

By the Office of Thrift Supervision.

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## NATIONAL CREDIT UNION ADMINISTRATION

### 12 CFR Parts 701, 708a, and 708b

RIN 3133-AD40

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

**AGENCY:** National Credit Union  
Administration (NCUA).

**ACTION:** Final rule.

**SUMMARY:** NCUA is issuing final amendments to its regulations covering several related subjects. The final rule documents and clarifies the fiduciary duties and responsibilities of Federal credit union (FCU) directors. The final rule amends NCUA's indemnification regulation limiting indemnification of FCU officials and employees for liability arising from improper decisions that affect the fundamental rights of credit union members, and makes conforming changes to the standard FCU and corporate credit union bylaws. In addition, the final rule adds new provisions establishing the procedures for insured credit unions merging into banks. The final rule also amends some of NCUA's existing regulatory procedures applicable to insured credit union mergers with other credit unions, conversions to mutual savings banks (MSBs), and termination of share insurance.

**DATES:** This rule is effective January 27, 2011.

**FOR FURTHER INFORMATION CONTACT:** Paul Peterson, Associate General Counsel; Elizabeth Wirick, Staff Attorney; or Jacqueline Lussier, Staff Attorney; Office of General Counsel, at the National Credit Union Administration, 1775 Duke Street, Alexandria, Virginia 22314-3428 or telephone (703) 518-6540.

#### SUPPLEMENTARY INFORMATION:

##### I. Background

On March 18, 2010, the NCUA Board issued a Notice of Proposed Rulemaking (NPR or Proposal) to amend parts 701, 708a, and 708b of NCUA's rules. 75 FR 15574 (March 29, 2010).

The Proposal would have:

- Added a new § 701.4 clarifying the authorities and duties of FCU directors

in managing the affairs of their credit unions and revising § 701.33 limiting indemnification of FCU officials and employees for liability arising from improper decisions that affect the fundamental rights of credit union members.

- Revised the existing provisions of Part 708a on insured credit union to MSB conversions.
- Added a new subpart C to Part 708a setting forth procedural and substantive requirements for converting an insured credit union to a bank by merger.
- Revised the existing provisions of Part 708b on insured credit union mergers with other credit unions and the termination of Federal share insurance.

The public comment period for the NPR closed on May 28, 2010. NCUA received comments from 40 commenters including ten Federal and State credit unions, 16 credit union trade organizations (which included 13 State credit union leagues), one State credit union regulators' association, six law firms, two credit union consultants, an individual credit union member, an election teller, a private deposit insurer, an association representing the interests of converting credit union members, and one bank trade association. The most significant comments on each part of the Proposal are discussed in the following section-by-section analysis of the revisions in this final rule.

## II. Section-by-Section Analysis

### A. Duties of Federal Credit Union Boards of Directors (§ 701.4)

The Proposal included a new § 701.4, titled "General authorities and duties of Federal credit union boards of directors."

#### Sec. 701.4(a) Management of a Federal Credit Union

Proposed paragraph (a) provided that the management of each Federal credit union is vested in its board of directors, and that 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 language of the proposal mirrors the duties of the Federal Home Loan Bank directors, as expressed in a rule promulgated by the Federal Housing Finance Agency (FHFA). 12 CFR 917.2(b)(1).

Some commenters stated that NCUA should clarify that while an FCU's board of directors has the ultimate responsibility for the management of the

credit union, this responsibility does not include day-to-day management. One commenter said that NCUA should withdraw the language in the second sentence of proposed paragraph (a) making the board's ultimate responsibility for the credit union's management non-delegable. This commenter stated the FCU Act vests the management of each FCU in the board of directors, but it does not prohibit the board from delegating the management of the credit union. The commenter further stated that since an FCU's board is composed primarily of unpaid volunteers the board of directors should be allowed to delegate the management to compensated executives. The commenter recommended NCUA substitute language that the board of directors provides the general direction for the credit union, which would better reflect the policy-making role of the board.

The NCUA Board agrees that paragraph (a) should more closely track the language of section 113 of the FCU Act, which employs the language "general direction and control." Accordingly, the final rule substitutes "general direction and control" for "management." This amendment clarifies that the directors do not actually manage the credit union. The board of directors, however, may not and cannot delegate its ultimate statutory responsibility for the proper management of the credit union.

#### Sec. 701.4(b) Duties of Federal Credit Union Directors

Proposed paragraph (b) set forth the fiduciary duties of FCU directors. It charged each director to:

- Carry out his or her duties as a director in good faith, in a manner reasonably believed to be in the best interests of the membership of the FCU, and with such care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstances (paragraph (b)(1));
- Administer the affairs of the FCU fairly and impartially and without discrimination in favor of or against any particular member (paragraph (b)(2));
- Understand the FCU's balance sheet and income statement and ask, as appropriate, substantive questions of management and the internal and external auditors (paragraph (b)(3)); and
- Direct the operations of the FCU in conformity with the requirements set forth in the Federal Credit Union Act, the NCUA's regulations, other applicable law, and sound business practices (paragraph (b)(4)).

Proposed paragraph (b)(1) stated that the directors have a fiduciary duty to act in the best interests of credit union members, particularly in connection with matters affecting the fundamental rights of members, such as mergers and conversions. A few commenters objected to the statement in (b)(1) that directors owe fiduciary rights to members and asserted that because members have little right to the equity in their credit unions, credit union members resemble customers of other depository institutions more than shareholders in corporations. Other commenters stated that the duties of the board of directors run first to the credit union and not to the members individually or collectively.

These views are wrong from both a philosophical and legal standpoint. As stated in the preamble to the NPR, the NCUA Board 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. 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.<sup>1</sup>

The Board cannot emphasize enough that the members own an FCU and that directors of an FCU must consider the interests of the membership as a whole, and put those interests first, when making decisions that affect the credit union. Accordingly, the NCUA Board is revising the final paragraph (b)(1) of § 701.4 of the Proposal to emphasize that each FCU director must carry out his or her duties in a manner the director believes to be in the best interests of the membership of the credit union *as a whole*.

One commenter was concerned that a focus on the membership *as a whole* might keep an FCU from developing new branches or ATMs because some members would be closer to the new branch or ATM and might find the new facility more convenient to use than other members. The Board recognizes that in the short term some members may benefit geographically from an FCU's expansion plans. Such marginal geographical benefits, or other marginal access benefits, will not by themselves cause an FCU expansion to violate the fiduciary duties of an FCU's Board.

