

GC/JT:sg

SSIC 3701

89-0843

[ ]

FROM: Assistant General Counsel

Hattie M. Ulan

SUBJ: Proposed Nonstandard Bylaw Amendments

[ ]

(Your August 31, 1989, Memorandum)

DATE: September 12, 1989

You have asked for our comments on two nonstandard bylaw amendments requested by the above referenced FCU. We believe that the proposed amendments are inconsistent with the FCU Act, and should not be approved.

#### BACKGROUND

The FCU has requested that Article VI of its bylaws be changed as

follows:

1. By adding a Section 9 to provide:

The board may establish by resolution that a member may not be nominated to serve on the Board of Directors if the member has a blood relative and/or a relative by marriage who is or has been an employee of the credit union during the immediately preceding three-year period.

2. By adding a Section 10 to provide:

The board may establish by resolution that a former employee of the credit union whose employment was terminated involuntarily because of unacceptable duty performance is ineligible for nomination to and may not serve on the Board of Directors.

#### ANALYSIS

We have reviewed similar nonstandard bylaw amendment requests in the past and have recommended that they be denied. We have taken the position that, as a general rule, nonstandard bylaw amendments that affect eligibility to be elected to the board of directors are inconsistent with the FCU Act, and should be denied. Attached is a memorandum to Region II that fully discusses the basis for our recommendation that you deny the proposed amendments.

Attachment GC/MM:sg

SSIC 3701

89-0516

FROM: Assistant General Counsel

Hattie M. Ulan

SUBJECT: Reconsideration of Request for Nonstandard Bylaw Amendment,

Article VIII, Section I, [ ]

(Your May 4, 1989, Memo)

DATE: June 8, 1989

You have asked for our comments on a proposed nonstandard bylaw amendment ("the proposed amendment") to Article VII of the FCU Bylaws. The proposed amendment would alter Article VII by changing Section 1 to prohibit a former employee from serving on the board of directors for a period of two years after termination of employment. You indicated that you were inclined to approve the proposed amendment for safety and soundness reasons if we do not have problems with its legality. After reconsideration, we have determined that this nonstandard bylaw amendment is inconsistent with the FCU Act.

## BACKGROUND

This FCU has previously requested a nonstandard bylaw amendment to Article VIII which would have prohibited a former employee from serving on the board of directors for a period of two years following termination of such employment. The request was denied by Region II based on the concurrence of all the Regions and this Office. The FCU has now requested a change in Article VII which would achieve the same result -- a prohibition against former employees from serving on the board of directors for a period of two years following termination of their employment.

The FCU has requested that Section I of Article VII be changed as follows:

The board shall consist of nine (9) members, all of whom shall be members of this credit union; provided however, that none shall be or have been employed by the credit union officer or employee for a period of at least two (2) years prior to their election. The number of directors may be changed to an odd number not fewer than 5 no [sic] more than 15 by resolution of the board. No reduction in the number of directors may be made unless corresponding vacancies exist as a result of deaths, resignations, expiration of terms of office, or other sections provided by these laws. A copy of the resolution of the board covering any increase or decrease in the number of directors shall be filed with the official copy of the bylaws of this credit union. (Nonstandard language underlined.)

The FCU states that the purpose of this proposed amendment is for the safety and soundness of the credit union and to prevent conflicts of interest. The FCU also points out that the proposed amendment is the reverse of a standard amendment to Article VIII, Section 7 of the Bylaws that provides, in part:

. . . no director or committee member may be a paid employee of this credit union for a minimum of two years from the date the official terminates his/her position as a director or committee member unless the employee position to be filled exists as the result of a death or disability. (See p. 11 of NCUA publication 8001A.)

The stated purpose for this standard amendment is that it:

diminishes the possibility of "insider" dealings to take advantage of a position of authority. For example, it may prevent abuses such as the board of directors discharging the manager to create a vacancy for a credit union director to be hired. (See p. 11 of NCUA publication 8001A.)

