

**7535-01-U**

**NATIONAL CREDIT UNION ADMINISTRATION**

**12 CFR Parts 701, 704, 708a, and 708b**

**Fiduciary Duties at Federal Credit Unions; Mergers and Conversions of Insured Credit Unions**

**AGENCY:** National Credit Union Administration.

**ACTION:** Notice of proposed rulemaking.

**SUMMARY:** The National Credit Union Administration (NCUA) is issuing a proposed rulemaking covering several related subjects. The proposal documents and clarifies the fiduciary duties and responsibilities of federal credit union directors. The proposal adds new provisions establishing the procedures for insured credit unions merging into banks. The proposal also amends some of the existing regulatory procedures applicable to insured credit union mergers with other credit unions and conversions to banks.

**DATES:** Comments must be received on or before [INSERT DATE 60 DAYS AFTER PUBLICATION IN THE FEDERAL REGISTER].

**ADDRESSES:** You may submit comments by any of the following methods (**Please send comments by one method only**):

- NCUA Web Site:  
<http://www.ncua.gov/Resources/RegulationsOpinionsLaws/ProposedRegulations.aspx>. Follow the instructions for submitting comments.
- E-mail: Address to [regcomments@ncua.gov](mailto:regcomments@ncua.gov). Include “[Your name] Comments on Advance Notice of Proposed Rulemaking (Specialized Lending Activities)” in the e-mail subject line.
- Fax: (703) 518-6319. Use the subject line described above for e-mail.
- Mail: Address to Mary Rupp, Secretary of the Board, National Credit Union Administration, 1775 Duke Street, Alexandria, Virginia 22314-3428.
- Hand Delivery/Courier: Same as mail address.

**FOR FURTHER INFORMATION CONTACT:** Paul Peterson, Director, Applications Section, Office of General Counsel; Elizabeth Wirick, Staff Attorney, Office of General Counsel; or Jacqueline Lussier, Staff Attorney, Office of General Counsel, at the above address or telephone (703) 518-6540.

## **SUPPLEMENTARY INFORMATION:**

### **A. Background**

In January 2008, the NCUA Board issued an Advance Notice of Proposed Rulemaking and Request for Comment (ANPR), asking whether it should adopt rules governing 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). The ANPR also sought comments about whether NCUA should amend its existing regulations regarding mergers, charter conversions, and changes in account insurance. 73 FR 5461 (Jan. 30, 2008). In particular, NCUA sought comments about how these transactions affect member rights and ownership interests, and whether regulatory changes are necessary to better protect member interests.

A particular focus of the ANPR was whether existing rules adequately protect member interests. Interestingly, all of the comments from individual credit union members and credit union attorneys stated that NCUA's current rules relating to conversions and mergers are inadequate.<sup>1</sup> Some of these commenters expressed concern that the fundamental changes brought about by the conversion and merger transactions referenced in the ANPR remove value from a credit union or transfer the value of some owners' interests to others, and so these transactions should be further regulated to protect all credit union member-owners. Accordingly, NCUA is now proposing rules designed to better protect the members.

This proposed rulemaking has four parts. First, a new §701.4 addresses the duties of federal credit union directors in managing the affairs of their credit unions. Second, revisions to part 708a address issues related to credit union conversions to mutual savings banks. Third, a new subpart to part 708a sets forth the procedures for merging a credit union into a bank. Finally, revisions to the existing provisions of part 708b address issues related to credit union mergers with other credit unions and the termination of federal deposit insurance.

The proposed new §701.4 provides that management of each FCU is vested in its board of directors who may delegate authority to carry out functions but not responsibility for the execution of such functions. Among other things, the proposal specifies the directors' duties of loyalty and care, requires that directors understand how to evaluate the credit union's financials, and instructs directors on when they may properly rely on the information and advice of third parties when making decisions. The proposal also

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<sup>1</sup> Several other commenters, including comments from some credit unions, generally opposed any rule changes related to any of the subjects in the ANPR. These commenters argued that prior revisions to the merger regulation as well as the member access to records rule provide adequate regulation of merger and conversion transactions. Some of these commenters also stated that credit unions have sufficient regulation in general and do not need further regulatory burden at this time. A few commenters asserted NCUA lacks authority to further regulate these transactions.

amends §701.33, and NCUA's standard FCU bylaws, to limit the indemnification of FCU directors for liability arising from improper decisions that affect the fundamental rights and interests of the credit union's members. The proposal makes a corresponding change to the standard federal corporate credit union bylaws.

The proposal revises the existing provisions of part 708a on the direct conversion of a credit union to a bank. The revisions are intended to better protect the secrecy and integrity of the voting process, to require converting credit unions provide members with additional information about how the conversion process could affect them, and to require these credit unions to provide NCUA copies of correspondence with other agencies related to the conversion.

The proposal also adds a new subpart to 708a that establishes procedural and substantive requirements for converting a credit union to a bank through a merger. The procedures are, generally, an amalgamation of the existing procedures for merging a credit union into another credit union and the procedures for converting a credit union into a mutual savings bank. The proposal also requires that the credit union determine the value of the transaction to the gaining bank and compensate the members of the merging credit union for the diminution of their ownership rights that results from the merger.

The proposal also provides for several amendments to the existing provisions of part 708b relating to credit union-to-credit union mergers and share insurance conversions. The proposed revisions include provisions that protect the secrecy and integrity of the voting process, that require disclosure to the members of information on any material increases in management compensation connected with the merger, that place time limits on completion of share insurance conversions, and that require disclosures related to share adjustments. The proposal also includes other technical amendments to part 708b.

## **B. Proposed Rule: §701.4 General authorities and duties of Federal credit union boards of directors.**

Proposed §701.4 establishes the fiduciary duties and responsibilities of federal credit union directors. A discussion of the basis for this rule, followed by a detailed paragraph-by-paragraph discussion, follows.

The directors of a credit union have a fiduciary duty to act in the best interests of the credit union members. As discussed in the ANPR, the Federal Credit Union Act (Act) has numerous references to the duty to act in the best interests of the credit union's members, including:

- The NCUA Board may act to remove or prohibit any institution-affiliated party, including a director, of a federally-insured credit union, if the institution-affiliated party has "committed or engaged in any act, omission, or practice, which constitutes a breach of such party's fiduciary duty . . . [and by reason of such

action] . . . the interests of the insured credit union's members have been or could be damaged." 12 U.S.C. 1786(g)(1)(B).

- Credit unions applying for federal account insurance must agree to maintain such special reserves as the NCUA Board may require "for protecting the interests of the members." 12 U.S.C. 1781(b)(6).
- The NCUA Board must review the application of any individual to become a director or senior manager at a newly chartered or troubled federally-insured credit union, and disapprove that application, if acceptance of the applicant would not be in the best interests of the depositors [members]. 12 U.S.C. 1790a.
- When acting as the conservator or liquidating agent of a federally-insured credit union, the NCUA Board may take any action it determines is in the best interests of the credit union's account holders [members]. 12 U.S.C. 1787(b)(2)(J)(2).
- A voluntary liquidation of a federal credit union must be in the best interests of the members. 12 U.S.C. 1766(b)(2).<sup>2</sup>

Although referring specifically to the NCUA Board, these provisions support the conclusion that credit union directors have a fiduciary obligation to credit union members. As previously stated by the NCUA Board:

A closer look at how the cited provisions function, however, connects them to the [credit union's board of] directors. Specifically, the best interests of the members will dictate the [NCUA] Board's actions when removing or prohibiting a director, approving the appointment of a director, operating a conserved credit union in the role of the board of directors, and reviewing the propriety of a board of directors' decision to pursue a voluntary liquidation. If the best interests of the members standard guides the conduct of the [NCUA] Board, it must also guide the conduct of the [credit union's board] of directors.

71 FR 77150, 77155 (Dec. 22, 2006)(preamble to NCUA's final rule on conversions of federally-insured credit unions to mutual savings banks).

A federal credit union's board of directors must understand its fiduciary duty to act in the best interests of the members. This understanding is particularly important when the board is considering a proposal to change the credit union's charter or insurance status. These extraordinary transactions may have a significant impact on the members'

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<sup>2</sup> 73 FR 5461, 5463 (Jan 30, 2008). In addition, NCUA's rule on conversions of insured credit unions to mutual savings banks requires that as part of the credit union's notice to NCUA of its intent to convert to an MSB, the credit union's board of directors must provide a certification of the board of directors' support for the conversion, which must state that each director signing the certification believes the proposed conversion is in the best interests of the credit union's members. 12 CFR 708a.5(a)(2).

financial interests, and may also present conflicts between member interests and the personal financial interests of credit union officials and management.

While the existence of fiduciary duties owed by directors to members is clear, neither the Act nor NCUA regulations provide specificity as to fiduciary duties and standards. Currently, an FCU's board must look to state statutory and case law to determine the scope of its fiduciary duties to members and the standard of care required as articulated by its state of location.<sup>3</sup> Statutory law and case law vary from jurisdiction to jurisdiction causing confusion for FCUs and a lack of uniformity between FCUs in different states.

In fact, NCUA is particularly concerned about assertions that the members of a credit union do not own the credit union, or that the duties of the directors do not flow to the members but, rather, flow in some amorphous way only to the institution. NCUA has observed this view both among some federal credit union directors and in one state court decision.<sup>4</sup> A lack of focus on the interests of the members makes it easier for officials and management to make decisions that benefit themselves personally, even if those decisions are not necessarily in the best interests of the membership as a whole. Accordingly, NCUA wants to make clear that directors at a federally chartered credit union must consider the interests of the membership, and put those interests first, when making decisions that affect the credit union.<sup>5</sup>

Considering the unique interests, concerns, and structure of credit unions as financial cooperatives, NCUA believes having a uniform regulatory standard of care for FCUs may be useful to eliminate confusion and may make it easier for FCU boards to fulfill their duties to members. Accordingly, NCUA is now proposing a regulatory standard of care for directors that will help ensure they meet their fiduciary duties to their members,

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<sup>3</sup> Duties of directors of for-profit corporations have been codified in many states, although fewer states have codified the duties of directors of credit unions. Some state credit union statutes incorporate the law applicable to the directors of for-profit corporations. In *Gully v. Nat'l Credit Union Admin. Brd.*, 341 F.3d 155 (2d Cir. 2003), an appeal from an NCUA prohibition order finding that the manager of a federal credit union engaged in unsafe and unsound practices and that she breached her fiduciary duty as the manager of the credit union, the court applied New York law. "The parties agree that New York law applies to [the] claim of breach of fiduciary duty and that the [federal credit union] is considered a corporation for purposes of New York fiduciary law." *Id.* at 165. The court concluded that New York's fiduciary law was consistent with the standard used by the NCUA Board in its decision. *Id.*

<sup>4</sup> See, e.g., *Save Columbia CU Committee v. Columbia Community Credit Union*, 139 P. 3d 386, 393, 394 (Wash. Ct. App. 2006). The court stated, in dicta, that under Washington state law the directors of a state chartered credit union owed no fiduciary duties to the members of the credit union. Although the credit union was federally insured, the state court did not discuss the applicable provisions of the Federal Credit Union Act.

<sup>5</sup> Of course, in the normal course of business when a board acts in the best interests of the credit union it is usually also furthering the interests of the members. But the duty to act in the best interests of members is primary, and, if there is any theoretical divergence or conflict between the interests of the institution and the interests of the members, the latter takes precedence. For example, when a credit union proposes a voluntary liquidation, the interests of the credit union as an institution, and the interests of the members, may diverge. The Act provides, however, that the decision to undertake a voluntary liquidation is determined by the best interests of the members and not the best interests of the institution. 12 U.S.C. 1766(b)(2).

both in general and also when making decisions that affect the fundamental interests of members.

The proposal provides that management of each FCU is vested in its board of directors who can delegate operational function but not the responsibility for operations. The proposal further provides that an FCU director must:

- Carry out his or her duties in good faith, in a manner reasonably believed to be in the best interests of the membership of the federal credit union, and with such care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstances;
- Administer the affairs of the federal credit union fairly and impartially and without discrimination in favor of or against any particular member;
- Understand the federal credit union's balance sheet and income statement and, ask, as appropriate, substantive questions of management and the internal and external auditors; and
- Direct the operations of the federal credit union in conformity with the requirements set forth in the Federal Credit Union Act (Act), the NCUA's regulations, other applicable law and sound business practices.

The proposal also discusses the authority and limits of the board's ability to rely on information provided by others. A director is generally entitled to rely on information prepared or presented by employees of the federal credit union or consultants whom the director reasonably believes to be reliable and competent in the functions performed.

The proposal also amends the indemnification provisions of NCUA's rules to prohibit a federal credit union from indemnifying officials and employees for liability from misconduct that is grossly negligent, reckless, or willful in connection with a decision that affects the fundamental rights of members. NCUA is also proposing a change to NCUA's standard bylaw on indemnification to conform that bylaw with the proposed change to the rule on indemnification. The proposal makes a corresponding change to the standard federal corporate credit union bylaw on indemnification.

The proposed rule applies to federal credit unions only, and not to state chartered federally-insured credit unions. The proposed rule applies generally to all of the actions of a federal credit union board of directors, but imposes a higher standard of care for actions by the board that affect members' ownership interests in federal credit unions and other fundamental rights. The proposed rule is modeled in part on an existing rule on the powers and responsibilities of the boards of directors of the Federal Home Loan Banks promulgated by the Federal Housing Finance Board in 2000.<sup>6</sup> The proposal is

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<sup>6</sup> 12 CFR § 917.2. See 65 FR 25267 (May 1, 2000) and 65 FR 81 (Jan. 3, 2000). The Federal Housing Finance Agency (FHFA) succeeded the Federal Housing Finance Board (FHFB). Housing and Economic

also based in part on Model Business Corporation Act §8.30, which defines the general standards of conduct for directors of for-profit corporations.

A paragraph-by-paragraph discussion of the rule follows.

§701.4(a) Management of a federal credit union.

Proposed paragraph (a) states:

(a) *Management of a Federal credit union.* The management of each Federal credit union is vested in its board of directors. While a Federal credit union board of directors may delegate the execution of operational functions to Federal credit union personnel, the ultimate responsibility of each Federal credit union's board of directors for that Federal credit union's management is non-delegable.

The first sentence restates section 113 of the FCUA, 12 U.S.C. §1761b, which provides that the board of directors shall have the general direction and control of the affairs of the federal credit union.<sup>7</sup> The board of directors must oversee the credit union's operations to ensure the credit union operates in a safe and sound manner. For example, the board must be kept informed about the credit union's operating environment, hire and retain competent management, and ensure that the credit union has the risk management structure and process suitable for the credit union's size and activities. The second sentence of proposed §701.4(a) makes clear that a credit union's board of directors may delegate responsibility for day-to-day operations to credit union management officials, but that, in so doing, may not and cannot delegate its ultimate statutory responsibility for the management of the credit union.

§701.4(b) Duties of Federal credit union directors.

Proposed paragraph (b) sets forth the fiduciary duties of federal credit union directors. Paragraph (b)(1) charges a director to:

Carry out his or her duties as a director in good faith, in a manner such director reasonably believes to be in the best interests of the membership

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Recovery Act of 2008, Pub. L. 110-289, 122 Stat. 2654 (enacted July 30, 2008). The entities the FHFB regulated, the Federal Home Loan Banks (now regulated by the FHFA), continue to operate under regulations promulgated by the FHFB until such regulations are superseded by regulations promulgated by the FHFA. See 74 FR 30975, 30975 (June 29, 2009).

