The Wisconsin Credit Union League

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Submitted electronically via *www.regulations.gov*

Aug. 7, 2017

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

Re: Notice of Proposed Rulemaking on Bylaws, Bank Conversions and Mergers; and Voluntary Mergers of Federally Insured Credit Unions
RIN 3133–AE73

Dear Mr. Poliquin:

On behalf of Wisconsin's credit unions® and their nearly 3 million members, The Wisconsin Credit Union League (the League) appreciates the opportunity to comment on the NCUA's Notice of Proposed Rulemaking (NPRM) on Bylaws, Bank Conversions and Mergers; and Voluntary Mergers of Federally Insured Credit Unions.

We generally support any NCUA regulatory policies that facilitate a voluntary merger when two credit unions determine that it is in their members' best interests. However, we cannot support this NPRM, which would 1) impede voluntary mergers with unnecessary and burdensome regulatory requirements and 2) leave a host of unanswered questions that could render the rule unworkable. One of our credit unions shared its thoughts with us about this NPRM:

> It is credit union management's fiduciary responsibility to fully and fairly disclose material items. Also, credit unions should always be in favor of effective transparency. Yet, what is the balance between effective information and burdensome and disregarded stacks of information? NCUA has good intentions, but might be swinging the pendulum a tad too far in the other direction on some points in this regulation.

We agree. We believe that this NPRM should be withdrawn and that the NCUA should seek other avenues to address its concerns about the merger process without imposing burdensome new regulatory requirements.

The NCUA merger rules should not apply to FISCUs

The NCUA has asked for comments on whether the proposed rule should also apply to merging federally insured state chartered credit unions (FISCUs) in addition to federal credit unions (FCUs). We see no reason to expand the NCUA rules in this way.

The Wisconsin Office of Credit Unions is best suited to oversee the mergers of state-chartered credit unions, because it is in the best position to understand local issues, trends, and needs. The Board has included no data in the NPRM to suggest that state regulators have somehow failed to regulate FISCU mergers properly in Wisconsin or in other states. Without a compelling reason, we see no justification for the NCUA to expand its substantive regulations and infringe on the dual chartering system.

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Nor has the Board included data to suggest that the directors or management of Wisconsin state-chartered credit unions have somehow failed to honor their fiduciary duties to act for the benefit of their members and not for personal gain. We simply see no justification for the NCUA to supplant the sound business decisions of state-chartered credit unions' managers and directors.

Regulatory burden is a primary driver of credit union mergers

Before addressing this proposal on its merits, we want to stress an overarching issue – the impact of federal financial regulations on the rate of credit union mergers.

Alarmingly, the number of Wisconsin state-chartered credit unions has been cut nearly in half in just the past 10 years – from 267 in 2006 to 143 at the end of 2016 – nearly all due to mergers.[1] Wisconsin credit unions have told us repeatedly that compliance burden is a key reason they are forced to merge. One credit union president summed it up this way:

> [W]e are being regulated to death. Just look at all of the mergers that have occurred and are in the planning stages. We all need regulatory relief, especially the small [credit unions]. In my 30 years it seems that my job has changed from serving the members best interest to making sure we are in compliance. This is not a good thing.

Nationally, regulatory burden diverts $7.2 billion a year from credit union services, as reported by the Credit Union National Association (CUNA).[2] For Wisconsin and in 2014 alone, it cost state-chartered credit unions $133.8 million to comply with federal regulations plus $28.1 million in reduced revenue from not being able to invest resources in member service. That's a total impact of $161.9 million, or $62 per credit union member here. No wonder credit unions cite regulatory burden as a primary driver of credit union consolidation.

Unfortunately, the NPRM glosses over this reality. In the Supplementary Information portion of the NPRM, the Board wrote:

> As with any maturing industry, the Board recognizes that credit unions are experiencing a period of significant consolidation. Much of this consolidation is occurring through voluntary mergers. This increase in merger activity is a natural part of the business lifecycle and can be driven by one or more of several factors including the desire to provide members with additional products or services, the difficulty in identifying successors for long-serving senior management or volunteers, or the need for additional staff resources. As credit unions seek to increase operating efficiencies through enhanced economies of scale and scope, the Board expects this trend to continue.

