

**H.R. 3206, THE CREDIT
UNION CHARTER CHOICE ACT**

HEARING
BEFORE THE
SUBCOMMITTEE ON
FINANCIAL INSTITUTIONS AND CONSUMER CREDIT
OF THE
COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES
ONE HUNDRED NINTH CONGRESS
SECOND SESSION

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H.R. 3206, THE CREDIT UNION CHARTER CHOICE ACT

Thursday, May 11, 2006

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
AND CONSUMER CREDIT,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:07 a.m., in room 2128, Rayburn House Office Building, Hon. Spencer Bachus [chairman of the subcommittee] presiding.

Present: Representatives Bachus, Royce, Jones, Miller of California, Hensarling, Neugebauer, Price, McHenry, Kanjorski, Waters, Sanders, Watt, Sherman, Moore of Kansas, Baca, and Matheson.

Chairman BACHUS. Good morning. The Subcommittee on Financial Institutions and Consumer Credit is called to order. I'm going to reserve my opening statement until after the first panel has given their testimony. But at this time, I'm going to recognize Mr. Sanders for an opening statement.

Mr. SANDERS. Good morning, Mr. Chairman. Thank you for holding this important hearing, and I would like to welcome our witnesses here this morning.

Today we will be learning more about H.R. 3206, the so-called Credit Union Charter Choice Act. Mr. Chairman, I have serious concerns about this legislation. In my opinion, we should not be making it easier for non-profit credit unions owned by their members to convert to for-profit banks owned by stockholders. I strongly believe that there should be more, not fewer, credit unions in this country.

Mr. Chairman, before 1998, only six credit unions converted to banks. That's mainly because during that period, the majority of credit union owners had to approve the conversion, and they also had to receive written permission to convert by the NCUA. But after 1998, the law was changed to make it much easier for these conversions to take place, and as a result, 23 credit unions have converted to banks since that time period.

I think Congress made a mistake by changing the conversion law in 1998. That is one of the reasons why I'm a proud co-sponsor of the Credit Union Regulatory Improvement Act that, among other things, amends the Federal Credit Union Act to require a minimum of 20 percent of the members to cast a vote regarding the conversion of credit unions.

Mr. Chairman, let us not be fooled. In many instances when credit unions convert to banks, a handful of senior executives can reap substantial monetary gains. For example, after the Community Credit Union in Plano, Texas, converted to ViewPoint Bank not too long ago, documents filed with the Securities and Exchange Commission showed that the former credit union CEO stood to gain roughly \$1 million through a run-up in its stock prices, etc., etc., etc.

So Mr. Chairman, I will give you back the gavel, but I want to express my concerns about this legislation. Thank you very much.

Chairman BACHUS. Thank you, Mr. Sanders. I appreciate your remarks. At this time, are there any other members wishing to make an opening statement? Mr. McHenry?

Mr. MCHENRY. Thank you, Mr. Chairman, and thank you for holding this hearing today on H.R. 3206, the Credit Union Charter Choice Act bill that I introduced to varying degrees of fanfare last year. I'd like to thank Chairman Johnson for being here today; I've enjoyed our discussions. I thank you for serving on the NCUA board, and thank you for serving previously in the State Senate in Iowa. I'd also like to thank Steve Polakoff from OTS for being here and being willing to testify.

I trust that we'll have a lively discussion with the second panel as well; they represent various credit union industries and the banking community, including my good friend Marc Schaefer from Truliant Credit Union in my home State of North Carolina. Marc and I—Marc is also part of the National Association of Federal Credit Unions. Marc and I have had wonderful discussions over the last 2 years in my service in Congress.

Now, you've asked me when I became interested in the credit union conversion issue. Last year, I learned about the conversions of Community and Omni America Credit Unions in Texas, and found the process to be, at the time, ridiculous. Actually, to quote myself, I think I said, "re-freaking-diculous." Again, to varying degrees of fanfare.

As I looked at that process, I saw a need which fits into my overall philosophy of government, which is common sense regulation and reasonable regulatory oversight. Specifically, the conversions and interaction with the NCUA in later litigation drew my attention to an area of potential regulatory overreach or mismanagement.

We can all have honest disagreements and debate about the merits of any particular conversion. However, conversions are the law of the land, and should be handled with integrity in a professional manner that does not have the appearance of any bias toward one particular charter or outcome.

The basic goals of my bill are threefold. First, to provide for full disclosure to the members of credit unions regarding the conversion from the credit union charter to the mutual savings charter. Second, to limit the arbitrary decisions by the NCUA that overturn the will of credit unions' members through free and fair elements. And third, to protect the rights of members to change the charter of their credit union if it is the will of the members, even if some in the industry disagree with the choice.

The Credit Union Charter Choice Act is not anti-credit union, as some have claimed. Instead, it is pro-credit union member, as it protects them from arbitrary bureaucratic decisions that overturn their will.

My bill would prevent speculative rhetoric that discusses things that may or may not happen in the future, and are covered by regulations from other Federal regulators. There's absolutely no need for the NCUA to require speculative disclosure on procedures of conversions that have well-established rules and regulations overseen by a world class regulator such as OTS.

I believe the ownership issue is a red herring used by credit union activists to prevent conversions. If a credit union converts to a mutual savings bank, it is simply changing the form of ownership of the members, not eliminating their ownership.

Additionally, if a credit union further wishes to convert from that mutual savings bank, there is an additional regulator at the OTS that governs that process by which they can switch to a stock-letting operation, and again, still retaining a different form of ownership, but ownership nonetheless.

On many occasions, I've had the opportunity to have productive conversations with interested parties on both sides of this issue. I'd like to thank the National Association of Federal Credit Unions, or NAFCU, for their willingness to bring forth constructive ideas, including a white paper on the conversion process, as they have continued to engage me in a productive dialogue to this day. I especially enjoyed speaking before over 500 participants at last year's NAFCU conference here in Washington, D.C. In fact, I think I even convinced most of them that I don't have horns and a tail.

And I am certainly pleased to see the recent addition to the board of NCUA with Rodney Hood from North Carolina, and Gigi Hyland as well. I think they have fine experience and will be a wonderful addition, as well as the new director of public and government relations, John McKechnie, who's been a fixture in the credit union industry for many years.

To conclude, I hope that we have a productive hearing talking about the future of this conversion process, not dwelling on the past. And thank you, Mr. Chairman, for your indulgence.

Chairman BACHUS. Thank you. Mr. Moore does not have an opening statement. Mr. Miller or Mr. Royce?

Mr. ROYCE. Thank you, Mr. Chairman. I want to welcome all of the witnesses here today, and especially Chairwoman Johnson from the NCUA board.

We are covering some important issues today, and I think all of us realize that credit unions play a very vital role in our economy and our financial system. And we need to ensure that they continue to receive proper supervision.

To that end, I look forward to the hearing that this subcommittee is going to be holding in the near future on the bill that my colleague and I, Mr. Kanjorski and I, have introduced to modernize the regulatory system for credit unions, H.R. 2317, the Credit Union Regulatory Improvements Act, or CURIA, unlike the legislation we're looking at today, will most importantly make long overdue revisions to the capital standards for credit unions. And I thank you again, Mr. Chairman, and I yield back.

Chairman BACHUS. I appreciate your remarks, Mr. Royce. Mr. Miller?

Mr. MILLER. Thank you, Mr. Chairman. I've been a supporter of credit unions since I was a kid. My mother was a retail clerk. So if we got anything, it was because a credit union lent her money to buy a sofa or whatever else she needed.

And you're unlike a stock-owned institution that exists basically for the enrichment of a handful of stock owners. Credit unions exist for the benefit of each and every member of that credit union. So it puts you in a different category, as far as I'm concerned, and I think we shouldn't do anything to prevent conversions from taking place, but we must ensure that the rights of credit union members are protected in this process.

And that's the difficult process for you, to make sure that they're informed, they're aware, they understand, and that the direction you're going is beneficial to the membership. Change and structure of credit unions should be done in a very well-informed manner to, basically, a well-educated membership. And education, again, is also the charge that you have to undertake. It's critical that credit union members have information that's prominent, accurate, and easy to understand, because not everybody is involved in the business sector, and specifically, not everybody's involved in what you do as a credit union as lenders and such in the charge you've undertaken. Members deserve to know that charter change will affect the credit union and the rights of membership in this position in a positive way. And that's important to have this hearing today, to hear your side of the argument.

I know you have some opponents who think that you shouldn't exist; but you exist for a good beneficial purpose. You are non-profits; you are there for the benefit of the members. And that's why I think any change needs to be done in a structurally beneficial way to the membership, and I look forward to the testimony. I yield back. Thank you, Mr. Chairman.

Chairman BACHUS. Thank you, Mr. Miller. And Mr. Hensarling, I apologize. I think I probably should have gone by the order we arrived, and I didn't. I recognize you at this time.

Mr. HENSARLING. Well, thank you, Mr. Chairman. Better late than never.

One, I want to thank you for holding this important hearing, and I want to thank the gentleman and commend the gentleman from North Carolina for his leadership on an issue that I think is important to our committee. I think, as a Nation, our citizens enjoy a multiplicity—they benefit from a multiplicity of financial institution models.

If you're a resident of the Fifth District of Texas, you can choose to keep your money with CitiBank of New York, but you can also choose to keep your money in City Bank of Forney, Texas—that's "City" with a "y"—and my good friend Jim Golston will treat you to a cup of coffee. You can do business with City Credit Union in Dallas, Texas, and my good friend Mike Kelly will also provide you with a cup of coffee. And if memory serves me right, his coffee was a little better than Jim Golston's.

You have an opportunity to put your money in a thrift, a State bank, a Federal bank, one regulated by the OCC, the FDIC, the

Fed. And even in our country, you are free to put your money under a mattress. And I think that is what benefits our Nation greatly. But I fear that there could be some erosion of consumer choice if we do have an agency that is biased in the area of conversions.

I became involved in this issue when a nearby credit union, Community Credit Union, was involved in a charter conversion. I became convinced that a billion-dollar transaction was held up based on how a single piece of paper was folded.

I had a very good dialogue with the NCUA chairman, who has always been very accessible, very professional, and has always provided me with the information that I needed. But I think at the end of our dialogue, we agreed to disagree.

However, I would point out that the Federal Court found in this case that the agency had acted, I believe, "in an arbitrary and capricious manner." So I think at the end of the day, they might have come closer to agreeing with me than with her.

I want to ensure that, as a matter of public policy, we work together to ensure that we have full and fair disclosure, but that public policy ought to be neutral as to where people choose to put their money and what financial institutions that they choose to do business with. And what I hope I don't see is an agency that is putting a Berlin Wall around their particular financial institution model to where there is no freedom of departure.

And so I hope that these hearings will shed light on that issue, and that we can work together for a common goal. With that, Mr. Chairman, I yield back.

Chairman BACHUS. Thank you. Ms. Waters?

Ms. WATERS. Thank you very much, Mr. Chairman. Good morning. Mr. Chairman, I'd like to thank you for holding today's hearing on H.R. 3206, the Credit Union Charter Choice Act. And I want to categorically state my continued support for credit unions.

Back in February of 2006, when I spoke before more than 1,500 members of the Credit Union National Association at their annual conference in Washington, I emphasized my strong support for credit unions. There are 9,000 credit unions operating in the United States. In California, there are some 2,000 credit unions. And what I think is remarkable is that there are more than 100,000 members of credit unions living in my district. While this evidence suggests that credit unions are an important financial resource to large numbers of persons in communities around the country, it does not show that credit unions are oftentimes the bedrock of many communities.

Credit unions create a financial buffer in communities where low and moderate income, disabled elderly, and working families live, and where predatory lenders, payday loan shops, and the like often flourish. The 100,000 credit union members who live in my district are not without alternatives for their banking and credit needs. But many of them have been able to work with their credit unions to achieve their dreams of higher education or mortgage, home improvements, their first car, etc.

H.R. 3206 is designed to address the charter conversion process. Specifically, H.R. 3206 addresses the voting process, rationale for the conversion, and the material effects of the conversion. Each of

these individual provisions of H.R. 3206 is important since conversions of credit unions to mutual thrift institutions has occurred numerous times since 1998.

In addition, the proposed legislation clarifies what type of information credit unions may or may not be required to disclose related to the conversion. On its face, the reporting requirement may not seem important, although it is directly tied to questions of fraud and abuse.

The legislation is simple enough. But the real question is whether this important legislation is balanced. Does the legislation have the support of all the interested parties, support of the credit union thrift and banking industries, and support of the credit union and thrift regulatory authorities? Rarely do the separate industries' regulators see things alike. And today, we have an opportunity to shed light on whether the conversion issue is controversial, or just one big turf battle.

As such, I'm very anxious to hear today's testimony about the conversion process and what H.R. 3206 will mean for credit unions, the regulatory authorities, and our financial services system. More important is what H.R. 3206 will mean to the members of our Nation's 9,000 credit unions.

I look forward to working with my colleagues on the subcommittee to answer many of these questions raised by the conversion process, and I thank you, Mr. Chairman. I yield back the balance of my time.

Chairman BACHUS. Thank you. I recognize Mr. Kanjorski and Mr. Baca. And other than that, I think those are the last two members who have opening statements, and then we'll go to our witnesses.

Mr. KANJORSKI. Mr. Chairman, I don't have a formal opening statement, although I wish to congratulate you for holding this hearing, because I think the issue of conversions is important. We haven't had an opportunity to revisit it since 1998. And quite frankly, in that conference, I remember quite well that two of my great reservations were the opening of the door toward allowing conversions, and my fears have proved correct. Since 1998, 21 credit unions have left the movement and exercised their right of conversions.

I look forward to the testimony today with a decided confession that I am not one of those individuals who want to encourage conversions, and certainly the weakening of what we have now, but in fact, would want to strengthen what we have now against conversion.

And if we move toward a lighter, more amenable way of converting, I fear that this may be the step in the door for taxation of those accumulated equity positions that credit unions have, or some way to empower the regulator to direct that those equities built up over the year not contributed by the present membership of a credit union be transferred or converted to some existing credit union, so the intent of the money continues on, as opposed to enriching the immediate leadership of the credit union, particularly without the strong majority support of the members of the credit union.

We should have an ability for conversion, but it should be a high standard, and certainly shouldn't be something that attracts the speculative part of our community to encourage that as a nature of rating credit unions. Thank you, Mr. Chairman.

Chairman BACHUS. Thank you. Mr. Baca?

Mr. BACA. Thank you very much, Mr. Chairman, for having this meeting this morning, along with Ranking Member Frank. I'm pleased to be here, and I look forward to hearing the witnesses.

Credit unions provide an important financial option for consumers. And in my district, we provide portable service to over 115,000 individuals. And they basically are in our communities, which are very important. A lot of the banking industries and others are not located in a lot of our communities. And they do a lot of outreach in the community, so they're an important part.

Unlike banks and thrifts, credit unions exist to provide service to their members, and not to maximize the profit outside of the investors or stockholders. All excess income is returned to their members in the form of the highest deposit rates, lower loan rates, and lower fees, which is important when you're operating and dealing within the communities, that you give lower loan rates and lower fees. And that's why they play an important part within our communities, because they do that outreach within the communities, with close proximities to a lot of the individuals of different diversities within our communities.

Every credit union member is entitled to equal ownership. And that's important. Equal ownership and one vote, regardless of how much money they have on deposit. With so much at stake, the decision to convert to mutual thrift is critical. In order for members to decide whether or not for conversion is in their best interest, the process must remain open and transparent. And that is important, remain open and transparent.

Members deserve accurate and complete information about all aspects of conversions so that they can make an informed decision about the best route to take. We must move past the politics. And I state move past the politics and focus on the best way to provide full and fair disclosure to credit union members that are considering this option. It's important for them to know their options, and to be fair and adequate and to disclose what could occur and how it will impact them.

Any legislation that Congress considers must protect the fundamental rights of each and every one of its members and individuals.

Again, I thank the witnesses for coming in. I look forward to their testimony, and I yield back the balance of my time.

Chairman BACHUS. Thank you, Mr. Baca. We have two Floor votes at this time. As soon as those votes are over, we will hear from our first panel. And I'm going to propose to the committee—and I don't think it violates the law to have the second panel then give their testimony, and then just address questions to both panels. Would that be—would that work?

The CLERK. I don't think we should have them both up there at the same time.

Chairman BACHUS. You don't think there's enough room? We won't do that. All right. There's too many frowns in the audience. I like to see happy faces. So we will keep the panels separated.

And let me—I'll say this. I was going to make my opening statement after the witnesses spoke. But this hearing, the title of it is H.R. 3206, the Credit Union Charter Choice Act, by Mr. McHenry. But the hearing obviously is going to cover the broader issue of credit unions converting. And there are obviously concerns that members have over the process, and I share those concerns, particularly about transparency and disclosure during those conversions.

And in particular, one of the questions I'll be focusing on is the requirement in the law before 1998 that 20 percent of the membership participate in the vote. To me, that, at least on its face, appears to be a reasonable requirement. I know it may have been part of a bargaining process, and that it was bargained away. I don't know. I would like to know the history of why that provision was taken out.

But it is important—when a credit union converts to another form of institution, that the credit union members are informed of exactly what process is going forward and how they will be affected, and how those that are leading the conversion effort, how they may benefit in the future going forward.

I think that we all share—I think all of us on both sides of the aisle see the value of disclosure and transparency in the process, and the people being fully informed before they make decisions. And hopefully, not this year, but maybe next year, we'll look at what regulations are enacted in response to our concerns, and take it from there.

But at this time, we'll recess until the conclusion of the second vote on the Floor, which at that point, we'll reconvene.

[Recess]

Mr. NEUGEBAUER. [presiding] The chairman has asked me to fill in for him for a little bit. He has to go and do another event. This is kind of a busy day, as you probably know. And in the interest of time, we're going to go ahead and hear from the panels. The chairman did want me to let the panel know that he will review your written testimony, and he's very interested in this. And so I'm going to then ask for the panelists to issue their opening statements.

And the first panel member that we'll hear from is the Honorable JoAnn Johnson, chairman of the National Credit Union Administration. Ms. Johnson, welcome.

**STATEMENT OF JOANN JOHNSON, CHAIRMAN, NATIONAL
CREDIT UNION ADMINISTRATION**

Ms. JOHNSON. Thank you, Mr. Chairman, and members of the committee, for the opportunity to testify today on H.R. 3206, the Credit Union Charter Choice Act, and on the subject of conversions in general. I appreciate that members of this committee, and Congressman McHenry in particular, are focusing on the issues of transparency in credit union conversions.

NCUA has learned from recent experience with conversions, and appreciates the attention that you are giving to what is a very im-

portant public policy matter. We welcome the opportunity to discuss these issues. These issues matter a great deal to federally-insured credit unions and their 84 million members. They relate to the fundamental concepts of ownership, and the rights of those owners to make informed decisions about their financial institutions.

Credit unions, unlike other types of depositories, are not-for-profit financial cooperatives owned by their members and governed by a volunteer board of directors whose fiduciary responsibility is to act in the members' best interest. Every member has the right to vote on fundamental matters related to the structure of the credit union, including conversion to another charter type.

NCUA fully supports the right of credit union members to decide the business model that is most appropriate and beneficial for them. That includes voting to change their charter to a mutual or stock bank. If those members believe, after assessing all the pros and cons, that converting to a bank is a better business option for them, NCUA has absolutely no interest in standing in the way.

The essential responsibility of NCUA's regulatory oversight of the conversion process is to ensure that the member-owners of credit unions receive clear, complete, and accurate information about the potential conversion, which will allow them to assess the consequences of a conversion prior to voting.

Members should know what will happen to their ownership rights. Members should know that the rates and services may change. Members should know if the new mutual savings bank will convert to a stock institution. And members should know what will happen to member equity.

Recent history is a relevant guide to what happens post conversion. Among credit unions that converted more than 2 years ago, 21 out of 24, or 87 percent, have converted to stock institutions. When that occurs, 25 percent or more of the equity that had been approved by the former members of the credit union typically is transferred to the directors, officers, and employees of the new institution.

Members who own the credit union and its net worth have a right to know that when they vote on a proposed conversion, the officials who are not only recommending the conversion also stand to benefit personally from this kind of transfer of member equity.

I'm not suggesting that there is anything improper about the management of a corporation having an interest in the company's performance, nor do I believe that stock plans and other methods of employee and director investment are inappropriate. Rather, I do firmly believe that the equity in a credit union belongs to the members, and those members deserve to be fully informed when deciding to give it to others who are positioned to benefit in ways not available to the average member.

NCUA is working on improvements to the regulation that will enhance member involvement in the process, communication, and disclosures. The forum you are offering today allows us to discuss these important matters.

H.R. 3206, Congressman McHenry's bill, addresses several aspects of consumer protection and disclosure in a positive way. For example, his legislation seeks to improve current law by requiring

a secret ballot, and also an independent inspector of elections. It also retains the requirement to notify members 90, 60, and 30 days prior to a vote on conversions. These are three important components in any effort to preserve the rights of credit union members, and we appreciate Congressman McHenry's work in this area.

However, NCUA would not support any legislative change that inhibits the role of the agency in monitoring the disclosures or diminishes in any way the responsibility of the credit union to provide accurate and complete information about the conversion and the vote.

This issue is one of consumer choice and protection. Our commitment is to ensure that members, and only members, control their own credit union. Information is the key; free-flowing, plain English, prominent information that empowers credit union members to make the decision that they believe is best. Again, if that decision is to convert from a credit union to another form of financial institution, that is the members' choice.

We will not be indifferent to any attempt to convert that obscures any of the critical details related to change in structure, change in ownership, and transfers of equity. You in Congress deserve nothing less, nor do America's consumers who are credit union members-owners.

Fellow NCUA board member Hyland has said, "If you believe in credit unions, you believe members have the right to vote to change the form of financial institution they want." You also have to believe that members must receive clear, complete, and accurate information to make a decision as important as whether or not to convert.

I would add that when members are given such an important decision, they must have faith that those who have been charged with overseeing these important procedures have put in place appropriate safeguards to ensure that the members have access to the necessary information in order to make an informed vote.

Thank you very much. I look forward to answering your questions.

[The prepared statement of Ms. Johnson can be found on page 56 of the appendix.]

Mr. NEUGEBAUER. Thank you, Ms. Johnson. And now we will hear from Scott Polakoff, Deputy Director, Office of Thrift Supervision. Welcome.

**STATEMENT OF SCOTT POLAKOFF, DEPUTY DIRECTOR,
OFFICE OF THRIFT SUPERVISION**

Mr. POLAKOFF. Good morning, Chairman Bachus, Ranking Member Sanders, and members of the subcommittee. I appreciate the opportunity to testify for OTS on H.R. 3206, the Credit Union Charter Choice Act. I want to thank you, Mr. Chairman, for holding these hearings, and I want to thank Congressmen McHenry and Gillmor and the other sponsors of H.R. 3206 for their leadership in this area.

Charter choice is a fundamental precept at OTS. Since the agency was created in 1989, many institutions have both left and entered the thrift charter. These so-called "charter flips" are a normal course of business at OTS and throughout the banking industry. In

our view, it is the role of the regulator to minimize regulatory obstacles, reduce burden, and facilitate legitimate business decisions regarding charter choice made by institutions we regulate.

While I cannot represent the views of the other Federal banking agencies regarding the issue of charter choice, I can tell you that all of the banking agencies handle charter flips similarly. Each requires an application to obtain a charter within their jurisdiction, but requires no application to leave their jurisdiction and oversight. While an agency may forward supervisory information to a new regulator, there is generally not a requirement that an institution obtain permission from one of the banking agencies to leave its jurisdiction, except where an institution has pending enforcement or similar issues, or is in potentially troubled condition.

In my written statement, I describe the charter conversion process at OTS, which is the same for any entity or group seeking a new thrift charter, and our mutual-to-stock and mutual holding company, or MHC, conversion process. I will not rehash that discussion here, but I want to clarify several misperceptions regarding membership rights of account holders of a mutual savings association. Similarly, I want to set the record straight on the issue of management benefits when a mutual savings association converts to a stock institution or into an MHC structure.

Some had advanced the notion that credit union members' rights are compromised when a credit union converts to a Federal mutual savings bank. In my view, nothing could be further from the truth. While there are certain differences in the rights of credit union and mutual thrift members, suggestions that one set is more equitable than the other is simply without merit. In fact, from an equity standpoint, a closer analysis of the differences reveals that if there is a judgment to be made, the rights accorded thrift mutual members are fundamentally more equitable than the rights accorded credit union members.

For example, credit union voting is conducted on a one member, one vote basis, while the Federal mutual thrift charter provides for one vote per \$100 on deposit, with the association being able to set, in its charter, the maximum number of votes per member at any number from 1 to 1,000. In our view, this type of voting provision, while different, is arguably more equitable than the one member-one vote rule, since it provides greater voting rights, up to a limit, to members that have made a greater contribution to the institution. And even in small institutions, a member with the maximum number of votes could not exercise control of the institution.

Another issue that has been raised is the fact that members of Federal mutual associations may, in most matters, vote by proxy, while credit union members vote by mail ballot. We do not find this to be a meaningful distinction. Members of a mutual thrift have the right to exercise their vote, whether by proxy or directly. The fact that members have the flexibility to grant management discretionary authority with respect to their vote does not make the voting process less meaningful. And of course, mutual thrift members always have the right to revoke the proxy and vote their shares directly.

Finally, the economic nature of the membership interest in mutual associations and credit unions is quite similar. When a person

becomes a member of either entity, the person has the same rights as other members to participate in dividends or any liquidation of the entity. When a person ceases to be a member, they have no continuing interest in the institution. Membership interest in either entity cannot be transferred, and members of either entity cannot compel management to declare dividends.

Although liquidations of either type of entity are extremely rare, liquidation rights in both entities are similar, with depositors sharing in any remaining equity after liquidation in proportion to the amount of their deposits. I note that this is consistent with providing greater voting rights to members with greater deposit investment in an institution.

The other piece of misinformation that I want to dispel is the notion that management unfairly benefits in the conversion process. This is based on the idea that credit union management is conducting a charter flip through a mutual thrift with the intent of subsequently conducting a mutual-to-stock or mutual holding company conversion to enrich themselves.

In fact, management benefits are limited in a mutual-to-stock and mutual holding company conversion. Most important, before conversion of a mutual holding company stock offering occurs, the members of the institution must approve the transaction. Full disclosure is provided regarding all aspects of the transaction, including management benefits. If members object to management benefits, they may vote against the transaction.

While managers may purchase stock when the institution converts to stock form, such purchases are subject to the same terms applicable to other members. All purchases, including those by management, are subject to maximum limits so that no party acquires control in the conversion. In addition, purchases by all managers are subject to an aggregate limit.

Converting savings associations may also establish an employee stock option plan in mutual-to-stock conversions. These are tax qualified employee benefit plans, and are subject to requirements regarding distribution of stock under the plans. Congress has encouraged the use of these plans, and we believe that they are no less appropriate for newly-converted stock associations than they are for any other type of entity. Again, these transactions are subject to member votes, so that if members object to the transaction, they may vote it down.

Finally, an institution may establish management recognition and stock benefit plans after conversion. OTS rules provide that they may not be established until at least 6 months after the stock conversion, and these plans are subject to a separate shareholder vote. We believe these plans are appropriate, since these institutions compete on the same basis as other stock entities. And stock benefit plans enable institutions to retain and attract qualified management in the same manner as other stock entities.

In summary, there are differences in certain aspects of the operations of a stock savings association from a mutual thrift or credit union, and this may be the very reason why an institution decides to pursue that charter strategy. All entities should be accorded the right, with member approval, to pursue whatever charter best meets their business strategy and needs.

OTS supports all efforts to ensure effective communications between an institution considering a charter conversion and its members. In our view, H.R. 3206 sets forth a clear set of guidelines that clarify appropriate standards of conduct and communications between an institution and its members. Freedom of charter choice only has meaning if members are able to exercise an informed choice.

OTS believes in charter choice and supports the efforts of depository institutions to organize under the charter that best supports their business plan and operating strategy. It is important for all regulators to uphold the basic right of freedom of choice. Regulatory barriers that do not protect consumers or institutions, but rather serve as regulatory obstacles, should be eliminated. The integrity of our financial services system requires this.

Thank you, and I will be happy to answer your questions.

[The prepared statement of Mr. Polakoff can be found on page 100 of the appendix.]

Mr. NEUGEBAUER. Thank you, Mr. Polakoff, for your testimony. I think we're going to have another vote here shortly, so what I'm going to do is I'm going to just briefly start the questioning period here.

Ms. Johnson, in 1998, Congress acted to ensure that credit union members were adequately informed, appropriate disclosures are made, voting requirements are reasonable, and that there were safeguards against insider abuse. In implementing the law, there is concern that NCUA has gone beyond the Congressional intent. And could you explain how you are complying with and not regulating beyond the Credit Union Membership Access Act?

