



June 22, 2007

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

RE: Comments on Proposed Part 701.3; Member Inspection of Credit Union  
Books, Records, and Minutes

Dear Ms. Rupp:

I am writing on behalf of the National Association of Federal Credit Unions (NAFCU), the only trade association that exclusively represents the interests of our nation's federal credit unions (FCUs), in response to the National Credit Union Administration's (NCUA) request for public comment on the proposed rule regarding member inspection of federal credit union (FCU) books, records, and minutes.

Specifically, the proposal, which would amend Part 701 of NCUA's Rules and Regulations, provides that a group of members representing approximately one percent of the credit union membership may, with a proper purpose and upon petition, obtain access to nonconfidential portions of the credit union's records.

NAFCU recognizes that member transparency is intrinsic to the cooperative and democratic principles at the heart of America's credit union system. NAFCU firmly believes in the fundamental member rights that are inherent to cooperative ownership and generally supports the member access rights that currently exist under state corporate law. We are not convinced, however, that these rights should be federally regulated at this time. Although we are mindful of the agency's concerns about the adequacy of state corporate law to appropriately govern member access to FCU records, NAFCU does not believe that current jurisprudence demonstrates a present need for additional regulation. Currently, members may look to publicly available annual, quarterly, and monthly financial statements, the credit union's annual reports, 5300 Call Reports, and other public documents for information about the credit union's overall financial condition. Additionally, Article VII, Section 6(c) of the FCU Bylaws requires credit unions to post monthly financials in a conspicuous place in the office of credit union. These publicly available reports provide extensive information for a comprehensive evaluation and assessment of the financial health of the credit union. Absent



significant, compelling and widespread cases of an egregious lack of FCU transparency, NAFCU recommends that NCUA continue to maintain its long-standing policy that FCUs' books and records are subject to member inspection under the same terms and conditions afforded to corporate shareholders under state corporate law until more deliberation takes place regarding member access. Member access is just one part of the larger overarching issue of the democratic rights of FCU members. NAFCU encourages the agency to examine its federal preemption policy over the broad issue of fundamental member rights.

NAFCU strongly urges the agency to withdraw its proposal. However, should the NCUA Board determine it is necessary to move forward with its proposal, NAFCU would provide the following specific comments as outlined below.

### **Member Petition Requirements**

NAFCU member credit unions have expressed significant concerns that the proposed rule, as written, is vulnerable to exploitation by outside parties with adverse interests or by select groups of agitators or disgruntled members representing minority interests in order to disrupt the business and operations of the credit union, or to interfere and impede the deliberations of the elected FCU Board.

#### *Minimum signature requirement*

Under the proposed rule, at least one percent of the credit union's members, with a minimum of 20 members and a maximum of 250 members, would be required to sign the petition in order to gain inspection rights.

While NAFCU generally agrees with the percentage threshold, we do not believe that the proposed signature requirement of a minimum of 20 and a maximum of 250 members is appropriate. In particular, NAFCU is concerned that the flat cap of 250 may not be a meaningful number for larger credit unions. Indeed, for *any* credit union with over 25,000 members, 250 signatures will be representative of only a very small portion (i.e. less than 1%) of the credit union membership. According to the NCUA 5300 Call Report for 1<sup>st</sup> Quarter 2007, 7% of all Federal Credit Unions have a membership size of over 25,000. Such a de minimus number could potentially expose larger credit unions to unwarranted inspection requests by a small minority of members; these requests would not only be unreasonably intrusive to the credit union, but unfair to the general membership as a whole whose collective interests would not be fairly represented by a relatively small percentage of the membership. Further, inspection requests by proportionally small groups of members would require a reallocation of valuable credit union resources, unjustly taking away from the quality or level of service provided to the membership as a whole.

The 250 flat cap could also be susceptible to exploitation by outside groups with malevolent intentions. Outside oppositional groups or parties with competitive interests



could easily organize a group of 250 to interfere with credit union operations, to obtain proprietary information, or disrupt the activities of the board of directors.

While acknowledging that the 1% requirement is consistent with the requirement for members seeking a nomination by petition to run for election to an FCU's board of directors, as well as the affidavit requirement in the OTS rule (i.e., at least one percent of outstanding shares), NAFCU believes that the proposed maximum of 250 is both arbitrary and inappropriate. *See* NCUA Standard FCU Bylaws, Art. V, Sec. 1 (Rev. April 2006); 12 CFR 552.11(b)(1) and (2); 12 C.F.R. § 552.11(b)(1). Indeed, the requirement for nomination by petition is coupled with a higher maximum flat cap—500 members. Also by way of comparison, the requirement for members to call a special meeting is also higher—5%, or a minimum of 25 and a maximum of 750 members. *See* NCUA Standard FCU Bylaws, Art. IV, Sec. 3 (Rev. April 2006). However, NAFCU has previously expressed concerns about the appropriateness of the 750 cap and has recommended a higher maximum cap for members to call a special meeting. *See* NAFCU Official Comment Letter on FCU Bylaws (October 13, 2005).

