Fried, Frank, Harris, Shriver & Jacobson LLP
1001 Pennsylvania Avenue, NW
Washington, DC 20004-2505
Tel: 202.639.7000
Fax: 202.639.7003
www.friedfrank.com

50

Direct Line: 202.639.7200
Fax: 202.639.7003
vartath@ffhsj.com

August 20, 2007

FRIED FRANK

Via Courier

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

Re: FCU Bylaws; Request for Comments

Dear Ms. Rupp:

Thank you for the opportunity to comment on the National Credit Union Administration's ("NCUA") proposed rule reincorporating the Federal Credit Union ("FCU") Bylaws into NCUA regulations.

Fried Frank is an international law firm that represents regulated financial institutions around the world in a variety of corporate, regulatory, securities, litigation and related matters. A number of the firm's partners have served in various capacities in federal bank regulatory agencies and are well-versed in the issues raised by the proposed rule. It is from this perspective that we assert that there are fatal flaws in the proposed rule that require it be withdrawn in its entirety. Among other things, the proposal cannot pass muster under the standards of the Administrative Procedures Act if it merely presents, as it continuously does, unsupported conclusions and statements that offer the public no real opportunity to comment on the rationale upon which the agency is relying.

The NCUA's Authority Over Bylaw Disputes

The proposed rule does not set forth a sufficient basis for the NCUA's conclusion that it has the authority or state law expertise to enforce FCU bylaws, even though state contract law and the courts already provide FCU members with adequate remedies for breaches of FCU bylaws. The NCUA does not offer any empirical evidence demonstrating that FCU members do not currently have adequate remedies for alleged

bylaw violations or that "reincorporating" its form FCU Bylaws into its regulations is necessary in order to protect members' contract rights under their bylaws.[1]

We respectfully disagree with the NCUA's determination that "another major [bylaw] review is unnecessary at this time" and that the NCUA need not revise its form FCU Bylaws before they are reincorporated into the NCUA's regulations. Provisions of the form FCU Bylaws, including provisions relating to the procedures for calling and conducting special meetings of members and provisions countenancing the removal of an FCU's entire board of directors by the votes of only a small group of dissident members who are physically present at a special meeting, are archaic, obsolete and violate the democratic principles of FCUs, as embodied in the Federal Credit Union Act

---

[1] The NCUA attempts to justify its effort to enhance its regulatory authority over FCU bylaw disputes by asserting that it "has learned of cases where members have been unable to use the judicial system to enforce rights granted by the Bylaws." The NCUA also asserts that, although it "continues to maintain members can enforce [FCU] bylaws as a contract, . . . in certain circumstances, this remedy may not be practical or provide adequate relief due to circumstances such as timing and cost." However, the NCUA does not cite any such "cases," does not identify any of the purported "challenges members can face in seeking to enforce the bylaws," and does not present any empirical evidence supporting its belief that members have been "unable to use the judicial system" to enforce their rights under FCU bylaws. In addition, the NCUA does not provide a meaningful opportunity for public comment because it does not explain or identify the following:

(i) why judicial enforcement of bylaw provisions would be inadequate, given that bylaws are contracts between FCUs and their members and may be enforced by the courts, as the NCUA consistently has acknowledged for more than 20 years;

(ii) why the NCUA should have the authority to intercede in state contract law disputes between FCUs and their members;

(iii) the basis for the NCUA's assumption that it has the expertise or authority to interpret and enforce state contract law;

(iv) the circumstances under which the NCUA would become involved in a bylaw dispute or institute an enforcement action under the proposed rule;

(v) the circumstances under which the NCUA would exercise the enforcement powers granted by the proposed rule, beyond the NCUA's cryptic statement that "credit union officials or members should contact the [NCUA's] regional office" in the event that a bylaw dispute "cannot be resolved";

(vi) the circumstances under which the NCUA would determine whether a bylaw dispute "cannot be resolved," necessitating NCUA intervention;

(vii) the circumstances under which the NCUA would exercise its purportedly "clear discretion to take administrative action as warranted" where a bylaw dispute involves "fundamental, material credit union member rights"; and

(viii) why any remedies that the NCUA would attempt to fashion would be superior to the remedies already available to FCU members under state contract law.

