

7535-01-U

NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Part 708b

Disclosure of Merger Related Compensation Arrangements.

AGENCY: National Credit Union Administration (NCUA).

ACTION: Proposed rule with request for comments.

SUMMARY: NCUA is issuing a proposed rule on mergers to require all federally insured credit unions to include in the merger plan submitted to NCUA a description of any arrangements providing a material increase in compensation or benefits to senior management officials in connection with the merger. The proposed rule also requires federal credit unions to disclose the existence of such compensation arrangements in the materials provided to members voting on whether to approve the merger. The proposed rule will ensure members of a merging federal credit union and NCUA are fully informed about arrangements providing for a material increase in compensation or benefits to senior management officials before considering whether to approve the merger. NCUA

believes this requirement will assure merger decisions are based on the best interests of the members.

DATES: Comments must be received on or before June 22, 2007.

ADDRESSES: You may submit comments by any of the following methods

(Please send comments by one method only):

- Federal eRulemaking Portal: <http://www.regulations.gov>. Follow the instructions for submitting comments.
- NCUA Web Site:
http://www.ncua.gov/news/proposed_regs/proposed_regs.html.
Follow the instructions for submitting comments.
- E-mail: Address to regcomments@ncua.gov. Include “[Your name] Comments on Proposed Rule Part 708b (Disclosure of Merger Related Compensation)” in the e-mail subject line.
- Fax: (703) 518-6319. Use the subject line described above for e-mail.
- Mail: Address to Mary Rupp, Secretary of the Board, National Credit Union Administration, 1775 Duke Street, Alexandria, Virginia 22314-3428.
- Hand Delivery/Courier: Same as mail address.

FOR FURTHER INFORMATION CONTACT: Ross Kendall, Staff Attorney, Office of General Counsel, at the above address or telephone: (703) 518-6540.

SUPPLEMENTARY INFORMATION:

A. Background

The Federal Credit Union Act (Act) authorizes the NCUA Board to prescribe rules regarding mergers of federally-insured credit unions and changes in insured status and requires written approval of the Board before one or more federally-insured credit unions merge. 12 U.S.C. 1766(a), 1785(b), 1785(c), 1789(a). Part 708b of NCUA's rules implements this authority and applies to both corporate credit union and natural person credit unions. 12 CFR part 708b. The rule provides for NCUA review and approval of any merger involving a federally-insured credit union. 12 CFR 708b.104(a). Where a merging credit union is a federal credit union, members have the right to vote on whether to approve the merger, subject to one exception; NCUA may permit a merger without a member vote if it determines the FCU is in danger of insolvency and a merger will protect the National Credit Union Share Insurance Fund. 12 CFR 708b.106, 708b.105(b).

As with any maturing industry, consolidation in the nation's credit unions is occurring and is expected to continue. Efforts to increase efficiencies through improved economies of scale, along with improvements in information technology and the increasing costs associated with compliance, all contribute to the trend toward consolidation. The increasingly competitive marketplace for financial services in which credit unions operate adds additional pressure to consolidate.

Most of this consolidation is occurring through voluntary mergers of credit unions. With the increase in merger activity, some credit unions may find themselves in the position of being a potential merger partner with more than one other credit union. In this position, management of the credit union will naturally want to evaluate competing opportunities and should consider which of the potential merger partners offers the best fit, in terms of member philosophy and continued or expanded services and products for its membership.

B. Proposed Rule

The NCUA Board is concerned that prospective merger partners may seek to improperly influence the outcome of deliberations by a board of directors of the merging credit union. The support of senior management officials of a credit union considered for merger may influence a decision to approve a merger plan with a particular merger partner. Thus, a potential merger partner might agree to provide financial incentives in exchange for support from senior management.

