



Credit Union National Association

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August 28, 2006

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

Re: 12 C.F.R. 708a, Proposed Changes to NCUA's Rules
On Conversions to Mutual Savings Banks

Dear Ms. Rupp:

The Credit Union National Association (CUNA) appreciates the opportunity to express its views on the agency's proposal to amend its regulations on the conversion of federally insured credit unions to mutual savings banks under 12 CFR 708a, which were published in the *Federal Register* June 28, 2006, with comments due today. By way of background, CUNA is the nation's largest trade association for credit unions, representing approximately 90 percent of the 8,800 state and federal credit unions in this country, which serve nearly 87 million members.

CUNA generally supports the proposal with recommendations for change as discussed below. NCUA has been given an extremely difficult task in implementing the conversion provisions of the Federal Credit Union Act. NCUA must, on the one hand, develop rules that are consistent with those of other regulators, while taking into full account the differences credit unions demonstrate, in order to protect members' interests. Congress provided no guidance as to how NCUA should accomplish this balancing act or how it should determine comparability with other agency's rules when conversion transactions under different agencies are not readily comparable in key areas.

Still, the agency cannot escape its mandated task of adopting a conversion rule that must meet competing objectives. It is regrettable that the agency has had to change its rules a number of times to respond to the changing tactics of conversion consultants. Nonetheless, the agency has not rushed to create changes in a vacuum but rather has developed its amendments, both the current and previous ones, based on its first-hand experiences with earlier conversions in which members' best interests were forfeited or not adequately protected.



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Summary of CUNA's Position

- The proposal is accompanied by solid analysis and explanation.
- The proposal is based on the principles that credit unions are different from banks and that credit union members have rights that do not accrue to bank depositors. CUNA wholeheartedly agrees.
- As a result, there are differences between the fiduciary duties of bank directors and credit union board members, which should be and are reflected in the rule.
- NCUA has sufficient authority to proceed with this proposal and the proposed changes are compatible with conversion regulations of other regulators.
- Important aspects of the proposal include: a process for member involvement prior to the board's vote; a process for members to share information with other members about the conversion; increased disclosures that members historically receive less advantageous rates when a credit union converts; and disclosures about the profits officers and directors typically receive after the conversion.
- While the proposed changes are commendable, CUNA urges NCUA to improve the proposal in a number of ways.
- Key among our recommendations is that NCUA should define "fiduciary duty" for officials in the context of the conversion rule.
- CUNA also strongly recommends that:
 - NCUA review its decision regarding bylaws for federal credit unions and determine that it will enforce properly adopted bylaws;
 - A credit union board should obtain a legal opinion supporting its decision;
 - Members should have the opportunity to review the opinion as well as the conversion plan;
 - The boxed disclosures should be included with all written materials;
 - The boxed disclosure regarding potential profits by directors should be modified to parallel the disclosure on rates and to reflect actual experience;
 - The provisions regarding access to books and records are too vague, even though the intent to ensure board members meet their fiduciary duties is commendable. The proposal should be changed to limit access to minutes and similar documents in which conversion issues are discussed.
 - NCUA should address the use of incentives in the body of the rule as well as in the guidance. The rule should prohibit the improper use of incentives that are offered to affect the outcome of a vote, rather than to encourage participation in the voting process.
 - NCUA's rule should state that it will coordinate with state regulators when a state credit union is converting.

The Development of CUNA's Letter

Our letter was developed under the auspices of the CUNA Examination and Supervision Subcommittee, chaired by Marla Marsh, and reflects comments from credit unions as well as leagues provided through CUNA's Operation Comment and other sources. CUNA utilized a number of resources in the development of our comments, including other state and federal agencies' regulations and related documents; relevant case law; written testimony of Tom

Dorety, President and CEO of Suncoast Schools Federal Credit Union and CUNA Treasurer before the House Subcommittee on Financial Institutions in May 2006; the American Association of Credit Union Leagues' August 2005 report, "Protecting the Rights and Interests of Credit Union Members," and the February 2006 study from the Fiscal and Economic Research Center at the University of Wisconsin –Whitewater, "Credit Union to Mutual Conversions: Do Rate Diverge?" A copy of CUNA's policy on conversions, which provided the foundation for this letter, is attached.

Before discussing specific aspects of NCUA's proposal and our recommendations, we feel it is important to address briefly two significant premises underlying the proposal: first, there are key differences between a credit union and a savings bank, including structural as well as ownership issues, and second, such distinctions must be taken into consideration by NCUA (and by the Office of Thrift Supervision) when a credit union converts to a savings bank in order to protect the interests of the affected members.

