MICHIGAN CREDIT UNION LEAGUE & AFFILIATES

August 7, 2017

Gerard Poliquin
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428

Re: Comments on Voluntary Mergers of Federally Insured Credit Unions – RIN 3133-AE73

Dear Mr. Poliquin:

The Michigan Credit Union League (MCUL) the statewide trade association representing 100% of the 243 credit unions located in Michigan and their 5 million members appreciates the opportunity to comment on the National Credit Union Administration's (NCUA) Notice of Proposed Rulemaking on Bylaws, Bank Conversions and Mergers; and Voluntary Mergers of Federally Insured Credit Unions.

Since the 1960's, there has been a long trend of consolidation that has driven down the number of community based financial institutions, including credit unions in Michigan and across the nation. These mergers particularly impact small asset sized (SAS) credit unions, which with great frequency are the institutions being consolidated or merged. This consolidation has continued for a wide variety of reasons, including the perceived economies of scale attendant with larger institutions; a desire to provide members with a wider range of financial products and services; the ever-increasing regulatory burdens, especially those from federal agencies; and the challenge of replacing a long-time, retiring CEO with a qualified replacement at the level of compensation able to be borne by the credit union. The NCUA takes note in its commentary to the proposal that credit unions are experiencing a period of significant consolidation where much of the consolidation is occurring through voluntary mergers.

The MCUL acknowledges this and understands this consolidation is certainly part of the industry life cycle for credit unions and community banks alike. Faced with a trend that no one in the credit union community is pleased with, it's perplexing that rather than working to address the underlying causes of consolidation (reducing regulatory burden, scaling regulatory requirements for SAS credit unions, etc…) the NCUA has chosen to propose a rule that appears to be designed to increase the regulatory burdens associated with mergers.

The MCUL spoke with Michigan credit unions, including SAS credit unions and larger asset sized credit unions that had seen significant merger activity over the previous three years as the merging credit union in order to assess the impact the proposal would have on credit unions of varying size and complexity

The following comments are a result of this feedback as well as concerns the MCUL has identified within the proposal.

At the outset, credit unions of all sizes challenged the NCUA to provide information to the industry regarding the number of problems that resulted in the development of this proposal. Out of the thousands of credit unions and hundreds of mergers over the last several years, how many exactly had problems associated with the disclosures that the NCUA staff detected? Undoubtedly there were a very small handful of situations in which less than complete disclosures were made. If this was the case, the NCUA needs to seriously assess the wisdom and propriety of dealing with these situations as candidates for broad-based rulemaking rather than handling the problem credit unions on a case-by-case basis.

In fact, if there were only a few notable cases that drove the development of this proposed rule, it crystalizes the problem with what we now understand about the rule-making process—which proves it is out of control. Rather than dealing with specific credit unions that engaged in specific bad behavior as part of a merger process in which the NCUA has an incredible amount of leverage, the reflexive answer is yet another broad-based rule. Ironically, this rule deals with mergers, which increasingly are driven by regulatory burden as dedicated SAS credit union CEO's decide to opt to leave the movement rather than continuing to fight against an unstoppable tide of federal regulations that inevitably disproportionately burden smaller institutions.

I. Disclosure of Merger-Related Financial Arrangements

General Comments on the Compensation Disclosure Approach

The approach envisioned by the NCUA would seriously undermine the democratic, representative governance model embedded in the Federal Credit Union Act and state laws around the country.

Members elect Board members to run the credit union. Board members have a series of duties and obligations under law, including hiring and providing oversight to the CEO. Board members always retain a fiduciary obligation to the credit union.

The framework proposed by the NCUA amounts to placing the compensation packages of the CEO and senior management up for review and approval by the general membership. Effectively displacing the credit union board in this way serves no purpose other than to embarrass and violate the privacy of the CEO and senior managers in the vast majority of merging institutions in which no conflicts of interest have been presented or detected.

Definition of Covered Person

The NCUA is proposing to expand the definition of covered person to the CEO or manager and the four most highly-compensated employees of the credit union other than the CEO or manager as well as any member of the Board of Directors or Supervisory Committee.

