

withholding on such payments is in a participant's best interest. That is, since the participant will be taxed on the full amount of the payment, it is in the participant's interest that 10 percent of the payment be directed toward satisfying the participant's tax liability.

The Agency considers these amendments to be procedural in character. As a result, no notice and comment period is required by the Administrative Procedure Act (APA). See 5 U.S.C. 553(b)(A). However, if any part of these amendments is held to be substantive in character, the Agency has "good cause," within the meaning of 5 U.S.C. 553(b)(B), to promulgate the amendments without a notice and comment period. Specifically, it would be impracticable for the Agency to comply with the APA's notice and comment period—and hence the Agency has "good cause"—because doing so would preclude the Agency from executing its statutory duties and carrying out its mission. See 5 U.S.C. 553(b).

Pursuant to statute, the Agency's Executive Director and the members of the Board must act "solely in the interest of the [TSP's] participants and beneficiaries" and for the exclusive purpose of providing benefits to participants and their beneficiaries and "defraying reasonable expenses of administering the [TSP]." 5 U.S.C. 8477(b)(1). Currently, the Agency effectively faces an emergency situation by virtue of the fact that it is trying to process more than 7,000 child support orders. If the Agency processes these orders in accordance with the 31 to 60-day time period prescribed in the current version of 5 CFR 1653.5, then the TSP will incur significant administrative expenses. However, these administrative expenses can be greatly defrayed if the Agency amends 5 CFR 1653.5 to reduce processing time to 30 days. Consequently, any meaningful delay in amending 5 CFR 1653.5 could cause the Agency to incur unreasonably large administrative expenses. Thus, the Agency's compliance with the notice and comment period would be impracticable. As a result, no notice and comment period is required. See 5 U.S.C. 553(b).

#### Regulatory Flexibility Act

I certify that this regulation will not have a significant economic impact on a substantial number of small entities. This regulation will affect Federal employees and members of the uniformed services who participate in the Thrift Savings Plan. It will also affect their legal dependents.

#### Paperwork Reduction Act

I certify that these regulations do not require additional reporting under the criteria of the Paperwork Reduction Act.

#### Unfunded Mandates Reform Act of 1995

Pursuant to the Unfunded Mandates Reform Act of 1995, 2 U.S.C. 602, 632, 653, 1501–1571, the effects of this regulation on state, local, and Tribal governments and the private sector have been assessed. This regulation will not compel the expenditure in any one year of \$100 million or more by state, local, and Tribal governments, in the aggregate, or by the private sector. Therefore, a statement under section 1532 is not required.

#### Submission to Congress and the General Accounting Office

Pursuant to 5 U.S.C. 810(a)(1)(A), the Agency submitted a report containing this rule and other required information to the U.S. Senate, the U.S. House of Representatives, and the Comptroller General of the United States before publication of this rule in the **Federal Register**. This rule is not a major rule as defined at 5 U.S.C. 814(2).

#### List of Subjects in 5 CFR Part 1653

Alimony, Child support, Claims, Government employees, Pensions, Retirement.

#### Gregory T. Long,

*Executive Director, Federal Retirement Thrift Investment Board.*

For the reasons stated in the preamble, the Agency amends 5 CFR part 1653 as follows:

#### PART 1653—COURT ORDERS AND LEGAL PROCESSES AFFECTING THRIFT SAVINGS PLAN ACCOUNTS

- 1. The authority citation for part 1653 continues to read as follows:

**Authority:** 5 U.S.C. 8435, 8436(b), 8437(e), 8439(a)(3), 8467, 8474(b)(5), and 8474(c)(1).

- 2. Amend § 1653.5 paragraphs (a) and (e)(2) to read as follows:

##### § 1653.5 Payment.

(a) *Payment date.* Payment pursuant to a qualifying retirement benefits court order will generally be made:

(1) 60 days after the date of the TSP decision letter when the payee is the current or former spouse of the participant. The payee can request to receive the payment sooner than 60 days, but in no event earlier than 30 days after the date of the TSP decision letter, if:

(i) The payee makes a tax withholding election, requests payment by EFT, or

requests a transfer of all or a portion of the payment to a traditional IRA or eligible employer plan (the TSP decision letter will provide the forms a payee must use to choose one of these payment options); and

(ii) Either the court order does not make an award to multiple payees or, if it does, each of the multiple payee requests expedited payment.

(2) Within 30 days of the date of the TSP decision letter when the payee is someone other than the current or former spouse of the participant.

\* \* \* \* \*

(e) \* \* \*

(2) If the payment is made to anyone other than the current or former spouse of the participant, the payment is taxable to the participant and is subject to 10 percent Federal income tax under Internal Revenue Code section 3405(b). The participant cannot elect to change the amount of Federal income tax withholding. The tax withholding will be taken from the payee's entitlement and the gross amount of the payment (i.e., the net payment distributed to the payee plus the amount withheld from the payment for taxes) will be reported to the IRS as income to the participant.

\* \* \* \* \*

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#### NATIONAL CREDIT UNION ADMINISTRATION

#### 12 CFR Parts 704, 741 and 750

RIN 3133–AD73

#### Golden Parachute and Indemnification Payments

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

**ACTION:** Final rule.

**SUMMARY:** NCUA is issuing a final rule to prohibit, in certain circumstances, a Federally insured credit union (FICU) from making golden parachute and indemnification payments to an institution-affiliated party (IAP). The rule will help safeguard the National Credit Union Share Insurance Fund (NCUSIF) by preventing the wrongful or improper disposition of FICU assets and inhibit unwarranted rewards to IAPs that can contribute to an FICU's troubled condition.

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

**FOR FURTHER INFORMATION CONTACT:** Pamela Yu, Staff Attorney, or Ross Kendall, Special Counsel to the General

Counsel, at the above address, or telephone: (703) 518-6540.

#### SUPPLEMENTARY INFORMATION:

### I. Background

On July 10, 2010, the NCUA Board (Board) issued a Notice of Proposed Rulemaking (proposal or proposed rule) to implement section 206(t)<sup>1</sup> of the Federal Credit Union Act (FCU Act), 12 U.S.C. 1786(t), by adding a new part 750 to NCUA's regulations. 75 FR 47236 (August 5, 2010).

The proposed rule would have prohibited, in certain circumstances, an FICU from making golden parachute and indemnification payments to an IAP. The purpose of the proposal, which tracked closely to existing regulations applying to banks,<sup>2</sup> was to safeguard the NCUSIF by preventing the wrongful or improper disposition of FICU assets and to inhibit rewards to IAPs who may have contributed to an FICU's troubled condition or, in the case of indemnification, are the subject of certain types of administrative enforcement actions brought by the regulator. It was also intended to provide FICUs with greater clarity on the distinction between legitimate employee severance payments and improper golden parachute payments.

#### General Comments

The public comment period for the proposed rule ended on September 7, 2010. NCUA received comments from eighteen commenters, including two national credit union trade organizations, a national association representing state credit union regulators, seven state credit union leagues, two credit unions, three attorneys or law firms, two credit union service providers (employee compensation/benefits providers), and one individual credit union volunteer. The majority of commenters were generally supportive of the rule, but all disagreed with some aspect of the proposal or offered suggestions on one or more aspects of the proposed rule. Six commenters, however, opposed the proposed rule in full. All of these commenters opposed the rule because they disagreed with the proposed indemnification provisions. One commenter supported the golden

parachute provisions but opposed the indemnification provisions. Virtually all commenters who were opposed to the indemnification provisions expressed concern that the proposed provisions would be a deterrent to credit union service and would have a negative impact on the ability of FICUs to attract and maintain qualified volunteers and management personnel. NCUA has carefully reviewed and analyzed the comment letters it received in response to the proposal.

### II. Summary of the Final Rule

The final rule applies to all FICUs, including natural person and corporate credit unions. NCUA previously issued a final rule to implement section 206(t) for corporate credit unions on September 24, 2010, as part of a comprehensive rule amending part 704, NCUA's rule governing corporate credit unions. 75 FR 64786 (October 20, 2010); *see also* 74 FR 65210 (Dec. 9, 2009) (publication of the proposed rule). Those provisions, which currently apply only to corporates, are substantially identical to the provisions contained in this final rule. Accordingly, to avoid duplicative sections on the same subject, the Board has determined to delete the indemnification and golden parachute provisions (codified at 12 CFR § 704.20) from the corporate rule. This rulemaking, which applies to corporate as well as natural person credit unions, consolidates the provisions into a single rule.

