

# Cooperative Credit Union Association

Massachusetts • New Hampshire • Rhode Island

*Creating Cooperative Power*

September 22, 2015

Mr. Gerard Poliquin  
Secretary of the Board  
National Credit Union Administration  
1775 Duke Street  
Alexandria, Virginia 22314

Re: Cooperative Credit Union Association, Inc. Comments on Regulatory Review  
Pursuant to EGRPRA

Dear Mr. Pollard:

On behalf of the member credit unions of the Cooperative Credit Union Association, Inc. (“Association”), please accept this letter of comment regarding the National Credit Union Administration (“NCUA”) Board’s request for comments on regulatory review pursuant to the Economic Growth and Regulatory Paperwork Reduction Act of 1996 (“EGRPRA”). Collectively the Association is the tri-state trade association of Massachusetts, New Hampshire, and Rhode Island serving over 200 credit unions, who further serve approximately 2.6 million consumer members, and operates as part of the Credit Union National Association (“CUNA”).

The Association commends the NCUA for electing to participate in the EGRPRA review process, including developing its own regulatory categories that are comparable with those developed by the appropriate federal banking agencies (“Agencies”) and issuing a separate notice from the Agencies that is consistent and comparable, except on issues that are unique to credit unions. The NCUA is not considered an “appropriate federal banking agency” and therefore is not required to participate in the EGRPRA review, and the Association praises the agency for its commitment to the objectives of EGRPRA, most notably the identification of regulations that are outdated, unnecessary, or unduly burdensome.

Credit unions are subject to hundreds of regulations from a multitude of agencies. This level of regulation limits credit unions’ ability to serve their members. Regulatory compliance invites costs, in the form of staff time, data processing systems, administrative costs, and training. The funds that are allocated to regulatory compliance are diverted from the member service side, resulting in a reduction of the services offered to members. It is the observation of the Association that regulatory compliance is a major factor underlying credit union mergers and the current local trend amongst mid-size credit unions.

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In the Notice of Regulatory Review (“Notice”), the Board specifically mentions its sensitivity to the impact of agency rules on small institutions. The Board very recently approved a final rule and policy statement which updated the definition of a “small entity” under the Regulatory Flexibility Act to include credit unions with assets of up to \$100 million from \$50 million. This now exempts these credit unions from the interest rate risk rule. The Board also changed the asset size threshold in the recently released risk-based net worth proposal from \$50 million to \$100 million. The same approach was taken regarding emergency liquidity. The Association encourages the agency to continue this focus on smaller and mid-size credit unions whose resources are more limited to adapt to the volume of regulatory changes.

While these comments will address the three categories of regulations on which burden reduction recommendations are requested holistically, we would like to emphasize the disproportionate burden faced by small and mid-size institutions due to regulations. It is critical that the agency tailor its supervisory and regulatory requirements to reflect the complexity and risk of individual credit unions. Small and mid-size credit unions have business models, corporate structures, and risk profiles that are very different from other larger institutions supervised by the agency. A flexible approach that considers both size and risk profiles allows the agency to adjust the rigor and intensity of its supervision and supervisory expectations to each institution.

### **I. Review Process**

It is the position of the Association that credit unions suffer under substantially too many regulations, which place barriers in the way of their ability to fully and efficiently serve their members and leaves the financial system underserved. While NCUA’s voluntary participation in the EGRPRA review process is appreciated, an alternative approach is suggested to further simplify the review process. Since 1987, NCUA has reviewed one-third of its regulations each year in an effort to streamline, modernize, or, where appropriate, eliminate regulations. The intent behind this one-third review mirrors that of the review conducted under EGRPRA. It is suggested that one cohesive approach with standardized deadlines is more beneficial to both the agency and credit unions, rather than the piecemeal approach currently in place. Credit unions could have a centralized focus on advocacy and provide more holistic operational views of the impact of regulations. It would be more efficient and productive if the agency combined the one-third review with the EGRPRA assessment in the years that the agency participates in EGRPRA.

### **II. Directors, Officers and Employees**

**Reimbursement, Insurance, and Indemnification of Officials and Employees - 12  
CFR 701.33**

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Indemnification is a complex topic and is governed by various different bodies of law. In addition to the NCUA regulations and the state laws that apply to federal credit unions, federal credit unions are subject to the NCUA's model bylaws. The original model bylaws from the NCUA did not contain an indemnification provision. When in 2007 the NCUA revised its model bylaws to include an indemnification provision, there was not a mandate that all credit unions update their bylaws to reflect this change. Credit unions were allowed to retain the previously approved version of the bylaws. Therefore, any federal credit union that has not reviewed its bylaws since 2007 may not have any indemnification provision at all.

Additionally, the regulation is cumbersome. The rule prohibits indemnification in cases where a court determines the decision is one of gross negligence, recklessness, or willful misconduct, and which is in connection with the fundamental rights and interests of the credit union's members. "Fundamental rights" decisions are those related to changing the credit union's charter or share insurance status.

The credit union can, however, still advance funds or reimburse reasonable legal expenses in lawsuits the credit union considers meritless. In order to advance these funds, the credit union board must first investigate and make a good faith determination that the director acted in good faith and in a manner that the director believed to be in the best interest of the members, and that payment or reimbursement of expenses would not materially adversely affect the federal credit union's safety and soundness. Additionally, the official in issue must provide a written affirmation of his reasonable good faith belief that the relevant standard of conduct has been met, and must provide a written undertaking to repay the credit union for any funds advanced or reimbursed, to the extent not covered by insurance, if it is found that the official is not entitled to indemnification. Notably, this exception allows for advancement of expenses only; it does not allow indemnification.