Credit Unions Are Different From Banks and Credit Union Members Have Rights Not Afforded to Bank Depositors

As NCUA is well aware, in passing the Credit Union Membership Access Act, CUMAA, Congress found, among other factors, that:

Credit unions, unlike many other participants in the financial services market, are exempt from Federal and most State taxes because they are member-owned, democratically operated, not-for-profit organizations generally managed by volunteer boards of directors.... (Credit Union Membership Access Act of 1998, Pub. L. No. 105-219, 112 Stat. 913 (1998).

This finding reflects the extensive legislative history of CUMAA which is replete with characterizations from Senators, Representatives and other policymakers about the unique structure of credit unions and the fact that there are not in business to maximize profits for stockholders.

These comments are best summarized in the statements of then Treasury Assistant Secretary for Financial Institutions, Richard Carnell, in his testimony to the Senate Banking Committee March 26, 1998.

As not-for-profit depository institutions, credit unions add something special to our financial system. They give their members an alternative cooperative structure for depositing savings and obtaining credit and other financial services. The credit union ideal is one of mutual self-help. ...Credit unions are member-owned and member-directed cooperatives. That is part of what makes them different." *Hearings on the Implications of the Recent Supreme Court Decision Concerning Credit Union Membership (First of Two Hearings): Hearing before the Senate Banking, Housing and Urban Affairs Committee, 105th Cong. (1998) (statement of the Hon. Richard S. Carnell, Assistant Secretary for Financial Institutions, Department of the Treasury).*

Unlike credit union members, mutual savings bank depositors generally have a limited interest in their bank, as a result of statutory and regulatory limitations. While there are a number of comparisons that would demonstrate this point, one of the most notable variances is the treatment of the equity in a mutual savings bank contrasted with the equity in a credit union.

The OTS has incorporated into its regulatory rulings a 2002 Maine Superior Court decision, *Guitard v. Gorham Savings Bank*, 2002 Me. Super. LEXIS 82 (2002), that recognizes only the narrowest of rights of depositors to the equity of a savings bank. Citing a 1992 case that “casts doubt on the status of depositors as equity owners of mutual savings banks...,” the Court stated that depositors in a mutual savings bank have only a “nebulous and contingent interest above and beyond the right to their deposits plus contractual interest.” *Id.*, at *4. Following that decision, the OTS issued a statement, P-2002-7, addressing the limited rights of federal mutual savings association members to the bank’s equity:

Federal law does not give the members of federal mutual savings associations any right to dividends or other distributions of the capital of such savings association except if (1) the board of directors of the savings association has exercised its discretion to declare a dividend and complied with applicable OTS regulations, or (2) there is an OTS authorized solvent liquidation of the institution. Carolyn J. Buck, OTS, Dept. of Treas. Letter No. P-2002-7, *The Rights of Federal Mutual Savings Association Members to Distributions of Capital*, June 21, 2002.

OTS also addresses this issue in its handbook, Office of Thrift Supervision, *Regulatory Handbook* §110 (2003). “The concept of ownership in mutual savings associations resulted in extensive discussion and subsequent litigation,” OTS’s Handbook states. “The courts have determined that mutual account holders have only a contingent interest in the surplus of mutual savings associations in the event of liquidation.” *Id.*

A recent study, “Credit Union Conversion to Banks: Fact, Incentives, Issues and Reforms,” James A. Wilcox, HAAS School of Business, University of California at Berkeley 2006, looks at the equity ownership issue in the context of conversions and concludes:

The OTS has recognized that, given the workings of the standard conversion method in practice, managers and directors often have the opportunity to transfer to themselves considerable amounts of the value (equity) in converting institutions. The OTS argues, however, this standard method strikes an appropriate balance between those outcomes and the opportunity to infuse significant amounts of new capital into the thrift industry.

This treatment contrasts sharply with the members’ ownership of the equity of a credit union. As stated most recently by NCUA in its Supervisory Letter No. 06-01, “Evaluating Earnings”:

As a cooperative not-for-profit organization, a credit union’s mission is to provide financial services to their [sic] members, not to earn a profit for stockholders. Any economic value generated by the credit union that is undistributed (i.e., not used to absorb costs or provide an immediate return to the members) **is held on behalf of and owned by the members.** (emphasis added)

In light of these differences discussed above, not only is it good policy for NCUA to develop rules that recognize the unique attributes of credit unions, but also it is imperative that the agency take such differences into account in fulfilling its duties under the Federal Credit Union Act to recognize and protect the interests of the members of credit unions.