#### Summary of Golden Parachute Provisions

The final rule prohibits, with some exceptions, FICUs that are insolvent, in conservatorship, rated composite CAMEL or CRIS 4 or 5, subject to a proceeding to terminate or suspend share insurance, undercapitalized (corporates only) or in an otherwise troubled condition<sup>3</sup> from making golden parachute payments. Golden parachutes are defined in the rule as payments made to an IAP that are contingent on the termination of that person's employment and received when the credit union making the payment is troubled.<sup>4</sup>

The Board recognizes, however, that certain post-employment payments have reasonable business purposes. Accordingly, the final rule includes several "exceptions" to the general prohibition against golden parachutes to

allow FICUs to offer, consistent with normal business practice, "bona fide" deferred compensation plans and "nondiscriminatory" severance pay plans. The rule also includes an exception to permit a troubled FICU, with NCUA's prior approval, to hire and agree to pay a golden parachute to competent management to assist in bringing a troubled credit union back to financial health. Additionally, the final rule permits limited golden parachute payments, with prior NCUA approval, in circumstances involving the merger of a troubled FICU and contains a general exception provision to allow an FICU to seek NCUA approval to pay an otherwise prohibited golden parachute.

#### Summary of Indemnification Provisions

The final rule prohibits FICUs, regardless of their financial condition, from paying or reimbursing an IAP's legal or other professional expenses incurred in an administrative or civil action instituted by NCUA or the appropriate state regulatory authority where the IAP is assessed a civil money penalty, removed from office or is required to cease and desist from an action or take an affirmative action described in section 206 of the FCU Act. 12 U.S.C. 1786. Federal credit unions may indemnify their officials and current and former employees in accordance with 701.33(c) of the NCUA regulations, 12 CFR 701.33(c). That section sets forth authority and restrictions on an FCU providing indemnification of officials and employees "for expenses reasonably incurred in connection with any judicial or administrative proceedings to which they are or may become parties by reason of their performance of their official duties." 12 CFR 701.33(c)(1). Federally insured, state-chartered credit unions look to state law for their general indemnification authority. This part 750 contains restrictions on the ability of all FICUs to provide indemnification payments to credit union officials, but the restrictions apply only in the limited circumstances described in the rule, *i.e.*, in the context of an administrative enforcement action brought by NCUA or the appropriate state regulatory authority. This part would, accordingly, take precedence in that specific instance over broader, generally applicable provisions of § 701.33 or of state law and regulation.

The final rule does permit FICUs to purchase reasonable commercial insurance policies or fidelity bonds. The final rule also allows for partial indemnification in circumstances in which there is a formal and final adjudication or finding in a settlement

<sup>1</sup> In 1990, section 2523 of the Comprehensive Thrift and Bank Fraud Prosecution and Taxpayer Recovery Act of 1990 (Fraud Act) amended the Federal Credit Union Act (FCU Act) by adding section 206(t). Public Law 101-647, 2523 (1990). The Fraud Act is title XXV of the Crime Control Act of 1990, S. 3266, which Congress passed on October 27, 1990 and the President signed into law on November 29, 1990.

<sup>2</sup> See 12 CFR part 359.

<sup>3</sup> "Troubled condition" is defined in 12 CFR 701.14(b)(3) and (4).

<sup>4</sup> In this preamble, the term "troubled" is used to refer to any of the triggering events listed in § 750.1(e)(1)(ii) of this final rule.

that the IAP has not violated certain laws or regulations or has not engaged in certain unsafe or unsound practices or breaches of fiduciary duty. In these instances, indemnification would be permitted for only that portion of the legal or professional expenses attributable to the charges for which there has been a finding in favor of the IAP.

FICUs may also advance funds to pay reasonable legal fees and other professional expenses (excluding judgments and penalties) for an IAP's defense of an administrative action under certain circumstances.

Specifically, the final rule permits an FICU to advance reasonable legal expenses to an IAP directly if its board of directors, in good faith, makes certain specific findings and the IAP provides a written affirmation and agrees in writing to reimburse the FICU if the administrative action ultimately results in a final order against the IAP.

#### *Application to Existing Employment Contracts*

The Board does not intend for the provisions in the rule restricting golden parachute payments to have a retroactive application. Accordingly, the final rule applies to all new employment contracts or arrangements entered into on or after the rule's effective date, as well as to existing contracts or arrangements that are renewed or materially modified in any way on or after the final rule's effective date. The Board adopts a similar construction for indemnification obligations that are specifically addressed in an employment contract. However, to the extent that an FICU's indemnification provisions are reflected in a general policy statement or a bylaw provision with general applicability, the Board takes the view that, following the effective date of the final rule, the policy or bylaw must be interpreted so as to give effect to the rule's prohibitions.

With respect to the golden parachute provisions, the final rule does not apply to contracts already in existence on the rule's effective date that contain reasonable provisions relating to the entitlement of an IAP to a payment that falls within the definition of a golden parachute. Thus, existing employment contracts that were legal when made and negotiated at arm's length will not be affected by the rule. The Board expects FICUs will, at the first opportunity, such as at renewal, renegotiate existing employment contracts to bring them into compliance with the rule. Moreover, on or after the effective date of the final rule, its restrictions are applicable, even in the

case of an FICU in a healthy condition that enters into a contract or arrangement for payment of a golden parachute to an IAP. Should that FICU subsequently fall into a troubled condition, the provisions in the rule would apply to the contract and would govern whether or not the payment called for in the contract could be made.

### **III. Detailed Analysis**

A detailed analysis and summary of the specific comments pertaining to the final rule's key provisions follows.

#### *Definitions*

Section 750.1 contains definitions applicable to this part. The key definitions are discussed below.

#### **"Bona fide Deferred Compensation Plan or Arrangement"**

This definition, which appears in the final rule as § 750.1(c), will permit FICUs to continue to provide deferred compensation plans, including supplemental retirement benefits and nonqualified deferred compensation plans, consistent with normal business practices.

Two commenters suggested that language dealing with this subject (§ 750.1(d)(3)(iii) in the proposed rule) should be clarified. These commenters noted that, while typically nonqualified deferred compensation plans vest if the participant remains employed to a specific date, benefits also vest if, prior to the specified vesting date, the participant dies or becomes disabled; in some plans, involuntary termination without cause may also result in vesting. As proposed, § 750.1(d)(3)(iii) required the IAP to have a vested right "at the time of termination of employment" to payments under the deferred compensation plan. Narrowly interpreted, commenters felt this language could be ambiguous with regard to circumstances where a participant vests in the benefit upon death, disability or involuntary termination without cause. Their concern was whether such an occurrence might trigger the restrictions pertaining to golden parachutes.

The Board agrees that this language should not be interpreted to exclude or limit an IAP who vests by death, disability, or, where applicable, involuntary termination without cause, and notes that proposed § 750.1(f)(2)(iii) specifically excluded "any payment made pursuant to a bona fide deferred compensation plan or arrangement" from the definition of "golden parachute payment." As such, a payment to an IAP who vests in a nonqualified deferred compensation plan by virtue of the

provisions in that plan is not a golden parachute payment for the purposes of this rule. Accordingly, the definition for "bona fide deferred compensation plan or arrangement" is adopted in final as proposed. As a technical amendment, the final rule redesignates § 750.1(d) as § 750.1(c).

#### **"Golden Parachute Payment"**

Proposed § 750.1(f) defined a "golden parachute payment" as any payment (or agreement to make any payment) to an IAP that is contingent on the termination of that party's employment and received when the FICU making the payment is insolvent, in conservatorship, rated CAMEL 4 or 5, undercapitalized (for corporates), subject to a proceeding to terminate or suspend its share insurance, or in an otherwise troubled condition, as defined in § 701.14(b)(3) and (4).

The proposed golden parachute definition provided exceptions for certain qualified pension or retirement plans under section 401 of the Internal Revenue Code (IRC); employee benefit plans that are permissible under § 701.19; bona fide deferred compensation plans; certain death and disability payments; certain "nondiscriminatory" severance plans; payments required by state law; and payments that the Board has determined permissible under § 750.4. These types of payments would not be considered golden parachute payments for purposes of the rule. The Board adopts § 750.1(f) substantially as proposed, with the exception of a revision pertaining to § 457 plans, as described in more detail below. For purposes of clarification, the Board has also revised the definition of "Benefit Plan" so it is now clear that, to the extent such a plan also exhibits characteristics of a deferred compensation or severance plan, it must meet the more specific requirements (*i.e.*, "bona fide" and "nondiscriminatory," respectively) in the rule that apply before payments under such plans will be permissible. Additionally, the Board has added where applicable references to Corporate Risk Information System (CRIS) ratings, which are the corporate credit union counterpart to CAMEL ratings. Finally, as a technical amendment, § 750.1(f) has been redesignated as § 750.1(e) in the final rule.