The Association remains concerned with the scope, effects, and unintended consequences of the provision that prohibits indemnification. Per the regulation, a credit union may not indemnify its officials or employees for grossly negligent, reckless, or willful misconduct on decisions that affect the fundamental rights of its members. Such prohibition is excessive as the FDIC prohibits indemnification for bank directors under a "gross negligence" standard only when the bank is in conservatorship. As a result, the Association urges the NCUA to defer to state law for the scope of indemnification for a director's fiduciary duties.

The unintended consequence of the provision could discourage qualified individuals from assuming the director position because of personal liability. In addition, the provision further disadvantages the federal credit union charter compared to the state charter. Any limited tangible benefits for the prohibition on indemnification is significantly outweighed by the greater cost, uncertainty, and burden on federal credit unions.

These provisions are confusing, onerous, and open-ended for credit unions, all of which present implementation problems. Additionally, there are no similar companion provisions in corporate law for other similarly situated Boards of Directors.

Throughout the regulation, the Association remains extremely concerned about the additional regulatory burden imposed, the strength of the federal charter, and the chilling impact on potential candidates for the volunteer director position which is one of the most important hallmarks of the credit union movement.

#### **General Authorities and Duties of Federal Credit Union Directors - 12 CFR 701.4**

The regulation establishes a uniform fiduciary duty standard for federal credit union directors. 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 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 needs 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 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.

These initial requirements of a director create confusion for credit unions. First, the duty to act fairly and impartially without discrimination to members does not exist in corporate law and raises the question of whether credit union boards have sufficient guidance on how to fulfill this duty. In addition, while some decisions could be justified by a board because they make the credit union profitable and therefore the members "as a whole" are better off under this item, this suggests that a class of members can complain if they feel unfairly treated. Moreover, it suggests that a credit union cannot make decisions on behalf of one class of members over another. This could be problematic because in hindsight it may turn out that a decision only benefited a minority of members over a majority of members in a different class. Without the business judgment rule protection, a court (or jury) could second-guess this kind of result. Additionally, the duty to manage the credit union in conformity with the law and sound business practices raises similar questions of guidance.

The financial literacy requirement is vague and confusing and raises questions on how this requirement is enforced. While general corporate law would suggest that directors be qualified and certain stock exchange and Sarbanes-Oxley Act requirements mandate financial literacy on the audit committees, Sarbanes-Oxley only requires there to be one financial expert on the audit committee. The NCUA rules require the federal credit

union's entire board to be financially literate. Moreover, none of these corporate law standards turn financial literacy into a separate duty in and of itself. Making financial literacy requirements a fiduciary duty may broaden the scope of who can bring litigation and the potential consequences that might result from such a claim. This again raises the issue of the lack of clear guidance on how to fulfill the duty. Most importantly, federal credit union directors face an even higher burden compared to compensated bank directors and state chartered credit union directors.

In general, the requirements that directors should act in good faith in the best interests of their members, and administer the affairs of the credit union fairly and impartially, are consistent with existing state law fiduciary duty standards. While it may be valuable for federal credit union directors to have their existing fiduciary duties clarified, the Association believes the proposed approach of including these requirements in the regulation is redundant with existing state law fiduciary duties.

Additionally, the regulation as it stands adds additional duties to volunteer credit union directors. However, the duties are not fully defined, and insufficient guidance is provided to credit union directors to know whether they are meeting the standards.

### **III. Money Laundering**

#### **Bank Secrecy Act - 12 CFR 748.2**

The Bank Secrecy Act ("BSA") is primarily enforced by the Financial Crimes Enforcement Network ("FinCEN") under the Department of the Treasury. However, the NCUA continues to impose its own rules on federal credit unions under the BSA. Any duplication in requirements regarding the BSA goes to the continued regulatory burden that already exists on credit unions.

It is suggested that the NCUA work collaboratively with FinCEN and its colleagues to eliminate duplication in any area under the BSA. Additionally, it is requested that the NCUA explain all examination policies and priorities, particularly new ones, and provide the information in one "examination issues" location on the agency's website and in agency documents, such as letters to credit unions and examiner's guides.

Lastly, the NCUA should provide flexibility based on reporting requirements under the BSA. It is requested that the NCUA adjust the rule to allow for examiners to work individually with credit unions who are having reporting trouble to eliminate the need to elevate the issue immediately higher up the chain. This flexibility will benefit both the credit union, who likely seeks to rectify the issue, as well as the NCUA in terms of operating expenses.

#### **IV. Safe Harbor**

The Association encourages the agency to address safe harbor provisions wherever possible in existing regulations. At a minimum, a safe harbor should indicate that compliance with comparable agency provisions ensures compliance with the indicated rule where applicable. Additionally, good faith efforts in complying with rules should be taken into consideration in non-compliance situations. The agency should consider enforcement flexibility in potential non-compliance situations by credit unions. Such flexibility would protect good faith efforts to comply with new and potential conflicting responsibilities.

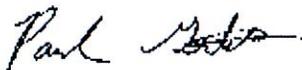
#### **V. Small Institution Exemption**

Lastly, the Association suggests that the Board consider small institution exemptions from regulations wherever possible. Small institutions, which it is suggested should be defined as those with less than \$100 million in assets, operate generally with very few employees, and are under acute pressure to remain in compliance with all applicable laws and regulations, while still providing valuable services and benefits to their members.

#### **VI. Conclusion**

Thank you so much for your consideration of these views. The Association appreciates the opportunity to provide input on such an important topic and I remain available to address any questions or concerns at (800) 842-1242 that you or your staff may have at your convenience.

Sincerely,



Paul Gentile  
President/CEO