



May 28, 2010

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

RE: NCUA Proposed Rule on Fiduciary Duties at FCUs; Mergers and
Conversions at Insured Credit Unions

Dear Ms. Rupp:

On behalf of the National Association of Federal Credit Unions (NAFCU), the only trade association that exclusively represents federal credit unions, I am writing to you regarding the National Credit Union Administration's (NCUA's) proposed rule to amend its regulations regarding fiduciary duties at federal credit unions (FCUs), and mergers and conversions at insured credit unions. NAFCU's comments are set out below.

Fiduciary Duties at Federal Credit Unions

The proposed rule would establish a uniform standard of care that directors would be required to meet in performing their duties. Currently, FCU directors must look to state law to determine the scope and standard of care related to their fiduciary duties as neither the Federal Credit Union Act (FCU Act), nor the NCUA regulations address the fiduciary duties of FCU directors. The FCU Act does contain a directive to the NCUA Board to remove a director if it finds a breach of the director's fiduciary duty. Still, other areas of the FCU Act direct that the NCUA act in the best interest of the credit union's members. NCUA has interpreted the references in the FCU Act regarding director removal, and the above noted references to NCUA's role, as imposing a credit union director duty to the members of the FCU. *See* 75 Fed. Reg. 15575 (2010).

NAFCU recognizes that there are strong arguments in favor of NCUA regulation in this area to create a national standard. First, some FCUs, especially those that operate in multiple states, find it to be desirable to comply with one set of legal standards.

Second, the ease of turning to one set of rules to merely understand the basic fiduciary duties a director must adhere to is clear.

NAFCU also recognizes, however, that there are strong arguments against implementing NCUA's proposal. In this regard, while NCUA sets out a basic standard to act in good faith, how a violation of that standard will be treated is unclear. There is a plethora of state case law regarding corporate law issues. How NCUA will judge violations of the standard of care in accordance with those issues is at question.

In discussions regarding fiduciary duties, NCUA has stated that the incorporation of the fiduciary duties into its regulations is not designed to create a cause of action. Despite this, however, the scope and standard of care that would be established would be used by courts to determine whether a director has met his or her fiduciary duties in cases where the lawsuit stems from other cause of actions. Further, how NCUA will examine fiduciary duty responsibilities from an examination standpoint is unclear.

Best Interest of Members

Under the proposed rule, FCU directors must act in the best interest of the credit union's membership, and with such care that an ordinarily prudent person in a like position would use under similar circumstances. NCUA indicates in the preamble to the rule that:

NCUA is particularly concerned about assertions that the members of a credit union do not own the credit union, or that the duties of the directors do not flow to the members, but flow in some amorphous way to the institution. NCUA has observed this view both among some federal credit union directors and in one state court decision. A lack of focus on the interests of the members makes it easier for officials and management to make decisions that benefit themselves personally, even if those decisions are not necessarily in the best interests of the membership as a whole. *Id.* at 15575.

NCUA also indicated that:

Of course, in the normal course of business when a board acts in the best interests of the credit union it is usually also furthering the interests of the members. But the duty to act in the best interests of members is primary, and if, there is any theoretical divergence or conflict between the interests of the institution and the interests of the members, the latter takes precedence. *Id.* at fn 5.

NAFCU believes that subtleties in this area of law are still unsettled and has concerns with NCUA's interpretation. Most of the controversy surrounding this issue comes into play when the surviving credit union as an entity is the question at hand. NCUA points to the FCU Act's discussion of a voluntary liquidation needing to be in the best interest of the members as evidence that credit union boards have a duty to act in the best interest of their members. This is only one type of transaction in which the result is the dissolution of the credit union as a corporate entity. In a conversion to a mutual savings bank, or a merger with another institution, the credit union also ceases to exist. In those cases it is more unclear as to what constitutes acting in the best interest of the membership. Accordingly, NAFCU believes that these issues will need to be further vetted.

Management of a Federal Credit Union

Proposed § 701.4(a) would state that the management of each federal credit union is vested in its board of directors and that the board may delegate the execution of operational functions to credit union personnel. It would add that while the operational functions may be delegable, "the ultimate responsibility of each Federal credit union's board of directors for that Federal credit union's management is non-delegable."

NAFCU urges NCUA to withdraw the proposed language that would make the ultimate management of a credit union non-delegable. The FCU Act vests the management of each federal credit union to the board of directors. It does not, however, prohibit the board from delegating the management of the credit union.

FCU board of directors, composed of unpaid volunteers, should be able to delegate the management to compensated executives. Thus, we recommend that the agency replace the language on non-delegation with language that recognizes that the board of directors provides the general direction for the credit union. We believe such language would better reflect the policy making role of credit union boards.

Requirement of Financial Literacy

NAFCU believes that it is reasonable to expect that credit union directors have a general understanding of basic financial concepts and financial statements. It appears that the intent of this standard of care is to ensure that directors meet a minimum level of understanding of their credit union's financial reports, and we believe this is a reasonable expectation.

Nonetheless, we do not think that it is either necessary or advisable to include financial literacy among the fiduciary duties of directors. We believe that this standard is open to interpretation and that this is an aspect of the proposed fiduciary duties that could lead to an increased number of lawsuits.

Instead of incorporating this standard of care into the NCUA regulations, we recommend the agency consider publishing a guide for directors of credit unions. Such a guide can include information that the agency deems appropriate for directors, including financial literacy and recommendations for specific volunteer training.

Indemnification

The proposed rule would prohibit FCUs from indemnifying directors for aggravated breach of duty on a matter significantly affecting the fundamental rights and interests of the FCU members.