One commenter believed each of the triggering events enumerated in proposed § 750.1(f)(1)(ii) is unique and FICUs that are either insolvent, undercapitalized, in conservatorship, rated CAMEL or CRIS 4 or 5, subject to a proceeding to terminate or suspend its

share insurance or in an otherwise troubled condition should not be treated in the same manner for the purposes of the rule. Another commenter believed the phrase “troubled condition” was vague.

The Board notes that the triggering events in proposed § 750.1(f)(1)(ii) are statutorily defined in the FCU Act, except for the “undercapitalized” standard, which is applicable only to corporates. See 12 U.S.C. 1786(t)(4)(A)(ii). Moreover, while each is a unique condition, the Board believes each triggering event poses a risk sufficient to warrant safeguards to prevent the improper disposition of FICU assets. The Board also notes that the term “troubled condition” is already defined in § 701.14 of NCUA’s regulations, which generally requires newly chartered and troubled credit unions to notify NCUA of any change in official. See 12 CFR 701.14(b)(3) and (4). Section 750.1(e)(1)(ii)(C) of the final rule contains a cross-reference to § 701.14; there is no new definition of “troubled condition” created in this rule. The definition of “troubled credit unions” set forth in § 701.14(b)(3) and (4) is not vague: It includes CAMEL and CRIS ratings of 4 and 5 for natural person and corporate credit unions, respectively, as well as credit unions receiving assistance under sections 208 or 216 of the FCU Act. 12 U.S.C. 1788, 1790d.

At least two commenters suggested “457 deferred compensation plans” (457 Plans) should be specifically excluded from the definition of “golden parachute payment”. Deferred compensation plans described in section 457 of the IRC are available for certain state and local governments and tax-exempt organizations under IRC 501(c), including Federal credit unions (tax-exempt under IRC 501(c)(1)) and state chartered credit unions (tax-exempt under IRC 501(c)(14)). These 457 Plans, which can be eligible plans under IRC 457(b) or ineligible plans under IRC 457(f), allow employees of sponsoring organizations to defer income into future years, for retirement purposes, thereby reducing current year income taxes.

The Board agrees 457 Plans should be excluded from the golden parachute definition. The definition is intended to permit FICUs to offer reasonable deferred compensation plans that are typical in executive compensation packages for credit union executives. The Board recognizes that credit unions, as tax-exempt organizations, are not able to offer equity-based incentive compensation. Deferred compensation plans, including 457 Plans, are an important tool for credit unions to

attract executive talent in a competitive market. Accordingly, the final rule specifically excludes 457 Plans from the definition of “golden parachute payment” in § 750.1(e)(2)(i).

Another commenter asked for clarification that the golden parachute definition is not intended to extend to collateral assignment, split dollar employee benefit plans (CASD Plans).

The Board notes § 750.1(f)(2)(ii) of the proposed rule excluded from the definition of “golden parachute payment” employee benefit plans that are permissible under § 701.19. NCUA’s Office of General Counsel has previously stated FCUs may purchase split dollar life insurance for the purpose of funding employee benefit plan obligations under § 701.19. OGC Op. 05–0117 (January 13, 2005); see also OGC Op. 06–0924 (January 19, 2007). Split dollar life insurance arrangements can be structured in a number of ways, including an arrangement known as a CASD Plan. In general, under this arrangement, an employee owns the insurance policy, while the credit union pays the premiums. The arrangement is structured as a loan from the credit union to the employee, with the loan secured by the employee’s assignment of an interest in the policy. To the extent CASD Plans are consistent with § 701.19, these arrangements are excluded from the golden parachute definition under § 750.1(e)(2)(ii) in the final rule.

#### “Nondiscriminatory”

Section 750.1(i) of the proposed rule defined “nondiscriminatory” as it relates to severance pay plans or arrangements. Under the proposal, only “nondiscriminatory” severance pay plans or arrangements would qualify as an exception to the prohibition on golden parachute payments. To meet the definition of nondiscriminatory under the final rule, a severance pay plan must apply to all employees of an FICU who meet reasonable and customary eligibility requirements applicable to all employees. Disparities in benefits are only acceptable if based on objective criteria like salary, total compensation, length of service, job grade or classification (with a variance in severance benefits relating to any criterion of plus or minus ten percent). Any group of employees that is designated for a different level of benefits based on objective criteria must consist of not less than 33 percent of all employees.

One commenter suggested a greater variance in severance benefits should be permitted and that the size of employee

groups designated for a different level of benefits should be capped.

The Board recognizes that severance plans providing somewhat more generous benefits to higher ranking IAPs are typical in the industry but believes the permitted 10 percent variance and required 33 percent group size are appropriate to meet this objective. The Board believes the final rule strikes a reasonable balance to allow FICUs to provide, if appropriate, severance plans with a modest variance in benefits while ensuring that such disparities are based on objective criteria to avoid unwarranted rewards to IAPs. The Board adopts § 750.1(i) as proposed.

#### “Prohibited Indemnification Payment”

Under proposed § 750.1(k), a “prohibited indemnification payment” would be defined as any payment or agreement to make any payment by an FICU to an IAP to pay or reimburse such person for any civil money penalty, judgment, or other liability or legal expense resulting from any administrative or civil action by NCUA or the appropriate state regulatory authority. The rule becomes operative if the IAP is, in fact, assessed a civil money penalty, removed from office or required to cease and desist from or take any affirmative action with respect to the credit union. The definition would not include any reasonable payment to purchase commercial insurance policies or fidelity bonds, provided the policy or bond is not used to pay or reimburse an IAP for the amount of a civil money penalty or judgment assessed against the IAP. The proposed definition would also allow partial indemnification in certain circumstances. The Board adopts § 750.1(k) as proposed.

Several commenters suggested that if an IAP is found not to have violated the law or breached his or her fiduciary duty, full indemnification, as opposed to partial indemnification, should be permitted.

If an IAP is charged with a violation of law and a breach of fiduciary duty and is ultimately absolved of all charges, then the IAP will receive full indemnification in such circumstance. The Board interprets these commenters to be suggesting that, if an IAP is found not to have violated the law or breached his or her fiduciary duty but, at the same time, the IAP is found to have engaged in unsafe or unsound practices, the IAP should nevertheless be fully indemnified. The Board disagrees. Permitting full indemnification of an IAP, including legal or professional expenses attributable to charges for which the IAP has been found liable, would be contrary to the spirit and

intent of section 206(t) of the FCU Act. Partial indemnification is an appropriate compromise in circumstances where an IAP is ultimately absolved of some, but not all, charges. Accordingly, the final rule permits payments representing a partial indemnification for legal or professional expenses specifically attributable to charges for which there has been a formal and final adjudication or finding in connection with a settlement that the IAP has not violated certain laws or regulations or has not engaged in certain unsafe or unsound practices or breaches of fiduciary duty. Partial indemnification is not permitted, however, in cases where there is a final prohibition order against the IAP.

One commenter asked for clarification on whether payment by the FICU of the amount of the deductible under an insurance policy would be permissible. The permissibility of a particular deductible payment would depend on the individual policy or bond and the nature of the insurance claim. Under the final rule, proceeds from an insurance policy or bond must not be used to pay or reimburse an IAP for the cost of a civil money penalty or judgment assessed against that IAP. In the same vein, a FICU may not pay any deductible amount to the extent that it would apply to any penalty or judgment against an IAP. However, a FICU may pay a deductible amount that is applied toward legal costs attributable to charges for which the IAP is ultimately found not liable.

#### Prohibited Golden Parachute Payments

Eight commenters provided specific comments on the provision prohibiting golden parachute payments, proposed in § 750.2. Most of the comments were not opposed to the rule but offered suggestions for improvement.

Several commenters expressed concern that the rule penalizes IAPs regardless of their culpability and suggested golden parachute payments should be permissible to IAPs who were not responsible for causing or contributing to the FICU's troubled condition.

The Board emphasizes that the final rule does not create a blanket prohibition on golden parachute payments. The final rule contains several exceptions to avoid unfairly prohibiting payments to individuals who were not responsible for causing or contributing to the FICU's troubled condition. As discussed in more detail below, a FICU may obtain approval to make or agree to make a golden parachute payment under certain circumstances. Where an IAP is not

responsible for causing or contributing to the FICU's troubled condition, an FICU may seek approval from NCUA to pay a golden parachute payment to the IAP under the general exception in § 750.4(a)(1).

