Illinois
Credit Union League

Filed via regcomments@ncua.gov

July 26, 2017

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

***Re: Notice of Proposed Rulemaking on Voluntary Mergers of Federally Insured Credit Unions; RIN 3133-AE73***

Dear Mr. Poliquin:

The Illinois Credit Union League ("ICUL") is the primary association for nearly 300 state and federally chartered credit unions doing business in the State of Illinois, who in turn serve over 3.5 million consumers. We thank you for the opportunity to comment on the National Credit Union Administration ("NCUA") Notice of Proposed Rulemaking ("NPRM"), regarding the voluntary merger of federally insured credit unions. The NPRM details new or expanded requirements relating to the disclosure of financial incentives to certain officials and staff of the merging credit union that may present a conflict of interest with the best interests of the merging credit union's membership.

## I. The Changes to NCUA Rule 708b Should Not Be Made Applicable to FISCUs.

NCUA has invited comment on the desirability of also applying the proposed rule to federally insured, state-chartered credit unions ("FISCUs"). We do not support the extension of any of the merger-related provisions to FISCUs. Pursuant to NCUA Rule, Section 708b.101(b), a federally-insured credit union must already have the prior written approval of the NCUA before merging with any other credit union (12 CFR Part 708b.101(b)). That existing oversight and approval authorization is sufficient. FISCUs that are merging with or into another credit union should continue to follow merger-related state law requirements established by their prudential regulator and the existing NCUA Rule 708b provisions that apply to them. Any additional standards in the NPRM are an unnecessary encroachment on the supervision provided by the state regulator.

The recent trend of NCUA to use its status as a share insurer to expand its substantive rules to FISCUs ultimately adversely impacts the viability of the dual chartering system. The best safeguard against the threat of prospective merger partners seeking to influence a merging credit union by offering excessive financial incentives to management (which is the impetus for the current rulemaking), is an engaged and involved board of directors exercising sound business judgement - not more and more federal regulations forced upon state-chartered credit unions. There is no evidence that the boards of directors of merging credit unions in Illinois are failing to fulfill their duty to do what is in the best interests of their members with respect to merger terms. Nor is there any evidence that suggests Illinois' prudential credit union regulator, the Illinois Department of Financial & Professional Regulation ("IDFPR"), is failing to properly review and evaluate mergers involving Illinois credit unions.

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We now address the particular provisions of the NPRM.

## II. The Expansion of the Scope of Employees Covered by the Rule for Disclosure of Merger-Related Financial Arrangements is Appropriate, but the NPRM's Definition of Merger-Related Financial Arrangement is Overbroad.

### A. The Expansion of the Disclosure Requirement to a Wider Group of "Covered Persons" is Reasonable.

We support NCUA's proposal to expand the federal credit union ("FCU") disclosure requirement of merger-related financial arrangements from "senior management officials" and directors to the top executives of a credit union (limited to the chief executive officer and the four most highly compensated employees other than the CEO or manager), the board of directors and the supervisory committee. We believe this is an appropriately tailored way to address potential conflicts of interest for those persons who may have decision-making authority or influence in the merger review process of the credit union. NCUA reports that in recent voluntary mergers involving smaller credit unions, the current definition of "senior management official" (chief executive officer, assistant chief executive officer, or chief financial officer) is under-inclusive. We agree that limiting the definition to those executive titles may be under-inclusive in certain cases.

The NPRM requests comment on the option to further increase disclosure coverage to the top ten most highly compensated employees, or to all employees, but we do not support any further expansion of coverage. While the NPRM acknowledges that in very large credit unions the number of employees who may be able to influence the merger deliberation process may be higher than four, we feel that the expansion of coverage to ten (or all) employees for all mergers is unwarranted. For many smaller credit unions, disclosing the top ten highest paid employees would be the entire staff of the credit union.

### B. The Expansion of the Definition of "Merger-Related Financial Arrangement" is Overbroad.

The expansion of the definition of "merger-related financial arrangement" goes too far and would be unduly burdensome to FCUs. In its NPRM Section-by-Section Analysis, NCUA asserts the proposed expansion will "simplify compliance." To the contrary, we strongly believe it will complicate compliance for credit unions and force credit unions to provide irrelevant and confusing information to the members of the merging credit union.