This proposed rule would require all federally-insured credit unions to describe any financial arrangements providing a material increase in compensation or benefit to a senior management official in the merger plan submitted to the NCUA. For purposes of the disclosure requirement, the proposal defines a material increase as an increase of 15% above the official's current compensation or \$10,000, whichever is greater. Compensation includes salary as well as any indirect compensation such as bonus, deferred compensation or

other financial reward. NCUA would determine, on a case by case basis, whether to request further details about an arrangement in connection with its review of the merger plan.

Where a merging credit union is federally chartered, the proposal would also require disclosure of the existence of a material increase in compensation to its members before their vote on the merger. State law governs whether members of a state-chartered credit union are entitled to vote; therefore, NCUA is only proposing this requirement for federal credit unions. Any individual member of a federal credit union wishing to review the details of the arrangement would be entitled to inspect the credit union's records detailing the arrangement. The inspection would be at an office of the credit union during regular business hours and a member requesting it would need to submit a request in writing to the credit union at least one day before the date announced for the meeting called for the purpose of voting on the merger.

NCUA notes that the proposed creation of a member inspection right in the context of merger related compensation arrangements is specific to these limited circumstances. Simultaneously with the adoption of this proposal, NCUA is also proposing a broader, more general rule to govern member access to federal credit union records. In accordance with settled rules of construction, a more specific provision in a rule takes precedence over a broader provision of general applicability. NORMAN J. SINGER, STATUTES AND STATUTORY CONSTRUCTION,

§51.05 (6th Ed., 2000). Thus, a member asserting a right to review documents relating to merger related compensation would be entitled to follow the procedures outlined in this rule and not the general procedures relating to member access to records.

The proposed rule would permit a member to review merger related compensation records without making or retaining copies at “an” office of the credit union, including branch office locations. The Board recognizes that requested documents may be at a credit union office at some distance from where members may live and that conducting a review may be difficult or expensive for members. The Board expects credit unions and their members to work out reasonable arrangements about how a review can take place that are mutually acceptable. For example, a credit union may agree to provide photocopies to a branch office location convenient to the member. The Board solicits comment on this subject.

The NCUA Board believes this proposed rule will help assure that management’s decision to recommend a merger is based on sound business judgment reflecting the best interests of the members. The Board also notes the proposal tracks an Office of Thrift Supervision (OTS) regulation that requires disclosure of officer compensation, among other matters, in a merging thrift’s merger approval application; the OTS rule states an increase in compensation paid to an officer, director or controlling person of a merging federal thrift or savings bank is

presumed to be unreasonable and a sale of control if it exceeds the greater of 15% or \$10,000. 12 C.F.R. §563.22(d)(1)(vi)(C). The Board also notes comparable disclosure requirements relating to economic benefits for directors and senior management officials are in NCUA's rule on conversions of insured credit unions to mutual savings banks. 12 CFR 708a.4(d)(1)(iii).

The proposed rule addresses arrangements providing material economic benefits to board members or senior management officials of the merging credit union. The NCUA Board believes these individuals are most likely to be in a position to negotiate personally advantageous compensation arrangements. The Board also understands retention agreements and bonuses for persons holding managerial or technical positions may be essential for a successful merger, and the proposed rule does not prohibit offering retention agreements or bonuses that a continuing credit union believes are appropriate, including arrangements affecting senior management officials. In this respect, the Board notes it does not intend to substitute its business judgment for that of the boards of the merging and continuing credit unions on marketplace demands and reasonable compensation arrangements. The proposed rule change focuses on transparency and the principle that full disclosure usually results in more informed and better membership decisions.

The Board recognizes that, in some cases, officials of the merging credit union may be retained by the continuing credit union and assigned additional duties

with greater responsibilities. In those cases, the continuing credit union may offer to pay officials relatively greater compensation than they earned with the merging credit union. Credit unions should be able to support these types of increases in compensation, bonuses, or retention agreements in the required disclosures. The proposed rule would simply require a description of these arrangements in the merger plan and, in the case of a merging federal credit union, disclosure of their existence to the membership before their vote on approving the merger.