Ms. JOHNSON. Thank you, Congressman. Well, we take our responsibility very seriously. NCUA is required, as you indicated, to administer the vote by statute, and we believe very strongly that as a part of that process, the credit union members should understand, they should know why their credit union is converting. And our efforts have been in that regard to ensure that the members are fully informed prior to taking their vote, and the regulations that we have implemented follow those guidelines.

Mr. NEUGEBAUER. Thank you. Mr. Polakoff, at what point does OTS regulatory authority begin, and does OTS have any role to play when the institution is still a credit union?

Mr. POLAKOFF. Thank you, Congressman. The OTS has a role in a conversion from a credit union to a mutual savings bank in inspecting the voting process. It's only after the conversion is completed that the OTS has a regulatory role in the oversight of the new institution.

Mr. NEUGEBAUER. Thank you. In the interest of time, I'm going to yield back the balance of my time and call on the gentleman from North Dakota, Mr. McHenry. I said North Dakota. North Carolina.

Mr. MCHENRY. Slightly different accent, Mr. Chairman.

Mr. NEUGEBAUER. Yes. Well, geography relocation.

Mr. MCHENRY. A lot like Texas.

Mr. NEUGEBAUER. Yes.

Mr. MCHENRY. Thank you, Mr. Chairman. If I may begin with Mr. Polakoff. In a typical conversion to the stock form of owner-

ship, do the executives of the institution profit by obtaining stock far in excess of that available to the institution's members?

Mr. POLAKOFF. Thank you, Congressman. The answer to that question is no, that there is a prescribed priority list for the opportunity to purchase stock. And that prescribed priority list starts with eligible account holders. And in fact, while there are five different categories, three of the five categories are account holders, one is the employee stock ownership plan, and the very last is the community. So indeed, it's quite possible that eligible account holders could purchase the entire stock offering.

Mr. MCHENRY. It's possible that all those groups could purchase 100 percent of the stock before management could purchase stock?

Mr. POLAKOFF. Congressman, management can only purchase stock in any of the four priority categories if they are account holders. So the only category upon which an insider, or management, could purchase stock if they're not an account holder is in the very last group, which is the community group.

Mr. MCHENRY. Thank you. Ms. Johnson, to that same end, I read from your disclosure statement from Omni America Credit Union that that previous conversion, which is something—number 3 in your disclosure form. Let me say about your disclosure form with NCUA, there are two things that are good about it.

First of all, the disclosure is clear. It's in plain English. Which for a government agency—

Ms. JOHNSON. We did pretty well there, didn't we?

Mr. MCHENRY.—is pretty good. Second, it's on one page, which, as we've discussed, and I've discussed a number of times here in this committee, that we've mandated so much disclosure that in the end, the consumer, the owner, the member, gets no disclosure, because there's so much of it. So I do want to commend you on having one page and it being in clear English.

However, Mr. Polakoff just explained in the conversion process that what you've included here is materially false. And, you know, to that effort that you said clear, concise—clear, complete, and accurate information, it appears that this number three conversion is materially false.

Ms. JOHNSON. Congressman, I would respectfully disagree. We're talking about the opportunities that are available to management and the employees that is not available to the regular members. There are management retention plans, there are employee stock option plans, and there are stock benefit plans that the average member does not participate in.

Mr. MCHENRY. Do all institutions offer that? Do all stock—forms of institutions offer those benefits?

Ms. JOHNSON. I would have to say I don't know on that. However, I would think that the equity that is transferred, we have seen in this portion just the management, the employees can receive anywhere from 20 to 40 percent of the equity that has been built up by the members.

Mr. MCHENRY. Okay. Mr. Polakoff, is there a limitation on which—in the event that the mutual savings bank then goes to stock institution, which is a possibility of which OTS regulates, not NCUA, is there a limitation on which management can purchase stock?

Mr. POLAKOFF. Thank you, Congressman.

Mr. MCHENRY. Just yes or no.

Mr. POLAKOFF. Yes.

Mr. MCHENRY. Yes. Is it 40 percent?

Mr. POLAKOFF. No.

Mr. MCHENRY. Okay. So it appears to me that, you know, number three, part of disclosure, which is part of the regs here, is materially false. And, you know, certainly as you go forward with the regulatory process, that would be something that I would regard as speculative in nature, which is what my legislation addresses. So Ms. Johnson, if you could consider that going forward, I would be much—I think it would be good for public policy.

Follow up for you, Ms. Johnson. In your testimony, your written testimony, you impressed upon us that the NCUA rules should not be required to be identical to those of other regulators such as OTS. However, CUMAA specifically directs NCUA to write conversion rules that are “consistent with rules promulgated by other financial regulators,” and “shall be no more or less restrictive than that applicable to charter conversions by other financial institutions.”

Your position seems to be in direct conflict with the standards set in law by CUMAA. How do you reconcile this disparity?

Ms. JOHNSON. Congressman, the statute does require that the rules be no more or less restrictive than the other financial regulators. However, it does not say that they are to be identical. And I would just say that the transactions may differ, but the principles remain the same among the Federal regulators, and that is to provide consumer protection and adequate disclosure. I think we both have that goal in mind. And because the transactions differ, there needs to be different information available.

Mr. MCHENRY. And if I may close—

Mr. NEUGEBAUER. The gentleman’s time has expired. In order to get to—and I thank the gentleman from North Carolina, by the way, for that, and I’m going to go to the gentleman from Texas, Mr. Hensarling.

Mr. HENSARLING. Thank you, Mr. Chairman. First I’d like to state again for the record that I could not be more passionately neutral as to the relative merits of doing business with a credit union and community bank, a thrift. And I certainly understand the zeal of those who believe that their particular model is a superior model. I, frankly, reserve my zeal for a competitive marketplace and freedom of choice.

Ms. JOHNSON, in your testimony, I think you stated early on that the—I don’t want to put words in your mouth—that the reason for being or the charter of the institution, that the NCUA is to provide for the safety and soundness, that that is your mission with respect to credit unions. And if that is true, what is the safety and soundness issue involved in charter choice?

Ms. JOHNSON. The role of the regulator, especially that of a financial regulator, includes that consumer protection element. We work together in truth in lending, truth in savings. The regulator is that cop on the beat, so to speak, to look out for the consumer. And this regulation is all about consumer protection, making sure

that the member has the information that they need prior to voting in order to make an informed vote.

And so I would say that the role of regulator is to do exactly that. That is the safety and soundness of the whole financial institutions, that the consumer can go into the institution and know not only are their deposits safe and sound, but that the regulator and the institution is looking at the best interests of the consumer.

Mr. HENSARLING. In conversations that I've had with you and with members of your staff—and again, I do not wish to put words in your mouth—but I've left with the impression that you consider the ownership rights of a member of a credit union to be analogous to those of one who may hold stock equity in a public company. Is that a fair representation of the position? Is that an analogy that has been used before?

Ms. JOHNSON. What I have said is that the member-owner of a credit union is indeed an owner. One member, one vote. And there's a difference between having ownership in a credit union and being a customer of a bank. I mean, there are risks and rewards to ownership. And so—

Mr. HENSARLING. Okay. If I'm a member of a credit union, and I decide to leave that credit union, and I cash out my account, what happens to my equity interest?

Ms. JOHNSON. Let me explain a little bit about what the ownership of a credit union is and how it differs. The Federal Credit Union Act says that a member's shares are equity, and equity in that regard does mean ownership.

A member receives—by being an owner in a not-for-profit cooperative, the member receives benefits through better rates, lower fees. And if the credit union does well, they receive dividends. If there is a voluntary liquidation, all the equity is returned.

However, there are also risks to being a member of a credit union and having ownership in that institution. Because if the credit union doesn't do well, there is no return of dividends, contrary to that of a bank, where a customer has a contract with the bank, a percent of interest on their deposits, etc.

If the credit union would become insolvent, the members in a credit union get theirs after the creditors in regards to uninsured shares. Where—

Mr. HENSARLING. Let me ask you this question, though. I somehow think that the case might be a little bit more persuasive if a credit union in a certain city might represent the last of the Mohicans. I live in Dallas. There are a lot of credit unions there, a lot of good credit unions there. If one credit union decides to have a conversion at the advice of management, if one wishes to stay a member of a credit union, again, in a competitive marketplace as of today, there are a whole lot of choices.

So I'm still trying to figure out if the member didn't invest on the front end, what is he losing if he has the opportunity to vote, and there are still a number of credit unions throughout our land with which he can do business?

Ms. JOHNSON. You're correct. That member should have the right to vote to convert that credit union to another charter of choice, if that's in their best interest. If they have the information and they

agree that that is best for them, they should have that opportunity to vote.

As you know, credit unions are restricted by fields of membership. And when you say whether a member then can just go to another credit union, that may or may not be the opportunity. They may not qualify as a member of another local credit union.

Mr. NEUGEBAUER. I'm going to have to kind of interrupt here. We have a vote, and we're down to 2 minutes. We're going to recess until after this vote. We're going to ask this panel to hold over. We do have some members that have some additional questions before we bring the next panel on. So we're recessed for about 15 minutes here until the end of this vote.

[Brief Recess]

Mr. PRICE. [presiding] The committee will be in order. I want to thank the panel for your patience. We apologize for the interruption. I appreciate your forbearance with the processes here.

We'll return to questioning for this first panel. And Mr. Sherman, are you—

Mr. SHERMAN. I'll yield to anyone else who has questions first. But if I'm the last question of this panel, I'll go forward.

Mr. PRICE. I'll take the prerogative of the Chair and ask a few questions, then, if I may. And I apologize for not being here for your testimony. I've read portions of your statements, and I appreciate that.

Ms. JOHNSON, I have a couple of questions. There seems to be some discrepancy in the number of conversions that folks cite. Some conversion opponents say that 21 converted credit unions have become stock-owned, and others say that seven—that that number is seven, or closer to seven. Do you have any thoughts about that discrepancy, or can you provide me with any clarification on that?

Ms. JOHNSON. Congressman, I'm not sure where the discrepancy lies. But I'm confident in our data, and I would be more than happy to provide that to you if you'd like.

Mr. PRICE. If you would, that would be helpful.

Ms. JOHNSON. I'd be glad to.

Mr. PRICE. I have a question about regulatory consistency. The rules—apparently, your position, or NCUA's position, is that when conversions occur, these rules cannot and should not be identical to those of other regulators. My reading of the rule seems to state that it doesn't require that the rules be identical. It requires that they are no more or no less restrictive. Do either of you have any comments on that apparent discrepancy?

Ms. JOHNSON. Congressman, from my standpoint, you're right, no more or less restrictive. The transactions are different, and so therefore, they certainly can't be identical. If we look closely, there are some things, I'm sure, between the two where OTS may be more restrictive and we're less restrictive, you know, in a very marginal way.

But I think on the whole, the rules are very comparable. We both have the consumers' best interest at heart, hopefully. That's what our goal is. And that is the full intent of our rules, is to provide that consumer protection.

Mr. PRICE. But you would agree that the rule is that it be—that the rules be no more or no less restrictive.

Ms. JOHNSON. That's right. But it's very hard to get them the same. Because, well, for instance, on notification, credit unions are required to send mailings out to all of their members, because it's a restricted field of membership, where a mutual is open to anyone. So as part of their regulation, they post the information in the lobby.

So, you know, do you consider that more or less restrictive? It's just that they're different.

Mr. PRICE. Mr. Polakoff, do you have any comment on those?

Mr. POLAKOFF. Well, Congressman, thank you. If we think of a credit union as a mutual institution, and if we compare that to a mutual savings bank as a mutual institution, a mutual savings bank can be two different charters. It could be a Federal charter or a State charter, and it can go back and forth between the two.

When a Federal mutual savings bank converts to a State charter, it simply provides a notice to OTS, and it is the responsibility of its new regulator to approve the transaction.

Mr. PRICE. Thank you. Ms. Johnson, I also would appreciate your clarifying or helping me understand the differences between the rules for credit unions and mutual banks in terms of the membership or the members of both. Are there, for example, voting rights, the right to request special meetings, the right to nominate directors, amend bylaws, etc.? Would you help me in understanding the differences between those two?

Ms. JOHNSON. I'd be glad to at least try, Congressman. There is a difference in the voting rights of the credit union members and those who belong to a mutual bank. In a credit union, it's one member, one vote. No proxy voting is allowed. In a mutual savings bank, they may allow proxy voting. And as my colleague stated earlier, that could mean \$100 equals one vote, \$100 deposited in the institution, up to a thousand votes.

So very simply, if a person has \$100,000 in a mutual savings bank, they would be allotted a thousand votes. So if you have 10 people, there's 10,000 votes. If I, as a member of a credit union, if that were the case—or if I were a member of the mutual and I only had \$100 on deposit, if I were a single mom or a college student with \$100, I would have one vote.

So I would not say that we have never indicated or tried to insinuate that anyone would have a majority of votes in a mutual savings institution. However, I would have to round up 10,000 of my closest friends with \$100 on deposit in order to equal the votes of those 10 people.

So it's a dilution, or it can be a dilution. It's a different type of voting representation. And I think bottom line, that's the beauty of the credit union system. The little guy counts.

Mr. PRICE. Thank you. I have some other questions that I'd like to be able to submit to you and receive responses.

Ms. JOHNSON. Be glad to.

Mr. PRICE. Thank you. Mr. Sherman, are you ready?

Mr. SHERMAN. Yes.

Mr. PRICE. You're recognized for 5 minutes.

Mr. SHERMAN. Well, thank you. This seems to be a hearing about a solution looking for a problem. I've spent a lot of time in my district over the last 10 years, and no one has ever said, "My life would be made better if only some particular credit union converted to a different structure."

I'm also quite concerned that I've seen non-profit health organizations convert to for-profit, particularly hospitals, and I've never seen a community celebration when a non-profit hospital converts to for-profit status.

From a consumer standpoint, I don't see what the benefit is from such a conversion of a credit union. We also need to be concerned about risks to the taxpayer. Chairman Johnson, when was the last time a credit union failure cost the insurance fund a penny, and when was the last time that lack of money in the insurance fund forced the taxpayers to bail out the credit unions?

Ms. JOHNSON. Congressman, the credit union insurance fund and those deposits have taken care of any credit union failures. There has never been—

Mr. SHERMAN. So the taxpayers never had to come up with a penny.

Ms. JOHNSON. Taxpayers have never bailed out the credit unions.

Mr. SHERMAN. When was the last time there was a credit union failure that cost the insurance fund money? Or is that something that tends to happen somewhere in the country every few months?

Ms. JOHNSON. There can be costs associated with involuntary mergers, and the insurance fund is there for that purpose.

Mr. SHERMAN. Now, if a credit union converts and it has capital—I'm more familiar with this from non-profit health organizations. They convert, and the value of their assets tends to go—well, it tends to stay in the health field. When a credit union converts, who owns the assets?

Ms. JOHNSON. We contend that the member-owners of the credit union own the assets, own that equity. The members have contributed their deposits to the institution, and then, of course, that's—

Mr. SHERMAN. Is that ownership per capita, or per dollar invested, or per dollar invested over a period of time?

Ms. JOHNSON. Ownership in a credit union is one member, one vote.

Mr. SHERMAN. So a credit union could be charging less to its members for loans or paying higher interest rates, and then it wouldn't accumulate quite as much value inside the organization. Or if it accumulates that, it could have a—you know, change its policies and charge less interest and pay more to depositors. So that if a credit union stays as a credit union, the beneficiaries of all that accumulated capital are supposed to be the members, right?

Ms. JOHNSON. Right. The members benefit by lower fees, better interest rates, so that equity that is sitting there at the time of a conversion could possibly have been returned to the members in the form of lower fees or interest rates. That is the members' equity sitting there.

Mr. SHERMAN. So if a credit union stays a credit union, it's supposed to use its capital to benefit its members through lower fees and better interest rates.

Ms. JOHNSON. Products and services, yes.

Mr. SHERMAN. Is there a counter argument that somehow a credit union could convert to another status and its capital could belong to anyone other than the members on a per capita basis? You said you contended that it belongs to the members. Is there somebody out there not wise enough to agree with your contention?

Ms. JOHNSON. We understand the credit union structure very well, Congressman, and it is the members' equity. Perhaps others would disagree. But that is the role of the credit union and their structure.

Mr. SHERMAN. Has there been a credit union conversion where someone other than the members reaped any benefit from that conversion?

Ms. JOHNSON. From the data that we have seen, it's clear that a portion of that equity does have a possibility of being transferred in particular to those who have recommended the conversion process. Now, it's legal, and all we're saying is that the members should be aware that this is available.

Mr. SHERMAN. When you say, "those who have recommended," do you mean outside consultants? Do you mean management? Do you mean board members? How can I get in on this gravy train? You know, send out a hundred letters to a hundred credit unions recommending conversion? I could somehow benefit from this?

Ms. JOHNSON. It's the board of the credit union that makes the decision. It has to be a majority of the board making the decision to do the conversion.

Mr. SHERMAN. How could the board member benefit from making that conversion?

Ms. JOHNSON. Again, Congressman, there are particular options that are available to management and employees that are just not available to the average member. The average member can purchase stock. There's no question. But there are options available that aren't available to each and every member. Again, we're not opposed to that, other than the members should have the opportunity to know that exists.

Mr. PRICE. The gentleman's time has expired.

Mr. SHERMAN. Thank you.

Mr. PRICE. Mr. Kanjorski? The gentleman is recognized for 5 minutes.

Mr. KANJORSKI. Thank you, Mr. Chairman. Chairman Johnson, I've heard a lot of the debate about the efforts of the Dearborn Federal Credit Union to convert. Could you describe that situation for me, and what NCUA's role was?

Ms. JOHNSON. Gladly, Congressman. I think a lot of the information out there has been misinformation, unfortunately. And I'd like to clarify a little bit on the steps that have been taken.

According to their Web site, the board members have been working on or studying the idea of a conversion for the last 4 years. They have had the opportunity to communicate with their members prior to the board taking a vote on whether to convert, but chose not to do so. The allegation is that the credit union has been prevented by NCUA from communicating with their members, and I would very strongly disagree with that. That's not the instance.

Dearborn submitted their application, and then submitted their notices to be sent to their members. They sent them in, and through the process, were required to get back within 30 days to give them, you know, if everything is according to Hoyle, and we did that. They sent their communication to their members. In no part of the process did NCUA restrict their ability to communicate with their members.

Mr. KANJORSKI. I have some very strong predilections against conversion. I've laid that on the table. Because I look at it as a form of rating of assets. And I have a great deal of high respect for the built-up equity of long-existing credit unions that present members have nothing to do with building up.

So for purposes of our discussion, assume that I see this \$1 billion or \$5 billion credit union out there, and I concoct a way that I could go and have an element when only three members show up, and myself and my friend will vote for conversion. And therefore, I will become the recipient of the largesse of the prior constructed equity when I wasn't a member, didn't participate in the credit union movement, or wasn't a member of that specific credit union.

Isn't there some—a vehicle that should be put into place to basically say that credit unions are rather unique institutions insofar as what equity they have is built up in multiple generational development, as opposed to the single member? And this whole idea of converting to a mutual bank, or eventually a stock company, is a method of rating the assets of generational building of equity.

And if people are tired of running the credit union, we have to find a way. Now, they can either, under your office, be merged into another credit union to perform the same function, or if we have too many credit unions in the company and too many assets in credit unions, we could find a trust vehicle or empower the court to act as a trustee to take equity and commit it to like purposes.

But we have in this country today, not only in the credit union movement but in the non-profit corporation movement, a lot of very sophisticated raters that see these pigeons out there with massive amounts of assets that by legal conversion can tap into those assets for their own advertisement or for the, as you had mentioned, the benefit of the managers and the board of the credit union. And the temptation to sell out your fiduciary relationship probably becomes high.

I've seen situations even in non-profit health conditions where a for-profit comes in to buy out a not-for-profit that has a great deal of assets. And generally, when you study the proposition of the president, the general counsel, and those people who have a fiduciary relationship to the public tend to walk away with golden parachutes of incredible amounts, millions and millions of dollars.

I had one general counsel who sold a non-profit health entity out, and his golden parachute was \$16 million. Quite a temptation for a lawyer, even though he's general counsel, and even though he has a fiduciary relationship. And I would imagine that the temptation exists at the credit union movement, particularly in an evolving, growing area where there's less association and identification with the credit union.

What can we do, or what can you do as a regulator, I should ask first, to prevent this concept of rating? And two, of course, I'm part

of a bill with Mr. Royce to move it up to 20 percent, and to provide for a lot of transparency. If I had my way, I'd go to 50 percent back at the overall, and I just wouldn't allow this, what I call, unconscionable rating to occur.

My friend from California asked how he can get in on the gravy train. And the reality is almost any smart lawyer in this town, and consultant, can get in on the gravy train. And it's about to happen. And it's happening not only in the credit union movement, but in the non-profit corporation movement where accumulated assets over generations intended to be done for good purposes are now being diverted to the selfish interest of those people who put the movement on to change the structure. What can we do and what can you do to disabuse what I consider that abuse, or what can we do to change the law?

Mr. PRICE. The gentleman's time has expired. You're certainly welcome to answer the question.

Ms. JOHNSON. Congressman, I think that's where the role of the regulator comes into play. Consumer protection. The best way to protect the consumer is to give them the information that they need. Complete transparency in the process. I have confidence in the credit union member to make the appropriate decision if they only know what they're voting on.

Mr. PRICE. The gentleman's time has expired. I'd ask unanimous consent that Mr. McHenry be allowed to ask one more question.

[No response]

Mr. PRICE. Without objection, Mr. McHenry is recognized.

Mr. MCHENRY. Thank you, Mr. Chairman. It's a simple line of questioning to OTS, and follow-up with Ms. Johnson, just so you're prepared, so we can click through this pretty quickly.

How much litigation has OTS faced in the conversion process over the last year?

Mr. POLAKOFF. Congressman, I'm not aware of any successful litigation against OTS.

Mr. MCHENRY. Okay. Speculation. Do you allow speculation on future operations that may or may not occur in a converted institution?

Mr. POLAKOFF. Congressman, we do not.

Mr. MCHENRY. Okay. Who is allowed to vote in a conversion process from mutual bank to a stock-letting institution?

Mr. POLAKOFF. For a mutual savings bank that converts to a stock savings bank, all the eligible voters, which is a defined term, can vote on that.

Mr. MCHENRY. How is that defined?

Mr. POLAKOFF. It is set, I believe, at 60 days before the vote, up to 20 days before the vote.

Mr. MCHENRY. Ms. Johnson, who's allowed to vote in a credit union conversion?

Ms. JOHNSON. Pardon me?

Mr. MCHENRY. Ms. Johnson, who is allowed to vote in a credit union conversion?

Ms. JOHNSON. All the members are allowed to vote on that conversion.

Mr. MCHENRY. And what is the amount of time they have to be members?

Ms. JOHNSON. The board of directors sets that time line of when that—

Mr. MCHENRY. The board of directors. Okay. OTS sets when the members are allowed—60 days before the conversion?

Mr. POLAKOFF. Congressman, I believe it's no more than 60, no less than 20 days before.

Mr. MCHENRY. Okay. Additionally, how many years has OTS had conversion regs on the books?

Mr. POLAKOFF. We've had credit union conversions starting in 19—

Mr. MCHENRY. No, no. Your conversions which you oversee.

Mr. POLAKOFF. Congressman, since, we believe, the late 1970's or early 1980's, sir.

Mr. MCHENRY. Okay. Ms. Johnson, how long have you had conversion regulations on the books?

Ms. JOHNSON. Just a minute. Let me check. I've been here for 4 years, and I know it's—

Mr. MCHENRY. The answer is since—

Ms. JOHNSON. 1995.

Mr. MCHENRY. Okay. Additionally, Ms. Johnson, the conversion from a mutual savings bank to a stock-letting institution, do you oversee that process at NCUA?

Ms. JOHNSON. No.

Mr. MCHENRY. No. Okay. Then I would simply ask that your disclosures to that end detailing—specifically number three disclosure in your regs, subsequent conversion to stock institution, is not under your regulatory purview. And therefore, your speculation about that is creeping into the area that OTS oversees.

Additionally, what I would add is—off the NCUA regulations on conversions; double-spaced, 12-point font, seven pages. I don't know how small this font is, but certainly a magnifying glass would help. Double columns from OTS, 27 pages of regulation.

I would say, if I could just end this way, Ms. Johnson, meet Mr. Polakoff. Mr. Polakoff, meet Ms. Johnson. Perhaps NCUA could learn something from OTS's regs on the books. As I've said repeatedly in our conversations and to other board members at NCUA, the preferable routes for addressing this conversion process would be through regulation that is clear and concise, where you don't have two attorneys sitting around the table and making a verbal agreement about something that goes on to be litigated.

And as I laughed to a room full of attorneys yesterday, I thought it was humorous that two attorneys sat down and said, "Take my word for it. We're going to have a verbal agreement here," nod, nod, wink, wink, and not expect litigation out of it.

And so I would ask that going forward, perhaps you can speak for a moment or two about the direction that you will be going at NCUA to clarify these regs. And is there anything that you could learn from OTS in their regs?

Ms. JOHNSON. Congressman, we've certainly learned from the process. I wouldn't say learning from OTS, necessarily, because the regs are different. But we've learned through the conversion process, correct.

Mr. MCHENRY. But CUMAA actually says that you should have like kinds, similar regs, as other financial institutions have in their conversion process. That's why you both are on this panel.

Ms. JOHNSON. Correct. The transactions differ, however, but the intent of the regulator is very much the same for ensuring that there's clear and concise information to that person as they make their vote.

The length of the regulations is immaterial, in my mind, if you want short and clarified. I think our disclosure is very much along that line.

Mr. MCHENRY. In closing, just to add one further thing, Mr. Chairman, the plans to convert, OTS says that a stock-letting institution to avoid corporate raters is not allowed—the board of directors is not allowed to talk about a stock offering, and that's strictly prohibited. NCUA details in their offering to members the disclosure on whether or not they will go to a stock-letting institution. Perhaps NCUA regs are leading to further speculation and what Mr. Kanjorski referred to as corporate raters. So perhaps that's something you could address as well, beyond just the speculation in your regs.

Thank you for—and you can answer that question. Thank you, Mr. Chairman.

Mr. PRICE. The gentleman's time has expired. Would you like to comment on that?

Ms. JOHNSON. I would like to make one comment. We do require the credit union to tell the members why they are making this conversion. And in many cases, they indicate that capital—the need for additional capital. In order to acquire additional capital, they have to have moved to a stock institution. So it's not speculative that that's where they're going.

So they indicate up front that capital is an additional need. In order to raise capital, the stock—a move to a stock-held institution.

Mr. PRICE. Thank you. As that was a few more than one question, the final questioner for this panel will be Mr. Kanjorski. And you're recognized for 5 minutes, sir.

Mr. KANJORSKI. Thank you, Mr. Chairman. Mr. Polakoff, do you have any regulations—if I were in a mutual savings entity and I wanted to get out of it, do I have to comply with any regulations, rules, or conditions?

Mr. POLAKOFF. You would simply notify us that you were moving to another sort of mutual form of ownership so it could go to a State charter organization or to a credit union.

Mr. KANJORSKI. Or we could move to a bank.

Mr. POLAKOFF. Well, to move to a—it could be a State chartered mutual bank. Yes, sir.

Mr. KANJORSKI. Well, as I understand it, with credit unions, we haven't taxed them. We give them a special condition because they are an accumulation of equity. But if a set of credit unions want to move out of the credit union situation into a mutual savings, and then move to a mutual bank with stock, which is a for-profit entity, why shouldn't we say well, then, these untaxed assets that aren't being distributed to the creators of the credit union, the past generations, because most of them are dead, and they aren't being distributed to the present membership, why shouldn't we start tax-

ing a portion or the whole amount at a corporate rate so that we capture back untaxed funds before they get in a for-profit organization?

Mr. POLAKOFF. The conversion, Congressman, that I believe we were talking about initially is the conversion from a mutual to a mutual institution.

Mr. KANJORSKI. Right. And it's a step. Let's face it. It's an unspoken step. What they're really doing is going to a for-profit. That's where the consultants, the developers, and the inner core are going to make their money, when they go to the stock. So why should we allow them to avoid taxation in every regard?

My friends in the banking industry are always on my back about the special protection the credit unions get in that they don't pay taxes. And I happen to favor that they don't pay taxes. But now if they're going to move to a for-profit organization, let's recoup back all our unpaid taxes to the Federal Government.

My other alternative would be to put it in a trust and distribute it to a like entity that would carry on the conditions of a credit union. But we don't have that condition in the law yet. I hope we move toward putting that condition in the law. But if we don't have that to protect that acquired equity in past generations, why should we allow them to avoid taxation on those profits and growth of equity?