One commenter suggested that there might be a difference between the short term interests of credit union members

and their long term interests. In the unusual situation where there might be such a perceived conflict, the board of directors should, as part of its due diligence, carefully define the perceived conflict, weight the competing short and long term interests, make a choice based on the greatest needs of the members, and explain the board's choice.

Proposed paragraph (b)(1) required FCU directors to carry out their duties with the care an *ordinarily prudent person* in a like position would use under similar circumstances. This language was based in part on Model Business Corporation Act (MBCA) § 8.30, titled "Standards of Conduct for Directors." Some commenters recommended updating the italicized phrase to omit the words "ordinarily prudent" so as to use a 1998 change to § 8.30 of the MBCA employing the language "with the care that a person in a like position would reasonably believe appropriate."<sup>2</sup> These commenters believe the words "ordinarily prudent" heighten the risk of litigation.

The NCUA Board does not agree with the commenters. The *ordinarily prudent person* formulation has been adopted by 41 States while the newer MBCA language has been adopted by only six States.<sup>3</sup> In addition, the proposed language mirrors the current standard applicable to directors of the Federal Home Loan Banks as set forth in 12 CFR 917.2(b)(1). Accordingly, the final rule retains the traditional formulation for a director's standard of care—"with the care an ordinarily prudent person in a like position would use."

Proposed paragraph (b)(2) required that the directors administer the affairs of the Federal credit union fairly and impartially and without discrimination in favor of or against any particular member. Proposed paragraph (b)(2) employed the language of the Federal Home Loan Bank regulation, 12 CFR 917.2(b)(2), and its underlying Federal Home Loan Bank Act (FHLB Act) statutory provision, 12 U.S.C. 1427(j). Some commenters expressed a concern that this "without discrimination" language, combined with the general statement of duties owed to the members in (b)(1), could provide members with a cause of action and increase the risk of litigation.

The NCUA Board does not agree with these comments. First, as stated in the preamble of the NPR, this rulemaking does not create a Federal cause of action in favor of particular individuals or groups of individuals. 75 FR 15574,

15578 n.11. Second, NCUA's research revealed no case law holding that there is an implied private right of action under the equivalent language in the FHLB Act or regulations. In fact, there is case law to the contrary holding that there is no express or implied private right of action under § 1427(j) of the FHLB Act. *Fidelity Financial Corp. v. Federal Home Loan Bank of San Francisco*, 589 F. Supp. 885, 891, 894 (N. D. Cal. 1983).

Proposed paragraph (b)(3) required each director, 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 FCU's balance sheet and income statement and to ask, as appropriate, substantive questions of management and the internal and external auditors.

Many commenters objected to three months as an unreasonably short period in which to become adequately proficient at understanding accounting and finance; several suggested substituting 12 months for three months. Those favoring 12 months stated that many credit union directors serve on a part-time basis, particularly at small credit unions, and acquiring proficiency within only three months would be extraordinarily difficult.

The NCUA Board believes that having a working familiarity with basic finance and accounting practices is essential to being able to perform a credit union director's functions. After considering these comments, however, the Board has decided that directors should be given more time in which to meet this requirement. Accordingly, this final rule revises paragraph (b)(3) to provide for a six-month period in which to gain 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. As the preamble to the NPR indicated, there are a multiple of sources of training in finance and accounting, including training provided by credit unions, outside sources, or, for small credit unions, NCUA's Office of Small Credit Union Initiatives. Accordingly, six months provides ample time for training while ensuring that directors who lack proper training do not procrastinate in obtaining the necessary training.

Some commenters asked for clarification about what the phrase *as appropriate* meant in the phrase: "to ask, *as appropriate*, substantive questions of management and the

<sup>2</sup> 1 Model Business Corporation Act Annot. xv, 8–187 (4th Ed., 2008 Supp., 2009 rev.).

<sup>3</sup> *Id.* at 8–209.

<sup>1</sup> See 75 FR 15574, 15575 (Mar. 29, 2010).

internal and external auditors.” The commenters wondered whether it meant that questions should be tailored to the size and complexity of the credit union. In fact, the NCUA Board added the *as appropriate* language to the proposed rule so directors would not feel they had to ask questions just for the sake of asking.

Several other commenters objected to the financial literacy requirement for a variety of reasons. For example, one commenter argued the Proposal takes away one of the core right of members to elect directors of their choice, and that requiring a director to be financially literate or become financially literate within a short period of time would impose an eligibility requirement in violation of the FCU Act and the bylaws. Another commenter asserted that the financial literacy requirement imposes an eligibility requirement in violation of the FCU Act. This commenter believes any member of a credit union, so long as he or she is an adult and has not been convicted of a crime involving dishonesty or breach of trust as provided for, is eligible to serve as a director, regardless of financial literacy. 12 U.S.C. 1761(a), 1785(d).

The Board agrees that any member of an FCU who meets the eligibility requirements of the FCU Act may run for, and serve as, an FCU director. As a matter of safety and soundness, however, a serving director does need to become literate within a reasonable period of time after election or appointment. The level of necessary literacy depends on the size and complexity of the FCU.

Another commenter stated that the Proposal is vague and subjective because it provides no definitive measurements for when and how a director will be considered sufficiently trained in the use of financial statements and other data. This commenter believes that without specific and objective standards, it will be left up to the subjectivity of a given examiner to determine whether directors are in compliance with this requirement. The NCUA Board disagrees. Again, directors must obtain financial knowledge commensurate with the size and complexity of their credit union. The Board also notes there are multiple ways for resolving disputes between credit unions and their examiners. *See, e.g.,* Interpretive Ruling and Policy Statement (IRPS) 95–1, as amended by IRPS 02–1.

Proposed paragraph (b)(4) required each director to direct the operations of the Federal credit union in conformity with the requirements set forth in the FCU Act, the NCUA’s regulations, other

applicable law, and sound business practices. The final rule revises this section to substitute the phrase “direct management’s operations” for “direct the operations.”

#### Sec. 701.4(c) Authority Regarding Staff and Outside Consultants

Proposed paragraph (c)(1) stated that the 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. Paragraph (c)(2) states that the board of directors or any committee of the board may require FCU staff that are providing services to the board or committee under paragraph (c)(1) report directly to the board or committee. Paragraph (c)(3) provides that 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 officers or employees of the FCU, legal counsel, independent accountants, or other experts, and committees of the board of which the director is not a member.