<sup>7</sup> See also § 111 of the FCUA, 12 U.S.C. § 1761, which states that the management of a federal credit union shall be by a board of directors, a supervisory committee, and where the bylaws so provide, a credit committee. This and other sections of the FCUA delineate the role and responsibilities of the board of directors, the supervisory committee and the credit committee, but do not articulate a general standard of fiduciary conduct for directors or members of any committee on which a director may serve.

of the Federal credit union, and with such care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstances . . . .

This standard is the most common fiduciary duty standard applicable to corporations under state law, and the language of (b)(1) mirrors the current standard applicable to FHLBs. 12 CFR 917.2(b)(1). This standard is crucial in defining a director's obligations to its members, and is the standard by which the members and NCUA will measure the actions of FCU directors.

Embedded in this standard is both a duty of loyalty and a duty of care. The duty of loyalty is set forth in the words “[e]ach federal credit union director has the duty to . . . carry out his or her duties as a director in good faith, in a manner such director reasonably believes to be in the best interests of the membership of the Federal credit union . . . .” Directors owe a duty to act in the best interests of the membership of the credit union and not in the director's personal interests. When carrying out his or her responsibilities, a director must always seek to advance what the director reasonably believes to be in the members' best interests, and must place the members' well-being above his or her own personal interests or those of third parties.

The obligation to act in good faith means honesty in purpose, making sure not to disregard the director's responsibilities or to act in a way that violates the law. Good faith also requires that all material facts known to a director be disclosed to other directors and also to the members where the members are charged with voting on a particular issue.

The federal credit union standard bylaws contain a provision on conflicts of interest. Article XVI., Section 4. A director who has a conflict of interest is disqualified from board deliberations upon or the voting on any question affecting his or her pecuniary or personal interest or the pecuniary interest of other entities in which he or she is interested, directly or indirectly. While the duty of loyalty goes beyond the terms of this provision or other specific conflicts of interest provisions, a director who violates this provision is also in violation of the duty of loyalty.

Section 701.4(b)(1) also establishes a duty of care with the words “[e]ach . . . director . . . must carry out his or her duties . . . with such care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstances . . . .” Compliance with the duty of care is measured by the “prudent person,” or “reasonable person” standard – what would such a prudent person have done under similar circumstances? This standard is consistent with the historic standards imposed on directors of national banks.<sup>8</sup> As suggested by the language, the duty of care includes a

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<sup>8</sup> In 1891, in the absence of an applicable federal statute or regulation, the Supreme Court considered the standard of care that should be applied to the officers and directors of a national bank. *See Briggs v. Spaulding*, 141 U.S. 132 (1891). In *Briggs*, a receiver for a national bank sought to hold several officers and directors liable for losses incurred by the bank on risky loans and general mismanagement of the bank. The receiver alleged that the directors failed to keep accurate books, have regular meetings, and

duty of inquiry that requires that directors inform themselves of “all material information reasonably available to them” prior to rendering a decision.<sup>9</sup> These duties of care and loyalty are amplified and reinforced by the remainder of proposed paragraph (b) and the provisions in proposed §701.4(c) and (d), as discussed further below.

Proposed paragraph (b)(2) requires that directors administer the affairs of the credit union fairly and impartially so as not to favor the interests of any particular member or group of members. The director’s obligation is to the membership as a whole, not to particular individuals or groups. So, for example, when the credit union makes determinations about extending credit to a particular member, the credit union has no fiduciary obligation to that particular member vis-a-vis that credit transaction but, rather, must make its decision on the credit transaction with regard only to the effects of the proposed transaction on the interests of the membership as a whole.

Proposed paragraph (b)(3) requires that each board director be financially literate. The directors must have a working familiarity with basic finance and accounting practices, (including the ability to understand the credit union’s balance sheet and income statement and to ask, as appropriate, substantive questions of management and the internal and external auditors) or become financially literate within a reasonable time, not to exceed three months, after his or her election or appointment to the board of directors. This financial literacy may be obtained through training provided by the credit union, outside sources, or, for small credit unions, NCUA’s Office of Small Credit Union Initiatives, if a director does not possess such financial literacy at the time of his or her election or appointment to the board.

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oversee the actions of the bank’s president. *Id.* at 137. They were accused of “passive negligence,” the failure to act when a duty existed, but not of “positive misfeasance.” *Id.* at 151. The Supreme Court held that “directors must exercise ordinary care and prudence in the administration of the affairs of the bank, and that this includes something more than officiating as figure-heads.” *Id.* at 165. The Court stated that the standard of care for bank directors was “that which ordinarily prudent and diligent men would exercise under similar circumstances.” *Id.* at 152.

<sup>9</sup> *See, e.g., Smith v. Van Gorkom*, 488 A.2d 858, 872 (Del. 1985). This case discusses various factors for determining whether a board of directors satisfied the standard of care when rendering an important decision, including:

- The amount of time directors spent researching the transaction, preparing for the decision and investigating the information and proposals;
- The amount of time spent in the meeting in which deliberation on the transaction took place;
- The source of any important numbers and dollar amounts, and whether they were based on credible information or were arbitrary;
- Whether the proposal and subsequent deliberations were thoroughly debated by the directors;
- Whether the directors had prior notice of what would be discussed before the meeting in which they deliberated and voted;
- Whether the directors were presented with or sought out outside information, such as an opinion of counsel or a fairness opinion; and
- Whether the board fully considered other alternatives to the transaction under consideration.

Proposed paragraph (b)(4) charges each director with the general duty to direct the operations of the federal credit union in conformity with the requirements of the FCUA, NCUA regulations, other applicable law, and sound business practices.

§701.4(c) Authority regarding staff and outside consultants.

Proposed paragraph (c) provides that:

(1) In carrying out its duties and responsibilities, each Federal credit union's board of directors and all its committees have authority to retain staff and outside counsel, independent accountants, financial advisors, and other outside consultants at the expense of the Federal credit union.

(2) Federal credit union staff providing services to the board of directors or any committee of the board under paragraph (c)(1) of this section may be required by the board of directors or such committee to report directly to the board or such committee, as appropriate.

(3) In discharging board or committee duties a director, who does not have knowledge that makes reliance unwarranted, is entitled to rely on information, opinions, reports, or statements, including financial statements and other financial data, prepared or presented by any of the persons specified in paragraph (d).

The board is the primary corporate decision-making body. The board in turn typically delegates significant authority for the day-to-day operations to senior management. To the extent that a board delegates to management, it must exercise reasonable oversight and supervision over management. Accordingly, proposed paragraph (c)(1) empowers the board of directors, and committees of the board, to hire staff (employees) and outside consultants, as necessary to carry out the board's duties and responsibilities.

Under proposed paragraph (c)(3), a director may generally rely on information, opinions, reports, or statements, including financial statements and other financial information, prepared by those to whom authority has been delegated. Still, as required by the duty of care, any reliance on the advice of others or information provided by others must be warranted under the circumstances. Limits on such reliance are discussed further in paragraph (d).

§701.4(d) Reliance.

Proposed paragraph (d) provides that:

(d) *Reliance.* A director may rely on:

(1) One or more officers or employees of the Federal credit union who the director reasonably believes to be reliable and competent in the functions performed or the information, opinions, reports, or statements provided;

(2) Legal counsel, independent public accountants, or other persons retained by the Federal credit union as to matters involving skills or expertise the director reasonably believes are matters (i) within the particular person's professional or expert competence, and (ii) as to which the particular person merits confidence; and

(3) A committee of the board of directors of which the director is not a member if the director reasonably believes the committee merits confidence.

Generally, a director must comply with the standard of care in making a judgment as to the reliability and competence of the source of information upon which the director proposes to rely or that it otherwise merits confidence. The director must also have read the information, opinion, report, or statement in question, or have been present at a meeting at which it was orally presented, or have taken other steps to become generally familiar with it.

Care in delegation and supervision includes evaluation of the capabilities and diligence of the person receiving the delegation in light of the subject and its relative importance, and paragraph (d) provides specificity as to when a director may rely on certain persons or groups.

Proposed paragraph (d)(1) permits a director to rely on one or more officers or employees of the Federal credit union who the director reasonably believes to be reliable and competent in the functions performed or the information, opinions, reports, or statements provided. In determining whether an office or employee is reliable, the director would typically consider the individual's record for honesty, care, and ability in carrying out responsibilities which he or she undertakes. In determining whether an individual is competent, the director would normally consider the individual's background, education, experience and scope of responsibility within the credit union, the individual's familiarity and knowledge with respect to the subject matter, and the individual's technical skill.

Proposed paragraph (d)(2) permits reliance on legal counsel, independent public accountants, or other persons retained by the Federal credit union, but only as to matters involving skills or expertise the director reasonably believes are matters (i) within the particular person's professional or expert competence, and (ii) as to which the particular person merits confidence. A determination of competence involves an examination of factors similar to those discussed in connection with determining competence under paragraph (d)(1). Likewise, a determination that the potential advisor merits confidence includes an examination of both competence and reliability, including whether the individual may be subject to conflicts of interests or may have a

vested interest in the outcome of any transaction under advisement. This paragraph covers not only lawyers and accountants, but also other potential external advisers with special experience and skills, such as investment bankers and management consultants.

Proposed paragraph (d)(3) permits reliance on a committee of the board if, again, the director reasonably believes the committee merits confidence. This paragraph applies when the committee is submitting recommendations for action by the full board of directors as well as when it is performing supervisory or other functions not requiring immediate board action.

The Board also notes that there are several sources of guidance on the fiduciary duties of directors of depository institutions. These sources include the Federal Credit Union Handbook; Office of Comptroller of the Currency (OCC), *The Director's Book* (1997) and *Corporate Governance and the Community Bank: A Regulatory Perspective* (2005), both available on the OCC's website: [www.occ.treas.gov](http://www.occ.treas.gov); and American Bar Association Committee on Corporate Laws, *Corporate Director's Guidebook*, 5<sup>th</sup> ed., 62 *Business Lawyer* 1482 (August 2007) (available on Lexis). FCU directors may follow this guidance to the extent that it does not conflict with the provisions of the proposed rule or any future guidance NCUA may put out in this area.

*Proposed amendment to §701.33.*

Section 701.33 of the NCUA regulations is NCUA's indemnification regulation. 12 CFR 701.33. Section 701.33(c)(1) states that a federal credit union may provide indemnification for its officials and employees. Section 701.33(c)(2) states that FCU indemnification shall be consistent either with the standards applicable to credit unions generally in the state in which the principal or home office of the FCU is located, or with the relevant provisions of the Model Business Corporation Act (MBCA). An FCU that elects to provide indemnification must specify whether it will follow state law or the MBCA. It also states that indemnification and the method of indemnification may be provided for by charter or bylaw amendment, contract, or board resolution, consistent with the procedural requirements of the applicable state law or the MBCA, as specified.<sup>10</sup> Section 701.33(c)(3) also permits a federal credit union to purchase and maintain insurance on behalf of its officials and employees against any liability asserted against them and expenses incurred by them in their official capacities and arising out of the performance of their official duties to the extent such insurance is permitted by applicable state law or the MBCA. 12 CFR 701.33(c)(4).

The preamble to the final rule on indemnification indicated that indemnification is not to be automatically provided in every case. "[T]he power to provide for indemnification does not relieve [a federal credit union] of its responsibility to determine whether indemnification is appropriate under the circumstances. NCUA will monitor indemnification provisions for consistency with the indemnification standards chosen, for

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<sup>10</sup> Id. The NCUA must approve any such charter or bylaw amendment.

the safety and soundness implications for the institution, and for their application in a given case.” 53 FR 29640, 29641 (Aug. 8, 1988).

The NCUA Board desires to ensure that FCU officials and employees are held personally accountable, where appropriate, for violations of their fiduciary duties. Accordingly, NCUA will not permit a federal credit union to indemnify officials and employees against liability based on an aggravated breach of the duty of care when such a breach may affect fundamental member rights and financial interests. Accordingly, NCUA proposes to amend §701.33 by adding a new paragraph (c)(5) to read as follows:

Notwithstanding paragraphs (c)(1) through (3) of this section, a federal credit union may not indemnify an official or employee for personal liability related to any decision made by that individual on a matter significantly affecting the fundamental rights and interests of the FCU’s members where the decision giving rise to the claim for indemnification is determined by a court to have constituted gross negligence, recklessness, or willful misconduct. Matters affecting the fundamental rights and interests of FCU members include charter and share insurance conversions and terminations.

Consistent with the proposed §701.4, matters affecting the fundamental rights and interests of federal credit union members are defined to include charter conversions and share insurance conversions and terminations.

The Board believes that, where directors and other officials and employees are charged with making decisions relating to the fundamental rights and interests of the members, a gross negligence standard for denying indemnification is appropriate. Gross negligence is a legal term of art, generally defined as a “conscious, voluntary act or omission in reckless disregard of a legal duty and of the consequences to another party . . . .” *Black’s Law Dictionary* 8<sup>th</sup> ed. (Thomson West 2004). Gross negligence is a more lenient standard than simple negligence, and indemnification will still be permitted under the proposal for liability premised on simple negligence.

One section of the FCU Act references the level of disregard by an official or employee of the duty of care. Section 207(h) of the FCU Act states that:

A director or officer of an insured credit union may be held personally liable for monetary damages in any civil action, by . . . the [NCUA] Board, which action is prosecuted wholly or partially for the benefit of the Board . . . acting as conservator or liquidating agent of such insured credit union . . . for gross negligence, including any similar conduct or conduct that demonstrates a greater disregard of a duty of care (than gross negligence) including intentional tortious conduct, as such terms are defined and determined under applicable State law. Nothing in this paragraph shall impair or affect any right, if any, of the Board under other applicable law.

12 U.S.C. 1787(h)(3). Section 207(h) applies only to actions taken by the Board, and only as conservator or liquidating agent, while the proposed indemnification provision applies to liability, whether to the Board or other parties. In the Board's view, the proposed limits on indemnification at FCUs are consistent with §207(h) and the associated case law.<sup>11</sup>

NCUA also proposes to make a conforming change to the FCU Standard Bylaws. Article XVI, §8 sets forth the requirements for director indemnification. The proposed change to Article XVI will limit indemnification in a manner parallel to paragraph (c)(5) of §701.33. The proposal makes a corresponding change to the standard federal corporate credit union bylaws.

### **C. Proposed Reorganization of Parts 708a and 708b**

Currently, part 708a of NCUA's rules covers the conversion of insured credit unions into MSBs, and part 708b covers the merger of insured credit unions with other credit unions and the conversion and termination of federal share insurance. This proposed rulemaking, if adopted, would result in a reorganization of part 708a.

Part 708a currently has no subparts, and the revisions to part 708a create three new subparts. The revision moves the current part 708a treatment of MSB conversions into subpart A. The new rule regarding the mergers of insured credit unions into banks would be located in subpart C. Subpart B would be reserved for a potential future rulemaking on the conversion of insured credit unions into stock banks.

The proposal does not affect the organization of part 708b, which currently consists of three subparts. The title of part 708b, however, would change slightly. The current title of part 708b, "Mergers of Federally-insured Credit Unions; Voluntary Termination Or Conversion of Insured Status," would change to read "Mergers of Federally-insured Credit Unions with Other Credit Unions; Voluntary Termination Or Conversion of Insured Status." With the addition of a new rule in part 708a on the merger of credit unions into banks, this change to the title of 708b is necessary to clarify the limited scope of part 708b.

