Final Rule Summary

Prepared by the NASCUS State Regulatory Affairs Department
October 16, 2013

State of Michigan
Department of Insurance
and Financial Services

Bulletin 2013-18-CU

Deferred Compensation
Arrangements and Related Assets

The State of Michigan Department of Insurance and Financial Services, Office of Credit Unions has issued a bulletin clarifying state rules surrounding permissible employee deferred compensation arrangements and related investment limitations. This information corresponds to Section 401(2)(ss) and 401(2)(i) of the Michigan Credit Union Act (MCUA).

The bulletin was issued and entered on October 14, 2013.

Bulletin at-a-Glance:

- Credit union boards of directors must document due diligence and consideration of interest rate risk, liquidity risk, transaction risk, compliance risk, credit risk, and strategic risk when entering into a deferred compensation plan.
- The board must be able to demonstrate a clear understanding of the investment type and structure, and be able to explain the rationale for choosing that product over other available options.
- Deferred compensation arrangements may be offered to credit union employees only, and the investment goals must align with the anticipated program expense.
- Aggregate plan-related assets must not present an unsafe concentration of risk (15% of net worth for a healthy well-run credit union).
- The board must obtain legal counsel related to the deferred compensation policy.
- Collateral Assignment Split Dollar (CASD) plans are subject to the aggregate loan limit and must be reported as "Loans to Officials" on the call report.
- CASD loans must have a documented ability to repay or else should be recorded at the collateral liquidation value with accrued interest only recognized when received.

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The final rule may be read here.

Background

In Michigan, a credit union may purchase and hold insurance policies and other investment products in order to fund deferred compensation programs for its employees. Although these types of investments are generally impermissible for Michigan credit unions, an exception was created to allow credit unions flexibility in attracting and retaining highly qualified employees. Nevertheless, investments purchased in connection with a deferred compensation program may not be speculative, and cannot be used to generate funds operating expenses of the credit union. A Michigan credit union may also grant loans to executives under a deferred compensation arrangement, as long as the arrangement does not present a risk to the safety and soundness of the institution. The bulletin lays out the minimum due diligence requirements that a Board of Directors must perform and document when undertaking a deferred compensation investment program, including basic safety and soundness concerns, defining the purpose and scope of the investment relationship, and utilizing an appropriate accounting and reporting structure for the specific provisions of each deferred compensation agreement.

Basic Safety and Soundness Considerations

To prevent undue risk to the credit union's earnings or net worth, the Board must, at a minimum, consider the interest rate risk, liquidity risk, transaction risk, compliance risk, credit risk, and strategic risk associated with any deferred compensation program. The credit union must calculate the total cost of the deferred compensation plan on at least an annual basis. The total cost calculation may estimate the term of the asset and the anticipated marketed rates, but it must include opportunity costs, such as the risk that the funds will receive less than a market rate of return. The total cost of the program must be calculated on an individual basis, and in aggregate, and must be reviewed and approved by the Board.

The Board must also take all unfunded commitments into account when assessing the safety and soundness of the program, and should develop dual controls and independent oversight over the program. Related assets and liabilities must be reconciled at least quarterly. In addition, periodic ongoing evaluations of the program's credit risks and documentation of the program's effect on the credit union's long term strategic plan are required. The Board must be able to demonstrate a clear understanding of the investment characteristics, and the careful deliberation that led to the chosen investment type and structure.

Purpose and Investment Relationship

The bulletin also clarifies the requirement that investments designated as part of a deferred compensation plan must directly fund a benefit plan offered only to the credit union's employees. The investment should be tailored to match the anticipated deferred compensation expense, and should be re-evaluated periodically to avoid a material disparity between anticipated revenue and program expense. The board must ensure that plan-related assets do not become an unsafe concentration of risk, which the bulletin defines as exceeding 15% of net worth in a well-capitalized and well-managed institution.

The board must also obtain legal counsel to advise on the credit union's potential liability from the deferred compensation program and document compliance with the Internal Revenue Code and other applicable statutes. The bulletin also states that Michigan is adopting the December 7, 2004 Interagency Statement on the Purchase and Risk Management of Life Insurance, which outlines due diligence considerations for life insurance products.

Accounting and Reporting

The bulletin outlines appropriate accounting and reporting practices surrounding deferred compensation programs, and focuses primarily on requirements specific to Collateral Assignment Split Dollar (CASD) plans. Under certain circumstances, CASD plans allow credit unions to extend credit to an employee that is secured by a life insurance policy on that employee. The bulletin clarifies that impermissible investment restrictions under MCUA Section 401(2)(ss) do not apply to CASD plans because the credit union does not directly purchase the investment. Instead, loans executed under a CASD plan should be included in the aggregate loan limit established by MCUA Section 423(12), and should also be listed as "Loans to Officials" on the call report. The credit union must consider and document the borrower's "capacity and intent" to repay the loan, and absent adequate evidence of capacity/intent to repay, should be recorded at the collateral liquidation value with accrued interest only recognized when received. The board is responsible for ensuring and documenting due diligence relating to CASD arrangements, and adjustments to regulatory capital and net worth may occur during an exam for any deficiency between the credit union's recorded assets and the underlying collateral value of a CASD plan.

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