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April 28, 2008

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

RE: Comments on Advance Notice of Proposed Rulemaking for Parts 708a and 708b

Dear Ms. Rupp:

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), I am writing in response to the National Credit Union Administration's (NCUA) request for public comment on the advance notice of proposed rulemaking (ANPR) regarding member rights relative to mergers, conversions from a credit union charter, and account insurance termination.

Specifically, NCUA is considering the possibility of issuing regulations to govern the merger of a federally insured credit union (FICU) into, or a FICU's conversion to, a financial institution other than a mutual savings bank (MSB). NCUA is also considering amending its regulations to address issues such as communications to members, voting integrity, insider fiduciary duties, and member interest in credit union equity.

NAFCU appreciates the agency's thoughtful consideration of these important member rights issues, which are so intrinsic to the principles of democratic and mutual ownership that lie at the very core of the credit union system. The types of transactions that the ANPR seeks to address can involve significant changes to the structure of a credit union and can have fundamental ramifications for member-ownership rights. As such, we recognize the agency's significant efforts to thoroughly examine and contemplate these complex issues.

However, given the considerable challenges presented by the present economic downturn, NAFCU cannot support additional regulatory burdens in the area of mergers and conversions at this time. NAFCU urges that, particularly in this difficult economic environment, the agency should exercise restraint in its pursuit of policy initiatives that are peripheral to NCUA's safety and soundness responsibilities. Instead, NAFCU encourages NCUA to focus its attention on enhancing credit union powers to foster greater operational efficiencies, in order that

the industry may endure through the current economic crisis and continue to thrive into the future.

Should NCUA decide to move forward with a proposed rulemaking, however, NAFCU continues to strongly support initiatives to enhance transparency in the mergers and/or conversions process. As such, NAFCU would not be opposed to some clarification of the standards for communications to members. We elaborate on these recommendations and provide detailed comments below.

Merger or Conversion into a Financial Institution Other than an MSB

Currently, NCUA uses a case-by-case approach in considering petitions for credit union mergers or conversions into a financial institution other than an MSB. However, the agency is considering whether to establish a new administrative and regulatory framework to govern these types of transactions.

As you know, several cases have arisen in the past few years for which there was no real precedent, giving rise to a multitude of novel policy issues in the mergers and conversions arena. Given the considerable concern among NAFCU's membership of the potential ramifications of these unprecedented cases, we appreciate the agency's action to consider these issues carefully by means of an advance notice of proposed rulemaking.

Over at least the past year, as part of a "top to bottom assessment of the standards and practices through which a member relates to their credit union," (*See* NCUA Media Advisory (January 23, 2007)) NCUA has issued a number of rulemakings to address issues related to member rights. *See* Member Inspection of Credit Union Books, Records, and Minutes, 72 FR 20061 (April 23, 2007); 72 FR 56247 (October 3, 2007); Disclosure of Merger Related Compensation Arrangements, 72 FR 20067 (April 23, 2007); and Federal Credit Union Bylaws, 72 FR 30984 (June 5, 2007); 72 FR 61495 (October 31, 2007). Further, amendments to the agency's conversion rules, which strengthened member protections, were completed in 2006. *See* Conversion of Insured Credit Unions to Mutual Savings Banks, 71 FR 77150 (December 22, 2006).

While NAFCU recognizes the fundamental importance of safeguarding member rights, particularly in the context of transactions that may fundamentally alter member-ownership rights, we believe that the agency's recent rulemakings are sufficient to allow NCUA to appropriately address any isolated cases of abuse that may arise with regard to mergers or conversions of credit unions into a financial institution other than an a mutual savings bank (MSB). Thus, particularly in light of the current economic climate, it is our opinion that new regulations are imprudent at this time.

Further, NAFCU urges the agency to be cautious not to hinder voluntary mergers or conversions. NAFCU firmly believes that federal credit unions should have the ability to fully exercise their business judgment to merge or convert should it be in their members' best interest. And while we recognize that transparency in the process is crucial to ensuring that interests of

the members remain paramount in any decision to enter into a merger or conversion transaction, NAFCU is concerned that additional regulation of this area may have a chilling effect on the right of federal credit unions to make reasonable business decisions to benefit their members. Accordingly, NAFCU firmly believes that any rulemaking should avoid imposing unnecessary barriers to voluntary merger or unduly interfere with credit unions' reasonable business judgment.