We support the inclusion of forms of compensation that may be different in kind from the current definition of compensation, but we believe the materiality requirement of 15% or $10,000 in value should be retained to exclude those payments or financial benefits that are relatively small and unlikely to cause any potential conflict of interest. We also believe that NCUA should continue to apply the "but for" test to all compensation and only require disclosure of compensation that would be paid to a covered person solely because of the merger.

In that regard, although the Section-by-Section Analysis in the NPRM acknowledges NCUA's use of the "but for" test, the proposed definition of "merger-related financial arrangement" dramatically reduces the scope of its applicability. The second sentence of the definition makes the explicit reference "because of the merger", but limits its coverage to post-merger future compensation. That sentence adds to the underlying definitional standard established in the first sentence, and the first sentence creates a 24-month look back period that is devoid of any

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reference to the "but for" test.[1] As a result and as acknowledged in the NPRM, a compensation adjustment, no matter how small, made up to *two years* in advance of the merger and totally unrelated to the merger would be disclosed in the merging credit union member notice. Such a disclosure is irrelevant to the merger and is therefore overbroad and inappropriate. The existing use of the "but for" test for all compensation should be preserved and the proposed pre-merger/post-merger distinction should be discarded as an unnecessary and complicating factor.

In restructuring the definition to make it more precise, we also believe the "but for" test should be described in greater detail to avoid doubt as to its scope. In a typical merger, it is not unusual for the continuing credit union to maintain a salary and benefits program that is better than the program offered by the merging credit union. For example, if the continuing credit union elects to retain the financial officer of the merging credit union, that officer will likely receive a higher salary and more comprehensive set of benefits than he or she earned at the merging credit union.

Ostensibly that benefits package is offered "but for" the merger, because the better benefits package would not have been offered to the financial officer if the credit unions had not merged. But since it is offered as part of the overall salary and benefits program to all other similarly situated management employees of the continuing credit union, it does not signal a potential conflict of interest and should not need to be disclosed. The rule should provide guidance that excludes disclosure of benefits that are offered to other similarly situated employees of the continuing credit union. In other words, the scope of the "but for" test should be limited to financial incentives that go beyond the benefits offered to management of the continuing credit union as part of its regular salary and benefits program.

Based on the foregoing points, we do not support requiring a blanket disclosure of a 24-month look back period from the date of the approval of the merger of all increases in compensation or benefits of a covered person. We would support NCUA's examination of a look back period, if a potential conflict of interest has been disclosed for a particular covered person during NCUA's merger review.[2] However, we believe requiring disclosure of the 24-month look back period is overbroad and not narrowly tailored to assist in uncovering actual conflicts of interest. That is especially the case, given the overbroad structure of the definitional term "merger-related financial arrangement" noted above.

We support requiring disclosure of merger-related financial arrangements to be provided at a future date, not just at the time or very close in time to the merger, but only if the limitations and refinements discussed above on

[1] The first sentence of the proposed definition requires disclosure of "*any* increase in compensation or benefits that any covered person of a merging credit union has received during the 24 months prior to the date of the approval of the merger plan by the boards of directors of both credit unions." §708b.2 (emphasis supplied).

[2] The creation of a pre-merger/post-merger standard with no "but for" test for pre-merger compensation and no materiality standard will impact the frequent practice of the merging credit union board in providing a parting compensation payment to a long time management official or other staff person. The payment is in the nature of a "thank you" gift for loyalty, hard work and commitment during a career of service to the merging credit union. It is the merging credit union's last act to recognize staff with a token of appreciation. The determination of the amount of the payment is made in the exercise of sound judgment by the board of the merging credit union, with review and acceptance by management and the board of the continuing credit union. There is no need for pages of federal regulation to address it, because the gift is not presented as an enticement to merge. However, the proposed deletion of the "but for" test for compensation paid in the 24-month period prior to the merger would make non-disclosure problematic. Disclosure of the payment would then also require an explanation of the reason for the gift. The disclosure and explanation would be irrelevant and immaterial to the merger and complicate compliance, rather than simplify it.

materiality and the "but for" test are applicable. The expansion of the time period for a covered disclosure could help to reveal potential conflicts of interests caused by financial incentives agreed to at the time of the merger, but designed to spring into effect at a later date in order to avoid scrutiny at or close to the time of the merger.

## III. The Proposed Submission of Board Minutes Should Be Modified to be Less Intrusive and Burdensome to Credit Unions, While the Board Certification of Disclosure of Merger-Related Financial Arrangements is Appropriate.