Based on these and other considerations, NAFCU strongly recommends that a 1% signature requirement be established, without a flat maximum cap. Alternatively, NAFCU urges NCUA to consider coupling the percentage threshold with a sliding-scale flat cap whereby the maximum signature requirement is adjusted according to the membership size of the credit union. This will help to ensure that inspection requests are limited to issues that are material to a significant number of members, not just a small group of members representing special interests.

Additionally, NAFCU recommends that the rule, if finalized, include a requirement that each individual petitioner must be a member of the credit union in good standing for a minimum of six months prior to the petition date. This would be consistent with the OTS rule, which requires stockholders to have “held of record such voting shares for a period of at least six months before making [written demand for records].” 12 C.F.R. § 552.11(b)(1). Such a requirement would help to prevent individuals from joining the credit union for the singular purpose of petitioning the credit union for access to its records and to ensure that the petitioners are truly acting in the best interest of the members.

#### *Proper purpose*

In order to gain access to the credit union's records under the proposal, the purpose of a member inspection must be “proper,” namely, related to the business of the credit union. Petitioners must also include a declaration that the inspection is not intended for the purposes of sale and that they have not aided or abetted such sales in the past five years.

NAFCU agrees that a member inspection petition must be supported by a legitimate or proper business purpose in order to prevent nuisance requests, improper use of records, and malicious ‘fishing expeditions.’ However, NAFCU is concerned that the proposed



requirements are insufficient to ensure that a proper purpose exists. The proposed rule is seemingly based on the assumption that the only—or primary—improper motivation for gaining access to credit union records is financial gain (i.e., the sale of records). However, with respect to the credit union industry, other, perhaps more antagonistic threats exist. For example, the proposed rule does not adequately recognize the ongoing bankers' attacks and the recent controversies regarding conversions and hostile takeovers of credit unions. In short, credit union records may be abused for purposes other than improper sale; access to credit union records could be exploited for political or competitive advantage, hostile conversions or mergers, and other uses that are clearly harmful to the best interests of the membership. Further, because a petition meeting the requirements of proposed §701.3(b) would *presumptively* have a proper purpose, it is crucial that the petition requirements provide meaningful protections to ensure that credit unions may have reasonable assurance that a legitimate purpose exists before groups may gain access to FCU records.

NAFCU is also concerned about the remedies available to credit unions in the event that members misuse information obtained from credit union records. Although disputes can be referred to the regional director if a question arises with regard to the sufficiency of the member petition (i.e., *prior* to inspection), a credit union that has *already* provided access to its records has very little recourse. The court system provides a uniform means to arbitrate disputes, yet litigation can be costly, time-consuming and burdensome.

### **Member Inspection Rights**

Upon proper petition, the proposed rule would permit members to inspect and copy the nonconfidential portions of the FCU's books and records of account and minutes of the proceedings of the credit union's members, board of directors, and committees of directors.

#### *“Minutes”*

The proposed rule interprets “minutes” broadly; the term would include any summary or recording of the proceedings, as well as all documents, reports, studies, and visual aids considered by participants in the meeting.

While we generally agree that members may have a right to access meeting minutes, NAFCU believes that the proposed interpretation of “minutes” is overly broad and could have a chilling effect on board and committee deliberations. Board and committee deliberations often involve very sensitive issues related to the business of the credit union, strategic planning, or credit union personnel. A free and candid exchange of ideas of credit union leadership is essential to the success and well-being of the credit union. NAFCU is concerned that an unnecessarily broad interpretation of minutes could stifle free discussion amongst the board and we encourage the agency to establish a more narrow interpretation. For example, NAFCU does not believe that closed executive session minutes should be subject to member inspection.



Additionally, NAFCU is concerned that an overly broad definition of minutes could lead some credit unions to maintain only basic meeting minutes. Boards seeking to protect proprietary information may rely on ‘off the record’ conversations or minimally detailed meeting minutes, for fear that information will be exploited. This would negate the very purpose of permitting member access (i.e., increasing transparency); as such, NAFCU urges NCUA to interpret “minutes” narrowly.

#### *Books and record of account*

The proposed rule takes a narrow interpretation of the phrase “books and records of account” to include only financial records. NAFCU agrees with this approach. Members’ understanding of the term is most likely based on its plain language meaning which, as noted in the preamble to the proposed rule, supports a limitation to accounting records.

#### *Inspection and copying*

The proposed rule also permits members to both inspect and copy credit union records. NAFCU agrees that inspection and note taking should be permitted; however, we do not believe that members should be allowed to copy and remove credit union records. While the petition requirement would purportedly ensure that a proper purpose exists before members may gain access to credit union records, there can be no assurance that copied records will thereafter be used for legitimate purposes. Once sensitive proprietary information leaves the control of the credit union, it is at perpetual risk of misuse by competitors, oppositional groups or other unauthorized third parties. As such, NAFCU recommends that, consistent with NCUA’s proposed rule on merger-related compensation, only inspection should be permitted.

