May 27, 2010

Mary Rupp, Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428

Re: Fiduciary Duties at Federal Credit Unions; Mergers and Conversions of Insured Credit Unions

VIA ELECTRONIC MAIL: regcomments@ncua.gov

Dear Ms. Rupp,

The Michigan Credit Union League (MCUL) appreciates the opportunity to comment on the NCUA Board's proposed amendments to its Chartering and Field of Membership Manual (IRPS 09-1). MCUL is a statewide trade association representing 95% of the credit unions located in Michigan. MCUL respectfully requests that the NCUA Board takes the following letter into serious consideration when deliberating the passage of a final rule.

MCUL generally supports the specification of a federal credit union's fiduciary duties, promoting the financial literacy of directors, and greater transparency with respect to the conversion and merger process. However, in addition to the specific issues outlined herein, MCUL believes that there are areas of the proposal that may conflict with NCUA's broad intent to protect a credit union's membership.

Discussion

General Authorities and Duties of Federal Credit Union Boards of Directors

Duties of the FCU Board

The proposed rule provides that an FCU director would be required to do the following:

- Carry out his or her duties in good faith, in a manner reasonably believed to be in the best interests of the membership of the FCU, and with such care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstances;

- Administer the affairs of the FCU fairly and impartially and without discrimination in favor of or against any particular member;

- Understand the FCU's balance sheet and income statement and, ask, as appropriate, substantive questions of management and the internal and external auditors; and

- Direct the operations of the FCU in conformity with the requirements set forth in the Federal Credit Union Act (Act), the NCUA's regulations, other applicable law and sound business practices.

MCUL is concerned that the result of these expressly enumerated duties exposes boards of directors to lawsuits by individual members who feel as though their board has not acted impartially and without discrimination against them. Therefore, MCUL believes that the duties should be in the best interest of the membership "***as a whole***," and that the second provision regarding individual members should be removed. For example, there are times when actions taken in the best interest of the membership as a whole, does result in perceived, or even actual, harm to individual members or groups of members (for example, increased fees or higher loan rates).

One potential side effect is directors that are held to a broader standard to treat every "particular member" fairly may likely be dissuaded from running for a board seat, knowing that every action could be perceived as impartial toward individual members and could expose them to liability. Most assuredly, providing this type of ammunition to individual members who are not satisfied with a particular board action would not be in best interest of a federal credit union's membership.

While it is understandable to require a director to possess a working familiarity with basic finance and accounting practices, it is vague, at best, to require such a director "to become financially literate within a reasonable time, not to exceed three (3) months, after his or her election or appointment to the board of directors." Without specific and objective standards, it will be left up to the subjectivity of a given examiner to determine whether a board of directors has obtained the necessary financial training to understand the credit union's balance sheet and income statement.

The financial training requirement for those not deemed to be "financially literate" becomes a slippery slope, as a board of directors is ultimately responsible for ensuring all aspects of a credit union's operations are conducted in a safe and sound manner. Many federal credit union boards operate effectively by having a wide variety of volunteers that represent the various areas of a credit union's operations (accounting, lending, technology, compliance, etc.). Imposing additional requirements on volunteer directors not only increases the operating expenses for federal credit unions, it may also have a deterrent effect, as additional qualification requirements will be imposed on holding a board seat. It may be unreasonable to expect every board member to be financially literate, as it follows that such a requirement would make recruiting volunteers more difficult. Many smaller credit unions have a difficult time as it is recruiting volunteers.

Authority Regarding Staff and Outside Consultants

The proposed rule would allow directors to rely on information prepared or presented by employees of the FCU, or consultants whom the director reasonably believes to be reliable and competent. The proposal would also provide that FCU staff providing services to the board of directors or any committee of the board under this section may be required by the board of directors or such committee to report directly to the board or such committee, as appropriate.

