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National Association of Federally-Insured Credit Unions

August 7, 2017

Mr. Gerald Poliquin
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, Virginia 22314-3428

Re: Comments on Voluntary Mergers of Federally Insured Credit Unions

Dear Secretary Poliquin,

On behalf of the National Association of Federally-Insured Credit Unions (NAFCU), the only national trade association focusing exclusively on federal issues affecting the nation's federally-insured credit unions, I would like to share with you our thoughts regarding NCUA's proposed rule on "Bylaws; Bank Conversions and Mergers; and Voluntary Mergers of Federally Insured Credit Unions." While NCUA's desire to promote radical transparency is commendable, NAFCU is not aware of any problematic trends in credit union mergers that warrant such a heavy-handed approach. While a few mergers may present challenging circumstances, whether because of confusion or misinterpretation of NCUA's regulations, there is no compelling need to trade a well-functioning set of rules for a regime that scrutinizes non-material aspects of the merger transaction.

The limited goals of the proposed rule may also be effectuated through existing authorities. NCUA may exercise its discretion to demand more expansive disclosure of merger-related financial arrangements, as well as require credit unions to provide more generous advance notice to members before a vote is called on the merger. Given NCUA's ability to apply special requirements in voluntary mergers, NAFCU does not see how the proposed rule constitutes anything less than regulatory burden. NCUA has not provided substantial evidence that lack of material disclosure in merger transactions is widespread, or that NCUA's current authority is inadequate to achieve the desired level of transparency in a given merger transaction. As a result, NAFCU cannot support the proposed rule.

General Comments

NAFCU supports a transparent and open merger process that grants credit union members the ability to understand the benefits and costs associated with consolidation. Mergers are carefully planned transactions that must reconcile the preferences of membership with changes that are necessary to support continued, high quality service. A successful merger depends upon meticulous assessment of the compatibility of the merging and continuing credit unions, which may take years to accomplish. The length of the merger process necessitates a commitment of not insubstantial resources—a fact that typically compels diligence and tempered expectations from both credit unions. Most importantly, the existing regulatory framework for mergers has supported a consolidation process that has consistently placed the needs of members first.

As a result of successful voluntary mergers, members gain access to more convenient locations and more accessible technology, as well as better rates and fees. Solid partnerships also give the combined credit unions an improved cost structure and new platforms to welcome new members to the credit union community. In short, a successful merger is one where the combined members and employees are better off—a "win-win."

Credit unions have benefited from NCUA's existing merger regulations because they provide the flexibility to identify a range of different merger processes which may be optimal in different circumstances. Credit unions must be able to select a merger process that best suits the unique facts and circumstances supporting strategic consolidation for the benefit of members and competitive viability. A prescriptive merger process—like the proposed rule—that demands protracted review of non-material information may offset the economic benefits that accrue from careful planning and timely execution of the merger transaction.

NCUA may exercise existing authority to address the conduct of specific mergers.

NAFCU has not seen evidence indicating that lack of transparency or inadequate communication methods have created problematic trends in credit union mergers. In the limited circumstances where such conditions may arise, additional disclosure may be compelled using existing regulatory tools. NCUA has the authority to approve a merger proposal "subject to any other specific requirements as it may prescribe to fulfill the intended purposes of the proposed merger."[1] The tailored language of § 708b.105(b) better achieves the purpose of promoting enhanced disclosure in merger transactions without imposing harmful presumptions regarding minor increases in compensation or benefits that are unrelated to a merger.

NAFCU supports the use of tailored requirements to achieve limited goals. Accordingly, NCUA's discretionary authority should remain a limited tool, and not a crutch for promulgating de facto requirements as supplements to the current merger rules. To clarify that § 708b.105(b) was never intended to circumvent ordinary rulemaking procedures, NCUA should refrain from instituting interpretative requirements that are not subject to exception.

Current merger rules provide an adequate means for member communication.

The proposed member-to-member communication procedures are cost-prohibitive, logistically challenging, and may invite unnecessary reputational risk. Under current rules, a merging credit union must provide notice to its members in advance of the meeting to vote on the proposed merger. The advance notice must contain important information about the merger, including the purpose of the merger, analyses of share values along with any proposed share adjustments, and

[1] *See* 12 CFR § 708b.105(b).

detailed information regarding merger related financial arrangements. At the special meeting, members are free to discuss the merits or costs of the merger transaction. Members are also capable of communicating before the vote to discuss details related to the merger and often do so through social media channels. Accordingly, NCUA's characterization of pre-vote communications as "radio-silence" is misleading and unsubstantiated.

Despite the detailed information provided in advance of the merger vote, the proposed rule presumes that the written notice to members, along with the meeting itself, do not adequately facilitate full and open discussion of the terms of the merger. NAFCU disagrees. The member notice provides points of contact at both the merging and continuing credit union that can answer any question or concern prior to the member meeting. Members are specifically invited to attend a meeting so that issues and concerns related to the merger may be aired in an open forum. Members may also telephonically attend the meeting if they cannot attend in person. Most importantly, a formal meeting of the members preserves the transparency and orderly conduct of the merger process, whereas an email forwarding system would be more susceptible to abuse and could risk substantial reputation harm to either the merging or continuing credit union.

