IDAHO
DEPARTMENT OF FINANCE

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April 29, 2008

MARY RUPP
SECRETARY OF THE BOARD
NATIONAL CREDIT UNION ADMINISTRATION
1775 DUKE STREET
ALEXANDRIA, VIRGINIA 22314-3428

RE: RIN 3133-AD40; Notice of Proposed Rulemaking; 71 Fed. Reg. 5461-01

Dear Secretary Rupp:

The Idaho Department of Finance (Department) appreciates the opportunity to comment on the Advance Notice of Proposed Rulemaking and Request for Comment (ANPR), RIN 3133-AD40, 71 Fed. Reg. 5461-01.

In the ANPR, the National Credit Union Administration (NCUA) notes that the focus of the ANPR is protection of member interests in six types of transactions: merger of an FICU into an FICU; merger of an FICU into a Privately Insured Credit Union (PICU); conversion of a Federally-Insured State Credit Union (FISCU) into a PICU; conversion of an FICU into an MSB; merger of an FICU into a financial institution other than a Mutual Savings Bank (MSB); and conversion of an FICU into a financial institution other than an MSB. The NCUA has requested comment on several proposals which would focus on these transactions. Those proposals and our comments follow.

A. Merger or Conversion to a Financial Institution Other Than an MSB

The NCUA has requested comment on whether it should issue a rule regulating the merger or conversion of credit unions into a financial institution other than an MSB or continue to address these transactions under the NCUA's statutory authority. The NCUA speculates that a rule governing these transactions would likely be complex. We would anticipate the same.

Credit unions are currently subject to state laws which regulate mergers as well as conversions to a different type of entity. Many provisions in these laws are designed to protect the shareholders

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or members of such entities. It is unlikely that credit unions or their members would benefit from a complex new regulatory structure intended to offer

similar or additional protections. Adding a complex regulatory structure to this process would significantly increase the costs of doing a merger or conversion transaction. A new federal regulatory structure governing these transactions would likely purport to preempt existing state laws which are inconsistent with it. The NCUA's proposed
regulation would establish extensive member notice, voting, and approval requirements; it would establish a standard of care for directors and officers considering conversions; it would establish record dates for member voting on conversions; it would require credit union directors to set a merger dividend in the case of the merger of credit unions with unequal net worth; and it would establish limitations on member contacts when the management of a credit union is proposing a merger or conversion. With the exception of conversions to Mutual Savings Banks, we are not aware of any statutory authority for the promulgation of a regulation preempting state law in this area (corporate governance), at least insofar as federally insured state-chartered credit unions (FISCUs) are concerned.

In the case of state-chartered credit unions, Idaho law provides ample authority for the Department to regulate conversions undertaken by Idaho credit unions and to monitor and prevent actions which would be detrimental to the interests of credit union members. Idaho Code §§ 26-1812 and 26-1813. The NCUA's proposals would preempt most, if not all of the provisions of these laws.

The foregoing proposals would purport to preempt significant portions of state laws dealing with corporate governance. The NCUA cites 12 U.S.C. § 1766(a), 12 U.S.C. § 1785(b), 12 U.S.C. § 1785(c), and 12 U.S.C. § 1789(a) as authority for its proposed regulation. None of these statutes either expressly or by implication evidences Congressional intent to preempt state laws pertaining to corporate governance in the case of FISCUs. FISCUs derive their very existence from the laws of the states in which they are chartered. It would be illogical at best to remove the power to regulate corporate governance from the jurisdiction which chartered a corporation.

Among other things, the non-profit corporation laws in the states are designed to protect the interests of the members of nonprofit corporations. In the case of FISCUs, the NCUA's proposal would replace an existing regulatory structure which protects members' interests with one designed by the NCUA. The NCUA has not demonstrated a compelling reason for doing this. The scenarios discussed in the ANPR do not justify the creation of a new regulatory framework to address them. Further, the NCUA has failed to demonstrate that the issues discussed in the ANPR are not addressed under existing federal or state law.

The addition of such a regulatory structure would create confusion and uncertainty for credit unions desiring to merge or convert to another entity while complying with both federal and state

law in the process. The added costs and confusion would not be sufficiently offset by any enhanced protection to credit union members.

In summary, we believe that a new NCUA rule regulating credit unions' mergers or conversions to another type of financial institution would be outside of the agency's authority, ill-advised and detrimental to the interests of credit union members.

B. Issues Affecting Members' Interests

The NCUA has requested comment on a number of issues which affect the interests of credit union members in restructuring transactions.

1. Management's Duties. The NCUA seeks comment on the need for a regulation establishing a standard of care for directors to help ensure that directors meet their fiduciary duty to credit union members. The NCUA recognizes that this is an area currently governed by state law. The NCUA opines that a uniform standard on this issue may eliminate confusion in the state-to-state differences in this area. We strongly **oppose** the issuance of a regulation by the NCUA to create a standard of care for credit union directors.