NAFCU understands the intent of the proposed prohibition against indemnification is to encourage fair dealing. However, we do not believe that it is appropriate for the agency to impose this limitation. Each credit union should be able to determine how and to what extent it should indemnify its directors. If NCUA moves forward with this requirement, each credit union should be permitted to delineate a fundamental bill of rights for their members so as to avoid fundamental rights disputes.

Fair and Impartial Administration of Affairs

Under the proposed rule, a director would have a fiduciary duty to administer the affairs of the credit union fairly and impartially so as not to favor the interests of any particular member or group of members.

We recommend that the agency clarify the scope of this duty because, as proposed, it can be interpreted broadly. For example, a FCU that serves multiple groups may offer ATM services at locations where only employees of a particular entity have access. Another is the situation where a particular product is offered or marketed to members of one group.

NAFCU respectfully requests that the agency clarify that the prohibition against favoring one group over another is limited to cases involving fundamental rights.

Finally, NAFCU believes that NCUA has not demonstrated at this time that there is a need to establish federal standards regarding fiduciary duties for directors. NCUA can issue guidance and recommendations regarding board training if it feels that credit union boards are not performing their duties appropriately.

Conversion to Mutual Savings Banks

The second part of the proposed rule addresses conversions to mutual savings banks (MSB). Generally, the proposed rule would require that a vote on conversion to a MSB be conducted by secret ballot and by an independent entity. It also adds to required disclosures, what a converting credit union must include when it submits to the NCUA its

certification of the member vote on the conversion proposal, and adds to existing voting guidelines.

Secret Ballot and Conducted by an Independent Entity

NAFCU supports the proposed requirement that a vote on conversion be conducted by secret ballot and an independent entity. We believe that these measures would improve the integrity of such a vote and accurately reflects the importance of a vote relative to conversion from a credit union charter.

Disclosures and Communications to Members

The proposed rule would add three items to the current list of disclosures that must be provided in notices. The new items would provide information about the costs of the proposed conversion, that the NCUA does not approve or disapprove the conversion proposal, and how the conversion will likely affect the availability of facilities and services.

NAFCU supports the proposed additional disclosures.

Mergers of Insured Credit Unions into Banks

The third part of the proposed rule addresses mergers of insured credit unions into banks. The scope of the proposed rule, which would be contained in a newly designated subpart of NCUA's regulations, would include both the situation where an insured credit union merges into a stock bank and a conversion that involves a preexisting agreement to transfer the credit union's assets into an existing bank. The proposed provisions that would apply to these situations would be the first of their kind as such mergers have been reviewed and approved on an *ad hoc* basis by the NCUA.

Merger Value

The proposed rule would require the credit union's board of directors to obtain a "merger value" of the credit union, to be defined as the amount that the stock bank would pay in an arms-length transaction. The value may be obtained through either a public auction process or an independent appraisal process.

NAFCU believes an appropriate measure of "merger value" in mergers with a bank, whether the merger is a direct merger or a "two-step" merger, should include an added value related to membership rights and benefits unique to the membership of the merging credit union. Because fundamental aspects of credit union membership, including ownership, would be extinguished in a merger to a stock bank and it is likely that members will get less favorable rates from the stock bank, members should be compensated to the fullest extent possible. To account for the value that members would lose, the valuation method should incorporate the value of intangible assets, including the

value of the relationships between the members and the credit union. The proposal, we believe, falls slightly short of achieving this goal.

NCUA specifically requests comments on the proposed definition of “qualified appraisal entity.” Under the proposed rule, if the credit union uses the appraisal method to obtain a value, it must use a “qualified appraisal entity,” which would be defined as:

[A]n entity that has significant experience in the valuation of depository institutions and that has no past financial relationship with the merging credit union, the continuing bank, or any law firm representing the credit union or the bank in connection with the merger.

Proposed § 708a.301.

NAFCU supports the intent of obtaining an unbiased appraisal. We believe that complete independence of the appraisal entity is paramount. To ensure that the appraisal entity is fully independent, we recommend that the definition is revised so that the appraisal entity is not only one that has no past relationship with the continuing bank, but also with any affiliate or holding entity of the bank.

Voting Incentives

The proposed rule would require disclosure of an incentive to encourage member participation in the vote for conversion, including a statement that members are eligible for the incentive regardless of how they vote.

NAFCU supports the proposed disclosure requirements. However, we recommend that the agency add that the credit union must also ensure that the incentive compensation actually be given regardless of how one votes and failure to do so constitutes a failure to follow the required process.

Mergers between FICUs and Other Credit Unions

The last part of the proposed rule addresses procedures in mergers involving FICUs and other credit unions. Of note, in the situation where the net worth of the merging credit union is 500 basis points more than the continuing credit union, the merger plan must contain an explanation of the share adjustments, if any, and the factors considered to establish the amount.

NAFCU believes the above noted requirement is reasonable. We would like to specifically note that the proposal would not disallow a determination that a share adjustment is not necessary despite any differences in the net worth of the credit unions. It is important, we believe, that credit unions have the ability to make this determination.

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NAFCU appreciates the opportunity to comment on the proposed rulemaking. Should you have any questions or would like to discuss these issues further, please contact me at (703) 842-2234 or chunt@nafcu.org or Tessema Tefferi at (703) 842-2268 or ttefferi@nafcu.org.

Sincerely,

A handwritten signature in cursive script that reads "Carrie R. Hunt".

Carrie R. Hunt
Senior Counsel and Director of Regulatory Affairs