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<sup>11</sup> See *Atherton v. FDIC*, 519 U.S. 213 (1997) (holding that 12 U.S.C. 1821(k), a federal statute addressing the standard of care owed by bank directors and officers under the Federal Deposit Insurance Act, provides for a gross negligence standard as the minimum level of disregard of the standard of care, but does not preempt state statutes that set a stricter level of disregard, such as simple negligence). The Court was reviewing the Federal Deposit Insurance Act's analog to §207(h) of the FCU Act. While this proposed rulemaking establishes fiduciary standards for FCU directors and limits indemnification for officials and employees, this rulemaking does not address causes of action based on those standards, nor does the rulemaking address the requisite level of disregard for a finding of liability based on any particular cause of action.

## **D. Proposed Amendments to Part 708a, Subpart A: Conversion of Insured Credit Unions to Mutual Savings Banks**

The proposed revisions to newly designated Subpart A of Part 708a (sections 708a.101 to 708a.113, as redesignated) protect the integrity of the voting process during conversions to a mutual savings bank, provide members with additional information about how the conversion process could affect them, and require converting credit unions to provide copies of correspondence with other agencies related to the conversion. The proposed changes are as follows:

### §708a.101 Definitions.

The proposal adds definitions for the terms “conducted by an independent entity” and “secret ballot.” These new definitions clarify Part 708a’s requirements for balloting in credit union conversions. Section 708a.106 (formerly §708a.6) requires elections to be by secret ballot and conducted by an independent entity. Along with the new definitions for “conducted by an independent entity” and “secret ballot,” the proposed amendments move the definition of “independent entity” from §708a.106 to the definitions section, §708a.101.

The proposal also adds a new definition of the phrase “conducted by an independent entity” to prevent credit union staff and officials from accessing interim vote tallies during the election and also to ensure that members learn the results of the membership vote. NCUA has concerns that the use of interim vote tallies by credit union management may unfairly skew the results of elections in favor of the result management prefers.

NCUA has observed in some FICU to MSB conversions that credit union management seeks periodic running tallies from the election teller as to how many members have voted yes and no and which members have not voted. Management has justified this practice by stating they only use the information for the purpose of encouraging members to vote. In investigations of conversions, however, NCUA has discovered that some credit unions use this interim vote information for soliciting only voters likely to vote in favor of the conversion. In addition, some converting credit unions have pressured or required employees to encourage members, including family, to vote in favor of conversion even where the employees did not wish to do so or did not believe conversion was in the members’ best interests. Other problematic tactics include determining how a member voted in violation of the voting secrecy requirement, using periodic voting tallies to management’s advantage and to the disadvantage of those members opposed to the conversion by not sharing that information with members during the voting period, and improperly handling ballots for members instead of having members mail them directly to the independent election teller. See the ANPR discussion at 73 FR 5461, 5466 (Jan. 30, 2008).

Since issuing the ANPR, NCUA also encountered a situation where management halted the vote on conversion shortly before the conclusion of the voting period and then declined to announce the interim results to the member-owners, and NCUA later

learned that management stopped the vote because the running vote tallies management was receiving from the election teller were nearly two-to-one in opposition to the conversion. In another situation, after a conversion vote was completed, management refused to disclose the results of the vote, in terms of the votes for and against the conversion, to its member-owners and failed to include these numbers in its certification to NCUA.

Accordingly, the proposal adds a definition of “conducted by an independent entity” that reads as follows:

- (1) The independent entity will receive the ballots directly from voting members and store them.
- (2) After the conclusion of the special meeting that ends the ballot period, the independent entity will open all the ballots in its possession and tabulate the results. The entity must not open or tabulate any ballots before the conclusion of the special meeting.
- (3) The independent entity will certify the final vote tally in writing to the credit union and to the NCUA Regional Director. The certification will include, at a minimum, the number of members who voted, the number of affirmative votes, and the number of negative votes. During the course of the voting period the independent entity may provide the credit union with the names of members who have not yet voted, but may not provide any voting results to the credit union prior to certifying the final vote tally.

This proposed definition of “conducted by an independent entity” prohibits interim vote tallies and ensures that member-owners and NCUA are properly informed of the results of any conversion vote. Some ANPR commenters opposed to a ban on the use of interim vote tallies expressed concern that without access to voting results, a converting credit union would be unable to determine which members had voted and so determine how to efficiently target their outreach efforts to ensure that all voters had an opportunity to vote. To address this concern, the proposal does not prohibit management from obtaining lists of members who have not voted at any point during the election process, but only prevents management access to running vote tallies.

The proposal adds a definition of “secret ballot” to read as follows:

Secret ballot means no credit union employee or official can determine how a particular member voted. Credit union employees and officials are prohibited from assisting members in completing ballots or handling completed ballots.

This proposal will ensure that employees and officials do not improperly influence members’ votes, even inadvertently. Some ANPR commenters opposed to a ban on employees handling ballots expressed concerns that the ban would make it less convenient for members to vote, but the proposed rule need not have this effect, as

nothing prohibits the independent teller from placing a secure ballot box at credit union branch locations for use by members who bring their completed ballots to the credit union. Also, nothing prohibits employees from distributing blank ballots to those members who may have misplaced their original ballot.

Some commenters opposed to prohibitions on management obtaining interim voting tallies and employees handling ballots stated it would be unfair to impose these rules in the context of conversions to a mutual savings bank and not also for credit union to credit union mergers or insurance conversions. NCUA agrees and as discussed under §708b, has added identical definitions and restrictions for elections involving other types of transactions as well.

The proposal also moves the current definition of “independent entity” into the definitions section but does not revise the substance.

§708a.104 Disclosures and communications to members.

Paragraph (c) of this section lists the information that credit unions seeking to convert must disclose to members. The proposal adds required disclosures about the estimated costs of conversion; the conversion’s affect on the availability of facilities, including branches and ATMs; and the fact that NCUA neither approves nor disapproves of the proposed conversion. The addition of these disclosures results in the addition of three new subparagraphs to paragraph (c) and the renumbering of the other five existing subparagraphs of paragraph (c).

One ANPR commenter suggested information about conversion-related expenses would be useful to members, and the Board agrees. Conversion costs are paid from a credit union’s earnings, and accumulated earnings are capital and represent members’ ownership interests, so members have a right to know how these ownership interests will be affected by consideration of the board of directors’ conversion proposal. The Board adds a new required disclosure about the costs of the conversion in subparagraph (5) of paragraph (c). The credit union must disclose the total estimated cost of the conversion with separate line items for printing fees, postage fees, advertising, consulting and professional fees, legal fees, staff time, the cost of holding a special meeting, the cost of conducting the vote, and any other conversion-related expenses.

As discussed in the ANPR, conversions have the potential to change members’ access to the institution. 73 FR 5461, 5465 (Jan. 30, 2008). Some converting credit unions, for example, plan to shut certain branches after conversion. In addition, a credit union participating in a credit union shared branching network could lose access to that network if it becomes a bank. Likewise, some ATM networks limit their services to credit unions. Members accustomed to accessing their credit union accounts through a particular branch, shared branch, or an ATM need to know if the conversion has the potential to disrupt that access before voting on the conversion. NCUA is concerned, however, that credit unions seeking to convert have not always provided members with

complete and accurate information about the potential for changes to services and facilities. *Id.* Accordingly, the proposal adds a disclosure in subparagraph (8) requiring disclosure of the conversion's affect on services and facilities.

NCUA will, at the request of a converting credit union, review draft notices and other member communications for compliance with NCUA rules. Some members may believe, erroneously, that NCUA's review of conversion-related materials in a particular conversion, and NCUA's non-disapproval of these materials, means that NCUA endorses the materials and, possibly, the proposed conversion. In fact, NCUA does not take a position on the merit of conversion proposals. NCUA conducts its reviews of the conversion materials and the associated process simply to fulfill its statutory duty of overseeing the methods and procedures of the member vote. 12 U.S.C. 1785(a)(2)(G)(ii). The ANPR requested comment on whether the disclosures to members should include a statement that NCUA does not approve of the proposed conversion. Most commenters opposed adding this statement because they found it biased, but several of these commenters also suggested they would not be opposed to a more neutral statement. Accordingly, the proposal adds a requirement in subparagraph (7) that the notice to members state that NCUA does not approve or disapprove of the conversion proposal. NCUA believes this disclosure is necessary to clarify for members what NCUA's role is in the conversion process.

Finally, the proposed revisions correct typographical errors in subparagraph (b)(4) and clarify the subject line of the email forwarding a member communication on the conversion proposal in subparagraph (f)(2).

#### §708a.106 Membership approval of a proposal to convert.

As discussed above, the proposal moves the definition of "independent entity," currently located in paragraph (c) of this section, to the definitions section.

#### §708a.107 Certification of vote on conversion proposal.

NCUA has encountered situations where the converting credit union experienced significant difficulties in obtaining approval from the gaining regulators. In at least one of these situations, NCUA learned well after the conversion attempt that the Federal Deposit Insurance Corporation (FDIC) had expressed concerns about the business plan, continuing operation of branches, internal controls, and loan underwriting, all at the same time the credit union was beginning the member voting process on its conversion proposal. Knowing of these concerns in a timely manner would have assisted NCUA in its role in approving the methods and procedures used by the credit union to conduct its member vote, including the accuracy of the communications provided to members. Accordingly, the proposal includes a new paragraph (c) that requires converting credit unions to submit to NCUA with their certification of the member vote copies of any correspondence with any agency where that correspondence is related to the conversion.

Also, to fulfill NCUA's mission to protect the share insurance fund in an efficient manner, NCUA must be able to gauge whether, and when, converting credit unions are likely to actually complete their attempted conversions. If NCUA is aware that gaining regulators might delay or derail approval of the new charter, NCUA can better schedule its supervisory resources in the time period between member approval and actual conversion.

#### §708a.113 Voting guidelines

Section 708a.113 contains guidance on conducting the member conversion vote. The proposal adds a new paragraph (e) to this section recommending that converting credit unions not use employees to solicit member votes. NCUA has observed a situation in which credit union management admitted that using employees to solicit votes diverted the employees from the primary duties in running the credit union. NCUA is also concerned that employees not be coerced to advocate a position on the conversion that they do not believe in.

NCUA also considered prohibiting employee solicitation of member votes, but most ANPR commenters were opposed to such a prohibition. For one thing, employees should be able to answer questions from members about the conversion, and it may be difficult to distinguish this activity from solicitation. Accordingly, the proposal does not contain an explicit prohibition on solicitation.

### **E. Proposed New Part 708a, Subpart C: Merger of Insured Credit Unions into Banks**

During the course of the past two decades, several credit unions have merged into banks. In some of these mergers, the continuing bank has been a mutual savings bank, such as the Roper Employees FCU merger into Carolina Federal Savings Bank. In other mergers, the continuing bank has been a stock bank, such as in the merger of Nationwide FCU merger into Nationwide Bank. Some of these mergers have been "two-step" mergers, that is, the credit union proposed to convert first to a bank and then immediately merge into an existing bank, such as in the merger of Salt City Hospital FCU into Beacon Federal Savings Bank. Other mergers have been "one-step" mergers, that is, the direct merger of the credit union into the bank, such as in the merger of Northeast Community Credit Union Into Haverhill Cooperative Bank.

What all of the above mergers, and other mergers not mentioned, had in common was that they were conducted and completed on an *ad hoc* basis. The FCU Act requires that no FICU may merge with a bank without the prior approval of the NCUA Board, 12 U.S.C. 1785(b)(1)(A), and the Act provides a listing of certain factors that the Board must consider when granting or withholding its approval. 12 U.S.C. 1785(c). Still, NCUA has never had any regulations establishing the procedural or substantive requirements for obtaining the approval of the NCUA Board or the credit union's members with regard to a particular merger proposal. This lack of regulations has

resulted in the Board adopting merger procedures and other merger requirements on an *ad hoc* basis each time a merger proposal has come to the Board.

The Board believes that it is time to replace the current, uncertain process with a regulation that prescribes a clear, predictable process governing all future merger proposals. The decision to convert a credit union charter to a bank charter through a merger fundamentally affects on the ownership rights of the credit union's members, and there should be a clearly defined process that protects those rights. There probably will be some credit unions that wish to merge with banks, and the credit unions considering such action deserve to know in advance the process and procedures governing these mergers. The rulemaking process will help define and standardize those procedures.

In crafting this rule, the Board considered its statutory responsibilities for approving mergers. 12 U.S.C. 1785(b), (c). The Board also looked to the existing regulatory procedures for credit union-into-credit union mergers, 12 CFR 708b, and for credit union conversions to mutual savings banks, 12 CFR 708a. A section-by-section discussion of the proposed rule follows.

#### 708a.301 Definitions.

This section provides definitions of key terms used throughout the regulation.

For example, the proposal defines *merger* as any transaction in which a FICU transfers all, or substantially all, of its assets to a bank. The merger provisions of subpart C also apply to any purported conversion of a credit union to a bank if the purported conversion is conducted pursuant to an agreement between a preexisting bank and the credit union that provides (1) the credit union will not conduct business as a stand-alone bank, and (2) the purported conversion will be followed by the transfer of all, or substantially all, of the credit union's assets to the preexisting bank.

This definition of merger means that NCUA will apply the provisions of subpart C to both "one-step" and "two-step" mergers. Regardless of whether the merger is accomplished in one or two steps as described above, in form it is still a merger, and thus subject to NCUA's approval under §205(b)(1)(A) and (c) of the FCU Act. 12 U.S.C. §1785(b)(1)(A) and (c). A transaction in which a credit union purports to convert to a bank -- but never actually opens its doors as a converted, stand alone bank -- is not a true conversion governed by the requirements of §205(b)(2) of the FCU Act. 12 U.S.C. §1785(b)(2).

Other key definitions are discussed below in the context they appear.

#### §708a.302 Authority to merge.

This section provides that a FICU, with the approval of its members, may merge into a bank only with the prior approval of NCUA, the Federal Deposit Insurance Corporation,

and the regulator of the continuing bank. If the credit union is state chartered, it also needs the prior approval of its state regulator.

§708a.303 Board of directors' approval and members' opportunity to comment.

The section describes what the board of directors of a credit union must do prior to adopting a proposal to merge with a particular bank.

The directors must conduct due diligence so as to determine that the concept of merging with a bank, and with the particular bank under consideration, is in the best interests of the credit union's members. As part of this due diligence, the directors must determine the merger value of the credit union, that is, the amount of money that a stock bank would pay in an arms-length transaction to purchase the credit union's assets and assume its liabilities and shares. The rule permits the credit union to obtain this valuation through either a public auction process or an independent appraisal process. The merger proposal may then be approved by an affirmative vote of a majority of board members who have determined that the merger partner selected by the directors is the best choice for the members, taking into account the merger value of the credit union and the amount that the selected merger partner is willing to pay the credit union's members to effect the merger.

The merger value of the credit union is important for the following reasons. The merger of a credit union into a bank will cause members to either 1) lose their ownership rights entirely, as in a merger with a stock bank, or 2) see a diminution in the ownership rights in a merger with a mutual bank. See 71 FR 77150, 77153 (Dec. 22, 2006) (Discussion in preamble to NCUA's final rule on conversion of credit unions to mutual savings banks). Following the merger, the credit union's members will also likely see a worsening of their rates and fees. Id., at 77157-58. See also the DATATRAC rate data posted on NCUA's website at <http://www.ncua.gov/DataServices/BankRateData/index.aspx>. Accordingly, the draft rule text seeks to ensure the credit union's members are properly compensated for these losses. The best way to ensure that the member is compensated for these losses is to obtain an informed valuation for the transfer of the credit unions assets, either through an auction or appraisal process.