Mr. POLAKOFF. I would defer to Congress, Congressman, on whether there should be taxation of credit unions or not.

Mr. KANJORSKI. I'm not talking about the taxation of credit unions, now. I'm talking about taxation to recover back assets that are now being converted to stock companies for profit that have never paid any taxes on the conversion. And it's obviously being done for the purpose of somebody making a profit. So if we're going to allow them to make a profit, why shouldn't we tax the assets that they're moving over from the credit union to the mutual savings bank to the bank, the stock bank?

Mr. POLAKOFF. Congressman, I believe the answer to that question resides in the fact that the very first priority of people who can purchase stock in a mutual-to-stock conversion indeed are the shareholders. And I think that may address your concern, sir.

Mr. KANJORSKI. Well, no. I mean, you know, there are a lot of people who are members of a credit union who will never be able to avail themselves. Most people in my district who belong to credit unions are not capable of investing and buying huge blocks of stock to protect their equity. They just couldn't do it. You know, the credit union movement is basically a grassroots, by-your-bootstrap protection of people in need.

In my area, I saw it when we had a recession, people were able to get relocation money from their local credit union, not from the bank, because they didn't have the assets. They didn't make the conditions of the bank loan. But a credit union was able to give a character loan so that people could sustain their family and relocate.

When you're moving out of the credit union movement, and now you're moving toward the mutual savings, and eventually to the mutual bank, now you're moving toward making profit. And I just

can't understand why you aren't up here advocating that boy, this is a chance to start getting back the government's money.

We gave a lot of leniency here to the credit union movement, because it supports something special. But when they voluntarily want to leave that special activity, and they don't want to put those funds into another credit union that would carry on that public purpose, then why shouldn't we at least capture back the tax benefits from that? I know I'm being argumentative here, but can you make an argument of why we shouldn't do it?

Mr. PRICE. The gentleman's time has expired, but you're welcome to answer that question.

Mr. POLAKOFF. Congressman, I certainly don't want to offer an argument to your position. There is an account called a liquidation account, sir. And when an institution goes from a mutual to a stock institution, a liquidation account is established. And down the road, if that stock institution ever is liquidated, the account holders at the institution do take advantage and reap the benefit of that liquidation account, sir.

Mr. KANJORSKI. The present living members.

Mr. POLAKOFF. Yes, sir.

Mr. PRICE. Thank you. The gentleman's time has expired. We want to thank Mr. Polakoff and Ms. Johnson for your testimony and for your patience. There will be some members, I think, who will have questions to submit to you, and we would appreciate prompt responses to those questions. Thank you very much. We appreciate you coming.

I ask unanimous consent to submit the following written testimony into the record: statement of Mr. Alan Theriault, president of CU Financial Services; statement of Mr. Lee Bettis, executive director of the Coalition for Credit Union Charter Operations; statement of Mr. Camden Fine, president and CEO of the Independent Community Bankers of America; and statement of the National Association of State Credit Union Supervisors, without objection.

We want to welcome the panel members on Panel II. We appreciate again your patience this morning and your tolerance of our schedule, and we look forward to your testimony.

Ms. Laurie Stewart, president and CEO of Sound Community Bank, representing America's Community Bankers, welcome; Mr. Tom Dorety, president of Suncoast Schools Federal Credit Union, representing the Credit Union National Association; and Mr. Edward Yingling, president and CEO, representing the American Bankers Association. We welcome you. And for introduction of Mr. Schaefer, I ask Mr. McHenry.

Mr. MCHENRY. Thank you, Mr. Chairman. My good friend Marc Schaefer is president and CEO of Truiliant Federal Credit Union, formerly AT&T Family Credit Union, in Winston-Salem, just right outside of my district. He's been CEO and president for 11 years. And he's at the very forefront of the banker lawsuits against NCUA and credit unions, as he would say.

Marc has addressed hundreds of credit unions, and has been active on the Hill for a number of years, as well as across the country, and in emerging democracies in Central and South America, as well as around the world, to discuss credit unions and financial literacy, which is very important.

Marc is currently serving as the chairman of NAFCU's Credit Union Committee, and is chairman of the NAFCU roundtable as well, as well as a part of CUMAA and a vice chair of one of their subcommittees as well. He lives in Forsyth County, and is very involved in the business community there.

We've had a number of interesting discussions. Again, as I referenced in my opening statement, perhaps he now believes that I do not have a horn or tail, at least not horns. And he's been well-published throughout the credit union industry, as well as in the banking industry, interestingly enough. And we're very happy to have Marc here.

Mr. PRICE. Mr. Schaefer, we welcome you and all panel members. We appreciate you coming today, and look forward to your testimony. I would just remind you of the light system. Five minutes of testimony. The yellow light comes on at 1 minute. And when you see the red light, if you would wrap up, that would be appreciated.

We thank you again very much, and Ms. Stewart, we look forward to your testimony. We recognize you.

**STATEMENT OF LAURIE STEWART, PRESIDENT AND CEO,
SOUND COMMUNITY BANK, ON BEHALF OF AMERICA'S COM-
MUNITY BANKERS**

Ms. STEWART. Mr. Chairman and members of the subcommittee, I am Laurie Stewart, president and CEO of Sound Community Bank in the Puget Sound area of Washington State. Sound Community Bank is a \$214 million community bank created by the conversion of Credit Union of the Pacific in 2003.

I am testifying on behalf of America's Community Bankers in strong support of H.R. 3206, the Credit Union Charter Choice Act. H.R. 3206 is critical to ensuring that the NCUA adheres to the law and follows the intent of Congress.

In the 1998 Credit Union Membership Access Act, Congress attempted to put a stop to NCUA's obstruction of credit union conversions by declaring that credit unions have the right to convert, and by limiting the authority of the NCUA in a conversion process. Congress was so concerned by the NCUA's behavior that it required the NCUA to write rules governing the conversion process that, "are consistent with rules promulgated by other financial regulators." Congress also declared that rules governing conversion votes, "shall be no more or less restrictive than that applicable to charter conversions by other financial institutions."

The NCUA has essentially ignored this mandate and put a de facto end to credit union conversions. The McHenry-Towns bill resolves these problems while still allowing the NCUA to ensure that the methods and procedures of conversion votes are properly followed.

In summary, H.R. 3206 would, number one, force the NCUA to revise its current regulations to eliminate the rules that are speculative, inaccurate, or that conflict with the rules of other financial regulators.

Number two, eliminate regulatory foot dragging that has made the conversion process unnecessarily long and costly. H.R. 3206 requires a reasonable 30 days for the NCUA to approve conversion disclosures.

Number three, this bill eliminates the de facto NCUA gag order that exists for converting credit unions. Under the current system, a credit union is not allowed to communicate with its members during the conversion process without NCUA approval. This prohibits the credit union from explaining its reasons for converting, while allowing conversion opponents to attack it. This creates a one-sided debate, much like a political candidate who must wait for FEC approval to speak while his opponent runs non-stop attack ads.

Number four, the bill restores certainty to the conversion process. When a credit union has a successful conversion vote, the NCUA finds hyper-technical reasons to invalidate the vote. This happened in Texas last year when the NCUA overturned two conversion votes based solely on how a piece of paper was folded. Fortunately, their decision was rejected. But the NCUA's behavior adds uncertainty to the conversion process that frightens away credit unions whose members want to convert.

Mr. Chairman, I want to take a moment to highlight why charter choice is critical to the strength of our Nation's financial system.

Over time, an institution will grow and change. The charter with which it started may no longer be the best fit for it now. My credit union is a good example. We found that the credit union charter prevented us from growing in a manner that best served our members and our community. By converting to a mutual savings association charter, Sound Community Bank was able to retain a mutual structure similar to a credit union. We were able to offer new products and make more loans to help our community grow. Since our conversion in 2003, Sound's loan portfolio has increased by 80 percent. That's 80 percent more loans that are helping the people and businesses of the Puget Sound area.

For some credit unions, converting charters may be an economic necessity. For example, DFCU attempted to convert charters earlier this year because of changing economic conditions in Michigan. Because of the NCUA's hostile actions, DFCU was forced to withdraw its application. As a result, DFCU is unable to diversify its membership and strengthen the institution.

Let me say a word about offering competitive rates. Converting charters has not caused Sound Community Bank to lower deposit rates. In 2004, Sound had the highest money market rate in the Nation, according to BankRate.com. In addition, we now offer a high yield checking account. Contrary to NCUA's mandated disclosures, this is the experience of many converted credit unions.

Mr. Chairman, thank you for inviting ACB to testify. I will gladly answer any questions the committee may have.

[The prepared statement of Ms. Stewart can be found on page 145 of the appendix.]

Mr. PRICE. Thank you, Ms. Stewart. I appreciate your testimony. I now recognize Mr. Marcus Schaefer, president and CEO of Truliant Federal Credit Union, representing the National Association of Federal Credit Unions.

Mr. Schaefer, you're recognized.

**STATEMENT OF MARCUS SCHAEFER, PRESIDENT AND CEO,
TRULIANT FEDERAL CREDIT UNION, ON BEHALF OF THE
NATIONAL ASSOCIATION OF FEDERAL CREDIT UNIONS**

Mr. SCHAEFER. Good afternoon, Mr. Chairman, Ranking Member Sanders, Representative McHenry, and members of the subcommittee. My name is Marc Schaefer, and I'm president and CEO of Truliant Federal Credit Union, located in Winston-Salem, North Carolina. I'm here today on behalf of the National Association of Federal Credit Unions to express our views on the process for credit unions to convert to mutual savings banks, and H.R. 3206, the Credit Union Charter Choice Act.

As with all credit unions, Truliant is a not-for-profit financial cooperative governed by a volunteer board of directors who are elected by our member-owners. Truliant is a multi-occupational credit union serving over 170,000 member-owners, and representing more than \$1 billion in member assets. More importantly, Truliant provides affordable and attainable products and services to our members. Over 16 percent of our members joined through employment in the furniture and textile industries, and over 45 percent through manufacturing jobs. I have personally been involved in the credit union movement for more than 24 years, and have previously served for 9 years on NAFCU's board of directors.

While NAFCU opposes H.R. 3206 as introduced, we would like to thank Representative McHenry and the co-sponsors of the legislation, Representatives Towns, Johnson, King, and Gillmor, for their leadership in the conversion debate, and their openness in considering the concerns of NAFCU regarding the legislation and conversion process.

In 2005, NAFCU formed a task force to study the issue of conversions, and recommended policy changes that should be made in the conversion process to better protect consumers. The work of that task force led NAFCU to outline principles that we believe are important in the conversion process.

NAFCU believes that credit unions should have the ability to convert their charters should it be in the best interest of the members. NAFCU also believes that the only way to ensure that the conversion process is fair is to make sure that the process is transparent so that members are adequately informed of all of the potential benefits and detriments that a conversion may have on the interests of the membership.

NAFCU also supports the ability of NCUA to use all of its powers, as granted by Congress, to effectively regulate Federal credit unions, including ensuring that conversions take place in a fair and consistent manner. In order to achieve these principles, NAFCU believes that the following elements are key to any policy governing credit union conversions.

First, transparency is paramount. As such, a credit union should be required to hold a meeting of its membership prior to the mailing of ballots to announce a credit union's intent to convert. Also, resources should be allocated and/or an opportunity should be provided for members opposed to the conversion to express their concerns. Additionally, clear plain language disclosures should be used to inform credit union members of the vote to convert.

Second, directors and senior management of a converted credit union should not be able to benefit financially from the transaction until at least 10 years after the initial conversion has taken place. Furthermore, there should be full disclosure of the potential maximum benefit a director or senior management could receive if the converting credit union were to then convert to a stock bank after the 10-year period has passed.

Third, a minimum of 20 percent of a credit union's membership who are eligible to vote should cast a ballot, and the majority of those credit union members must then vote in favor of the conversion. This minimum requirement will serve as a quorum of the membership for the conversion vote, much the way that Members of Congress cannot decide an issue without a quorum.

Of the 29 credit unions that have converted to mutual savings banks, 19 have gone on to become for-profit stock-issuing institutions. Unfortunately, this scenario often benefits insiders who receive stock benefits and options to buy additional stock, along with others wealthy enough to purchase stock.

Many members of the credit union may not have the funds to purchase stock, and end up losing their ownership interest in the institution they were once member-owners of when it was a credit union.

In conclusion, while we oppose H.R. 3206 as introduced, we welcome the opportunity to continue the debate on the conversion process in an effort to serve the interest of credit union members. We look forward to working with you, Mr. Chairman, Congressman McHenry, and members of the subcommittee and NCUA on this issue.

At the end of the day, we all want sound public policy on credit union conversions. And I welcome your questions and discussions on this matter. Thank you.

[The prepared statement of Mr. Schaefer can be found on page 111 of the appendix.]

Mr. PRICE. Thank you for your testimony. The Chair now recognizes Mr. Tom Dorety, who is the president of Suncoast Schools Federal Credit Union, representing the Credit Union National Association.

Mr. Dorety.

STATEMENT OF TOM R. DORETY, PRESIDENT, SUNCOAST SCHOOLS FEDERAL CREDIT UNION, ON BEHALF OF THE CREDIT UNION NATIONAL ASSOCIATION

Mr. DORETY. Thank you, Representative Price, and members of the committee. I'm Tom Dorety, president and CEO of Suncoast Schools Federal Credit Union, Tampa, Florida. I also serve on the board of directors and as treasurer of the Credit Union National Association, and I certainly appreciate the opportunity to appear before the subcommittee today on behalf of CUNA to address the issues of credit union conversions to mutual savings banks.

CUNA represents more than 8,800 Federal and State chartered credit unions and their 88 million members. Suncoast Schools is located in Tampa, Florida, and has over \$5 billion in assets and 400,000 members.

CUNA believes that the credit union charter currently provides the best vehicle for serving the financial needs of consumers, and that members have a unique ownership right in their credit unions. At the same time, we do firmly support the right of informed credit union members to exercise their full democratic control of the structure and operation of their credit union. However, we do not believe the Credit Union Charter Choice Act, as drafted, adds any value to the process of a credit union conversion to a mutual thrift charter.

As outlined in my written testimony, CUNA believes there are some important principles that should govern all conversions of credit unions to mutual charters. In particular, we cite the fiduciary responsibility of the credit union board of directors to present objective and honest information to the members, the need for full, plain language disclosure, and that the net worth of the credit union belongs to the members. No unjust enrichment should be realized by directors and senior management upon a conversion to a mutual thrift or subsequent conversion to a stock institution.

Credit unions are unique. We are not-for-profit cooperatives, and appropriately have been granted an exemption from Federal and State income tax. As a result, we provide a tangible economic benefit to our members. Through higher deposit rates, lower loan rates, and lower service fees than comparable bank products, credit union members saved \$6 billion in 2002, or roughly \$160 per member household. Given this clear member value, it's difficult to imagine a scenario where a credit union that converts to a bank would provide a better value to its member-owners than a for-profit bank.

Despite some statements to the contrary, there are significant differences between the credit union structure and that of a mutual thrift. However, today this is not really significant due to the minimal use of the mutual structure by thrifts.

Between 1975 and 2004, mutual thrift assets, as a percentage of all depositories, declined from over 23 percent to 1.4 percent. Over the past 2 years, two credit unions with over 1 billion in assets have converted to mutual thrifts, and each one has already taken steps to convert to a stock thrift.

Two other credit unions with over a billion in assets attempted to convert, and both indicated that they had plans to issue stock. In fact, as Chairman Johnson and Mr. Schaefer have suggested, almost all credit unions that converted to mutuals have flipped. There are about three exceptions, and of course, Sound Community Bank happens to be one of those.

This brings me to the issue of insider enrichment as a motive for credit union conversions. I'm not implying that all conversions have been motivated by hopes of private gain. But the ability of insiders to profit from conversions is constantly emphasized by consultants who specialize in this effort. As do many of my peers who manage large credit unions, I receive regular mailings from these consultants. It's very similar to the number of credit card applications you receive in your household.

At Suncoast, we engaged a reputable law firm that specializes in many different types of conversions to analyze what would result from a conversion to a mutual, followed by a conversion to a stock-owned thrift. They determined that we would have an \$850 million

stock offering, based on acceptable OTS guidelines, and a conservative increase in stock price. I, as CEO, would realize a personal gain of approximately \$35 million, and that does not include any annual compensation.

In conclusion, the concept of converting a not-for-profit credit union to a for-profit bank is something that has not been given sufficient attention or deliberation by lawmakers. The fundamental nature of the institution is altered, and ownership rights and economic benefits are at risk.

NCUA is doing all it can under less than ideal guidelines to protect member rights. If this subcommittee is really interested in ensuring a fair and objective conversion process, we would suggest you look at ways to help NCUA, rather than stripping them of their already limited ability to protect members, which this bill does. Work with them to improve member understanding of the issues so an intelligent, objective decision is made when a conversion is being considered.

I appreciate the opportunity to appear here today, and look forward to your questions.

[The prepared statement of Mr. Dorety can be found on page 47 of the appendix.]

Mr. PRICE. Thank you, Mr. Dorety. I appreciate your testimony. We again thank you all for your patience and for understanding the chaos of Capitol Hill. We've been called for another vote. What we'd like to do is to complete the prepared statements, and then return at about 1:00 p.m. for questions. And we would ask for your forbearance for that.

Mr. Edward Yingling, we welcome you, president and CEO, representing American Bankers Association. Thank you.

STATEMENT OF EDWARD YINGLING, PRESIDENT, AMERICAN BANKERS ASSOCIATION

Mr. YINGLING. Mr. Chairman, members of the subcommittee, I'm Ed Yingling, and I am president and CEO of the ABA. I am substituting today for Harris Simmons, who is ABA's chairman. Unfortunately, his father passed away Tuesday night, so he cannot be here.

ABA appreciates the opportunity to be here. We believe that credit unions should have the ability to choose the charter most appropriate to their current and future lines of business. Many credit unions today have determined that it is in their members' interest to branch out into banking activities and exercise broader banking powers, yet the current conversion process is totally out of balance, tilted to those groups that oppose any conversion from a credit union for any reason.

The Credit Union Charter Choice Act takes important steps to restore the necessary balance that Congress sought to achieve when it enacted the conversion provisions in the 1998 Credit Union Membership Act. It is unfortunate that this bill is needed, because actually, Congress has already spoken on this issue.

In 1998, Congress very specifically acted to ensure that credit union members are adequately informed, that appropriate disclosures are made, and that safeguards against insider abuse are in place. Congress clearly stated that conversions were appropriate.

In spite of these statutory standards, and in clear disregard of Congressional intent, NCUA's rules and procedures continue to impede the process and add confusion instead of clarity. The NCUA has substituted its judgment about conversions for that of Congress. The NCUA's actions last year regarding the fold in a letter were called silly by a Texas magistrate, and similar terms were used by many Members of Congress.

But things have not really changed. Today, Mr. Chairman, it's no longer a fold; it's a hold. There are delays holding communications hostage. The NCUA has set up a process that makes it nearly impossible for credit unions to convert.

Yet the existence of charter options is particularly important now, as some credit unions have strayed from the central purpose of their charter, and are pursuing lines of business identical to mutual savings banks and commercial banks. We must never forget that credit unions have a legal mandate to serve people of modest means. That is why credit unions have their special privileges. With these privileges, there also come limitations, including restrictions on business lending and fields of membership.

Distinct from traditional credit unions, a new breed of credit unions has emerged that wants to serve a broad customer base, to do complex business lending, and offer asset management services targeted at wealthier customers.

Fortunately, there are other charters that provide greater flexibility, with effective supervision by banking regulators, while preserving the mutual member focus.

Nearly 30 credit unions have converted over the last 10 years to a mutual savings bank charter, continuing to serve their existing markets and seeking new ones, while remaining member-focused. Moreover, these former credit unions are thriving.

Unfortunately, the current skewed process is making it almost impossible for other credit unions to follow the same path, denying their credit union customers the expanded products and services that would be available under a mutual bank charter.

The ABA believes that balance once again needs to be restored to the credit union conversion process. We commend Congressman McHenry and support the goals and objectives of his bill. For one thing, it will make the process fair by limiting the NCUA's practice of stifling the ability of elected credit union officials to communicate with their members. In fact, it basically tries to make clear that NCUA should do what Congress said and clearly intended in 1998. Whether by fold or by hold, NCUA should not substitute its philosophical bias for the law.

I appreciate the opportunity to present the ABA's views.

[The prepared statement of Mr. Yingling can be found on page 179 of the appendix.]

Mr. PRICE. Thank you, Mr. Yingling. We appreciate all of your prepared statements. And again, thank you for your patience. We will resume this hearing with the question period at 1:00 p.m. This committee stands in recess.

[Recess]

Mr. PRICE. [presiding] The hearing will come to order. We appreciate again your tolerance and patience of this schedule today. I know everybody is busy, and we will move forward as expeditiously

as possible. My sense is that we will be done here prior to 2:00 p.m., so just for folks' planning purposes.

The Chair recognizes himself for a couple of questions. Mr. Dorety, in your testimony, you stated that the credit union members have enjoyed a collective savings of over \$6 billion in 2002 from services provided by credit unions. Help me understand and appreciate where that number comes from, what kind of plays into that, how you arrive at that.

Mr. DORETY. Certainly. That comes from our economists, who did a comparison using bank rate monitor and other surveys for the year 2002. Approximately—that's divided almost three equal ways, in fact—\$2 billion comes from savings on additional amount paid on deposits, about \$2 billion comes from lower loan rates, and about \$2 billion comes from lower service fees. And we would be happy to provide that information to you at the appropriate time.

Mr. PRICE. I think that would be helpful. I appreciate that. Just to follow up about the number of conversions, do you have a sense that the number of conversions will continue to increase? And if you would comment on the impact, if that were to occur, of that on the credit union's system as a whole.

Mr. DORETY. My sense is that the number of conversions will not increase. I think what we've seen is when members have an opportunity to get a sense of what is going on with a conversion, as we've seen in a couple of recent examples, that I think members are smart enough to figure this out. And so I don't think that you would see excessive changes, unless there is regulation that alters the conversion process as we see it.

As far as an impact on the credit union system, there has been minimal impact on the credit union system with conversions. And to be honest with you, that's not something that we're concerned about. We're concerned about the members' rights, and not really the impact on the credit union system.

Mr. PRICE. Thank you. Mr. Schaefer, do you have a comment on that question?

Mr. SCHAEFER. Yes, I would agree with Mr. Dorety. Our focus would be on the member interest. We don't believe that the scale certainly has not reached an area in which we would be concerned about the National Credit Union Share Insurance Fund or anything of that nature. And I also agree with Mr. Dorety that I think members are going to step forward and protect their form of member ownership, and so I wouldn't expect to see a lot of additional conversions.

Mr. PRICE. Mr. Yingling, do you have any comment about the trends?

Ms. STEWART. I do. Thank you. I believe that both gentlemen are correct. We will see fewer credit union conversions. But I believe the reason for that is the nature of the process. And I believe most credit union executives who may have considered conversion are reconsidering because of the costs and the fear of hyper-technical criticisms that will invalidate their votes, even if they are positive.

Mr. YINGLING. I agree with that. I think the door, frankly, is almost closing on conversions, and I think it will be interesting to watch what happens if the process isn't changed.

You're in a situation now where, if you're the management and the board of a credit union, you know when you go for a conversion that there is going to be a well-funded group outside your credit union that's going to come in with legal help, public relations help, and organizing help to organize people to oppose it. And there are no limitations whatsoever, maybe except the libel laws, on what that group can say and do.

And yet you're in a position where, if you want to respond, you have one of two choices. You can go ahead and respond, although you do have to include the warning that Mr. McHenry has, I think, correctly characterized as misleading. You have to do that.

But if you go ahead without prior approval from the NCUA and respond, you run the risk, if not the almost certainty, that the response will be used after the fact to invalidate the vote.

Your other choice is to go to the NCUA and have the response cleared in advance, which may take a good deal of time, and which may subject it to highly-technical criticisms. And by the time you have responded, it's too late.

And the credit union people we talked to, many of whom were—we talked to a certain group—were looking at conversions, think the door is almost being closed on them.

Mr. PRICE. I'm going to end my question at this point and recognize Mr. McHenry for 5 minutes.

Mr. MCHENRY. Thank you, Mr. Chairman. I appreciate my colleague from Georgia giving me a moment to ask questions.

Ms. Stewart, why did you convert? As Mr. Dorety explained, in his view, the credit union charter is the best charter. As for me as a public policy maker, I think it's for a marketplace to decide, your members to decide, or shareholders to decide, or account holders to decide. It's for the marketplace of ideas. But why did you convert? Or why did your organization convert?

Ms. STEWART. Thank you. There are probably four major reasons for the conversion of Credit Union Pacific to Sound Community Bank. And I believe the members who voted in favor of the conversion understood those reasons and had a vision of an organization that would serve them better.

First of all, our organization was predominantly, and atypical for a credit union, a real estate lender. We had a large book of business, long-term real estate loans on our books, and it was a product line that the regulator at the time took a fairly dim view of. And it was a product that our members demanded of us. So we needed to be able to expand and enhance that product line, and the conversion to a mutual savings bank and a thrift charter allowed that.

Mr. MCHENRY. That's one reason. What are the other three, very quickly?

Ms. STEWART. The other reasons related to products and services, increasing products and services, to the ability to leverage the infrastructure that we already had. Because of restrictions on field of membership, we needed more clients to support the expense that we were operating.

And finally, as a credit union, there's no way to build capital except with earnings. We talk a lot about not-for-profit organizations, but in a credit union, if you want to build capital so you can grow, you have to make money. As a mutual savings bank, we have an

opportunity to raise capital without offering stock through the formation of a mutual holding company and by doing a trust-preferred security. So accessing capital—

Mr. MCHENRY. What's a trust-preferred security?

Ms. STEWART. It's similar to, if I can describe it as a debt issue.

Mr. MCHENRY. Would that be members losing equity, or would that be members leveraging equity?

Ms. STEWART. No. It's an opportunity to go to the investment market and literally borrow money that becomes capital. And we pay a price for it. We pay an interest rate for it. It's like a debt.

Mr. MCHENRY. Do your owner-members lose equity because of that?

Ms. STEWART. Absolutely not.

Mr. MCHENRY. Do they lose ownership because of that?

Ms. STEWART. Absolutely not. It does not dilute their ownership. And they have to vote to form the holding company.

Mr. MCHENRY. Are you currently a stock-offering institution?

Ms. STEWART. Absolutely not.

Mr. MCHENRY. Okay. Simple question for the whole panel. Yes or no. I love these questions, because we can click through them pretty quickly. And I'm going to be mindful of everyone's time and their hunger.

For everyone here, is it possible, even probable, that a credit union which converts to a mutual savings bank and then separate conversion to a stock-offering institution, is it possible, or even probable, that members could actually improve their net worth in financial security? Just yes or no, across the panel. We'll start left to right. Ms. Stewart.

Ms. STEWART. Yes.

Mr. MCHENRY. Mr. Schaefer.

Mr. SCHAEFER. Yes, it's possible.

Mr. MCHENRY. Mr. Dorety.

Mr. DORETY. Technically possible, highly impossible. Implausible. Excuse me.

Mr. MCHENRY. Implausible. Okay. I was going to say that's Washington-speak. And I know Mr. Dorety is actually from North Carolina, and I know we don't engage in that. And then Mr. Yingling?

Mr. YINGLING. Yes.

Mr. MCHENRY. Yes. All right. Well, that's wonderful. I'm glad we have unanimity here. This is a wonderful, maybe rare, thing.

Additionally, as I said with my interaction with the previous panel, the NCUA, we're not going to debate a fold today, thankfully. But their disclosure says, "Subsequent conversion to stock institutions, conversions to a mutual savings bank is often the first step in a two-step process to convert a stock-issuing bank or holding company. In a typical conversion to the stock form of ownership, the executives of the institution profit by obtaining stock far in excess of that available to the institution's members." Ms. Stewart, have you done that?

Ms. STEWART. No.

Mr. MCHENRY. Okay. Well, it's very different from the disclosure. Did you have to put out a disclosure like this?

Ms. STEWART. Fortunately, I did not have to provide such speculative information to my members.

Mr. MCHENRY. Okay. Would the rest of the panel just briefly comment? Is that speculative on future operations or not?

Mr. SCHAEFER. Congressman McHenry, with 19 of the 23 credit unions that have converted in the period under study, having moved to stock ownership, we don't believe that is speculative. With 95 percent of the assets that OTS supervises in stock-owning banks, we don't believe that's speculative.

Mr. MCHENRY. Two final questions. And if the chairman will indulge for a moment.