#### Permissible Golden Parachute Payments

Section 750.4 of the proposal included three major exceptions to the general prohibition on golden parachute payments. The exceptions would permit, in certain circumstances, payments that would otherwise satisfy the definition of a prohibited golden parachute payment.

First, the proposal included a general exception to permit golden parachute payments where the Board, with written concurrence of the appropriate state supervisory authority in the case of a state chartered credit union or corporate credit union, determines such a payment is permissible.

Second, the proposal included an exception to allow an FICU in a troubled condition to agree to pay a golden parachute payment in order to hire new management to help bring a troubled FICU back to sound financial health. This exception was intended to ensure an FICU can attract qualified senior management with appropriate expertise to help improve a troubled FICU's financial condition. An FICU would be required to notify and obtain the written permission of the Board, and, if applicable, the concurrence of the state supervisory authority, before employing this exception to commit to or make a golden parachute payment.

Third, the proposed rule included an exception to allow FICUs to offer reasonable severance plan payments in the context of a merger involving a troubled credit union. The merger must be unassisted, that is, without assistance from, and at no cost to, NCUA or the National Credit Union Share Insurance Fund. Reasonable severance arrangements related to an unassisted merger must not exceed twelve months' salary. Additionally, under the proposal, an FICU would be required to obtain the written consent of the Board before making the severance payment.

In applying to the Board for any of the three exceptions discussed above, the FICU would be required to demonstrate that the IAP does not bear any responsibility for the troubled condition of the FICU. Specifically, under the proposal, an FICU must demonstrate that it does not possess, and is not aware of, any information providing a reasonable basis to believe that the IAP:

- Has committed any fraudulent act or omission, breach of trust or fiduciary duty, or insider abuse;

- Is substantially responsible for the insolvency of, the appointment of a conservator or liquidating agent for, or the troubled condition of the FICU; or
- Has violated or conspired to violate any applicable Federal or state law or regulation or certain specified criminal provisions of the United States Code.

Under the proposal, the Board would consider the following factors in determining whether to permit a golden parachute payment:

- Whether, and to what degree, the IAP was in a position of managerial or fiduciary responsibility;
- The length of time the IAP was affiliated with the FICU, and the degree to which the proposed payment represents a reasonable payment for services rendered over the period of employment; and
- Any other factors or circumstances which would indicate that the proposed payment would be contrary to the intent of section 206(t) of the FCU Act.

One commenter stated that, in the case of unassisted mergers, severance package decisions should be left to the surviving credit union's management to decide. This commenter also suggested severance packages of 24 months' pay should be permitted under the rule to more accurately reflect common industry standards.

The Board is not convinced a modification to the proposed exception for severance payments made in connection with unassisted mergers is necessary. While the Board believes it is important to provide an exception for circumstances involving payments made in connection with an unassisted merger involving a troubled credit union, reasonable limits need to be placed on such payments. In the Board's opinion, 12 months' pay is an appropriate severance payment in the event of an unassisted merger.

None of the comment letters specifically addressed the other proposed exceptions. As such, the Board adopts § 750.4, substantially as proposed, in the final rule. Minor technical modifications have been made, however, to provide that requests for permission to make a golden parachute payment under § 750.4 must be submitted to "NCUA" rather than "the Board." Additionally, more detailed filing instructions, further discussed below, are provided in § 750.6 of the final rule to clarify the approval process, including provisions governing the right to appeal an initial adverse decision to the Board.

The Board also emphasizes that some of the general concerns expressed by commenters about the golden parachute provisions should be alleviated by the

exceptions available in § 750.4, particularly the general exception in § 750.4(a)(1).

#### Prohibited Indemnification Payments

The most prevalent concerns raised by commenters were with regard to the indemnification provisions in the proposed rule. The majority of commenters were either opposed to or concerned about the proposed indemnification provisions. Six commenters opposed the proposed rule in full due to the indemnification provisions. Another eight commenters either opposed one or more aspects of the proposed indemnification provisions, expressed concern with some aspect of the provisions, or offered suggestions on how the rule could be improved or clarified. Four commenters did not provide any comments on the indemnification provisions.

Of the commenters providing specific comment on the proposed indemnification provisions, most expressed concern that the rule would make it difficult, if not impossible, to provide any indemnification to credit union volunteers, thus deterring qualified and experienced individuals from credit union service. Credit union board members serve without pay, on a voluntary basis. Several commenters noted the unique nature of voluntary credit union service, and expressed concern that individuals will be unwilling to serve as board members if they perceive their personal net worth to be at risk because the FICU cannot offer them protection against the potential of personal financial exposure.

The Board does not agree with these commenters. While recognizing that credit unions' voluntary governance structure presents unique recruitment and retention challenges, the scope of the rule is very limited. The indemnification limitations apply only to administrative actions brought by NCUA or appropriate state regulator. Such actions are not only rare, but most often take the form of either a removal action or an action to prohibit an individual from serving on behalf of an insured depository institution in the future. These actions do not typically threaten the individual credit union official with significant exposure to personal liability. Moreover, the Board emphasizes that the rule does not create a blanket prohibition on indemnification payments. Under certain conditions, which are described in more detail below, an FICU may make indemnification available to an IAP unless or until the administrative proceeding or civil action results in civil money penalties, removal or

prohibition, or an order against the IAP to cease and desist from or take any affirmative action with respect to the credit union.

Several commenters argued the proposed indemnification provisions may interfere with an IAP's right to counsel. One commenter argued that if IAPs must advance their own legal expenses, they will obtain the most affordable representation, as opposed to the best available representation, in their defense of an administrative action. One commenter suggested that, in prohibiting the advancement of legal expenses, the rule would incentivize IAPs to agree to fines or admit liability in an administrative action to avoid advancing their own personal funds to absolve themselves of the charges brought against them. On the other hand, another commenter stated the rule would be a disincentive to settlement since indemnification payments are prohibited where the settlement provisions are adverse for the IAP. One commenter also suggested NCUA would effectively be depriving IAPs the right of judicial review because indemnification is unavailable following an adverse outcome in an administrative action.

The Board disagrees with these commenters. First, the Board does not agree with the contention that a reasonable limitation on indemnification where an IAP is subject to an adverse final order in an administrative action, such as that proposed, interferes with an IAP's due process rights or is otherwise contrary to public policy. While IAPs may have to use their own funds to pay for or reimburse legal expenses in their defense of an administrative action, IAPs maintain their fundamental right to counsel. Similarly, IAPs maintain their right of judicial review even if indemnification is prohibited. The proposed rule's limitations on indemnification would not disturb an IAP's right to appeal a final administrative order to the U.S. Court of Appeals; furthermore, if the appellate court reversed an administrative order, then the IAP would again be entitled to indemnification. Second, under the proposal an FICU can advance reasonable legal expenses to IAPs directly to assist in defending themselves against administrative actions. While proposed § 750.1(k) defined "prohibited indemnification payment" as any payment for the benefit of an IAP to pay or reimburse such person for, among other things, "any legal expense" resulting from an administrative action, this statement was qualified with the language: "that results in a final order or settlement

[against the IAP]". Thus, under the proposal, an indemnification payment would not be prohibited unless and until the administrative action resulted in a final order or settlement pursuant to which the IAP is assessed or agrees to a civil money penalty, removal from office, prohibition from participating in the conduct of the affairs of an insured credit union, or cease and desist from or take an affirmative action described in section 206 of the FCU Act. 12 U.S.C. 1786.

Proposed § 750.5 then described the circumstance when an indemnification payment would be permissible; specifically, where the FICU's board of directors makes a good faith determination, after due investigation, that:

- The IAP acted in good faith and in a manner he or she believed to be in the best interests of the FICU;
- The payment will not materially adversely affect the FICU's safety and soundness;
- The payments do not ultimately become prohibited indemnification payments as defined in § 750.1(k), that is, the administrative action does not ultimately result in a civil money penalty, removal order, or cease and desist order against the IAP; and
- The IAP agrees in writing to reimburse the FICU, to the extent not covered by payments from insurance, for "that portion of the *advanced* indemnification payments, if any, *which subsequently becomes* a prohibited indemnification payment." (Emphasis added).