MCUL is concerned that such a requirement usurps the ability of credit union management to oversee the actions of staff selected to report directly to the board, especially in cases where the board has delegated this responsibility to management. Article VII, Section 8 of the Standard Bylaws, for certain employees, the board of directors has no authority to prescribe duties where it has been delegated to management. Section 8 reads as follows:

> Section 8. *Board powers regarding employees*. The board employs, fixes the compensation, and ***prescribes the duties of employees as necessary***, and has the power to remove employees, ***unless it has delegated these powers to the financial officer or management official***. ***Neither the board***, the financial officer, nor the management official ***has the power or duty to*** employ, ***prescribe the duties of***, or remove ***necessary clerical and auditing assistance*** employed or used by the supervisory committee and, if there is a credit committee, ***the*** power or duty to employ, ***prescribe the duties of, or remove any loan officer appointed by the credit committee***. [emphasis added]

Therefore, the board may not have the authority to prescribe staff duties and/or require certain FCU staff to report directly to the board. This authority, when delegated to management, should be left to management. Additionally, the prohibitions against the board direction of certain employees under Article VI, Section 8 of the Standard Bylaws should remain in place. If finalized, MCUL believes the Standard Bylaws would need to be amended as well to reflect the changes to the regulation.

Indemnification

The proposal would amend the indemnification provisions of NCUA's rules to prohibit an FCU from indemnifying officials and employees for liability from misconduct that is grossly negligent, reckless, or willful in connection with a decision that affects the fundamental rights of members. "Matters affecting the fundamental rights and interests of FCU members" would include charter and share insurance conversions and terminations. The proposal would make corresponding changes to the standard FCU and federal corporate credit union bylaws on indemnification.

Gross negligence is a legal term of art, generally defined as a "conscious, voluntary act or omission in reckless disregard of a legal duty and of the consequences to another party . . . ." *Black's Law Dictionary* 8th ed. (Thomson West 2004). Gross negligence is a more lenient standard than simple negligence, and indemnification would still be permitted under the proposal for liability premised on simple negligence.

Though MCUL sincerely believes that NCUA is attempting to protect federal credit unions from rogue directors seeking to dismantle a credit union, this language will have an effect that is in opposition to NCUA's good intentions.

Taken in conjunction with the proposed provision regarding the impartial and non-discriminatory treatment of "particular members," these indemnification provisions could very well result in an increase in lawsuits and a decrease in volunteerism. In order to avoid any personal liability, a credit union board will most certainly avoid deliberating or acting on any issue regarding a potential charter or share conversion/termination. Such inaction may not be in the best interest

of the credit union or the membership as a whole, but it could be perceived as being in the best interest of the individual board members. This result completely contradicts a board's duty to avoid any self interest (which, in turn, exposes board members to liability).

It appears that NCUA is attempting to protect its turf by granting an FCU's membership the power to sue board members individually and attach board members' personal assets in areas related to those in which NCUA would lose its regulatory authority.

Proposed Amendments to Part 708a, Subpart A: Conversion of Insured Credit Unions to Mutual Savings Banks (MSBs)

Before getting into the specifics of the proposed conversion provisions, MCUL would like to express its strenuous objection to these conversion proposals, as they are in direct and express contravention with the Credit Union Membership Access Act (CUMAA). 12 U.S.C. §1785. Specifically, §1785(b)(2)(G)(i) states as follows:

> (G) Consistent rules. –
>
> (i) In general. – Not later than 6 months after August 7, 1998, the Administration shall promulgate final rules applicable to charter conversions described in this paragraph that are consistent with rules promulgated by other financial regulators, including the Office of Thrift Supervision and the Office of the Comptroller of the Currency. ***The rules required by this clause shall provide that charter conversions by an insured credit union shall be subject to regulation that or no more or less restrictive than that applicable to charter conversions by other financial institutions.*** [emphasis added]

It is MCUL's position that until the "other financial regulators" issue charter conversion rules that provide provisions similar to what NCUA has proposed, NCUA's proposal is contrary to the authority provided in CUMAA.