The Board's statement downplays that the burden of complying with expanding federal regulations is one of the biggest factors driving credit unions to merge. After reading this NPRM, a Wisconsin credit union told us:

> The Board should realize and acknowledge the impact of excessive regulation on our industry, from a myriad of government agencies, including NCUA. In being transparent for the reasons behind mergers, regulations are a key impact to small and mid-sized credit unions in a merger decision. NCUA should acknowledge and own this fact.

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[1] From the Wisconsin Department of Financial Institutions, Office of Credit Unions, "2016 Year End Credit Union Bulletin," available online at: http://www.wdfi.org/_resources/indexed/site/fi/cu/QuarterlyReports/2016/2016YearEndBulletin.pdf
[2] See http://www.cuna.org/regburden/

In the end, the unintended consequence of recent financial regulatory reforms from Washington will be fewer and larger financial institutions nationwide. Consumers will have fewer options for financial services. They'll be driven to big banks (which can better absorb compliance costs) and to predatory lenders that are far less consumer-friendly than credit unions.

We sincerely appreciate the NCUA's recent efforts to ease regulatory burdens in certain areas,[3] but it seems ironic that this proposal would add to the unneeded compliance burdens that push many credit unions to seek mergers in the first place. The Board should recognize that "creeping compliance complexity" often drives credit union mergers and dedicate itself to reducing unnecessary regulatory requirements, not adding new layers of complex rules at the merger stage.

The proposed changes to the disclosure of "merger-related financial arrangements" would be too broad

The financial disclosures required by the NCUA's merger rules are designed to ensure that members of a merging credit union know about any compensation or other benefits that senior management and directors may receive as a result of a proposed merger. The NPRM says that the Board has observed various shortcomings in this current disclosure regime, which the NPRM tries to address. While we certainly favor transparency in the merger process, we believe that certain aspects of the proposed changes go too far.

<u>The definition of "covered persons"</u>

The proposal would expand the definition of "merger-related financial arrangements" that must be disclosed. It would accomplish this (in part) in two steps:

- Removing the definition of "senior management official" from §708b.2, which now defines that term as "the chief executive officer (who may hold the title of president or treasurer/manager), any assistant chief executive officer, and the chief financial officer;" and

- Replacing it with "covered person," which would be defined to mean "the chief executive officer or manager (or a person acting in a similar capacity); the four most highly compensated employees other than the chief executive officer or manager; and any member of the board of directors or the supervisory committee."

The proposed definition is too expansive, particularly for small credit unions. In March 2017, Wisconsin's 140 credit unions had a median asset size of just $44 million. At that size, a Wisconsin credit union has, on average, just 10.5 employees. As a result, the four most highly compensated employees could well include staff with no managerial responsibilities at all. We believe that it would be better to eliminate the phrase "the four most highly compensated employees other than the chief executive officer or manager" from the proposed "covered person" definition.

The NPRM seeks input on whether the NCUA should expand its definition even further, to include the 10 most highly compensated employees or simply all employees. We oppose both options. As explained earlier, the median Wisconsin credit union only has about 10 employees, and we see no need for a small credit union to disclose the compensation of its entire staff. Furthermore, the privacy interests of credit union employees outweigh whatever potential benefit might be gained from such expansive definitions. Members don't need to know how much every credit union employee is paid to decide how to vote on a proposed merger.

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[3] For example, the NCUA detailed its efforts to reduce unnecessary regulatory burdens in the March 2017 Federal Financial Institutions Examination Council's (FFIEC's) Joint Report to Congress of the second Economic Growth and Regulatory Paperwork Reduction Act (EGRPRA) review.

The proposed definition of “merger-related financial arrangements”

The Board has proposed to redefine the “merger-related financial arrangements” that must be disclosed as part of a proposed merger.

The term is now defined in part 708b as any material increase in compensation (including indirect compensation, for example, bonuses, deferred compensation, or other financial rewards) or benefits that any board member or senior management official of a merging credit union may receive in connection with a merger transaction. A “material increase” means an increase that exceeds 15% of the senior management official’s or director’s current compensation or $10,000, whichever is greater. This definition covers any compensation (meeting the 15% or $10,000 thresholds) that a senior management official or director would not otherwise receive if the merging credit union does not merge.

The proposal would eliminate the 15% or $10,000 threshold. Instead, it would define “merger-related financial arrangements” to include “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.” It would also include all future compensation or benefits that would not be received but for the merger taking place, regardless of the amount. NCUA would reserve the right to review any future compensation paid to a covered person of the merging credit union by the continuing credit union.