Mr. YINGLING. Can I say something? It's not only speculative—and I'm a lawyer. It's not only speculative; it's grossly misleading.

Mr. MCHENRY. Well, as OTS previously testified, the answer is that it's purely false.

Mr. PRICE. The gentleman's time has expired. But if you would—

Mr. MCHENRY. But if I could summarize with a few final questions.

Mr. PRICE. Quickly.

Mr. MCHENRY. How long did it take you to convert, Ms. Stewart?

Ms. STEWART. I believe that the process, beginning to end, was in excess of 2 years. It was a slow process for us.

Mr. MCHENRY. Okay. Mr. Dorety, walk through this process with me. You said you would stand to net \$35 million in a conversion of your credit union. Would you be able to determine that you received \$35 million?

Mr. DORETY. Would I be able to determine? Absolutely, once I—after 5 years lapsed, and I realized that \$35 million gain? Sure, I would.

Mr. MCHENRY. Really? So you have the ability to vote yourself a pay raise and options in a future form of ownership.

Mr. DORETY. No. As I stated, if we went through the conversion to a mutual and then followed it with a stock conversion, the result of that, the amount of stock that I would be enabled to under the various options that OTS allows under their regulations, the value of that stock would equal \$35 million.

Mr. MCHENRY. Who sets your salary?

Mr. DORETY. My board of directors.

Mr. MCHENRY. Who sets options for stock-offering institutions?

Mr. DORETY. I assume the board of directors.

Mr. MCHENRY. Who elects the board of directors?

Mr. DORETY. The stock owners of the entity.

Mr. MCHENRY. Who elects the board of directors on your institution?

Mr. DORETY. Our members.

Mr. MCHENRY. Do you see that members have final say over whether or not stocks would be offered to any future leaders of any future institution?

Mr. DORETY. Members have no value in stock. There are no stocks for members to vote in a credit union entity.

Mr. MCHENRY. In a conversion, which is the mutual form, they have complete power of that conversion process, as OTS previously testified. Okay.

Mr. DORETY. And with the voting changes on the rights per vote and the ability for them to use—what's the term I'm looking for—proxies, clearly it is far easier for a mutual to have a vote than it is for a credit union.

Mr. MCHENRY. Final question to Mr. Schaefer, my good friend from North Carolina. We've had hours of discussion on this. And I appreciate NAFCU being willing to offer a white paper on this. You say 20 percent, at least, should vote in a conversion process. Did you vote in the primary election last week in North Carolina, along with 10 percent of the total registered voters in North Carolina?

Mr. SCHAEFER. If I might say that in a membership organization, there probably should be a quorum. If you're in a homeowners' association and a group wants to charge you \$10,000, there probably should be a minimum group that participates in that vote. But I understand the analogy. I don't think—

Mr. MCHENRY. And finally, can you comment on NAFCU's white paper and the overall—the one idea that I do like that I think should be added to the regs is a member meeting to explain the conversion. Can you comment on that?

Mr. PRICE. The gentleman's time has expired, but you're welcome to answer that question.

Mr. SCHAEFER. Thank you for your support of that. We feel that that would certainly give the members a heads-up of what was intended and give them an opportunity to response. Thank you for your support.

Mr. PRICE. Thank you. Mr. Kanjorski.

Mr. KANJORSKI. Thank you, Mr. Chairman. Ms. Stewart, I'm not familiar with the circumstances of your conversion. But just for the record, I assume that none of the board of directors or the management were offered stock options or any other benefits as a result of a conversion; is that correct?

Ms. STEWART. Congressman, that is correct. We are not a stock organization. We are a mutual savings bank.

Mr. KANJORSKI. And have no intention of going to a stock operation.

Ms. STEWART. No intention of going to a stock organization. I believe we will form a mutual holding company, but we won't issue stock.

Mr. KANJORSKI. Why in a democracy—would you be very comfortable if everything in our system required a vote, a majority vote of only those that are present in a change of any circumstance, including elections? Do you have some difficulty with understanding the need to have a basic quorum to perform functions?

Ms. STEWART. I believe you asked me if I believe things should be subject to a vote. I'm a strong believer in democracy, and I think people should exercise their right to vote, in a credit union or—

Mr. KANJORSKI. But I'm asking you the question whether or not that vote should be thought to be legitimate only when some base number, whatever it may be—20 percent, 30 percent, 50 percent, as the case may be—as opposed to just those people who show up at the meeting.

Ms. STEWART. Well, I think it's very difficult to regulate what an equitable base number is.

Mr. KANJORSKI. How many voted in your conversion?

Ms. STEWART. Seventy-seven percent voted in favor, and slightly less than 20 percent voted.

Mr. KANJORSKI. Okay. So that if we maintained a change, that wouldn't have prevented your conversion.

Ms. STEWART. If it was 20 percent, it would have.

Mr. KANJORSKI. Even if it were 50 percent, you could have converted.

Ms. STEWART. I could have converted?

Mr. KANJORSKI. Did you have a 50 percent quorum or a 70 percent quorum?

Ms. STEWART. No. Seventy-seven percent of the members that voted voted in favor—

Mr. KANJORSKI. I'm interested in what the count—what the people voting constituted as relative to the total membership.

Ms. STEWART. Less than 20 percent of the membership.

Mr. KANJORSKI. Oh, less than 20 percent. So you wouldn't have been able to convert—

Ms. STEWART. That's what I just said.

Mr. KANJORSKI. And you don't feel that the people who didn't show up, do you consider they cast a vote by not showing up?

Ms. STEWART. I believe, if you are asking for my opinion in my credit union, that I mailed information about the conversion to my members three times. I also had that information available in the branches. I also had education of my staff. They had an opportunity to vote.

Mr. KANJORSKI. How long had your credit union been in existence?

Ms. STEWART. Our credit union was formed in 1953.

Mr. KANJORSKI. So about 52 years, 53 years.

Ms. STEWART. Approximately.

Mr. KANJORSKI. And all of the people who formed the credit union originally are still living, I assume.

Ms. STEWART. Well, I don't know about that. That would be a pretty difficult assumption to make, wouldn't it?

Mr. KANJORSKI. Well, do you think any of those folks who belonged in 1953 put in their money. They got advantages. But also, the credit union built up their equity by virtue of not turning back all of the profits. They kept it and grew. What do you think should happen to that money? We should hand it over to somebody who possibly could convert from a mutual savings to a stock company and reap the benefits. Do you think that should happen?

Ms. STEWART. Well, if I could respectfully disagree with you, I don't think the money gets handed over to anyone. The idea of doing a stock issuance, even if you go all the way to stock, creates additional capital for your organization.

Mr. KANJORSKI. Well, somebody gets the distribution of the existing assets. The people buy the new stock.

Ms. STEWART. Do they? Does somebody in a credit union who is a member get a distribution of the current assets? Does somebody in my mutual savings bank—

Mr. KANJORSKI. No. That's the problem I'm suggesting, they don't.

Ms. STEWART. Right.

Mr. KANJORSKI. And that's why—

Ms. STEWART. They don't in a mutual savings bank.

Mr. KANJORSKI. So we have to find a protective mechanism so that generationally-accumulated equity doesn't get disbursed either for people who want an advantage, or want to cash in, or want—I mean, how do you look at this as your money? The present membership's money. This isn't the present membership; it's the accumulated membership of 53 years.

Ms. STEWART. And let's use that example.

Mr. KANJORSKI. Yeah.

Ms. STEWART. The first member of our credit union, the first member, the first membership-owning member, voted in favor of our conversion. So my point is that the assumption that someone who was a member in 1953 was giving up equity clearly wasn't the case in our credit union.

Mr. KANJORSKI. Well, because the first member doing it—I mean, you know, for all intents and purposes, under the existing law, three members could show up, and out of how many hundreds of thousands, did you have, members?

Ms. STEWART. How many hundreds of thousands I have?

Mr. KANJORSKI. Members.

Ms. STEWART. Ten thousand members, approximately, at the time of conversion.

Mr. KANJORSKI. Only 10,000 members. And less than 1,500 showed up.

Ms. STEWART. I believe it's in the record. The total positive votes was 1,600 and something.

Mr. KANJORSKI. And you don't think that we should ask the regulator to be certain that there's transparency, that there's disclosure, that there's understanding. If I had my way, every member of the board of directors signs an affidavit that they will receive no benefits or whatever. And if they do, of course, that should be prosecutable.

Ms. STEWART. I absolutely think that there should be transparency. It is not transparent to disclose to consumers that this is the first part of a two-step operation. That's speculative. And it's not in the fiduciary responsibility of the directors to provide speculative information to the membership base.

Mr. PRICE. The gentleman's time has expired.

Mr. KANJORSKI. If I may, just to—

Mr. PRICE. You may.

Mr. KANJORSKI. Since we're lonely here. You know, I was particularly interested, Mr. Dorety, you had 36 million reasons to support conversion. And quite frankly, I may take a second to compliment you. I'm not sure I know that many people who have 36 million reasons to vote for a conversion who would have showed the dedication and commitment to the credit union movement to turn that down. So you should be complimented. But would that have an effect, do you think, on other credit union members if they had 36 million reasons to convert?

Mr. DORETY. First of all, I don't want to exaggerate. The number was 35 million.

Mr. KANJORSKI. Thirty-five million. Okay.

Mr. DORETY. I just don't want to be on record with that. And the reason I turned it down was that I called my predecessor, who was the second CEO of my credit union. I mentioned to him the fact that I may have that number. And he said, "Yes. But if you did it, you're not going to go to heaven." So I had reasons for not doing it.

I can't answer for others. I know that by the inquiries we get and the mailings that we get that there are folks out there who truly believe that they will find interested parties in the credit union world who will be interested in getting some enrichment from this process, without question.

Mr. KANJORSKI. Yeah. If I could just take a few moment, Mr. Chairman. I wanted the record to reflect that I was very much involved with H.R. 1151, both in the creation of the legislation and the marshaling it through the Congress, and in the conference. And I remember very well. And I want to disabuse some of the testimony that was here earlier by some of the panel.

The decision to go from 50 percent to zero on the dissolution was made at 11:30 at night, when we were faced with the proposition that if H.R. 1151 hadn't passed, it would literally destroy the credit union movement and destroy their capacity to exist. And many of us who were in support of that legislation or participated in the drafting of it felt very strongly that it was the survival of the credit union movement that was most important that night. And we all recognized that this was a dangerous situation that was in the bill, and hoped in the future to make that correction and change that circumstance.

But hardly was it a discussed issue at the conference or by the sponsors and drafters of the legislation. It was a quirk thrown in at 11:30 at night. I remember it very well, because I was one of those who would have said drop the bill, let it lose on this, because I thought it was onerous to put that in. But it went in, and we were able to pass the amendment.

But the record should not reflect that was a considered issue in conference. That is nonsense. That was a special provision put in by some position, some people in leadership at the time. As a matter of fact, it was sort of based on, if I remember, Utah organizations that wanted to make these conversions. And many of us thought well, if that's Utah wanting to do that, that's their problem. But we didn't think it would be spreading across the country as it has since 1998. But I wanted the record to reflect that.

Mr. PRICE. Thank you very much. I appreciate that. And the Chair is pleased to learn that things happened at 11:30 at night in previous Congresses as well. So we thank you.

I want to thank the panel. The Chair notes that some members may have additional questions for this panel which they may wish to submit in writing. And without objection, the hearing record will remain open for 30 days for members to submit written questions to these witnesses and place their responses in the record.

I want to thank you all very, very much for your patience and tolerance today, and for your testimony. It's been very enlightening. Thank you. This hearing is adjourned.

[Whereupon, at 1:28 p.m., the subcommittee was adjourned.]

A P P E N D I X

May 11, 2006

OPENING STATEMENT OF CHAIRMAN SPENCER BACHUS

**SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
AND CONSUMER CREDIT**

**Legislative Hearing on H.R. 3206,
the "Credit Union Charter Choice Act"**

May 11, 2006

Good morning. The Subcommittee will come to order. This morning the Subcommittee will hear testimony on a legislative proposal introduced by our colleague, the Honorable Patrick McHenry, that is designed to streamline the process by which a credit union charter is converted to a mutual savings bank or savings association charter. I would like to thank Mr. McHenry for bringing this timely issue to the attention of the Committee. A uniform and clear process for charter choice is important, and today's hearing will allow us to better understand how the process works and what possible improvements could be made.

Today the Subcommittee will hear from the Chairman of the National Credit Union Administration (NCUA), JoAnn Johnson, and Mr. Scott Polakoff, the Deputy Director of the Office of Thrift Supervision (OTS). The second panel will provide the perspective of bank and credit union representatives on the process. We welcome four distinguished witnesses this morning: Ms. Laurie Stewart on behalf of America's Community Bankers (ACB); Ms. Stewart is President and CEO of Sound Community Bank in Seattle, Washington. Mr. Marcus Shaefer representing the National Association of Federal Credit Unions (NAFCU); Mr. Shaefer is President and CEO of Truliant Federal Credit Union in North Carolina. Mr. Tom Dorety representing the Credit Union National Association (CUNA); Mr. Dorety is President and CEO of Suncoast Schools Federal Credit Union in Florida.

And Mr. Edward Yingling, President and CEO of the American Bankers Association.

We are here today because we need to learn more about this issue from the regulators and those institutions which are impacted by the process. I would like to take this opportunity to again welcome our witnesses. I look forward to hearing from each of you and thank you for taking time from your schedules to join us. I would also like to again thank Mr. McHenry for his interest in this subject and his work in introducing H.R. 3206, the "Credit Union Charter Choice Act."

I am now pleased to recognize the Ranking Member, Mr. Sanders, for any opening statement that he would like to make.

**OPENING REMARKS OF THE HONORABLE RUBEN HINOJOSA
HOUSE COMMITTEE ON FINANCIAL SERVICES
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
A HEARING ON
“H.R. 3206, CREDIT UNION CHARTER CHOICE ACT”**

Chairman Bachus and Ranking Member Sanders,

I want to express my sincere appreciation for you holding this important hearing on credit union conversions, particularly the “Credit Union Charter Choice Act” introduced by my colleague Congressman McHenry.

Although I am not a cosponsor of his bill, I do share some of his concerns about some of the decisions made and actions taken by the National Credit Union Administration relative to credit union conversions.

Last year, my fellow Texan, Congressman Hensarling, and I, along with several other members of the Texas delegation, sent a letter to NCUA to express our concerns over actions NCUA took that could have invalidated the charter conversion votes of two Texas credit unions seeking to become mutual savings banks.

The letter noted that recent reports at that time seemed to indicate that the NCUA had interpreted its electoral oversight authority in a way that we could only describe as hostile to charter conversions. This included NCUA’s attempt to encumber votes by rejecting the method in which disclosure notices to members were folded.

Mr. Chairman, it was absurd for NCUA to base its charter conversion decision on how a piece of paper was folded instead of on the votes cast by members of the credit union. A lawsuit between the two Texas credit unions and the NCUA ensued.

On August 31, 2005, I was pleased to learn that the NCUA decided to no longer object to the methods and procedures applicable to the membership votes on the two Texas credit unions’ proposals to convert from credit unions to mutual savings banks. NCUA should have focused its efforts, as should we, on ensuring that members of the credit union receive full disclosure of the content, the procedure and the potential impact the conversion vote will have on them.

Mr. Chairman, I opposed the NCUA’s actions relative to the two Texas credit unions because NCUA’s decision centered on the way in which a document was folded. Nonetheless, I look forward to working with you and with NCUA to ensure that its regulations and decisions provide the following: adequate disclosure of the timing and content of credit union conversion vote regulations to credit union members; and, a reasonable explanation of the potential impact a vote in favor of, or in opposition to, the conversion could have on the members’ “control over/share in” the institution. I am open to any and all suggestions on this seemingly controversial issue, and I remain committed to ensuring that all financial institutions are permitted to operate on equal footing.

I ask that all the documents I have in my possession regarding the two Texas conversion cases be inserted into the official hearing record.

Mr. Chairman, I yield back the remainder of my time.



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WRITTEN TESTIMONY
OF
TOM R. DORETY, PRESIDENT & CEO
SUNCOAST SCHOOLS FEDERAL CREDIT UNION
ON BEHALF OF THE
CREDIT UNION NATIONAL ASSOCIATION
HEARING ON
H.R. 3206, CREDIT UNION CHARTER CHOICE ACT
BEFORE THE
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS,
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HOUSE COMMITTEE ON FINANCIAL SERVICES

May 11, 2006

Chairman Bachus, Ranking Member Sanders, and members of the Subcommittee, I am Tom Dorety, President and CEO of Suncoast Schools Federal Credit Union in Tampa, Florida. I also serve on the Board of Directors and as Treasurer of the Credit Union National Association (CUNA). I appreciate the opportunity to appear before the Subcommittee today on behalf of CUNA to address the issue of credit union conversions to mutual savings banks. CUNA is the largest credit union advocacy organization, representing over 90 percent of our nation's more than 8,800 federal and state chartered credit unions and their 88 million members.

Suncoast Federal Credit Union was chartered in 1934 as Hillsborough County Teachers Credit Union. Today it serves public and private school employees, students and county employees in 15 counties along the west coast of Florida. With over \$5 billion in assets and 400,000 members, Suncoast is the largest credit union in Florida and the seventh largest credit union in the United States as ranked by assets. The driving force behind Suncoast's growth and success is the same mission for which it was founded over 70 years ago: to improve the quality of our members' lives by maintaining a strong, secure and innovative credit union that builds trust, shows respect and maximizes efficiency.

I am honored to provide CUNA's position on a number of important issues relating to credit union conversions to mutual bank charters. I also want to respond to the inaccurate or misleading information Congress has received regarding these conversions and the role of the National Credit Union Administration (NCUA) in overseeing the conversion process. CUNA believes that the credit union charter currently provides the best vehicle for serving the financial needs of consumers. However, we also support the right of credit union members to exercise their full democratic control over the structure and operation of their credit union. Should, after full and balanced disclosure, credit union members decide to convert the credit union to a mutual savings bank, CUNA supports their legal right to do so, but strongly believes that the unique ownership interest of credit union members must be protected and that members be fully informed of what is at stake in a conversion.

Toward this end, CUNA believes that five important principles should govern all conversions of credit unions to mutual charters:

1. Credit union boards that are considering conversions should make their decisions based solely on the best interests of their members.
2. Credit union directors and managers have a fiduciary responsibility to present objective and honest information to members regarding conversion proposals as well as other reasonable business alternatives.
3. Full, plain language disclosures are essential to furthering the democratic process of deciding to approve or reject a conversion proposal.
4. Since the net worth of the credit union belongs to the members, there should be no unjust enrichment to directors and senior management upon conversion of a credit union to a mutual thrift or any subsequent conversion to a stock institution.
5. The NCUA and state regulators must make full use of their current authority to ensure that credit union members understand the conversion process and that fiduciary duties of credit union boards are fully enforced.

Key Differences Between Credit Unions and Mutual Thrifts

Conversion decisions are significant because they diminish and ultimately may extinguish credit union members' ownership rights in their institution. Mutual savings banks are not just credit unions by another name as some would have you believe. Credit unions are not-for-profit cooperatives, which are operated solely for the benefit of the member-owners—not for the benefit of stockholders, boards of directors, or for the institution itself. Credit unions operate without paying a dime to most of our boards of directors and without providing stock options to our senior management. We are able to do this because of the devoted efforts of tens of thousands of selfless volunteers for whom credit unions are not just a business, but a cause. Our guiding principle, “not for profit, but for service,” clearly makes us unique among financial institutions.

Mutual savings banks, on the other hand, are for-profit businesses. When a credit union converts to a mutual charter, the character of the institution materially changes. There are significant ownership differences between credit unions and mutual thrifts that conversion advocates tend to obscure, and the process set up by the Office of Thrift Supervision (OTS) to review and approve conversions fails to take such differences into account.

Voting Rights: In a federal credit union, each member has one vote regardless of the amount of funds in his or her account, and proxy voting is not permitted. This differs from the voting rights of depositors of mutual savings banks in which proxy voting is

generally used and votes are routinely apportioned based on account balances. Unlike credit unions, depositors of a mutual savings bank do not control the institutions. As explained in OTS's 2003 *Regulatory Handbook*, "Except for provisions relating to the conversions of a federal mutual to stock form, there is no statutory requirement that federal mutual savings associations' members have voting rights."

Ownership Rights: Credit union members are not simply depositors of, or borrowers from the institution. They own the net worth of their credit union and have a vote in selecting their peers who will determine how the net worth can best be used to benefit the membership. This is not the case in mutual institutions, as OTS and the courts have stated. In a June 2002 opinion, the OTS Office of General Counsel clearly stated: "The federal courts have concluded that owners of federal mutual savings associations have only very limited equity interests in those institutions and those interest do not include any rights as owners..."

Personal Enrichment: As not-for-profit organizations, credit union directors and managers are prohibited from taking actions that benefit themselves at the expense of the broader credit union membership. Board directors also generally do not receive compensation, and the Federal Credit Union Act specifically prohibits directors and senior managers from receiving any economic benefit from a charter conversion. OTS rules for mutual savings banks, by contrast, permit considerable personal gain, both in terms of director compensation and eventual stock ownership. While imposing some restrictions on self-dealing by insiders in the conversion process, OTS permits considerable stock ownership by directors and management when mutuals convert to partial or full stock ownership.

Economic Benefits of Credit Union Membership

Whether credit union members relinquish significant rights and economic benefits when their institution converts to a mutual savings bank is a central question in considering the appropriateness of such conversions. CUNA believes that credit union members enjoy substantial benefits as a result of doing business with a credit union which are both tangible and intangible. On the intangible side is the sense of belonging and control that many members enjoy with a credit union. This is reflected in the high customer satisfaction ratings members give their credit unions. The *American Banker* survey of customer satisfaction with financial providers published in June 2005 gave credit unions the highest rating of all financial institutions, while a number of banks were rated unfavorably, and no mutual savings bank was even noted. Similar surveys published over the prior eighteen years also gave credit unions consistently higher member/ customer satisfaction scores than both banks and thrifts.

A number of factors combine to create tangible economic benefits for credit union members. These include the absence of having to pay stock dividends to stockholders, the effect of tax exemption, and the near absence of directors' fees. These factors help to produce higher returns on shares, lower interest rates on loans, and lower service fees

than comparable bank products. CUNA's Research and Policy staff estimates saving for credit union members of over \$6 billion in 2002, or roughly \$160 per year per member household.¹ Credit unions also help to moderate bank fees and interest charges for all consumers.

No economic analysis has been presented that can demonstrate that any mutual conversion has advanced the ownership rights or economic benefits of credit union members. On the contrary, several recent studies show that both member rights and economic benefits may be substantially reduced following conversion to a stock institution. For example:

- A cross-sectional analysis of interest rates charged on loan and savings products by 175 banks, thrifts, credit unions and recently converted credit unions by University of Wisconsin-Whitewater researchers Heinrich and Kashian found that credit unions "offer significantly higher rates on savings accounts and lower rates on many loan products than do banking institutions." The study found that the cost differential was "especially notable" when comparing interest rates between credit unions and former credit union/mutual banks and that the financial benefits of not-for-profit credit unions "either disappear or are much diminished when those institutions convert to banking institutions."²
- In a broad study of credit union conversions, including a review of the 17 credit unions that converted to mutual savings banks and subsequently to stock institutions between 1995 and 2002, Professor James Wilcox of the University of California analyzed the effects of such conversions on member interests. First, he found that only those members who exercise their subscription rights and purchase stock protect themselves from losing their share of the credit union's net worth. He points out that "Historically, only a relatively small percent of members purchase share of stock via the subscription offerings." As a result, the net worth of the credit union is redistributed to "well-informed insiders" and outside investors. His analysis goes on to conclude that even if all members were to buy their *pro rata* share of stock, they still might have been better off without a conversion depending on the credit union's initial net worth ratio, and how advantageous the credit union's loan and saving pricing was relative to stock-owned alternatives.³

¹ "The Benefits of Credit Union Membership", CUNA Research and Policy Department, at http://advice.cuna.org/econ/member/download/whpaper_mmbrrshp.pdf

² Heinrich, Jeff and Russ Kashian (February 2006). "Credit Union to Mutual Conversion: Do Rates Diverge?". Fiscal and Economic Research Center, University of Wisconsin-Whitewater.

³ Wilcox, James (January 2006) "Credit Union Conversions to Banks: Facts, Incentives, Issues, and Reforms." Haas School of Business, University of California at Berkeley.

- A government report on conversions of British non-profit mutual building societies and life assurance companies to stock companies between 1995 and 2000 found that the remaining mutuals outperformed their converted rivals in a variety of financial performance indicators and passed along these cost advantages to consumers in terms of better rates. The study also found “there had been substantial increases in remuneration enjoyed by directors of those institutions which had demutualized...but no corresponding improvement in performance.”⁴ In part due to the experience of these conversions, Britain has issued rules prohibiting conversions of credit unions to banks.

Need for Greater Transparency in Mutual Conversions

The conversion of a credit union to a mutual savings bank involves a complex legal process in which the credit union ceases to exist and changes into another form of financial institution with different, and lesser, democratic control and ownership rights. As the size of the converting credit unions has increased, the issues involved have become even more complex and controversial. Because the fundamental nature of the institution is changed and ownership rights and benefits are at risk, it is imperative that members be given timely, objective and balanced disclosures about a proposed conversion well in advance of any conversion vote.

The experience of recent conversions in Michigan and Washington illustrate that when credit union members have sufficient information to understand that a proposed conversion may not be in their best interest, they will take action to block or oppose it.

Congress has assigned to NCUA a number of key oversight responsibilities regarding credit union conversions. NCUA has been directed to write and implement regulations governing conversions. The agency also administers membership votes and sets standards for membership communications and disclosures that must be met by converting credit unions. The Federal Credit Union Act and NCUA rules require converting credit unions to provide written notices to members three months, two months and one month prior to any conversion vote. NCUA expanded its rules governing the disclosures in these notices in 2004, and again in 2005, to address the key questions of whether, and the extent to which, credit union members understand their ownership interests, and whether they understand and fully appreciate how these interests could be changed by conversion to a mutual bank and any subsequent conversions to a stock institution. These additional disclosures, with specific information required to be prominently featured, were designed to make disclosure more meaningful, not more burdensome, and to prevent important or needed information from being lost in small print.

While recent rule changes have improved the overall transparency of the conversion process, CUNA believes additional measures are needed to enhance the

⁴ The All-Party Parliamentary Group for Building Societies and Financial Mutuals (March 2006) “Windfalls or Shortfalls? The True Cost of Demutualization.” ACCA, London.

ability of members to fully understand and participate in all aspects of the conversion debate. In particular, CUNA urges NCUA to consider possible rule changes to:

- Require that all disclosures be given in plain language that can be easily read and understood by credit union members.
- Clarify the fiduciary obligation of credit union directors and managers to present factual and objective information to document how a proposed conversion would serve the best interests of members.
- Provide for a public comment period on conversion proposals in advance of the distribution of ballots to members.
- Establish a process or mechanism for members opposing a conversion proposal to communicate with the full credit union membership.

The Credit Union Charter Choice Act

CUNA wishes to go on record as strongly opposing H.R. 3206, the "Credit Union Charter Choice Act," as introduced by Representative McHenry. We believe he, too, wants to improve the conversion process. However, rather than improving the process of providing members with sufficient information to make an intelligent decision regarding a proposed conversion, H.R. 3206 would imprudently erode NCUA's authority to make sure that credit union members facing a conversion vote have sufficient information to make informed decisions. As a result, no regulator would have sufficient authority to protect members' interests. Particularly harmful, from the credit union perspective, are changes in H.R. 3206 that would:

- Eliminate any prior review by the NCUA Board of proposals to convert a credit union to a mutual charter and limit the Board's oversight only to review of the written notice, ballot and related materials to be mailed to members regarding the conversion vote.
- Eliminate important disclosures in the written notice to members relating to possible subsequent conversions to a stock institution and the potential impact on members' ownership and voting rights.
- Prohibit the NCUA Board from any action to regulate the content of any other communication relating to the conversion, except to prevent communications from including inaccurate material facts that are "knowingly false or misleading."
- Strip NCUA of any role in overseeing the conversion vote, other than to certify the voting results transmitted by the independent inspector to the OTS within 10 calendar days of the vote.

- Prohibit NCUA from requiring a new member vote in response to improper notice or voting procedures, except where it can show that a notice contained a “knowingly false statement that affects the outcome of a conversion vote.”

In addition, while H.R. 3206 retains the current law prohibition against credit union directors or senior managers receiving any economic benefit in connection with a conversion to a mutual bank, it would prevent NCUA from having any authority over the conversion process once the member vote is certified. Given OTS’ record, this provision effectively nullifies any possible enforcement of this important protection against insider enrichment for credit union members.