Per discussions and feedback from a number of SAS credit unions in Michigan (under $50mm) the expansion of the definition to the four most highly-compensated employees would ultimately encompass the entire staff of these credit unions and would lead to over-disclosure. These small credit unions would be forced disclose the salary of everyone, including tellers and non-exempt staff. A significant point of concern shared by the majority of small credit unions that participated in our focus group was that disclosing such salary information to membership, in the smaller communities in which a number of these credit unions serve, could be used in a derogatory manner towards an employee of the credit union and will ultimately circumvent the privacy of employees.

Our credit unions—regardless of size—had fundamental concerns with the propriety of releasing credit union salary data. This would be especially damaging in small towns and communities where many SAS credit unions are located. Providing friends, family and neighbors this salary information would violate their privacy with little appreciable benefit to the credit union, which the staff frequently have spent their professional lives dedicated to nurturing and growing.

Merger-Related Financial Arrangement

The NCUA is proposing to eliminate the current materiality requirement for increases in compensation of 15% or $10,000 in value and instead is proposing a broad and albeit ambiguous requirement of “all increases in compensation or benefits that a covered person has received during the 24 months prior to the date of the approval of the merger plan by the boards of both credit unions. This would include all future compensation or benefits that would not be received “but for” the merger taking place, regardless of the amount. In addition, the NCUA would reserve the right to review any future compensation paid to a covered person of the merging FCU by the continuing credit union for an unknown period of time.

The proposal’s expansion of the definition of “compensation” to include all compensation and or benefits received in connection with a merger including early payout of pension benefits and increased insurance coverage is cause for concern among credit unions of all sizes. However, this is a particular area of concern for smaller credit unions merging into a medium or larger asset size credit union. A small credit union merging into a larger credit union is likely to see a better benefits package. Presumably the benefits package is offered “but for” the merger as the better package would not have been offered to the smaller credit union had the credit unions not merged.

Credit union employees, like the credit union members, are stakeholders in the credit union. Where a merging credit union’s employees are provided a standard, but more generous benefits package, this should not trigger disclosure obligations. It’s no secret that larger credit unions frequently offer better salaries and benefit packages than what one would find in a typical SAS credit union. They often also are able to offer a wider variety of products and services. Requiring the disclosure of salaries and benefits without the more complete context of the benefits of a merger may result in members unfairly thinking that the pecuniary interests of covered persons is the primary driving factor in the combination.

One of our small credit union CEOs offered the following example of his concern with this particular provision; If a credit union CEO has opted out of the credit union's insurance plan and at the point of the merger elects the new insurance plan offered by the merging credit union this would immediately trigger disclosure as it would show a 100% or greater increase in compensation to the CEO, or other employees for that matter. This type of increase is certainly not material to the merger and should not be disclosed. 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.

II. 24-Month Regulatory Lookback Period and Look Forward Period

The MCUL does not support the proposed 24 month historical lookback period. The NCUA is proposing to require merging FCUs to disclose all increases in compensation or benefits made during the 24 month lookback period, regardless of whether that increase was made because of the merger. The NCUA indicates this will help "avoid undue hardship on merging FCUs." The MCUL believes that this is overreaching and is not narrowly tailored to uncover potential conflicts of interest in a merger. The NCUA has complete access to all board minutes during examinations of the credit union.

In addition, if the NCUA wishes to have enhanced disclosures, members should be instructed, as part of the democratic process through the election of the credit union board members, that the credit union Board is making the decisions in the best interest of the credit union and ultimately for the membership so the membership should choose wisely when electing directors.

There is also no stated time period governing the regulatory look-ahead of future compensation paid after the merger has taken place, which also begs the question of the NCUA, what might the remedy be, if any, if the NCUA determines compensation paid after a merger must be disclosed and what purpose would this serve given that the merger is complete at this point? Credit unions would ultimately be faced with the burden of proof as to whether or not any regular bonus paid or any other compensation has been received as part of the merger.