Read together, the proposed provisions would allow for reasonable indemnification payments and the advancement of legal expenses to assist IAPs in their defense of administrative actions under certain conditions. To alleviate commenters' concerns, however, the Board has elected to make several modifications in § 750.5 of the final rule to clarify the circumstances under which indemnification will be permissible. These modifications are discussed more fully below.

#### Permissible Indemnification Payments

Several commenters suggested changes or clarifications with regard to proposed § 750.5. As discussed above, a number of commenters expressed concern that the proposal would not permit the advancement of legal funds, essentially depriving an IAP of the right to counsel and otherwise eroding principles of due process.

Additionally, several commenters opposed the requirement that a FICU's board of directors make a "good faith determination" that an indemnification

payment will not ultimately become prohibited. These commenters characterized the requirement as overly subjective, insofar as it involves, in their view, the interpretation of law and facts and places an unrealistic expectation on the FICU board to predict the outcome of an administrative action. Thus, according to these commenters, the determination should not reasonably be required to be made by a FICU board. Some commenters expressed concern that NCUA could second guess the credit union's good faith decision to indemnify an IAP and noted there are no safeguards to preclude NCUA from disagreeing with a board's good faith determination and blocking the indemnification payment. One commenter also disagreed with proposed § 750.5(a)(4), which would require an IAP to agree to reimburse the FICU, to the extent not covered by payments from insurance and bonds, for that portion of the advanced indemnification payments for which the IAP has ultimately been found liable. This commenter argued that such a requirement would essentially render futile the mitigating purpose of the exception.

To both alleviate concerns regarding the advancement of legal expenses and to provide clarification about the "good faith determination" requirement, the Board is modifying § 750.5(a) of the final rule. Under the final rule, an FICU may make or agree to make reasonable indemnification payments to an IAP, including advancing funds to pay or reimburse reasonable legal fees and other professional expenses incurred by an IAP in an administrative proceeding or civil action initiated by NCUA or a state regulatory authority. The decision to approve payment of such funds requires the FICU's board of directors to make a good faith determination, after due consideration, that:

- The IAP acted in good faith and in a manner he or she believed to be consistent with his or her fiduciary duty;<sup>5</sup> and
- The payment will not materially adversely affect the FICU's safety and soundness.

The Board has also determined to clarify that the FICU board of directors'

determination as to whether or not an advance is appropriate should take into consideration the ability of the affected IAP to repay the advance if required. This would include, for example, a review of the affected individual's financial circumstances, including whether or not he or she has collateral that might be pledged to secure the repayment obligation. Accordingly, the rule text includes this element as part of the board's due consideration.

The IAP will be required to provide:

- A written affirmation of his or her good faith belief that the IAP acted in manner he or she believed to be consistent with his or her fiduciary duty; and
- A written agreement to reimburse the FICU, to the extent not covered by payments from liability insurance or surety bond, for that portion of the advanced indemnification payment which ultimately becomes a prohibited indemnification payment as defined in § 750.1(k).

An indemnification payment can ultimately become a prohibited indemnification payment because of the entry of a final order or settlement pursuant to which the IAP is assessed a civil money penalty, subject to a prohibition or removal order, or required to cease and desist from or take any affirmative action described in section 206 of the FCU Act. If such a final order or settlement is the result, then the IAP must reimburse the FICU for all legal and professional fees advanced. Moreover, the FICU must not, under any circumstance, agree to reimburse any civil money penalty actually entered against the IAP.

The Board believes the final rule is clear in describing how an FICU may provide for the advancement of legal and other professional expenses in appropriate circumstances. The modifications also provide greater clarification about the conditions under which indemnification payments will be permitted under § 750.5. Further, the added requirement that an IAP provide a written affirmation of a good faith belief that he or she acted in a manner believed to be in the best interests of the members will assist the FICU's board in conducting its own due diligence investigation and determination that the "good faith" standard has been met.

The Board believes the new provisions in § 750.5 are consistent with the spirit and intent of § 206(t) of the FCU Act and effectively balance the interest in allowing for the protection of volunteer officials while preventing the improper use of FICU funds to unjustly reward IAPs who are not deserving of indemnification.

Additionally, as discussed above, for purposes of clarification the final rule makes a generic reference to an IAP's fiduciary duty, rather than referring specifically to a duty to serve the "best interests of the institution." This avoids inconsistency with the NCUA's recent rule outlining the fiduciary duties and responsibilities of Federal credit union directors, (*See*, 12 CFR 701.4), while recognizing that applicable standards governing conduct and duties of IAPs of state chartered institutions are established by state law. *See* footnote 5.

#### Filing Instructions

Section 750.6 of the final rule is revised to provide greater detail about the procedures for submitting written requests to make excess nondiscriminatory severance plan payments pursuant to § 750.1(e)(2)(v) and golden parachute payments permitted by § 750.4. The final rule clarifies that, in the case of a Federal or state chartered natural person credit union, such written requests must be submitted to the NCUA regional director for the region in which the credit union is located. In the case of a Federal or state chartered corporate credit union, such written requests must be submitted to the Director of the Office of Corporate Credit Unions. Additionally, the final rule clarifies that, in the case of a state chartered natural person or corporate credit union, where written concurrence by the state supervisory authority is required, the requesting party must submit a copy of its written request to the state supervisory authority where the credit union is located.

The Board has also determined, on its own, to add provisions to this section of the rule outlining a process by which a requester may appeal an adverse decision to the Board. The provisions, at new subsection (b), include time frames and procedural considerations and are modeled on the provisions found elsewhere in NCUA's regulations governing the appeal of creditor and share insurance claims. *See* 12 CFR 709, 745, 747.

#### IV. Regulatory Procedures

##### *Regulatory Flexibility Act*

The Regulatory Flexibility Act requires NCUA to prepare an analysis to describe any significant economic impact a rule may have on a substantial number of small entities (primarily those under ten million dollars in assets). This rule does not impose any regulatory burden but prohibits improper golden parachute and indemnification payments to IAPs by FICUs in certain circumstances.

<sup>5</sup> Directors of Federal credit unions have a fiduciary duty to act in the best interest of the members. By necessary implication, an FCU's officers and employees, who are under the oversight and direction of the board, have the same obligation. *See* 75 FR 81378 (December 28, 2010); 12 CFR 701.4. Directors and officers of credit unions chartered at the state level should look to applicable standards as contained in state law to determine the scope and extent of their duties. The text of the rule has been clarified to reflect this distinction.

Accordingly, it will not have a significant economic impact on a substantial number of small credit unions, and therefore, no regulatory flexibility analysis is required.

#### *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. Part 750 will impose new information collection requirements. Specifically, § 750.6 will require requests for an FICU to make nondiscriminatory severance plan payments under § 750.1(e)(2)(v) and golden parachute payments permitted by § 750.4 to be submitted in writing to NCUA.

In FY 2009, there were 351 problem FICUs with CAMEL 4 or 5 ratings. Of those, 156 FICUs had less than \$10 million in total assets and 117 FICUs had between \$10 million and \$100 million in total assets. As of year-end 2010, there were 365 CAMEL 4 and 5 FICUs. Of those, 163 had less than \$10 million in assets and 130 had total assets between \$10 million and \$100 million. Smaller FICUs are unlikely to seek NCUA approval to make golden parachute payments because these payments are more typically seen in the executive compensation of larger, more complex FICUs. Of the remaining larger, problem FICUs, NCUA anticipates no more than 20 percent would seek NCUA approval to make a golden parachute payment. Accordingly, NCUA estimates that 15 FICUs will need to solicit NCUA approval in advance of making a severance or golden parachute payment within the scope of the proposed rule and that preparing the request for approval may take four hours: 15 FICUs × 4 hours = 60 hours.

As required by the PRA, NCUA has submitted a copy of this final regulation to the Office of Management and Budget (OMB) for its review and approval.

#### *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).

#### *Small Business Regulatory Enforcement Fairness Act*

The Small Business Regulatory Enforcement Fairness 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 APA. 5 U.S.C. 551. NCUA does not believe this final rule is a “major rule” within the meaning of the relevant sections of SBREFA. NCUA has submitted the rule to the Office of Management and Budget for its determination in that regard.

#### **List of Subjects**

##### *12 CFR Part 704*

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

##### *12 CFR Part 741*

Bank deposit insurance, Credit unions, Reporting and recordkeeping requirements.

##### *12 CFR Part 750*

Credit Unions, Golden parachute payments, Indemnity payments.

Dated: By the National Credit Union Administration Board, this 19th day of May 2011.