Recommendations for Congressional Action

CUNA urges the Subcommittee to reject H.R. 3206 and, instead, take more proactive measures to address the underlying issues of credit union conversions. First, we urge Congress to adopt measures to address the key problems that have prompted credit unions to seek mutual bank charters, including the need for more flexible capital requirements less stringent limits on investment, and more flexible small business and real estate lending authority. Proposals that address these problems are currently pending before this Subcommittee as part of the Credit Union Regulatory Improvement Act (H.R. 2317), introduced last year by Representatives Royce and Kanjorski.

Second, Congress should address the gap in current regulatory authority by directing the Office of Thrift Supervision to enforce the current prohibition against credit union directors or senior managers receiving excessive compensation or other economic benefit in connection with the conversion of a credit union to a mutual charter.

Third, to minimize the potential for insider self-enrichment as a motive for credit union conversions, Congress should enact proposals, like that proposed in the past by former Chairman Leach, to restrict the ability of directors and managers involved in credit union conversions to obtain stock and other compensation in connection with any subsequent conversion to a partial or full stock institution.

Conclusion: The Reality of Insider Enrichment

Mr. Chairman, let me make a personal appeal to the Subcommittee to give careful consideration to the issue raised by my last recommendation: the potential for insider enrichment as a motive for credit union conversions. Of the 18 credit unions that converted to mutual savings banks between 1995 and 2004, 16 (89 percent) have undergone subsequent conversion to stock banks or partial stock mutual holding companies. One of two Texas credit unions that converted to mutual charters less than five months ago has already filed notice with the Securities and Exchange Commission of its intent to convert to a stock thrift, with 8 directors dividing at least \$1.7 million in stock in the initial stock offering.

I am not implying that all these conversions have been motivated by hopes of private gain. But with less than 20 percent of credit union members actually participating in most of these conversion votes, significant opportunity is created for insider directors and senior managers to enrich themselves in subsequent conversions at the expense of unwary or less informed credit union members. According to a survey published by *Credit Union Journal* in June, 2005, directors and managers have acquired voting control of nearly all former credit unions converting to stock institutions. Outside investors also stand to benefit at the expense of former credit union members with well-timed deposits in mutual thrifts in anticipation of stock purchases based on deposits. The April 2005 conversion of one mutual bank, a former credit union with \$400 million in assets before its initial conversion, attracted nearly \$100 million in additional deposits leading up to its initial stock offering.

The ability of insiders to “game” these conversions for their own financial benefit is frequently emphasized by the consultants who have handled most of the recent credit union conversions. I have been informed by these consultants that Suncoast could raise \$850 million in a stock conversion if it converted to a bank, and that I personally could expect to receive \$35 million after five years, assuming stock purchases and compensation plans common to recent conversions.

Its one thing to start a public company, invest your own money and realize whatever gain is possible from its sale. Its another thing, however, to use capital that belongs to all members of a credit union, that has been acquired over decades of hard work by volunteer boards and the benefit of federal tax exemption, to enrich a select group of individuals who do little more than engineer the conversion of the credit union to a bank. Not only is this bad public policy, it is anti-consumer, anti-taxpayer, and just plain wrong.

In conclusion, we appreciate the opportunity to appear here today on the very important issue. I hope my statement has helped shed light on the real concerns involved with conversions. I look forward to your questions. Thank you.



STATEMENT

OF

THE HONORABLE JOANN M. JOHNSON
CHAIRMAN
NATIONAL CREDIT UNION ADMINISTRATION

"H.R. 3206, CREDIT UNION CHARTER CHOICE ACT."

BEFORE THE

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER
CREDIT
U.S. HOUSE OF REPRESENTATIVES

THURSDAY, MAY 11, 2006

Chairman Bachus, Ranking Member Sanders, and Members of the Subcommittee, on behalf of the National Credit Union Administration (NCUA), thank you for the opportunity to present the Agency's views on H.R. 3206, the Credit Union Charter Choice Act, introduced July 12, 2005 by Representative Patrick McHenry, and on credit union conversions to mutual savings banks or associations (MSBs).

NCUA's primary mission is to ensure the safety and soundness of federally insured credit unions. It performs this important public function by examining all federal credit unions (FCUs), participating in the supervision of federally insured state chartered credit unions (FISCU) in coordination with state regulators, and insuring credit unions. In its capacity as the administrator for the National Credit Union Share Insurance Fund (NCUSIF), NCUA provides oversight and supervision to approximately 8695 federally insured credit unions, representing 98 percent of all credit unions and approximately 84 million members.¹

A credit union is owned and governed on a democratic, cooperative basis by the members. It is the member-owners, not NCUA or any other group, who should decide the future of their credit union. NCUA fully supports the right of credit union members to decide the business model that is most appropriate and beneficial to them, and whether a charter conversion serves their best interest. In that regard and in the interest of basic consumer protection, NCUA strongly believes that the member-owners deserve to receive information about the conversion of their credit union to another form of financial institution that is accurate, complete and understandable.

My statement today provides a brief history of NCUA's rulemaking on conversions, responds to criticism of NCUA's current rule, addresses the statutory limitations on NCUA's rulemaking authority and provides comments on H.R. 3206.

History of Statutory Provisions and NCUA Rulemakings on Conversions

In 1995, NCUA first adopted a rule to address the conversion or merger of a credit union into a non-credit union institution.² The purposes of the rule were to ensure that transactions took place only pursuant to an informed vote of the credit union's member-owners and to prevent self-dealing and other abuses by individuals involved in the transactions.³ The rule addressed, among other things, voting procedures, disclosures, member approval, and NCUA approval.

¹ Approximately 180 state chartered credit unions are privately insured and are not subject to NCUA oversight.

² 60 Fed. Reg. 12695 (March 8, 1995). In 1995, prior to CUMAA, the Federal Credit Union Act stated that no credit union could convert into a noninsured credit union or institution without the prior approval of the NCUA Board but contained no other provisions relating to MSB conversions. NCUA's 1995 rulemaking specific to MSB conversions was in response to problems observed in credit unions attempting to convert. 59 Fed. Reg. 33702 (June 30, 1994)(Proposed NCUA Rules on Mergers of Federally-Insured Credit Unions: Voluntary Termination or Conversion of Insured Status).

³ *Id.*

Congress enacted the Credit Union Membership Access Act (CUMAA) on August 7, 1998.⁴ Section 202 of CUMAA amended the provisions of the Federal Credit Union Act (Act) concerning the conversion of insured credit unions to MSBs. These amendments provide that a majority of a credit union's board of directors must approve a proposal to convert, and membership approval shall be determined by a majority of the members who vote on the proposal.⁵ The CUMAA voting standard was a significant departure from the pre-CUMAA standard, which required that a majority of the credit union's members approve a conversion, not just a majority of those members who actually voted on the proposal.

CUMAA requires that a credit union give its members notice of the vote 90 days, 60 days, and 30 days in advance and provide NCUA with notice of its intent to convert.⁶ CUMAA also requires that NCUA administer the member vote on a proposed conversion and review the methods and procedures by which the vote is taken. It provides authority to either NCUA or the federal or state regulatory agency that would have jurisdiction over the institution after the conversion to disapprove of the methods by which the member vote was taken or procedures applicable to the member vote and to require that the member vote be taken again.

Under CUMAA, NCUA was required to promulgate final rules regarding charter conversions within six months of the passage of CUMAA that were: (1) consistent with CUMAA; (2) consistent with the charter conversion rules promulgated by other financial regulators; and (3) no more or less restrictive than rules applicable to charter conversions of other financial institutions. NCUA issued final rules on November 19, 1998 to implement §202 of CUMAA.⁷

NCUA's first post-CUMAA conversion rule, while necessarily different from NCUA's pre-CUMAA rule, shared the common goal of enhancing consumer protection for credit union members. The rule acknowledged that under CUMAA, an insured credit union could convert to an MSB without the prior approval of the NCUA. It also articulated NCUA's statutory responsibility to administer the methods and procedures of the member vote, and to disapprove them and direct a new vote be taken if warranted.

In the approximately 8 years since the first post-CUMAA conversion rule was issued, NCUA has refined the rule three times.⁸ In each of these rulemakings, NCUA has been motivated by the same basic concern, namely, that members receive accurate and complete information to make an informed decision on a conversion proposal. Among these amendments were requirements that converting credit unions disclose additional information to their members, that the member vote be by secret ballot, and that the vote be conducted by an independent entity.

⁴ Public Law 105-21.

⁵ 12 U.S.C. 1785(b)(2)(B).

⁶ 12 U.S.C. 1785(b)(2)(C); 12 U.S.C. 1785(b)(2)(D).

⁷ 63 Fed. Reg. 65532 (November 27, 1998).

⁸ 64 Fed. Reg. 28733 (May 27, 1999); 69 Fed. Reg. 8548 (February 25, 2004); 70 Fed. Reg. 4005 (January 28, 2005).

Since 1995, of the 33 credit unions that sought to convert to MSBs, 29 have converted. Of the four that did not convert, one did not receive the requisite member vote under provisions of the relevant state credit union law; one had difficulties with the banking regulators and withdrew its application to become a bank; one chose not to conduct a second member vote after NCUA discovered significant problems and irregularities, such as failure to allow some members to vote and inconsistencies in voting procedures; and one withdrew its application for reasons unknown to NCUA after sending its 90-day notice and ballot to members.

Overview of NCUA's Current Conversion Rule

As noted above, the Act requires NCUA to administer the member vote on a proposed conversion and review the methods and procedures by which the vote is taken.⁹ This requirement is a directive to ensure converting credit unions provide accurate and complete disclosures to members so that they can make an informed decision about the conversion. Towards that end, NCUA's conversion rule requires a converting credit union to provide disclosures to its members with the statutorily required three written notices at 90, 60 and 30 days prior to the vote. It also specifies that the member notices must adequately describe the purpose and subject matter of the vote.

Additionally, NCUA's rule tracks the Act's language that allows a converting credit union to notify NCUA of its intent to convert. The credit union must provide NCUA a copy of its member notice, ballot, and all other written materials it has provided or intends to provide to its members in connection with the conversion. A converting credit union has the option of submitting these materials to NCUA before it distributes them to its members. This enables the credit union to obtain NCUA's preliminary determination on the methods and procedures of the member vote. If NCUA disapproves of the methods and procedures of the member vote after the vote is conducted, then NCUA may direct the credit union to take a new vote. NCUA's responsibility to review the methods and procedures of the member vote includes determining that the member notice and other materials sent to the members are accurate and not misleading, all required notices are timely, and the membership vote is conducted in a fair and legal manner. As discussed below, these requirements are consistent with and no more or less restrictive than the rules promulgated by other financial regulators, including the Office of Thrift Supervision and the Office of the Comptroller of the Currency.

A converting credit union can provide information to its members regarding any aspect of the conversion in any format it wishes, provided all communications are accurate and not misleading. In accordance with the Act and NCUA's rules, a converting credit union must provide certain minimal information in the notices to members. Most converting credit unions choose to provide significantly more information concerning the conversion.

⁹ 12 U.S.C. 1785 (b)(2)(g)(ii)

NCUA's conversion rule allows a converting credit union to communicate with its members as it deems appropriate, but requires that members receive a short, simple disclosure prepared by NCUA. This disclosure, which is included with the three notices and other written communication to members after the board votes to convert, addresses: (1) ownership and control of the credit union; (2) operating expenses and their effect on rates and services; (3) the effect of a subsequent conversion to a stock institution; and (4) the costs of conversion.

This disclosure represents basic and fundamental consumer protection. Additionally, it maximizes the ability of members to exercise real control over an institution that they not only own but to which they have contributed in the accumulation of owner equity.

Credit union members should be particularly aware of these topics as they consider voting to convert their credit union to another form of financial institution. NCUA recognizes a credit union might discuss these topics elsewhere in its communications with members, but NCUA is concerned that this information may not be conspicuous or clearly stated, given the volume of information provided. Accordingly, a converting credit union must include the form disclosures in a prominent place with each written communication it sends to its members regarding the conversion and ensure that the disclosures are conspicuous to the member. If a credit union wishes to modify the disclosure, it may do so with the prior consent of the Regional Director and, in the case of a state credit union, the appropriate state supervisory authority.

A converting credit union must conduct its member vote on a conversion in a fair and legal manner. NCUA requires the credit union to conduct the vote using secret ballots and an independent teller to ensure the integrity of the voting process and the privacy of each member's vote. To assist credit unions in achieving the goal of a fair and legal voting process, NCUA's conversion rule includes guidelines that address such topics as understanding the relationship between federal and state law, determining voter eligibility, and holding a special meeting.

H.R. 3206, "The Credit Union Charter Choice Act"

NCUA appreciates the concerns of Representative McHenry and the cosponsors of H.R. 3206, The Credit Union Charter Choice Act, for recognizing the importance of the credit union conversion issue.

Provisions NCUA Supports

Two provisions of H.R. 3206 would improve current law – the requirements for a secret ballot and an independent inspector of elections. NCUA's current conversion regulation includes both of these provisions and adding them to the statute as well will ensure that credit unions conduct charter conversion elections fairly. Further, we support the retention of the requirement to notify credit union members of the conversion vote 90, 60, and 30 days before the vote. NCUA also has no objection to

being required to review the proposed notices within 30 days. These proposed changes to the statute further enhance transparency and member ability to exert control over the voting process.

Provisions NCUA Does Not Support

However, NCUA respectfully suggests that many of the provisions of this bill will prevent the agency from achieving the goal of allowing informed credit union members to select the type of charter that best serves their needs. NCUA is concerned that provisions of H.R. 3206 will prevent members from obtaining complete and accurate information regarding the potential conversion of their credit union. H.R. 3206 seriously diminishes oversight in a conversion vote. The bill deletes the requirement for NCUA to administer the vote. Without this oversight, there would be no enforcement of the bill's notice provisions or of the requirements for secret ballots and independent inspectors of election.

NCUA does not seek to block conversions, but to ensure that member-owners of the credit union understand the fundamental change on which they are voting, and that the vote is transparent and legal. Absent NCUA's authority to administer the vote, there would be no consequences for violations of the conversion notice and voting requirements. NCUA's oversight protects members' right to complete and accurate information, and this role should be preserved.

The importance of regulatory oversight was underscored during a recent widely-publicized conversion case. Allegations were made of misrepresentations by management concerning issues such as post-conversion access to credit union shared service centers, ability of management and board members to acquire stock other than through the IPO, and ability of management to freely communicate with members. Through its oversight authority, NCUA was able to promptly address and clarify these issues.

H.R. 3206 would also prevent NCUA involvement in the key area of communications. The bill recognizes the current ability for the management of the credit union to engage, in direct communication to members in addition to the 90-, 60-, and 30-day notices, but eliminates any effective oversight on the content of this communication. Although the bill prohibits inconsistent, false, or misleading information in any additional communications, the bill prohibits NCUA from reviewing any of these communications. NCUA encourages open and honest communication to members before a conversion vote and does not seek to limit management's ability to communicate about a conversion proposal. However, any such communications should be subject to oversight to ensure accuracy and fairness.

NCUA is concerned that the prohibition on "speculative" information about the institution's future operations is subject to interpretation. The bill is also unclear about what type of information would "distort the impact of conversion," another prohibited item in notices. Similarly, the prohibition on "information attributable to the Board" could

be interpreted to prevent the inclusion of NCUA-suggested language in notices, but another section of the bill charges NCUA with reviewing and commenting on proposed conversion notices.

Another area of uncertainty involves the conflicting standards the bill establishes for review of the conversion process. For example, one section of the bill would prohibit post-vote review unless there were "fraud or reckless disregard for fairness," but another section prohibits NCUA from requiring a new membership vote unless a communication "contains a knowingly false statement that affects the outcome of a conversion vote."

Effects of H.R. 3206 on Current Regulatory Requirements

The bill would appear to prohibit the NCUA mandated disclosure of additional critical facts of a conversion that are necessary for members to make an informed decision. Below is a discussion of NCUA's specific concerns based on our experience with the current conversion rule.

A. Higher loan rates or lower savings rates

NCUA's rule requires that the disclosures include verbiage that members may experience higher loan rates or lower savings rates. This requirement has been criticized as speculative or uncertain. NCUA disagrees. NCUA engaged the services of Datatrac Corporation to gather and analyze data on historic loan and savings rates and verify the possible adverse changes in post-conversion rates.¹⁰ Datatrac provided NCUA data on over 20 distinct loan and savings products offered by thousands of banks and credit unions.¹¹ Datatrac broke each of these products down into average rates for all institutions over several years. Datatrac data for 2002-2005 is attached as appendix A. The data is clear: the historic consumer loan and savings rates offered by credit unions are more favorable for members than those same rates offered by banks of all types, including savings banks.

Recently, researchers at the Fiscal and Economic Research Center at the University of Wisconsin - Whitewater also examined the differences in loan and savings rates between credit unions and banks.¹² That study considered loans and savings rate data from 175 credit unions and banks, including some banks that had converted from credit unions. The study's findings were consistent with NCUA's analysis of the Datatrac data, including that "[c]redit unions offer significantly higher interest rates on

¹⁰ Datatrac is a market research, information technology company specializing in the financial services industry. It has been an independent source of deposit and lending product information for more than 15 years, specializing in the banking and credit union industries and representing that it provides its services to over 17,000 financial institutions nationwide.

¹¹ These products included automobile loans; fixed and variable rate mortgage products; credit cards; and savings products, such as short and long-term certificates of deposit, savings, checking, and money market accounts.

¹² J. Heinrich and R. Kashian, *Credit Union to Mutual Conversion: Do Rates Diverge?*, February 22, 2006 (hereinafter the Heinrich study). A copy of the study is attached as Appendix B.

all savings products examined and charge lower interest rates on three of four loans products compared to converted credit unions after accounting for all other variables.”¹³

NCUA respectfully submits that a disclosure about the consequences on loan and savings rates is crucial to a member’s informed decision and vote on changing from a credit union to another financial institution charter.

B. Distribution of Owner Equity

The conversion rule requires that the disclosure include language that conversion to an MSB is often a prelude to a stock conversion in which insiders realize financial gain far in excess of that available to average members. The history of the 29 former credit unions that converted to mutual savings banks provides a useful guide to what happens to former member equity after a conversion occurs.

Of those 29 mutual savings banks, 21 have converted to stock institutions. A mutual-to-stock conversion permits directors and officers to obtain significant financial benefits from the conversion, in part through the acquisition and control of stock. The directors and officers obtain ownership and control of stock in several different ways. While other members of the converting MSB have access to stock, none of them have the same access as the directors and officers.

After a stock conversion, a converted bank may establish an Employee Stock Ownership Plan (ESOP), funded by the bank, as well as additional stock benefit plans for directors and officers, such as a management stock benefit plan and a stock option plan. Members of the credit union-turned-MSB who are not employees or directors cannot participate in these stock plans.

NCUA is not suggesting that there is anything improper about the management and the compensated directors of a corporation having a vested interest in the company’s financial performance. However, using a simple example to illustrate the point, if a credit union with \$100 million in net worth converts to a mutual and then to a stock bank, and the officers, directors, and employees exercise their rights through the IPO, ESOP, stock option plan, and management stock benefit plan, they may own 25% or more of the total stock. This represents, among other compensation, a transfer of \$25 million to those individuals that was previously member-owner equity in the credit union. Members who own the credit union and its net worth have a right to know when they vote on a proposed conversion that the officials who are recommending the conversion stand to benefit from this kind of transfer of member equity.

Distribution of member equity in the form of stock is an important facet in the conversion process. Even though all members of the converting institution technically have equal subscription rights during the initial public offering (IPO) of stock, directors and officers

¹³ Id. at 1.

are able to use their position to gain greater understanding of and access to the IPO subscription than other members. Rules governing federally chartered mutual savings banks (FMSB) to stock conversions were specifically written to “enhance the ability of officers, directors, and employees of an institution to acquire stock when their institution converts, through various types of employee stock benefit vehicles . . . [so as to] . . . provide a means for officials and employees of converting institutions to acquire larger ownership stakes in their institutions upon conversion”¹⁴

These rules permit the MSB directors, officers, employees, and the benefit plans created for those persons to obtain a substantial portion of the shares and the associated net worth of the institution. This fact is not lost on those who advocate conversion. Consultants who advise credit unions to pursue conversions make specific claims about the magnitude and extent of the financial benefits available to the directors and officers at converting credit unions. One newsletter article prepared by such a consultant states:

- Bank CEOs typically receive much greater compensation than credit unions CEOs, with the bank CEOs receiving from 20% to 57% more for institutions of similar assets size.¹⁵
- Bank directors typically earn between \$2,500 to over \$50,000 annually, in addition to travel and expense allowances, while credit union directors are uncompensated in almost every instance.¹⁶
- The gap in pay can be much wider at individual banking institutions that utilize stock compensation programs. For example, assuming a credit union with \$50 million in capital converts to a stock bank with an IPO amount of \$100 million, directors would share a \$2 million grant of stock and management would receive an equal grant. Each member of a five-director board would get \$400,000 in stock, vested over five years, at the IPO value.¹⁷

This article continues by detailing various other opportunities for a credit union-turned-bank executive to accrue wealth, and concludes “[t]he reward for performance could lead to a \$10 million plus, ownership stake for a capable CEO If the conversion is not made during the current tenure, the next CEO in charge may very well realize the value.”¹⁸

¹⁴ 51 Fed. Reg. 40127 (November 5, 1986)(Preamble to final Federal Home Loan Bank Board rule on federal mutual savings bank stock conversions).

¹⁵ Theriault, Alan D., *CEO & Directors: Salary Imbalance is Corrected by Converting to a Bank*, CONVERTING FROM A CREDIT UNION FAX UPDATE, Sept. 16, 2002, available at <http://www.cufinancial.com/pdfs/NL2002.pdf>.

¹⁶ *Id.*

¹⁷ *Id.*

¹⁸ *Id.* at 2-3.

The financial trade press has reported on the specific benefits that directors and officers of credit unions obtain from their access to stock following a mutual to stock conversion. In one converted credit union, the officers and directors made \$7 million in profit on the IPO increase in value, commonly called an "IPO pop,"¹⁹ and set aside another \$5 million in free stock for themselves through stock benefit plans.²⁰ At another converted credit union, the officers and directors amassed more than \$14 million in stock and cash benefits during the three-year period following stock conversion, with the CEO alone receiving \$4 million in cash compensation and \$3 million in stock.²¹ At still another converted credit union, the officers and directors made about \$1 million in profits at the time of the IPO and set aside another \$3.5 million that was later distributed to those officers and directors.²² At another converted credit union, the CEO made \$600,000 on the IPO, received rights to another \$1 million in stock, and received additional stock option benefits.²³

NCUA maintains there is ample evidence to support the conclusion, as set forth in the required disclosures, that "[i]n a typical conversion to the stock form of ownership, the executives of the institution profit by obtaining stock far in excess of that available to the institution's members."²⁴ If the potential benefits that may accrue to the credit union officials are accurately disclosed, and there is transparency in the process, NCUA has no concern with the transfer of member-owner equity. Experience has shown us that in the absence of regulatory oversight, these disclosures are not accurately or prominently made.

¹⁹ See *Credit Union Journal Daily*, February 22, 2003, located at www.cujournal.com (discussing the conversion of Rainier Pacific Credit Union).

²⁰ "On Feb. 17, directors of [Rainier Pacific Financial Group, the parent of Rainier Pacific Savings Bank], known until 2000 as Rainier Pacific CU, approved a lucrative post-conversion compensation for both themselves and managers. Under the plan, disclosed in documents filed with the Securities and Exchange Commission, top executives and directors of Rainier Pacific will be granted a total of 288,500 shares of stock valued at almost \$5 million, to be vested over the next five years. The largest recipients will be [the President and CEO], who will receive 60,000 shares valued at almost \$1 million, and [the Senior Vice President], who will receive 40,000 shares valued at more than \$650,000. But directors also voted themselves a share in the so-called management recognition stock plan, with each of the eight non-employee directors in line for 10,000 shares valued at \$165,000 over the next five years. That's on top of the \$13,750 each of the once-volunteer directors now earns each year to serve on the board. But that's not all. The group, as well as other employees will share in a pool of options to buy 680,000 bank shares at a discount over the next five years. Officials of Rainier Pacific did not return phone calls last week to comment." "Taking It to the Bank; Filings Show How CEOs, Boards at Converts Have Cashed In," *Credit Union Journal*, March 29, 2004, p.1 (hereinafter Taking it to the Bank).

²¹ See "Excessive Compensation Charged at Convert CU," *Credit Union Journal Daily*, February 6, 2006 (Discussing SEC proxy filings involving the converted Synergy Federal Credit Union).

²² "The biggest winners at Kaiser [Federal Credit Union] were [the CEO] who bought the maximum allowable 30,000 shares, netting her \$108,000 in IPO profits. Four directors and two other top execs also subscribed to the maximum 30,000 allotment. In all, the four top managers and six non-management directors earned \$918,000 of profits on their 265,000 shares in last week's IPO. The ex-CU has also set aside another 255,000 shares, worth \$3.5 million, as free stock grants to be awarded to the same individuals over the next five years." *Credit Union Journal*, April 5, 2004, p.1.

²³ See Taking it to The Bank, *supra* note 23 (Discussing the conversion of Pacific Trust Credit Union); *Credit Union Journal*, February 25, 2004. Four years after the IPO, the CEO had received stock grants and stock options of a total value of about \$3.8 million. *Credit Union Journal*, April 14, 2006.

²⁴ 12 C.F.R. §708a.4(c).

C. Voting Rights

NCUA's conversion rule requires converting credit unions explain to members how the conversion from a credit union to an MSB will affect members' voting rights and whether the MSB will base voting rights on account balances. Voting rights in credit unions and MSBs are in fact different in two important ways: (1) the use of proxy voting and (2) how many votes each member gets.

Proxy voting is not allowed in Federal credit unions, meaning that credit union members cannot delegate their voting rights to the credit union's board of directors. Federal mutual savings banks, in contrast, are allowed to use proxy voting, and they typically collect these proxies from their account holders at the time of account opening. With the exception of the vote to convert to a stock charter, these proxies may be "running," meaning that the MSB's board of directors will vote the proxies indefinitely unless the account holder takes action to affirmatively revoke the proxy.²⁵ Also, credit unions are purely democratic. Every member gets one vote, regardless of account balances. Federal MSBs may choose to dilute the voting power of lower balance depositors by allotting each customer one vote per \$100 on deposit, up to 1000 votes.²⁶ Recently converted credit unions have elected this account balance voting option. One result is that directors, officers and other customers of greater means have increased voting power in determining whether to convert to a stock institution.

D. Regulatory Consistency

Section 205 of the Act, as amended by CUMAA, requires that NCUA's conversion rules be consistent with the rules of other financial regulators, including OTS and the Office of the Comptroller of the Currency and that NCUA's rules be "no more or less restrictive" than the rules applicable to charter conversions by other financial institutions.²⁷

Clearly, NCUA's rule cannot and should not be identical to those of the other regulators. The other regulators' rules are not identical to one another, making cross-uniformity impossible for NCUA. More importantly, the rules address different transactions, with different statutory requirements, requiring different regulatory approaches. NCUA interprets the consistency requirement as a mandate that NCUA's rules be compatible with and adhere to the same principles as the conversion rules of other regulators.

²⁵ "In practice, members delegate voting rights and the operation of federal mutual savings associations through the granting of proxies typically given to the board of directors (trustees) or a committee appointed by a majority of the board." OTS Thrift Activities Regulatory Handbook, Section 110.2 (December 2003).

²⁶ An FMSB may adopt a range of voting rights, from one-person one-vote to one vote per \$100 account balance up to 1000 votes. NCUA believes, however, that all credit unions that have converted to FMSBs to-date have made a conscious decision to abandon the one-person one-vote concept.

²⁷ 12 USC 1785(b)(2)(G)(i).

Similarly, NCUA interprets the “no more or less restrictive” requirement to mean that, consistent with underlying principles of informed member choice, NCUA should adopt restrictions of other regulators that make sense for credit union conversions, while not confining a credit union’s choices more significantly than the regulatory options of other institutions.

By comparison to NCUA’s rules, OTS maintains significant authority over the conversion approval process from mutual associations to stock associations and remains involved throughout the entire process.²⁸ The rules of both OTS and NCUA have different requirements at different stages of a conversion; some of these requirements are more detailed than that of the other agency, given that the conversions governed by each agency differ.

