



**CUNA**

Credit Union National Association

601 Pennsylvania Ave., NW | South Building, Suite 600 | Washington, DC 20004-2601 |

cuna.org

PHONE: 202-638-5777 | FAX: 202-638-7734

Ms. Mary Rupp  
Secretary to the Board  
National Credit Union Administration  
1775 Duke Street

Re: 12 CFR Parts 701, 708a, and 708b Fiduciary Duties at Federal Credit Unions; Mergers and Conversions of Insured Credit Unions

Dear Ms. Rupp:

This comment letter represents the views of the Credit Union National Association (CUNA) regarding the National Credit Union Administration Board's (NCUA's) proposal, published in the [Federal Register](#) for comments on March 29, 2010, to clarify the fiduciary duties and responsibilities of federal credit union directors, and add new provisions for insured credit union conversions and mergers. By way of background, CUNA is the largest credit union advocacy organization in this country, representing approximately 90% of our nation's 7,800 state and federal credit unions, which serve 92 million members.

CUNA appreciates NCUA's efforts to clarify the fiduciary duties of federal credit union directors and to protect the rights of credit union members during a conversion or merger. However, based on feedback from credit unions and our analysis, CUNA has a number of significant concerns with the proposed rules.

### **Summary of CUNA's Views**

- With respect to federal credit union fiduciary duty, we recognize that in a limited number of conversions, and in at least one credit union takeover attempt, the members' interests did not seem to be the primary concern. Rather, in those situations, the interests of the board and senior management seemed to have been overarching.
- However, a better approach to fiduciary duty would be to issue a regulation clarifying in what ways state corporate law applies to federal credit unions, as the Office of the Comptroller of the Currency (OCC) has



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done for national banks. This approach would clarify not only directors' existing fiduciary duties but also how other areas of state corporate law apply to federal credit union on issues not addressed by the Federal Credit Union Act (FCUA) and NCUA regulations, and would also protect member rights without having negative operational consequences. Further, a state law approach would be consistent with current NCUA policies as well as the legislative history and judicial interpretation of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA) provisions on which the proposed rule is premised. Finally, incorporating state law by way of a federal regulation would open the door to effective enforcement by NCUA of adherence to fiduciary standards by federal credit unions.

- The proposed prohibition on director indemnification is unnecessary because of existing state law and FCUA provisions and may have the unintended consequence of making it difficult for federal credit unions to find qualified, volunteer board members. The proposed indemnification prohibition also appears to be inconsistent with the FCUA in some respects because FCUA Section 207(h) expressly limits the statutory indemnification prohibition in the Act to matters where the NCUA Board is a party.
- We support ensuring directors should understand the finances and balance sheet of the credit union they serve. However, it should be the credit union board's collective responsibility to ensure this is the case for each board member and not an authority that an examiner could enforce against an individual director. The credit union board should have a written policy that could be reviewed by the examiner.
- While we support adequate due diligence and integrity in the voting process, the proposed rules would increase the complexity and lead times of the affected transactions, especially for credit union to credit union mergers.
- We strongly urge NCUA to support greater regulatory relief for credit unions because credit unions continue to face a challenging business and regulatory environment.

### **Background**

The proposed rule is related to an Advance Notice of Proposed Rulemaking and Request for Comment (ANPR) from January 2008. In the ANPR, NCUA asked if it should adopt proposed rules for credit union mergers and conversions. At the time, CUNA did not support the suggested rules in the ANPR, because credit unions faced significant regulatory burdens from NCUA and other regulators, but CUNA noted that some guidelines were appropriate for specific circumstances such as a "hostile merger" situation. In

addition, CUNA has supported dialogue within the credit union system to determine if appropriate fiduciary duty guidelines could be developed.

## **1. Fiduciary Duties**

### **Uniform Fiduciary Duty Standard**

The proposed rule would establish a uniform fiduciary duty standard for federal credit union directors. Federal credit union boards of directors would be able to delegate operational functions, but not the ultimate responsibility for these operations. The proposed rule provides the following:

- Directors are required to carry out their duties in good faith in a manner reasonably believed to be in the best interest of the membership, with the care of an ordinarily prudent person in a similar situation. A director should administer the credit union's affairs fairly and impartially.
- In addition, a director should understand the balance sheet and income statement and ask any appropriate questions of management and auditors. This financial literacy would need to be achieved within three months after election or appointment to the board of directors.
- A director should ensure that the credit union's operations are in accordance with applicable law and sound business practices. In addition, a director may also retain individuals for advice and counsel, and rely on such advice, provided that there is a reasonable belief that such individuals are reliable, competent, and merit confidence.

In general, the requirements that directors should act in good faith in the best interest of their members, and administer the affairs of the credit union fairly and impartially, are consistent with existing state law fiduciary duty standards. We recognize the value of federal credit union directors having their existing fiduciary duties clarified.

