NAVY FEDERAL Credit Union

Office of the President

June 15, 2007

Ms. Mary Rupp
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, Virginia 22314-3428

Re: Proposed Rule 701.3, Member Inspection of Credit Union Books, Records, and Minutes

Dear Ms. Rupp:

Navy Federal Credit Union provides the following comments in response to National Credit Union Administration (NCUA) Proposed Rule 701.3 regarding Member Inspection of Credit Union Books, Records, and Minutes.

Summary

Navy Federal believes that federal credit unions (FCUs) should rely on appropriate federal law and regulation rather than state law for the disclosure of information involving the business of the FCU. However, the proposed regulation overreaches prudent federal authority on issues we believe Congress intended to be determined by democratically elected FCU boards of directors. The extent of information disclosure mandated by the proposed regulation is unnecessary, unjustified, and ill advised. We believe any benefits of the proposed regulation would be negligible while overall risk of harm to the credit union movement, including its abilities to serve low and moderate members, is increased significantly. Navy Federal urges NCUA to withdraw the proposed regulation and consider alternatives to support FCU reliance on federal law for the disclosure of information.

Comments on Proposed Federal Policy

NCUA's long-standing legal opinion that FCU members may inspect the FCU's books and records under the same terms and conditions that state corporation law permits shareholder inspection of corporate records needs thorough reevaluation and modernization. In recent years, controversial plans for credit union mergers and conversions to mutual savings banks prompted FCU members to request information about their FCUs that is not readily available in the public domain. Other FCU members have requested nonpublic FCU information for their own special interests. Undoubtedly, media reports of credit union insiders amassing personal fortunes

derived from members' equity following conversion to another form of financial institution have sparked the interests of outside "investors" for additional credit union information. We believe requests for nonpublic FCU information, particularly those involving the use and disposition of credit union members' equity, dictate a need for prudent and reasonable federal policy guidance for the release of information by FCUs.

In today's environment, we agree with the NCUA Board that federal regulation of member inspection and release of FCU records is preferable to reliance on state law, *but only if* such federal regulation is within prudent, reasonable, and carefully defined parameters. NCUA's proposed provisions of Section 701.3 are not prudent and reasonable or carefully defined. For many reasons, we believe the proposed amendments would seriously erode the long-standing integrity of federal credit union governance and place a shadow of risk over the entire credit union movement. We urge NCUA to withdraw the proposed Section 701.3 and provide a new proposal for the release of FCU records that would, first and foremost, protect the common interests of all FCU members while recognizing valid requests of individual member-owners for additional information about their credit unions.

Within the current regulatory framework for FCUs there is a risk, albeit small, of unwanted or unethical takeover. Additionally, NCUA's conversion rule virtually guarantees that FCU members will not receive just compensation for their ownership interests upon conversion to a mutual savings bank. History has shown that insiders have profited handsomely from several conversions and media reports suggest that outsiders have shown interests in "investing" in credit unions to reap monetary rewards upon conversion. We believe NCUA's proposed Section 701.3 will facilitate harmful interests such as these and accrue little if any benefit to FCU members who are genuinely interested in the long-term viability of their credit union.

FCU members may rely on publicly available annual, quarterly, and monthly financial statements to provide extensive, substantive, and sufficient information for evaluation of the FCU's overall financial condition and viability. Annual reports, Form 5300 Call Reports, and other public reports include extensive financial and statistical information for assessment of the safety and soundness of FCUs. In addition, FCU Bylaws, Article VII Section 6(c), require posting monthly financials, including a summary of delinquent loans, in a conspicuous place in the office of the FCU. These reports provide a comprehensive and transparent picture of the financial health of any particular FCU. NCUA provides little justification for its proposed mandate to release additional details of an FCU's operations. We know of no way the release of additional information would benefit the FCU membership. The additional information could be used against the FCU. Therefore, we strongly urge NCUA to limit the mandatory release of information to that which current federal laws and regulations make available to the public.