For example, OTS’s involvement in the conversion process is mandatory even before the board of the mutual association passes a conversion plan; the board of the converting mutual bank must meet with OTS prior to passing the conversion plan and provide OTS with a written strategic plan that outlines the objectives of the proposed conversion and the intended use of the conversion proceeds.²⁹ NCUA’s rules by comparison do not require a mandatory meeting prior to the board of the credit union passing a conversion plan or a business plan. OTS also requires that a converting MSB adopt a plan of conversion that contains specific information.³⁰ NCUA’s rules merely require that the converting credit union “approve a proposal to convert,” but do not dictate what must be in that proposal.³¹

The notice requirements differ between OTS and NCUA because MSBs and credit unions are structurally different. The difference is highlighted by the individuals they may serve or with whom they can transact business. Any member of the public may utilize an MSB. Thus, the MSB must notify the public-at-large of the potential conversion. OTS’s notice requirements mandate that the converting MSB publish a notice of its application and post the notice in the bank’s home office and at all branch offices; the converting MSB must also send notice of the plan’s approval either by mailing a letter to each member or by publishing a notice in the local newspaper in every local community where the bank has an office.³²

Credit unions, on the other hand, do not serve the public-at-large, but serve a defined group of members.³³ By statute, those members must each receive notice “on the matter of” the credit union’s intent to convert at the prescribed 30-day intervals.³⁴ The fact that NCUA requires certain information in its notice that OTS does not similarly require does not render NCUA’s notice provision in violation of the statute. Both

²⁸ See 12 C.F.R. part 563b.

²⁹ See 12 C.F.R. §§ 563b.100, 563b.105 (outlines required information to be included in business plan).

³⁰ See 12 C.F.R. §§ 536b.125, 536.130.

³¹ See 12 C.F.R. § 708a.3.

³² *Supra* note 53; 12 C.F.R. §§ 536b.135, 563b.180.

³³ See 12 U.S.C. 1759.

³⁴ 12 U.S.C. 1785(2)(C).

agencies essentially prohibit their converting entities from omitting any material facts in their notices.³⁵ NCUA requires that converting credit unions include certain disclosures in its notices, precluding them from omitting these material facts. NCUA maintains that the provisions of its current conversion rule do not exceed NCUA's statutory authority, are consistent with other financial regulators and are no more or less restrictive than rules applicable to charter conversion by other financial institutions.

E. Management Communication with Members

NCUA's conversion rule does not prevent a converting credit union from communicating with its members to refute or correct misinformation supplied by groups opposed to the conversion. The disclosures required by §708a.4(e) of NCUA's regulations provide important, factual information to make members aware of the potential effects of converting to a bank so they can make an informed decision. Any credit union that has a concern about the disclosures can contact the appropriate NCUA Regional Director to request that the disclosures be modified to address those concerns.³⁶

While §708a.4(e) requires a converting credit union to include NCUA's disclosures with written conversion-related communications to its members, there are communications to which the requirement does not apply. NCUA has advised the attorneys who have represented most converting credit unions that conversion-related press releases and advertisements, not directly mailed to members, are not written communications to members contemplated by §708a.4(e).

Additionally, the form disclosures are not required until after the board of directors vote to approve a plan of conversion. Therefore, a credit union is free to communicate with its members in any way it deems appropriate, before the board's vote on the plan of conversion, to provide its members with earlier notice that conversion is under consideration without including the NCUA disclosure. Indeed, many who have opposed recent credit union conversions have complained that they learned of the board's intention to convert only when they received the first (90-day) notice and ballot.

Finally, communications with individual members, in response to specific questions posed by these members, are not required to be accompanied by the NCUA disclosures under §708a.4(e).

Possible Changes to the Conversion Rule

NCUA believes that certain changes can and should be made to clarify and improve its conversion rule. NCUA recognizes and fully supports the rights of credit union members to convert their credit union to a bank charter. This charter change, however, is a fundamental shift in the institution's structure, which in turn changes the rights of the

³⁵ See, e.g., 12 C.F.R. § 563b.285.

³⁶ 12 C.F.R. §708a.4(e).

owner-members. The services supplied to the members, and the cost of those services to the members, are also likely to change.

The decision to change to a bank charter ultimately belongs to the credit union members. It belongs directly to the members in the sense that the member vote decides the conversion issue. It also belongs to the members because the directors, when adopting a proposal to convert to a bank and advocating that position to the members, have a fiduciary duty to act in the best interests of the members.

With these fundamental issues at stake, and with NCUA's statutory obligation, it is imperative that the voting process be transparent and fair. Inherent to the process is the right of members to be fully informed as to the reasons for the proposed conversion. They must also have time to consider the pros and cons of the proposed conversion and should have an opportunity to discuss the proposal with other members and to communicate their views to the credit union's directors. This is not possible under the procedures currently used by converting credit unions, where members first receive notice at the time the ballot is mailed. The current conversion process can be improved to facilitate the quality and flow of information about the conversion between and among members and directors.

One possible regulatory change NCUA is considering would require a converting credit union to give advance notice to members that the credit union's board intends to vote on a conversion proposal. This notice would provide members, whether they are initially for or against the conversion, an opportunity to express their opinions to the credit union's board before the board has expended significant resources on the conversion process. NCUA has determined that some states have adopted similar early notice laws and regulations for their state-chartered credit unions considering conversion to banks.³⁷

Another change under consideration would further enhance member involvement and communication. OTS regulations require a thrift to forward information from one customer to all the thrift's customers if the requesting customer agrees to reimburse the thrift for its expenses. No such system currently exists in NCUA regulations for credit union members to communicate with each other about a pending conversion, and we believe it may be a valuable tool to improve the member decision process in conversions.

NCUA is considering whether the disclosures that a credit union must provide to its members as part of the conversion process should be simplified. NCUA's required disclosures have been characterized by some as inhibiting a credit union board's ability to communicate with their members outside the formal notice process. While NCUA respectfully disagrees with this characterization, NCUA is considering modifying the

³⁷ See, e.g., Mich. Comp. Laws 490.373(1)(a) and (1)(b)(ii) and 8 Vt. Stat. Ann. Tit. 8, §35102 (2006).

current requirement that certain disclosures be delivered with all written communications, and, instead, only require that those disclosures be delivered with the formal notices of member vote.

NCUA will continue to refine the proposed rule prior to Board issuance for public comment. The actual proposed rule may include all or some of the ideas under consideration, as well as additional suggestions from commenters. Of course, NCUA will carefully consider all comments it receives before issuing final amendments to the conversion rule. NCUA believes that such a rulemaking is timely and will provide for a clearer, more efficient and effective conversion rule.

Conclusions and Recommendations

Credit unions exist for the purpose of promoting thrift and providing a source of credit for their members. Since their inception, credit unions have been organized as democratically controlled, nonprofit cooperatives, managed by volunteer directors. Credit unions exist to provide affordable services to their members, rather than to maximize profits to outside investors or stockholders. Credit unions are unique and an important financial option for consumers.

While NCUA fully supports the ability of members to vote democratically to change the charter of their financial institution, NCUA also believes its primary role in this matter is to ensure that members receive complete, accurate, and timely disclosures regarding the conversion. Consumers have a right to expect regulatory bodies to carefully monitor the disclosures to ensure transparency and maximize the amount of control that the member-owners exercise over their credit unions. In the same vein, Congress has a valid and important oversight role in the process, and consumers derive benefits from the active interest on the part of their elected representatives. NCUA supports the provisions of H.R. 3206 that make the requirements of a secret ballot and an independent inspector of elections statutory. As discussed previously, NCUA believes other provisions of the bill would interfere with the Agency's ability to ensure that credit union members receive clear, complete and accurate information on a conversion.

NCUA believes that any changes to improve the conversion process can be accomplished through regulation. In that regard, NCUA is taking steps to enhance clarify, and improve the effectiveness of its regulation. NCUA remains concerned that, absent important regulatory refinements outlined in this statement, consumers may not have access to plainly-worded, accurate and prominent disclosures that inform them about their stake in a charter change. When member-owners are asked to vote on their credit union's future, they should have every opportunity to assess all facts and make an informed choice. Ownership, particularly of the kind conferred by membership in a financial cooperative, is a significant and important concept that should be protected by diligent regulatory oversight.

NCUA looks forward to working with Congress and the credit union industry to address these important issues.

Appendix A

Appendix AComparison of Historical Rates: Credit Unions, Savings Banks, and Other Banks

Data compiled by Datatrac, Inc.

Contact: Ken Wanek at 1-800-257-7101.

*36 month Used Auto Loan, 2 Year-Old Auto**(Comparison of average credit union, savings bank, and other bank rates at year-end)*

Type of Institution	Rates at Year-end 2003	Rates at Year-end 2004	Rates at Year-end 2005
Credit Unions	4.94	4.95	5.62
Savings Banks	7.05	6.96	7.49
Other Banks	7.78	7.09	7.78

*48 month Used Auto Loan, 2 Year-Old Auto**(Comparison of average credit union, Savings Bank, and other bank rates at year-end)*

Type of Institution	Rates at Year-end 2003	Rates at Year-end 2004	Rates at Year-end 2005
Credit Unions	5.05	5.07	5.72
Savings Banks	7.05	6.92	7.51
Other Banks	7.21	7.14	7.81

*48 Month New Auto Loan**(Comparison of average credit union, Savings Banks, and other bank rates at year-end)*

Type of Institution	Rates at Year-end 2003	Rates at Year-end 2004	Rates at Year-end 2005
Credit Unions	4.72	4.76	5.44
Savings Banks	6.52	6.37	6.93
Other Banks	6.49	6.43	7.12

Appendix AComparison of Historical Rates: Credit Unions, Savings Banks, and Other Banks

Data compiled by Datatrac, Inc.

Contact: Ken Wanek at 1-800-257-7101.

*60-month New Auto Loan**(Comparison of average credit union, Savings Banks, and other bank rates at year-end)*

Type of Institution	Rates at Year-end 2003	Rates at Year-end 2004	Rates at Year-end 2005
Credit Unions	4.84	4.88	5.57
Savings Banks	6.61	6.44	7.04
Other Banks	6.56	6.51	7.21

*36 Month Unsecured Loan, Fixed Rate**(Comparison of average credit union, savings bank, and other bank rates at year-end)*

Type of Institution	Rates at Year-end 2003	Rates at Year-end 2004	Rates at Year-end 2005
Credit Unions	11.10	10.82	10.97
Savings Banks	12.27	12.37	12.41
Other Banks	12.02	12.04	12.50

*1 Year Adjustable Rate Mortgage**(Comparison of average credit union, savings bank, and other bank rates at year-end)*

Type of Institution	Rates at Year-end 2003	Rates at Year-end 2004	Rates at Year-end 2005
Credit Unions	3.72	4.06	4.92
Savings Banks	4.00	4.23	5.30
Other Banks	4.04	4.49	5.68

Appendix AComparison of Historical Rates: Credit Unions, Savings Banks, and Other Banks

Data compiled by Datatrac, Inc.

Contact: Ken Wanek at 1-800-257-7101.

*15 Year Fixed Rate Mortgage**(Comparison of average credit union, savings bank, and other bank rates at year-end)*

Type of Institution	Rates at Year-end 2003	Rates at Year-end 2004	Rates at Year-end 2005
Credit Unions	5.31	5.32	5.98
Savings Banks	5.23	5.24	5.92
Other Banks	5.32	5.25	5.98

*3 Year Adjustable Rate Mortgage**(Comparison of average credit union, savings bank, and other bank rates at year-end)*

Type of Institution	Rates at Year-end 2003	Rates at Year-end 2004	Rates at Year-end 2005
Credit Unions	4.34	4.59	5.55
Savings Banks	4.40	4.70	5.66
Other Banks	4.46	4.88	5.95

*30 Year Fixed Rate Mortgage**(Comparison of average credit union, savings bank, and other bank rates at year-end)*

Type of Institution	Rates at Year-end 2003	Rates at Year-end 2004	Rates at Year-end 2005
Credit Unions	5.92	5.82	6.38
Savings Banks	5.93	5.81	6.39
Other Banks	5.95	5.79	6.39

*5 Year Adjustable Rate Mortgage**(Comparison of average credit union, savings bank, and other bank rates at year-end)*

Type of Institution	Rates at Year-end 2003	Rates at Year-end 2004	Rates at Year-end 2005
Credit Unions	4.96	5.06	5.82
Savings Banks	4.97	5.07	5.83

Appendix AComparison of Historical Rates: Credit Unions, Savings Banks, and Other Banks

Data compiled by Datatrac, Inc.

Contact: Ken Wanek at 1-800-257-7101.

Other Banks	5.04	5.19	6.09
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*Credit Card (Classic)**(Comparison of average credit union, savings bank, and other bank rates at year-end)*

Type of Institution	Rates at Year-end 2003	Rates at Year-end 2004	Rates at Year-end 2005
Credit Unions	12.18	11.97	12.06
Savings Banks	11.92	11.60	13.27
Other Banks	12.33	12.39	14.13

*Credit Card (Gold)**(Comparison of average credit union, savings bank, and other bank rates at year-end)*

Type of Institution	Rates at Year-end 2003	Rates at Year-end 2004	Rates at Year-end 2005
Credit Unions	10.40	10.25	10.26
Savings Banks	10.75	10.51	10.86
Other Banks	10.49	10.83	11.13

*3 Month Certificate of Deposit (Share Certificate), \$10,000 Minimum**(Comparison of average credit union, savings bank, and other bank rates at year-end)*

Type of Institution	Rates at Year-end 2003	Rates at Year-end 2004	Rates at Year-end 2005
Credit Unions	1.13	1.48	2.59
Savings Banks	0.94	1.34	2.31
Other Banks	0.87	1.29	2.29

*6 Month Certificate of Deposit (Share Certificate), \$10,000 Minimum**(Comparison of average credit union, savings bank, and other bank rates at year-end)*

Type of Institution	Rates at Year-end 2003	Rates at Year-end 2004	Rates at Year-end 2005
Credit Unions	1.35	1.79	3.13
Savings Banks	1.11	1.65	2.88

Appendix AComparison of Historical Rates: Credit Unions, Savings Banks, and Other Banks

Data compiled by Datatrac, Inc.

Contact: Ken Wanek at 1-800-257-7101.

Other Banks	1.04	1.63	2.83
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*1 Year Certificate of Deposit (Share Certificate), \$10,000 Minimum
(Comparison of average credit union, savings bank, and other bank rates at year-end)*

Type of Institution	Rates at Year-end 2003	Rates at Year-end 2004	Rates at Year-end 2005
Credit Unions	1.62	2.22	3.62
Savings Banks	1.35	2.05	3.37
Other Banks	1.27	2.03	3.34

*2 Year Certificate of Deposit (Share Certificate), \$10,000 Minimum
(Comparison of average credit union, savings bank, and other bank rates at year-end)*

Type of Institution	Rates at Year-end 2003	Rates at Year-end 2004	Rates at Year-end 2005
Credit Unions	2.11	2.79	3.93
Savings Banks	1.88	2.63	3.64
Other Banks	1.80	2.55	3.59

*3 Year Certificate of Deposit (Share Certificate), \$10,000 Minimum
(Comparison of average credit union, savings bank, and other bank rates at year-end)*

Type of Institution	Rates at Year-end 2003	Rates at Year-end 2004	Rates at Year-end 2005
Credit Unions	2.60	3.28	4.14
Savings Banks	2.42	3.04	3.83
Other Banks	2.30	2.97	3.79

*4 Year Certificate of Deposit (Share Certificate), \$10,000 Minimum
(Comparison of average credit union, savings bank, and other bank rates at year-end)*

Type of Institution	Rates at Year-end 2003	Rates at Year-end 2004	Rates at Year-end 2005
Credit Unions	2.98	3.66	4.33

Appendix AComparison of Historical Rates: Credit Unions, Savings Banks, and Other Banks

Data compiled by Datatrac, Inc.

Contact: Ken Wanek at 1-800-257-7101.

Savings Banks	2.74	3.32	3.94
Other Banks	2.64	3.27	3.91

*5 Year Certificate of Deposit (Share Certificate), \$10,000 Minimum
(Comparison of average credit union, savings bank, and other bank rates at year-end)*

Type of Institution	Rates at Year-end 2003	Rates at Year-end 2004	Rates at Year-end 2005
Credit Unions	3.43	4.07	4.58
Savings Banks	3.22	3.73	4.20
Other Banks	3.08	3.61	4.13

*Interest Checking Account (Dividend Checking)
(Comparison of average credit union, savings bank, and other bank rates at year-end)*

Type of Institution	Rates at Year-end 2003	Rates at Year-end 2004	Rates at Year-end 2005
Credit Unions	0.48	0.48	0.51
Savings Banks	0.44	0.42	0.49
Other Banks	0.32	0.34	0.45

*Money Market Account
(Comparison of average credit union, savings bank, and other bank rates at year-end)*

Type of Institution	Rates at Year-end 2003	Rates at Year-end 2004	Rates at Year-end 2005
Credit Unions	0.97	1.01	1.44
Savings Banks	0.65	0.70	0.99
Other Banks	0.51	0.57	0.85

*Regular Savings Account, \$10,000 minimum
(Comparison of average credit union, savings bank, and other bank rates at year-end)*

Type of Institution	Rates at Year-end 2003	Rates at Year-end 2004	Rates at Year-end 2005

Appendix AComparison of Historical Rates: Credit Unions, Savings Banks, and Other Banks

Data compiled by Datatrac, Inc.

Contact: Ken Wanek at 1-800-257-7101.

Credit Unions	0.56	0.55	0.67
Savings Banks	0.60	0.60	0.67
Other Banks	0.49	0.36	0.49

Appendix B

Credit Union to Mutual Conversion: Do Rates Diverge?

Prepared by the Fiscal and Economic Research Center
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All the views expressed in this report are those of the authors.

February 22, 2006

Executive Summary

This study conducts a cross-sectional analysis of 175 depository institutions, assessing the impact on the interest rates charged on loan products and offered on savings products by the size of the institution, its liquidity, its net worth, its tax and salary payments, and its status as a credit union, a traditional banking institution, or a converted credit union (i.e., an institution that recently converted from a credit union charter to a banking institution charter). The principal findings are:

- Credit unions offer significantly higher rates on savings accounts and lower rates on many loan products than do banking institutions after accounting for all other variables.
- Credit unions offer significantly higher interest rates on all savings products examined and charge lower interest rates on three of four loan products examined compared to converted credit unions after accounting for all other variables.
- Although we identify a significant credit union pricing advantage compared to both traditional banking institutions and converted credit unions, we are unable to conclude that this advantage arises simply from differences in tax status or salary levels. This suggests that other factors associated with the cooperative structure of credit unions also play a role in the credit union pricing advantage.

1. INTRODUCTION

Over the past ten years, roughly 30 credit unions in the U.S. have converted to mutual banking institutions. The majority of these institutions have subsequently converted to stockholder-owned banking institutions. This activity, while very limited in terms of number of institutions, has been hotly debated. Advocates of this activity say that converted credit unions can maintain and even improve the level of financial benefits delivered to members. They argue these conversions increase flexibility and make institutional growth easier. Opponents, on the other hand, say that in almost every case this process has been motivated by insider greed because it results in a massive transfer of wealth from credit union members to insiders. Opponents also say that the financial benefits provided to credit union members are substantially reduced after conversion. Further, opponents argue, credit union members are not properly informed of these negative consequences of the conversions.

In a recent directive, the National Credit Union Administration (NCUA) proposed that a converting credit union include the following disclosures in each written communication it sends members regarding conversion: "Credit union directors and committee members serve on a volunteer basis. Directors of a mutual savings bank are compensated. Credit unions are exempt from federal tax and most state taxes. Mutual savings banks pay taxes, including federal income tax. If [insert name of credit union] converts to a mutual savings bank, these additional expenses may contribute to lower savings rates, higher loan rates, or additional fees for services".

This powerful paragraph intends to warn credit union members of the consequences of demutualization. However, this statement is without citation or evidence by the regulators. It could be argued that, without evidence supporting this claim, the NCUA is simply protecting its turf and conducting an argument that retains membership. As a result, several considerations demand examination. All relate to the issue of member/owner benefits and include considerations of the financial benefits associated with interest rates on deposits and loans. First,

do recently converted credit unions charge lower loan interest rates and/or pay higher dividend rates on savings than credit unions? Second, do salary differences, which would to some extent reflect the compensation of directors, result in significant consumer interest rate-related pricing differences between institutions? We approach these questions by comparing not just traditional banking institution rates to credit union rates, but also by analyzing the interest rate differentials between credit unions and recently-converted credit unions (i.e., institutions that converted from credit union charters to banking institution charters).

2. LITERATURE REVIEW

While relatively small, credit unions hold a material position in the market as a supplier of financial services: credit unions' provide for 12.4% of the consumer credit market (Srinivasan and King, 1998). Feinberg (2002) argues that credit unions serve the market on the fringe, resulting in lower loan interest rates. Feinberg based his argument on the relationship between credit union concentration and interest rates on unsecured loans at banks: as the share of deposits held in credit unions rise, bank loan interest rates fall. Tokle and Tokle (2000) determine that large, chain banks pay lower interest rates on deposits than do credit unions. Tokle and Tokle (2000) also do not address a critically important question: do banking institutions and credit unions offer significantly different interest rates? This idea, that there is an institutional difference in interest rates, recognizes that other factors may also account for interest rate differentials between institutions. These factors, which we use as independent variables, include salary payment differences, size differences (economies of scale), and differences in market concentration. Institutional differences owing to philosophical differences between credit unions and banking institutions, or differences in institutional objectives may be important but we do not attempt to quantify those factors as such here.

While there is limited literature regarding interest rate differentials specifically in the area of credit union vs banking institutions, there is research within the banking sector that analyzes a variety of determinants within the industry. McCall (1980) determined that higher bank

concentration results in lower deposit interest rates and higher interest rates on loans. Focarelli and Panetta (2003) find that there is an inverse and significant relationship between asset size and deposit interest rates.

Berger and Hannan (1989) find that banks in markets with a high local banking wage rate witness significantly higher deposit interest rates. Hannan (2003) finds that thrifts offer higher rates on money market deposits than banks. In addition, Hannan finds negative relationships between a) asset size and deposit interest rates, and b) teller wages and deposit interest rates. Feinberg and Rahman (2001) find that there is a competitive interaction between credit unions and banks within a defined market: the greater the presence of credit unions, the lower the interest rates on loans charged by banks. Feinberg (2003), in his comparison of credit unions and bank rates, finds that loan interest rates fall with asset size for both unsecured and new vehicle loans, and in a follow-up piece [Feinberg (2004)] based on those results calculates that a halving of credit union market share would imply an increase in nationwide bank customer borrowing costs of \$1.73 billion annually.¹

There is no readily available research regarding the impact taxes have on interest rates. However, the general expectation is that banking institutions have less favorable interest rates than credit unions to compensate for the taxes that are paid to the government. If this is accurate, it is argued that the tax exempt status of credit unions is simply a subsidy. However, due to methodological difficulties it is not possible for us in this paper to evaluate this claim.

3. METHODOLOGY

In all of the regressions that are presented, the dependent variable is the interest rate for a savings or loan product. The seven products in question are standard savings accounts; interest-bearing checking accounts; 1-year Certificates of Deposit; money market accounts; 48-month

¹ In a related exercise, Tokle (2005) uses the estimates from Tokle and Tokle (2000) and Hannan (2002) to estimate that a decline in credit union market share of one deviation would decrease bank customer interest payments on CDs by \$203 million and \$726 million, respectively, and decrease bank customer interest payments on money market deposits by \$1.67 billion and \$1.8 million respectively.

used car loans; 60-month new car loans; and regular visa credit cards². A number of independent variables are employed across all regressions and consistent with similar measures found in the literature. One is a measure of market concentration, the Herfindahl-Hirschman Index (HHI index). The HHI is a widely-accepted measure of market concentration calculated by squaring the market share of each firm competing in a market and then summing the resulting numbers. The HHI can range from close to zero to 10,000, with higher values corresponding to higher levels of market concentration. This analysis uses the HHI for each Metropolitan Statistical Area (MSA), expressed in log form ($\ln HHI$). Other independent variables include total assets of the institution as a measure of size, also in log form ($\ln Assets$); the Capital-to-Asset ratio as a measure of the institution's net worth ($Capital/A$); the Loan-to-Asset ratio as a measure of institutional liquidity ($Loan/A$); and the salary-to-asset ratio as a measure of labor costs which will to an uncertain extent indirectly include director compensation differentials ($Salary/A$).

In addition, we include a dummy variable to help us identify institutional pricing differences that are not captured by the aforementioned independent variables. The dummy simply identifies the row in the regression as a credit union, a recently-converted credit union, or a banking institution. If, for example, a regression is conducted in which we are comparing the current credit union loan rates with banking institutions, the banking institution is given a value of one (1) while the credit union is provided a value of zero (0). If the coefficient on banking institution is positive and significant, it means that the banking institution will charge a higher loan interest rate than a credit union. For each product, three regressions are run corresponding to three sets of institutions included in the sample:

1. Regressions "a" include credit unions and all banking institutions (i.e., thrifts, and commercial banks, including recently converted credit unions);

² We also ran regressions for home equity loans, 36-month unsecured loans and gold credit cards, but these regressions yielded no results of any statistical significance with regards to our primary concern, namely the impact of credit union conversion.

2. Regressions “b” include credit unions and recently-converted credit unions (i.e., former credit unions); and
3. Regressions “c” includes credit unions and banking institutions that have never been credit unions.

In each case, the dummy is assigned to all banking institutions with credit unions remaining the excluded variable. The dummies are denoted B_All , $ConvCU$, and B_NoConv , respectively.

Descriptive statistics for all variables for each sub-sample we investigate are included in Table 1a, and summary averages of interest rates by product and single institution type are presented in Table 1b.

The interest rate data was obtained via a Datatrac survey of the 5 largest for-profit institutions, the 5 largest credit unions, and the converted institutions present in each of 25 MSAs for a total of 275 institutions. Other financial and demographic data was obtained from year-end 2004 regulatory reports filed by each institution (i.e., call reports). The call report data was obtained from the NCUA and FDIC websites. The data set thus represents a cross-section of the industry. From this, we removed the 100 largest institutions by assets leaving 175 institutions in the dataset. The excluded institutions proved to be nationwide banks with branches in a great number of MSAs and with little or no variation in interest rates or other variables across their branches (as call reports are on an institutional rather than branch basis). Failure to exclude these institutions would have therefore presented the estimations with a multicollinearity problem.

To maintain consistency with the literature, we utilize the basic ordinary least squares (OLS) estimation procedure in all cases. OLS is a technique that provides the summary coefficient of the extent of relationships between the dependent variable and one or more independent variables. OLS is a regression analysis that develops an equation describing the nature of the relationship between these variables.

One of the more recent studies regarding interest rate differentials is by Tokle and Tokle (2000). That paper strictly focused on saving products and limited the scope of its data to May

27th and 28th of 1998, and to a defined area in Idaho and Montana. This paper extends the Tokle and Tokle focus to both loan and savings products on a national scope. This paper also focuses on one day, June 27, 2005. Surveying on multiple dates adds substantial data collection costs.

We also ran these regressions adding a CAMEL rating variable synthesized by a private sector firm. In no case did the camel rating, a proxy for safety and soundness, serve as a significant determinant of interest rates for credit unions and banks and so the regressions including the camel rating are not reported here. The fit of the regressions varies substantially, with the R-squared's on average rather low in an absolute sense but are still consistent with the earlier literature, in particular Feinberg (2002) and Berger and Hannan (1989).

4. RESULTS

Savings Products

Table 2 presents the regression results for the interest rate on four savings products; standard savings accounts (1), interest-bearing checking accounts (2), 1-year certificates of deposit (3), and money market accounts (4) with three regressions for each dependent variable as noted. In the case of savings products (regressions 1-4), the first thing to note is that for all products but interest-bearing checking accounts, we find that there is a significant difference between credit unions and other institutions as evidenced by the coefficients on the for-profit dummy variable. Aside from the impact of any of the other included variables, we find for three of the products that credit unions offer interest rates on savings products typically around 30 basis points higher than the rates offered by banking institutions, including former credit unions. The difference, independent of other included variables, between credit unions and former credit unions is estimated to be largest for standard savings accounts. The exception is for checking accounts, where we find no significant difference between credit unions and converted institutions. However, there is a significant difference between credit unions and all banking institution checking accounts. This is estimated at 13.6 basis points, but as we do not find any difference significantly different from zero comparing credit unions to either converted

institutions or those that were always banking institutions, this result does not seem particularly robust. Notably, credit union conversion seems to prompt the greatest decrease in savings rates in the case of standard savings accounts.

Salary-to-asset variation only seems significant for standard savings accounts, but this appears to be the case in all regressions for that product.³ The *Salary/A* variable is weakly significant for checking accounts in regressions including banks and for money market accounts in the regression including only current and former credit unions. Thus, it would seem that the extent to which institutions have higher costs, perhaps due to having salaried directors, these are passed on to customers primarily through lower interest rates on savings products, primarily standard savings accounts. Indeed, no lending product indicates any sensitivity to variation in salaries.