Precedent exists for the use of an appraisal process. During the 2006 – 2007 merger of Nationwide Federal Credit Union into Nationwide Bank, the continuing bank obtained an independent appraisal of the value of the credit union's accounts and the bank made a significant payment for those accounts. The payment, which included the net worth of the credit union plus a premium, was ultimately distributed to the credit union's members in compensation for their loss of ownership rights. Similar appraisal and auction valuation techniques have been employed in the merger of one bank into another. For example, in a 1998 letter from the FDIC to an MSB considering a merger into a stock bank the FDIC wrote:

Neither FDIC nor OTS regulations regarding conversions specify a methodology for determining fair value for an institution in the context of a merger/conversion. In the preamble to the FDIC Final Rule on conversions, the FDIC indicated that industry innovation was encouraged. One method of determining value which may have validity would be to "shop" the institution among prospective acquirers. This methodology would establish a market-based value, which the converting institution's board could take into consideration, in the proper exercise of its fiduciary duty, when determining whether a specific proposal would provide for a distribution of appropriate value to rightful recipients. The FDIC looks for tangible evidence that the board of an institution proposing to enter into a merger/conversion marketed the institution widely enough to ascertain a valid market-based value. While a formal "shopping" of the mutual savings bank is not required [for several reasons] . . . the FDIC continues to strongly encourage mutual institutions that are considering any form of a merger/conversion proposal to demonstrate their best effort to "shop" the institution among prospective acquirers. Such institutions should not rely on the FDIC's action on [Corry Savings Bank's] notice, which was dependent upon a number of factors, as a precedent for their respective merger/conversion proposal.

Letter from Mark S. Schmidt, Associate Director, to the Board of Trustees of Corry Savings Bank, dated July 16, 1998, available at <http://www.fdic.gov/regulations/laws/bankdecisions/Mutual/CorrySavings.html>.

If the credit union chooses to use the appraisal process, the credit union must use a "qualified appraisal entity" to conduct the appraisal. Section 708a.301 of the proposal defines such an entity as:

[A]n entity that has significant experience in the valuation of depository institutions and that has no past financial relationship with the merging credit union, the continuing bank, or any law firm representing the credit union or the bank in connection with the merger.

The intent is to ensure that this entity provides an unbiased appraisal that ensures the members receive appropriate consideration for the effects of the transaction on their financial interests. The Board specifically does not want an appraisal from an entity that might be influenced to undervalue the transaction so as to facilitate the transaction at the expense of the members' interests. The Board invites comment on this proposed definition and how it might be improved without sacrificing the intent.

If the merging credit union's directors pursue an appraisal rather than a public auction, they must publish an advance notice of the proposal to merge that alerts their members to the pending possibility of a merger. The rule also requires that the directors collect, review, and retain any comments about the merger proposal that they receive during the merger process.

§708a.304 Notice to NCUA and request to proceed with member vote.

Following adoption of a merger proposal, the credit union's board of directors must provide its NCUA Regional Director with a Notice of Intent to Merge and Request for NCUA Authorization to proceed with the member vote (NIMRA). The contents of the NIMRA are similar to the merger proposal documentation that two credit unions desiring to merge with each other must submit to NCUA. 12 CFR 708b.103, 708b.104. The NIMRA requires certain additional documentation related to the merger valuation and merger payments to be made to members; certain information about any merger-related compensation to be received by any director or senior management official of the merging credit union; and a certification that the directors believe the merger is in the best interests of the credit union's members. The NIMRA must also include a description of the due diligence conducted by the directors in determining that the merger is in the best interests of the members and that the merger satisfies the statutory considerations for such members in §205(c) of the FCU Act. For state chartered credit unions, the NIMRA must include a discussion of the authority for such mergers under state law and the use by the credit union of any parity provision. This discussion is similar to that required by §708a.5(a)(3) of NCUA's rules governing conversions of credit unions to mutual savings banks.

If the Regional Director receives a NIMRA from a credit union, the Regional Director will, for state charters, consult with the appropriate state supervisory authority. The Regional Director will then, for both state and federal charters, either disapprove the merger proposal or authorize the credit union to proceed with a vote of its members on the proposal.

The proposed regulation specifies that the Regional Director must disapprove the proposed merger if the NIMRA either lacks the documentation required by this section or lacks substantial evidence to support each of the factors in §205(c) of the Act. Two of the important considerations in that section of the Act are "the economic advisability of the transaction," 12 U.S.C. 1785(c)(3), and whether the transaction meets "the convenience and needs of the members," 12 U.S.C. 1785(c)(5). In particular, the Regional Director must disapprove the proposed merger for failing to meet the requirements of these two provisions of the Act if the if the merger payment offered by the bank to the members is less than the merger valuation, absent some additional, quantifiable benefit to the members from the selected merger partner. Similarly, the Regional Director must disapprove the proposed merger if the NIMRA fails to adequately explain the nature and amount of any merger-related compensation to be received by the credit union's directors or senior management officials or to justify that compensation.

If the Regional Director disapproves a merger proposal, the credit union may appeal the Regional Director's determination to the NCUA Board. The appeal must be filed within 30 days, and the Board has 120 days to act on the appeal.

§708a.305 Disclosures and communications to members.

After a credit union's board of directors approves a merger proposal and receives NCUA approval to proceed with the member vote, the credit union will schedule a special meeting and then mail the notice of vote twice to the members: 90 days before the special meeting and 30 days before. The credit union will also prepare and send the ballot with the 30 day notice.

The proposal describes the required content of the two notices, including disclosures to enable members to make an informed decision about the merger. The disclosures are, for the most part, similar to those required by NCUA's rules governing the conversions of credit unions to mutual savings banks in part 708a. 12 CFR part 708a. The rule has slightly different disclosure requirements depending on whether the continuing bank is organized in mutual form or stock form. For example, the required boxed disclosure for a stock bank merger discusses the loss of ownership rights, while the required boxed disclosure for a mutual stock bank merger discusses the potential profits for management associated with a future stock conversion. The rule also requires the disclosure of the merger value and whether the members will receive a merger payment based on the merger value. The rule provides a mechanism similar to that in part 708a for interested members to communicate with one another about the pending merger and also provides for a ballot form similar to that in part 708a.

§708a.306 Membership approval of a proposal to merge.

A proposal for merger requires approval by a majority of the members who vote on the proposal, with the additional requirements that at least 20 percent of the members eligible to vote must participate in the vote. This quorum requirement is the same as the quorum required when a credit union's members make certain other decisions affecting their fundamental rights, such as a share insurance conversion. 12 U.S.C. 1786(d)(2).

The board of directors must set a voting record date to determine member voting eligibility. The members may vote in person or by mail, and the vote must be by secret ballot and conducted by an independent entity. Again, these requirements are similar to the current requirements for conversion to a mutual savings bank in part 708a.

§708a.307 Certification of vote on merger proposal.

The board of directors of the merging credit union must certify the results of the membership vote to the Regional Director within 10 calendar days after the vote is taken. The certification requirements are similar to those required in a conversion to a mutual savings bank in part 708a.

§708a.308 NCUA approval of the merger.

Following the member vote, the Regional Director will review the methods by which the membership vote was taken and the procedures applicable to the membership vote. The Regional Director will determine if the notices and other communications to members were accurate, not misleading, and timely; if the membership vote was conducted in a fair and legal manner; and if the credit union has otherwise met the requirements of subpart C of part 708a, including whether there is substantial evidence that the factors in Section 205(c) of the Act are satisfied. After completion of this review, the Regional Director will approve or disapprove the proposed merger and issue the approval or disapproval within 30 calendar days of receipt from the credit union of the certification of the result of the membership vote. A merging credit union has 30 days to appeal any disapproval to the NCUA Board, and the NCUA Board will act on the appeal within 120 days of receipt. Again, this process is similar to the review process conducted by the Regional Director following the certification of member vote in a conversion to a mutual savings bank as described in part 708a.

§708a.309 Completion of merger.

The credit union must complete the merger within one year of the date of NCUA approval. If a credit union fails to complete the merger within one year the Regional Director will disapprove the merger, and the credit union's board of directors must then adopt a new merger proposal and solicit another member vote if it still desires to merge. The Regional Director may, upon timely request and for good cause, extend the one year completion period for an additional six months. The process of completion of the merger is substantially the same as the process for completion of a conversion to a mutual savings bank as described in part 708a.

§708a.310 Limits on compensation of officials.

No director or senior management official of an insured credit union may receive any economic benefit in connection with the merger of a credit union other than reasonable compensation and other benefits paid in the ordinary course of business. This compensation limitation is substantially the same as the limitation imposed in part 708a for conversions to a mutual savings bank.

§708a.311 Voting incentives.

If a merging credit union offers an incentive to encourage members to participate in the vote every reference to such incentive made by the credit union in a written communication to its members must also state that members are eligible for the incentive regardless of whether they vote for or against the proposed merger. This requirement is substantially the same as the requirement imposed in part 708a for conversions to a mutual savings bank.

§708a.12 Voting guidelines.

This section provides guidance on the conduct of the member vote. It is substantially the same as NCUA's guidance in part 708a on the conduct of the member vote in conversions to a mutual savings bank.

## **F. Proposed Amendments to Part 708b: Mergers of Federally-insured Credit Unions with Other Credit Unions; Voluntary Termination or Conversion of Insured Status.**

Part 708b of NCUA's rules implements NCUA's authority under the FCU Act to prescribe rules governing mergers of federally-insured credit unions. Like other financial services entities, credit unions are increasingly consolidating, and this trend is likely to continue. Much of the consolidation in the credit union industry results from voluntary mergers of credit unions. The proposed amendments to Part 708b will help assure that management's decision to recommend a merger is based on sound business judgment reflecting the best interests of the members.

NCUA must review and approve any merger involving a FICU. 12 CFR 708b.104(a). As part of this process, merging credit unions must submit a merger plan to NCUA. *Id.* The proposed amendments in this area revise and clarify items in the merger plan submitted to NCUA.

If the merging credit union is a federal credit union, members have right to vote on whether to approve the merger, unless NCUA determines the FCU is in danger of insolvency and waives the member vote. 12 C.F.R. 708b.106, 708b.105(b). Under the proposal, FCUs would have to disclose to members the same additional information the proposal requires in the merger plan submitted to NCUA before the member vote on the merger proposal.

A section-by-section summary of the proposed changes follows.

### §708b.2 Definitions.

The proposal adds definitions for the terms "conducted by an independent entity," "merger-related financial arrangement," and "secret ballot," and "senior management official." The new definitions of "conducted by an independent entity" and "secret ballot" clarify requirements for balloting in insurance conversions, and match the proposed revisions to the voting requirements in Subpart A of Part 708a (conversions to mutual savings banks). The new definitions of "merger-related financial arrangement" and "senior management official" relate to the proposed new required disclosures in connection with credit union mergers. Each of these definitions is discussed in greater detail in the relevant section below.

### §708b.103 Preparation of merger plan.

#### 1. Share adjustments

The proposal amends subparagraph (a)(5) of this section to require additional information in the merger plan submitted to NCUA in cases where the merging credit union has a higher net worth ratio (NWR) than the continuing credit union. In these situations, the proposal would require the merger plan to discuss not only actual share adjustments, but an explanation of the factors used to establish the amount of the adjustment or to determine no adjustment is necessary.

NCUA is proposing these additional disclosures because of the potential for unfair treatment of members of the credit union with higher net worth. In many merger situations, a smaller credit union offering limited services seeks to merge with a larger credit union. Often, the smaller, merging credit union will have a NWR much higher than the continuing credit union's NWR. Credit unions' only source of capital is retained earnings, so the higher NWR of the merging credit union represents retained earnings directed toward increasing the NWR, perhaps in lieu of spending on additional service or products, or more favorable rates on savings and loans. In these situations, the members of the merging credit union have paid for their higher NWR with fewer services or less favorable rates on savings and loan products, or both. These members then face the potential dilution of their membership interests as a result of the merger if the merging credit union's capital is simply subsumed into the less well-capitalized continuing credit union.

One way to prevent this loss of equity by members of a merging credit union that has a higher NWR than the continuing credit union is to compensate members of the merging credit union with a merger dividend, termed a share adjustment in Part 708b. In a share adjustment, some or all of the capital of the credit union with the highest NWR that is above the amount of capital needed to match NWR of the other credit union would be distributed to members of credit union with the higher NWR. Current rules require the merger plan to include only an explanation of any proposed share adjustment as part of the merger. 12 C.F.R. 708b.105(a)(5). Under the proposal, where a merging credit union has a significantly greater NWR than the continuing credit union, meaning in excess of 500 basis points greater, the required explanation must also include the factors considered in establishing the amount of the adjustment or in determining no adjustment is necessary.

Many ANPR commenters opposed any NCUA-mandated share adjustment or calculation method. Most of these opposing commenters cited the need for credit union boards of directors and market forces to determine whether and how much of a share adjustment should be paid in each particular situation. Consistent with these comments, the proposal does not require a share adjustment or specific calculation method. Instead, the proposal simply requires that where a merging credit union has a significantly greater NWR than a continuing credit union, credit union management disclose the basis for its calculation of a share adjustment or the determination that a share adjustment is unnecessary.

## *2. Disclosure of merger-related financial arrangements*

The proposal amends paragraph (a) of this section to add a new paragraph (f), requiring all federally insured credit unions disclose to NCUA any “merger-related financial arrangements” received by officials or senior managers of a merging credit union in connection with the merger.<sup>12</sup> A merger-related financial arrangement is defined as:

[A] material increase in compensation (including indirect compensation, for example, bonuses, deferred compensation, or other financial rewards) or benefits that any board member or senior management official of a merging credit union may receive in connection with a merger transaction. For purposes of this definition, a material increase is an increase is an increase that exceeds the greater of 15 percent or \$10,000.

Proposed §708b.2. “Senior management official” is defined as

[A] chief executive officer, an assistant chief executive officer, a chief financial officer, and any other senior executive officer as defined by the financial institution regulatory agencies pursuant to §32(f) of the Federal Deposit Insurance Act.

This definition is currently included in §708a, but was not in §708b. NCUA first proposed an amendment requiring merging FICUs to disclose any material increase in compensation for officials and senior managers in 2007, with a material increase defined as the greater of 15 percent of \$10,000. 72 FR 20067 (April 23, 2007). This proposed definition of material is identical to a definition of material employed by the Office of Thrift Supervision (OTS) in a similar context. 12 CFR 563.22(d)(1)(vi)(C). Under the OTS rule, an increase in compensation paid to an officer, director or controlling person of a merging federal thrift of savings bank is presumed to be unreasonable if it exceeds the greater of 15 percent or \$10,000. *Id.*

The Board intends that all compensation arrangements, formal and informal, be covered by this disclosure requirement. The scope of disclosure includes both arrangements that are written and those not immediately reduced to writing, as well as arrangements involving deferred compensation.