We also support ensuring that directors understand the finances and balance sheet of the credit union they serve. However, it should be the credit union board's collective responsibility to ensure this is the case for each board member, and not an authority that an examiner could enforce against an individual director. The credit union board should have a written policy that could be reviewed by the examiner.

However, the proposed approach—issuing a regulation applicable to federal credit unions primarily premised on deposit insurance provisions of the FCUA established by FIRREA—would be redundant with existing state law fiduciary duties.

We therefore ask the Board to consider adopting an approach to state fiduciary duty law similar with the OCC's policy regarding state corporate

law's application to national banks. Under 12 C.F.R. § 7.2000, OCC has clarified that a national bank's corporate governance is controlled by "applicable Federal banking statutes and regulations, and safe and sound" operation but is otherwise controlled by state corporate law. The OCC regulation permits a national bank to adopt a bylaw, which specifies one of three sources of state corporate law: (1) the corporate law of the state of its home office; (2) the corporate law of Delaware; or (3) the Model Business Corporations Act.

We recognize that state law does not always specifically address corporate governance questions about credit unions per se. However, we believe that it would be reasonable for NCUA to specify by rule that a state's law for governance of stock corporations applies to federal credit unions to the extent that the state law does not conflict with the FCUA or NCUA rules. State fiduciary duty and other laws applicable to corporations are usually well delineated, especially in the case of Delaware. This approach would be consistent with the Agency's goal of better defining federal credit union directors' fiduciary duties.

Even though the concept, purposes, and culture of not-for-profit credit unions are highly distinct from those of most for-profit stock corporations, an NCUA regulation similar to 12 C.F.R. § 7.2000, which specifically references state laws for stock corporations, would be reasonable because Congress borrowed liberally from the law of stock corporations in providing standards for credit union governance. For instance, federal credit union members are shareholders in the federal credit union and, like common stock, these shares represent equity ownership interests. See 12 U.S.C. § 1757(6). Also like corporate shareholders, federal credit union shareholders elect the institution's board, are paid dividends on their shares, and have other rights analogous to those of corporate shareholders, such as the right to examine the institution's books and records.

We recognize that not all aspects of state corporate law for stock corporations make sense for federal credit unions. Some of the differences between credit unions and stock corporations might need to be specifically addressed in any NCUA rule so as not to have unintended consequences, especially since federal credit unions are not-for-profit enterprises whereas most stock corporations operate for profit. Nevertheless, we believe that state corporate laws are the appropriate place to start any rulemaking on the fiduciary duties of credit unions boards of directors.

Such a rule would enable NCUA to take prompt enforcement action against breaches of fiduciary duty by making violations of state corporate law standards violation of a federal rule as well. In addition, in many situations, state corporate law provisions which conflict with the FCUA or NCUA rules would be preempted, as is the case for national banks pursuant to 12 C.F.R. § 7.2000.

Adopting a regulation for federal credit unions similar to 12 C.F.R. § 7.2000 would help clarify not only the fiduciary duties of directors, but also many other areas of federal credit union governance not addressed by the FCUA or NCUA regulations. Such a regulation would be generally consistent with NCUA's current policies holding that the corporate law of the state where the federal credit union's home office is located controls on matters of corporate governance not addressed by federal law, but would make NCUA's policy clearer for federal credit unions, for their members, and for any court.

The approach suggested here would also minimize the creation by this rule of additional regulatory burdens for credit unions, since we believe that credit unions (including federal credit unions) are already subject to most of the state standards that we are suggesting for incorporation into federal law.

Rather than adopt this standard now, NCUA should help increase credit unions' awareness of their fiduciary duties by issuing a regulation clarifying how state fiduciary duty and other corporate laws apply to federal credit unions, as suggested above, and discuss these standards more broadly with credit unions in agency meetings around the country.

### **No Indemnification for Fundamental Rights Decisions**

We are very concerned with the scope, effects, and unintended consequences of the proposed rule that prohibits indemnification. In the proposed rule, a credit union may not indemnify its employees for grossly negligent, reckless, or willful misconduct on decisions that affect the fundamental rights of its members.

For a number of reasons, we believe that the proposed rule that prohibits indemnification is not reasonable.

- For the reasons stated in this letter, we believe that NCUA should look to state law for the scope of indemnification for a director's fiduciary duties. The same reasoning applies to indemnification for violations of those duties.
- The proposed rule exceeds the scope of Section 207(h) of the FCUA, which only applies to actions between NCUA and a credit union under conservatorship or in receivership. While we recognize that Section 207(h) expressly allows NCUA to recover notwithstanding any indemnification agreement, it seems inconsistent with the plain language of the statute and congressional intent to extend this prohibition on director indemnification to situations where NCUA is not a party.
- An unintended consequence of the proposed rule would be that the proposed rule could discourage qualified individuals from assuming the director position because of the expanded potential for personal liability.

