Act), NCUA may issue regulations for certain forms of benefits to institution-affiliated parties (IAPs).² NCUA's regulations may cover: golden parachutes and indemnification payments, the factors to be taken into account for such prohibitions and limitations; certain prohibited payments; the definition of a golden parachute; and other definitions.

For the indemnification provision, the proposed regulation does not grant or enhance any authority state chartered credit unions may have under state law to provide indemnification. For the golden parachute provision, NCUA states that the purpose of the proposed regulation is to safeguard the NCUSIF by preventing the wrongful or improper disposition of FICU assets and to inhibit rewards to IAPs who may have contributed to an FICU's troubled condition. In addition, the proposed regulation is also intended to clarify the differences between legitimate employee severance payments and improper golden parachute payments, and to track similar regulations for banks.³

Applicability

The proposed rule would apply to all FICUs, including both natural person and corporate credit unions.

The final rule would apply to all new employment contracts on or after the effective date and existing contracts that are renewed or modified after the effective date.

An institution-affiliated party (IAP) means any individual that meets the definition under section 206(r) of the FCU Act. IAPs include a committee member, director, officer, or employee of or agent for an insured credit union and certain consultants and independent contractors that have knowingly violated a law or regulation and caused a financial loss to the credit union.⁴

¹ 74 FR 6520 (Dec. 9, 2009).

² 12 U.S.C. § 1786(t)(1).

³ 12 C.F.R. § 359.

⁴ 12 U.S.C. § 1786(r).

Brief Description of the Proposed Rule

The proposed rule would prohibit FICUs from making golden parachute and indemnification payments to IAPs under certain conditions with some exceptions, as discussed below.

Prohibited Indemnification Payments

Under the proposed rule, FICUs, regardless of their financial condition, may not make indemnification payments to an institution-affiliated party (IAP) for legal and other professional expenses related to administrative and civil proceedings by NCUA or a state regulatory agency in which the IAP is assessed a civil money penalty, removed from office or made subject to a cease and desist order.

However, FICUs may continue to purchase reasonable commercial insurance policies or fidelity bonds. Such insurance does not cover any penalty or judgments against an IAP, but does cover the potential future cost of defending against these administrative and civil proceedings.

The proposed rule would also allow partial indemnification for a portion of the legal or professional expenses attributable to the charges that have a finding in favor of the IAP in these administrative and civil proceedings.

ii. Permissible Indemnification Payments

FICUs may pay or agree to pay an indemnification payment for an IAP for reasonable legal and other professional expenses under some circumstances if certain conditions are met.

The FICU's board must first make a good faith determination after a due investigation that: 1) the IAP acted in good faith in a manner that he or she believed to be in the best interests of the FICU; 2) the payments will not materially affect the safety and soundness of the FICU; 3) the payments will not ultimately become prohibited indemnification payments that are related to administrative or civil proceedings as described above; and 4) the IAP agrees in writing to reimburse the FICU for indemnification payments that subsequently become prohibited, to the extent not covered by the commercial insurance policies or fidelity bonds.

Prohibited Golden Parachute Payments

A golden parachute payment is a payment that is made to an IAP that is contingent on the termination of the IAP's employment.

Under the proposed rule, FICUs may not generally make golden parachute payments to an IAP if the FICU is: insolvent, in conservatorship, rated CAMEL 4

or 5, or in an otherwise troubled condition.⁵ A credit union that has received assistance under sections 208 or 216 of the FCU Act would be considered in a “troubled condition.”

i. Compensation of other plans that are not considered golden parachute payments

Certain deferred compensation plans and legitimate “nondiscriminatory” severance pay plans are not considered golden parachute payments. Deferred compensation plans include plans under section 401 of the IRC, employee benefit plans under § 701.19; bona fide deferred compensation plans; any payments made by reason of death or by reason of termination caused by the disability of an IAP; payments required by state law; and payments that the Board has determined as permissible golden parachute payments, as discussed below. Nondiscriminatory plans apply to all employees of an FICU that meet reasonable and customary eligibility requirements, and differences in benefits per employee are acceptable if they are based on objective criteria.

ii. Permissible Golden Parachute Payments

In addition, the NCUA Board may also approve three other exceptions to permit a FICU to pay a golden parachute payment. The credit union must request approval from the Board in writing.

- FICUs that are insolvent, in conservatorship, rated CAMEL 4 or 5, or in an otherwise troubled condition⁶, may pay golden parachute payments in order to hire new management to help bring a troubled FICU back to sound financial health or in an effort to prevent the credit union from imminently satisfying the criteria for a troubled condition;
- FICUs may also pay reasonable severance plan payments if there is an unassisted merger that involves a troubled credit union. Such reasonable severance payments related to an unassisted merger require the consent of the Board prior to making the payment and must not exceed twelve months of the IAP’s salary; and
- In addition, there is a general exception under which the Board may permit FICUs to pay golden parachute payments. The Board, with the concurrence of the appropriate state supervisor for a state chartered credit union, will determine if the payment is permissible based on the factors discussed below.

For each of these three exceptions, an FICU must demonstrate to the Board that the IAP did not have any responsibility for the troubled condition of the FICU. The Board may consider these factors: 1) whether, and to what degree, the IAP was in a position of managerial or fiduciary responsibility; 2) length of time the IAP was affiliated with the FICU, and the degree to which the proposed

⁵ 12 C.F.R. § 701.14(b)(3)-(4).

⁶ Id.

payment represents a reasonable payment for services rendered over the period of employment; and 3) any other factors or circumstances.

We know this proposal will give many of you heartburn. CUNA's Examination and Supervision Subcommittee will be reviewing this proposal and help develop CUNA's comments. Please weigh in on this proposal as soon as you can.

Questions to Consider Regarding the Proposed Rule

1. Should the same golden parachute and indemnification prohibitions apply for both corporate and natural person credit unions?

2. Are there any concerns that these prohibitions may further discourage IAPs from working for or providing services to credit unions?

3. Are there any other concerns about these prohibitions?

4. Should the NCUA prescribe an indemnification prohibition on IAPs regardless of the financial condition of the credit union? Should there be additional exceptions?

5. Are there cost or other considerations for commercial insurance policies or fidelity bonds?

6. NCUA states that the purpose of the golden parachute prohibition is to safeguard the NCUSIF. Do you believe the rule will be effective?

7. Should there be additional exceptions for the proposed golden parachute prohibition for troubled credit unions?