Some commenters opposed the provision requiring FCU employees (staff) to report directly to the board of directors or committees of the board, stating this would undermine management’s authority over the employees of the credit union. Another commenter questioned whether committees other than the supervisory committee had the authority to require employees to report directly to the committee. One commenter argued that direct contact between the board of directors and the credit union’s employees would put employees at the beck and call of the board and could interfere with the employees’ regular duties.

The NCUA Board disagrees. An FCU’s board of directors cannot permit the chief executive officer (CEO) to screen all the board’s information sources. While the board of directors should not attempt to bypass the CEO in giving *direction* to management and employees, the board is free to ask any manager, employee, or independent contractor to provide the board and its committees information directly and not through the filter of the CEO. The NCUA’s Office of General Counsel has previously opined that board members must be free to gather information from any source in the credit union to perform their board duties. OGC Op. No. 03–0763 (Sept. 29, 2003).

#### Sec. 701.4(d) Reliance

The Proposal instructed FCU directors on the authority and limits of the director’s ability to rely on information provided by others. A director is generally entitled to rely on information prepared or presented by employees or consultants whom the director reasonably believes to be reliable and competent in the functions performed. No commenters addressed proposed paragraph (d) of § 701.4.

#### Sec. 701.4 and the Business Judgment Rule

Some commenters asked about the interplay between § 701.4 and the business judgment rule. One commenter recommended that in the preamble to a final rule NCUA indicate its policy and intention whether the business judgment rule applies in actions brought against the directors of FCUs.

The business judgment rule is a burden of proof issue associated with particular causes of actions. Since the proposed rule does not create an express or implied private right of action, a third party seeking to bring a cause of action must look to State law to establish the cause of action. It is likely that the existence, and form, of any business judgment rule would depend on the law of the State under which the private cause of action would reside. Of course, the business judgment rule does not apply at all to administrative enforcement actions brought by NCUA.

Accordingly, and except as described above, the NCUA Board adopts § 701.4 as proposed.

#### B. Indemnification (§ 701.33)

As stated in the NPR preamble, the NCUA Board desires to ensure that FCU officials and employees are held personally accountable, where appropriate, for egregious violations of their fiduciary duties. NCUA will not permit an FCU to indemnify officials and employees against liability based on an aggravated breach of the duty of care when such a breach may affect fundamental rights and financial interests of the FCU members.

Accordingly, the Proposal included a new paragraph (c)(5) in § 701.33 prohibiting an FCU from indemnifying 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. Such indemnification, however, was limited to situations in which 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.

The Proposal also included corresponding amendments to the indemnification provisions of the standard bylaws of FCUs and Federal corporate credit unions. Of the 24 commenters addressing this revision, most opposed it. Most of those opposed argued that the proposed provision would have the unintended consequence of discouraging qualified individuals from serving as directors because of the expanded potential for personal liability. Others asserted it would disadvantage the FCU charter as compared to the State charter because FCU directors would face an even higher burden compared to State chartered CU directors.

The NCUA Board does not agree with these commenters. The proposed prohibition on indemnification is limited to the extraordinary circumstance of a board considering a proposal to change the credit union's charter or insurance status. Not only are these situations rare, but the prohibition would only apply in the very limited circumstance of an aggravated breach of the duty of care as determined by a court.

Some commenters stated that the proposed rule's silence on the advancement of expenses would also disadvantage FCUs in attracting directors. To alleviate this concern, the final rule permits the FCU to advance funds to pay or reimburse reasonable legal fees and other professional expenses incurred by the official or employee to assist the official or employee in resisting lawsuits that the FCU considers meritless. The decision to advance funds requires the FCU's board of directors make a good faith determination, after due investigation, that:

- The official or employee acted in good faith and in a manner he or she believed to be in the best interests of the members;
- The payment will not materially adversely affect the credit union's safety and soundness; and
- The official or employee provides a written affirmation of his or her good faith belief that the relevant standard of conduct in § 701.4 have been met and a written undertaking to reimburse the credit union, to the extent not covered by payments from insurance, the advanced funds if it ultimately decided that the official or employee is not entitled to indemnification.

The NCUA Board is also adding a new provision to § 701.33 reinforcing that fiduciary duties are owed to the members. Existing (and unchanged) § 701.33(c)(2) states that indemnification shall be consistent either with the standards applicable to credit unions generally under the law of the State where the FCU is located or the MBCA, as specified by the credit union. The MBCA standard under which a corporation may indemnify a director requires that the director acted in good faith and with the reasonable belief that his or her conduct was in the best interests of the corporation. MBCA § 8.51(a). A commenter stated that this appears to conflict with the Proposal's statement that FCU directors' duties are owed to the membership and not to the credit union *per se*. The NCUA Board agrees that there is an apparent conflict and has added a new paragraph (c)(7) to § 701.33 to resolve this conflict. The new (c)(7) states that, the extent an FCU has chosen to follow State law or the MBCA, the FCU must substitute "best interests of the members" for any language in State law or the MBCA indicating that duties are owed to any persons or entities (such as the credit union or the corporation) other than the membership as a whole.

Accordingly, and except as described above, the final rule amends § 701.33 as proposed.

#### C. Parts 708a and 708b

The proposed amendments to Parts 708a and 708b revise existing rules on credit union to mutual savings bank (MSB) conversions and conversions to nonfederal deposit insurance. The revisions are designed to better protect the secrecy and integrity of the voting process. The Proposal also reorganized Part 708a and added a new subpart C to Part 708a that establishes procedural and substantive requirements for converting a credit union to a bank through a merger.

The preamble to the Proposal included a detailed section-by-section description and analysis for revised Parts 708a and 708b. 75 FR 15574, 15579–15585 (March 29, 2010). The Board adopted many sections of the Proposal without change, and the detailed analysis of most of these sections is not repeated in this preamble.

#### Credit Union Conversion to MSB, Part 708a, Subpart A

##### Sec. 708a.101 Definition of Secret Ballot

The Proposal included a new definition of "secret ballot" in

§ 708a.101 to prohibit credit union employees from helping members complete ballots or handling completed ballots. One commenter argued the prohibition would prevent employees from responding to any questions at all about the election because of the unclear delineation between answering questions and helping with a ballot. The NCUA Board disagrees. The definition of "secret ballot" prohibits credit union officials from assisting members in completing ballots or handling completed ballots. The provision only prohibits an employee from physically touching a ballot or telling a member which way to vote, and does not prohibit an employee from answering questions. While one commenter said the prohibition on employees handling ballots would create unnecessary difficulties for members, another commenter suggested the rule should also require the independent entity to empty the ballot boxes in credit union branches. After considering the comments, the NCUA Board determined the rule as proposed appropriately protects the secrecy of members' votes without imposing an undue burden on credit unions. Accordingly, the final rule adopts the definition as proposed.