In the meantime, MCUL strongly encourages NCUA to reduce the regulatory burden on credit unions to make the conversion option less attractive. That being said, MCUL would be remiss by not addressing the specific aspects of the conversion portion of the proposed rule.

The proposal would add a new definition of the phrase "conducted by an independent entity" to prevent FICU staff and officials from accessing interim vote tallies during the election and also to ensure that members learn the results of the membership vote.

MCUL supports the requirement to have an independent entity conduct the vote for a conversion to a mutual savings bank. However, it does not follow that a credit union should be prohibited from knowing the tally of a vote prior to the official count. So long as a credit union is not told how individual members voted, there should be nothing preventing a credit union from understanding how their "get out the vote" efforts are faring. If an overwhelming majority of members have voted (which is most often highly unlikely), and the vote is overwhelmingly negative, it would not be in the best interest of the membership, as a whole, to incur the unnecessary expenses of continuing a conversion effort (i.e., notices, marketing materials, ballots and a special meeting).

Furthermore, with a secret ballot, there can be no way of knowing for sure how someone voted. So long as the credit union does not make it difficult or impossible for certain members to cast their ballot, there should also be nothing wrong with encouraging members to vote. Additionally, a credit union could save expenses by targeting its voting efforts to those that have not already voted.

MCUL is also concerned with the requirement that the independent entity is prohibited from opening all of the ballots until the conclusion of the special meeting that ends the ballot period. The concern lies with the fact that some members may not have filled out their ballot correctly, may have voted more than once, may not in fact be eligible to vote, or did not properly indicate their identity. Members should have the ability to have their voices heard by being able to fix any issues related to a ballot disqualification. This requirement prevents this from occurring and may prohibit a credit union from getting the most accurate count.

Disclosures and Communications to Members

The proposed rule would list the information that federally insured credit unions (FICUs) seeking to convert would be required to disclose to members, which would include the following:

- The estimated costs of conversion, with separate line items for printing fees, postage fees, advertising, consulting and professional fees, legal fees, staff time, the cost of holding a special meeting, the cost of conducting the vote, and any other conversion-related expenses;
- The conversion's affect on the availability of facilities, including branches and ATMs; and
- The fact that NCUA neither approves nor disapproves of the proposed conversion.

MCUL supports transparency in the conversion process and agrees that the estimated costs related to the conversion effort should be disclosed. However, this proposal only adds to the cost. Costs could be reduced by allowing credit unions to know the vote tallies and which members have voted, so as to cut down on marketing, printing and mailing expenses. MCUL believes the rules should be structured in such a way as to promote thrift, which is in the best interest of the membership as a whole.

The proposed rule would require credit unions to disclose that NCUA's review of the materials does not represent an endorsement of the conversion effort. However, this statement could potentially have the opposite effect. Members who view this statement may believe that NCUA does <u>not</u> support the effort. Instead, MCUL believes that the statement should read as follows: "NCUA conducts its reviews of the conversion materials and the associated process simply to fulfill its statutory duty of overseeing the methods and procedures of the member vote. NCUA does not take a position on the merit of conversion proposals."

<u>Proposed New Part 708a, Subpart C: Merger of Insured Credit Unions into Banks</u>

Board of Directors' Approval and Members' Opportunity to Comment

Under the proposal, FICU directors would be required to conduct due diligence so as to determine that the concept of merging with a bank, and with the particular bank under consideration, is in the best interests of the credit union's members. As part of this due diligence, the directors must determine the merger value of the credit union, that is, the amount of money that a stock bank would pay in an arms-length transaction to purchase the credit union's assets and assume its liabilities and shares.

MCUL supports this provision only if, as indicated earlier in this letter, the director fiduciary duties for federal credit unions are amended to state "in the best interests of the membership of the federal credit union, ***as a whole***" [emphasis added]. Failure to do so exposes directors to lawsuits by individual members who claim that a decision to merge with a bank would have an impartial and discriminatory effect.