("FCUA") itself. As discussed at the end of this comment, a superior approach would be a modernization of the bylaws to incorporate contemporary governance practices. If NCUA enforcement of FCU bylaws is still deemed to be necessary at that point, then any rule or regulation that the NCUA promulgates should include specific criteria that must be met before the NCUA would become involved in a bylaw dispute and should identify the actions, escalations and appeal rights that would be available in the event of a dispute. The proposed rule does not address any of these issues.

Extreme Remedies

The NCUA rationalizes its desire for expanded administrative powers by citing a purported need for additional mechanisms by which the NCUA could address violations of FCU bylaws beyond the "extreme remed[ies]" of charter suspension/revocation or involuntary liquidation. However, the additional "remedy" that the proposed rule creates – allowing a very small percentage of an FCU's membership to force a quick vote, remove an entire board of directors, replace it with an unelected supervisory committee and, sometime thereafter, replace them with another group of inexperienced members – would be a truly extreme remedy that would have a devastating impact on an FCU, leaving it in an unsafe and unsound condition.[2] The NCUA explains neither its bald assertion that any such remedy is "a more appropriate" response to a bylaw violation than the state contract law remedies that already are available to FCU members, nor how it can or why it should foster unsafe and unsound practices and conditions to develop at FCUs.

Supervisory Committee

The proposal would create a new bylaw change related to the responsibilities of an FCU's supervisory committee if, "for any reason, including removal or other inability to serve, an FCU has no remaining directors." This proposed rule is fatally flawed since, among other reasons, it would exceed the scope of the NCUA's authority because (i) the FCUA requires that an FCU's board of directors be comprised of no fewer than five directors and that any vacancies on a board be filled by the remaining directors,[3] (ii) the

---

[2] We believe that no federal banking agency would ever permit the arbitrary removal of an entire board of directors by a small fraction of the shareholders without good cause, or by a small number of shareholders of a commercial bank or thrift institution. Such an action would, in most instances, leave the bank in an unsafe and unsound condition. Indeed, in this regard, the NCUA appears to afford the members of FCUs ownership rights for which there is no support under the law and related cases that speak to the rights of depositors of similar institutions. In fact, the NCUA is providing FCU members with more ownership rights and privileges than shareholders of a bank who actually do own the bank. Offering a proposal that does not attempt to explain the rational for such actions raises significant issues.

[3] *See* 12 U.S.C. § 1761(a).

NCUA cannot allow or facilitate an unsafe and unsound practice or condition (*e.g.*, having no board of directors), and (iii) the volunteer members of an FCU's supervisory committee, who previously believed they had a specific charge to oversee the board, could find themselves acting as the FCU's board with no clear authority to do so. The FCU would be at risk that each and every action taken or transaction completed, which would not likely be insured or insurable under the FCU's insurance policies, while the supervisory committee purported to act as the board of directors, could be challenged by members, service providers, or third parties as being *ultra vires* or otherwise unauthorized. At the same time, if the supervisory committee could not act on policy matters, the FCU would be left rudderless and leaderless. This vacuum of credit union leadership, responsibility and direction would continue until new directors were elected to the board, which likely would take many months given the extensive time required to conduct valid board elections.

Rights and Principles

The proposed rule appears to portray membership rights in a new way that is unsupported by either the law or NCUA precedents. The NCUA has previously opined that a member's "fundamental" rights to vote and maintain a share account cannot be taken away without a special meeting. This proposal expands these basic rights to include access to facilities, participation in the election process and removal of directors and committee members. The NCUA indicates that "these rights are those that go to the very heart of the cooperative principles that serve as the cornerstone of the credit union system." But the NCUA's assertion ignores the fact that an FCU's bylaws set forth the specific member rights that the FCU and its membership have decided should be defined as "fundamental" for the members of that FCU.[4] Rather than seek to dictate industry philosophies, the NCUA should focus on its intended purpose as a safety and soundness regulator. In substance the NCUA intends to impose its administrative, economic and political philosophies on all FCUs, thereby usurping the right of each individual credit union's membership to self govern.