##### Sec. 708a.101 Definition of "Conducted by an Independent Entity"

The Proposal added new definitions for "independent entity" and "conducted by an independent entity." These definitions describe the qualifications of, and requirements applicable to, the entity responsible for tabulating member votes on the conversion proposal. The new definitions would prohibit the independent entity from providing any interim vote results to credit union management as well as prohibit the opening or tallying of ballots during the election period. As discussed in the Advance Notice of Proposed Rulemaking, NCUA has documented several instances where credit union management's access to interim vote tallies raised concerns about the fairness of elections and the communications to members. 73 FR 5461, 5466 (January 30, 2008).

Several commenters stated the definition of "conducted by an independent entity" as proposed would pose practical challenges. Some of these commenters said the requirement to delay the counting of ballots until after the conclusion of the special meeting would make counting the ballots and certifying the results to NCUA within 10 days much more difficult. The NCUA Board agrees that the change in procedure contemplated by the Proposal could make certification within 10 days

more difficult and has lengthened the period for certification under section 708a.107 to 14 days. Another commenter, a company that conducts corporate elections, explained that the usual way the independent entity determines which members have voted is by opening the ballot and checking the validity of the control number and matching it with a member name. This commenter stated that because the independent entity needs to know which members have voted to produce a list of members who have not voted, the bar on opening ballots during the election period would make it much more difficult to produce the list of members who have yet to vote. The NCUA Board understands the Proposal might require election tellers and credit unions to modify the envelope format so that the outside of the envelope would show the ballot control number. The documented problems with interim vote tallies and the difficulty of ensuring that election tellers with access to interim tallies do not share these tallies with credit union management justify requiring election tellers to change their usual procedures if necessary. NCUA believes those rare cases where voters might not complete a ballot correctly, and so be listed as having voted when they did not actually vote properly, will not affect the fairness of the overall voting process.

Another of the commenters suggested that the independent entity should be allowed to tally ballots as they are received, and only communicating the interim tallies to the credit union should be prohibited. The Board believes it would be too easy for a teller to unintentionally communicate the interim voting results to the credit union.

One commenter who supported the rule as proposed suggested the rule should also prohibit giving credit union management the names of members who have not voted, because members opposing the conversion cannot obtain this information. As an alternative, this commenter suggested allowing management to provide an election reminder notice to the independent entity and having the independent entity mail it to members who have not voted. The Board is not aware of situations where allowing credit union management to obtain lists of non-voting members during the election period has compromised the fairness of an election, and having such lists allows the credit union to conserve resources by only soliciting those who have not yet voted.

Accordingly, the final rule adopts the definitions of "independent entity" and

"conducted by an independent entity" as proposed.

#### Sec. 708a.104 Disclosures

The Proposal also amended the list of disclosures in § 708a.104 (previously § 708a.4) to add disclosures related to the cost of the conversion, the conversion's effect on the availability of facilities, and a statement that NCUA neither supports nor endorses the conversion proposal.

Most commenters were opposed to the requirement to disclose the costs of the conversion. One opposing commenter asserted that the costs are irrelevant to members and most of the costs are incurred before members are notified, while another said any such disclosures would be only speculation. The NCUA Board disagrees that simply because, as one commenter alleges, most of the costs have occurred, or, as another commenter alleges, most of the costs are in the future, that members will find these costs, or cost estimates, irrelevant. One of the commenters supporting the cost disclosures also suggested the cost disclosures should be updated in the mailings to members 60 and 30 days before the vote, because any attempted opposition to a conversion proposal causes the credit union to incur additional advertising expenses to respond to the opposition. This suggestion goes beyond the scope of the Proposal. The NCUA Board will consider how these cost disclosure requirements will work in practice before proposing any additional disclosure requirements.

The Proposal also required the converting credit union to disclose the projected effect of the conversion on the availability of facilities, including, at a minimum, the name and location of any branches, shared branches, and ATM networks to which members may lose access. Two commenters objected on the grounds it requires too much precision in advance predictions. The NCUA Board disagrees, as considering the future availability of facilities is a fundamental part of planning for the charter conversion transactions to which this disclosure applies.

Moreover, the rule does not require a definitive, final statement about the availability of facilities—the disclosure can state a transaction "could" result in the loss of certain facilities, for example.

The Proposal required the disclosure to include the statement that "NCUA does not approve or disapprove of the conversion proposal or the reasons advanced in support of the proposal." Most commenters did not oppose this disclosure, although several suggested slight amendments. One commenter

suggested either deleting the phrase "or the reasons advanced in support of the proposal" or revising the phrase to read "or the reasons in support of or against the proposal." The NCUA Board agrees that adding the language "or against" is a helpful clarification of NCUA's neutrality in the final rule and has made this change. A commenter also suggested including this disclosure on the member-to-member communication as well, but this suggestion goes beyond the scope of the Proposal and the Board declines to adopt it.

Except as described above, the final rule adopts § 708a.104 as proposed.

#### Sec. 708a.113 Recommendation Against Using Credit Union Staff To Solicit Member Votes

The Proposal added a new paragraph to the voting guidelines section, § 708a.113 (previously § 708a.13), recommending against the use of credit union employees to solicit member votes. Although most commenters opposed this guidance, the opposing commenters tended to mischaracterize it as a requirement. The voting guidelines, including the recommendation to not use staff to solicit member votes, do not impose mandatory requirements, but simply suggest how credit unions can ensure an election is conducted fairly and in a manner that does not jeopardize the operations and condition of the converting credit union. NCUA may in the future propose a requirement that converting credit unions to use an independent third party to solicit votes rather than diverting credit union employees from their usual duties. In this final rule, NCUA strongly encourages credit unions to use an independent third party if soliciting votes.

Accordingly, the final rule adopts the revisions to § 708a.113 as proposed, with minor revisions to highlight NCUA's recommendation against using credit union employees to solicit votes.