NAFCU believes that the proposed member-to-member communication procedures are unwieldly and would not improve the accuracy or content of member discussion about the merger. Furthermore, the proposed timeline for facilitating exchange of member communications creates an unworkable deadline to circulate or respond to correspondence received at the last minute—particularly when a merging credit union has elected (under the proposed rule) to provide advance notice to its members 45 days before the meeting to vote.[2] As a result, the proposed communications procedures would likely compel an even longer notice period and increase the cost of the merger transaction.

In addition, the operational costs of establishing and monitoring an email exchange would also be burdensome. Although the proposed rule explains that members must agree to reimburse the credit union's costs for transmitting communications, it remains unclear whether that cost would cover the overhead for monitoring, responding to, and otherwise ensuring the security and privacy of communications sent through an email forwarding system. Moreover, both the merging and continuing credit union would need to monitor communications to ensure that defamatory or misrepresentative statements do not incur legal liabilities, cause significant reputational harm, or otherwise imperil the merger. The proposed requirement that NCUA and credit unions arbitrate the validity of member comments places a time-consuming and unnecessary burden on the process.

The definition of "covered person" may result in competitive harm by requiring disclosure of executive compensation information.

The proposed "covered person" definition relates exclusively to the extent of disclosure for merger-related financial arrangements and may require the merging credit union to report salary and benefit information for certain "highly compensated" employees. The proposed definition

[2] The proposed rule specifies that the merging FCU must facilitate exchange of member correspondence during a 30-day window, and the FCU must forward opinions to other members in accordance with specific email procedures until 15 days before merger.

inadequately preserves the sensitive and private nature of information relating to executive compensation, and would put federal credit unions at a significant disadvantage to banks.

Under the current rule, disclosure of merger-related financial arrangements is required for any board member or senior management official of a merging credit union. Under the proposed rule, disclosure would apply to the merging credit union's chief executive officer or manager; the four most highly compensated employees other than the chief executive officer or manager; and any member of the board of directors or supervisory committee.

NAFCU believes that employees that exercise supervisory or management control are the only employees that should fall within the scope of the disclosure rules for merger-related financial arrangements. The current rule adequately reflects this important distinction by limiting the scope of disclosure to the chief executive officer (who may hold the title of president or treasurer/manager), any assistant chief executive officer, and the chief financial officer. By contrast, the proposed rule would create an arbitrary coverage threshold that does not distinguish between decision-makers and regular employees.

Including the four most highly compensated employees within the scope of disclosure would only serve to reveal sensitive and private information regarding executive compensation and benefits. In the experience of NAFCU's members, making such information public can cause irreparable damage from a privacy and employee retention standpoint. Furthermore, disclosure of this sensitive information could compromise the willingness of certain employees to fill needed roles during the merger transition period.

The proposed definition of merger-related financial compensation adds unnecessary burden.

NAFCU believes that the current definition of "merger-related financial arrangement" in 708b is sufficient and better balances the need for disclosure with appropriate limits on scope and materiality. By contrast, the proposed definition would constitute clear regulatory burden by mandating comprehensive evaluation of all compensation received by covered persons over a 24-month look back period. Not only does this requirement necessitate painstaking review of all indirect compensation that a covered employee may have received prior to the merger, but it also requires forward estimates given NCUA's intent to evaluate prospective increases in compensation because of a merger.

These additional burdens are completely unnecessary. Disclosing non-merger-related increases in compensation and benefits would provide no value to members. Yet it would create privacy concerns for federal credit union employees, create competitive disadvantages, and cost both time and money for federal credit unions.

NCUA should also be aware that the proposed rule presents significant challenges in terms of calculating indirect benefits. A dollar valuation for health insurance or retirement plans offered by a surviving credit union could depend on any number of assumptions; yet the proposal seems to invite speculation about which coverage types and which contribution amounts each employee would choose. In addition, the process of estimating future compensation and benefits could be particularly misleading when a credit union must provide a range of compensation based on the outcome of numerous variables or conditions. To compound these difficulties, full compliance with the proposed rule might entail calculating the net gain in benefits a covered employee would receive should they continue with the surviving credit union—a process that would be inordinately time consuming given that such information may have no material impact on the merger.

Given the difficulties of providing accurate and complete information regarding all increases in compensation received by covered persons over a two year period, NAFCU disagrees with NCUA's characterization of the proposal as "regulatory relief." Furthermore, the certainty gained by imposing a more definite look-back period is offset by more nuanced reporting considerations and the open-ended inquiry that NCUA reserves for prospective increases in compensation. Moreover, the additional paperwork documenting unrelated, non-material compensation information could distract members from the substantive aspects of the merger

NAFCU believes that the threshold for reporting increases in compensation or benefits should continue to depend upon the materiality of the increase and whether it occurred because of the merger. In sum, abrogating the materiality thresholds and "but for" test would not simplify compliance but add tremendous burden.