FCU boards of directors should have authority to release additional records (except those prohibited by federal law and regulation) when they determine the disclosure to be in the best

interest of the credit union. FCU boards, democratically elected by each credit union's members, are in the best position to know what information should be released to benefit the membership. The authors of the Federal Credit Union Act (FCUA) understood that the day-to-day operations of the FCU could not be run by the many individual members of the cooperative and conferred responsibility for "the general direction and control" to its board of directors with provision for certain delegations to management and employees. The FCUA gives the FCU's board broad authority to "carry out the purpose and powers of the Federal credit union, subject to regulations issued by the Board." We believe NCUA regulations should not curtail the statutory authority of the FCU board provided the purpose and powers of the FCU are not compromised. To do otherwise and mandate the release of requested operational details, opens the doors for any member, member representative, or group of members to second guess the decisions of the board and management. Incomplete information or information taken out of context would likely lead to confusion, misunderstanding, and ill-conceived opposition with respect to FCU board and management actions and decisions. We believe the release of nonpublic information would be detrimental to the reliable and orderly management and operations of the vast majority of FCUs.

FCU boards of directors and committees of directors are comprised of unpaid volunteers democratically elected by the credit union's members. To open detailed board discussions and deliberations to public scrutiny via routine member requests for information would have a chilling and lasting effect on the governance of FCUs as envisioned in the FCUA. Directors faced with the potential for a high level of scrutiny of their comments are not as likely to be open and frank in their discussions and deliberations. The awareness that portions of discussions or statements may be taken out of context and used for unintended purposes inhibits full and candid exchanges and negotiations. As a consequence, the thorough deliberative processes of credit union governance envisioned in the FCUA would likely be abandoned by some. The decision making processes would be driven from the boardroom to back rooms and break rooms where conversations are not recorded, reasoning is not documented, and full deliberations are not possible. Recruiting highly qualified volunteers would become more difficult. FCUs and their members would suffer the adverse consequences of weakened decision processes that could trigger irreparable damage across the entire movement.

Just as Exemption 5 of the Freedom of Information Act (FOIA) exempts the deliberative processes of government agencies from public disclosure, FCU board deliberative processes should be exempt from mandatory NCUA disclosure to credit union members. Although the FOIA does not apply to FCUs, all three purposes for the Deliberative Process Privilege of Exemption 5 as outlined in the *Freedom of Information Act Guide, March 2007*, are applicable to the deliberations of FCU boards – (1) to encourage open, frank discussions, (2) to protect against premature disclosure, and (3) to protect against public [member] confusion that might result from disclosure of reasons and rationales that were not in fact grounds for action.

NCUA provides no justification for its proposed mandatory disclosure of FCU deliberative governance processes other than for members to obtain information on how to vote. Credit union members vote only on very limited issues; therefore, we do not understand why it is necessary, nor do we see any benefits of the proposed disclosure. With overwhelming indications that disclosure of an FCU's deliberative processes would harm an FCU's ability to carry out its purpose, we strongly urge NCUA to withdraw its proposal for mandatory disclosure of minutes of the board of directors and committees of directors, "recording of the proceedings," and "all documents, reports, studies, and visual aids considered by the meeting participants."

Navy Federal urges NCUA to withdraw Section 701.3 on the basis that its requirements provide no significant benefits, would harm credit union governance and operations, and create unnecessary burden. NCUA should issue a new proposed section 701.3 stipulating that FCUs are not required to release any information that is not necessary to be disclosed under other federal law or regulation and that duly elected FCU boards are authorized to determine whether the release of additional information serves the interest of the FCU's membership. However, if NCUA solidly determines that disclosure of additional FCU information upon member requests would significantly benefit the disclosing credit union, we urge the agency to craft a proposal that adheres to concepts and guidelines embedded in the FOIA. For example, such a proposal should assure that FCUs could deny requested information for at least the following reasons:

1. Purpose of disclosure inconsistent with benefiting the credit union,
2. Nonexistent record,
3. Nonpublic personal information,
4. Prohibited by federal law or regulation,
5. Internal communications, deliberations, and proceedings,
6. Internal rules and practices, or
7. Confidential business information.

Comments on Proposed Language of Section 701.3

Although Navy Federal vigorously opposes the new rule as written, we provide the additional comments on various points within the proposal. The proposed section 701.3 would set member inspection rights of credit union books, records and minutes as follows:

> *(a) Member inspection rights.* A group of members of a federal credit union has the right, upon submission of a petition to the credit union as described in paragraph (b) of this section, to inspect and copy nonconfidential portions of the credit union's:
> (1) Books and records of account; and
> (2) Minutes of the proceedings of the credit union's members, board of directors, and committees of directors.

