NASCUS
National Association of State Credit Union Supervisors

August 7, 2017

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

Re: NASCUS Comments on Voluntary Mergers of Federally Insured Credit Unions

Dear Secretary Poliquin:

The National Association of State Credit Union Supervisors ("NASCUS"), the professional association of the state credit union regulatory agencies and the nation's state credit union system, submits the following comments in response to the National Credit Union Administration's ("NCUA's") proposed changes to Part 708b regarding voluntary mergers of federally insured credit unions.[1] As detailed in our comments that follow, we oppose the application of the proposed changes in Part 708b to federally insured state chartered credit unions (FISCUs). Furthermore, we believe that the proposal should have been published as an Advanced Notice of Proposed Rulemaking (ANPR) rather than as a proposed rule given the uncertainty of the proposal's applicability to FISCUs.

Finally, as a general matter, NASCUS questions whether the proposed rule is properly tailored, particularly with respect to FISCUs. Since January of 2014, there have been over 700 voluntary mergers of federally insured credit unions.[2] It is unclear from the proposed rule how many of those voluntary mergers involved problematic conduct requiring additional rulemaking. There is certainly no evidence offered to support the proposition that past conduct with respect to mergers presents so high a risk as to justify the preemption of state merger rules.

State Law and State Regulation Dictate Governance for FISCUs

With respect to a FISCU, NCUA's sole concern should be mitigating risk to the National Credit Union Share Insurance Fund (NCUSIF). In the absence of any clear and compelling nexus between the activity being regulated and risk to the NCUSIF, NCUA

[1] 82 Fed. Reg. 26605 (June 8, 2017).
[2] Strozniak, Peter, Credit Union Mergers Keep Falling, *Credit Union Times* (May 19, 2017). Available at http://www.cutimes.com/2017/05/19/credit-union-mergers-keep-falling.

should defer to state law. Nowhere in the preamble to the proposed rule does NCUA articulate a NCUSIF risk that would compel extension of this proposal to FISCUs.[3]

When two state-chartered credit unions merge, NCUA's proper role is to ensure the surviving institution is sufficiently capitalized and managed so as to absorb the merged credit union without posing a material risk to the insurance fund: continued insurability. If the surviving credit union is safe and sound, the motive of the merged credit union should be irrelevant to NCUA as the share insurer. It is for state regulators to decide whether a board decision to merge was invalidly influenced. Most states have the ability to collect compensation information and many states in fact collect such information in the course of reviewing a merger proposal. As the chartering authority, that is proper.[4] Whether that information is reviewed by the chartering authority and/or provided to the members is a policy decision for the states.

With respect to transparency, FISCUs are already subject to more extensive disclosure requirements than their federal counterparts. All FISCUs must complete annual Internal Revenue Service Form 990 filings. Part VII of those filings is public and requires FISCUs to disclose ***any*** compensation paid to directors and officers; the compensation paid to "key employees" (employees earning more than $150,000.00 in reportable compensation; and "highly paid" employees (the top 5 employees earning more than $100,000.00 in reportable compensation).[5]

Issuance of an Advanced Notice of Proposed Rulemaking (ANPR)

As a procedural matter, this proposed rule should have been issued as an ANPR, particularly with respect to its application to FISCUs. On its face, the proposal as published is unclear as to what exactly NCUA proposes to apply to FISCUs. On page 26606 of the *Federal Register* notice NCUA observes that problems could arise out of undue influence exercised in a merger involving a FISCU and seeks comments on whether the proposed rule should be extended to cover state charters.

Because NCUA is proposing changes to Part 708b beyond expanded compensation disclosure, it is not clear if the extension of the proposed rule to FISCUs refers exclusively to the compensation disclosure, or to the voting requirements and member to member communication provisions as well. This lack of clarity in the proposal puts the state system at a disadvantage evaluating the rule.

Even if it is presumed that NCUA intended to extend not just the compensation related provisions, but the additional provisions in the proposal to FISCUs, questions remain as to which of the additional provisions would apply. Currently, NCUA's merger rule

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[3] NCUA states "Offering financial incentives to management and certain highly compensated employees of a merging credit union to support a merger may present safety and soundness risks, as well as member protection issues…" without expanding on what those specific safety and soundness issues are. Id. 26606.
[4] In cases involving merger between a state and a federal credit union, NCUA has the authority to require the federal credit union to disclose the offer or receipt of compensation related to the merger.
[5] See Internal Revenues Service Form 990 Instructions. Available at https://www.irs.gov/instructions/i990/ch02.html.

applies to FISCUs by way of incorporation in Part 741.208. This provision instructs FISCUs to comply with "applicable requirements of Section 206 of the [Federal Credit Union] Act and Parts 708a and 708b" of NCUA's rules. Within Part 708b, section 708b.106 does not apply to FISCUs, nor does Part 708b.104(a)(4) and (a)(5). Whether NCUA's proposal intends to now apply those to FISCUs is muddled at best.