However, as a potential alternative, NAFCU could support a modified materiality test which drops the $10,000 requirement and requires reporting of any increase in compensation of at least 15%. This change may be more equitable given the wide range of salaries among credit unions. In addition, NAFCU could support a modification of the "but for" test that lends additional consideration to the exclusivity of increases in compensation or benefits. Specifically, the modified test would ask whether surviving employees at the continuing credit union receive benefits above and beyond what the rest of the employees at the continuing credit union receive. In other words, benefits that are provided to all employees at a surviving credit union should not be considered "merger-related."

Lastly, it is important to mention that a severance package of up to 5 years in salary is not disproportionate compensation for an executive who has been serving with dignity and loyalty for many years (decades on some occasions). An unintended consequence of the rapid consolidation of the financial industry is the corresponding reduction of employment opportunities within the credit union movement. Providing adequate severance to employees based on their tenure, seniority, and specific retirement situation is the right and humane action to take.

Consummation of the merger transaction may be more costly with longer notice periods.

NAFCU believes that the proposed requirement to send members written notice of the meeting to vote on the merger at least 45 days in advance may imperil mergers where the resources of the merging credit union are inadequate to maintain interim operations. NAFCU has heard from its members that for small credit unions with relatively few employees, the costs of a protracted merger can risk turning a voluntary transaction into an emergency merger. To avoid situations where the merging credit union lacks the necessary resources to wait at least 45 days (plus any additional time NCUA might request to review member-to-member communications), NAFCU supports maintaining the notice period defined in current 708b.

Notwithstanding the current regulation's designation of a seven day minimum notice period, NAFCU has heard from our members that NCUA has arbitrarily extended approval periods, sometimes in excess of 120 days, for mergers that pose no safety and soundness concerns. In general, NCUA should avoid unnecessarily delaying the approval process. The longer NCUA postpones the merger transaction, the longer members of the merging credit union must wait for more convenient locations, more accessible technology, and more attractive products and services with better rates and fees. Moreover, unpredictable and lengthy wait times may exhaust net worth and result in wasteful extensions of contracts and leases.

NAFCU is also concerned that NCUA's rationale for extending the timeframe for sending member notices lacks a compelling basis. The proposal states that the "[t]he Board is concerned that the current voluntary merger rule's reference to the provisions of the FCU Bylaws *may*, in many cases, result in an insufficient notice period for members of a merging FCU." *See* 82 Fed. Reg. 26605, 26608 (June 8, 2017). The speculative language of the proposal suggests that NCUA has not—in many cases—observed a trend where a majority of interested credit union members have complained about inadequate time to review merger-related materials in advance of a vote.

As with much of the proposal, NAFCU believes that certain key assumptions regarding the adequacy of timeframes or the extent of disclosure may be based on anecdotal evidence rather than observation of consistent trends. As stated previously, NCUA could achieve its intended goals by using its existing, discretionary authority instead of extending the notice timeframes for all mergers without exception.

In the alternative, NAFCU could support a 21-day minimum notice period, as this may strike an appropriate balance between encouraging timely approval of the merger and granting members extra time to consider the transaction.

The proposed contents of the member notice would require reductive interpretations of complex issues.

NAFCU believes that the proposed guidance for addressing “share values” and “share adjustment” in the notice to members may place a tremendous burden on continuing credit unions. The recommendation that continuing credit unions distill an otherwise complicated explanation that involves contract breakup termination fees, mark-to-market calculations, and other complex accounting adjustments “in a way that is legible and easily understood” is unrealistic.

NCUA should seek to alleviate existing barriers to healthy mergers.

A merger proposal calibrated to achieve deregulatory action should address the unnecessary restrictions placed on voluntary mergers between credit unions with dissimilar charters. For example, under NCUA's current rules, mergers between multiple common bond and community credit unions must forgo the benefits of combined fields of membership without regard for the resulting loss in member benefits. NAFCU believes that restrictions on this type of voluntary merger transaction reflect an arbitrary interpretation of current chartering and field of membership rules. Accordingly, NAFCU asks that NCUA lift this barrier to healthy mergers and alleviate regulatory burden.

Conclusion

NAFCU appreciates the opportunity to comment on NCUA's proposed rule for voluntary mergers. While we strongly value transparent and robust discussion regarding mergers, the proposed rule would add significant new burdens aimed at resolving presumed or hypothetical problems. In the absence of any compelling evidence indicating widespread trends of problematic mergers, NCUA should withdraw the proposed rule and instead use its discretionary authority to address the narrow circumstances where enhanced transparency and communication may be necessary. If NAFCU can be a source of any additional information relevant to the proposed rule, please do not hesitate to contact me or Andrew Morris, Regulatory Affairs Counsel, at 703-842-2266, or amorris@nafcu.org.

Sincerely,

Carrie R. Hunt

Carrie R. Hunt
Executive Vice President of Government Affairs & General Counsel