## ANALYSIS

In addition to the standard bylaw amendment cited above (hereinafter referred to as the first standard bylaw amendment), there is one other standard bylaw amendment that applies to this issue. It provides that ". . . no director or committee member or members of the immediate family of a director or committee member may be a paid employee of this credit union." (See p.10 of NCUA publication 8001A.) This amendment (hereinafter referred to as the

second standard bylaw amendment) is permitted for purposes of internal control.

The FCU is correct in stating that the proposed amendment is the reverse of the first standard bylaw amendment. The first standard amendment places a limitation on a director's ability to become an employee of the FCU. Conversely, the proposed nonstandard amendment places restrictions on an employee's ability to become a director.

As you are well aware, it has long been our position that the only eligibility requirements for FCU board membership are those contained in the FCU Act and the Standard FCU Bylaws. That is, as long as an individual is a member (Section 111 Of the FCU Act) and has not been convicted of a crime involving dishonesty or breach of trust (Section 205(d) of the FCU Act), or if they have been convicted of such a crime the NCUA Board has waived the Section 205(d) prohibition, he or she is eligible to be elected as a director. Article VI, Section 7, of the FCU Bylaws permits the board to establish a minimum age of 16 to run for the board. Article VIII, Section 6 specifies that neither management officials nor assistant management officials shall be Members of the board. This amendment does not affect the eligibility to be elected to the board. If elected, management officials would have to choose between serving on the board or in a management (employee) capacity. NCUA has generally not granted nonstandard bylaws that affect eligibility to be elected to the board of directors.

The amendment sought by the FCU would prohibit an FCU employee from running for and serving as a director while he or she is working for the FCU and for two years thereafter. The second standard bylaw amendment permits an FCU to prohibit a director from being a paid employee of the FCU. NCUA has allowed this amendment since (1) it does not bar an individual from running for and serving on the board; it simply requires the individual to determine whether he or she wants to be a paid employee or a member of the board of directors; and 2) it promotes principles of sound internal control. The proposed amendment goes a step further from this standard amendment in that it continues the prohibition for two years after termination of employment. In our view, this prohibition is impermissible as it serves as an absolute, albeit temporary, bar against an FCU member running for and serving as a director during the two-year period.

The proposed amendment is distinguishable from the first standard bylaw amendment, which is a prohibition against a director serving as an employee. The first standard amendment does not limit eligibility for board membership.

We recommend you deny the request for the proposed amendment. The FCU may, of course, adopt any of the standard bylaw amendments.

As you are aware, while we do not believe that the FCU should be permitted to adopt this proposed amendment the FCU's nominating committee may consider the fact that an individual was an employee of the FCU in deciding against including the person as a nominee. This is inherent in the discretion given to the nominating committee by Article VI of the Bylaws.

We apologize for any confusion we may have caused concerning this nonstandard amendment. GC/JT:sg

SSIC 3701

89-0921

[ ]

FROM: Assistant General Counsel

Hattie M. Ulan

SUBJ: Proposed Nonstandard Bylaw Amendment

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(Your September 20, 1989 Memorandum)

DATE: October 6, 1989

You have asked for our comments on a proposed nonstandard bylaw amendment to Article X, Section 1 of the FCU Standard Bylaws. The amendment is legally permissible. We defer to your judgment as to whether it should be approved. We would note that it is consistent with the principles of internal control set forth in the Accounting Manual for FCU's.

#### ANALYSIS

The FCU submitted a proposed bylaw amendment to Article X, Section 1 of the FCU Standard Bylaws regarding appointment to the supervisory committee. The standard bylaw states, in part, that:

The supervisory committee shall be appointed by the board from among the members of this credit union, one of whom may be a director other than the financial officer.

The proposed amendment changes this sentence to provide:

The supervisory committee shall be appointed by the board from among the members of this credit union, with the exception of any director of financial officer. (Proposed amendment is underlined.)

While the standard amendment permits one board member, other than the financial officer, to be appointed to the supervisory committee, the proposed amendment would prohibit any director from being on the supervisory committee. The proposed amendment is legally permissible. We believe that it is also consistent with the principles of internal control. The Accounting Manual for FCU's at page 5-115 states that for purposes of sound internal control, neither a board officer, loan officer, membership officer or assistant treasurer shall be a supervisory committee member. The proposed nonstandard amendment extends the proscription to all directors.