State law governs whether members of a merging state chartered credit union are entitled to vote on a proposed merger. If a state law requires a state supervisory authority's approval, NCUA's rule requires evidence that the state supervisory authority has approved the merger as part of the material submitted to the appropriate Regional Director. 12 CFR 708b.104(a)(6). For corporate credit unions, the NCUA Merger and Conversion Manual specifies that credit unions submit their merger requests to NCUA's Office of Corporate Credit Unions. NCUA 8056/M 6300 (June 2005).

C. Proposed Amendments

Definitions. The proposal adds two new definitions to the rule. "Merger related financial arrangement" is defined to mean an increase in direct or indirect compensation of 15% or \$10,000, whichever is greater, that any board member or senior management official of a merging credit union may receive in

connection with a merger transaction. Such an increase is considered material and would need to be disclosed. The term does not include an agreement to retain a senior management official in a comparable managerial role with the continuing credit union, so long as the agreement is limited to retention and does not include any financial component resulting in a material increase, as defined, above the official's existing compensation package. The second new definition, "senior management official," includes the chief executive officer (who may hold the title of president or treasurer/manager), any assistant chief executive officer, and the chief financial officer. This definition conforms to other NCUA rules affecting members of senior management of credit unions; see, e.g., 12 CFR Part 703.

Disclosures. The proposed rule would add to the rule's provisions describing the merger plan and the approval of the merger proposal by members of the merging credit union. 12 CFR 708b.103(a), 106(a)(2). The new provisions require financial arrangements providing a material increase in compensation or benefits for senior management officials and related to a merger to be described in the merger plan and, in the case of a merging federal credit union, disclosed to the membership in the balloting materials. These disclosure obligations would only be triggered where the proposed financial arrangement results in an increase in compensation equal to 15% or \$10,000, whichever is greater. Furthermore, the rule would simply require that the disclosure to the members indicate the existence of a material financial arrangement involving one or more senior

management officials. Any individual member would be entitled to inspect the credit union's records pertaining to the arrangement, at the credit union's office during business hours.

REGULATORY PROCEDURES

Regulatory Flexibility Act

The Regulatory Flexibility Act requires NCUA to prepare an analysis to describe any significant economic impact a proposed rule may have on a substantial number of small credit unions (those under ten million dollars in assets). Most of the mergers of federal credit unions involve small credit unions. In almost all cases, the small credit union merges into a much larger continuing credit union. The larger credit union is available to assist the small credit union with each step in the merger process, keeping the economic impact on the small credit union to a minimum. Accordingly, the Board does not anticipate that this proposed rule would have a significant economic impact on a substantial number of small credit unions, and, therefore, a regulatory flexibility analysis is not required.

Paperwork Reduction Act

The proposed changes to part 708b contain information collection requirements. As required by the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)), NCUA is submitting a copy of this proposed rule as part of an information collection package to the Office of Management and Budget (OMB) for its review and approval for revision of Collection of Information, Mergers of Federally Insured

Credit Unions, Control Number 3133-0024.

The proposed changes ensure that NCUA has sufficient information to determine whether to approve a proposed merger. The changes would also help ensure, in the case of a merging federal credit union, that members have sufficient and accurate information to exercise their vote properly concerning the proposed merger.

In the five-year period ending June 30, 2006, NCUA approved 1,567 mergers involving federally insured credit unions. On average for the past five years, therefore, there were approximately 313 mergers each year that would be covered by the proposed rule. NCUA estimates less than one percent of these mergers will involve merger related financial arrangements as defined in the proposed rule. NCUA estimates it will take the merging credit unions about five hours to describe any merger related financial arrangements and include the description in the merger plan and, in cases involving a merging federal credit union, to make materials available to members upon request. One percent of 313, treating the two merging credit unions as one respondent, or 3.1 times five hours per respondent equals sixteen (rounding up from fifteen and one-half) total annual burden hours associated with this revision to the existing collection of information associated with this rule, OMB Control Number 3133-0024.