**Mary F. Rupp,**

*Secretary of the Board.*

For the reasons discussed above, NCUA amends 12 CFR parts 704 and 741, and adds part 750 of title 12, chapter VII, of the Code of Federal Regulations as follows:

#### **PART 704—CORPORATE CREDIT UNIONS**

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

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

##### **§ 704.20 [Removed]**

- 2. Remove § 704.20.

#### **PART 741—REQUIREMENTS FOR INSURANCE**

- 3. The authority citation for part 741 continues to read as follows:

**Authority:** 12 U.S.C. 1757, 1766(a), 1781-1790, and 1790d; 31 U.S.C. 3717.

- 4. Add new § 741.224 to read as follows:

##### **§ 741.224 Golden parachute and indemnification payments.**

Any credit union insured pursuant to Title II of the Act must adhere to the requirements stated in part 750 of this chapter.

- 5. New part 750 is added to read as follows:

#### **PART 750—GOLDEN PARACHUTE AND INDEMNIFICATION PAYMENTS**

Sec.

750.0 Scope.

750.1 Definitions.

750.2 Golden parachute payments prohibited.

750.3 Prohibited indemnification payments.

750.4 Permissible golden parachute payments.

750.5 Permissible indemnification payments.

750.6 Filing instructions; appeal.

750.7 Applicability in the event of liquidation or conservatorship.

**Authority:** 12 U.S.C. 1786(t).

##### **§ 750.0 Scope.**

(a) This part limits and prohibits, in certain circumstances, the ability of Federally insured credit unions, including Federally and state chartered natural person credit unions and Federally and state chartered corporate credit unions, to enter into contracts to pay and to make golden parachute and indemnification payments to institution-affiliated parties (IAPs).

(b) The limitations on golden parachute payments apply to troubled Federally insured credit unions that seek to enter into contracts to pay or to make golden parachute payments to their IAPs. A “golden parachute payment” is generally considered to be any payment to an IAP which is contingent on the termination of that person’s employment and is received when the Federally insured credit union making the payment is troubled. The definition of golden parachute payment does not include payments pursuant to qualified retirement plans, nonqualified bona fide deferred compensation plans, nondiscriminatory severance pay plans, other types of common benefits plans, state statutes and death benefits. Certain limited exceptions to the golden parachute payment prohibition are provided for in cases involving unassisted mergers and the hiring of new management to help improve a troubled Federally insured credit union’s financial condition. A procedure is also set forth to permit a Federally insured credit union to request permission to make what would otherwise be a prohibited golden parachute payment.

(c) The limitations on indemnification payments apply to all Federally insured credit unions, including state chartered credit unions, regardless of their financial health. Generally, this part prohibits Federally insured credit unions from indemnifying an IAP for

that portion of the costs sustained with regard to an administrative proceeding or civil action commenced by NCUA or a state regulatory authority that results in a final order or settlement pursuant to which the IAP is assessed a civil money penalty, removed from office, prohibited from participating in the affairs of a Federally insured credit union or required to cease and desist from an action or take an affirmative action described in section 206 of the Federal Credit Union Act, 12 U.S.C. 1786. There are exceptions to this general prohibition. First, a Federally insured credit union may purchase commercial insurance to cover these expenses, except judgments and penalties. Second, the credit union may advance legal and other professional expenses to an IAP directly (except for judgments and penalties) if its board of directors makes certain specific findings and the IAP provides a written affirmation and agrees in writing to reimburse the credit union if it is ultimately determined that the IAP violated a law or regulation or has engaged in certain unsafe or unsound practices or breaches of fiduciary duty. For Federal credit unions, fiduciary duty is defined in 701.4 of this chapter. State chartered credit unions should look to applicable state law.

#### **§ 750.1 Definitions.**

As used in this part:

(a) *Act* means the Federal Credit Union Act.

(b) *Benefit plan* means any employee benefit plan, contract, agreement or other arrangement subject to the requirements in § 701.19 of this chapter; provided, however, that to the extent the plan exhibits characteristics of a deferred compensation plan or arrangement, or severance plan, it meets the criteria set forth in paragraph (c) or (i), respectively, of this section.

(c) *Bona fide deferred compensation plan or arrangement* means any plan, contract, agreement or other arrangement where:

(1) An IAP voluntarily elects to defer all or a portion of the reasonable compensation, wages or fees paid for services rendered that otherwise would have been paid to the IAP at the time the services were rendered, including a plan providing for crediting a reasonable investment return on the elective deferrals, and the Federally insured credit union either:

(i) Recognizes compensation expense and accrues a liability for the benefit payments according to generally accepted accounting principles (GAAP); or

(ii) Segregates or otherwise sets aside assets in a trust that may only be used to pay plan and other benefits, except that the assets of the trust may be available to satisfy claims of the Federally insured credit union's creditors in the case of insolvency; or

(2) A Federally insured credit union establishes a nonqualified deferred compensation or supplemental retirement plan, other than an elective deferral plan described in paragraph (c)(1) of this section:

(i) Primarily for the purpose of providing benefits for certain IAPs in excess of the limitations on contributions and benefits imposed by sections 415, 401(a)(17), 402(g) or any other applicable provision of the Internal Revenue Code of 1986 (26 U.S.C. 415, 401(a)(17), 402(g)); or

(ii) Primarily for the purpose of providing supplemental retirement benefits or other deferred compensation for a select group of directors, management or highly compensated employees, excluding severance payments described in paragraph (e)(2)(v) of this section and permissible golden parachute payments described in § 750.4; and

(3) In the case of any nonqualified deferred compensation or supplemental retirement plans as described in paragraphs (c)(1) and (2) of this section, the following requirements apply:

(i) The plan was in effect at least one year before any of the events described in paragraph (e)(1)(ii) of this section;

(ii) Any payment made pursuant to the plan is made in accordance with the terms of the plan as in effect no later than one year before any of the events described in paragraph (e)(1)(ii) of this section and in accordance with any amendments to the plan during that one year period that do not increase the benefits payable under the plan;

(iii) The IAP has a vested right, as defined under the applicable plan document, at the time of termination of employment to payments under the plan;

(iv) Benefits under the plan are accrued each period only for current or prior service rendered to the employer, except that an allowance may be made for service with a predecessor employer;

(v) Any payment made pursuant to the plan is not based on any discretionary acceleration of vesting or accrual of benefits that occurs at any time later than one year before any of the events described in paragraph (e)(1)(ii) of this section;

(vi) The Federally insured credit union has previously recognized compensation expense and accrued a liability for the benefit payments

according to GAAP or segregated or otherwise set aside assets in a trust that may only be used to pay plan benefits, except that the assets of the trust may be available to satisfy claims of the credit union's creditors in the case of insolvency; and

(vii) Payments pursuant to the plans must not exceed the accrued liability computed in accordance with GAAP.

(d) *Federally insured credit union* means a Federal credit union, state chartered credit union, or corporate credit union the member accounts of which are insured under the Act.

(e) *Golden parachute payment.*

(1) The term *golden parachute payment* means any payment or any agreement to make any payment in the nature of compensation by any Federally insured credit union for the benefit of any current or former IAP pursuant to an obligation of the credit union that:

(i) Is contingent on, or by its terms is payable on or after, the termination of the party's primary employment or affiliation with the credit union; and

(ii) Is received on or after, or is made in contemplation of, any of the following events:

(A) The insolvency of the Federally insured credit union that is making the payment; or

(B) The appointment of any conservator or liquidating agent for the Federally insured credit union; or

(C) A determination by NCUA or, in the case of a state chartered credit union, the appropriate state supervisory authority that the Federally insured credit union is in a troubled condition, as defined in § 701.14(b)(3) and (4) of this chapter; or

(D) The Federally insured credit union has been assigned:

(1) In the case of a Federal credit union, 4 or 5 CAMEL composite rating by NCUA; or

(2) In the case of a Federally insured state chartered credit union, an equivalent 4 or 5 CAMEL composite rating by the state supervisor; or

(3) In the case of a Federally insured state chartered credit union in a state that does not use the CAMEL system, a 4 or 5 CAMEL composite rating by NCUA based on core workpapers received from the state supervisor; or

(4) In the case of a corporate credit union, the corporate credit union is undercapitalized as defined in § 704.4, or has been assigned a 4 or 5 Corporate Risk Information System (CRIS) rating by NCUA in either the Financial Risk or Risk Management composites, or, in the case of a state chartered corporate credit union, assigned a rating equivalent to a 4 or 5 CRIS rating in either composite

by the state supervisory authority (SSA) or by NCUA, based on core exam work papers received from the SSA (in states not using the CRIS or CAMEL rating systems); or

(E) The Federally insured credit union is subject to a proceeding to terminate or suspend its share insurance; and

(iii) Is payable to an IAP whose employment by or affiliation with a Federally insured credit union is terminated at a time when the Federally insured credit union by which the IAP is employed or with which the IAP is affiliated satisfies any of the conditions enumerated in paragraphs (e)(1)(ii) (A) through (E) of this section, or in contemplation of any of these conditions.