- In addition, the proposed rule would further disadvantage the federal credit union charter as compared to the state charter. The rule would mean that federal credit union directors would face an even higher burden compared to state credit union directors.

## **2. Credit Union Conversions and Mergers**

While we support adequate due diligence and integrity in the voting process, the proposed rules would unnecessarily increase the complexity and time to complete a credit union merger.

### **An Independent Entity for Voting; A Credit Union Conversion into a Mutual Savings Bank**

We support an independent entity that is intended to improve the fairness and integrity of the voting process. However, it is important that a rule governing such an entity be drafted and implemented with sensitivity to any additional costs and complexity it would create for credit union conversions and mergers.

In the proposed rule, there would be procedures for an independent entity to tally, record, and certify the votes for a credit union conversion into a mutual savings bank, a credit union merger into a bank, or a credit union merger with another credit union. These procedures are intended to protect the “secrecy and integrity” of the voting process. The vote must be conducted by an independent entity that would prevent credit union staff from accessing interim vote tallies during the balloting. In addition, the proposal would require disclosure of the estimated costs of conversion on separate lines, and disclosure to NCUA of correspondence with any other agency that is related to the conversion. The proposal also recommends that converting credit unions not use employees to solicit member votes.

### **A Credit Union Merger with a Bank**

We support adequate and independent due diligence requirements for a credit union merger into a bank. In the proposed rule, there would be a broader merger definition that includes a transfer of “substantially all” its assets. There are additional proposed related due diligence requirements for directors to obtain an independent valuation of the credit union; determine any compensation for the diminished or loss of ownership rights for credit union members; disclose other pertinent merger-related information; and use the proposed independent entity for the voting process.

### **A Credit Union Merger with another Credit Union**

These proposed rules would impose additional costs and complexity to a significant number of credit unions that are interested in a merger with

another credit union for further growth or consolidation. There will be a significant impact because there were over 200 credit union mergers in 2009. Unlike conversions or mergers between a bank and a credit union, mergers between two federally-insured credit unions do not result in fundamental changes to members' rights or to the insurance status of their deposits.

Here are the concerns we have with these credit union to credit union merger provisions:

- Additional disclosures on any share adjustments for credit unions with higher net worth ratios and material merger-related financial compensation may discourage viable credit union mergers, is not necessary, and will add to confusion for credit union members. In such mergers, the total net worth of the two credit unions combined is neither increased nor decreased. Further, simply having a higher net worth does not necessarily equate with improved member services or value, as the proposed disclosure implies. A post-merger, combined credit union may provide many benefits to its members that are greater than those the members of either credit union enjoyed prior to the merger. This is because economies of scale typically lead to lower loan interest rates, better rates on savings, and a wider range of services available to members.
- NCUA's definition of "material merger-related financial arrangements" as the greater of either \$15,000 or 10 percent of the manager's annual compensation seems arbitrarily low. The definition of "material" should have higher dollar and percentage amounts. Additional compensation disclosures may not even be necessary. State credit unions are required to disclose the compensation details for executives to the IRS and NCUA's regulation allowing federal credit union members to examine the institution's books and records provides members with access to this information.

### **The Termination of Federal Share Insurance**

We do not oppose more direct disclosure for a conversion from federal share insurance, which will provide greater notice to credit union members.

In the proposed rules, for a conversion of federal share insurance to nonfederal insurance, NCUA's approval is contingent on a six month period to complete the conversion and merger. For the termination of federal share insurance for state credit unions, the proposed disclosure explicitly lists the name of the private share insurer.

### **Regulatory Relief and Conclusion**

In general, the proposed regulations should be tailored to avoid adding significant costs and regulatory burden to credit unions.

CUNA appreciates NCUA's efforts to clarify the fiduciary duties of federal credit union directors and to protect the rights of credit union members during a conversion or merger process. While we support protecting the rights of credit union members, we think that the state law approach discussed in this letter strikes a reasonable balance between member protection and minimizing burdensome regulation.

We strongly urge NCUA to support greater regulatory relief for credit unions because credit unions continue to face a challenging business and regulatory environment.

Thank you for the opportunity to express our views on this important rulemaking. If you have any questions about our letter, please do not hesitate to give me a call at (202) 508-6736 or you may contact Michael Edwards, CUNA Counsel for Special Projects at (202) 508-6705.

Sincerely,

A handwritten signature in cursive script that reads "Mary Mitchell Dunn".

Mary Mitchell Dunn  
CUNA Senior Vice President and Deputy General Counsel