III. Member to Member Communication

The NCUA is proposing to include provisions for member to member communication similar to the approach used by the NCUA for credit union conversions to a bank charter. The assumption that there needs to be a rigorous debate among members similar to the credit union to bank conversion is parochial. The NCUA is neglecting to recognize that the majority of voluntary mergers have been to expand services to the membership of both credit unions, as identified in the NCUA's Insurance Reports of Activity.

The MCUL would like to take the opportunity to address first the issue of timing outlined in the proposal. Looking at the minimum deadlines currently provided in rules and bylaws, the new deadlines do not appear to mesh with the existing framework.

Under current 708b.105 and the FCU Bylaws the notice requirements are:

708b.105 Annual Meeting: 60 days after NCUA approval or at a special meeting called with 60 days of NCUA approval

Article IV – FCU Bylaws– Meetings of Members: At least 30 days but no more than 75 days before the date of the annual meeting or at least 7 days before the date of a special meeting.

Proposed: 45 days but no more than 90 days, before the meeting to vote on the merger

Member to Member Communications: Members must submit comments within 30 days of notice of the meeting to merge and credit unions must notify all members of communications received no later than 15 days before the membership vote.

So if a credit union, per the NCUA requirements, provides the required disclosures 45 days prior to the membership meeting, a member would have the right to submit comments within the next 30 days after receipt of the proposed merger. If a member wanted to submit comments but waited until day 30 to do so, the credit union would have up to 7 days to review and research their assertions and then submit them to the NCUA regional office, which would have an additional 7 days to review and make a determination, meaning the if each in turn took the 7 days provided under the proposed rule that the member communication would go out on day 44, one day prior to the meeting to vote on the merger. How can a credit union distribute member communications on day 44 and still comply with the requirement that they be sent at least 15 days prior to the membership meeting?

For credit unions that had their member email addresses for distribution of these comments, this would be cutting it close. For those requiring US postal service delivery, this seems wholly unworkable, as the mail would be delivered after the vote.

While the NCUA acknowledges within the proposal that the timing could be problematic it merely offers the remedy of suggesting that the credit union discern that comments will be forthcoming and extend voting dates if there is a concern that a member(s) may wish to make a member-to-member communication. In addition, the proposal suggests that a member should provide the communication as soon as possible to the merging credit union. However, there is no requirement for a member to communicate as quickly as possible and under the current proposed framework, any such communications would very likely delay the merger vote.

Additionally, the credit union is required to distribute the communication to all members, proving an additional burden, especially to those members who do not receive electronic communications. Mailing communications is costly, and while the proposal states the member is to pay for such distribution the credit union is tied to timing constraints on distributing the member communication back to the voting membership and ultimately may never recover the costs from the members. If the NCUA is set on such a communication process they should facilitate other methods for communication via website and other electronic channels.

What if several members wish to comment? Will these be aggregated or will each require a separate member communication?

Of most significant concern to Michigan credit unions as it relates to the member to member communication is a credit union's inability to provide supplementary information to contextualize member comments received that are false, misleading or inflammatory in any way. Such arguments are left to the NCUA regional director which are to be reported to the regional director within 7 days of receipt of the communication if the credit union believes the communication to be false or misleading. Again, the credit union must still distribute the comments received, as is, within the 15 days before the membership vote and can make no comments without approval of the regional director or the director of the office of national examinations and supervision (for those credit unions with assets in excess of $10bb.)

The MCUL strongly encourages the NCUA to assess the timing and impact of this communication.

IV. Proposed Changes to NCUA Rule 708b Should Not Be Applicable to Federally Insured State Chartered Credit Unions

The NCUA is seeking comment from the industry on whether the proposed rule should also apply to merging Federally Insured State Chartered Credit Unions (FISCUs). In the request the 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 risk, as well as member protection issues, which endanger the continuing credit union regardless of whether the merging credit union is a Federal Credit Union (FCU) or federally insured, state-chartered credit union."[1]

The MCUL does not support the extension of any merger related provisions to FISCUs. Pursuant to NCUA's 708b.101 (b) a federally insured credit union must already have prior written approval from the NCUA before merging with another credit union. [2] This requirement is sufficient, particularly given that FISCUs are subject through a thorough merger application and approval process with Michigan's Department of Insurance and Financial Services (DIFS) their prudential regulator. Any additional standards imposed upon a FISCU would be encroachment on supervision of the prudential state regulator.

