

Chron



NATIONAL CREDIT UNION ADMINISTRATION
Washington, D.C. 20456

October 20, 1986

GC/HMU:sg
4150

Office of General Counsel

Durant S. Abernathy III, Esq.
Executive Vice President and General Counsel
Credit Union National Association, Inc.
Box 431
Madison, WI 53701-0431

Dear Mr. Abernathy:

This is in response to your letter of August 28, 1986, concerning the filling of a corporate Federal credit union board of directors' position "vacated" when a member credit union's designated representative leaves (for any reason) his/her position with the corporate Federal credit union prior to the expiration of the term on the board.

As you noted, Section 704.4 of the NCUA Rules and Regulations (12 C.F.R Section 704.4) addresses the issue raised in your letter. It states as follows:

"An organizational member (i.e., a member other than a natural person) of a corporate FCU may appoint one of its members or officials as a representative to the corporate credit union. The representative shall be empowered to attend meetings, to vote and to stand for election on behalf of the member. No individual may serve as the representative of more than one organizational member in the same corporate FCU."

As background, the NCUA Board adopted an Interpretive Ruling and Policy Statement in 1980 (IRPS 80-3) which set out questions and answers concerning corporate Federal credit unions. IRPS 80-3 was repealed in December 1984 with the finalization of an amended Part 704 of the NCUA Rules and Regulations. Although the IRPS was repealed because it was determined to no longer be necessary, the positions expressed in it continue to serve as useful points of reference.

Durant S. Abernathy III, Esq.

Page Two

Conceptually, the question presented in your letter is as follows: Who is really elected to the corporate board of directors, the organizational member (i.e., the credit union) or the individual representing the organizational member?

Once this question is answered, the answer to the question of how the board position is filled follows naturally. It is our opinion that the initial question can be answered in one of two ways depending upon the individual circumstances and intent of the corporate FCU and its members.

The first possible answer is that the organizational member is elected to the board, rather than the individual representing the organizational member. We would expect that the factors surrounding such an election would show, for example, that the ballot contained the names of the credit union members along with their designated representatives, and that the member credit unions cast their votes based primarily on the credentials of the credit unions and not their representatives. Section 704.4 easily lends itself to this interpretation. Under these circumstances, if the representative can no longer serve, for whatever reason, the organizational member would have the authority to appoint another designate to serve as its new representative on the board. We would not consider this to be a vacancy on the board. A vacancy would only occur if the organizational member resigned its position or dropped out of the corporate FCU. (The corporate's board would fill the vacancy pursuant to its bylaws. See Article VI, Section 3 of the Corporate FCU Bylaws.)

The second possible answer is that the designated representative, as the embodiment of the organizational member, is elected to the board. We would expect that the factors surrounding this election would show, for example, that the representative was elected based on his/her own qualifications, and that the name of the organizational member either did not appear on the ballot or was used only for purposes of identification. This conclusion is supported by question and answer (e) of IRPS 80-3 (attached). If the elected representative is truly the recipient of the votes (as the embodiment of the organizational member), and he/she leaves the board before the end of the term, a vacancy is created. The vacancy can be filled pursuant to Article VI, Section 3 of the Corporate FCU Bylaws. (You will note that answer (e) refers to the Standard FCU Bylaws. This is due to the fact that IRPS 80-3 was issued prior to the drafting of the Corporate FCU Bylaws.)

Durant S. Abernathy III, Esq.

Page Three

It is our opinion that either of the above procedures is supported by Part 704 of the Rules and Regulations. So that problems of interpretation do not arise, we suggest that a corporate FCU resolve with its members, prior to the annual meeting and election, the approach to be followed. That approach should then be formally adopted by the corporate FCU's board as its policy. We would also suggest that the board adopt procedures to be followed regarding attempts to change the policy in order to avoid annual revisions.

I hope that we have been of assistance. Please let me know if you have any additional questions or problems.

Sincerely,



STEVEN R. BISKER
Assistant General Counsel

HMU:sg

Attachment

**NATIONAL CREDIT UNION
ADMINISTRATION**

12 CFR Part 704

(IRPS No. 80-3)

**Corporate Central Federal Credit
Union; Interpretative Ruling and Policy
Statement**

February 28, 1980.

AGENCY: National Credit Union
Administration.

ACTION: Interpretive ruling and policy
statement.