Problematic Provisions within the Proposed Rule

Our concerns with the proposed rule are not limited to the unnecessary preemption of state governance authority. Numerous specific provisions are problematic in their own right. As detailed below, we are concerned that several proposed changes, while well intended, will prove more problematic than productive.

- Proposed §708b.2 would expand the definition of covered persons to include the 4 most highly compensated officials after the credit union's CEO.[6] There is no asset size threshold proposed, therefore this provision could lead to the disclosure of all the employees of some modest sized credit unions. Whether the benefits to governance outweigh the invasive nature of a result are dubious.

  NCUA also proposes dramatically expanding the scope of compensation that must be disclosed. The text of the proposed rule requires "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. It also means any increase in compensation or benefits that any covered person of a merging credit union will receive in the future because of the merger."[7] As a result, only compensation received after the merger is subject to the limiting "but for the merger" test. All compensation increases, whether related to the merger or not, received in the 24 months prior to the merger is required to be disclosed. This is too broad.

- Proposed §708b.105 amends the current merger disclosure provisions to require submission of the previous 24 months board minutes that reference the merger.[8] NCUA asserts the submission of the board minutes helps NCUA understand "the types of alternatives considered by the credit unions in addition to the merger proposal."[9] NCUA, and state regulators, have unlimited access to a credit union's books and records, including board minutes. Should specific facts or events so warrant, both NCUA and the state may require submission of additional information. Using that approach is more targeted supervision than an overly broad requirement that all mergers submit the minutes going back 24 months.

  Furthermore, with respect to the submission of board minutes, as the share insurer for FISCUs, NCUA should have minimal concern with "alternatives considered by the credit union."

[6] 82 Fed. Reg. 26613 (June 8, 2017).
[7] Ibid.
[8] Ibid.
[9] Id. at 26608.

- Proposed §708b.106(d) creates a member-to-member communication mechanism to empower dissenting members wishing to persuade their fellow members to oppose the proposed merger.[10] Even a casual perusal of social media in today's environment would indicate the potential problems that could ensue by mandating credit unions send communications on behalf of members. In fact, NCUA envisions the problems, listing a litany of prohibited communications:

  - ✓ 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

  Proposed §708b.106(f) provides that the credit union may not alter a member message, only submit it to the NCUA Regional Director (RD) for review. The RD will then determine whether the member communication is appropriate to send or not. We are concerned about the practical operation of this provision. For one, if the RD rejects a member communication, the proposal implies that the credit union would communicate with the member to provide notice that the message had been rejected. This seems to be adding fuel to the fire of a presumably already disgruntled member.

  If a requested communication is deemed inappropriate, NCUA should communicate that fact to the member at the credit union's request.

  Another concern regards the timing of the member communication. Per the proposed rule, credit unions have between 45 and 90 days to notify the members of the vote on the proposed merger. Members in turn have 30 days from receipt of the notice to exercise the proposed right to send a member-to-member communication. The process of having a member communication vetted by the RD can take up to 14 days.[11] As a result, the member-to-member communication process itself could take 45 of the 45 to 90 day window. Such a tight timeframe is unrealistic.

[10] Id. at 26614.
[11] Credit unions have 7 days to evaluate a member message to identify any concerns to be vetted by the RD. The RD in turn has 7 days to make a determination. See proposed 12 C.F.R. 708b.106.

A third issue relates to the desire of members to receive a communication, or respond to one. The proposed rule is silent as to whether credit union members should have the ability to opt-out of communication from their fellow members. While the proposed rule addresses the permissible steps the credit union may take in response to a member message, it provides no guidance for managing the foreseeable consequence of a member-to-member communication: that a recipient member wishes to respond with a counterpoint to their fellow members. The proposal considers member recipients wishing to respond to the credit union or the sending member, but not the possibility that a recipient member wishes to respond to the entire membership.

NCUA should more carefully consider whether the potential for acrimony among members is outweighed by the marginal benefit of compelling the credit union to send unsolicited member communications to other members. Ultimately, it is the credit union's reputation at risk in member-to-member communications. Disclaimers aside, members receiving and unwanted communication will lay blame on the credit union as the transmitter of the communique.

As the chartering authority for federal credit unions, the rights of federal credit union members is a legitimate concern for NCUA. Furthermore, in the merger of a federal credit union and a FISCU, NCUA is well within its chartering authority to require merger related compensation disclosure as a prerequisite for allowing the federal credit union's participation in the merger. However, NCUA should not directly intervene in FISCU governance with this proposed rule. Exempting FISCUs from the application of this proposed rule would be more consistent with NCUA's call for "enlightened right-sized" regulation.[12]

We would be pleased to discuss these comments in detail at NCUA's convenience.

Sincerely,

- *signature redacted for electronic publication* -

Brian Knight
Executive Vice President and General Counsel

[12] Remarks of NCUA (then) Boardmember J. Mark McWatters, CUNA GAC (2016). Available at https://www.ncua.gov/newsroom/Pages/speeches/2016/speech-2016-feb-mcwatters-remarks.aspx.