An NCUA regulation creating a standard of care for credit union directors would be intended to preempt existing state statutory and case law governing the subject. The Idaho Nonprofit Corporation Act (INCA) specifically delineates the standards of care applicable to the directors of non-profit corporations. Nonprofit corporation directors must act in good faith, with the care an ordinarily prudent person would exercise under similar circumstances, and in a manner the director reasonably believes to be in the best interests of the corporation. Idaho Code § 30-3-80. The NCUA's proposed regulation would preempt this rule in the case of Idaho state-chartered credit unions. In addition to the fact that there is no statutory authority for the preemption of state law in this area, the NCUA has not articulated sufficient justification for doing this.

The INCA also addresses conflict of interest transactions engaged in by non-profit corporation directors. Idaho Code § 30-3-81. There is no demonstrated need to enact a federal regulation which would cover the same issues and preempt existing state law on the subject. The mere fact that differences exist from state to state is not a lawful basis to preempt state law. If this provided adequate basis for the preemption of state law, there would be little law in this country other than federal law.

As opposed to laws which restrict things such as permissible fees and credit practices, laws dealing with directors' fiduciary duties do not impact the day-to-day operations of credit unions, nor do they affect credit unions' costs of doing business. These laws only come into play when a director has done something inappropriate or detrimental to credit union members or members' interests. In light of these considerations, there is no value in having a uniform standard governing the fiduciary duties of directors as an alternative to existing state law on the subject.

We are also unaware of any provision in the Federal Credit Union Act which would empower the NCUA to issue a regulation preempting state laws governing the fiduciary duties of directors and officers of state- chartered credit unions. Uniformity is not adequate justification for replacing state law with an NCUA-designed standard governing the fiduciary duties of directors in merger and conversion transactions.

In the ANPR, the NCUA acknowledges that merger and conversion transactions are legally permissible. 73 FR 5462. Despite that acknowledgment, the NCUA states "many observers believe" conversions to an institution other than an MSB are in the best interest of members only in unusual circumstances. 73 FR 5463. These statements cause one to question whether the NCUA's apparent goals are consistent with the mandate of Congress.

For these reasons, we **oppose** the NCUA's issuance of a regulation creating a uniform standard of care for credit union directors.

2. Insider Enrichment. The NCUA has observed a problem with family members of credit union board members joining credit unions in noticeable numbers before a conversion transaction in order to take advantage of the eventual sale of the new entity's stock. Although we have not observed this problem, we would find it very troubling. To the extent this problem arises, it can be addressed under existing state laws such as the INCA. The INCA deals with conflict of interest transactions engaged in by non-profit corporation directors. Idaho Code § 30-3-81.

The INCA deals extensively with the subjects of record date for notice, voting, and members' exercise of any rights with respect to lawful actions of a non-profit corporation. Idaho Code § 30-3-52. This statute generally allows the record date for member voting and other actions to be determined by the bylaws of a non-profit corporation.

Under the INCA, if the bylaws are silent on the issue and the directors have not fixed the record date in advance of the action, only members on the books at the close of business on the day the board adopts the resolution relating to the action, or the sixtieth day prior to the date of such action, whichever is later, are entitled to exercise their rights or vote. *Id.* These Idaho statutory restrictions present a significant impediment to the scenario where family members of the board join a credit union prior to a conversion in order to take advantage of the eventual sale of stock. The NCUA's proposal would purportedly preempt these restrictions. Such a result would be without benefit to credit unions or their members.

3. Member Right to Equity. The NCUA notes that there can be unequal net worth ratios among merging credit unions. The NCUA further notes that this imbalance can result in unfair treatment of members of a credit union with higher net worth than the credit union's merger partner. To address this issue, the NCUA proposes a regulation requiring a merger dividend in such cases or alternatively requiring credit unions' boards to consider this issue in their pre-merger due diligence. The NCUA recognizes that not imposing such a requirement allows credit unions the flexibility to decide for themselves whether to include a merger dividend in merger negotiations, as well as the calculation of a merger dividend. This flexibility should remain in place.

A merger dividend requirement would inject the NCUA into the deliberations occurring when a credit union's board considers a potential merger. This requirement would give the NCUA some control over the monetary terms of a merger. This is a matter which is not within the province of a financial institution regulator. The requirement would be analogous to giving a governmental agency the authority to set the price and terms (including shareholder stock exchange ratios) of a merger between two for-profit business corporations. This would significantly overstep the boundaries of legitimate government oversight of such transactions.

The INCA requires non-profit corporations to have a plan of merger prior to completing a merger transaction. Idaho Code § 30-3-100. Not only must the board of directors approve the plan of merger, the members must approve it by a majority vote. Idaho Credit Union Act (ICUA), at Idaho Code § 26-2132. In light of these requirements, the members of a credit union can block a merger if the members will not be treated equitably in the transaction.