The proposed revisions to the merger plan regarding the calculation of any share adjustment and the existence of merger-related financial arrangements are disclosure requirements only. That is, the proposal would not prohibit a higher net worth credit union from merging into a lower net worth credit union without paying a merger dividend to members of the merging credit union, as long as this fact and the reasoning behind it is disclosed to NCUA and, for FCUs, to members. Similarly, the proposal would not prohibit mergers where the merger resulted in a material increase in compensation to

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<sup>12</sup> Proposed 708b.106, discussed below, requires a similar disclosure to members preceding the member vote.

directors or senior management officials of the merging credit union, as long as this fact is properly disclosed.

§708b.104 Submission of merger proposal to the NCUA.

This section details the requirements for the merger proposal submitted to NCUA, and the current paragraph (a)(8) requires a statement about whether a merging credit union, if it is above \$50 million in assets, plans to submit a Hart-Scott-Rodino Act (HSRA) premerger notification to the Federal Trade Commission (FTC). The HSRA requires certain entities contemplating a merger to notify the FTC of the pending merger and wait for a designated time period before consummating the merger. 15 U.S.C.

18a(a)(2)(B)(i). Only mergers above a certain asset size threshold are subject to the notification requirement, and the FTC adjusts this threshold amount annually. *Id.* The proposal updates the \$50 million threshold in paragraph (a)(8) to the current threshold amount for HSRA filings, which is \$63.4 million for 2010. 75 FR 3468 (Jan. 21, 2010).

§708b.106 Approval of the merger vote by members.

This section addresses the member vote generally required when the merging credit union is an FCU, and lists the required elements of the notice to members.

Subparagraph (a)(2)(ii) of this section requires that the members be given a summary of the merger plan. The proposal amends this subparagraph to require this summary include a detailed description of any “merger-related financial arrangement” made available to any board member or senior management official of the merging credit union. The description must include the name and title of each individual recipient and an explanation of the financial impact of each element of the arrangement, including direct salary increases and any indirect compensation, such as any bonus, deferred compensation or other financial rewards. As noted above, the term merger-related financial arrangement applies only to material increases in compensation, which means an increase exceeding the greater of \$15,000 or 10 percent of the individual’s compensation.

§708b.107 Certificate of vote on merger proposal.

The proposal corrects a typographical error in the title of this section. The corrected title is “Certification of vote on merger proposal.”

§708b.201 Termination of insurance.

This section addresses state credit unions terminating federal share insurance, and requires member votes taken in connection with share insurance termination to be conducted by an independent entity and secret ballot. Because the proposal includes the terms “secret ballot” and “independent entity” in the definitions section, the proposal deletes the existing explanation of secret ballot in paragraph (c) of §708b.201.

§708b.203 Conversion of insurance.

This section addresses credit unions converting from federal share insurance to nonfederal insurance, and implements the statutory requirement that at least 20 percent of credit union members must vote on the conversion proposal in order to approve it. 12 U.S.C. 1786(d)(2). Paragraph (d) of this section also requires member votes taken in connection with share insurance conversions to be conducted by an independent entity and secret ballot. Because the proposal includes the terms “secret ballot” and “independent entity” in the definitions section, the proposal deletes the existing explanation of secret ballot in paragraph (d) of §708b.203.

The current paragraph (g) of this section also states that, generally, NCUA will act to approve or disapprove a conversion within 14 days of receiving the certification of vote. The proposal amends paragraph (g) to clarify that such approval is conditional on the credit union completing the conversion within six months of the date of the NCUA approval letter. This six month timeframe ensures that the conversion is completed before the member vote becomes stale and also ensures that NCUA can properly plan for and allocate scarce examination resources that would otherwise be devoted to examining the converting credit union. Six months should be more than ample time to complete the conversion, since the credit union will already have obtained the approval of the gaining insurer for the conversion prior to notifying NCUA of the credit union’s intent to convert. 12 CFR 708b.204(e)(2).

§708b.206 Share insurance communications to members.

Currently, paragraph (b) of this section requires that certain communications about a pending share insurance conversion that a converting credit union provides to its members must include the following disclosure:

IF YOU ARE A MEMBER OF THIS CREDIT UNION, YOUR ACCOUNTS ARE CURRENTLY INSURED BY THE NATIONAL CREDIT UNION ADMINISTRATION, A FEDERAL AGENCY. THIS FEDERAL INSURANCE IS BACKED BY THE FULL FAITH AND CREDIT OF THE UNITED STATES GOVERNMENT. IF THE CREDIT UNION CONVERTS TO PRIVATE INSURANCE AND THE CREDIT UNION FAILS, THE FEDERAL GOVERNMENT DOES NOT GUARANTEE THAT YOU WILL GET YOUR MONEY BACK."

The proposal amends and this disclosure language slightly by changing the third sentence to read:

IF THE CREDIT UNION CONVERTS TO PRIVATE INSURANCE WITH (insert name of private share insurer) AND THE CREDIT UNION FAILS, THE FEDERAL GOVERNMENT DOES NOT GUARANTEE THAT YOU WILL GET YOUR MONEY BACK."

This clarification ensures the reader understands the reference to “private insurance.”

## **REGULATORY PROCEDURES:**

### **A. Regulatory Flexibility Act.**

The Regulatory Flexibility Act requires NCUA to prepare an analysis to describe any significant economic impact a rule may have on a substantial number of small credit unions, defined as those under ten million dollars in assets. At this time, NCUA does not believe that this proposed rulemaking will have a significant economic impact on a substantial number of small credit unions.

As discussed above, the proposed fiduciary standards for FCUs are intended to replace existing standards on a state-by-state basis, so these new standards should not have a significant impact on small credit unions. The proposal does specifically provide that an FCU director “have a working familiarity with basic finance and accounting practices, including the ability to read and understand the Federal credit union’s balance sheet and income statement,” but this requirement would likely be implicit in the existing state fiduciary standards governing a federal credit union since all credit unions are financial institutions and all credit union directors must obtain some level of familiarity to properly perform their governance function. If a director of a small, noncomplex credit union does not begin his or her directorship with such familiarity, the director should be able to obtain this familiarity shortly after assuming the directorship. Training is available from various external sources and, for small credit unions, training is also available from NCUA’s Office of Small Credit Union Initiatives.

Also, the proposed rules related to bank conversions and mergers should not affect a substantial number of small credit unions because very few credit unions typically seek such a charter conversion, and those that do seek such a charter are not small. Finally, the proposed revisions to the rules relating to credit union mergers with other credit unions are seem economically significant. NCUA invites comment, however, on the potential economic impact of this rulemaking on small credit unions, including the nature of the impact, the size of the impact, and the number of small credit unions that could be affected in any given year. NCUA also invited comment on the necessity for a Regulatory Flexibility Act analysis.

### **B. Paperwork Reduction Act**

Currently, parts 708a and 708b contain various information collection requirements as described in the Paperwork Reduction Act of 1995 and implemented by the Office of Management and Budget (OMB) and previously submitted by NCUA. 44 U.S.C. 3507(d); 5 CFR Part 1320. The proposed revisions to part 708a include a new subpart C: Merger of Insured Credit Unions into Banks. This new subpart will increase the existing paperwork burden, since the existing part 708b on Mergers of Federally Insured

Credit Unions only applies to mergers involving two credit unions. Accordingly, as required by the Paperwork Reduction Act, NCUA is forwarding an information collection package to the OMB for its review and approval on the mergers of insured credit unions with banks to revise a prior collection.

The proposed new subpart C of part 708a ensures that 1) directors of credit unions perform sufficient due diligence on any proposed merger so as to ensure the merger is in the best interests of the credit union's members, 2) the credit union provides NCUA with sufficient information about the proposed transaction for NCUA to fulfill its statutory duties, and 3) the credit union provides its members with sufficient information to enable them to vote on the proposal. Based on the history of such merger proposals, NCUA estimates that approximately one credit union a year will propose to merge with a bank. NCUA further estimates the annual reporting and recordkeeping burden associated with the new rule for each merging credit union at about 714 hours, for a total annual burden of 714 hours. This estimate is calculated as follows.

Proposed §708a.303(a) requires a merging credit union to obtain a merger valuation. NCUA estimates that it will take a credit union approximately 50 hours to obtain such a merger valuation.

Proposed §708a.303(b) requires, under certain circumstances that a merging credit union prepare and publish an advance notice of intent to merge. NCUA estimates that it will take a credit union approximately 2 hours to prepare an advance notice of intent to merge.

Proposed §708a.303(c) requires that a merging credit union solicit and review member comments. NCUA estimates that it will take a credit union approximately 10 hours to any member comments.

Proposed §708a.303(d), and associated due diligence requirement in §708a.304(d), require that a merging credit union's directors conduct due diligence and affirmatively approve a proposal to merge. NCUA estimates that it will take the directors approximately 50 hours to properly consider and approve such a proposal.

Proposed §708a.304(a) and (b) requires that a merging credit union prepare and submit to NCUA a Notice of its Intent to Merge and Request for NCUA Authorization (NIMRA) to conduct a member vote. The preparation of the NIMRA, and the associated merger plan, requires collection and preparation of numerous items, and NCUA estimates this collection and preparation will take about 100 hours.

Proposed §708a.304(c) requires that a merging credit union prepare a director's certification of support for the merger proposal and plan. NCUA estimates this collection and preparation will take about 1 hour.

Proposed §§708a.305 and 708a.306 require that a merging credit union conduct a member vote on the proposed merger. Members must be allowed to vote either by mail

or in person at a special meeting. NCUA estimates the preparation and mailing of notices and ballots, and the collection of ballots, will take about 500 hours.

Proposed §708a.305(g) requires that, when a member of merging credit union requests to communicate with other members, the merging credit union provide such communication to other members at the expense of the requesting member. NCUA estimates the associated burden on the merging credit union at zero hours.

Proposed §708a.307 requires that a merging credit union certify the results of the member vote to NCUA. NCUA estimates that the preparation of the certification will take about 1 hour.

The following table summarizes this information.

<b>Proposed Rule Section (part 708a, subpart C)</b>	<b>Estimated Associated Burden (Hours):</b>
§708a.303(a)	50
§708a.303(b)	2
§708a.303(c)	10
§708a.303(d) and §708a.304(d)	50
§708a.304(a) and §708a.304(b)	100
§708a.304(c)	1
§708a.305 and §708a.306	500
§708a.305(g)	0
§708a.307	1
Total Estimated Burden Hours (per Respondent) =	714
Estimated Number of Respondents (Annual) =	x 1
<b>Total Annual Burden Hours =</b>	<b>714</b>

Organizations and individuals desiring to submit comments on the proposed information collection requirements should send them to: Office of Information and Regulatory Affairs, OMB, New Executive Office Building, Washington, DC 20503; Attention: National Credit Union Administration Desk Officer, with a copy to Mary Rupp, Secretary of the Board, National Credit Union Administration, 1775 Duke Street, Alexandria, Virginia 22314-3428.

The NCUA considers comments by the public on this proposed collection of information in:

- Evaluating whether the proposed collection of information is necessary for the proper performance of the functions of the NCUA, including whether the information will have a practical use;
- Evaluating the accuracy of the NCUA's estimate of the burden of the proposed collection of information, including the validity of the methodology and assumptions used;

- Enhancing the quality, usefulness, and clarity of the information to be collected; and
- Minimizing the burden of collection of information on those who are to respond, including through the use of appropriate automated, electronic, mechanical, or other technological collection techniques or other forms of information technology; e.g., permitting electronic submission of responses.

The Office of Management and Budget will make a decision concerning the collection of information contained in the proposed regulation between 30 and 60 days after publication of this proposed rule in the Federal Register. Therefore, a comment to OMB is best assured of having its full effect if OMB receives it within 30 days of publication. This does not affect the deadline for the public to comment to the NCUA on the proposed regulation.

### **C. Executive Order 13132.**

Executive Order 13132 encourages independent regulatory agencies to consider the impact of their actions on state and local interests. In adherence to fundamental federalism principles, NCUA, an independent regulatory agency as defined in 44 U.S.C. 3502(5), voluntarily complies with the executive order. The proposed rule would not have substantial direct effects on the states, on the connection between the national government and the states, or on the distribution of power and responsibilities among the various levels of government. NCUA has determined that this proposed rule does not constitute a policy that has federalism implications for purposes of the executive order.

### **D. The Treasury and General Government Appropriations Act, 1999 – Assessment of Federal Regulations and Policies on Families.**

The NCUA has determined that the proposed rule would not affect family well-being within the meaning of §654 of the Treasury and General Government Appropriations Act, 1999, Pub. L. 105-277, 112 Stat. 2681 (1998).

### **List of Subjects**

#### **12 CFR part 701**

Credit unions, Loans.

#### **12 CFR part 704**

Credit unions, Corporate credit unions, Reporting and recordkeeping requirements.

#### **12 CFR part 708a**

Charter conversions, Credit unions, Mergers of credit unions.

**12 CFR part 708b**

Credit unions, Mergers of credit unions, Reporting and recordkeeping requirements.

By the National Credit Union Administration Board on March 18, 2010.

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Mary Rupp  
Secretary of the Board

For the reasons stated in the preamble, the National Credit Union Administration proposes to amend 12 CFR parts 701, 704, 708a, and 708b as set forth below:

**PART 701 - ORGANIZATION AND OPERATIONS OF FEDERAL CREDIT UNIONS**

1. The authority citation for part 701 continues to read as follows:

**Authority:** 12 U.S.C. 1752(5), 1755, 1756, 1757, 1759, 1761a, 1761b, 1766, 1767, 1782, 1784, 1787, and 1789. Section 701.6 is also authorized by 31 U.S.C. 3717. Section 701.31 is also authorized by 15 U.S.C. 1601 et seq.; 42 U.S.C. 1981 and 3601-3619. Section 701.35 is also authorized by 42 U.S.C. 4311-4312.

2. In part 701, add a new §701.4 to read as follows:

**§701.4 General authorities and duties of Federal credit union boards of directors.**

(a) *Management of a Federal credit union.* The management of each Federal credit union is vested in its board of directors. While a Federal credit union board of directors may delegate the execution of operational functions to Federal credit union personnel, the ultimate responsibility of each Federal credit union's board of directors for that Federal credit union's management is non-delegable.

(b) *Duties of Federal credit union directors.* Each Federal credit union director has the duty to:

(1) Carry out his or her duties as a director in good faith, in a manner such director reasonably believes to be in the best interests of the membership of the Federal credit union, and with such care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstances;

(2) Administer the affairs of the Federal credit union fairly and impartially and without discrimination in favor of or against any particular member;

(3) At the time of election or appointment, or within a reasonable time thereafter, not to exceed three months, have at least a working familiarity with basic finance and accounting practices, including the ability to read and understand the Federal credit union's balance sheet and income statement and to ask, as appropriate, substantive questions of management and the internal and external auditors; and

(4) Direct the operations of the Federal credit union in conformity with the requirements set forth in the Federal Credit Union Act, this chapter, other applicable law, and sound business practices.

(c) *Authority regarding staff and outside consultants.* (1) In carrying out its duties and responsibilities, each Federal credit union's board of directors and all its committees have authority to retain staff and outside counsel, independent accountants, financial advisors, and other outside consultants at the expense of the Federal credit union.

(2) Federal credit union staff providing services to the board of directors or any committee of the board under paragraph (c)(1) of this section may be required by the board of directors or such committee to report directly to the board or such committee, as appropriate.

(3) In discharging board or committee duties a director, who does not have knowledge that makes reliance unwarranted, is entitled to rely on information, opinions, reports or statements, including financial statements and other financial data, prepared or presented by any of the persons specified in paragraph (d).

