

LEGAL UPDATES AND NEWS

NCUA Adopts New Rule on Indemnification Payments to Directors, Officers and Employees

Overview

The National Credit Union Administration (“NCUA”) has adopted final rules governing the indemnification of directors, officers and employees of federally insured credit unions (“FICU”). This Rule implements the authority granted to the NCUA in 1990 to adopt rules governing indemnification payments by FICUs.

Under the Rule, FICUs, regardless of their financial condition, are prohibited from paying or reimbursing an institution affiliated party’s (“IAP”) legal or expenses incurred in an administrative or civil action instituted by the NCUA or a state regulatory authority where the IAP is assessed a civil money penalty, removed from office or placed under a cease and desist or required by an order from the NCUA to take an affirmative action, such as restitution.

Applicability

This Rule applies to all federally insured credit unions and their IAPs, which include directors, officers and employees.

One of the most prevalent concerns raised during the rulemaking process was that the indemnification rule would make it difficult to provide any indemnification to credit union volunteers, especially credit union board members who generally serve without pay on a voluntary basis. NCUA has responded by emphasizing that the rule is limited in scope to administrative actions brought by the NCUA or appropriate state regulator. The Rule is not a blanket prohibition on indemnification payments and applies only to administrative

actions brought by the NCUA or appropriate state regulator.

This Rule does not preclude the FICU from making 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 in an administrative proceeding or in a civil action brought by the NCUA or state regulator.

Full Indemnification Available Where the IAP Is Absolved of All Charges

Full indemnification is available if an IAP is absolved of all charges related to a violation of law or breach of fiduciary duty by the NCUA or state regulatory authority. Full indemnification is also allowable regarding any action that is not an administrative action brought by the NCUA or appropriate state regulator.

Partial Indemnification Available Where the IAP Is Absolved of Some, But Not All, Charges

Partial indemnification is available 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 in cases where there is a final prohibition order against the IAP.

FICU Board of Directors May Advance Legal or Professional Expenses to the IAP

Indemnification payments are not prohibited until the administrative action results in a final legal order or settlement. Therefore, an FICU may choose to advance reasonable legal and professional expenses to an IAP to assist in defending themselves against administrative actions. The decision to approve an advanced payment 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; and
- The payment will not materially adversely affect the FICU’s safety and soundness

In addition, the IAP must provide the board of directors with:

- A written affirmation of his or her good faith belief that the IAP acted in a manner he or she believed to be consistent with his or her fiduciary duty;
- 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.

In essence, the board of directors should consider whether, based on the facts presently available to them, the IAP has acted consistent with his or her fiduciary duties and whether any negative financial effects indemnification payments would have on the FICU. The NCUA emphasizes that the board of directors should consider the IAP’s ability to repay the FICU in the event the administrative action results in a final order or settlement where 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 action.

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If you would like more information about this final rule, please do not hesitate to contact one of the following attorneys:

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