NCUA's Rulemaking Authority on Conversions

CUNA strongly agrees that NCUA has sufficient rulemaking authority to ensure credit union members' best interests are preserved in the conversion process, which is an important objective of each new change the agency is proposing.

The Federal Credit Union Act imposes requirements on converting credit unions and NCUA in a number of areas, such as the requirement for a conversion proposal; disclosure to members; the membership vote and NCUA's approval of the administration thereof; notice to NCUA; the prohibition of unjust enrichment; and the directive to NCUA to write a conversion rule (12 U.S.C. §1785). Each of the proposals falls within one or more of the statutory directives and with some limited exceptions, as discussed, is generally consistent with principles of fairness, transparency, membership ownership, and thwarting inappropriate compensation to officials.

While we support NCUA's analysis that its proposal is consistent with requirements of other regulators, including state agencies, it is important to note an anomaly in current law. The voting requirement for a credit union conversion is notably lower than the requirement for a mutual savings bank conversion to a mutual holding company or stock association. Even though to change from a credit union to a bank is arguably a far more drastic step than a conversion from a bank to a mutual holding company structure, the former may be accomplished by a majority of those choosing to vote, whereas, the latter requires votes by a majority of all eligible members. That key difference, in our view, gives NCUA additional latitude in developing a rule that protects members' interests and ensures the voting as well as disclosure processes are fair, and the significance of the transaction is fully appreciated by the membership.

Proposed New Requirements

I. Before the CU's Board Votes On the Conversion

NCUA is proposing several new requirements that a credit union board must meet prior to the time it votes on the conversion proposal. This is a critical time period in the conversion process, and the proposal would establish a procedure under which this time frame would be utilized to further members' interests.

Currently, boards have no incentives or inducements, other than their own understanding of their fiduciary duties, to reveal their intentions to their members until after the board has already decided to approve the conversion. This result strengthens the position of pro-conversion consultants and facilitates the ability of boards to make single-minded decisions without sufficient information or consideration of members' views.

Under the proposal, members would be apprised of the board's impending action and be afforded opportunities to present different views to the board and other members before the board votes on the conversion proposal. CUNA supports these amendments and makes recommendations for facilitating the ability of members to communicate with the board and other members, as discussed below.

The proposal would require a credit union's board to inform members about the potential for a conversion by publishing a notice in a local newspaper and on the credit union's website, and by providing a notice in the credit union's offices no later than 30 days before the meeting in

which the board will vote on the conversion proposal. NCUA is specifically seeking comments on whether the final rule should direct or permit the use of other communication channels, such as statement stuffers to members. CUNA supports the use of such other communication outlets as well. For example, if a credit union communicates with its members via e-mail, the notice should be provided through that medium as well.

Notices must inform members they can comment to the credit union board before it votes, and the board must review those comments before it decides whether to support the conversion. Copies of the comments must be maintained at the credit union's main office and, as applicable, on the credit union's website until the conversion is completed. These are positive changes which will help to improve the board's decision-making process by compelling it to consider a broader range of views. We also support permitting the members to review the conversion plan. The disclosures should highlight that the plan is available for inspection, upon proper request, and that members may comment to the board about specific aspects of the proposal.

In order to support the conversion, each board member that approves the plan must determine that the conversion is in the best interests of the members. This is a critical addition, which we strongly endorse. We also urge NCUA to include factors in the guidance to the regulation that would instruct board members on how this determination is to be made. For example, if a credit union is seeking to convert in order to increase its member business lending activity, how has the board assessed whether members are interested in obtaining more loans of this nature?

We further recommend that NCUA require that the board obtain an opinion from counsel that discusses the board's compliance with applicable legal requirements, and that the opinion should be available to the members upon request. This requirement will assist the board in making a comprehensive assessment about the advisability of a conversion.

II. Disclosures and Communications to Members Prior to the Membership Vote

NCUA is proposing amendments that would address the conversion process after the board has approved the conversion plan. We support these changes, including the revisions to the 90, 60 and 30-day notices, and offer additional recommendations as discussed below.

NCUA is proposing that the ballot may only be distributed with the last notice thirty days before the vote and notices provided 90 and 60 days before the vote must state that a written ballot will be mailed with the 30-day notice. This is a key change as it will prevent conversion supporters from enticing premature votes before members have had a chance to understand all that is at stake.

Another important change is that the 90-day notice must inform members that if they wish to provide material to the members, they can submit them to the CU and the CU will submit them to the members. A contact for delivery of the materials and a statement that the member must reimburse the CU and provide an advance payment must be included.