Under Idaho law, if the articles of incorporation or bylaws of a non-profit corporation require that amendments to the articles or bylaws be approved by a third person other than the board, this approval requirement must be met in a

merger transaction. *Id.* These existing statutory requirements provide ample safeguards to ensure that the members of a merging state-chartered credit union will not receive inequitable treatment in the transaction. These existing state law protections would purportedly be preempted by the NCUA's proposal.

For the foregoing reasons, we **oppose** this proposal.

4. Communications to Members. The NCUA is concerned that improper communications are made with members when a credit union is considering a conversion. The NCUA believes there are occasions when a credit union's board has implied to members that the NCUA endorses the transaction. To address the problem, the NCUA is considering specifically prohibiting communications from credit union officials that state or imply that the NCUA endorses the charter change. The NCUA is also considering requiring a credit union to include a statement in its materials to the effect that the NCUA has not endorsed the transaction.

We believe there may be value in prohibiting credit union officials from stating or implying that the NCUA endorses a charter change when that is not the case. Such conduct is clearly improper and we support the NCUA's effort to deal with this problem, assuming that it is not a rare occurrence.

We strongly **oppose** a requirement that a credit union include a statement in merger materials sent to members that the NCUA has not endorsed the transaction. This would create a problem similar to the one the NCUA is attempting to address. Such a statement would carry the implication that the NCUA is against the charter change or feels it is ill-advised. As with an attempt by credit union officials to suggest that the NCUA endorses a conversion, this requirement would be equally improper. It would also add to the costs of the materials a credit union must prepare and send to its members in the event of a proposal to convert the credit union to another entity. We are therefore **opposed** to such a requirement.

5. Third Party Communications. The NCUA has noted a problem with communications being directed from a credit union desiring to acquire another credit union to the target credit union's members. The NCUA is considering whether to rely on existing regulations to address this problem or to issue a new regulation addressing the problem.

We recommend that the NCUA continue to address this problem through its existing regulations. Tailoring a new regulation to address this problem would be

complex, since communications to a target credit union's members can take many forms and say many things. In some cases, a ban on such communications could prove to be detrimental to the interests of the members of a target credit union. Abuses in this area

should be approached on a case-by-case basis under existing NCUA regulations.

6. Member Voting – Recount Requests and Vote Tallies. The NCUA indicates that in its review of close votes on conversions in recent years, it has found irregularities and improprieties in a number of cases. The NCUA has noted that at times management will obtain interim vote tallies and then contact members who have not voted and encourage them to vote for conversion. The NCUA is considering prohibiting management from obtaining interim vote tallies, prohibiting management from obtaining lists of members who have not voted, prohibiting management from soliciting members to vote, and prohibiting credit union employees from completing ballots or handling ballots.

Many of the activities the NCUA describes are not viewed as problems in the case of for-profit corporations. In proxy statements sent to shareholders, management will give its recommendation on each resolution or other matter to be decided by vote of the shareholders. When an insufficient number of shareholders have completed and submitted their proxy statements on an important issue, it is not uncommon for management to contact shareholders and encourage them to complete and submit their proxy statements. These activities are not rendered inappropriate if the corporation is non-profit as opposed to for-profit.

The NCUA apparently desires to prevent credit union management from in any way commenting on a proposed restructuring of the credit union. Not only is such a goal unrealistic, it is contrary to commonly accepted corporate practices. We **oppose** any attempt by the NCUA to prohibit these activities.

One of the NCUA's proposals for preventing any management influence over members' votes on a restructuring transaction is to prohibit credit union employees from handling or completing ballots. Prohibiting credit union employees from handling ballots would require credit unions to hire an independent third party to handle and count ballots. This would greatly increase the costs of the voting process in these circumstances.

If there is some impropriety in allowing credit union employees to handle member ballots, a prohibition on this should apply to votes on any matter and not just votes on restructuring proposals. Such a prohibition would likely harm, rather

than benefit, the interests of the members of credit unions. For these reasons, we are strongly **opposed** to the NCUA's issuance of a rule prohibiting credit union employees from
handling ballots when members vote on a proposed restructuring transaction.

In summary, most of the issues addressed in the ANPR are governed by existing federal and state law. To the extent the NCUA would adopt rules implementing some or all of the proposals discussed in the ANPR, the NCUA lacks authority to impose any of those requirements on state-chartered credit unions and to preempt state law in the process.

Thank you for affording us the opportunity to comment on the ANPR. We hope you find it helpful in your deliberations regarding the issues discussed in it.

Yours Truly,

Gavin M. Gee, Director
Idaho Department of Finance

cc. Idaho Credit Union League
Idaho State Chartered Credit Unions
National Association of State Credit Union Supervisors

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