(d) *Reliance.* A director may rely on:

(1) One or more officers or employees of the Federal credit union who the director reasonably believes to be reliable and competent in the functions performed or the information, opinions, reports or statements provided;

(2) Legal counsel, independent public accountants, or other persons retained by the Federal credit union as to matters involving skills or expertise the director reasonably believes are matters (i) within the particular person's professional or expert competence, and (ii) as to which the particular person merits confidence; and

(3) A committee of the board of directors of which the director is not a member if the director reasonably believes the committee merits confidence.

\* \* \* \* \*

3. Revise paragraph (c)(5) of §701.33 to read as follows:

§701.33 Reimbursement, insurance, and indemnification of officials and employees.

\* \* \* \* \*

(c) \* \* \*

(5) Notwithstanding paragraphs (c)(1) through (3) of this section, a federal credit union may not indemnify an official or employee for personal liability related to any decision made by that individual on a matter significantly affecting the fundamental rights and interests of the FCU's members where the decision giving rise to the claim for indemnification is determined by a court to have constituted gross negligence, recklessness, or willful misconduct. Matters affecting the fundamental rights and interests of FCU members include charter and share insurance conversions and terminations.

4. Section 8 of Article XVI of appendix A to part 701 is revised to read as follows:

**Appendix A to Part 701 -- Federal Credit Union Bylaws**

\* \* \* \* \*

Section 8. Indemnification. (a) Subject to the limitations in §701.33(c)(5) of the regulations, the credit union may elect to indemnify to the extent authorized by (check one)

- law of the state of \_\_\_\_\_:
- Model Business Corporation Act:

the following individuals from any liability asserted against them and expenses reasonably incurred by them in connection with judicial or administrative proceedings to which they are or may become parties by reason of the performance of their official duties (check as appropriate).

- current officials
- former officials
- current employees
- former employees

(b) The credit union may purchase and maintain insurance on behalf of the individuals indicated in (a) above against any liability asserted against them and expenses reasonably incurred by them in their official capacities and arising out of the performance of their official duties to the extent such insurance is permitted by the applicable state law or the Model Business Corporation Act.

(c) The term “official” in this bylaw means a person who is a member of the board of directors, credit committee, supervisory committee, other volunteer committee (including elected or appointed loan officers or membership officers), established by the board of directors.

## **PART 704 – CORPORATE CREDIT UNIONS**

4. The authority citation for part 704 continues to read as follows:

**Authority:** 12 U.S.C. 1762, 1766(a), 1781, and 1789.

[Note: The following revision to the appendix to part 704, a document entitled “Corporate Federal Credit Union Bylaws,” will not appear in the Code of Federal Regulations.]

5. Section 4 of Article XI of the document entitled “Corporate Federal Credit Union Bylaws,” an appendix to part 704, is revised to read as follows:

### *Article XI. General*

\* \* \* \* \*

*Section 4.* (a) Subject to the limitations in 12 CFR §701.33(c)(5) of the NCUA regulations, the corporate credit union may elect to indemnify to the extent authorized by (check one) ( ) law of the state of \_\_\_\_\_ or ( ) Model Business Corporation Act the following individuals from any liability asserted against them and expenses reasonably incurred by them in connection with judicial or administrative proceedings to which they are or may become parties by reason of the performance of their official duties: (Check as appropriate) ( ) current officials, ( ) former officials, ( ) current employees, ( ) former employees.

(b) The corporate credit union may purchase and maintain insurance on behalf of the individuals indicated in (a) above against any liability asserted against them and expenses reasonably incurred by them in their official capacities and arising out of the performance of their official duties to the extent such insurance is permitted by the applicable state law or the Model Business Corporation Act.

(c) The term “official” in this bylaw means a person who is a member of the board of directors, supervisory committee, other volunteer committee (including elected or appointed loan officers or membership officers), established by the board of directors.

\* \* \* \* \*

## **PART 708a – BANK CONVERSIONS**

6. Revise the authority citation for part 708a to read as follows:

**Authority:** 12 U.S.C. 1766, 1785(b), and 1785(c).

7. Revise the heading and table of contents for part 708a to read as follows:

## **PART 708a – BANK CONVERSIONS AND MERGERS**

### **Subpart A: Conversion of Insured Credit Unions to Mutual Savings Banks**

Sec.

- 708a.101 Definitions.
- 708a.102 Authority to convert.
- 708a.103 Board of directors' approval and members' opportunity to comment.
- 708a.104 Disclosures and communications to members.
- 708a.105 Notice to NCUA.
- 708a.106 Membership approval of a proposal to convert.
- 708a.107 Certification of vote on conversion proposal.
- 708a.108 NCUA oversight of methods and procedures of membership vote.
- 708a.109 Other regulatory oversight of methods and procedures of membership vote.
- 708a.110 Completion of conversion.
- 708a.111 Limit on compensation of officials.
- 708a.112 Voting incentives.
- 708a.113 Voting guidelines.

### **Subpart B: [RESERVED]**

### **Subpart C: Merger of Insured Credit Unions Into Banks**

Sec.

- 708a.301 Definitions.
- 708a.302 Authority to merge.
- 708a.303 Board of directors' approval and members' opportunity to comment.
- 708a.304 Notice to NCUA and request to proceed with member vote.
- 708a.305 Disclosures and communications to members.
- 708a.306 Membership approval of a proposal to merge.
- 708a.307 Certification of vote on merger proposal.
- 708a.308 NCUA approval of the merger.
- 708a.309 Completion of merger.
- 708a.310 Limits on compensation of officials.
- 708a.311 Voting incentives.
- 708a.312 Voting guidelines.

8. Redesignate §§708a.1 through 708a.13 as §§708a.101 through 708a.113, respectively.

9. Revise §708a.101 by inserting definitions of “conducted by an independent entity,” “independent entity,” and “secret ballot” to read as follows:

§708a.101 Definitions

\* \* \* \* \*

Conducted by an independent entity means:

- (1) The independent entity will receive the ballots directly from voting members and store them.
- (2) After the conclusion of the special meeting that ends the ballot period, the independent entity will open all the ballots in its possession and tabulate the results. The entity must not open or tabulate any ballots before the conclusion of the special meeting.
- (3) The independent entity will certify the final vote tally in writing to the credit union and provide a copy to the NCUA Regional Director. The certification will include, at a minimum, the number of members who voted, the number of affirmative votes, and the number of negative votes. During the course of the voting period the independent entity may provide the credit union with the names of members who have not yet voted, but may not provide any voting results to the credit union prior to certifying the final vote tally.

\* \* \* \* \*

Independent entity means a company with experience in conducting corporate elections. No official or senior management official of the credit union, or the immediate family member of any official or senior management official, may have any ownership interest in, or be employed by, the entity.

\* \* \* \* \*

Secret ballot means no credit union employee or official can determine how a particular member voted. Credit union employees and officials are prohibited from assisting members in completing ballots or handling completed ballots.

\* \* \* \* \*

10. Revise §708a.104(b) as follows:

- a. In paragraph (b)(4)(i), insert the word “of” after the word “plan.”
- b. In paragraph (b)(4), correct the paragraph designation “(ii)” to “(iii)” the second time it appears.

11. Revise paragraphs (4) and (5) of §708a.104 (c), and insert new paragraphs (6), (7), and (8), to read as follows:

§708a.104 Disclosures and communications to members.

\* \* \* \* \*

(c) \* \* \*

(4) An affirmative statement that, at the time of conversion to a mutual savings bank, the credit union does or does not intend to convert to a stock institution or a mutual holding company structure;

(5) A clear and conspicuous disclosure of the estimated, itemized cost of the proposed conversion, including printing fees, postage fees, advertising, consulting and professional fees, legal fees, staff time, the cost of holding a special meeting, other costs of conducting the vote, and any other conversion-related expenses;

(6) A clear and conspicuous disclosure of how the conversion from a credit union to a mutual savings bank will affect the institution's ability to make non-housing-related consumer loans because of a mutual savings bank's obligations to satisfy certain lending requirements as a mutual savings bank. This disclosure should specify possible reductions in some kinds of loans to members;

(7) A clear and conspicuous disclosure that the National Credit Union Administration does not approve or disapprove of the conversion proposal or the reasons advanced in support of the proposal; and

(8) A clear and conspicuous disclosure of how the conversion from a credit union to a mutual savings bank is likely to affect the availability of facilities and services. At a minimum, this disclosure should include the name and location of any branches, including shared branches, and automatic teller networks, to which members may lose access as a result of the conversion. This disclosure must be based on research and analysis completed before the date the board of directors votes to adopt the conversion proposal.

\* \* \* \* \*

c. In paragraph (f)(2), insert the phrase "to a Bank" after the word "Conversion."

12. Revise §708a.107 by inserting the following new paragraph (c) at the end:

§708a.107 Certification of vote on conversion proposal.

\* \* \* \* \*

(c) The certification must be accompanied by copies of all correspondence between the credit union and any federal banking agency whose approval is required for the conversion.

13. Revise §708a.113 by adding the following new paragraph (e) at the end:

§708a.113 Voting guidelines.

\* \* \* \* \*

(e) *Solicitation of votes.* Some credit unions may wish to contact members who have not voted and encourage them to vote on the conversion proposal. However, using credit union employees to solicit votes can lead to problems. NCUA is aware of at least one instance where credit union employees were directed to solicit member votes for the conversion, forcing them to neglect duties critical to the credit union's safe and sound operations. Also, employees may feel pressured to solicit votes for the conversion, regardless of whether or not they support it. Given these potential problems, NCUA recommends that a converting credit union planning to solicit votes use a third party to solicit votes rather than diverting credit union employees from their usual duties.

14. Add and reserve Subpart B and add Subpart C to part 708a to read as follows:

**Subpart C -- MERGER OF INSURED CREDIT UNIONS INTO BANKS**

**§708a.301 Definitions.**

As used in this part:

Bank has the same meaning as in section 3(a) of the Federal Deposit Insurance Act, 12 U.S.C. 1813(a).

Clear and conspicuous means text in bold type in a font size at least one size larger than any other text used in the document (exclusive of headings), but in no event smaller than 12 point.

Credit union has the same meaning as insured credit union in section 101 of the Federal Credit Union Act.

Distribution formula is the formula the bank will use to determine each member's portion of that payment to be received upon completion of the merger.

Federal banking agencies have the same meaning as in section 3 of the Federal Deposit Insurance Act.

Merger means any transaction in which a credit union transfers all, or substantially all, of its assets to a bank. The term merger includes any purported conversion of a credit union to a bank if the purported conversion is conducted pursuant to an agreement between a preexisting bank and the credit union that provides (1) the credit union will not conduct business as a stand-alone bank, and (2) the purported conversion will be followed by the transfer of all, or substantially all, of the credit union's assets to the preexisting bank.

Merger value or merger valuation is the amount that a stock bank would pay in an arms-length transaction to purchase the credit union's assets and assume its liabilities and shares (deposits).

Qualified appraisal entity means entity that has significant experience in the valuation of depository institutions and that has no past financial relationship with the merging credit union, the continuing bank, or any law firm representing the credit union or the bank in connection with the merger.

Regional director means the director of the NCUA regional office for the region where a natural person credit union's main office is located. For corporate credit unions, regional director means the director of NCUA's Office of Corporate Credit Unions.

Senior management official means a chief executive officer, an assistant chief executive officer, a chief financial officer, and any other senior executive officer as defined by the appropriate federal banking agencies pursuant to section 32(f) of the Federal Deposit Insurance Act.

#### **§708a.302 Authority to merge.**

A credit union, with the approval of its members, may merge into a bank only with the prior approval of NCUA, the Federal Deposit Insurance Corporation, and the regulator of the bank. If the credit union is state chartered, it also needs the prior approval of its state regulator.

#### **§708a.303 Board of directors' approval and members' opportunity to comment.**

(a) Merger valuation. Before selecting a bank merger partner and voting on a proposal to merge, a credit union's board of directors must determine, as part of its due diligence, the merger value of the credit union. In making its determination of the merger value of the credit union, the credit union must either:

- (1) Conduct a well-publicized merger auction and obtain purchase quotations from at least three banks, two or more of which must be stock banks; or
- (2) Retain a qualified appraisal entity to analyze and estimate the merger value of the credit union.

(b) Advance notice. A credit union that does not conduct a public auction as described in paragraph (a)(1) of this section must comply with the following notice requirements before voting on a proposal to merge.

(1) No later than 30 days before a board of directors votes on a proposal to merge, it must publish a notice in a general circulation newspaper, or in multiple newspapers if necessary, serving all areas where the credit union has an office, branch, or service center. It must also post the notice in a clear and conspicuous fashion in the lobby of the credit union's home office and branch offices and on the credit union's website, if it has one. If the notice is not on the home page of the website, the home page must have a clear and conspicuous link, visible on a standard monitor without scrolling, to the notice.

(2) The public notice must include the following:

- (i) The name and address of the credit union;
- (ii) The name and type of institution into which the credit union's board is considering a proposal to merge;
- (iii) A brief statement of why the board is considering the merger and the major positive and negative effects of the proposed merger;
- (iv) A statement that directs members to submit any comments on the proposal to the credit union's board of directors by regular mail, electronic mail, or facsimile;
- (v) The date on which the board plans to vote on the proposal and the date by which members must submit their comments for consideration; which submission date may not be more than 5 days before the board vote;
- (vi) The street address, electronic mail address, and facsimile number of the credit union where members may submit comments; and
- (vii) A statement that, in the event the board approves the proposal to merge, the proposal will be submitted to the membership of the credit union for a vote following a notice period that is no shorter than 90 days.

(3) The board of directors must approve publication of the notice.

(c) Member comments. A credit union must collect and review any member comments about the merger received during the merger process. The credit union must retain the comments until the merger is consummated.

(d) Approval of proposal to merge. The merger proposal may only be approved by an affirmative vote of a majority of board members who have determined:

- (1) A merger with a bank is in the best interests of the members, and
- (2) The merger partner selected by the directors is the best choice for the members, taking into account the merger value of the credit union and the amount that the selected merger partner is willing to pay the credit union's members to effect the merger.

#### **§708a.304 Notice to NCUA and request to proceed with member vote.**

(a) NIMRA. If a credit union's board of directors adopts a proposal to merge, it must, within 30 days of the adoption, provide the Regional Director with a Notice of its Intent to Merge and Request for NCUA Authorization (NIMRA) to conduct a member vote. The NIMRA must include the following:

- (1) The merger plan (as described below);
- (2) Resolutions of the boards of directors of both institutions;
- (3) Certification of the board of directors (as described below);
- (4) Proposed Merger Agreement;
- (5) Proposed Notice of Special Meeting of the Members and any other communications about the merger that the credit union intends to send to its members, including electronic communications posted on a website or transmitted by electronic mail;
- (6) Proposed ballot to be sent to the members;
- (7) For state chartered credit unions, evidence that the proposed merger is authorized under state law (as described below);
- (8) A copy of the bank's last two examination reports;
- (9) A statement of the merger valuation of the credit union;
- (10) A statement of whether any merger payment will be made to the members and how such a payment will be distributed among the members;
- (11) Information about the due diligence of the directors in locating a merger partner and determining that the merger is in best interests of the members of the credit union (as described below);
- (12) Copies of all contracts reflecting any merger-related compensation or other benefit to be received by any director or senior management official of the credit union;
- (13) If the merging credit union's assets on its latest call report are equal to or greater than the threshold amount established annually by the Federal Trade Commission under 15 U.S.C. 18a(a)(2)(B)(i), currently \$63.4 million, a statement about whether the two institutions intend to make a Hart-Scott-Rodino Act premerger notification filing with the Federal Trade Commission and, if not, an explanation why not;
- (14) Copies of any filings the credit union or bank intends to make with another federal or state regulatory agency in which the credit union or bank seeks that agency's approval of the merger; and
- (15) Proof that the accounts of the credit union will be accepted for coverage by the Federal Deposit Insurance Corporation.