#### Credit Union-Into-Bank Merger, Part 708a, Subpart C

The Proposal included a new subpart C to Part 708a regulating mergers of credit unions into banks. The majority of commenters on these provisions generally supported the concept of regulating these types of transactions, and several commenters noted that these provisions fill a gap in current regulations. Specific comments addressed to certain provisions of subpart C are discussed below.

#### Sec. 708a.303(a) Merger Valuation

§ 708a.303(a) requires a credit union's board of directors, when looking to

merge into a bank, to determine the merger value of the credit union either by conducting an auction or retaining a “qualified appraisal entity” to estimate the merger value of the credit union before directors select a bank merger partner and vote on a proposal to merge. A qualified appraisal entity must have 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.

Proposed § 708a.304 requires the credit union to disclose its merger value, and whether any merger payment will be made to members, to NCUA. This section also requires the notice to NCUA to include all information the credit union relied on in making the selection of a merger partner and, if the payment to members is less than the merger value, an explanation of why the merger and the merger partner selected are in the best interests of the members. The Regional Director must disapprove a proposed merger where the merger payment is less than the merger valuation, unless members receive some additional, quantifiable benefit.

Commenters on the merger value provisions were equally divided. Opposing commenters found the merger value requirement too onerous, costly, or beyond NCUA’s authority. The NCUA Board disagrees with these latter commenters. In a transaction that fundamentally changes the nature of the credit union and its members’ ownership, knowing the value of the credit union is critical to the members’ decision on approving the merger proposal. This valuation is also critical to NCUA’s ability to make the statutorily required determination of whether a proposed merger meets the “convenience and needs of the members.” 12 U.S.C. 1785(c)(5). While the merger valuation requirement may entail addition procedures, analysis, and costs for the credit union proposing the transaction, knowing the merger value, and whether members are receiving compensation for this value, outweighs institutions’ concerns about additional procedures.

Some supporting commenters suggested revisions to the merger valuation process. A few would expand the requisite analysis to include intangible items such as the value of the relationship between the members and the credit union and would exclude the value of benefits a credit union member could get simply by becoming a bank customer in addition to a credit union member. The NCUA Board has not modified the rule as suggested by these commenters. The NCUA Board will

examine how the merger valuation provision works in future practice before making adjustments to the procedure.

Finally, one commenter suggested that a “qualified appraisal entity” under this provision should not only have no past relationship with the continuing bank or the merging credit union and any law firm representing either institution, but also no past relationship with the bank’s affiliates or holding company. The NCUA Board agrees that to be a qualified appraisal entity, the entity must also have no past relationship with a bank’s owners, affiliates, or holding companies, and the final rule reflects this.

#### Sec. 708a.304(g) Regional Director Approval

Proposed paragraph 708a.304(g) required the Regional Director to review the merging credit union’s Notice of Intent to Merge and Request for Approval (NIMRA) and either disapprove the NIMRA or authorize the credit union to proceed to the member vote. Section 708a.308 requires the Regional Director to review the methods and procedures of the membership vote and approve or disapprove the merger. Several commenters expressed concerns about the amount of discretion given to the Regional Directors in these reviews, with some suggesting these reviews exceed the scope of NCUA’s authority.

The NCUA Board does not share these concerns, and the final rule retains the proposed delegations. The authority and discretion the NCUA Board gives to Regional Directors under this provision is entirely in keeping with the role assigned to the NCUA Board and the NCUA Board’s authority to delegate duties to staff under the FCU Act. The FCU Act requires the NCUA Board to assure that a Federally insured credit union’s merger with another type of financial institution, among other requirements, meets the “convenience and needs of the members.” 12 U.S.C. 1785(c)(5). The FCU Act also permits the NCUA Board to delegate any of its responsibilities to staff. 12 U.S.C. 1766(d). As part of its statutorily required assessment of whether a proposed transaction meets the convenience and needs of the members, the NCUA Board is delegating to the Regional Director the determination of whether the notice of a proposal to merge and the methods and procedures used to conduct the member vote were adequate.

#### Sec. 708a.305 Disclosures

Proposed § 708a.305 includes required disclosures to credit union

members for credit union-to-bank mergers similar to those required for credit union-to-bank conversions. Comments were evenly split between support of and opposition to the disclosures.

One commenter recommended a change to § 708a.305(d)(2), which says a member “could” lose all ownership interests if the bank converts to a stock bank and members do not purchase stock. This commenter recommended replacing the word “could” with “will,” because the fact that a member needs to re-purchase the ownership interest indicates the member no longer has it. Conversely, an opposing commenter stated the member rights disclosures ignore the rights of MSB members to subscribe to the initial stock offering. While the NCUA Board agrees with the first commenter that a former credit union member will lose ownership interests if the MSB later converts to a stock bank and the MSB member does not subscribe to the stock offering, the final rule retains the word “could” because a total loss of ownership interests is dependent on the MSB converting to a stock bank. The NCUA Board does not agree the disclosure ignores MSB members’ rights to subscribe to the initial stock offering, since the disclosure explicitly mentions the possibility that the MSB member may purchase stock.

#### Sec. 708a.306 Participation Requirement

Proposed § 708a.306 requires that at least 20 percent of members participate in the vote on merging with a bank. One commenter deemed 20 percent too low, since it would allow a merger with a bank with only 10 percent of the credit union members voting affirmatively. Another commenter deemed 20 percent too burdensome and opined the expenses of recruiting members to vote would drive down the value of the credit union to the potential merger partner. The final rule retains the 20 percent participation requirement. This requirement is identical to the participation requirement for converting from Federal deposit insurance under the FCU Act. 12 U.S.C. 1786(d)(2).

As discussed above, the final part 708a, Subpart A (for credit union conversions to MSBs) contained modified definitions of “independent entity” and “conducted by an independent entity.” This final part 708a, Subpart C (for credit union mergers into banks) contains similar modifications.

Accordingly, and except as described above, the final rule adopts the new part 708a, subpart C as proposed.

## Credit Union-into-Credit Union Merger, Part 708b, Subpart A

Subpart A of Part 708b regulates credit union-to-credit union mergers and termination of NCUSIF insurance. As discussed below, the Proposal required merging credit unions disclose and explain, in certain mergers, the factors used to determine whether a share adjustment will be paid to members of the merging credit union. The Proposal also required additional disclosures to members and to NCUA regarding compensation increases to key credit union staff and officials. 708b.103(a)(5) Disclosures related to share adjustments.