Management's Duties

While it is clear that a fiduciary duty exists, case law applying fiduciary principles in the trust and corporate contexts vary widely from jurisdiction to jurisdiction, and neither the FCU Act nor NCUA regulations establish a standard of care for directors. As such, NCUA is considering establishing, by regulation, a uniform standard of care for directors who are considering proposals for restructuring transactions. The agency is also seeking comment on the need for additional regulatory provisions to guard against insider enrichment.

Fiduciary Duties and a Regulatory Standard of Care

While NAFCU acknowledges some potential benefits to establishing a uniform regulatory standard of care for credit union boards of directors, we feel this issue warrants further study and discussion. Due to the significant complexity involved with state law preemption and other relevant issues, more careful consideration must be given to the potential legal implications of a federal standard of care. Accordingly, NAFCU believes it is prudent that NCUA refrain from regulating credit union fiduciary duties at this time.

Insider Enrichment

To ensure that credit union officials are not driven by personal gain at the expense of member interests in restructuring transactions, NCUA is considering establishing a record date requirement for members voting on a conversion proposal or other transaction.

Should NCUA determine to move forward with a further rulemaking, NAFCU is supportive of a record date requirement for members voting on restructuring proposals. In our opinion, a record date requirement would be a reasonable and effective means of ensuring that a conversion vote is not purposefully skewed by individuals who are attempting to interfere with the voting results for their own financial gain. Care should be taken, however, to ensure that legitimate, albeit new, members are not disenfranchised. As such, NAFCU suggests that a record date requirement of at least six months prior to any credit union board approval of a conversion proposal would be effective in guarding against insider enrichment, while ensuring that genuine, well-intentioned members are not deprived of their democratic rights of ownership.

Member Right to Equity

In order to address the potential issue of unequal net worth ratios among merging credit unions and the possibility of unfair treatment of members of the credit union with the higher net worth, NCUA is considering either (1) requiring a merger dividend, or (2) requiring the board of directors of a merging credit union to consider members' right to equity as part of its due diligence, allowing the board to come to its own conclusion on whether to provide a merger dividend, and justify that decision to the credit union membership.

To ensure that credit unions maintain sufficient flexibility to make sound business decisions in the best interest of their members, NAFCU does not support a required merger dividend. Determining whether capital equalization is appropriate in any given case requires careful and nuanced analysis. Requiring a merger dividend in all mergers would impose a one-size-fits-all approach that ignores the variables and complexities that are specific to each merger situation. Indeed, the many factors at play in any particular merger decision will vary greatly from case to case.

Furthermore, we observe that it is arguable whether credit union members have a legal right to have equity returned to them in a merger situation; indeed, members have no clear legal right to equity, except in liquidation. Accordingly, NAFCU favors the more flexible approach, which would provide each credit union's board of directors with the individual discretion to determine whether an equalization of capital is in the best interest of the members, and to determine their own calculation of any appropriate merger dividend.

Communications to Members

False Endorsements

NCUA is considering a regulatory prohibition on communications from credit union officials that state or imply that NCUA has endorsed the charter change transaction or the accompanying credit union materials. Alternatively, the agency is considering requiring a credit union to include a statement in its materials that NCUA has not endorsed the transaction.

NAFCU continues to strongly support enhanced member transparency, particularly in the conversions context. To ensure that the conversion process is fair, it is crucial that members are fully informed of the potential benefits and detriments that a charter change may have on the ownership interests of the members. As such, NAFCU is supportive of a regulatory prohibition on false endorsements.

We do not, however, feel that it is appropriate to require a disclosure which expressly states that "NCUA has *not* endorsed the restructuring transaction." Such a negative statement is misleading in and of itself, as members could easily misinterpret this disclaimer as implying that NCUA actually opposes the transaction. While NAFCU would not be opposed to a neutral statement, any required disclosure must be carefully worded to ensure that it is clear that NCUA neither endorses *nor* opposes the transaction.

Impact on Kind and Quality of Services

In light of the agency's observance of several past transactions, in which credit unions have made inaccurate or misleading statements to members about the services that would be available after completion of the transaction, the NCUA is considering requiring converting credit unions to disclose this type of information to members.