Total annual burden hours = Sixteen

The Paperwork Reduction Act and OMB regulations require that the public be provided an opportunity to comment on the paperwork requirements, including an agency's estimate of the burden of the paperwork requirements. The NCUA Board invites comment on: (1) whether the paperwork requirements are necessary; (2) the accuracy of NCUA's estimates on the burden of the paperwork requirements; (3) ways to enhance the quality, utility, and clarity of the paperwork requirements; and (4) ways to minimize the burden of the paperwork requirements.

Comments should be sent to: OMB Reports Management Branch, New Executive Office Building, Room 10202, Washington, DC 20503; Attention: Mark Menchik, Desk Officer for NCUA. Please send NCUA a copy of any comments submitted to OMB.

The Paperwork Reduction Act requires OMB to make a decision concerning the collection of information contained in these proposed regulations between 30 and 60 days after publication of this document in the Federal Register. Therefore, a comment to OMB is best assured of having its full effect if OMB receives it within 30 days of publication. This does not affect the deadline for the public to comment to the NCUA on the proposed regulations.

Executive Order 13132

Executive Order 13132 encourages independent regulatory agencies to consider the impact of their actions on state and local interests. In adherence to fundamental federalism principles, NCUA, an independent regulatory agency as defined in 44 U.S.C. 3502(5), voluntarily complies with the executive order. The proposed rule would not have substantial direct effects on the states, on the connection between the national government and the states, or on the distribution of power and responsibilities among the various levels of government. NCUA has determined that this proposed rule does not constitute a policy that has federalism implications for purposes of the executive order.

The Treasury and General Government Appropriations Act, 1999 - -

Assessment of Federal Regulations and Policies on Families

The NCUA has determined that this proposed rule would not affect family well-being within the meaning of §654 of the Treasury and General Government Appropriations Act, 1999, Pub. L. 105-277, 112 Stat. 2681 (1998).

List of Subjects

12 CFR part 708b

Credit unions, Mergers of credit unions, Reporting and recordkeeping requirements.

By the National Credit Union Administration Board on April 12, 2007.

Mary F. Rupp
Secretary of the Board

For the reasons stated above, NCUA proposes to revise 12 CFR part 708b as follows:

PART 708b — MERGERS OF FEDERALLY-INSURED CREDIT UNIONS;
VOLUNTARY TERMINATION OR CONVERSION OF INSURED STATUS

1. The authority citation for part 708b continues to read as follows:

Authority: 12 USC 1766(a), 1785(b), 1785(c), and 1789(a).

2. Amend §708b.2 by removing current alphabetical paragraph designations (a) through (k) and adding new definitions of “merger related financial arrangement” and “senior management official” in alphabetical order to read as follows:

§708b.2 Definitions.

* * * * *

Merger related financial arrangement means a 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. For purposes of this definition, a material increase is an increase of 15% or \$10,000, whichever is greater.

* * * * *

Senior management official means the chief executive officer (who may hold the title of president or treasurer/manager), any assistant chief executive officer, and the chief financial officer.

3. Amend §708b.103 by redesignating paragraphs (a)(7) through (10) as paragraphs (a)(8) through (11) and adding new paragraph (a)(7) to read as follows:

§708b.103 Preparation of merger plan.

(a) * * *

(7) Description of any merger related financial arrangement, as defined in §708b.2.

* * * * *

4. Amend § 708b.106:

A. By removing the semicolon at the end of paragraph (a)(2)(ii) and adding

“, and disclosure of the existence of any merger related financial arrangement, as defined in §708b.2;” and

B. By adding a new paragraph (a)(2)(vii) to read as follows:

§708b.106 Approval of the merger proposal by members.

(a) * * *

(2) * * *

(vii) Inform the members they have the right to inspect the credit union's records pertaining to any merger related financial arrangement, as defined in §708b.2, by submitting a request in writing to the credit union at least one day before the date announced for the meeting called for the purpose of voting on the merger. The inspection must occur at an office of the credit union during regular business hours and is limited to the right to review pertinent documents on site, without making or retaining copies.