Proposed paragraph 708b.103(a)(5) expanded on the existing requirement in § 708b.103 for merging credit unions to state the amount of any share adjustment in the summary of the merger plan given to members. The Proposal required, where the net worth ratio of the merging credit union exceeds the net worth ratio of the continuing credit union by more than 500 basis points, an explanation of the factors used in establishing the amount of any proposed adjustment or in determining no adjustment is necessary. Contrary to some commenters' interpretations, the Proposal did not require payment of a share adjustment.

Several commenters argued these disclosures were unnecessary and would discourage mergers or disputed that members of a merging credit union are entitled to the net worth of a merging credit union. The NCUA Board disagrees. As discussed in the preamble to the Proposal, in many cases a merger involves a smaller credit union with limited services and a high net worth ratio (NWR) seeking to merge with a much larger credit union with more services but a lower NWR. 75 FR 15574, 15584 (March 29, 2010). The higher NWR of the merging credit union includes retained earnings that could have been spent, but were not spent, on additional product offerings or more favorable rates. Because, in these situations, the members of the merging credit union have paid for the higher NWR with reduced services or less favorable rates, the NCUA Board believes that where a NWR disparity exists, the members of the merging credit union need to know how any merger dividend, if a merger dividend is offered, was calculated. Accordingly, the final rule adopts paragraph (a)(5) as proposed.

## Secs. 708b.103 and 708b.106 Disclosures Related to Compensation Increases Resulting From the Merger

The Proposal amended §§ 708b.103 and 708b.106 to require disclosure to NCUA and to credit union members of any "merger-related financial arrangement," defined to include any increase in direct or indirect compensation to board members or senior management officials that exceeds *the greater of* 15% or \$10,000. Half of the comments on this provision supported the general concept of increased disclosure in this area. Most opposing commenters suggested a higher threshold for compensation increases that would trigger disclosures, and several found the \$10,000 trigger too low for larger credit unions. The NCUA Board reiterates that the threshold for requiring disclosure is a compensation increase that exceeds *the greater of* 15% or \$10,000. Accordingly, for officials with higher salaries, the threshold for disclosure would be compensation increases of more than 15%. The Proposal required disclosures only for compensation increases above certain thresholds and thus balances any privacy interests of the employees with the interests of members in knowing when material financial incentives have been proposed to directors and senior management officials.

Several commenters also suggested this disclosure was unnecessary because it would be included in Internal Revenue Service filings and, for FCU members, accessible under NCUA's regulation on access to books and records. The NCUA Board disagrees that these alternate means of accessing compensation information are adequate for the purposes of a member vote on a merger, because information from these sources is unlikely to be available to members during the voting period. The NCUA Board believes members should know whether credit union directors or senior management officials stand to gain financially from a merger before voting on the merger proposal. Accordingly, the final rule adopts these disclosure changes as proposed.

## Share Insurance Conversions, Part 708b, Subpart B

Subpart B of Part 708b regulates share insurance conversions. The proposed changes to Part 708b include the prohibition on interim vote tallies and the ban on employees assisting with or handling ballots in transactions resulting in the termination of NCUSIF share insurance.

The commenters' chief concern about the practical effects of the Proposal—that the prohibition on opening ballots in the definition of "conducted by an independent entity" would make it difficult to ascertain which members had voted—was the same as the concern expressed in the context of credit union-to-bank conversions. Commenters on this section also noted that for conversions from Federal deposit insurance the FCU Act requires 20% of credit union members to vote. 12 U.S.C. 1786(d)(2). The 20% quorum requirement, commenters said, makes it especially important that the credit union proposing the insurance conversion knows how many members have voted, and also more difficult to count the ballots and certify the results within 10 days after the election because a higher proportion of members must vote. As discussed above, the NCUA Board sees no reason why the election teller cannot modify the ballot envelope to allow the election teller to produce a list of members who have voted, and thus a list of those who have not yet voted, and so the Board has not changed the proposed definition. Also as discussed above, the Board is extending the deadline for certifying the election results from 10 days to 14 days after the close of the voting period to allow the teller more time for counting the ballots.

Several commenters opined that applying the ban on interim vote tallies to insurance conversions was unnecessary because the concerns NCUA has documented with previous elections occurred in the context of charter conversions rather than insurance conversions. The NCUA Board disagrees. The same potential for problems exists with any election where credit union officials have access to interim voting tallies, so the NCUA Board has prohibited credit union officials from obtaining interim vote tallies on all transactions affecting a credit union's charter or insurance status. Other commenters suggested NCUA's requirements in this area impermissibly preempt State law. Again, the NCUA Board disagrees, because the FCU Act explicitly gives the NCUA authority to regulate conversion from Federal deposit insurance. 12 U.S.C. 1785(b)(1)(D).

Accordingly, and except as described above, the final rule adopts the proposed changes to Subpart B of § 708b.



### III. Regulatory Procedures

#### A. Regulatory Flexibility Act

The Regulatory Flexibility Act requires NCUA to prepare an analysis to describe any significant economic impact a proposed rule may have on a substantial number of small credit unions (those under ten million dollars in assets). Only a few credit unions convert in a given year. Accordingly, the NCUA Board certifies that this final rule will not have a significant economic impact on a substantial number of small credit unions, and, therefore, a regulatory flexibility analysis is not required.

#### B. Paperwork Reduction Act

The Paperwork Reduction Act of 1995 (PRA) applies to rulemakings in which an agency by rule creates a new paperwork burden on regulated entities or modifies an existing burden. 44 U.S.C. 3507(d). For purposes of the PRA, a paperwork burden may take the form of either a reporting or a recordkeeping requirement, both referred to as information collections. NCUA identified and described several information collection requirements in the proposed rule. As required by the PRA, NCUA submitted a copy of the proposed regulation to the Office of Management and Budget (OMB) for its review and approval and invited comment on the PRA aspects.

While NCUA received comments on the proposed rule, no commenters specifically addressed the agency's estimates of burden hours or costs as set out in the preamble to the Proposal. Accordingly, NCUA anticipates that OMB will approve NCUA's submission.

#### 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.

This final rule will 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 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

NCUA has determined that this rule will not affect family well-being within the meaning of section 654 of the Treasury and General Government Appropriations Act, 1999, Public Law 105–277, 112 Stat. 2681 (1998).

#### E. Small Business Regulatory Enforcement Fairness Act

The Small Business Regulatory Enforcement Act of 1996 (Pub. L. 104–121) (SBREFA) provides generally for congressional review of agency rules. A reporting requirement is triggered in instances where NCUA issues a final rule as defined by section 551 of the Administrative Procedure Act. 5 U.S.C. 551. The Office of Management and Budget's determination about whether this rule is a major rule for purposes of SBREFA is pending.