We oppose these changes for several reasons:

- First, any change to a covered person’s compensation, even a $1 increase or a raise given up to 24 months before the merger, would have to be disclosed to members. As a result, the merger proposal information disclosed to members would become longer and denser, filled with potentially irrelevant data, and therefore less useful to members. The 15% or $10,000 thresholds should be retained (even increased), so that only significant increases are disclosed. Alternatively, the thresholds should be tied to credit union reserve levels. That would make the rule more flexible, tailoring disclosures for credit unions of different sizes that may have very different notions of what constitutes a “material” compensation increase.

- Second, the proposal, as worded, would require disclosure of any prior compensation increase (in the past two years), but would only require disclosure of future compensation increases if they were to be paid “because of the merger.” This distinction between past and future compensation would muddy the compliance waters for merging credit unions and undermine the transparency of disclosures for members. We believe that credit unions and their members would be better served if the rules required disclosure of significant compensation increases – past or future – that would not be paid to the covered person “but for” the merger. For example, the staff of a smaller merging credit union might typically expect some increase in compensation or a bonus from a larger continuing credit union, simply because of economic and labor market factors that are not related to the merger. However, members could misinterpret the increases as merger-related inducements that create conflicts of interest. Using the “but for” standard would eliminate irrelevant disclosures of financial arrangements that have no bearing on a merger proposal.

- Third, a 24-month “look back” period is unreasonably long. At most, a one-year period seems adequate to uncover compensation increases that may be linked to the proposed merger and thus constitute a conflict of interest.

The member-to-member communication proposal would be unworkable

The proposed rule would add new procedures for member-to-member communications in advance of a member vote on a proposed merger. As part of the member notice, covered credit unions would be required to inform members that if they wished to provide their opinions about the proposed merger to other members, they could submit their opinions in writing to the merging credit union within 30 calendar days of receipt of the notice and that the credit union would forward those opinions to other members.

We strongly oppose this unnecessary addition to the merger process, for several reasons:

- First, its timing provisions would lead to delays in the merger process and allow disgruntled members to "game" the system. Under the proposal, within 30 calendar days of receiving the advance written notice of any member meeting called to vote on a merger proposal, members may make a written request to the merging credit union that it mail or email merger-related communications to other members. The merging credit union would have to ensure that members receive all merger-related communications at least 15 calendar days before the meeting to vote on the merger proposal.

  The Board acknowledges that "in some cases, the timing could force a merging FCU to postpone the date of the member vote." It goes on to explain how an eleventh-hour request by a member could easily force a postponement under the proposed timing rules. Only those who are opposed to a merger are likely to take advantage of the proposed system, and they could easily use it to force delays, perhaps repeatedly, by taking unfair advantage of this rule. Furthermore, proposed §708b.106(e)(4) gives a credit union no option to refuse a member-to-member communication request that appears to be intended just to cause delays or hamper the merger process.

- Second, the proposed process would be unduly burdensome for credit unions. They would be required either to mail or to email the member's communication to other members. Email could only be used for those members "who have agreed to accept communications electronically from the credit union." Further, the merging credit union would be required to "inform the member of the percentage of members for whom it does not have an email address." The process of forwarding communications to all members will be difficult and time-consuming for staff, and mailing will be costly. The rule provides for member reimbursement of the costs, but it fails to state whether the member can be required to pay in advance, and if so, how the costs are to be estimated. If the rules would only require member reimbursement after the fact, how can the credit union ensure payment? What would the consequences be if the member refuses to pay? The proposal does not say.

- Third, the mechanics for sending communications are unclear. The vague nature of the proposal raises all sorts of questions. For example, how are credit unions to "ensure that members receive" mailed communications within a specific timeframe? Must they be sent by certified mail to obtain verification of receipt? Will a "mailbox rule" allow the credit union to presume receipt within a certain number of days after sending out the communications? What about credit unions that have no internal system to easily calculate the percentage of members without email addresses – can they provide a reasonable estimate to the requesting member? Must the credit union ensure that the email addresses it uses are current and valid? What must it do when email is returned as undeliverable? The proposal addresses none of these issues.

- Fourth, it's unclear whether the Board intends to require that the credit union email only members who have consented to receive electronic communications under the federal Electronic Signatures in Global and National Commerce Act (E-SIGN). Whether yes or no, the rule should say so explicitly.