The current rule requires some key disclosures to be presented in a box to draw more attention to them. NCUA is proposing that additional information regarding the loss of credit union membership, rates on loans and savings and potential profits by officers and directors be included in the boxed section. We support these changes.

NCUA is seeking specific comments on how rates, fees and service levels have changed in credit unions that have converted to banks. The data demonstrate that following a conversion, members have been disadvantaged through lower savings rates and higher loan rates and charges. In that connection, we are attaching our testimony before the House Financial Services Subcommittee in May detailing the facts that members typically receive less favorable treatment after a conversion.

NCUA is also requesting specific comments on changes in disclosures regarding compensation for directors and management in credit unions that have converted to banks, Disclosure # 3, Potential Profits By Officers and Directors. Disclosures. How this information should be disclosed was the subject of considerable discussion during the House hearing in May, in which such a disclosure was characterized as “speculative.” We disagree with that depiction. However, to make the disclosure parallel with Disclosure #2, Rates on Loans and Savings, the second sentence of that disclosure should be amended to state:

Available historic data indicate that in such situations, the officers and directors of the institution have profited by obtaining stock in excess of that available to other members.

This statement is factual and in our view will better assist members because it clearly discloses that insiders have indeed routinely benefited disproportionately in mutual to stock conversions.

The proposal would establish a procedure under which members may request to have the credit union send materials expressing their views on the conversion to other members. We strongly endorse this procedure and think a disclosure should be added to the required notices informing credit union members that they may provide such materials to be distributed to the members.

Currently, all written communications on the conversion must include the boxed disclosures. The proposal states that the boxed disclosures would only be sent with the 90, 60, and 30-day notices. CUNA supports retention of the current treatment that the boxed disclosures must be included with all written communications. However, we do not support limiting verbal communications and are confining this recommendation to written communications only.

We also support a change in the rule that would prohibit the board or other members to refute the boxed disclosures in materials that are provided to the membership. The boxed disclosures provide essential information to the members and help to inform them about the nature of the conversion. They present facts, not opinion, and should not be subject to interpretation or rebuttal.

Finally regarding this section, we support the addition of a new disclosure that would inform members that if they have concerns about the conversion process and the way it is being handled, they can communicate such concerns directly to the appropriate NCUA regional office. Such a disclosure would state:

The directors and management of your credit union must act with due care on your behalf as a member of the credit union. This means that they cannot place their interests above those of the credit union or its members. If you feel that the officials of the credit union are not acting in the best interests of the members in the conversion process, you can contact the National Credit Union Administration at _____. NCUA is an agency of the federal government which oversees the conversion voting process.

We think such a disclosure fits the congressional mandate that NCUA's conversion rule be no more or less restrictive than other conversion rules as the proposal imposes no new requirements on a credit union. Further, it is consistent with the objectives of the conversion regulations to ensure the process is fair, balanced and in the members' best interests.

III. Member Voting Rights

NCUA proposes to retain the current requirement that disclosures explain how credit union member voting rights differ from those of a mutual savings bank depositor. These disclosures are essential in order for members to understand and appreciate what a conversion will mean for them. CUNA also supports a change to this section that would allow members to change their votes, until the time balloting closes at the special meeting. This change would help prevent hasty decisions that, upon reflection, members might regret. It is consistent with the members' rights to control the fate of the credit union and could be handled to preserve current requirements for secret balloting. It is also consistent with the ability of stockholders to change their proxies.

IV. Notice to NCUA of the Board's Intent to Convert (provided during the 90-day period preceding the membership vote)

NCUA is proposing several new requirements concerning the notice to NCUA of the board's decision to present the conversion issue to the membership. CUNA supports the new requirements, including the proposed requirement that a credit union board must submit a certification of its support for the conversion proposal and plan that is signed by each supporting board member.

The certification would include a statement that each director signing the document supports the proposed conversion and believes that the proposed conversion is in the best interests of the members of the credit union. The certification requirement is extremely important and reinforces the proper execution of the board's fiduciary duties. The board would also have to attest to the accuracy of the materials submitted to NCUA in connection with the conversion, which is also consistent with the board's implementation of its fiduciary obligations.

Currently, a credit union may request NCUA to make a preliminary determination regarding the intended methods and procedures applicable to the membership vote. The proposal expands that process to allow a credit union to also request review of all of its proposed notices, including the public notice it intends to publish before the board of directors vote on a conversion proposal. This is a positive change that will improve the conversion process and help ensure compliance responsibilities are fully met.