We do not support the proposed requirement, as part of the merger package submitted to NCUA, of the credit union board minutes for those meetings that reference the merger during the 24 months preceding the date of approval of the merger plan by the boards of directors of both credit unions. We feel this requirement is overbroad and not narrowly tailored to accomplish the goal of uncovering potential conflicts of interest. To support this requirement, the NPRM cites an actual instance where a credit union chief executive officer voted on a merger proposal that included significant merger-related compensation for himself. The NPRM also states that the board minutes would be helpful to show alternatives considered by the credit unions in addition to the merger proposal. While these two scenarios do illustrate information that would be relevant to a merger investigation by NCUA, we believe that requiring a simple disclosure by the board of such information would be less intrusive and less burdensome than requiring two years of minutes of the meetings where the merger was discussed. Alternatively, the merger package submitted to NCUA could require a disclosure by the board as to whether any covered person who received a merger-related financial arrangement actually voted on the merger, and a disclosure of whether any alternatives to the merger were discussed.

We support requiring the boards of directors of the merging credit union and the surviving credit union to certify that there are no merger-related financial arrangements (assuming the definition of the term is clarified as discussed above), other than those disclosed to the members of the merging credit union in the member notice. Since the board of directors is the steward of the credit union and serves the best interest of the membership, it is appropriate to require evidence of board oversight through a certification that it has complied with the disclosure requirements designed to identify to the membership potential conflicts of interest by credit union staff or directors. However, if the board has certified compliance with the requirement in good faith and inadvertently omitted a merger-related financial arrangement, we do not believe there should be any penalty.

## IV. The Proposed Changes to the Membership Merger Approval Process.

### A. The Timeframe for Sending Member Notices Must Continue to Allow for a 7-Day Notice Period for a Special Meeting.

We believe that the NCUA should preserve the currently available option for an FCU to consider a merger proposal at a special meeting, requiring only 7-day notice. The NPRM proposes to increase the time for member notices to be mailed to members to at least 45 days but no more than 90 days before the meeting to vote on the merger. Currently, FCU Bylaws require mailing at least 30 days but not more than 75 days before the annual meeting. However, FCU Bylaws also currently allow only 7 days' notice before a special meeting. In addition, the NPRM's proposed 45-90 day timeframe is unworkable with the NPRM's proposed member-to-member communications process, as discussed in detail below.

We do not oppose the 45-90 day timeframe if the member-to-member communication process is eliminated and the 7-day notice period is still an option for a special meeting. We believe that the 45-90 day time frame is a reasonable one to inform the membership and give them an opportunity to seek and review merger information before the vote on the merger. However, there may be circumstances (as acknowledged in the NPRM), where a special meeting is required in order to address serious issues quickly, including circumstances where the merging credit union is in financial distress. In that situation, a credit union should have the option to choose a 7-day notice for a special meeting on the proposed merger.

**B. With Two Exceptions, The Proposed Changes to the Content of Notices to the Membership are Reasonable and Appropriate.**

We generally support the NPRM's proposed changes to the content of the merging credit union member notices set forth in NCUA Rule 708b.106(b). The proposed changes primarily address the format and understandability of the information presented to members, but do not impose any problematic substantive changes. However, we oppose the addition of a statement of the right of members to communicate with other members (proposed §708b.106(b)(3)), because, as discussed in Subsection IV.C. below, we oppose the proposed process for sharing member-to-member communications. We also oppose requiring a detailed description of all merger-related financial arrangements involving a covered person (proposed §708b.106(b)(4)(v)), based on the overbroad definitional structure of "merger-related financial arrangement" and blanket 24 month look back period discussed above. We have no objection to disclosure of merger-related financial arrangements, if the term is redefined to be more precise.

We have no objection to the additional requirement to list locations of branches of the continuing credit union. NCUA Rule 708b.106(b)(6). We are pleased the NPRM acknowledges the relevance of a local connection, by requiring identification of the continuing credit union's branches that are in reasonable proximity to the merging credit union's locations. If credit unions report practical difficulties in submitting the information in the format requested in the proposed rule, we encourage NCUA to revisit the requirement.

**C. The Proposed Process for Sharing Member-to-Member Communications is Ill-Advised and Unworkable.**

We strongly oppose the NPRM's requirement that credit unions share member communications with other members in writing, by mail or email. The purported rationale behind this requirement is the concern that members who do not attend the meeting do not benefit from the "rigorous debate" that may take place with members, management, and directors of the credit union. While the urge to support open debate on the merger by the membership is commendable, the method outlined in the NPRM will only serve to complicate or even completely halt the merger approval process.