#### List of Subjects

##### 12 CFR Part 701

Credit unions, Loans.

##### 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 December 16, 2010.

**Mary F. Rupp,**

*Secretary of the Board.*

■ For the reasons stated in the preamble, the National Credit Union Administration amends 12 CFR parts 701, 708a, and 708b as follows:

#### 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, 1758, 1759, 1761a, 1761b, 1766, 1767, 1782, 1784, 1786, 1787, and 1789. Section 701.6 is also authorized by 15 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. Add a new § 701.4 to read as follows:

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

(a) *General direction and control of a Federal credit union.* The board of

directors is responsible for the general direction and control of the affairs of each Federal credit union. 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 direction and control 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 as a whole, and with the 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 six 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 management's 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. Add paragraphs (c)(5) through (7) to § 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 Federal credit union'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 Federal credit union members include charter and share insurance conversions and terminations.

(6) A Federal credit union may, before final disposition of a proceeding referred to in paragraph (c)(5) of this section, advance funds to pay for or reimburse the expenses, including legal fees, reasonably incurred in connection with the proceeding by an official or employee who is a party to the proceeding because that individual is or was an official or employee of the credit union if:

(i) The disinterested members of the credit union's board of directors (or in the event there are fewer than two disinterested directors, the supervisory committee), in good faith, determine in writing after due investigation and consideration that the official or employee acted in good faith and in a manner he or she reasonably believed to

be in the best interests of the credit union's members;

(ii) The disinterested members of the credit union's board of directors (or the supervisory committee, as the case may be), in good faith, determine in writing after due investigation and consideration that the payment or reimbursement of the expenses will not materially adversely affect the credit union's safety and soundness; and

(iii) The official or employee provides:

(A) A written affirmation of the individual's reasonable good faith belief that the relevant standard of conduct described in § 701.4(b) of this chapter has been met by the individual; and

(B) A written undertaking to repay the credit union for any funds advanced or reimbursed, to the extent not covered by payments from insurance, if the official or employee is not entitled to indemnification under paragraph (c)(5) of this section.

(7) To the extent a Federal credit union has elected to follow State law or the Model Business Corporation Act in accordance with paragraph (c)(2) of this section, the credit union must substitute the phrase "in the best interests of the members" for any language indicating that fiduciary duties are owed to persons or entities other than the members of the credit union, including, but not limited to, language such as "in the best interests of the credit union" or "in the best interests of the corporation."

■ 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**

\* \* \* \*

**Article XVI. General**

\* \* \* \*

Section 8. *Indemnification*. (a) Subject to the limitations in § 701.33(c)(5) through (c)(7) 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 708a—BANK CONVERSIONS AND MERGERS**

■ 5–6. 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 for part 708a to read as set forth above:

**§§ 708a.1 through 708a.13 [Redesignated as §§ 708a.101 through 708a.113]**

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

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

■ 8b. Add a new subpart A, consisting of newly redesignated §§ 708a.101 through 708a.113 with the heading as shown above:

■ 9. Revise § 708a.101 by adding 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.

(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.

\* \* \* \* \*

■ 10–11. Amend § 708a.104 as follows:

■ a. In paragraph (b)(4)(i), add the word “of” after the word “Plan”.

■ b. Revise paragraphs (c)(4) and (5), and add new paragraphs (c)(6), (7), and (8).

■ c. In paragraph (f)(2), add the phrase “to a Bank” after the word “Conversion” in the last sentence.

The revisions and additions 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 and the reasons against 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.

\* \* \* \* \*

■ 12. Amend § 708a.107 by revising paragraph (a) and adding paragraph (c) to read as follows:

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

(a) The board of directors of the converting credit union must certify the results of the membership vote to the Regional Director within 14 calendar days after the vote is taken.

\* \* \* \* \*

(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. Amend § 708a.113 by adding paragraph (e) to read as follows:

#### § 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. NCUA believes, however, that using credit union employees to solicit votes is problematic. Employees directed to solicit votes could easily neglect everyday duties critical to the credit union’s safe and sound operation. Also, employees may very well feel pressured to solicit votes for the conversion, regardless of whether or not they support the conversion. Accordingly, NCUA strongly encourages converting credit unions to use an independent third party to solicit votes rather than diverting credit union employees from their usual duties.

#### Subpart B—[Reserved]

■ 14a. Add a reserved subpart B.

■ 14b. Add subpart C to part 708a to read as follows:

#### 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.

#### 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.

*Conducted by an independent entity* means:

(1) The independent entity will receive the ballots directly from voting members.

(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.

*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 arm's-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, the continuing bank's owners, affiliates, or holding companies; 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.

*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 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 Web site, if it has one. If the notice is not on the home page of the Web site, 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 in paragraph (b) of this section);

(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 Web site 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:

(1) 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;

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

(3) 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

(4) 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:

(1) 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

(2) 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.

(1) 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 Regional Director must disapprove the proposed merger if:

(i) 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

(ii) 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.

(2) 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 Board. The credit union must file the appeal within 30 days after receipt of the Regional Director's determination. The 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 (g)(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

(iii) 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 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 Web site, then it must simultaneously make a portion of its Web site available free of charge to its members to post and share their opinions on the merger. A link to the portion of the Web site 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 14 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.312 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 (FISCUs) 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.

(e) *Solicitation of votes.* Some credit unions may wish to contact members who have not voted and encourage them

to vote on the merger proposal. NCUA believes, however, that using credit union employees to solicit votes is problematic. Employees directed to solicit votes could easily neglect everyday duties critical to the credit union's safe and sound operation. Also, employees may very well feel pressured to solicit votes for the merger, regardless of whether or not they support the merger. Accordingly, NCUA strongly encourages credit unions to use an independent third party to solicit votes rather than diverting credit union employees from their usual duties.

#### **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. Amend § 708b.2 by removing alphabetical paragraph designations (a) through (k) and adding 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.

(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.

\* \* \* \* \*

■ 17–18. Amend § 708b.103 by revising paragraph (a)(5), redesignating paragraphs (a)(7) through (10) as paragraphs (a)(8) through (11), and adding new paragraph (a)(7) 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. In § 708b.104, revise paragraph (a)(8) 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. In § 708b.106, revise paragraph (a)(2)(ii) 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;

\* \* \* \* \*

**§ 708b.107 [Amended]**

■ 21. Amend the heading to § 708b.107 by removing the word "Certificate" and adding the word "Certification" in its place.