V. Membership Approval Process

Currently, the board of a converting credit union must certify the results of the member vote to NCUA within ten days of the member vote and certify that the materials provided to the members were the same as those previously submitted to NCUA or explain the differences. NCUA's proposal clarifies that the credit union board must set a date to determine member eligibility to vote and that the voting date of record must be at least one hundred and twenty days before the credit union board publishes the notice of intent to consider conversion. We support these changes.

The Bylaws for Federal Credit Unions developed by NCUA are an important source of instruction for federal credit unions, particularly in the conversion process. Elsewhere in this letter CUNA discusses additional changes to the bylaws that we feel are highly appropriate, given recent legal developments. Regarding the voting process, CUNA encourages NCUA to consider whether the bylaws should be amended to set a quorum requirement that is higher than 15 members for annual and special meetings.

VI. NCUA Oversight of the Voting Process

NCUA is proposing amendments to its approval of the membership vote and attendant process. CUNA supports these changes. Currently, a regional director must issue a determination to approve or disapprove a credit union's methods and procedures for the membership vote within ten calendar days of the receipt of the credit union's certification of the member vote. The NCUA Board is proposing to lengthen this time period to 30 calendar days and clarify in the rule that a credit union dissatisfied with the determination would be permitted to appeal to the NCUA Board for a final agency determination.

These changes allow NCUA more time to review the voting process while imposing no real burden on the credit union.

VII. Completion of Conversion

NCUA is proposing to amend the current rule to require a credit union to complete the conversion transaction within one year of the date of receipt of its approval from NCUA. Otherwise, the process starts all over, although as we understand the proposal, disclosures that remain accurate could be utilized in an additional conversion attempt. While OTS permits a two-year year period before the process must be renewed, we think NCUA's proposed changes are appropriate and legally supportable. The changes are fair to the affected parties and consistent with NCUA's efforts to ensure the conversion is conducted in the members' best interests. For depositors who have no real ownership interests, whether the institution converts in one or three years time should be of no consequence. However, for credit unions, there should be an opportunity to review the matter after a year if a member-approved conversion has not been completed.

VIII. Review of Books and Records of CUs

The proposed rule includes a new provision stating that members may request access to the books and records of the converting credit union for purposes such as facilitating contact with other members about the conversion or obtaining copies of documents related to the due diligence performed by the credit union's board.

This provision is designed to ensure board members have met fiduciary duties in considering the conversion and would enhance transparency by permitting the members to review documents that relate to the board's conversion deliberations. These objectives are laudable.

However, while acknowledging that members are entitled to appropriate access, credit unions who contacted CUNA on the proposal raised considerable concern about these provisions. After considering their issues and NCUA's discussion of the proposed amendments, CUNA is recommending modifications which we believe will improve the provisions and achieve the agency's objectives to promote transparency and facilitate execution of the board's fiduciary duties.

CUNA recommends that NCUA clarify the kinds of documents that members could review, such as a copy of the conversion proposal, written copies of the minutes addressing the conversion or summaries of the board's conversion discussions at board meetings, and similar related documents, including the comments of other members, as required elsewhere in the proposal.

It should be made clear in the rule that the access to books and records does not give members permission to disrupt the normal course of business or to have access to information restricted by privacy laws or safety and soundness considerations.

IX. Use of Prizes and/or Raffles

In this proposal, NCUA has chosen not to prohibit the use of prize raffles in the context of a conversion but rather provides a discussion in the guidelines. CUNA strongly supports NCUA's objective to ensure a fair process by cautioning credit unions on the use of raffles to induce a positive vote, but urges the agency to strengthen these provisions.

We recommend that NCUA add a provision to the regulation to prohibit the improper use of prizes that seek to affect the vote's outcome as opposed to encouraging voter participation. The voting guidelines that address incentives should also be retained.

Under the voting guidelines that accompany the proposal, credit unions offering incentives to members, such as an entry for a prize raffle, to encourage participation in the conversion vote, must exercise care in the design and execution of such incentives.

The guidelines state that credit unions should ensure that the incentives comply with all applicable state, federal, and local laws; that the incentives should not be unreasonable in size; and that all materials promoting the incentive to members should make clear that they have an equal opportunity to participate in the incentive program regardless of whether they vote for or against the conversion.

The guidelines are positive as far as they go, but we think NCUA has authority to include in the regulation a ban on the improper use of such incentives, such as prizes offered to affect the outcome of the vote, not just to increase member participation.