Industry concentration amongst banking institutions negatively impacts rates paid to checking accounts and CDs across all three regressions in each case. As to other independent variables, institutions which have a higher proportion of loans to assets are estimated to offer lower savings rates, though why this should be is not clear. Institutions that have higher total assets seem to offer higher rates on CDs, though this could reflect an endogeneity problem as it is just as plausible that an institution with higher CD rates and thus more deposits ends up with higher assets.

Loan Products

Table 3 shows the results with the rates for three loan products as the independent variable: 48-month used car loans; 60-month new car loans; and regular credit cards. The best fit of all regressions in this paper occurs for the car loans, though less so for the 'b' regressions. At the same time, the only variable which consistently shows any significance in these regressions is

³ The range for the *Salary/A* variable is from a low of zero to a high of about .04 with an average around .014, which means the practical range implied by the estimated coefficient is in the low tens of basis points.

the for-profit dummy, suggesting that something about banking institutions not accounted for in the other independent variables leads to them charging higher interest rates on car loans. Also, the coefficient on the dummy for converted credit unions (in 5b and 6b) suggests that the differential is not as large between credit unions and converted credit unions as it is between banks and credit unions, in fact at best half as large in our estimations. However, this still translates into at least a full percentage point in all regressions except 6b. This could possibly be the result of a convergence process where there is a phase-in period as converted credit unions raise their car loan interest rates from the level typical to a credit union to the level typical of banks, though it is not possible with our cross-sectional data to shed any light on this hypothesis.⁴ The level of firm concentration does not seem to impact car loan rates.

For regular credit cards, there is again a consistently lower interest rate amongst credit unions compared to other institutions, and further it seems that the differential between credit unions and converted credit unions is larger than the differential between credit unions and banks or all for-profits, nearly two full percentage points. Curiously, it seems that institutions in more concentrated markets offer lower interest rates, a result for which we cannot offer any explanation. We do not find any impact of the salary-to-asset ratio on loan rates.

Overall, it seems clear that there are structural differences in the interest rate structures between credit unions and banking institutions that are clearly to the benefit of credit union members which are in most cases difficult to attribute to anything other than institution type. Salary levels seem important to the interest rates offered on savings deposits, but otherwise do not seem to be a deciding factor. Industry concentration seems to lower rates paid on some savings products and credit cards, but also seems otherwise neutral.

5. CONCLUSIONS

⁴ Our data does include the number of years since a former credit union converted to for-profit status, but a casual examination of this data yielded no insights into this speculation.

The purpose of this paper was twofold. First, the paper seeks to review the strong admonition provided by the NCUA against mutualization. Second, to evaluate the unique interest rate benefits provided to credit union members. Both inquiries provide intriguing results.

The results presented here suggest that both loans and savings accounts offered by credit unions offer favored rates to the member for all products studied except interest-bearing checking accounts, and this result is robust across all specifications. This is especially notable in the area of former credit unions. This result is an addition to the credit union and bank literature. It argues that credit union rates are not solely the result of differences in salary payments which might be due to director compensation; the estimations indicate a good portion if not all of the differential is independent of this advantage. It determines that while higher concentration results in lower rates to savers, bank rates are independently lower for most savings products and higher for lending products excepting home equity and unsecured loans.

In terms of the warnings by the NCUA: the concern over the impact salaries will have on interest rates is mixed. While higher salary payments consistently associate with lower rates on standard savings accounts, no such association is found with any of the other products examined. Nonetheless, in many cases credit unions offered higher rates on savings products, while banks did not offer higher rates in any savings products. The NCUA may not have correctly identified the source of credit union financial benefits, at least in terms of director salaries and the impact on interest rates. It is entirely possible that director compensation or indeed tax burdens might be passed on in other forms, such as through fees. Nonetheless, NCUA did ultimately correctly conclude that the financial benefits provided by member-owned, not-for-profit credit unions either disappear or are much diminished when those institutions convert to banking institutions.

This paper presents a static view of an interest rate environment based on a single day. While there is no cause to believe that that day was unusual, time series data would offer additional insight. Through the collection of data over several time periods, panel data can be assembled. This would offer additional information regarding the sequence or timing of the

changes in pricing behavior following conversion to for-profit status. Finally, it should give insight into the increasing or decreasing impact of consolidation on interest rates.

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Table 1a - Descriptive Statistics by Sample, Savings Products									
Checking with Interest					Regular Savings				
All Institutions	Mean	StdDev	N	All Institutions	Mean	StdDev	N		
<i>APY-checking with interest</i>	0.4296	0.3114	128	<i>APY--regular savings</i>	0.8121	0.5595	164		
<i>Log HHI/1000</i>	6.9841	0.3697	128	<i>Log HHI</i>	6.9749	0.3550	164		
<i>Log Assets</i>	20.1866	2.0547	128	<i>Log Assets</i>	19.6031	2.2768	164		
<i>Capital/Asset</i>	0.1108	0.0771	128	<i>Capital/Asset</i>	0.1110	0.0693	164		
<i>Salary/Asset</i>	0.0139	0.0076	128	<i>Salary/Asset</i>	0.0144	0.0077	164		
<i>Loan/Asset</i>	0.6345	0.1722	128	<i>Loan/Asset</i>	0.6315	0.1796	164		
<i>B_All</i>	0.4688	0.5010	128	<i>B_All</i>	0.3963	0.4906	164		
Current and Converted CUs					Current and Converted CUs				
<i>APY-checking with interest</i>	0.4620	0.3077	85	<i>APY--regular savings</i>	0.8736	0.4869	120		
<i>Log HHI/1000</i>	7.0109	0.3603	85	<i>Log HHI</i>	6.9952	0.3452	120		
<i>Log Assets</i>	19.2407	1.2296	85	<i>Log Assets</i>	18.7142	1.6067	120		
<i>Capital/Asset</i>	0.1168	0.0909	85	<i>Capital/Asset</i>	0.1149	0.0777	120		
<i>Loan/Asset</i>	0.6318	0.1744	85	<i>Loan/Asset</i>	0.6332	0.1772	120		
<i>Salary/Asset</i>	0.0154	0.0077	85	<i>Salary/Asset</i>	0.0156	0.0077	120		
<i>ConvCU</i>	0.2000	0.4024	85	<i>ConvCU</i>	0.1750	0.3816	120		
Banks & CUs Excl. Converted					Banks & CUs Excl. Converted				
<i>APY-checking with interest</i>	0.4316	0.3091	111	<i>APY--regular savings</i>	0.8420	0.5754	143		
<i>Log HHI/1000</i>	6.9853	0.3711	111	<i>Log HHI</i>	6.9731	0.3563	143		
<i>Log Assets</i>	20.3319	2.1439	111	<i>Log Assets</i>	19.6636	2.4091	143		
<i>Capital/Asset</i>	0.1138	0.0820	111	<i>Capital/Asset</i>	0.1137	0.0734	143		
<i>Loan/Asset</i>	0.6200	0.1704	111	<i>Loan/Asset</i>	0.6170	0.1798	143		
<i>Salary/Asset</i>	0.0146	0.0067	111	<i>Salary/Asset</i>	0.0152	0.0070	143		
<i>B_NoConv</i>	0.3874	0.4894	111	<i>B_NoConv</i>	0.3077	0.4632	143		
One Year CD					Money Market Account				
All Institutions	Mean	StdDev	N	All Institutions	Mean	StdDev	N		
<i>APY-1 year CD</i>	3.0547	0.5820	156	<i>APY-Money Market</i>	1.0547	0.5463	130		
<i>Log HHI</i>	6.9811	0.3554	156	<i>Log HHI</i>	6.9943	0.3643	130		
<i>Log Assets</i>	19.7076	2.2327	156	<i>Log Assets</i>	20.1374	2.0540	130		
<i>Capital/Asset</i>	0.1108	0.0704	156	<i>Capital/Asset</i>	0.1070	0.0735	130		
<i>Loan/Asset</i>	0.6445	0.1703	156	<i>Loan/Asset</i>	0.6585	0.1662	130		
<i>Salary/Asset</i>	0.0147	0.0077	156	<i>Salary/Asset</i>	0.0146	0.0077	130		
<i>B_All</i>	0.4231	0.4956	156	<i>B_All</i>	0.4692	0.5010	130		
Current and Converted CUs					Current and Converted CUs				
<i>APY-1 year CD</i>	3.1199	0.5327	111	<i>APY-Money Market</i>	1.1526	0.4584	87		
<i>Log HHI</i>	7.0065	0.3457	111	<i>Log HHI</i>	7.0351	0.3515	87		
<i>Log Assets</i>	18.7895	1.5313	111	<i>Log Assets</i>	19.1921	1.2096	87		
<i>Capital/Asset</i>	0.1144	0.0800	111	<i>Capital/Asset</i>	0.1100	0.0862	87		
<i>Loan/Asset</i>	0.6529	0.1632	111	<i>Loan/Asset</i>	0.6747	0.1518	87		
<i>Salary/Asset</i>	0.0161	0.0076	111	<i>Salary/Asset</i>	0.0161	0.0076	87		
<i>ConvCU</i>	0.1892	0.3934	111	<i>ConvCU</i>	0.2069	0.4074	87		
Banks & CUs Excl. Converted					Banks & CUs Excl. Converted				
<i>APY-1 year CD</i>	3.0563	0.5572	135	<i>APY-Money Market</i>	1.0627	0.5538	112		
<i>Log HHI</i>	6.9800	0.3569	135	<i>Log HHI</i>	6.9958	0.3810	112		
<i>Log Assets</i>	19.7879	2.3649	135	<i>Log Assets</i>	20.2743	2.1518	112		
<i>Capital/Asset</i>	0.1136	0.0749	135	<i>Capital/Asset</i>	0.1089	0.0786	112		
<i>Loan/Asset</i>	0.6311	0.1703	135	<i>Loan/Asset</i>	0.6468	0.1670	112		
<i>Salary/Asset</i>	0.0156	0.0069	135	<i>Salary/Asset</i>	0.0154	0.0068	112		
<i>B_NoConv</i>	0.3333	0.4732	135	<i>B_NoConv</i>	0.3839	0.4885	112		

Table 1a (cont.) - Descriptive Statistics by Sample, Loan Products							
48 month Used Car Loan				60 month New Car Loan			
All Institutions	Mean	StdDev	N	All Institutions	Mean	StdDev	N
<i>APY--used car loan</i>	6.0654	1.4861	153	<i>APY--new car loan</i>	5.7842	1.2524	158
<i>Log HHI</i>	6.9888	0.3585	153	<i>Log HHI</i>	6.9788	0.3592	158
<i>Log Assets</i>	19.4647	2.2597	153	<i>Log Assets</i>	19.4927	2.2551	158
<i>Capital/Asset</i>	0.1084	0.0364	153	<i>Capital/Asset</i>	0.1137	0.0708	158
<i>Loan/Asset</i>	0.6293	0.1765	153	<i>Loan/Asset</i>	0.6254	0.1803	158
<i>Salary/Asset</i>	0.0147	0.0076	153	<i>Salary/Asset</i>	0.0145	0.0075	158
<i>B_All</i>	0.3529	0.4795	153	<i>B_All</i>	0.3734	0.4852	158
Current and Converted CUs				Current and Converted CUs			
<i>APY--used car loan</i>	5.5526	1.0916	119	<i>APY--new car loan</i>	5.2804	0.8345	119
<i>Log HHI</i>	7.0010	0.3439	119	<i>Log HHI</i>	6.9986	0.3453	119
<i>Log Assets</i>	18.6970	1.6246	119	<i>Log Assets</i>	18.6737	1.6164	119
<i>Capital/Asset</i>	0.1097	0.0361	119	<i>Capital/Asset</i>	0.1172	0.0786	119
<i>Loan/Asset</i>	0.6250	0.1858	119	<i>Loan/Asset</i>	0.6265	0.1840	119
<i>Salary/Asset</i>	0.0157	0.0076	119	<i>Salary/Asset</i>	0.0157	0.0076	119
<i>ConvCU</i>	0.1681	0.3755	119	<i>ConvCU</i>	0.1681	0.3755	119
Banks & CUs Excl. Converted				Banks & CUs Excl. Converted			
<i>APY--used car loan</i>	6.0378	1.5216	133	<i>APY--new car loan</i>	5.7780	1.2919	138
<i>Log HHI</i>	6.9872	0.3597	133	<i>Log HHI</i>	6.9759	0.3604	138
<i>Log Assets</i>	19.5002	2.3975	133	<i>Log Assets</i>	19.5309	2.3872	138
<i>Capital/Asset</i>	0.1107	0.0377	133	<i>Capital/Asset</i>	0.1166	0.0749	138
<i>Loan/Asset</i>	0.6133	0.1754	133	<i>Loan/Asset</i>	0.6094	0.1794	138
<i>Salary/Asset</i>	0.0155	0.0067	133	<i>Salary/Asset</i>	0.0153	0.0067	138
<i>B_NoConv</i>	0.2556	0.4379	133	<i>B_NoConv</i>	0.2826	0.4519	138
Regular Credit Card							
All Institutions	Mean	StdDev	N				
<i>APY--classic credit card</i>	12.3275	2.1122	102				
<i>Log HHI</i>	6.9986	0.3354	102				
<i>Log Assets</i>	19.4337	1.8820	102				
<i>Capital/Asset</i>	0.1138	0.0822	102				
<i>Loan/Asset</i>	0.6195	0.1659	102				
<i>Salary/Asset</i>	0.0151	0.0064	102				
<i>B_All</i>	0.2647	0.4434	102				
Current and Converted CUs							
<i>APY--classic credit card</i>	12.1987	2.0474	85				
<i>Log HHI</i>	7.0108	0.3325	85				
<i>Log Assets</i>	18.8853	1.3509	85				
<i>Capital/Asset</i>	0.1162	0.0885	85				
<i>Loan/Asset</i>	0.6184	0.1593	85				
<i>Salary/Asset</i>	0.0162	0.0061	85				
<i>ConvCU</i>	0.1176	0.3241	85				
Banks & CUs Excl. Converted							
<i>APY--classic credit card</i>	12.2009	2.1554	92				
<i>Log HHI</i>	6.9807	0.3254	92				
<i>Log Assets</i>	19.4998	1.9490	92				
<i>Capital/Asset</i>	0.1162	0.0857	92				
<i>Loan/Asset</i>	0.6154	0.1660	92				
<i>Salary/Asset</i>	0.0157	0.0060	92				
<i>B_NoConv</i>	0.1848	0.3902	92				

Table 1b - Average Interest Rates by Product and Institution Type			
	Always Credit Unions	Converted Credit Unions	Always Banks
Savings Products			
Regular Savings Accounts	0.93	0.61	0.64
Money Market Accounts	1.19	1.01	0.86
Checking With Interest	0.47	0.42	0.37
One Year CD	3.17	3.14	2.89
Loan Products			
Unsecured Loans	11.02	12.14	12.87
Regular Credit Cards	12.03	13.49	12.97
Gold Credit Cards	10.38	11.16	11.38
Used Auto Loans	5.41	6.25	7.86
New Auto Loans	5.17	5.83	7.21
Home Equity Loans	5.97	6.07	6.15

Indep. Vars	1a		1b		1c		2a		2b		2c		3a		3b		3c		4a		4b		4c			
	StdSav	StdSav	StdSav	StdSav	StdSav	StdSav	Check	Check	Check	Check	Check	Check	Check	1yr CD	1yr CD	1yr CD	1yr CD	1yr CD	MoneyMkt	MoneyMkt	MoneyMkt	MoneyMkt	MoneyMkt	MoneyMkt		
R2 (AdjR2)	.186 (.155)	.335 (.299)	.201 (.166)	.154 (.112)	.124 (.057)	.144 (.095)	.137 (.102)	.234 (.190)	.169 (.130)	.137 (.102)	.234 (.190)	.144 (.095)	.137 (.102)	.3926***	5.288***	4.323***	.085 (.040)	.085 (.016)	.106 (.055)	1.906**	1.238	2.079*				
F	5.980***	9.470***	5.048***	3.681***	1.839	2.926**	3.926***	5.288***	4.323***	1.839	2.926**	3.926***	5.288***	3.926***	5.288***	4.323***	1.906**	1.238	2.079*	1.906**	1.238	2.079*				
constant	3.107	3.381	3.330	2.407	2.681	2.335	2.407	2.681	2.335	2.407	2.681	2.335	2.407	4.617	3.164	4.617	2.566	2.513	2.665	2.566	2.513	2.665				
lnHHI	-0.161	-0.232**	-0.144	-0.222***	-0.245***	-0.194**	-0.222***	-0.245***	-0.194**	-0.222***	-0.245***	-0.194**	-0.222***	-0.388***	-0.338**	-0.402***	-0.127	-0.095	-0.152	-0.127	-0.095	-0.152				
(<i>t-stat</i>)	-1.403	-2.096	-1.138	-3.133	-2.666	-2.527	-3.133	-2.666	-2.527	-3.133	-2.666	-2.527	-3.133	-3.079	-2.490	-3.130	-0.961	-0.665	-1.109	-0.961	-0.665	-1.109				
lnAssets	-0.020	0.000	-0.032	-0.022	-0.027	-0.029	-0.022	-0.027	-0.029	-0.022	-0.027	-0.029	-0.022	0.057**	0.107***	0.074***	-0.019	-0.029	-0.009	-0.019	-0.029	-0.009				
Capital/A	0.060	0.227	-0.054	-0.006	0.019	-0.018	-0.006	0.019	-0.018	0.019	-0.018	-0.018	0.019	2.376	3.360	2.783	-0.717	-0.686	-0.281	-0.717	-0.686	-0.281				
Loan/A	0.102	0.460	-0.089	-0.017	0.052	-0.051	-0.017	0.052	-0.051	0.052	-0.051	-0.051	0.052	-1.412	-1.068	-1.207	-0.164	-0.029	-0.196	-0.164	-0.029	-0.196				
Salary/A	-0.703***	-0.844***	-0.707***	-0.315**	0.235	0.340*	-0.315**	0.235	0.340*	0.235	0.340*	0.340*	0.235	0.449*	0.819***	0.174	-0.025	0.262	-0.025	-0.025	0.262	-0.025				
	-3.035	-3.551	-2.764	1.984	1.063	1.929	1.984	1.063	1.929	1.063	1.929	1.929	1.063	1.706	2.693	0.651	-0.088	0.735	-0.088	-0.088	0.735	-0.088				
	-15.107**	-20.259***	-21.400***	-7.778*	-6.052	-9.143*	-7.778*	-6.052	-9.143*	-6.052	-9.143*	-9.143*	-6.052	0.212	-5.613	-3.591	-4.568	-15.048*	-6.602	-4.568	-15.048*	-6.602				
B_All	-2.361	-3.454	-2.891	-1.942	-1.137	-1.758	-1.942	-1.137	-1.758	-1.137	-1.758	-1.758	-1.137	0.032	-0.784	-0.465	-0.657	-1.978	-0.657	-0.657	-1.978	-0.657				
	-0.318***	-0.377***	-0.303**	-0.136**	-0.144	-0.113	-0.136**	-0.144	-0.113	-0.144	-0.113	-0.113	-0.144	-0.386***	-3.379	-0.297**	-0.333**	-2.363	-0.333**	-0.333**	-2.363	-0.333**				
ConvCU	-3.029	-3.244	-2.330	-2.029	-1.421	-1.436	-2.029	-1.421	-1.436	-1.421	-1.436	-1.436	-1.421	-0.297**	-2.148	-0.557***	-0.557***	-4.292	-0.557***	-0.557***	-4.292	-0.557***				
B_NoConv																										

*** = significant at the 1% level; ** = significant at the 5% level; * = significant at the 10% level

Table 3

	Sa 48m used	Sb 48m used	Sc 48m used	6a 60m new	6b 60m new	6c 60m new	7a CreditCard	7b CreditCard	7c CreditCard
Indep. Vars									
R2 (AdjR2)	.386 (.361)	.119 (.072)	.508 (.484)	.437 (.415)	.153 (.108)	.574 (.550)	.136 (.082)	.143 (.077)	.123 (.062)
F	15.309***	2.530**	21.663***	19.560***	3.374***	29.467***	2.500**	2.171*	1.994*
constant	4.656	8.475	6.680	3.467	5.995	4.457	19.709	20.572	19.264
lnHHI	-0.142	-0.255	0.012	-0.089	-0.097	0.077	-1.058*	-1.535**	-1.345*
<i>(t-stat)</i>	-0.526	-0.891	0.044	-0.414	-0.451	0.369	-1.738	-2.282	-1.944
lnAssets	0.075	-0.077	-0.067	0.140**	-0.047	-0.011	-0.106	0.049	0.005
	1.439	-1.144	-1.161	2.547	-0.974	-0.260	-0.882	0.284	0.029
Capital/A	4.821*	1.953	1.428	1.603	0.753	0.917	3.345	2.604	3.487
	1.722	0.658	0.524	1.453	0.791	0.909	1.336	1.047	1.334
Loan/A	-0.772	-0.282	-0.367	0.080	1.128**	0.490	0.659	0.729	0.563
	-1.303	-0.471	-0.613	0.178	2.486	1.089	0.505	0.474	0.389
Salary/A	16.852	5.991	-3.082	9.268	-2.506	-1.743	53.447	29.565	76.903
	1.144	0.393	-0.177	0.779	-0.219	-0.128	1.340	0.682	1.012
B_All	1.888***			1.473***			1.84***		
	7.294			7.184			3.135		
ConvCU		1.006***			0.543**			1.998**	
		3.289			2.373			2.570	
B_NoConv			2.697***			2.194***			1.482*
			9.095			9.822			1.914

*** = significant at the 1% level, ** = significant at the 5% level, * = significant at the 10% level

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May 11, 2006, at 10:00 am

Statement of

Scott M. Polakoff, Deputy Director
Office of Thrift Supervision

concerning

The Credit Union Charter Choice Act, H.R. 3206

before the

Subcommittee on Financial Institutions and Consumer Credit

of the

House Financial Services Committee

May 11, 2006

Office of Thrift Supervision
Department of the Treasury

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Statement required by 12 U.S.C. 250: The views expressed herein are those of the
Office of Thrift Supervision and do not necessarily represent those of the President.

**Testimony on the Credit Union Charter Choice Act, H.R. 3206
before the
Subcommittee on Financial Institutions and Consumer Credit
of the
House Financial Services Committee**

May 11, 2006

**Scott M. Polakoff, Deputy Director
Office of Thrift Supervision**

I. Introduction

Good morning, Mr. Chairman, Ranking Member Sanders, and members of the Subcommittee. Thank you for the opportunity to testify on the Credit Union Charter Choice Act, H.R. 3206, sponsored by Representatives McHenry and Gillmor, among others, and the role of the Office of Thrift Supervision (OTS) when a credit union or other entity seeks a savings association charter.

Charter choice is a fundamental precept at OTS. Since the agency was established in 1989, many institutions have both left and entered the thrift charter. These so-called “charter flips” are a normal course of business at OTS and throughout the banking industry. In our view, it is the role of the regulator to minimize regulatory obstacles, reduce burden and facilitate legitimate business decisions regarding charter choice made by the institutions we regulate.

While I cannot represent the views of the other federal banking agencies (FBAs) regarding the issue of charter choice, I can tell you that all of the FBAs handle the charter flip conversion process similarly. That is, each requires an application to obtain a charter within their jurisdiction, but not to leave their jurisdiction and oversight. While an agency may pass on supervisory and regulatory information to a new regulator, there is generally not a requirement that an institution obtain permission from one of the FBAs to leave its jurisdiction, except where an institution has pending enforcement or similar issues or is in potentially troubled condition.

In my testimony today, I have been asked to describe for you the charter conversion process at OTS, as well as the mutual-to-stock and mutual holding company (MHC) conversion processes in place at OTS. I will also address issues relating to membership rights of mutual account holders, or members, of a mutual savings association, and benefits to management insiders when a mutual savings

association converts to a stock institution or into a MHC structure. Finally, I will conclude with some general observations about H.R. 3206 in light of the discussion of the various OTS conversion processes and comparing these to the requirements of the proposed legislation. But first, I will highlight our general understanding of the provisions of the bill.

II. Summary of H.R. 3206, the “Credit Union Charter Choice Act”

The Credit Union Charter Choice Act is designed to clarify the communications between credit unions and their members. Specifically, the legislation requires that notifications to members of a credit union regarding a proposed conversion should include the following:

- the date that the membership vote will be taken and the date by which ballots must be received by the inspector of elections;
- a brief statement of why the directors of the converting credit union are considering the conversion and the board’s recommendation to the members; and
- a brief statement of the material effects of the conversion on the credit union, as converted, and the members, including any differences in powers between a credit union and a savings association.

The bill also clarifies that a credit union may not be required to include in a conversion notice any information or statements that:

- are speculative with respect to the future operations, governance, or form of organization of the institution;
- are inaccurate with respect to a proposed conversion;
- conflict with regulations of other regulators with regard to the subsequent conversion of the institution from mutual to stock form;
- distort the impact of conversion on the members of the credit union; or
- are attributable to the National Credit Union Administration (NCUA) or state the NCUA’s position on conversions.

Generally, the bill streamlines the review and approval process conducted by the NCUA regarding conversion materials submitted by converting credit unions to the NCUA. In addition, the legislation requires a credit union’s member vote on a conversion to be conducted by secret ballot, with an independent inspector of elections appointed by the credit union to receive and tally the votes. The bill effectively denies the NCUA any further review or approval authority over

the conversion process, absent fraud or reckless disregard for fairness during the voting process that affects the vote outcome.

III. OTS and the Thrift Industry: A Legacy of Charter Choice

OTS oversees an industry and charter that is primarily engaged in retail banking; or, more precisely, retail community banking. The savings association charter is a vital and growing choice in the financial services world, and an important resource for economic growth in this country. The industry is rapidly growing, with total assets up 12.0 percent in 2005 from the prior year to a record \$1.46 trillion. In the past five years, industry assets grew 57.7 percent, representing a robust average annual growth rate of 9.5 percent.

Earnings were also strong last year, and have been strong for the last five years. For 2005, earnings were up 17.6 percent from 2004, and the industry earnings more than doubled the last five years, climbing from \$8.0 billion in 2000 to a record \$16.4 billion in 2005.

Throughout the history of the OTS, there have been many institutions that have left the thrift charter, and many that have opted for the thrift charter as the choice for conducting their ongoing business operations. From 2000 to 2005, there were 90 institutions that converted from the thrift charter to another type of depository institution charter, and 51 institutions that converted to the thrift charter from another type of depository institution charter. Of the 51 institutions opting for the thrift charter, 9 were credit unions and the rest were banks. Clearly, charter choice is a fundamental aspect of the U.S. banking system.

As the retail community banking sector grows, the savings association charter is well positioned to provide a structural and regulatory alternative both for established financial services businesses and for new entrants that are working to grow market share in this area. The savings association charter is remarkably flexible in adapting to the many products and structures present in today's financial services marketplace. It is deployed in neighborhoods all across America, and is also used by leading nationwide lenders, by investment banks offering a full array of financial services, and by global conglomerates involved in a wide array of diverse businesses. These organizations have all come to the savings association charter at different times and for reasons as diverse as their underlying businesses and the markets they serve.

At the same time, there are numerous institutions that seek to conduct their business operations in a different charter form, and OTS supports the ability of any

institution to gravitate to the charter that best serves its business needs and interests.

As long as applicants meet all of the necessary regulatory requirements to create or convert to a savings association, or to opt for another charter type, we strongly support such a choice, and support any legislation that promotes such freedom of choice.

IV. The OTS Charter Conversion Process

Conversions of banks or credit unions to become OTS chartered institutions are generally subject to the same standards for approval as applications for permission to organize a new, or de novo, savings institution.

In summary, OTS regulations authorize credit unions to convert directly to federal mutual savings associations. The institution must have its deposits insured by the FDIC upon completion of the charter conversion and comply with all applicable federal or state laws and OTS policies, and obtain all required regulatory and member approvals.

In addition, the Home Owners Loan Act (HOLA) and OTS regulations set forth standards that OTS must consider when granting a federal charter. Because a credit union conversion requires a new federal charter, OTS must consider these standards. The HOLA states that OTS may grant a charter only if all of the following criteria are satisfied:

- the organizers are persons of good character and responsibility;
- a necessity exists for the savings association in the community to be served;
- there is a reasonable probability of the savings association's usefulness and success; and
- the savings association can be established without undue injury to other local thrift and home-financing institutions.

In addition, OTS regulations provide that OTS must consider whether the savings association will perform a role of providing credit for housing consistent with the safe and sound operation of a federal savings association.

Furthermore, OTS Community Reinvestment Act regulations provide that an applicant for a federal thrift charter must submit with its application a description of how it will meet its CRA objectives. OTS must take the CRA

description into account when considering the application, and may deny or condition the application on CRA grounds.