(b) Merger plan. The merger plan must include:

- (1) Current financial statements for both institutions;
- (2) Current delinquent loan summaries and analyses of the adequacy of the Allowance for Loan and Lease Losses account for both institutions;
- (3) Consolidated financial statements of the continuing institution after the

- merger;
- (4) Explanation of any provisions for reserves, undivided earnings or dividends;
  - (5) Provisions with respect to notification and payment of creditors; and
  - (6) Explanation of any changes relative to insurance such as life savings and loan protection insurance and insurance of member accounts.

(c) Director certification. The NIMRA must include a certification by the credit union's board of directors of their support for the merger proposal and plan. Each director who voted in favor of the merger proposal must sign the certification. The certification must contain the following:

(i) A statement that each director signing the certification supports the proposed merger and believes the proposed merger, and the selected bank merger partner, are both in the best interests of the members of the credit union;

(ii) A description of all materials submitted to the Regional Director with the notice and certification;

(iii) A statement that each board member signing the certification has examined all these materials carefully and these materials are true, correct, current, and complete as of the date of submission; and

(iv) An acknowledgement that federal law (18 U.S.C. 1001) prohibits any misrepresentations or omissions of material facts, or false, fictitious or fraudulent statements or representations made with respect to the certification or the materials provided to the Regional Director or any other documents or information provided to the members of the credit union or NCUA in connection with the merger.

(d) Due diligence. The NIMRA must include a description of all the credit union's due diligence in determining that the merger satisfies the factors contained in Section 205(c) of the Act. In particular, the NIMRA must describe how the board located the merger partner, how the board negotiated the merger agreement, and how the board determined that this merger was in the best interests of the credit union's members. The description must include all information relied upon by the credit union in determining the merger value of the credit union, the amount of any payment to be made by the bank to the credit union's members (the "merger payment"), and, if that merger payment is less than the merger value of the credit union, an explanation why the merger and the merger partner selected is in the best interests of the members. The description must include an explanation of the distribution formula by which the merger payment will be distributed among the credit union's members.

(e) State chartered credit unions. A state chartered credit union must state as part of its NIMRA if its state chartering law permits it to merge into a bank and provide the specific legal citation. A state chartered credit union will remain subject to any state law

requirements for merger that are more stringent than those this part imposes, including any internal governance requirements, such as the requisite membership vote for merger and the determination of a member's eligibility to vote. If a state chartered credit union relies for its authority to merge into a bank on a state law parity provision, meaning a provision in state law permitting a state chartered credit union to operate with the same or similar authority as a federal credit union, it must:

- (i) Include in its notice a statement that its state regulatory authority agrees that it may rely on the state law parity provision as authority to merge; and
  - (ii) Indicate its state regulatory authority's position as to whether federal law and regulations or state law will control internal governance issues in the merger such as the requisite membership vote for merger and the determination of a member's eligibility to vote.
- (f) Consultation with state authorities. After receiving a NIMRA from a state chartered credit union, the Regional Director will consult with the appropriate state supervisory authority.
- (g) Regional Director approval. After receiving a NIMRA, the Regional Director will either disapprove the proposed merger or authorize the credit union to proceed with its membership vote.
- (i) The Regional Director will disapprove the proposed merger if the NIMRA either lacks the documentation required by this section or lacks substantial evidence to support each of the factors in Section 205(c) of the Act. As part of this determination, the Region Director must disapprove the proposed merger if:
    - a. The merger payment offered by the bank to the members is less than the merger valuation, absent some additional, quantifiable benefit to the members from the selected merger partner; or
    - b. The NIMRA fails to adequately explain the nature and amount of any compensation to be received by the credit union's directors or senior management officials in connection with the merger or to justify that compensation.
  - (ii) NCUA's authorization to proceed with the member vote does not mean NCUA has approved of the merger proposal.
- (h) Appeal of adverse decision. If the Regional Director disapproves a merger proposal, the credit union may appeal the Regional Director's determination to the NCUA Board. The credit union must file the appeal within 30 days after receipt of the Regional Director's determination. The NCUA Board will act on the appeal within 120 days of receipt.

#### **§708a.305 Disclosures and communications to members.**

(a) After the board of directors approves a merger proposal and receives NCUA's authorization as described in §§708a.303 and 708a.304, the credit union must provide written notice of its intent to merge to each member who is eligible to vote on the merger. The notice to members must be mailed 90 calendar days and 30 calendar days before the date of the membership vote on the merger. A ballot must be included in the same envelope as the 30-day notice and only with the 30-day notice. A merging credit union may not distribute ballots with the 90-day notice, in any other written communications, or in person before the 30-day notice is sent.

(b)(1) The notice to members must adequately describe the purpose and subject matter of the vote and clearly inform members that they may vote at the special meeting or by submitting the written ballot. The notice must state the date, time, and place of the meeting.

(2) The 90-day notice must state in a clear and conspicuous fashion that a written ballot will be mailed together with another notice 30 days before the date of the membership vote on merger. The 30-day notice must state in a clear and conspicuous fashion that a written ballot is included in the same envelope as the 30-day notice materials.

(3) For purposes of facilitating the member-to-member contact described in paragraph (f) of this section, the 90-day notice must indicate the number of credit union members eligible to vote on the merger proposal and state how many members have agreed to accept communications from the credit union in electronic form. The 90-day notice must also include the information listed in paragraph (f)(9) of this section.

(4) The member ballot must include:

- (i) A brief description of the proposal (e.g., "Proposal: Approval of the Plan of Merger by which [insert name of credit union] will merge with a bank");
- (ii) Two blocks marked respectively as "FOR" and "AGAINST;" and
- (ii) The following language: "A vote FOR the proposal means that you want your credit union to merge with and become a bank. A vote AGAINST the proposal means that you want your credit union to remain a credit union." This language must be displayed in a clear and conspicuous fashion immediately beneath the FOR and AGAINST blocks.

(5) The ballot may also include voting instructions and the recommendation of the board of directors (i.e., "Your Board of Directors recommends a vote FOR the Plan of Merger") but may not include any further information without the prior written approval of the Regional Director.

(c) For mergers into stock banks, an adequate description of the purpose and subject matter of the member vote on merger, as required by paragraph (b) of this section, must include:

(1) A clear and conspicuous disclosure that if the merger is approved the members will lose all of their ownership interests in the institution, including the right to vote, the right to share in the value of the institution should it be liquidated, the right to share in any extraordinary dividends, and the right to have the net worth of the institution managed in their best interests;

(2) A clear and conspicuous disclosure of any post-merger employment or consulting relationships offered by the bank to any of the credit union's directors and senior management officials and the amount of the associated compensation;

(3) A clear and conspicuous disclosure of how the merger of the credit union will affect the members' ability to obtain non-housing-related consumer loans from the bank because of because of the bank's obligations to satisfy statutory or regulatory lending requirements (if any). This disclosure should specify possible reductions in some kinds of loans to members;

(4) A clear and conspicuous statement of the merger value of the credit union, the total dollar amount the selected bank merger partner has agreed to pay to effect the merger, and the distribution formula the bank will use to determine each member's portion of that payment to be received upon completion of the merger; and

(d) For mergers into mutual banks, an adequate description of the purpose and subject matter of the member vote on merger, as required by paragraph (b) of this section, must include:

(1) A clear and conspicuous disclosure of how the merger will affect members' voting rights including whether the bank bases voting rights on account balances;

(2) A clear and conspicuous disclosure that the merger could lead to members losing all of their ownership interests in the credit union if the bank subsequently converts to a stock institution and the members do not purchase stock;

(3) A clear and conspicuous disclosure of any post-merger employment or consulting relationships offered by the bank to the credit union's directors and senior management officials and the associated compensation for each;

(4) A clear and conspicuous disclosure of how the merger of the credit union will affect the members' ability to obtain non-housing-related consumer loans from the bank because of because of the bank's obligations to satisfy statutory or regulatory lending requirements (if any). This disclosure should specify possible reductions in some kinds of loans to members;

(5) A clear and conspicuous statement that, at the time of merger, the bank does or does not intend to convert to a stock institution or a mutual holding company structure;

(6) A clear and conspicuous statement of the merger value of the credit union, the total dollar amount the selected bank merger partner has agreed to pay to effect the merger, and the distribution formula the bank will use to determine each member's portion of that payment to be received upon completion of the merger; and

(7) If the bank plans to add one or more of the credit union's directors to its board or employ one or more senior officials of the credit union, a clear and conspicuous statement that bank could convert to a stock bank in the future and a comparison of the opportunities available to those officials and employees to obtain stock with the opportunities available to the depositors of the bank.

(e)(1) A merging credit union must provide the following disclosures in a clear and conspicuous fashion with the 90-day and 30-day notices it sends to its members regarding the merger:

IMPORTANT REGULATORY DISCLOSURE ABOUT YOUR VOTE

The National Credit Union Administration, the federal government agency that supervises credit unions, requires [insert name of credit union] to provide the following disclosures:

1. **LOSS OF CREDIT UNION MEMBERSHIP.** A vote "FOR" the proposed merger means you want your credit union to merge with and become a bank. A vote "AGAINST" the proposed merger means you want your credit union to remain a credit union.

2. **[For Mergers into Stock Banks Only]. LOSS OF OWNERSHIP INTERESTS.** If your credit union merges into the bank, you will lose all the ownership interests you currently have in the credit union and you will become a customer of the bank. The bank's stockholders own the bank, and the directors of the bank have a fiduciary responsibility to run the bank in the best interests of the stockholders, not the customers.

2. **[For Mergers into Mutual Banks Only]. POTENTIAL PROFITS BY OFFICERS AND DIRECTORS.** Merger into a mutual savings bank is often the first step in a two-step process to convert to a stock-issuing bank or holding company structure. In such a scenario, the officers and directors of the bank often profit by obtaining stock in excess of that available to other members.

3. RATES ON LOANS AND SAVINGS. If your credit union merges into the bank, you may experience changes in your loan and savings rates. Available historic data indicates that, for most loan products, credit unions on average charge lower rates than banks. For most savings products, credit unions on average pay higher rates than banks.

(2) This text must be placed in a box, must be the only text on the front side of a single piece of paper, and must be placed so that the member will see the text after reading the credit union's cover letter but before reading any other part of the member notice. The back side of the paper must be blank. A merging credit union may modify this text only with the prior written consent of the Regional Director and, in the case of a state chartered credit union, the appropriate state regulatory agency.

(f) All written communications from a merging credit union to its members regarding the merger must be written in a manner that is simple and easy to understand. Simple and easy to understand means the communications are written in plain language designed to be understood by ordinary consumers and use clear and concise sentences, paragraphs, and sections. For purposes of this part, examples of factors to be considered in determining whether a communication is in plain language and uses clear and concise sentences, paragraphs and sections include the use of short explanatory sentences; use of definite, concrete, everyday words; use of active voice; avoidance of multiple negatives; avoidance of legal and technical business terminology; avoidance of explanations that are imprecise and reasonably subject to different interpretations; and use of language that is not misleading.

(g)(1) A merging credit union must mail or e-mail a requesting member's proper merger-related materials to other members eligible to vote if:

(i) A credit union's board of directors has adopted a proposal to merge;

(ii) A member makes a written request that the credit union mail or e-mail materials for the member;

(iii) The request is received by the credit union no later than 35 days after it sends out the 90-day member notice; and

(iv) The requesting member agrees to reimburse the credit union for the reasonable expenses, excluding overhead, of mailing or e-mailing the materials and also provides the credit union with an appropriate advance payment.

(2) A member's request must indicate if the member wants the materials mailed or e-mailed. If a member requests that the materials be mailed, the credit union will mail the materials to all eligible voters. If a member requests the materials be e-mailed, the credit union will e-mail the materials to all members who have agreed to accept communications electronically from the credit union. The subject line of the credit

union's e-mail will be "Proposed Credit Union Merger – Views of Member (insert member name)."

- (3) (i) A merging credit union may, at its option, include the following statement with a member's material:

On (date), the board of directors of (name of merging credit union) adopted a proposal to merge the credit union into a bank. Credit union members who wish to express their opinions about the proposed merger to other members may provide those opinions to (name of credit union). By law, the credit union, at the requesting members' expense, must then send those opinions to the other members. The attached document represents the opinion of a member (or group of members) of this credit union. This opinion is a personal opinion and does not necessarily reflect the views of the management or directors of the credit union.

(ii) A merging credit union may not add anything other than this statement to a member's material without the prior approval of the Regional Director.

- (4) The term "proper merger-related materials" does not include materials that:

(i) Due to size or similar reasons are impracticable to mail or e-mail;

(ii) Are false or misleading with respect to any material fact;

(iii) Omit a material fact necessary to make the statements in the material not false or misleading;

(iv) Relate to a personal claim or a personal grievance, or solicit personal gain or business advantage by or on behalf of any party;

(v) Relate to any matter, including a general economic, political, racial, religious, social, or similar cause, that is not significantly related to the proposed merger;

(vi) Directly or indirectly and without expressed factual foundation impugn a person's character, integrity, or reputation;

(vii) Directly or indirectly and without expressed factual foundation make charges concerning improper, illegal, or immoral conduct; or

(viii) Directly or indirectly and without expressed factual foundation make statements impugning the stability and soundness of the credit union.

- (5) If a merging credit union believes some or all of a member's request is not proper it must submit the member materials to the Regional Director within seven days of receipt. The credit union must include with its transmittal letter a specific statement of why the

materials are not proper and a specific recommendation for how the materials should be modified, if possible, to make them proper. The Regional Director will review the communication, communicate with the requesting member, and respond to the credit union within seven days with a determination on the propriety of the materials. The credit union must then mail or e-mail the material to the members if so directed by NCUA.

(6) A credit union must ensure that its members receive all materials that meet the requirements of §708a.305(g) on or before the date the members receive the 30-day notice and associated ballot. If a credit union cannot meet this delivery requirement, it must postpone mailing the 30-day notice until it can deliver the member materials. If a credit union postpones the mailing of the 30-day notice, it must also postpone the special meeting by the same number of days. When the credit union has completed the delivery, it must inform the requesting member that the delivery was completed and provide the number of recipients.

(7) The term “appropriate advance payment” means:

(i) For requests to mail materials to all eligible voters, a payment in the amount of 150 percent of the first class postage rate times the number of mailings, and

(ii) For requests to e-mail materials only to members that have agreed to accept electronic communications, a payment in the amount of 200 dollars.

(8) If a credit union posts merger-related information or material on its website, then it must simultaneously make a portion of its website available free of charge to its members to post and share their opinions on the merger. A link to the portion of the website available to members to post their views on the merger must be marked “Members: Share your views on the proposed merger and see other members’ views” and the link must also be visible on all pages on which the credit union posts its own merger-related information or material, as well as on the credit union’s homepage. If a credit union believes a particular member submission is not proper for posting, it will provide that submission to the Regional Director for review as described in paragraph (g)(5) of this section. The credit union may also post a content-neutral disclaimer using language similar to the language in paragraph (g)(3)(i) of this section.