■ 22. In § 708b.201, revise paragraph (c) 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. In § 708b.203, revise paragraphs (d), (f), and (g) 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.

\* \* \* \* \*

(f) The board of directors of the credit union and the independent entity that conducts the membership vote must certify the results of the membership vote to the NCUA within 14 calendar days after the deadline for receipt of votes. The certification must include the total number of members of record of the credit union, the number who voted on the conversion, the number who voted in favor of the conversion, and the number who voted against. The

certification must be in the form specified in subpart C of this part.

(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. In § 708b.206, revise paragraph (b) to read as follows:

**§ 708b.206 Share insurance communications to members.**

\* \* \* \* \*

(b) Every share insurance communication 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 Web site 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.

\* \* \* \* \*

**Note:** The following revision to a document entitled "Corporate Federal Credit Union Bylaws," will not appear in the Code of Federal Regulations.

Section 4 of Article XI of the document entitled "Corporate Federal Credit Union Bylaws" is revised to read as follows:

*Article XI. General*

\* \* \* \* \*

Section 4. (a) Subject to the limitations in 12 CFR 701.33(c)(5) through (c)(7) 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.

\* \* \* \* \*

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## FEDERAL HOUSING FINANCE BOARD

### 12 CFR Part 906

### FEDERAL HOUSING FINANCE AGENCY

### 12 CFR Part 1207

RIN 2590-AA28

### Minority and Women Inclusion

**AGENCIES:** Federal Housing Finance Board; Federal Housing Finance Agency.

**ACTION:** Final rule.

**SUMMARY:** The Federal Housing Finance Agency (FHFA or agency) is adopting a final rule to implement section 1116 of the Housing and Economic Recovery Act of 2008 (HERA). Section 1116 of HERA requires FHFA, the Federal National Mortgage Association (Fannie Mae), the Federal Home Loan Mortgage Corporation (Freddie Mac), and the Federal Home Loan Banks (Banks) to promote diversity and the inclusion of

women and minorities in all activities. The final rule implements the provisions of section 1116 of HERA that apply to Fannie Mae, Freddie Mac, and the Banks.

**DATES:** This rule is effective January 27, 2011.

**FOR FURTHER INFORMATION CONTACT:** Eric Howard, Equal Employment Opportunity and Diversity Director, [Eric.Howard@fhfa.gov](mailto:Eric.Howard@fhfa.gov), (202) 408-2502, 1625 Eye Street NW., Washington, DC 20006; or Mark Laponsky, Deputy General Counsel, [Mark.Laponsky@fhfa.gov](mailto:Mark.Laponsky@fhfa.gov), (202) 414-3832 (not toll-free numbers), Federal Housing Finance Agency, Fourth Floor, 1700 G Street, NW., Washington, DC 20552. The telephone number for the Telecommunications Device for the Hearing Impaired is (800) 877-8339.

### SUPPLEMENTARY INFORMATION:

#### I. Background

Effective July 30, 2008, HERA, Public Law 110-289, 122 Stat. 2654, amended the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (12 U.S.C. 4501 *et seq.*) (Safety and Soundness Act) to establish FHFA as an independent agency of the Federal government.<sup>1</sup> HERA transferred the supervisory and oversight responsibilities of the Office of Federal Housing Enterprise Oversight (OFHEO) over Fannie Mae and Freddie Mac (collectively, Enterprises), and of the Federal Housing Finance Board (FHFB) over the Banks (collectively, regulated entities) and the Bank System's Office of Finance to FHFA.

The Safety and Soundness Act provides that FHFA is headed by a Director with general supervisory and regulatory authority over the regulated entities. FHFA is charged, among other things, with overseeing the prudential operations of the regulated entities. FHFA is also charged to ensure that the regulated entities: Operate in a safe and sound manner including maintenance of adequate capital and internal controls; foster liquid, efficient, competitive, and resilient national housing finance markets; comply with the Safety and Soundness Act and rules, regulations, guidelines and orders issued under the Safety and Soundness Act, and the respective authorizing statutes of the regulated entities; carry out the respective missions through activities authorized and consistent with the Safety and Soundness Act and the authorizing statutes; and, engage in

activities and operations that are consistent with the public interest.

Section 1116 of HERA amended section 1319A of the Safety and Soundness Act (12 U.S.C. 4520) to require FHFA to engage in certain activities to promote a diverse workforce. It also requires each regulated entity to establish an Office of Minority and Women Inclusion, or designate an office, responsible for carrying out the requirements of the section and such requirements and standards established by the Director. Section 1319A of the Safety and Soundness Act requires the regulated entities to promote diversity in all activities and at every level of the organization, including management, employment and contracting. Furthermore, 12 U.S.C. 1833e, as amended, and Executive Order 11478 require FHFA and the regulated entities to promote equal opportunity in employment and contracting.

On January 11, 2010, FHFA published a proposed rule on Minority and Women Inclusion to implement section 1116 of HERA, 12 U.S.C. 4520. The proposal set forth minimum requirements for regulated entity diversity programs as well as requirements for reporting on these programs. The proposal also set forth the minimum requirements for the agency's own diversity program.

The proposed rule consisted of the following subparts: Subpart A addressed matters of general application; subpart B applied only to FHFA's internal operational requirements under section 1116 of HERA; and subpart C implemented the requirements under section 1116 of HERA for the regulated entities. FHFA initially established a 60-day comment period but, at the request of the public, extended that period another forty-five (45) days.<sup>2</sup> The extended comment period closed on April 26, 2010.

FHFA received 23 comment letters to the proposed rule from individuals and entities. Three letters came from private citizens. Fannie Mae, Freddie Mac, and eleven of the Banks submitted comment letters. The Banks of Atlanta, Boston, Chicago, Dallas, Indianapolis, New York, San Francisco, Seattle, Topeka, Des Moines and Pittsburgh sent comments that were generally similar. The Bank System's fiscal agent, the Office of Finance, also submitted a comment. The following trade associations or potential vendors to the regulated entities submitted comment letters: The National Association of Hispanic Real Estate Professionals

<sup>1</sup> See Division A, titled the "Federal Housing Finance Regulatory Reform Act of 2008," Title I, section 1101 of HERA.

<sup>2</sup> See 75 FR 10446, March 8, 2010.