SUMMARY: 12 CFR Part 704 permits member credit unions of corporate central Federal Credit Unions to appoint representatives to attend meetings, vote and stand for election on behalf of the credit union. This statement sets forth the National Credit Union Administration's interpretation of the requirements for and operational aspects of member credit union representation in the operation of Corporate Central Federal Credit Unions. This statement clarifies the relationship between the member credit union and its appointed representative and explains that the corporate central may establish requirements regarding notification by the member credit union of the identity of its representative. This statement describes the effect of withdrawal by a member credit union of its designation of a representative and amplifies on the requirement for audits by licensed auditors.

EFFECTIVE DATE: March 7, 1980.

ADDRESS: National Credit Union
Administration, 1776 G Street, NW.,
Washington, D.C. 20458.

FOR FURTHER INFORMATION CONTACT:
Mike Fischer, Chief Accountant, Office
of Examination and Insurance at the
above address. Telephone (202) 357-
1065.

SUPPLEMENTARY INFORMATION: On
October 10, 1979, the Agency published
a final rule governing the operations of
and requirements for corporate central
Federal credit unions where such
operations and requirements differ from
those of natural person credit unions.
Since the publication of the final rule
several questions have been raised with
respect to member credit union
representation in the affairs of the
corporate central Federal credit union.
These questions were not raised during
the formal comment period and have
sufficient broad application to require
clarification at this time.

Interpretation (IRPS No. 80-3)

This interpretive ruling is presented in question and answer format. Those questions, of general applicability, which have been raised since the issuance of the final rule on corporate central Federal credit unions are stated, followed by the Agency position and the rationale for the position taken.

a. Question: Must the representative appointed by a member credit union be a member of the appointing credit union?

Agency Position: Yes, the designated representative must be a member of the appointing credit union.

Rationale: The representative appointed by a member credit union to attend meetings, vote, and stand for election on behalf of the member credit union must be capable of representing the best interests of the credit union. It is essential that the representative have a bond with the credit union being represented and be free of actual or potential conflicts of interest which could cause such representative to act contrary to the interests of the credit union being represented. The Agency believes that a member of the credit union being represented would be likely to have a commonality of interests with that credit union.

b. Question: Can an individual be appointed as the representative of more than one credit union?

Agency Position: No, an individual cannot serve as the designated representative of more than one credit union.

Rationale: Again the designated representative must be free of actual or potential conflicts of interest which could cause such representative to act contrary to the interests of the credit union being represented. Permitting an individual to represent more than one credit union could result in such conflicts. Further, if an individual were to be designated as representative by more than one credit union, that individual could amass sufficient votes to singly affect the outcome of policy decisions of a corporate central credit union. The prevention of such undue influence is one of the primary reasons for the prohibition against voting by proxy contained in Section 110 of the Federal Credit Union Act and Section 4 of Article VI of the Federal Credit Union Bylaws.

c. Question: May non-natural person members other than member credit unions appoint representatives to attend meetings, vote, and stand for election.

Agency Position: No, non-natural person members other than member credit unions may not appoint

representatives to attend meetings, vote, and stand for election.

Rationale: The mission of a corporate central Federal credit union is to serve credit unions. Originally no corporate entity was permitted to stand for election. However, other non-credit union corporate entities and their officials were included in corporate Federal credit unions in order to provide some natural person members to serve as officials. These entities have had and will continue to have an opportunity to be involved in the management of the corporate central through those officials in their capacity of natural person members. Part 704 provides only for member credit unions, which typically comprise the bulk of the membership, to now also be involved in the management of the corporate credit union by appointing representatives to attend meetings, vote, and stand for election. Other members which are not natural persons may vote through an agent designated in writing for that purpose in conformance with Section 110 of the Federal Credit Union Act and Section 4, Article VI of the Federal Credit Union Bylaws. Agents designated by members which are not natural persons (other than member credit unions) may not stand for election in place of that non-natural person member. Further, such non-natural person members are not eligible to serve in any elective or appointive capacity in the corporate central credit union.

d. Question: May a corporate central Federal credit union establish requirements and/or procedures to insure timely appointment of representatives by its member credit unions?

Agency Position: Yes, the board of directors of the corporate central credit union may, by resolution, establish time frames and methods by which member credit unions will notify the corporate central credit union of the names of the designated representatives. It is anticipated that the notification requirements, so established, will call for written notification within a reasonable period of time; which time is sufficiently in advance of the annual meeting so that the designated representatives may be considered during the nominating process. It is also anticipated that, on any ballot, designated representatives will be so identified and the name of the designating credit union will be shown with equal prominence.