The NCUA is proposing to extend its rulemaking to FISCUs under the guise of risk to the share insurance fund. The recent trend of NCUA to use its status as a share insurer to expand its rules to FISCUs 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

[1] Federal Register Vol. 82, No. 109, Thursday, June 8, 2017, p. 26606
[2] Federal Register Vol. 70, No 14, January 24, 2005, p. 3288

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 additional federal regulations forced upon state-chartered credit unions.

The state of Michigan has a progressive state charter with sixty percent of credit unions chartered under the state. Corporate governance and litigation is dealt with at the state level through state law. If the NCUA were to extend such requirements to FISCUs it would ultimately be co-opting the corporate governance structure under the guise of safety and soundness.

Furthermore, in the proposal, the NCUA does not specify the number of credit union mergers identified for cause in issuance of such a proposal. The proposal merely states “recent merger trends” and “some credit unions” as the rationale behind this proposal. This proves ambiguous. A review of the NCUA’s Monthly Activity Reports – Insurance Related Activity, further provides further skepticism as to the necessity of this proposal as the majority of voluntary mergers over the past three years, indicates the rationale behind the mergers were for the expansion of services to the membership of both credit unions.

V. Regulatory Procedures

3. Executive Order 13132

Executive Order 13132 encourages independent regulatory agencies to consider the impact of their actions on state and local interests. The NCUA concludes:

The final rule does not have substantial direct effects on the states, on the relationship between the national government and the states, or on the distribution of power and responsibilities among the various levels of the government and has therefore determined that this final rule does not constitute a policy that has federalism implications for purposes of the executive order.

The MCUL disagrees, as addressed in our previous comments regarding an extension of the rule to Federally Insured State Chartered Credit Unions. Such an extension of authority would ultimately preempt state law and an Agency cannot promulgate rules under E/O 13132 that would preempt state law or a rule with substantial direct compliance costs on state and local governments not required by statute. [3]

Conclusion

The MCUL appreciates the opportunity to comment on this proposed rule. However, we would strongly encourage the NCUA to evaluate the ultimate impact such a rulemaking would have upon credit unions, particularly small credit unions. Small credit unions are faced with the amount of regulatory burden with voluntary mergers being the only means of survival to remain competitive and relevant and continue to serve their members with high quality products and services they

[3] Federal Register, Vol. 64, No. 153, Tuesday, August 10, 1999

demand. With so much additional burden from the credit union regulator it appears as though the NCUA is now discouraging voluntary mergers. If the regulatory burden from the NCUA and other regulatory bodies would decrease, instead of increase, there would not be as many mergers as the pressure from the top down would not be as strong.

If the NCUA wishes to encourage additional disclosure to members during a merger the NCUA should recognize and promote disclosures including the value to the credit union membership, additional products and services, enhanced technology and more locations to meet their needs to name a few. If credit unions are seeking to merge to meet such member needs they should not be discouraged from doing so or distracting the membership from what the benefits to them will be because “recent merger trends” and “some credit unions” have been cause for concern.

The MCUL appreciates the NCUA’s efforts for process enhancements for the membership during the merger process, however, we do not support requirements that would add to the regulatory burden credit unions are continuing to face. Credit unions are constantly challenged by the mountain of regulation and rulemaking issued since the financial crisis, which, as previously discussed, has fueled the consolidation of the industry through voluntary mergers, the very basis of this proposed rulemaking. The NCUA should not be taking a one-size fits all approach with this proposal as would ultimately do more harm than good to credit unions in an already difficult and ongoing era of regulatory burden.

Sincerely,

Dave Adams
CEO, Michigan Credit Union League and Affiliates