(2) *Exceptions.* The term *golden parachute payment* does not include:

(i) Any payment made pursuant to a deferred compensation plan under section 457 of the Internal Revenue Code of 1986, 26 U.S.C. 457, or a pension or retirement plan that is qualified or is intended within a reasonable period of time to be qualified under section 401 of the Internal Revenue Code of 1986, 26 U.S.C. 401; or

(ii) Any payment made pursuant to a benefit plan as that term is defined in paragraph (b) of this section; or

(iii) Any payment made pursuant to a *bona fide deferred compensation plan or arrangement* as defined in paragraph (c) of this section; or

(iv) Any payment made by reason of death or by reason of termination caused by the disability of an IAP; or

(v) Any payment made pursuant to a nondiscriminatory severance pay plan or arrangement that provides for payment of severance benefits to all eligible employees upon involuntary termination other than for cause, voluntary resignation, or early retirement; provided, however, that no employee will receive any payment that exceeds the base compensation paid to the employee during the twelve months, or a longer period or greater benefit as the NCUA will consent to, immediately preceding termination of employment, resignation or early retirement, and the severance pay plan or arrangement must not or cannot have been adopted or modified to increase the amount or scope of severance benefits at a time when the Federally insured credit union was in a condition specified in paragraph (e)(1)(ii) of this section or in contemplation of that condition without the prior written consent of NCUA; or

(vi) Any severance or similar payment required to be made pursuant to a state statute applicable to all employers within the appropriate jurisdiction, with the exception of employers that may be

exempt due to their small number of employees or other similar criteria; or

(vii) Any other payment NCUA determines to be permissible in accordance with § 750.4.

(f) *Institution-affiliated party (IAP)* means any individual meeting the criteria in section 206(r) of the Act, 12 U.S.C. 1786(r).

(g) *Liability or legal expense* means:

(1) Any legal or other professional fees and expenses incurred in connection with any claim, proceeding, or action;

(2) The amount of, and any cost incurred in connection with, any settlement of any claim, proceeding, or action; and

(3) The amount of, and any cost incurred in connection with, any judgment or penalty imposed with respect to any claim, proceeding, or action.

(h) *NCUA* means the National Credit Union Administration.

(i) *Nondiscriminatory* means that the plan, contract or arrangement applies to all employees of a Federally insured credit union who meet reasonable and customary eligibility requirements applicable to all employees, such as minimum length of service requirements. A nondiscriminatory plan, contract or arrangement may provide different benefits based only on objective criteria, such as salary, total compensation, length of service, job grade or classification, applied on a proportionate basis (with a variance in severance benefits relating to any criterion of plus or minus ten percent) to groups of employees consisting of not less than 33% of all employees.

(j) *Payment* means:

(1) Any direct or indirect transfer of any funds or any asset;

(2) Any forgiveness of any debt or other obligation;

(3) The conferring of any benefit; or

(4) Any segregation of any funds or assets, the establishment or funding of any trust or the purchase of or arrangement for any letter of credit or other instrument, for the purpose of making, or pursuant to any agreement to make, any payment on or after the date on which the funds or assets are segregated, or at the time of or after such trust is established or letter of credit or other instrument is made available, without regard to whether the obligation to make such payment is contingent on:

(i) The determination, after such date, of the liability for the payment of such amount; or

(ii) The liquidation, after such date, of the amount of such payment.

(k) *Prohibited indemnification payment.* (1) *Prohibited indemnification*

means any payment or any agreement or arrangement to make any payment by any Federally insured credit union for the benefit of any person who is or was an IAP of the Federally insured credit union, to pay or reimburse such person for any civil money penalty, judgment, or other liability or legal expense resulting from any administrative or civil action instituted by NCUA or any appropriate state regulatory authority, in the case of a credit union or corporate credit union chartered by a state, that results in a final order or settlement pursuant to which such person:

(i) Is assessed a civil money penalty;

(ii) Is removed from office or prohibited from participating in the conduct of the affairs of the Federally insured credit union; or

(iii) Is required to cease and desist from an action or take any affirmative action described in section 206 of the Act (12 U.S.C.1786) with respect to the credit union.

(2) *Exceptions. Prohibited indemnification payment* does not include any reasonable payment that:

(i) Is used to purchase a commercial insurance policy or fidelity bond, provided that the insurance policy or bond must not be used to pay or reimburse an IAP for the cost of any judgment or civil money penalty assessed against the IAP in an administrative proceeding or civil action commenced by NCUA or the appropriate state supervisory authority, in the case of a credit union or corporate credit union chartered by a state, but may pay any legal or professional expenses incurred in connection with a proceeding or action or the amount of any restitution, to the Federally insured credit union or its conservator or liquidating agent; or

(ii) Represents partial indemnification for legal or professional expenses specifically attributable to particular charges for which there has been a formal and final adjudication or finding in connection with a settlement that the IAP has not violated certain laws or regulations or has not engaged in certain unsafe or unsound practices or breaches of fiduciary duty, unless the administrative action or civil proceeding has resulted in a final prohibition order against the IAP.

(l) *Troubled condition* means any Federally insured credit union that meets the criteria as described in § 701.14(b)(3) and (4) of this chapter, or has been granted assistance described in sections 208 or 216 of the Act.

**§ 750.2 Golden parachute payments prohibited.**

A Federally insured credit union must not make or agree to make any golden parachute payment, except as permitted by this part.

**§ 750.3 Prohibited indemnification payments.**

A Federally insured credit union must not make or agree to make any prohibited indemnification payment, except as permitted by this chapter.<sup>1</sup>

**§ 750.4 Permissible golden parachute payments.**

(a) A Federally insured credit union may agree to make or may make a golden parachute payment if:

(1) NCUA, with written concurrence of the appropriate state supervisory authority in the case of a state chartered credit union or corporate credit union, determines the payment or agreement is permissible; or

(2) An agreement is made in order to hire a person to become an IAP at a time when the Federally insured credit union satisfies or in an effort to prevent it from imminently satisfying any of the criteria in § 750.1(e)(1)(ii), and NCUA, with written concurrence of the appropriate state supervisory authority in the case of a state chartered credit union or corporate credit union, consents in writing to the amount and terms of the golden parachute payment. NCUA's consent will not improve the IAP's position in the event of the insolvency of the credit union since NCUA's consent cannot bind a liquidating agent or affect the provability of claims in liquidation. In the event the credit union is placed into conservatorship or liquidation, the conservator or the liquidating agent will not be obligated to pay the promised golden parachute and the IAP will not be accorded preferential treatment on the basis of any prior approval; or

(3) A payment is made pursuant to an agreement that provides for a reasonable severance payment, not to exceed twelve months' salary, to an IAP in the event of a merger of the Federally insured credit union; provided, however, that a Federally insured credit union must obtain the consent of NCUA before making a payment and this paragraph (a)(3) does not apply to any merger of a Federally insured credit union resulting from an assisted transaction described in section 208 of the Act, 12 U.S.C. 1788, or the Federally insured credit union being placed into conservatorship or liquidation; and

(4) A Federally insured credit union or IAP making a request pursuant to paragraphs (a)(1) through (3) of this section must demonstrate it does not possess and is not aware of any information, evidence, documents or other materials indicating there is a reasonable basis to believe, at the time the payment is proposed to be made, that:

(i) The IAP has committed any fraudulent act or omission, breach of trust or fiduciary duty, or insider abuse with regard to the Federally insured credit union that has had or is likely to have a material adverse effect on the Federally insured credit union;

(ii) The IAP is substantially responsible for the insolvency of, the appointment of a conservator liquidating agent for, or the troubled condition, as defined by § 750.1(l), of the Federally insured credit union;

(iii) The IAP has materially violated any applicable Federal or state law or regulation that has had or is likely to have a material effect on the Federally insured credit union; or

(iv) The IAP has violated or conspired to violate sections 215, 656, 657, 1005, 1006, 1007, 1014, 1032, or 1344 of title 18 of the United States Code, or sections 1341 or 1343 of that title affecting a Federally insured financial institution, as defined in title 18 of the United States Code.