If E-SIGN compliance is needed, however, the rule would likely be unworkable. That's because E-SIGN says that before a consumer can consent to receive records electronically, the credit union must give a "clear and conspicuous" statement that informs the consumer of (among other things) "whether the consent applies (I) only to the particular transaction which gave rise to the obligation to provide the record, or (II) to identified categories of records that may be provided or made available during the course of the parties' relationship…" 15 U.S. Code § 7001(c)(1)(B)(ii).

The quoted language poses a particular problem: E-SIGN does not allow for blanket consents. Instead, credit unions must tailor their E-SIGN disclosures to specific categories of information. It's safe to say that no credit union has identified "member-to-member communications regarding proposed mergers" as one of the "identified categories" of communications covered by an E-SIGN disclosure to its members. As a result, a credit union would likely have to send new E-SIGN disclosures and get fresh consents from its members before it could forward any member-to-member merger messages electronically. This would lead to additional delays and impose even more burdens on credit unions.

- Fifth, there is no need for member-to-member written communication, since the member meeting already gives members adequate opportunity to debate a proposed merger. The NCUA's explained its rationale for introducing a member-to-member communications requirement this way:

  > … [T]he Board is concerned that members voting by mailed ballot do not benefit from the rigorous debate that may take place during a member meeting where members are free to discuss the proposed merger openly with management or the directors of the FCU. This proposed addition to the voluntary merger rule allows members to communicate with other members in advance of the merger vote, and provides the opportunity for members to share ideas with other members who may be unable to attend the member meeting. These new procedures will allow for healthy member debate of a proposed merger prior to a member vote. While this may result in additional administrative burdens on merging FCUs, the Board believes that requiring merging FCUs to facilitate member-to-member communications is the least restrictive means to achieve this compelling objective.

  No, requiring credit unions to facilitate member-to-member communications is not the "least restrictive means" of allowing member debate. The least restrictive means would be simply to encourage members to attend the member meeting. We explained earlier that the timing requirements of the proposed member-to-member communications rules could lead to unnecessary delays. The Board has already shrugged off that risk, saying simply: "Accordingly, the Board encourages members desiring to communicate with other members about the merger to submit their communication as soon as possible." If "encouragement" is enough to address the risk of delays, it should be enough to address the risk of members not attending meetings, too.

- Sixth, the proposal allows false, misleading or inflammatory communications requests to be rejected, but the NCUA would unnecessarily interject itself into the rejection process, requiring the credit union to consult with its NCUA regional director first. The credit union should be able to make its own good-faith determination of whether grounds exist to reject a requested communication. Federal savings associations have this ability when presented with member-to-member communications about their affairs under 12 C.F.R §144.8. The NCUA should entrust credit unions with the same authority.

  In addition, the process of seeking a regional director's approval to reject a communication would lead to even more delays and unanswered questions. Under the proposal, the credit union would have seven days to forward a requested communication to the regional director, along with a detailed explanation of the credit union's objections, and the regional director would have seven days to contact the requesting member, review the communication, and then respond to the credit union. And what if the director cannot reach the member? What if the director misses the seven-day deadline? In those cases, the proposal doesn't say whether the credit union can/should/must forward the communication to its membership or not.

A requirement to submit two years of board minutes would serve no purpose

Under the proposal, both the merging and continuing credit union would have to submit to the NCUA any board minutes that reference the merger, stretching back to a date 24 months before the credit unions' directors approved the merger plan. This seems like an unnecessary "make-work" rule that would do little to help the NCUA uncover conflicts of interest. Instead, the NCUA should only require submission of minutes directly related to the merger approval and immediately preceding it. The NCUA and its examiners already have the power to access board minutes and other financial data quarterly, when on-site completing audits, and otherwise as they see fit. If issues or questions arise, they can request minutes as needed.

Conclusion

For all of the reasons set forth in this letter, The League respectfully opposes this NPRM and asks the NCUA to withdraw it. If the NCUA proceeds with this rule-making, it should not extend its coverage to FISCUs. We believe that this rule would impede voluntary mergers with unnecessary and burdensome regulatory requirements and that it would leave a host of unanswered questions that could render the rule unworkable. We urge the NCUA not to add new layers of regulation to the merger process, especially since the burden of complying with expanding federal regulations is one of the biggest factors driving credit unions to merge in the first place.

Sincerely,

Paul Guttormsson
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The Wisconsin Credit Union League