Accordingly, paragraph (d) of section 107.3 denies members' rights to inspect confidential books, records, and minutes as follows:

> (d) *Confidential books, records, and minutes.* Members do not have the right to inspect any portion of the books, records, or minutes of a federal credit union if:
> (1) Federal law or regulation prohibits disclosure of that portion,
> (2) The portion contains nonpublic personal information as defined in §716.4 of this part; or
> (3) The portion contains information about credit union employees or officials the disclosure of which would constitute a clearly unwarranted invasion of personal privacy. Members may, however, inspect materials describing the compensation and benefits provided by the credit union to its senior executive officers, and the qualifications of the senior executive officers, as that term is defined in §701.14 of this part.

Our plain language reading of paragraph 701.3(a) leads us to believe that FCU members have a right to inspect only the accounting records ("books and records of account") and minutes of various proceedings. NCUA's statement in the Supplementary Information of the *Federal Register* (p. 20063), "The plain language meaning of 'of account' supports a limitation to accounting records" seems to confirm our interpretation of "books and records of account." However, NCUA points out that "Courts have interpreted the phrase 'books and records of account' differently." Additionally, we become thoroughly confused about NCUA's intent as we read the following discussion in the Supplementary Information (p. 20065):

> This proposal, like the OTS Rule, has no confidentiality provisions related to internal memoranda or trade secrets for several reasons. First, credit unions do not generally have trade secrets, that is, secret formulas or technology on which the success of the organization is dependent, and cases that deal with confidential internal correspondence generally do not provide a standard by which confidentiality can be measured. Second, it is unlikely that, given the narrow interpretation of "books and records of account" intended by the Board, any materials deserving of confidentiality would appear among those materials subject to inspection. Third, even if confidential materials appear among the materials subject to this rule, requested materials must be relevant to the petitioners' stated business purpose before they become subject to inspection.

If NCUA is aware that use of the phrase "books and records of account" has caused interpretation problems and it construes the term to mean "accounting records," why doesn't the proposed regulation use the term "accounting records" and in plain language clearly identify what is meant by accounting records? The Supplementary Information discussion states the proposal has "no confidentiality provisions related to internal memoranda" and concludes that it is unlikely that "materials deserving of confidentiality" would appear in the books and records of account. However the Supplementary Information (p. 20063) states, ". . . a petition meeting the requirements of paragraph (c) creates a presumption of proper purpose . . ." We believe the cross reference should be to paragraph (b) or paragraphs (a) and (b). Notwithstanding, the language, "creates a presumption of proper purpose" seems to indicate the information listed in the petition must be released as the proposed regulation offers no guidance on denying a request.

Also, the proposed regulatory language makes no reference to relevancy or "proper purpose" of the requested information – terms used liberally in the Supplementary Information. If FCUs applied NCUA's logic that internal memoranda would not be released because they would not appear in the books and records of account, then senior executive compensation and benefit information would not be released because it does not appear in the books and records of account nor the minutes of board meetings. However, the plain language of the regulation in subparagraph (d)(3) clearly exempts senior executive compensation from confidential books, records, and minutes that cannot be released. We believe the apparent contradictions in logic and lack of plain language clarity in this proposed regulation would create considerable confusion and serious compliance problems for many credit unions.

Navy Federal believes disclosure of senior executive compensation and benefits to requesting FCU members serves no beneficial purpose. It does, however, represent an unwarranted invasion of personal privacy. The background on disclosure of executive compensation is discussed in a November 14, 2005 paper, *Historical Trends in Executive Compensation, 1936 – 2003* by Frydman and Saks (Harvard University and Federal Reserve Board) as follows:

> Revelations regarding executive pay first occurred during World War I, when railroad corporations became managed by the federal government and the exorbitant salaries of railroad officers were exposed. Public scrutiny intensified during the 1920s, when the compensation of railroad and banking executives were published in the popular press. . . Created to enforce the Securities Exchange Act of 1934, the SEC was put in charge of the disclosure of data by firms participating in the securities market, thereby regulating corporate finance (Seligman 2003). Disclosure of information related to the remuneration of executive officers and directors was intended to deter managers from engaging in wrongful behavior and mismanaging corporate assets (Loss and Seligman 1995). Thus, the inception of the SEC has made executive compensation data available to the public from the 1930s to the present.