(9) A merging credit union must inform members with the 90-day notice that if they wish to provide their opinions about the proposed merger to other members they can submit their opinions in writing to the credit union no later than 35 days from the date of the notice and the credit union will forward those opinions to other members. The 90-day notice will provide a contact at the credit union for delivery of communications, will explain that members must agree to reimburse the credit union’s costs of transmitting the communication including providing an advance payment, and will refer members to this section of NCUA’s rules for further information about the communication process. The credit union, at its option, may include additional factual information about the communication process with its 90-day notice.

(10) A group of members may make a joint request that the credit union send its materials to other members. For purposes of paragraphs (g)(2) and (g)(3) of this section, the credit union will use the group name provided by the group.

(h) If it chooses, a credit union may seek a preliminary determination from the Regional Director regarding any of the notices required under this subchapter and its proposed methods and procedures applicable to the membership merger vote. The Regional Director will make a preliminary determination regarding the notices and methods and procedures applicable to the membership vote within 30 calendar days of receipt of a credit union's request for review unless the Regional Director extends the period as necessary to request additional information or review a credit union's submission. A credit union's prior submission of any notice or proposed voting procedures does not relieve the credit union of its obligation to certify the results of the membership vote required by §708a.307 or eliminate the right of the Regional Director to disapprove the merger if the credit union fails to conduct the membership vote in a fair and legal manner consistent with the Federal Credit Union Act and these rules.

#### **§708a.306 Membership approval of a proposal to merge.**

(a) A proposal for merger approved by a board of directors also requires approval by a majority of the members who vote on the proposal. At least 20 percent of the members eligible to vote must participate in the vote. The credit union must also have NCUA's written authorization to proceed with the member vote.

(b) The board of directors must set a voting record date to determine member voting eligibility. The record date must be at least one day before the publication of notice required in §708a.303.

(c) A member may vote on a proposal to merge in person at a special meeting held on the date set for the vote or by written ballot delivered by mail or otherwise. The vote on the merger proposal must be by secret ballot and conducted by an independent entity. The independent entity must be a company with experience in conducting corporate elections. No official or senior management official of the credit union or the immediate family members of any official or senior management official may have any ownership interest in or be employed by the independent entity.

#### **§708a.307 Certification of vote on merger proposal.**

(a) The board of directors of the merging credit union must certify the results of the membership vote to the Regional Director within 10 calendar days after the vote is taken.

(b) The certification must also include a statement that the notice, ballot, and other written materials provided to members were identical to those submitted to NCUA

pursuant to §708a.305. If the board cannot certify this, the board must provide copies of any new or revised materials and an explanation of the reasons for any changes.

(c) The certification must include copies of any correspondence between the credit union and other regulators related to the pending merger.

#### **§708a.308 NCUA approval of the merger.**

(a) The Regional Director will review the methods by which the membership vote was taken and the procedures applicable to the membership vote. The Regional Director will determine if the notices and other communications to members were accurate, not misleading, and timely; if the membership vote was conducted in a fair and legal manner; and if the credit union has otherwise met the requirements of this subpart, including whether there is substantial evidence that the factors in Section 205(c) of the Act are satisfied.

(b) After completion of this review, the Regional Director will approve or disapprove the proposed merger. The Regional Director will issue the approval or disapproval within 30 calendar days of receipt from the credit union of the certification of the result of the membership vote required under §708a.307, unless the Regional Director extends the period as necessary to request additional information or review the credit union's submission. The Regional Director's approval is conditional on the credit union completing the merger in the timeframes required by §708a.309.

(c) If the Regional Director disapproves the methods by which the membership vote was taken or the procedures applicable to the membership vote, the Regional Director may direct that a new vote be taken.

(d) A merging credit union may appeal a Regional Director's disapproval to the NCUA Board. The credit union must file the appeal within 30 days after receipt of the Regional Director's determination. The NCUA Board will act on the appeal within 120 days of receipt.

#### **§708a.309 Completion of merger.**

(a) After receipt of the approvals under §§708a.302 and 708a.308 a credit union may complete the merger.

(b) The credit union must complete the merger within one year of the date of NCUA approval under §708a.308. If a credit union fails to complete the merger within one year the Regional Director will disapprove the merger. The credit union's board of directors must then adopt a new merger proposal and solicit another member vote if it still desires to merge.

(c) The Regional Director may, upon timely request and for good cause, extend the one year completion period for an additional six months.

(d) After notification by the board of directors of the bank that the merger has been completed, the NCUA will cancel the insurance certificate of the credit union and, if applicable, the charter of a federal credit union.

#### **§708a.310 Limits on compensation of officials.**

No director or senior management official of an insured credit union may receive any economic benefit in connection with the merger of a credit union other than reasonable compensation and other benefits paid in the ordinary course of business.

#### **§708a.311 Voting incentives.**

If a merging credit union offers an incentive to encourage members to participate in the vote, including a prize raffle, every reference to such incentive made by the credit union in a written communication to its members must also state that members are eligible for the incentive regardless of whether they vote for or against the proposed merger.

#### **§708a.12 Voting guidelines.**

A merging credit union must conduct its member vote on merger in a fair and legal manner. NCUA provides the following guidelines as suggestions to help a credit union obtain a fair and legal vote and otherwise fulfill its regulatory obligations. These guidelines are not an exhaustive checklist and do not by themselves guarantee a fair and legal vote.

(a) *Applicability of state law.* While NCUA's merger rules apply to all mergers of federally insured credit unions, federally insured state chartered credit unions (FISCU) are also subject to state law on mergers. NCUA's position is that no merger of a state chartered credit union is authorized unless permitted by state law, and also that a state legislature or state supervisory authority may impose merger requirements more stringent or restrictive than NCUA's. States that permit mergers may have substantive and procedural requirements that vary from federal law. For example, there may be different voting standards for approving a vote. While the Federal Credit Union Act requires a simple majority of those who vote to approve a merger, some states have higher voting standards requiring two-thirds or more of those who vote. A FISCU should be careful to understand both federal and state law to navigate the merger process and conduct a proper vote.

(b) *Eligibility to vote.*

(1) Determining who is eligible to cast a ballot is fundamental to any vote. No merger vote can be fair and legal if some members are improperly excluded. A merging credit union should be cautious to identify all eligible members and make certain they are included on its voting list. NCUA recommends that a merging credit union establish internal procedures to manage this task.

(2) A merging credit union should be careful to make certain its member list is accurate and complete. For example, when a credit union converts from paper record keeping to computer record keeping, some member names may not transfer unless the credit union is careful in this regard. This same problem can arise when a credit union merges from one computer system to another where the software is not completely compatible.

(3) Problems with keeping track of who is eligible to vote can also arise when a credit union merges from a federal charter to a state charter or vice versa. NCUA is aware of an instance where a federal credit union used membership materials allowing two or more individuals to open a joint account and also allowed each to become a member. The federal credit union later converted to a state chartered credit union that, like most other state chartered credit unions in its state, used membership materials allowing two or more individuals to open a joint account but only allowed the first person listed on the account to become a member. The other individuals did not become members as a result of their joint account, but were required to open another account where they were the first or only person listed on the account. Over time, some individuals who became members of the federal credit union as the second person listed on a joint account were treated like those individuals who were listed as the second person on a joint account opened directly with the state chartered credit union. Specifically, both of those groups were treated as non-members not entitled to vote. This example makes the point that a credit union must be diligent in maintaining a reliable membership list.

(c) Scheduling the special meeting. NCUA's merger rule requires a merging credit union to permit members to vote by written mail ballot or in person at a special meeting held for the purpose of voting on the merger. Although most members may choose to vote by mail, a significant number may choose to vote in person. As a result, a merging credit union should be careful to conduct its special meeting in a manner conducive to accommodating all members wishing to attend, including selecting a meeting location that can accommodate the anticipated number of attendees and is conveniently located. The meeting should also be held on a day and time suitable to most members' schedules. A credit union should conduct its meeting in accordance with applicable federal and state law, its bylaws, Robert's Rules of Order or other appropriate parliamentary procedures, and determine before the meeting the nature and scope of any discussion to be permitted.

(d) Voting incentives. Some credit unions may wish to offer incentives to members, such as entry to a prize raffle, to encourage participation in the merger vote. The credit union must exercise care in the design and execution of such incentives.

(1) The credit union should ensure that the incentive complies with all applicable state, federal, and local laws.

(2) The incentive should not be unreasonable in size. The cost of the incentive should have a negligible impact on the credit union's net worth ratio and the incentive should not be so large that it distracts the member from the purpose of the vote. If the board desires to use such incentives, the cost of the incentive should be included in the

directors' deliberation and determination that the merger is in the best interests of the credit union's members.

(3) The credit union should ensure that the incentive is available to every member that votes regardless of how or when he or she votes. All of the credit union's written materials promoting the incentive to the membership must disclose to the members, as required by §708a.311 of this part, that they have an equal opportunity to participate in the incentive program regardless of whether they vote for or against the merger. The credit union should also design its incentives so that they are available equally to all members who vote, regardless of whether they vote by mail or in person at the special meeting.

## **PART 708b – MERGERS OF FEDERALLY INSURED CREDIT UNIONS; VOLUNTARY TERMINATION OR CONVERSION OF INSURED STATUS**

15. The authority citation for part 708b continues to read as follows:

Authority: 12 U.S.C. 1752(7), 1766, 1785, 1786, 1789.

16. Revise §708b.2 by removing alphabetical designations (a) through (k) and inserting definitions of "conducted by an independent entity," "merger-related financial arrangement," "secret ballot" and "senior management official" in alphabetical order to read as follows:

### §708b.2 Definitions

\* \* \* \* \*

Conducted by an independent entity means:

- (1) The independent entity will receive the ballots directly from voting members and store them.
- (2) After the conclusion of the special meeting that ends the ballot period, the independent entity will open all the ballots in its possession and tabulate the results. The entity must not open or tabulate any ballots before the conclusion of the special meeting.
- (3) The independent entity will certify the final vote tally in writing to the credit union and provide a copy to the NCUA Regional Director. The certification will include, at a minimum, the number of members who voted, the number of affirmative votes, and the number of negative votes. During the course of the voting period the independent entity may provide the credit union with the names of members who have not yet voted, but may not provide any voting results to the credit union prior to certifying the final vote tally.

\* \* \* \* \*

Merger-related financial arrangement means a material increase in compensation (including indirect compensation, for example, bonuses, deferred compensation, or other financial rewards) or benefits that any board member or senior management official of a merging credit union may receive in connection with a merger transaction. For purposes of this definition, a material increase is an increase that exceeds the greater of 15 percent or \$10,000.

\* \* \* \* \*

Secret ballot means no credit union employee or official can determine how a particular member voted. Credit union employees and officials are prohibited from assisting members in completing ballots or handling completed ballots.

Senior management official means the chief executive officer (who may hold the title of president or treasurer/manager), any assistant chief executive officer, and the chief financial officer.

\* \* \* \* \*

17. Revise §708b.103 by redesignating paragraphs (a)(7) through (10) as paragraphs (a)(8) through (11).

18. Revise paragraph (a)(5) of §708b.103, and add a new paragraph (a)(7) to §708b.103, to read as follows:

§708b.103 Preparation of merger plan.

(a) \* \* \*

(5) Explanation of any proposed share adjustments, and where the net worth ratio of the merging credit union is more than 500 basis points higher than the net worth ratio of the continuing credit union, an explanation of the factors considered in establishing the amount of any proposed adjustment or in determining no adjustment is necessary;

\* \* \* \* \*

(7) Description of any merger-related financial arrangement, as defined in §708b.2;

\* \* \* \* \*

19. Revise paragraph (a)(8) of §708b.104 to read as follows:

§708b.104 Submission of merger proposal to the NCUA.

(a) \* \* \*

(8) If the merging credit union’s assets on its latest call report are equal to or greater than the threshold amount established annually by the Federal Trade Commission under 15 U.S.C. 18a(a)(2)(B)(i), currently \$63.4 million, a statement about whether the two credit unions intend to make a Hart-Scott-Rodino Act premerger notification filing with the Federal Trade Commission and, if not, an explanation why not; and

\* \* \* \* \*

20. Revise paragraph (a)(2)(ii) of §708b.106 to read as follows:

§708b.106 Approval of the merger proposal by members.

(a) \* \* \*

(2) \* \* \*

(ii) Contain a summary of the merger plan, including, but not necessarily limited to, current financial statements for each credit union, a consolidated financial statement for the continuing credit union, analyses of share values, explanation of any proposed share adjustments, explanation of any changes relative to insurance such as life savings and loan protection insurance and insurance of member accounts, and a detailed description of any merger related financial arrangement, as defined in §708b.2. The description must include the name and title of each individual recipient and an explanation of the financial impact of each element of the arrangement, including direct salary increases and any indirect compensation, such as any bonus, deferred compensation or other financial reward;

\* \* \* \* \*

21. Revise the title of §708b.107 by replacing the word “Certificate” with “Certification.”

22. Revise paragraph (c) of §708b.201 to read as follows:

§708b.201 Termination of insurance

\* \* \* \* \*

(c) A majority of the credit union's members must approve a termination of insurance by affirmative vote. The vote must be taken by secret ballot and conducted by an independent entity.

\* \* \* \* \*

23. Revise paragraphs (d) and (g) of §708b.203 to read as follows:

§708b.203 Conversion of insurance.

\* \* \* \* \*

(d) Approval of a conversion of federal to nonfederal insurance requires the affirmative vote of a majority of the credit union's members who vote on the proposition, provided at least 20 percent of the total membership participates in the voting. The vote must be taken by secret ballot and conducted by an independent entity.

\* \* \* \* \*

(g) Generally, the NCUA will conditionally approve or disapprove the conversion in writing within 14 days after receiving the certification of the vote. The credit union must complete the conversion within six months of the date of conditional approval. If a credit union fails to complete the conversion within six months the Regional Director will disapprove the conversion. The credit union's board of directors, if it still wishes to convert, must then adopt a new conversion proposal and solicit another member vote.

\* \* \* \* \*

24. Revise paragraph (b) of §708b.206 to read as follows:

§708b.206 Share insurance communications to members.

\* \* \* \* \*

(b) Every share insurance communication about share insurance conversion must contain the following conspicuous statement: "IF YOU ARE A MEMBER OF THIS CREDIT UNION, YOUR ACCOUNTS ARE CURRENTLY INSURED BY THE NATIONAL CREDIT UNION ADMINISTRATION, A FEDERAL AGENCY. THIS FEDERAL INSURANCE IS BACKED BY THE FULL FAITH AND CREDIT OF THE UNITED STATES GOVERNMENT. IF THE CREDIT UNION CONVERTS TO PRIVATE INSURANCE WITH (insert name of private share insurer) AND THE CREDIT UNION FAILS, THE FEDERAL GOVERNMENT DOES NOT GUARANTEE THAT YOU WILL GET YOUR MONEY BACK." The statement must:

(1) Appear on the first page of the communication where conversion is discussed and, if the communication is on an internet website posting, the credit union must make reasonable efforts to make it visible without scrolling; and

(2) Must be in capital letters, bolded, offset from the other text by use of a border, and at least one font size larger than any other text (exclusive of headings) used in the communication.

\* \* \* \* \*