Burden of the Proposed Rule

We also respectfully disagree with the NCUA's conclusions that promulgation of the proposed rule would impose no new regulatory burden, would not increase paperwork requirements under the Paperwork Reduction Act and OMB regulations, and would not have "substantial direct effects" on state interests. The NCUA cites no basis for or evidence supporting these assertions, and we would argue there are bases to conclude

---

[4] The NCUA also asserts, without identifying any factual basis or empirical evidence, that, "[f]or most FCUs], the option to draft bylaws completely on their own is unattractive because of the amount of research required to ensure inclusion of all necessary provisions."

the opposite. In fact, the NCUA does not provide any information to enable commenters to evaluate these conclusions. The proposed change would be a reversal of 25 years of NCUA policy and guidance, under which parties have looked to state and federal courts and state contract law to resolve bylaw disputes. As a result, there are no precedents that FCUs can study to understand when the NCUA will get involved in FCU bylaw disputes and what specific enforcement tools it would use. Such uncertainty is a significant regulatory burden and hinders the FCUs ability to make well-reasoned decisions.

The NCUA Does Not Identify Its Actual Motivation for the Proposed Rule

Finally, among other things, given the absence of specific explanations and support in the proposed rule, a reviewing court would be on solid ground to allow parties to probe the NCUA's actual motivation for seeking to adopt the rule, which the NCUA has not revealed to the public in the proposal. Some may argue, based on the NCUA's recent actions in a variety of matters involving proposed conversions of FCUs, that the agency's motivation actually may be to prevent any and all reasonable and legitimate efforts to convert FCUs into federal mutual savings banks. The NCUA's enabling of very small numbers of FCU members to call unlimited special meetings, block corporate decisions, punish FCU board members, and even remove all of them without good cause raises the fundamental policy question of why the NCUA would ever support forms of FCU governance that no other regulator has or would.

For all of the reasons summarized/outlined above, the NCUA should withdraw the proposal as any adoption of it would be arbitrary and capricious, beyond the scope of the NCUA's authority and in violation of applicable law.

Modernization of FCU Bylaws

NCUA should evaluate the extent to which it and its form FCU bylaws actually undercut good corporate governance and promote institutional anarchy. **For example, we understand that the NCUA and its form bylaws would allow 8 members of an FCU with 100,000 members (a mere 0.008% of its membership) to remove the entire board of directors.**[5] Should the NCUA, in an honest effort to promote principles of good corporate governance, issue a revised proposed rule curing the deficiencies identified above in the present proposal, then any such revised proposal

---

[5] Under the form bylaws currently in use by FCUs, we understand that the NCUA would assert that an FCU with 00,000 members could arguably be required to call a special meeting if just 750 members signed a petition. We urther understand that the NCUA takes the position that only in-person voting would be permitted at such a meeting. 'hus, if just 15 members attended the meeting, a majority of that "quorum" – 8 members – could remove all of the irectors. Any suggestion that such a result would represent the product of sound democratic corporate governance

dressing the procedures for calling and conducting special meetings of FCU members ould provide, at a minimum, consistent with corporate governance practices of banks d thrift institutions, that

(i) any petition seeking a special meeting must contain a reasonably representative number of signatures of the FCU's current members before a special meeting may be called;

(ii) any vote conducted in connection with a special meeting must be balloted, and both FCU members who physically attend the meeting and those who do not physically attend the meeting must be provided the opportunity to cast ballots;

(iii) FCU members, including members who do not physically attend a special meeting, must be allowed a reasonable amount of time to cast their ballots in any vote conducted in connection with any such meeting (*e.g.*, 45 days);

(iv) a minimum voter turnout constituting a sufficient level of member participation to ensure that the will of the members will be adequately represented, as represented in person or by their ballots, should be required in order to constitute a quorum for the transaction of business at any such special meeting; and

(v) an FCU director may be removed from office at a special meeting called for that purpose only by the affirmative votes of a percentage of the FCU's members who are at that time eligible to vote in the FCU's annual election of directors that is sufficient to ensure that the will of the members will be adequately represented.

urge the NCUA to look to standard corporate governance principles in use oughout the country and study the abuses that can result from permitting a fraction of voting members or shareholders to speak for the majority.

appreciate the opportunity to comment on this proposed regulation.

5

Respectfully yours,

Thomas P. Vartanian

Credit Union National Association
National Association of Federal Credit Unions