First, the proposed process for addressing inappropriate content is lengthy and likely would interfere with the entire merger consideration and approval process, perhaps even rendering approval impossible. One need only look at social media or the internet to see the universal truth that people are much more likely to say inappropriate things in writing than they are in person. Requiring the credit union to submit every member submission with inappropriate content to the NCUA Regional Director for review is likely to overwhelm or completely subvert the merger approval process.

The very list of inappropriate content provided in the NPRM is a perfect illustration of what unfortunately can be reasonably expected to be received from some members. The list includes communications that:

- are false or misleading with respect to any material fact;
- omit a material fact necessary to make the statement in the material not false or misleading;
- relate to a personal claim or personal grievance, or solicit personal gain or business advantage by or on behalf of any party;
- relate to any matter, including a general economic, political, racial, religious, social, or similar cause that is not materially related to the proposed merger;
- directly or indirectly and without expressed factual foundation impugn a person's character, integrity, or reputation;
- directly or indirectly and without expressed factual foundation make charges concerning improper, illegal, or immoral conduct; or
- directly or indirectly and without expressed factual foundation make statements impugning the safety and soundness of the credit union.

Policing the member communications for such content would be unduly burdensome on the credit union, who must determine what to submit to the NCUA Regional Director for consideration. Further, the review process timeframe requires the credit union to submit communications to the Regional Director within 7 days of receiving the communication, and then the Regional Director has 7 days to review it. Regardless of whether this timeframe is even practicable for either the credit union or Regional Director (and we submit that it is not), it is completely impracticable when paired with the 30-day comment request period proposed for these member-to-member communications.

An example, acknowledged by the NPRM, clearly illustrates that the member-to-member communication timeframe is unworkable. The NPRM would allow a member to request sharing the member-to-member communication within 30 days of receipt of the notice of the meeting to vote on the merger. Under the new proposed 45-90 day timeline, a meeting could be scheduled for 45 days from the notice, then a member could request a member-to-member communication on Day 30 of that 45-day notice period. If the communication has any content that may be inappropriate as set forth above, the credit union has 7 days to submit to the NCUA Regional Director who in turn has 7 days to consider whether the communication should be sent at all. If at the end of that combined 14-day period the Regional Director determines that the communication should be sent it would be only 1 day prior to the vote on the merger. To deal with this impossible situation, the NPRM suggests that members be encouraged to request member-to-member communications early in the 30-day period. That proposed solution is wholly insufficient and it is unfair to credit unions to impose an unworkable process on what is already a labor-intensive process.

The NPRM acknowledges that the proposed member-to-member communication process "may result in additional administrative burdens" on the merging credit union but is the "least restrictive means to achieve the compelling objective of ensuring that members vote on a proposed merger with all information reasonably available to them." That "compelling objective" of an adequately informed membership is already met by Board oversight of the credit unions during the merger process and the existing requirements for member disclosure, further enhanced by the opportunity to attend the meeting on the merger vote. There is no showing of abuse or a need for a written member-to-member communication process in order to maintain the integrity of the membership approval process.

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**D. The Majority Vote Required to Approve Merger Should Remain a Majority of Members Who Vote, Not a Majority of the Entire Credit Union Membership.**

We vigorously oppose requiring a majority vote of the entire membership of the merging credit union to approve the merger, instead of the current requirement of the majority of the members voting on the merger. The credit union cannot control voter turnout for a merger vote and should not be penalized if a majority of the membership does not vote on approval of the merger. There is nothing broken with the current voting standard and it should be maintained.

**V. Conclusion.**

We support NCUA's efforts to create more precision in the process by which the membership of a merging credit union votes to approve a proposed merger. However, we do not support requirements that would place an undue burden on credit unions in the merger approval process or generate disclosure of immaterial or irrelevant information to the merging credit union membership. Credit unions already suffer under an avalanche of rulemaking since the financial crisis and recession, which, ironically, has fueled many of the mergers that are the subject of the NPRM. All regulatory requirements on credit unions should be narrowly tailored to accomplish their salutary purpose, but not add to the already overwhelming compliance and regulatory burden borne by credit unions every day. We thank you for your time and consideration.

Sincerely,

ILLINOIS CREDIT UNION LEAGUE

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