Notice to NCUA and Request to Proceed with Member Vote

Following adoption of a merger proposal, the FICU's board of directors would be required to provide its NCUA Regional Director with a Notice of Intent to Merge and Request for NCUA Authorization to proceed with the member vote (NIMRA), that would be similar to the merger proposal documentation that two credit unions desiring to merge with each other must submit to NCUA. The NIMRA would require the following:

- Certain additional documentation related to the merger valuation and merger payments to be made to members;
- The disclosure of certain information about any merger-related compensation to be received by any director or senior management official of the merging credit union; and
- Certification that the directors believe the merger is in the best interests of the credit union's members, including a description of the due diligence conducted by the directors in determining that the merger is in the best interests of the members and that the merger satisfies the statutory considerations for such members in the FCUA.

MCUL does not believe the disclosure of merger-related compensation received by any director or senior management official of the merging credit union is relevant if the decision to merge is required to rest with what is in the best interests of the membership as a whole, the proper due diligence is conducted, and the members support the decision to merge. Requiring such disclosure only serves to impose NCUA's subjective opinion as to what is adequate compensation. That amount of compensation provided to a senior management official should be decided solely by what individual credit unions believe is justified.

Membership Approval of a Proposal to Merge

Similar to the quorum required when a credit union's members make certain other decisions affecting their fundamental rights, such as a share insurance conversion, the proposal for merger would require approval by a majority of the members who vote on the proposal, with the additional requirements that at least 20% of the members eligible to vote must participate in the vote.

MCUL believes that the requirement to have at least 20% of the members eligible to vote participate in the vote is unreasonably burdensome. This also appears to be consistent with NCUA's apparent desire to maintain its regulatory authority over credit unions. Again, if the board has decided to merge based on what is in the best interest of the membership as a whole and proper due diligence is conducted, the decision should rest with the majority of those who decide to vote. Credit unions could be placed in a precarious economic position if required to expend money to recruit 20% of all eligible voting members, which could result in a loss of perceived, or actual, value of the credit union. If the best interests of the membership, as a whole, are better served by merging with a bank, there should not be such a burdensome impediment placed on doing so.

Limits on Compensation of Officials

No director or senior management official of an insured credit union could receive any economic benefit in connection with the merger of a credit union other than reasonable compensation and other benefits paid in the ordinary course of business.

Again, MCUL believes that what is "reasonable compensation" should be left solely to the individual credit unions to decide, in relation to additional responsibilities, the complexity of the transaction and the size of the institution. Therefore, MCUL believes this provision should be removed, as it opens the door to NCUA subjective scrutiny.

Voting Incentives

If a merging credit union offers an incentive to encourage members to participate in the vote, every reference to such incentive made by the credit union in a written communication to its members would be required to also state that members are eligible for the incentive regardless of whether they vote for or against the proposed merger.

MCUL believes that so long as the credit union does not know how individual members voted, credit unions should not be prohibited from encouraging members to vote by offering an incentive, especially if the 20% of eligible members voting requirement is finalized.

<u>Proposed Amendments to Part 708b: Mergers of Federally-Insured Credit Unions with Other Credit Unions; Voluntary Termination or Conversion of Insured Status</u>

Definitions

The proposal adds definitions for the terms "conducted by an independent entity," "merger-related financial arrangement," and "secret ballot," and "senior management official." The new definitions of "conducted by an independent entity" and "secret ballot" clarify requirements for balloting in insurance conversions, and match the proposed revisions to the voting requirements in the provisions regarding conversions to MSBs.

MCUL reiterates its concerns with regard to the defined terms above as they are applied to conversions to mutual savings banks and mergers with banks (specifically, with regard to the vote tally conducted by the independent entity and the merger-related financial arrangement).

