

LEGAL UPDATES AND NEWS

NCUA Approves New Rule Restricting Golden Parachute Payments for Troubled Credit Unions

Overview

The National Credit Union Administration (“NCUA”) has approved a final rule regarding golden parachute payments. Troubled credit unions are now prohibited from making or entering into a contract to make golden parachute payments absent an exception from the Rule. The stated purpose of the rule is to protect credit union members and guard against unwarranted disbursements to individuals whose actions may have contributed to the credit union’s distressed financial condition. This Rule is comparable to the golden parachute rule that applies to all FDIC insured institutions. The impact of the Rule will have greater significance than it would have just a few years ago due to the greater number of troubled credit unions.

Tax Impact

A payment of a permissible golden parachute payment must be structured to avoid adverse tax consequences under Section 409A of the Internal Revenue Code. Most “deferred compensation” payments are subject to 409A. For example, if an employment agreement or supplemental executive retirement plan provides for severance pay or benefit payments upon termination of employment, the time and form of the payment generally must be set forth in the agreement or plan document. It is generally too late to fix a non-compliant 409A agreement at the time the termination of employment is imminent. However, some relief from severe tax penalties is available if the termination of employment will not occur during the 12 to 18 months after the agreement has been brought into compliance with 409A.

Applicability

Golden parachutes are payments made to any current or former institution affiliated party (“IAP”), such as an executive officer, which are contingent on the termination of that person’s employment and

received when the credit union making the payment is considered in troubled condition.

The Rule applies to any federally insured credit union (FICU) that is designated:

- Insolvent;
- In conservatorship;
- Rated CAMEL 4 or 5;
- Rated CRIS 4 or 5 (corporate CUs only);
- Subject to a proceeding to terminate or suspend share insurance;
- Undercapitalized (corporate CUs only); or
- In otherwise troubled condition.

The Rule is not retroactive. Therefore, it will not apply to contracts that are already in existence on the Rule’s effective date. However, the Rule will apply to all new employment contracts or arrangements entered into on or after the effective date. The Rule will also apply to existing contracts and arrangements that are renewed or materially modified in any way on or after the effective date.

A payment means (1) any direct or indirect transfer of any funds or any asset, (2) forgiveness of any debt or obligation, (3) conferring of any benefit or (4) the segregation of any funds or assets or the establishment of a trust to hold assets for making a later payment.

Since the Rule applies to all golden parachute contracts created on or after the effective date, if a healthy credit union subsequently becomes troubled, the rule would prohibit golden parachute payments absent an exemption or exception.

Golden Parachute Exceptions

The NCUA has carved out certain exceptions for payments that are not to be considered as a golden parachute. These include:

- Bona fide deferred compensation plans, retirement plans, pensions, 457 plans, excess benefit plans, top-hat plans, and supplemental executive retirement plans (SERP); and
- Nondiscriminatory severance pay plans applicable to all employees of the FICU not exceeding 12 months of base compensation (unless otherwise approved by the NCUA). Disparities in benefits are only acceptable if based on objective criteria like salary, total compensation, length of service, or job classification. The severance benefits may vary by 10% and each class of employees designated for a different level of benefits must be at least 33% of all employees.

Permissible Golden Parachute Payments

A golden parachute payment may be made if:

- NCUA approval (and any state approvals) is obtained;
- The payment consists of a reasonable severance payment (not to exceed 12 months' salary) and NCUA approval is obtained;
- A troubled credit union seeking to hire competent management to bring the credit union back to financial health may agree to a golden payment plan, with NCUA's prior approval; and
- A troubled credit union engaged in a merger may offer a limited golden parachute to management, with prior NCUA approval.

Applying for an Approval

When applying for NCUA approval of a particular individual's payment, the FICU must state that it does not possess, and is not aware of, any

information providing a reasonable basis to believe that the individual

- Has committed any fraudulent act or omission, breach of trust or fiduciary duty, or insider abuse;
- Is substantially responsible for the troubled condition of the credit union; or
- Has violated any applicable federal or state law.

The NCUA will consider the individual's

- Position in the FICU;
- Length of employment or affiliation with the credit union and the degree to which the payment represents a reasonable payment for services rendered over the period of employment; and
- Any other facts or circumstances NCUA finds applicable.

Essentially, the NCUA will consider granting exceptions to this Rule on a case-by-case basis based upon the individual's involvement, as interpreted by the NCUA, in the distressed financial situation of the credit union.

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If you would like more information about golden parachute payment plans, please do not hesitate to contact one of the following attorneys:

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