NCUA has not demonstrated that FCU executive behavior meets the standards that were used to mandate the disclosure of executive pay in the early twentieth century, i.e. "exorbitant salaries," "wrongful behavior," and "mismanaging corporate assets." Events in the late twentieth century and early twenty first century such as those at Enron and WorldCom may indicate executive salary disclosure is not an effective tool against inappropriate executive behavior. In the absence of a compelling justification for release of executive compensation, we believe common law that respects individual rights to financial privacy and privacy concerns such as those expressed in Gramm-Leach-Bliley should prevail. We strongly believe NCUA should withdraw its proposed rule that indicates senior executive compensation should be released to FCU members on request.

If NCUA proceeds with this overreaching proposal, we urge the strengthening limitations on its use and improving confidentiality of the subject information and documents to prevent them from reaching any compromising individuals who might harm the FCU. For example,

proposed paragraph 701.3(b) requires petitioners to "state that the **inspection is not desired** for any purpose in the interest of a business or object other than the business of the credit union . . . and **do not now intend to** sell or offer for sale, any information obtained from the credit union . . ." (emphasis added). To strengthen safeguards against improper use of FCU information obtained by requesters, we encourage NCUA to change the highlighted phrases to "documents inspected will not be used" and "will not" respectively.

The proposal requires at least one percent of the FCU's members, with a minimum of twenty and a maximum of 250 members, to sign a petition to inspect the credit union records. The 250 member cap is unacceptable for larger FCUs. While each FCU member is important, the cap represents only a negligible portion of our membership. If NCUA moves forward with this proposal, we recommend that the number of signatures required for a petition remain at a minimum of one percent of membership or twenty members, whichever is greater, and that the 250 member cap be eliminated to help ensure that the number of frivolous requests would be kept at a minimum.

Proposed paragraph 701.3(c) states, "Member inspection rights under this paragraph are in addition to any other member inspection rights afforded by law, regulation, or the credit union's bylaws." This statement should be clarified by inserting the word "federal" before "law" and "regulation." Otherwise the NCUA intent to move FCU records inspection from state law jurisdiction may be defeated.

The cross reference in subparagraph 701.3(d)(2) should be § 716.3 rather than § 716.4.

With respect to dispute resolutions involving Section 701.3, Navy Federal strongly encourages NCUA to permit FCUs and their members to appeal a decision of the Regional Director concerning petitions for inspection to the NCUA Board. The consequences of opening FCU books and governance deliberations to the public via member requests are far too important to deny access to the NCUA Board. Additionally, Navy Federal favors a common appeal procedure to be established that would apply to all NCUA regulations and policies. If the appeal procedure is to be viewed as a genuine and impartial means for resolution, and effectively serve to strengthen the movement, an industry-wide standard would enhance consistency in the application of federal regulations. We also suggest that FCUs and FCU members should have the right to appear and orally present their cases before the Board. Appellants should also have rights to counsel and representation in absentia. We believe that NCUA's Board would lend impartiality and experience to the decision making processes related to FCUs.

Finally, Navy Federal urges NCUA to reconsider the estimated burden associated with enacting this proposal. NCUA estimates an annual burden of 20 hours per FCU to evaluate each petition, with perhaps five petitions per year for all FCUs, for a total of 100 hours per year. We believe the estimate of public burden is exceedingly low considering the labor involved to

compile, organize, and deliver documents for a potentially much larger number of requests, particularly once a new federal law is in place. A single request to Navy Federal could easily deplete the agency's estimated public burden for all FCUs for the next 20 to 25 years. Reports of public burden required by the *Paperwork Reduction Act of 1995* are intended to document for Congress continued efforts towards the fulfillment of the purposes and planning requirements of the Act. Navy Federal believes it is important that agency burden estimates as reflected in these reports are as accurate as possible.

We appreciate the opportunity to provide our comments in response to this proposal. If you have any questions, please contact Bill Briscoe, Vice President Compliance & Public Policy, at (703) 255-7496.

Sincerely,

Cutler Dawson
President/CEO

CD/cd

bcc: Mr. Fred Becker
President/CEO
National Association of Federal Credit Unions

Mr. Daniel A. Mica
President
Credit Union National Association, Inc.

Ms. Mary Dunn
Senior Vice President for Regulatory Advocacy
Credit Union National Association, Inc.

Ms. Jane Walters
Regional Director, Region II
National Credit Union Administration

Mr. Richard D. Pillow
President
Virginia Credit Union League