In this connection, we strongly recommend that NCUA retain the language in the guidelines and add an amendment to Section 708a.6, "Membership Approval of a Proposal to Convert" to state:

(d) Voting incentives. It is improper for credit unions to offer incentives to their members to affect the outcome of a conversion vote. Credit union boards offering incentives to encourage participation should ensure such incentives are consistent with the Voting Guidelines, Sec. 708a.13.

X. NCUA Should Include a Discussion of "Fiduciary Duty" in the Conversion Regulation

One area in which we believe NCUA has more authority than it has chosen to use is in addressing "fiduciary duty" within the context of the rule itself, as opposed to discussing the term and its ramifications in the *Supplementary Information*.

NCUA discusses the fiduciary duty of board members and senior staff in the *Supplementary Information*, and the points raised are well reasoned. However, rather than address this highly significant terminology in the accompanying discussion, NCUA should clearly define the term in the rule, noting specific factors that comprise “fiduciary duty,” as discussed below.

A plain language definition would facilitate a credit union board member’s understanding of the level of care she or he must take when executing official duties related to a conversion, while fostering members’ appreciation of their rights. The definition should not attempt to establish all the elements of “fiduciary duty” or provide a mechanism for individual members to challenge the routine workings of the credit union. Rather, a clear statement of the basic concept of “fiduciary duty” would serve as guidance for credit union officials as they consider conversion issues and assist the members as they assess the extent to which board and senior management are acting in the best interests of the membership.

It is important to note that for the most part, directors are volunteers, a fact which must be taken into consideration in discussion of fiduciary obligations. However, as courts have determined, volunteer status does not relieve an individual of the responsibility to meet his or her official duties. This position is reinforced by the fact that provisions such as those contained in Financial Institutions Reform, Recovery and Enforcement Act (FIRREA) which address breach of duties, apply to credit union directors as well as to directors of banks and thrifts.

In light of these considerations, “fiduciary duty” should be defined as:

A legal obligation directors and senior management have in their capacity as officials of the credit union to place the interests of the credit union’s membership ahead of their own personal financial interests.

In addition to the definition, we believe NCUA should address “fiduciary duty” in the voting guidelines and discuss officials’ obligations to act with due care and prudence, with loyalty to the membership, and in good faith. The guidelines should also discuss factors in the context of a potential conversion that board members should consider in fulfilling their duties which include: the extent to which the board has considered whether the conversion is in the member’s best interests; the extent to which the stated reasons for the conversion reflect business objectives that conform to the members well-documented needs; whether alternatives to the conversion are appropriate for consideration; and whether modifications in the credit union’s business plans and/or execution, as opposed to conversion, would better address the members’ needs.

NCUA has authority under the Federal Credit Union Act to determine what constitutes “fiduciary duty” as that term applies to the relationship of the directors and senior management of a credit union to the membership.

This reasonable conclusion is based on provisions in the Act that direct NCUA to regulate credit union actions in the best interests of the members. Such provisions, which presuppose a common understanding by the agency and a credit union’s board of what those duties entail, include NCUA’s authority to disapprove the addition of an individual to a credit union’s board if such addition “would not be in the best interests of the [members], 12 U.S. C. §1790a(e); require special reserves of state credit unions “for protecting the interests of members...,” 12 U.S. C. §1781(b)(6); and NCUA’s authority to examine a credit union in voluntary liquidation if the liquidation “is not being conducted ...in the best interests of ...members,” 12 U.S. C. §1766.

Also, under the FIRREA amendments to the FCUA, NCUA was given authority to assess civil money penalties against institution-affiliated parties for “breach of fiduciary duty,” 12 U.S.C. §1786. As NCUA has authority to execute this provision, it should have authority to define its terms.

There is another reason why NCUA has an important role to play in articulating the fiduciary duties of credit union board of directors and management. One obligation of directors of limited-purpose organizations is surely to make certain that the organization fulfills its purposes. For instance, a director of a charitable organization has a duty to ensure that the organization fulfills its charitable purposes; if he or she were to ensure that the organization generated substantial revenue, without ensuring that those revenues were put to work for charity, that director would have failed to fulfill his or her duties. Similarly, credit unions have certain purposes, defined by Congress or state legislatures, depending on whether a credit union is federally or state-chartered.

NCUA is the agency with expertise on the federal credit union charter and the purposes for which it was created. These included promoting thrift and providing a source or credit for provident or productive purposes. In addition, the very concept of member ownership—which creates an identity of interest between the institution and its users by eliminating third-party suppliers of capital, such as shareholders—suggests that the purpose of a credit union is to promote member interests above all. When member ownership is coupled with not-for-profit status, as it is in credit unions, the case is even stronger that the inherent purpose of the institution is to help members, rather than its board or management. These ideas are the basis of the traditional credit union motto, “not for profit, not for charity, but for service.” Only NCUA (other than credit unions themselves) has the understanding of the relevant statutes and history to set practical standards for the implementation of these concepts.

