

## Corporate Governance Update

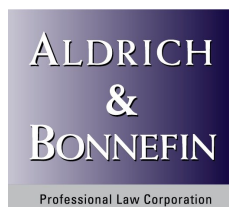
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### D.C. DISTRICT COURT OVERTURNS PART OF NCUA'S FOM RULE

The Federal Credit Union Act (FCUA) limits the membership of federal credit unions to certain defined categories. A “community credit union” is one category in which a federal credit union serves persons or organizations within a well-defined “local community, neighborhood or rural district.” 12 USC 1759(b)(3). The statute gives the NCUA authority to establish criteria for defining a local community, neighborhood and rural district. 12 USC 1759(g)(1). On October 27, 2016, the NCUA published a final rule amending its chartering and field of membership (FOM) rules (Final Rule). 81 FR 88412. The NCUA’s purpose in revising the rule was to maximize access to federal credit union (FCU) services to the extent permitted by law. In general, the rule implements changes in policy affecting: (i) the definition of a local community, a rural district, and an underserved area; (ii) the chartering and expansion of a multiple common bond credit union; (iii) the expansion of a single common bond credit union that serves a trade, industry or profession; and (iv) the process for applying to charter or to expand an FCU. Part One, Section II.A.1.c. of BCG Standard Procedures Manual #17, *Managing Financial Institutions*, provides a detailed discussion of the NCUA Final Rule.

Shortly after the NCUA issued the Final Rule, the American Bankers Association (ABA) filed suit in federal court seeking to overturn the Final Rule. Specifically, the ABA argued that the Final Rule allows community credit unions to operate even though their FOM is not limited to a single, well-defined local community, neighborhood, or rural district as defined in the statute. As such, the ABA sought to overturn: (1) the expanded definition of well-defined local community; and (2) an increase in the population limit for rural districts. On March 29, 2018, in *Am. Bankers Ass’n v. NCUA*, 2018 U.S. Dist. LEXIS 52632 (D.D.C. Mar. 29, 2018), a U.S. district court judge overturned two portions of the NCUA’s Final Rule: (i) the combined statistical area as a local community; and (ii) the population increase for rural districts. The court’s rationale is discussed in turn below. However, the judge did not overturn two other portions of the rule: (i) the elimination of the core area service requirement; and (ii) allowing the addition of adjacent areas to an existing service area.

***Combined statistical area as a well-defined local community (WDLC).*** The Final Rule defined a WDLC as any contiguous portion of a “combined statistical area” (CSA) designated by the Office of Management and Budget (OMB) that did not exceed 2.5 million people. The court held that since WDLC language in the statute suggests a geographically limited area, the definition in the



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Final Rule was manifestly contrary to the statute. The court reasoned that this expansion was unreasonable since any part of a CSA would qualify as a local community no matter how geographically dispersed so long as it contained fewer than 2.5 million people. The court illustrated this by drawing a narrow red rectangle through portions of Virginia and Pennsylvania that stretched north and south. The court stated that this strip would qualify as a single local community even though the residents lived 200 miles from each other and might share no commonality whatsoever. As such, the court vacated this portion of the Final Rule.

**Rural districts.** The FCUA does not mandate a population limit for a rural district. Prior to adopting the Final Rule, the FOM requirements restricted an area's total population to no greater than either 250,000 people or 3 percent of the population of the state in which most of the proposed rural district's residents would be located. The Final Rule revised the definition to increase the rural district population cap to 1 million and removed the 3 percent alternative.

The Final Rule also changed provisions that permitted the expansion of a rural district beyond the boundaries of the state in which an FCU maintains its headquarters. Under the FOM Final Rule, to qualify as a rural district, an area's boundaries must not exceed the outer boundaries of the states that are immediately contiguous to the state in which the credit union maintains its headquarters (that is, not to exceed the outer perimeter of the layer of states immediately surrounding the headquarter's state).

The court held that while the statute allows the NCUA to define the term rural district it must do so only within the bounds of reason. The court noted that since the FCUA's inception in 1934, the use of the term "rural district" has carried a distinct meaning – that is, it refers to areas much smaller than a state. Moreover, the court noted that there have been dozens of judicial decisions in which the phrase "rural district" was used to simply distinguish from urban areas and that none of the opinions appeared to envision a rural district approaching the size of a state. As such, the court held that the NCUA's definitional decision was unreasonable and manifestly contrary to the statute. The court reasoned that the low threshold for the rurality requirement in conjunction with the population increase allowed the service area to expand well beyond what the statute intended.

In sum, this was a partial victory and a partial loss for both the ABA and NCUA. Both sides have indicated they will continue to fight. However, whether an appeal is filed remains to be seen. For more information on the Final Rule contact Mark Aldrich at [MAldrich@ABLAWYERS.COM](mailto:MAldrich@ABLAWYERS.COM) or Joel Cook at [JCook@ABLAWYERS.COM](mailto:JCook@ABLAWYERS.COM).