Information regarding any loss or reduction of credit union services or member convenience can be critical to a member's voting decision. Thus, NAFCU agrees that converting credit unions should be required to disclose this type of information to members prior to any conversion vote. However, NAFCU would caution against any disclosure requirement that is too speculative. In our opinion, credit unions should disclose any reasonably certain or determinate loss or reduction of services within their knowledge at the time of the disclosure, but should not be required to conjecture as to any and all potential downgrades in service or convenience that may occur as a result of the transaction.

"Hostile Takeovers"

Last year, the credit union community experienced an unprecedented "hostile takeover" attempt of one credit union by another. In the so-called hostile takeover scenario, an institution seeking merger communicates directly with the members of the targeted credit union—against the wishes of the target's management and board—in order to encourage the membership to support the merger or consolidation. To address this issue of third party merger communications in a hostile takeover situation, NCUA is considering the possibility of issuing a new regulation or amending a current rule to address these types of scenarios.

NAFCU believes that cooperation is not only vital to the integrity of our industry but also to the safety and soundness of the National Credit Union Share Insurance Fund and its unparalleled record. In that regard, hostile takeovers among credit unions may threaten the cooperative tradition of the credit union system by undermining the key credit union philosophy of mutual assistance and support.

While recognizing that a greater trend toward coerced mergers could have a significant adverse impact on the entire credit union system, NAFCU has concerns about regulating third party merger communications, particularly with regard to the practicality of enforcing such rules. As such, NAFCU believes that credit union boards should have the option of adopting FCU Bylaws provisions in accordance with corporate law, to address issues relating to hostile takeovers and/or third party merger communications.

We believe that such corporate governance issues are best addressed on the individual credit union level, rather than via broad regulation. For example, Pentagon Federal Credit Union recently adopted a board resolution to maintain its credit union charter, which states, in part:

> "The board of directors recognizes the importance and value to its membership of Pentagon Federal Credit Union's mutual form of ownership as a federal credit union. . . The board of directors will consider a change in the institution's organizational form only under circumstances that would materially and negatively impact the benefits accruing to the membership from its current organizational form, and only when another organizational form would provide greater benefits. . ."

Encouraging credit union boards to adopt similar protections could create additional safeguards against coercive merger attempts by credit unions, banks, and other financial institutions, while still preserving key principles of fair competition and member choice.

Member Voting

Member Right to Request a Recount

In light of certain irregularities and improprieties in voting procedures that have been observed by the agency in some of the close votes taken in recent years, NCUA is considering a recount provision or a rule that would permit members to request a formal recount of a merger or conversion vote.

Recognizing the importance of voting integrity, especially in instances involving fundamental restructuring transactions, NAFCU agrees that there circumstances in which a voting recount should be undertaken. For example, a recount may be appropriate where the voting margin is very close (i.e., margin is less than 1%), or where there is evidence of impropriety or irregularity that may have undermined the final tally. However, it is our opinion that voting integrity and other discrete corporate governance issues should be addressed via credit union bylaws as opposed to regulation. Accordingly, NAFCU recommends that NCUA consider amendments to the FCU Bylaws, to encourage credit union boards to establish formal procedures for voting recounts.

Interim Tallies

NCUA has also observed certain potentially inappropriate uses of interim tallies in some recent FICU to MSB conversions. For example, the agency has observed situations where credit union management has sought periodic running tallies from the election teller to determine how many members have voted "yes" and "no" and how many have not voted. To ensure that such tactics do not improperly influence the outcome of a membership vote, NCUA is considering various means for ensuring the integrity of the voting process, including prohibiting interim vote tallies and banning credit union employees from soliciting members to vote.

Again, NAFCU emphasizes that specific corporate governance issues, including those relating to member voting, are best addressed through credit union bylaws or resolutions and we do not support formal regulation in this area.

Nevertheless, NAFCU agrees that interim tallies of "yes" and "no" votes are generally inappropriate. However, we observe that running tallies may be suitable if only to determine the number of votes that have been cast. Such tallies allow credit unions to assure reasonable member participation in a vote. Additionally, NAFCU believes that employees should be permitted to encourage members to vote. In most cases, credit union employees are also credit union members and they should be permitted to freely exercise their democratic ownership rights, including the ability to speak with other members about the direction of their credit union.

NAFCU appreciates the opportunity to share its views on these important issues. 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,

Carrie R. Hunt
Senior Counsel and Director of Regulatory Affairs

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