In reviewing the fiduciary duty of credit union boards and management, NCUA cites several court cases and compares the rights of credit union members to those of the shareholders of a corporation, who like credit union members, own their institution.¹

In *Anheuser-Busch Employees Federal Credit Union v. FDIC*, 651 F. Supp. 718 (1986), the court clearly analogized the ownership status of credit union member to shareholders in a public corporation. Noting that such a duty is owed to the members as a result of their ownership interests in the credit union, the court said that the duty owed to members is similar to the duty owed to the shareholders of a corporation.

The issue of whether a definition of “fiduciary duty” would render NCUA’s conversion rule incompatible with those of other regulators must be considered. In CUNA’s view, adding this definition would be entirely consistent, particularly considering NCUA’s discussion on the issue of comparability in the *Supplementary Information* (71 Fed. Reg. 36,947 (June 28, 2006)).

Based on NCUA’s analysis of “comparability” in the *Supplementary Information*, the definition should be included because it does not contravene a requirement of OTS or the FDIC and is no more or less restrictive than directives from other regulators.

While OTS does not include a definition within its conversion requirements, it has issued legal opinions on fiduciary duties, including those referenced by the Supreme Court in *Atherton v.*

¹ A recent state court case in Washington raises issues regarding the fiduciary duty of credit union directors. That case turns wholly on specific directives in state law that has not been applied elsewhere.

FDIC, 519 U.S. 213 (1997). There is no documentation available to the public from OTS that indicates these opinions do not apply to decisions made during a conversion.

Also, in February of this year, OTS issued proposed regulations to permit the adoption of standard bylaws, including a bylaw that discusses fiduciary duties of savings bank directors. 71 Fed Reg. 7,695 (Feb. 14, 2006). Even though the adoption of the bylaws would be optional, the duties they highlight are required standards that OTS has identified and that directors must meet.

Importantly, the definition CUNA is proposing does not establish **any** new restrictions but merely recognizes and seeks to call directors attention to the fiduciary duties they already face, and particularly in the context of a conversion, when the life of the institution as a credit union is under consideration.

Further, the definition is consistent with the conversion principles of NCUA as well as with other regulators in that it furthers “an orderly and fair conversion process that takes into account the interests of the credit union’s owners...and ensures they make an informed conversion decision.” (71 Fed. Reg. 36,948 (June 28, 2006)).

The *Atherton* case referenced above is a 1997 Supreme Court case that some may cite as precluding federal regulators from defining “fiduciary duty.” We think the case does not bar such action, for the following reasons. (Much has been made of this 1997 Supreme Court case, and it was cited prominently by banking groups in their opposition to the OTS’s bylaw change referenced above.) In that case, the Court was asked to recognize a federal common law standard of care and conduct for directors. *Atherton* held that in general courts should look to state law when considering certain corporate governance issues and that Congress through a FIRREA amendment (12 U.S. C. §1821(k)) had established a “floor” for determining at least “gross negligence” which cannot be lowered by looser state standards. A corollary from *Atherton* is that, generally, there is no colorable argument for federal common law as it applies to issues such as fiduciary duty, “absent some congressional authorization to formulate substantive rules of decision.” 519 U.S. at 226.

In our view, Congress has provided sufficient authority for NCUA to address “fiduciary duties” as such duties affect virtually every operation of the credit union. The amendment CUNA is advocating would merely incorporate a definition for purposes of reminding directors of their existing duties as they relate to a conversion. We urge NCUA to consider our recommendation and incorporate our proposed definition of “fiduciary duties.”

XI. Bylaw Provisions

Federal credit union bylaws governing the rights of members and corporate governance procedures to be followed during a conversion have received significant attention lately, particularly in light of the DFCU conversion case.

Sly v. DFCU Financial FCU, No. 2:06-CV-12400 (E.D. Mich. 2006).

Central to that litigation was a bylaw provision that allowed the members to call a special meeting, in this case to remove the directors. Even though members followed the requirements of the bylaws, when the directors refused to hold such a meeting, the members turned to NCUA to enforce the bylaws. NCUA failed to stand behind the bylaws, leaving the members no recourse but to go to court.