Preparation of Merger Plan

1. Share Adjustments

The proposal would require additional information in the merger plan submitted to NCUA in cases where the merging credit union has a higher net worth ratio (NWR) than the continuing credit union. In these situations, the proposal would require the merger plan to discuss not only actual share adjustments, but an explanation of the factors used to establish the amount of the adjustment or to determine no adjustment is necessary.

NCUA is proposing these additional disclosures because of the potential for unfair treatment of members of the credit union with higher net worth, as these members then face the potential dilution of their membership interests as a result of the merger if the merging credit union's capital is simply subsumed into the less well-capitalized continuing credit union.

MCUL believes that NCUA is, in essence, encouraging individual member lawsuits against directors for the perceived "unfair treatment" of individual members. This is further support for the removal of the proposed fiduciary duty to "administer the affairs of the FCU fairly and impartially and without discrimination in favor of or against any particular member" versus the membership as a whole.

2. Disclosure of Merger-Related Financial Arrangements

The proposal would require all FICUs to disclose to NCUA any "merger-related financial arrangements" received by officials or senior managers of a merging credit union in connection with the merger. A merger-related financial arrangement would be defined as:

"[A] material increase in compensation (including indirect compensation, for example, bonuses, deferred compensation, or other financial rewards) or benefits that any board member or senior management official of a merging credit union may receive in connection with a merger transaction. For purposes of this definition, a material increase is an increase is an increase that exceeds the greater of 15% or $10,000."

"Senior management official" would be defined as "[A] chief executive officer, an assistant chief executive officer, a chief financial officer, and any other senior executive officer as defined by the financial institution regulatory agencies pursuant to §32(f) of the Federal Deposit Insurance Act."

The Board intends that all compensation arrangements, formal and informal, be covered by this disclosure requirement. The scope of disclosure includes both arrangements that are written and those not immediately reduced to writing, as well as arrangements involving deferred compensation.

MCUL strongly opposes these provisions. With all due respect, MCUL does not believe the proper role for NCUA is to involve itself in compensation negotiations; this is the role of the individual credit unions to decide. If the board is acting in the best interests of the membership, as a whole, part of this consideration is the economic impact of the compensation to its senior management officials. There would be little incentive to take on additional, and perhaps

troubled, credit unions if there is little financial reward. Senior management officials should be compensated in such a way as to reward competence and the level of responsibility. MCUL believes that the standard should remain with what is in the best interests of the credit union membership as a whole, and not on an arbitrary and subjective opinion about what amount of compensation is considered reasonable to NCUA.

Approval of the Merger Vote by Members

Currently, members must be given a summary of the merger plan. Under the proposed rule, this summary would be required to include a detailed description of any "merger-related financial arrangement" made available to any board member or senior management official of the merging credit union. This description would have to include the name and title of each individual recipient and an explanation of the financial impact of each element of the arrangement, including direct salary increases and any indirect compensation, such as any bonus, deferred compensation or other financial rewards. As noted above, the term "merger-related financial arrangement" would apply only to material increases in compensation, which would mean an increase exceeding the greater of $15,000 or 10% of the individual's compensation.

MCUL strongly opposes these provisions. If the best interests of the membership as a whole are being served by merging, the issue of compensation is largely irrelevant. The senior management officials of the surviving institution should be duly rewarded for acting in the best interests of the merging credit union's membership.

Conclusion

MCUL is concerned with the deterrent effect these proposed rules will have on credit union members deciding whether to run for a board seat. While MCUL supports greater transparency in the conversion and merger process, MCUL believes that these proposals could have a chilling effect on a credit union board's decision to convert to or merge with banks, as well as the decision to merge with other federally insured credit unions.

MCUL urges NCUA to make the credit union charter more attractive by proposing and finalizing rules that reduce the regulatory and bureaucratic burdens that continue to plague the credit union industry at an increasingly alarming rate. MCUL believes that this proposal only adds to the problem.

MCUL appreciates the opportunity to provide comment on this proposed rule.

Sincerely,

Veronica Madsen
Director of Compliance & General Counsel
MCUL & Affiliates