### **Confidential Records**

The proposal would provide confidentiality protection for documents that are prohibited from being disclosed under federal law, documents containing nonpublic personal information, and personal information about employees and officials. However, internal memoranda, trade secrets and privileged documents would be subject to inspection. Additionally, the proposed confidentiality provision provides for an express exception for information regarding qualifications, compensation and benefits of “senior executive officers.”

NAFCU does not believe that the proposed rule provides sufficient confidentiality protection for credit union records.

#### *Trade secrets and privileged documents*

NAFCU strongly recommends that privileged documents and information analogous to trade secrets be provided with confidentiality protection. In the preamble to the proposed



rule, NCUA asserts that “credit unions do not generally have trade secrets, that is, secret formulas or technology on which the success of the organization is dependent.” NAFCU, however, disagrees with this assertion. While we acknowledge that credit unions do not generally have “secret formulas or technology,” credit union records contain myriad covert plans, for example those concerning growth strategies, succession, disaster recovery, marketing, demographic studies, entrance into new markets, and other “secret” plans for which the success of the credit union is dependent. NAFCU believes that these and other similar records must be protected in order to ensure the credit union’s success and to preserve the members’ financial interests.

Privileged documents, in particular, information subject to the attorney-client privilege and exempt from discovery in court cases should also be withheld from member inspection. The attorney-client privilege “is the oldest of the privileges for confidential communications known to the common law.” *Upjohn Co. v. U.S.*, 449 U.S. 383, 389 (1981). “Although the underlying rationale for the privilege has changed over time . . . courts long have viewed its central concern as on ‘to encourage full and frank communication between attorneys and their clients and thereby promote broader public interests in the observance of law and administration of justice.’” *U.S. v. Zolin*, 491 U.S. 554, 562 (1988) (citations omitted). The attorney-client privilege is a firmly entrenched legal doctrine, the importance of which is very well established. Accordingly, NAFCU urges the agency to provide confidentiality protection for privileged materials.

At minimum, should the final rule permit copying, NAFCU suggests that privileged documents be exempted from such requirement, to ensure that privileged information remains within the custody and control of the credit union and thus, protected from any harmful dissemination to unauthorized parties.

#### *Executive compensation*

The proposed rule explicitly permits members to inspect materials describing the qualifications, compensation and benefits of “senior executive officers.”

Recently, transparency of executive compensation of non-profit and tax-exempt executives has been a major concern on Capitol Hill. NCUA’s Outreach Task Force is currently considering this issue. NAFCU believes that transparency of executive compensation is an important issue that must be considered carefully and deliberatively by the agency. At this time, we feel that it is prudent that NCUA refrain from addressing this issue in the current rulemaking. If based on the recommendation of the Outreach Task Force and other considerations the NCUA Board determines that greater transparency is needed, the method and process for collecting and disclosing executive compensation should be dealt with in a separate, comprehensive rulemaking. Further, NCUA should provide ample advance opportunity for public comment before promulgating any proposed rule on executive compensation.





*Other sensitive records*

Other records are crucial to the safety and protection of the credit union and should not be subject to member inspection. For example, building schematics, IT and security system blueprints, information identifying any alarm monitoring company, internal security reports (which may note deficiencies or weaknesses in alarms or perimeter security), and designs or outlines of other physical security measures are highly sensitive and should remain confidential to ensure that the credit union is effectively safeguarded.

**Inspection Procedures**

*14-day compliance timeline*

The agency has proposed a 14-day compliance deadline to ensure that credit unions respond promptly to member petitions for access to records. The OTS rule does not impose a similar compliance timeline.

NAFCU does not believe that the proposed timeline allows for sufficient time for credit unions to respond to member requests for inspection. In many instances, requested records will be stored off-site, requiring additional time for delivery to the credit union. Also, the credit union may in some cases wish to refer the member petition to its attorney for review, which would require more time. Sufficient time must also be provided to allow the credit union to verify the signatures on the petition.

Accordingly, NAFCU suggests that a 30-day timeline is reasonable. Additionally, we request clarification on whether the compliance timeline is measured in calendar or business days.

**Dispute Resolution Procedures**

The proposed rule does not establish a specific timeframe for regional director action on disputes between an FCU and its members concerning a petition for inspection or the associated costs; the rule also does not establish a right to appeal to the NCUA Board.

NAFCU recommends that a reasonable timeframe be established for action on dispute resolution requests. While we acknowledge that the circumstances under which a dispute might arise vary, NAFCU believes that the adoption of a general timeframe would be beneficial to both the credit union and the members. NAFCU also urges the agency to allow for appeals to the NCUA Board. The right to appeal is fundamental to any dispute resolution process and ensures fairness and consistency by serving as an important check on the regional directors' authority.



Ms. Mary F. Rupp

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NAFCU appreciates the opportunity to comment on this proposed rulemaking. Should you have any questions or require additional information please call me or Pamela Yu, NAFCU's Associate Director of Regulatory Affairs, at (703) 522-4770 or (800) 336-4644 ext. 218.

Sincerely,



B. Dan Berger  
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