The DFCU case is complex. However, one issue that is very clear is that directors and members alike should be able to rely on the bylaws to handle corporate governance issues, including conversion issues. When that is not the case, chaos may ensue and principles of fairness, good order, and the best interests of the members will likely be compromised, as they have been in the DFCU situation. The enforcement of bylaws should not be strictly a matter of legal action, which is costly and may not afford a timely remedy.

Separate from the conversion context, federal credit unions across the country are scratching their heads, wondering why they need to follow the agency's bylaws and amendment procedures.

CUNA urges NCUA to redress this unfortunate stalemate and review its position thereby enforcing bylaw provisions for federal credit unions, particularly as they relate to the conversion process.

Also regarding the bylaws, in addition to addressing their enforceability, NCUA should allow credit unions to adopt a bylaw provision that spells out the fiduciary duties of board members, with NCUA's definition and state law requirements serving as a foundation to which additional duties may be added by the directors themselves.

XII. State Credit Unions

The proposal would apply to federal and state credit unions, although state credit unions would have to comply with the laws of their state that are more restrictive.

As is the process for certain determinations under Prompt Corrective Action, we recommend NCUA include language in the final rule that requires the agency to coordinate with the relevant state regulator, when a state credit union is involved. This should not be a burden on the process, as the state and federal regulators already discuss pending conversions. However, we feel that it is important for dual chartering that the rule expressly acknowledges state interests in this manner and that NCUA will consult with the appropriate state regulator on conversion issues to identify particular interests that have a bearing on the interests of the members. The *Supplementary Information* to the final rule should explain, however, that in light of some previous conversions such as in Texas, if coordination is not possible, NCUA will nonetheless execute its legal responsibilities.

XIII. Regulatory Burden

As acknowledged by NCUA, the proposal would increase the time and resources a credit union must devote to meeting its compliance responsibilities under NCUA's conversion rule. CUNA supports efforts by NCUA to closely monitor this issue under the new regulation.

Conclusion

As stated above, NCUA has a complicated task in implementing the conversion provisions of the Federal Credit Union Act. In developing this proposal, NCUA has made a good faith effort to consider the extent of its authority and develop modifications that are designed to improve the conversion process by adding protections for the membership, while remaining within the confines of congressional intent. CUNA supports the proposal with modifications as discussed above.

Thank you for the opportunity to present our comments. If you have questions about this letter or CUNA's views, please do not hesitate to contact me.

Sincerely,

A handwritten signature in cursive script that reads "Mary Mitchell Dunn". The signature is written in black ink and is positioned to the left of a vertical red line.

Mary Mitchell Dunn
CUNA SVP and Deputy General Counsel

Appendix A

- CUNA's Policy on Conversions

CUNA POSITION ON CONVERSION TO A MUTUAL THRIFT/BANK

Position (*adopted February 2004, last updated June 2005*): CUNA fully accepts its responsibility to protect and advance the cooperative structure of the U.S. Credit Union movement. Specifically, regarding credit union conversions:

- We support the right of member/owners to exercise their democratic control of their credit unions.
- The credit union charter currently provides the best vehicle for serving the financial needs of consumers.
- CUNA encourages credit unions that are considering conversions to make their decisions based solely on the best interests of their members.
- Full, plain language, disclosures are essential to furthering the democratic process.
- Credit union directors and managers have a fiduciary responsibility to present objective and honest information as well as reasonable business alternatives (e.g. mergers, liquidations).
- We believe that the net worth of the credit union belongs to the members and should remain with them. There should be no unjust enrichment to directors and senior management upon later conversion to a bank.
- CUNA supports NCUA and state regulators in the full use of their current authority to ensure members understand the conversion process and that fiduciary duties of credit union boards are fully enforced.

To further these principles, the Board is directing CUNA to:

- Support and advocate the strongest possible federal and state charter enhancements for credit unions.
- Work with NCUA and state regulators to ensure that their current statutory authority is fully used. For example:
 - ⌚ Permit bylaw changes to ensure members understand the conversion process and that their interests are protected;
 - ⌚ Establish a public comment period prior to distribution of ballots to members;
 - ⌚ Establish a mechanism for members opposing the conversion to communicate with the full membership;
 - ⌚ Enhance member disclosures so members fully understand the impact to them in the conversion process;

⌚ Ensure the integrity of the voting process including disclosure around the use of credit union funds; and take other actions as necessary.



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Act as the leading "Public Advocate" for the cooperative structure of credit unions, including the promotion of the "America's Credit Unions" philosophy.

- Take steps to help credit unions educate their members about the credit union difference, including members' ownership rights and the cooperative structure of the Credit Union System.
- Seek ways to eliminate "unjust enrichment" in conversions.



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