(b) In making a determination under paragraphs (a)(1) through (3) of this section, NCUA may consider:

(1) Whether, and to what degree, the IAP was in a position of managerial or fiduciary responsibility;

(2) The length of time the IAP was affiliated with the Federally insured credit union and the degree to which the proposed payment represents a reasonable payment for services rendered over the period of employment; and

(3) Any other factors or circumstances indicating the proposed payment would be contrary to the intent of section 206(t) of the Act or this part.

**§ 750.5 Permissible indemnification payments.**

(a) A Federally insured credit union may make or agree to make reasonable indemnification payments to an IAP, including advanced funds to pay or reimburse reasonable legal fees or other professional expenses incurred by an IAP in an administrative proceeding or civil action initiated by NCUA or a state regulatory authority if:

(1) The Federally insured credit union's board of directors, in good faith, determines in writing after due investigation and consideration that:

(i) The IAP acted in good faith and in a manner he or she believed to be consistent with his or her fiduciary duty;

(ii) The advancement or payment of the expenses will not materially adversely affect the credit union's safety and soundness; and

(iii) The IAP has the financial capability or has otherwise made appropriate financial arrangements sufficient to repay the advance if required in accordance with this rule; and

(2) The IAP provides:

(i) A written affirmation of his or her reasonable good faith belief that he or she acted in a manner believed to be consistent with his or her fiduciary duty; and

(ii) An agreement in writing to reimburse the Federally insured credit union, to the extent not covered by payments from insurance or bonds purchased pursuant to § 750.1(k)(2)(i), for that portion of any advanced indemnification payments which ultimately become prohibited indemnification payments as defined in § 750.1(k); and

(3) The indemnification payments do not ultimately constitute prohibited indemnification payments as defined in § 750.1(k).

(b) An IAP seeking indemnification payments must not participate in any way in the board of director's discussion and approval of such payments; however, the IAP may present his or her request to the board and respond to any inquiries from the board concerning his or her involvement in the circumstances giving rise to the administrative proceeding or civil action.

(c) In the event a majority of the members of the board of directors are named as respondents in an administrative proceeding or civil action and request indemnification, the remaining members of the board may authorize independent legal counsel to review the indemnification request and provide the remaining members of the board with a written opinion of counsel as to whether the conditions in paragraph (a)(1) through (3) of this section have been met. If independent legal counsel concludes that the conditions have been met, the remaining members of the board of directors may rely on the opinion in authorizing the requested indemnification.

(d) In the event all of the members of the board of directors are named as respondents in an administrative proceeding or civil action and request indemnification, the board will authorize independent legal counsel to

<sup>1</sup> The provisions in this part 750 control to the extent of any inconsistency with § 701.33 of this chapter.

review the indemnification request and provide the board with a written opinion of counsel as to whether the conditions in paragraph (a)(1) through (3) of this section have been met. If independent legal counsel concludes the conditions have been met, the board of directors may rely on the opinion in authorizing the requested indemnification.

#### **§ 750.6 Filing instructions; appeal.**

(a) Requests to make excess nondiscriminatory severance plan payments pursuant to § 750.1(e)(2)(v) and golden parachute payments permitted by § 750.4 must be submitted in writing to NCUA. In the case of a Federal or state chartered natural person credit union, such written requests must be submitted to the NCUA regional director for the region in which the credit union is located. In the case of a Federal or state chartered corporate credit union, such written requests must be submitted to the Director of the Office of Corporate Credit Unions. The request must be in letter form and must contain all relevant factual information as well as the reasons why such approval should be granted. If written concurrence by the state supervisory authority is required, the requesting party must submit a copy of its written request to the state supervisory authority where the credit union is located.

(b) An FICU whose request for approval by NCUA in accordance with paragraph (a) of this section has been denied may file an appeal of that denial with the NCUA Board by following the procedures set out in this paragraph.

(1) The appeal must be in writing and filed with the Secretary of the Board, National Credit Union Administration, 1775 Duke Street, Alexandria, VA 22314-3428, and must be filed not later than sixty days after the initial determination denying the request.

(2) The Board shall make its determination concerning the appeal based on what is submitted in writing; there shall be no personal appearance before the Board in connection with an appeal under this paragraph.

(3) The Board shall make its determination concerning the appeal within 180 days from the date of its receipt of the appeal. The decision by the Board on appeal shall be provided to the appellant in writing, stating the reasons for the decision, and shall constitute a final agency decision. Failure by the Board to issue a decision on appeal within the 180-day period provided for under this section shall be deemed to be denial of such appeal.

(4) A final determination by the Board is reviewable in accordance with the provisions of chapter 7, title 5, United States Code, by the United States District Court for the Eastern District of Virginia or the U.S. District Court for the Federal judicial district where the FICU's principal place of business is located. Any request for judicial review under this section must be filed within 60 days of the date of the Board's final decision. If any appellant fails to file before the end of the 60-day period, the Board's decision shall be final, and the appellant shall have no further rights or remedies with respect to the request.

#### **§ 750.7 Applicability in the event of liquidation or conservatorship.**

The provisions of this part, or any consent or approval granted under the provisions of this part by NCUA, will not in any way bind any liquidating agent or conservator for a failed Federally insured credit union and will not in any way obligate the liquidating agent or conservator to pay any claim or obligation pursuant to any golden parachute, severance, indemnification or other agreement. Claims for employee welfare benefits or other benefits that are contingent, even if otherwise vested, when a liquidating agent or conservator is appointed for any Federally insured credit union, including any contingency for termination of employment, are not provable claims or actual, direct compensatory damage claims against such liquidating agent or conservator. Nothing in this part may be construed to permit the payment of salary or any liability or legal expense of any IAP contrary to 12 U.S.C. 1786(t)(3).

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## **NATIONAL CREDIT UNION ADMINISTRATION**

### **12 CFR Part 740**

**RIN 3133-AD83**

#### **Accuracy of Advertising and Notice of Insured Status**

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

**ACTION:** Final rule.

**SUMMARY:** The NCUA Board is amending certain provisions of NCUA's official advertising statement rule. Specifically, insured credit unions will be required to include the statement in a greater number of radio and television advertisements, annual reports, and statements of condition required to be published by law. The NCUA Board also

is defining the term "advertisement" and clarifying size requirements for the official advertising statement in print materials.

**DATES:** The rule is effective June 27, 2011. To minimize the costs to credit unions and provide ample opportunity to prepare for the revisions, the mandatory compliance date is January 1, 2012.

**FOR FURTHER INFORMATION CONTACT:** Frank Kressman, Senior Staff Attorney, Office of General Counsel, at the above address or telephone (703) 518-6540.

#### **SUPPLEMENTARY INFORMATION:**

##### **A. Background**

Section 740.5 of NCUA's regulations requires each insured credit union to include NCUA's official advertising statement in all of its advertisements, including on its main Internet page. 12 CFR 740.5(a). The official advertising statement is in substance as follows: "This credit union is federally insured by the National Credit Union Administration." Insured credit unions, at their option, may use the short title "Federally insured by NCUA" or a reproduction of NCUA's official sign, as depicted in § 740.4(b), as the official advertising statement. 12 CFR 740.4(b); 12 CFR 740.5(b).

The official advertising statement must be in a size and print that is clearly legible. 12 CFR 740.5(b). If the official sign is used as the official advertising statement, an insured credit union may alter the font size to ensure its legibility as provided in § 740.4(b)(2). 12 CFR 740.4(b)(2); 12 CFR 740.5(b).

As noted in the current rule, however, a number of advertisements need not include the official advertising statement.<sup>1</sup> Among those currently

<sup>1</sup> Exempted advertisements in the current rule include: (1) Statements of condition and reports of condition of an insured credit union which are required to be published by state or federal law or regulation; (2) Credit union supplies such as stationery (except when used for circular letters), envelopes, deposit slips, checks, drafts, signature cards, account passbooks, and noninsurable certificates; (3) Signs or plates in the credit union office or attached to the building or buildings in which the offices are located; (4) Listings in directories; (5) Advertisements not setting forth the name of the insured credit union; (6) Display advertisements in credit union directories, provided the name of the credit union is listed on any page in the directory with a symbol or other descriptive matter indicating it is insured; (7) Joint or group advertisements of credit union services where the names of insured credit unions and noninsured credit unions are listed and form a part of such advertisement; (8) Advertisements by radio that do not exceed thirty (30) seconds in time; (9) Advertisements by television, other than display advertisements, that do not exceed thirty (30) seconds in time; (10) Advertisements that because of their type or character would be impractical to

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