Rationale: The preamble to the final regulation recognized the fact that knowing the name of the designated representative in advance would permit members of the corporate central to

assess the individual's personal qualifications and fitness to represent their views. It is equally important for the members (voters) of the corporate central credit union to be aware that a particular candidate is in fact the designated representative for a given member credit union. This will alert the members of the corporate central credit union to the fact that the candidate will be influenced by the officials of the credit union being represented. It is also apparent that the names of the designated representatives must be known by the corporate central credit union prior to any meeting in order to control the voting process i.e., to ensure that only eligible voters cast ballots. The corporate central credit union must know, not only which individuals have been appointed representatives of member credit unions, but also which individuals have had such designations revoked. Further, the names of such representatives must be known to the corporate central credit union sufficiently in advance so that these representatives can be considered during the nomination process.

e. Question: What is the effect of a credit union's revoking its designation of an individual as its representative? What is the effect of a representative's terminating membership in the designating credit union?

Agency Position: If a representative terminates membership in the appointing credit union or if the appointing credit union revokes an individual's designation as a representative than any position held by that representative must be declared vacant. Such vacancies will be filled in accordance with Section 3 of Article VII of the Federal Credit Union Bylaws.

Rationale: The board of directors of a member credit union is free, at any time, to revoke its designation of one individual and appoint a new representative. Generally, such action by the member credit union would not significantly impact upon the corporate central credit union. However, in those cases where the designated representative has been elected to the board of directors or elected or appointed to a committee of the corporate central credit union, the voters (or the appointing official) were, at least in part, swayed by the qualifications of the individual. To permit the board of directors of a member credit union to substitute another individual in the place of a representative who has been elected to an office, defeats the purpose of an election. To permit the board of directors of a member credit union to

substitute another individual in the place of a representative who has been appointed to an office, is a usurpation of the powers of the appointing official. To protect the rights of both the voters and the officials of the corporate central credit union, it is necessary to declare vacant any position occupied by a representative of a member credit union when that representative can no longer serve. This is necessary whether the inability to serve is due to the action of the representative or the appointing credit union. Section 3 of Article VII of the Federal Credit Union Bylaws places the authority for filling vacancies on the board and the committees with the board of directors of the credit union (in this case the corporate central credit union board of directors).

f. *Question:* May any individual who is licensed to practice as an auditor perform audits of a corporate central credit union?

Agency Position: The fact that a person is licensed to practice as an auditor does not in and of itself ensure competency in the field of auditing. The corporate central must satisfy itself that the individual(s) selected as auditor(s) possess the requisite knowledge and skills to perform audits of financial institutions.

Rationale: Because of the complexity of corporate central operations, a high level of technical expertise is required on the part of the auditor. As pointed out in the preamble to the final rule the Agency intended to rely on the licensing processes of the various states and territories "to ensure that the licensee possesses the requisite knowledge and skills to perform audits". It has come to the attention of the Agency that certain states license persons to practice as auditors without any competency requirements. In selecting auditors corporate central credit unions should assure themselves that the auditors are knowledgeable and skilled in performing audits of financial institutions. To select as an auditor an individual who does not have the requisite knowledge and skills to perform audits of financial institutions could be deemed an unsafe and unsound practice.

g. *Question:* Are audits performed in accordance with generally accepted auditing standards (GAAS) acceptable for corporate central credit unions, or must all audits be performed in accordance with the requirements of the Supervisory Committee Manual for Federal Credit Unions?

Agency Position: Audits of corporate central Federal credit unions performed by qualified auditors in compliance with GAAS are considered acceptable to

meet the audit requirements of section 115 of the Federal Credit Union Act and Sections 701.12 and 704.4 of the NCUA Rules and Regulations.

Rationale: The Supervisory Committee Manual for Federal Credit Unions describes steps and procedures for the performance of audits of Federal credit unions. These steps and procedures were designed to ensure that appropriate checks and tests of transactions would be performed, and adequate confirmations made to determine the reliability and accuracy of the accounting records of Federal credit unions. This manual covers the types of activities which existed in Federal credit unions at the time Public Law 93-383 became law (August 22, 1974, 88 Stat. 739). Corporate central federal credit unions are now engaged in a number of complex activities which are not covered in the present manual. These complex activities have existed in other financial institutions for some time and have been reviewed by auditors using generally accepted auditing standards (GAAS).

Rosemary Brady,

Secretary to the Board.

[FR Doc. 80-2891 Filed 3-4-80 2:45 am]

BILLING CODE 7530-01-M