Applications by credit unions to convert to federal savings associations are also subject to publication and public comment requirements. In addition, OTS is required to verify, under statutes and regulations applicable to credit unions, the member vote concerning conversions of credit unions to federal mutual savings associations.

Membership Rights

An issue often raised in conversions of credit unions to federal mutual savings associations is the rights of credit union members relative to those of federal mutual associations. Certain parties have advanced various reasons why they believe credit union members' rights are compromised when a credit union converts to a federal mutual savings bank.

Much has been made of the fact that credit union voting is conducted on a one vote per member basis, while the federal mutual charter provides for one vote per \$100 on deposit, with the association being able to set, in its charter, the maximum number of votes per member at any number from one to one thousand. In our view, this type of voting provision, while different, is at least as equitable as the one member-one vote rule, since it provides greater voting rights, up to a limit, to members that have made a greater contribution to the institution. We believe it is appropriate for an institution to have the flexibility to provide for voting rights based on the extent of the depositors' relationship with the institution.

It is important to note that even though some depositors may have a greater number of votes than others, even in a relatively small institution no account holder with the maximum number of votes could have any appreciable amount of control of an institution. The smallest credit union to convert to a federal mutual association had assets of approximately \$8 million. Even assuming deposits with voting rights totaling \$7 million, and a depositor with \$100,000 on deposit having 1000 votes, the maximum percentage of votes of a depositor/member would be less than 2 percent of the voting rights of the institution. Only three of the credit unions that converted to a federal charter had assets of less than \$20 million. OTS has not reviewed a credit union conversion in which a depositor could have any control of the vote.

Another issue that has been raised is the fact that members of federal mutual associations may, in most matters (excluding mutual-to-stock conversions

and mutual holding company reorganizations), vote by proxy, while credit union members vote by mail ballot. We do not find this to be a meaningful distinction. Members of mutual associations, through proxies, may specify exactly the way they wish to vote. The fact that depositors also have the flexibility to grant management discretionary authority with respect to their vote does not make the voting process less meaningful. While federal mutual associations are able to use running proxies, members may revoke those proxies or use new proxies. The membership voting interest of mutual savings associations is no less meaningful simply because members may use proxies.

The economic nature of membership interests in mutual associations and credit unions is quite similar. The moment a person becomes a depositor/member of either type of entity, the person has the same rights as other members to participate in dividends, or any liquidation of the entity. The moment the person ceases to be a member, they have no continuing interest in the institution. Membership interests in either entity cannot be transferred. Members of either entity cannot compel management to declare dividends. In addition, although liquidations of either type of entity are extremely rare, it is worthwhile to note that liquidation rights in both entities are similar, with depositors sharing in any equity remaining after a voluntary liquidation in proportion to the amount of their deposits. This is a practice consistent with providing greater voting rights to members with a greater deposit investment in an institution.

V. The OTS Process for Mutual-to-Stock and MHC Conversions

The HOLA permits mutual savings associations to convert to the stock form of organization. The statute also permits savings associations to reorganize into MHC form, and to conduct a minority stock issuance of less than 50 percent of the institution's stock. Such transactions are subject to significant regulatory and disclosure requirements.

Since the conversion program began in 1972, mutual-to-stock conversions and minority stock issuances have raised over \$35 billion in new capital for the industry. These transactions have enabled savings associations to raise additional capital in a short period of time, rather than raise additional capital slowly, through earnings. In addition, the conversion process enables converted thrift institutions to attract top management by the use of stock benefit plans that formerly were only available to commercial banks and other stock chartered entities.

Today's regulatory system is a result of decades of experience and is designed to produce a fair result to all parties -- depositors, the community at large, new stockholders, and others.

It is important to point out that the mutual to stock conversion process is designed to protect the interests of the institution's mutual accountholders. Conversions and MHC reorganizations must be approved by an association's accountholders, by a majority of the institution's eligible votes. The accountholders are provided detailed, comprehensive disclosures regarding the transaction. Significantly, accountholders are provided priority subscription rights in the conversion stock offering. Furthermore, the converting association establishes a liquidation account in the conversion, which reflects the value of the institution immediately prior to the conversion.

Every conversion begins with an independent appraisal of the mutual institution. That appraisal determines a fair value for the institution as a converted entity. The appraiser presents the results of its analysis to the board of directors of the institution, who vote on the valuation and submit it as part of their application to convert.

Individual members (or depositors) of a mutual thrift institution that determines to convert, are given first priority rights, as noted above, to subscribe for stock based on having a deposit account at the institution at least one year prior to the board of directors vote on a plan of conversion. After the subscription orders of the members are satisfied, a tax-qualified employee stock benefit plan is permitted to purchase shares on behalf of the employees of the institution. The next priority is for depositors who had deposits at the institution fifteen months later than the first priority depositors. Next, any other depositors/members of the mutual thrift who had not been included in earlier categories are given the opportunity to subscribe for shares, i.e., after the subscriptions of earlier subscribers have been satisfied and shares remain. Finally, a community offering may be conducted at the same time as the subscription offering, or later, with any remaining shares sold to natural persons residing in the local community.

It is important to note that management may participate in an offering if they are also depositors, or later as members of the community, and that management purchases are limited by OTS regulations. In addition, management may also participate in stock benefit plans, but only if the stockholders of the newly converted entity passed such plans at least six months following a conversion. OTS regulations strictly limit the amount of shares permitted for

employee stock benefit plans, to assure that the reason for the conversion is not simply to provide shareholder benefits to management.

A critical aspect of the conversion process is preparation of a business plan that shows how the institution intends to deploy the proceeds from the offering during the three years after the conversion.

OTS considers its conversion program to be a tremendous success. While we are strong supporters of mutuality, a mutual-to-stock conversion is the right business strategy for some institutions. For those that choose to convert, OTS' conversion program has been a win-win proposition for all parties.

Mutual institutions that have undertaken the conversion process have been able to raise substantial sums of new capital to grow their businesses. In addition, as part of that process they have been able to compete with other stock institutions by offering management stock benefits to attract top quality managers. By encouraging the use of tax-qualified employee stock ownership plans, OTS has seen the employees who work at the institution be able to participate in the stock offering and become owners of their company. Communities have benefited from conversion transactions, because converted institutions have grown, opening new offices and providing additional services in their communities. Finally, the regulatory system has benefited from the strengthened balance sheets of the institutions we regulate.

Limitations on Management Benefits

As noted above, management benefits are limited in a mutual-to-stock conversion or minority stock offering. Most importantly, before a conversion or MHC stock offering occurs, the members of the institution must approve the transaction. Full disclosure is provided regarding all aspects of the transaction, including management benefits. If the membership objects to management benefits, they may vote against the transaction.

Most managers are also depositors of the institution, and when they purchase stock in the institution, they purchase subject to the same terms that are applicable to other members. All purchases, including those by management, are subject to maximum limits so that no party acquires control in the conversion. In addition, purchases by all managers are subject to an aggregate limit. In rare cases where a manager is not a depositor, the manager's purchase rights are subordinated to those of the members.

Converting savings associations also establish employee stock ownership plans in mutual-to-stock conversions. These are tax qualified employee benefit plans, and are subject to requirements regarding distribution of stock under the plans. Congress has encouraged the use of these plans, and we believe they are no less appropriate for newly converted stock associations than they are for any other type of entity. As I noted earlier, these transactions are subject to member votes, so that if members object to the transaction, they may vote it down.

The institution may also establish management recognition and stock benefit plans after the conversion. OTS regulations provide that these may not be established until at least six months after the conversion. These plans are subject to a separate shareholder vote.

OTS believes that it would be inappropriate to prohibit institutions from establishing these plans after a conversion or minority stock offering. These institutions compete on the same basis as other stock entities, and these benefit plans enable management to retain and attract qualified management in the same manner as other stock entities.

VI. Observations on H.R. 3206 in Light of the OTS Experience

OTS supports all efforts to ensure effective communications between an institution considering a charter conversion and its members. A charter conversion is an important business decision for any institution, and membership input is critical both to inform management regarding member support for a proposed conversion as well as to ensure members will continue to support the institution after a conversion. In our view, H.R. 3206 sets forth a clear set of guidelines that clarify appropriate standards of conduct in communications between an institution and its members. Fundamentally, sound communications assist in the formulation of sound decisions regarding the members rights to exercise their freedom of charter choice.

H.R. 3206 is consistent with existing OTS information requirements and standards of conduct for member communications in connection with mutual-to-stock and MHC conversions. Generally, OTS rules incorporate by reference the disclosure requirements of the federal securities laws. The rules require a meaningful disclosure of all relevant information in connection with a conversion, including the disclosure of potential risk factors and future business plans of an institution. The rules also make clear that disclosures must be clear, accurate, balanced, and not so forward-looking as to be speculative in nature. Again, the

bottom line is that all disclosures must be meaningful. We believe this is a good standard to follow.

For example, requiring detailed disclosures on potential future business plans that may or may not happen serves no meaningful purpose. While it is certainly appropriate to highlight the possibility of future transactions, requiring detailed information on the downsides of such a future transaction and barring discussion of the upside is, in our view, not meaningful and may be best characterized as misleading to the members of an institution. Such disclosures are barred by OTS rules.

Freedom of charter choice only has meaning if members are able to exercise an informed choice, which requires sound and reliable information to be provided to members in the context of a proposed charter conversion. It is critical to find the right balance to ensure that disclosures are both meaningful and useful to institution members.

VII. Conclusion

OTS believes in the fundamental precept of charter choice and supports the efforts of financial services providers to be organized under the charter that best supports their business plan and operating strategy. It is important for all regulators to uphold the basic rights of freedom of choice. Regulatory barriers that do not protect consumers and/or institutions, but rather that serve as regulatory obstacles should be eliminated. The integrity of our financial services system requires this.

I want to thank you, Mr. Chairman, Representatives McHenry and Gillmor, and others who have shown leadership on this issue. We look forward to working with the Subcommittee as you continue to work through this important issue.



Testimony of

Marcus Schaefer

President/CEO of Truliant Federal Credit Union

On behalf of

The National Association of Federal Credit Unions

"H.R. 3206, The Credit Union Charter Choice Act"

Before the

House Financial Services Committee

Subcommittee on Financial Institutions and Consumer Credit

United States House of Representatives

May 11, 2006

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Introduction

The National Association of Federal Credit Unions (NAFCU) appreciates the opportunity to participate in this discussion regarding credit union conversions and *The Credit Union Charter Choice Act*, H.R. 3206. We would like to thank Chairman Bachus, Ranking Member Sanders, Representative McHenry and Members of the Subcommittee for having us here today. NAFCU is the only national organization exclusively representing the interests of the nation's federally chartered credit unions. NAFCU is comprised of over 800 federal credit unions—member owned financial institutions across the nation—representing over 27 million individual credit union members. NAFCU—member credit unions collectively account for approximately two-thirds of the assets of all federal credit unions in the United States.

I am Marc Schaefer and I currently serve as the President and CEO of Truliant Federal Credit Union headquartered in Winston-Salem, North Carolina, a position I have held for the last 11 years. Truliant FCU is a multi-occupational credit union serving over 170,000 members-owners and representing more than \$1 billion in member assets. More importantly, Truliant provides affordable and attainable products and services to our member-owners; with over 16% of our members joining through employment in the furniture and textile industries and over 45% through manufacturing jobs. I have been involved in the credit union movement for more than 24 years, and have previously served for nine years on NAFCU's Board of Directors.

Recognizing that the issue of conversions is a growing one for the credit union community, the NAFCU Board of Directors created the NAFCU Conversions Task Force in 2005 to examine the issue of credit unions converting to mutual savings banks. The NAFCU Task Force made certain policy recommendations to the NAFCU Board, which evaluated and incorporated those ideas into a “white paper” on credit union conversions that was issued on September 19, 2005 in conjunction with NAFCU’s Congressional Caucus. The white paper outlined NAFCU’s principles and policy recommendations regarding credit union conversions.

NAFCU Recommendations Regarding Credit Union Conversions

NAFCU believes that credit unions should have the ability to convert their charters should it be in the best interest of the members. NAFCU also believes the only way to ensure that the conversion process is fair is to make sure the process is transparent so members are adequately informed of the potential benefits and potential detriments that a conversion may have on the interests of the membership. NAFCU also supports the ability of NCUA to use all of its powers, as granted by Congress, to effectively regulate federal credit unions, including ensuring that conversions take place in a fair manner and that adequate consumer protections are in place. Specifically, NAFCU proposes the following policy to protect credit union membership:

- 1) Transparency is paramount. As such:
 - a) A credit union should be required to hold a meeting of its membership, prior to the mailing of the ballots, to announce a credit union's intent to convert.
 - b) Resources should be allocated, or an opportunity should be provided, for members opposed to the conversion to express their concerns.
 - c) Clear, plain language disclosures should be used to inform credit union members of the vote to convert.

- 2) Directors and/or senior management of a converted credit union should not be able to benefit financially from the transaction until at least 10 years after the initial conversion has taken place. Furthermore, there should be full disclosure of the potential maximum benefit a director or senior management could receive if the converting credit union were to convert to a stock bank after the 10 year period. This would include an approximate amount in dollars that the director could potentially receive based on the size of the institution.

- 3) A minimum of 20% of a credit union's members eligible to vote should cast a ballot in the vote taken to convert and a majority of those credit union members must vote in favor of the conversion. This minimum requirement will serve as a "quorum" of the membership for the conversion vote (much the way that Members of Congress cannot decide an issue without quorum). Prior to 1998, federal law required a minimum of 20% participation in order for a conversion to go forward.

My testimony today will focus on the history, background and the current debate on the conversion issue.

Legal Authority for Conversions Pre-CUMAA

Until 1998, the laws regarding insured credit unions converting to mutual savings banks went virtually unchanged. The Federal Credit Union Act (FCUA) stated that, prior to such a conversion, credit unions must obtain written approval from the NCUA. (12 U.S.C. § 1785 (1994)). NCUA implemented changes in its regulations in 1995 by adding language that set forth specific requirements for converting credit unions. (70 Fed. Reg. 4005 (1995)). The additional regulations required credit unions to give advance notice to members containing specific information and required the conversion to be approved by an affirmative vote of a majority of the entire credit union membership.

Legal Authority Under CUMAA

In 1998, the Credit Union Membership Access Act (CUMAA) was signed into law. CUMAA significantly changed the law regarding credit union conversions to Mutual Savings Banks (MSBs) in three ways:

- It restricted NCUA's authority to regulate credit union conversions by providing that the conversions may take place without NCUA's prior approval.
- It eased the burden of converting credit unions by only requiring a majority of those voting to approve the conversion, in lieu of the previous super-majority requirement.

It required NCUA to draft final charter conversion rules that were consistent with those promulgated by other financial regulators.

Although credit unions were not required to obtain NCUA approval, CUMAA still required credit unions to provide NCUA a notice of intent to convert and obtain verification from NCUA that the methods or procedures concerning the membership vote were administered correctly.

Post-Credit Union Membership Access Act

In February 2004, NCUA approved final rules updating the conversion rules for the first time since the passage of CUMAA. NCUA was concerned that oftentimes members of credit unions pursuing a conversion to a MSB were not fully aware of what they were being asked to approve, especially with respect to the ramifications of the conversion on members' ownership interest, voting rights, and the potential for management and directors to benefit financially. Under current Federal Credit Union Bylaws, attendance of 15 members at a special meeting constitutes a quorum. Thus, if only 15 members of the credit union voted on the proposal to convert, a conversion could proceed with the approval of only 8 members, irrespective of the size of the credit union.

Types of Credit Union Conversions

Conversion to a Mutual Savings Bank

As noted above, under the FCUA, a federally insured credit union may convert to a mutual savings bank or savings association in mutual form without prior approval of NCUA,

subject to the Act and regulations promulgated there under. (12 U.S.C. § 1785(b)(2)) (*See* 12 C.F.R. Part 708a) The Act requires that: a credit union conversion be approved by the credit union board and set for a vote of approval by the membership; notice of the conversion vote be sent to the members 90 days, 60 days and 30 days before the vote; and no director or senior management official receive a benefit in connection with a conversion other than fees or benefits paid in the ordinary course of business. In contrast, a federal credit union (FCU) is prohibited without prior approval of the NCUA Board from merging or consolidating with any non-insured credit union or institution, assuming liability to pay any member accounts of any non-insured institution, transferring assets to any non-insured credit union or institution or converting into a non-insured credit union or institution. (12 U.S.C. §1785(b)(1)).

Conversion from a Mutual Savings Bank to a Credit Union

A federally chartered MSB is a for-profit banking institution that is owned by its members and supervised by the Office of Thrift Supervision (OTS). The ability of a federally chartered MSB to convert to a credit union is not delineated in federal law. Under 12 U.S.C. § 1464 a federal savings association, including a mutual savings bank, may convert to a federal stock bank, state savings association, and state bank if in accordance with federal law, state law or regulation. (*See* 12 C.F.R. §§ 544 and 552). A MSB or a stock bank may consolidate or merge with a credit union. (12 C.F.R. §§ 456.2 and 552.13).

In 1995, Eastman Savings and Loan (ESL), a saving and loan organized under the law of New York, converted to a federal savings and loan pursuant to the laws of New York and subsequently became a FCU. Under New York requirements, the conversion was approved if

two-thirds of all eligible depositors voted in favor, or if three-quarters of those votes cast by members in person or by proxy at the special meeting were in favor, of the conversion. ESL also had a separate requirement in its bylaws that a majority of depositors voting had to approve the conversion. The conversion would be successful only if both methods resulted in voter approval. Both methods were successful and, in practical terms, ESL chartered a credit union under federal law and merged with the credit union after the conversion was approved. (See Appendix B: Institutions Converting to a Federal Credit Union). Other state laws permit the conversion of savings associations to federal charters as well.¹ Also, in 1997, EMSBLA Credit Union in Wisconsin converted from a savings and loan to a state-chartered credit union.

The Current Situation with Conversions

In recent years, credit union conversions to mutual savings banks and subsequent conversions to stock banks or mutual holding companies have increased significantly. In fact, since August, 1998, when the law governing credit union conversions changed as part of the *Credit Union Membership Access Act*, 23 credit unions have converted to mutual savings banks. The trend of credit unions seeking to convert has continued, most recently with DFCU, a \$1.8 billion dollar credit union in Dearborn, Michigan, that sought to convert earlier this year until a campaign by members to save the credit union led to a reversal of that decision. Prior to the change in law in 1998, only six credit unions had converted to mutual savings banks. In all, 19 credit unions subsequently have converted to stock banks or mutual holding companies. (See Appendix A: Credit Unions Converting to MSBs.)

¹ For instance, the state of Texas permits the conversion of a savings and loan into another institution upon the majority of those eligible to vote approving the conversion. See § 69.11 of the Texas Administrative Code.

Policy Concerns Regarding Conversions

The Task Force examined all sides of the policy debate on conversions. Credit unions list a number of reasons as to why it may be in the best interest of a credit union to convert to a mutual savings bank. Field of membership issues, limitations on member business loans and the need to raise capital are three of the more commonly cited reasons. There is also anecdotal evidence that certain law and accounting firms market a conversion to credit union boards, CEOs and senior staff by highlighting financial gain that the directors, CEOs and senior staff could receive. This is an issue that Congress should study further.

There is concern among industry groups that oftentimes the reasons stated for converting are not valid reasons and that credit union members frequently are economically harmed by the conversion. NCUA has implemented strong disclosure requirements for conversions and has suggested two bylaws amendments that credit unions may implement should they choose to strengthen their own rules regarding conversions.

Equity and Voting Rights

Credit unions are owned by their members equally. Each member has one vote in matters relative to the credit union, irrespective of the size of his/her deposit in the share account. (12 U.S.C. § 1760). Alternatively, a MSB is also cooperatively organized but may adopt a one-vote-per-member provision (12 C.F.R. § 544.2(b)(4)) or choose to permit voting relative to an individual's deposit in the institution (12 C.F.R. § 544.1(6)). When a credit union converts to an MSB, the question of who owns the equity of the credit union emerges. One possible solution is to return the equity to the members. Opponents to this view argue that the members have a right

only to the equity of the credit union upon liquidation. Further, an MSB is organized so that its members also have an ownership interest in the equity of the thrift; thus, a member's interest may be protected in the new institution. An MSB may be owned by its members, but is a for-profit institution and is not required to return profit to its members.

Raising Capital

Directors of some converting credit unions indicate they are converting because they are unable to raise capital quickly enough to operate their credit unions in a competitive financial marketplace. Often, this inability to raise capital limits the ability to grow. Credit unions seeking to convert often encourage their members to support the conversion as a means to overcome the restraint on capital. In looking at the 29 credit unions that have converted or are attempting to convert, only three were/are not considered "well-capitalized" under NCUA's prompt corrective action regulations. (12 C.F.R § 702.102) (see Appendix C: Voting Record of Credit Union Conversions). Prior to the year of conversion or pending conversion, most of the credit unions had or have net worth ratios above 7 percent, an increasing net worth and had or have net worth growth during the previous three years that outpaced asset growth over the same period. Further, of the 29 completed or pending credit union to savings bank conversions, 18 have engaged in the sale of stock; thus, any capital that was raised in the conversion from a credit union is not necessarily benefiting the membership.

Member Business Lending

Directors of some converting credit unions also indicate that they are converting because of the restrictive member business lending regulations. Credit unions seeking to convert

encourage their members to support the conversion as a means to overcome this restriction. Of the 29 credit unions that have converted or are attempting to convert, however, 19 (over 65 percent) had only negligible member business lending and only 4 exceeded the aggregate member business lending limit at the time of conversion. (12 C.F.R. § 723.16)

Insider Compensation

One argument that has been raised against conversions is that insiders may receive exorbitant financial benefit if an institution converts to a stock bank. The FCUA prevents directors from receiving a benefit from the conversion to a MSB, but no such prohibition is in place for subsequent conversions to stock institutions.

A. Comparison of Bank and Credit Union Compensation

In the case of an MSB, the board has the ability to set the compensation of the directors. (12 C.F.R. § 544.5(b)(12)(ii)). In contrast, credit unions are run by a mostly volunteer board. Stock institutions may offer stock options as compensation to their compensated directors and officers.

In general, the compensation between credit union executives and bank executives is fairly comparable when compared by base salary at a given asset level. Best estimates put bank executives at an average 5% higher than credit union executives. However, the major difference in compensation comes in the area of variable pay (incentives and bonuses).

In the largest credit unions with total assets greater than \$1 billion, variable pay averages \$60-\$70,000, or close to 1/4 of base salary. In large banks, variable pay can double an executive's base salary (average more than \$300,000 in variable pay). While most pronounced in the largest banks and credit unions, this trend continues among all credit unions with bank executives' total compensation about 30% higher than comparable credit union executive total compensation.

B. Management and Employee Compensation After the Conversion of a Mutual Savings

Bank to Stock Form

OTS outlines specific rules regarding a conversion of a mutual savings bank to a stock form, and included in those rules are provisions as to who can receive what percentage of the initial stock offering and subsequent stock offerings.

Under OTS rules, institutions must first offer conversion shares to all eligible account holders, as of a specified date. (12 C.F.R. § 563b.320). Thus, the members of the mutual savings association have first priority to purchase stock. The stock is then offered in the following priorities: employee stock ownership plan (ESOP); depositors as of a supplemental eligibility record date; other voting members who have subscription rights; community offering and/or the general public. There are also specific limitations as to how much stock may go to the remaining priorities. There is a concern that those credit union members of modest means are particularly vulnerable to losing their rights in a conversion, as they likely have fewer resources available to purchase stock and remain owners in the new institution.

The ESOP may purchase stock at the time of conversion up to 10% of the stock sold in the offering. In a typical transaction, this number is 8%, due to aggregate limitations set on the total amount of stock that management may eventually purchase. A stock option plan (SOP) and a restricted stock option plan (RRP) may be established no earlier than six months after the initial offering. (12 C.F.R. 563b). A SOP gives the recipient the right to acquire the stock at a specific price over a period of time. A RRP is a type of deferred compensation plan in which shares are taxable compensation to the recipient upon vesting. There are also restrictions regarding these plans that are effective until one year after the initial offering. A SOP may consist of up to 10% of the shares sold in the stock offering. A RRP may consist of up to 4% of the number of shares sold in the stock offering, if the institution after converting has 10 percent tangible capital; it may consist of up to 3% of shares otherwise. Also, the total shares of stock included in the ESOP and the RRP plans that may go to management may not exceed 12%, again if the institution has 10 % tangible capital. Thus, including the SOP, approximately 20% of stock that is offered when a mutual savings bank converts may eventually be acquired by employees, directors, and other management.

Bylaws

In addition to disclosures, which will be discussed below, some credit unions have sought to amend their bylaws to prevent the credit union from converting to a mutual savings bank charter. One suggestion is to increase voting requirements. However, on its face, any amendment to increase voting requirements is in contradiction to the FCUA and NCUA rules. (12 U.S.C. 1785(b)(2)(B); 12 C.F.R. § 708a.3(b)). Another suggestion is to prohibit the board of directors from considering a conversion to a non-credit union without the request of membership.

This proposal would allow the board to vote for or against a conversion. A final suggestion is to only nominate candidates who agree to sign a statement agreeing not to propose a conversion to a non-credit union. This provision may tie a director's hands if the credit union needed to convert to improve the safety and soundness of the institution.

Disclosures

In 2004, NCUA amended its rules to provide for disclosures that a converting credit union must give to its members and to include specific voting requirements. In the approximately five years since NCUA first amended 12 C.F.R. Part 708a to comply with CUMAA, NCUA has become concerned that credit union members may not fully appreciate the effect a conversion to a mutual savings bank may have on their ownership interests. (69 Fed. Reg. 46111 (2004)). As noted above, CUMAA changed the role that NCUA could play in the conversion process. NCUA's rules provide for stringent disclosures of the conversion process to members.

NCUA believes its regulations enhance a member's ability to make informed decisions about the conversion without increasing the regulatory burden for converting credit unions and also help converting credit unions to more fully understand what NCUA expects of them. The rules require that a majority of the members voting on the conversion proposal must approve. (12 C.F.R. § 708a.3). The regulations also require that a converting credit union provide a notice to members that "adequately describes the purpose and subject matter of the vote to be taken." (12 C.F.R. §708a.4(c)). The rule (12 C.F.R. 708a.4(d)(1)(ii)) clarifies that an "*adequate description of the purpose and subject matter*" includes the following three disclosures in the credit union's notice of intent to convert given to its members:

- 1) The conversion could lead to members losing their ownership interest if the mutual savings bank subsequently converts to a stock institution and the members do not become stock holders;
- 2) How the conversion will affect members' voting rights, and;
- 3) Any conversion-related economic benefits that a director or senior management official may receive with a subsequent conversion to a stock institution—including a comparison of the opportunities to acquire stock that are available to officials and employees with the opportunities available to the general membership.

In addition, the final rule requires the converting credit union to include an “affirmative statement” with the notice to its members. The *affirmative statement* must include whether the credit union intends to:

- 1) Convert to a stock institution;
- 2) Provide any compensation, or increase compensation, (including any stock related benefits) to directors or senior management officials; and
- 3) Base member voting rights on account balances.

These disclosures must also be offset from the other disclosures in the text. NCUA refers to this as the “prominent and conspicuous” requirement; in the sample regulations, the disclosures are in a box. The disclosures must be provided to the Regional Director within the 90-day time period preceding the membership vote on conversion. In addition, the credit union

has an option to have the Regional Director make a preliminary determination regarding the methods and procedures applicable to the membership vote prior to the 90-day time period. Also, NCUA has the ability to disapprove the vote because the vote was not in accordance with the procedures set out in 12 C.F.R. §§ 708a.5 and 708a.7.

Agency Role and Regulatory Conflict

Some critics argue that the NCUA's disclosure requirements regarding subsequent conversion to stock are in direct conflict with OTS conversion rules regarding the conversion from mutual to stock form. The FCUA requires that NCUA's rules be consistent with, and no more restrictive than, other agencies rules. As noted above, NCUA regulations require a credit union converting to a mutual savings bank to disclose whether it intends to convert to a stock institution at a later date, a requirement that may violate the confidentiality requirement in OTS regulation 563(b).120. Under this regulation, a mutual savings bank is required to keep all information about a stock conversion confidential until the board of directors adopts a plan of conversion.

In NAFCU's opinion, these two regulations are not necessarily in conflict. NCUA's rules regarding disclosure govern credit unions. At the moment in time that the credit union is disclosing that it may or may not seek to convert to a stock institution, the institution is governed by a credit union board of directors. The disclosure only relates to the materiality of the decision and intent of the credit union board. When the credit union converts to a mutual savings bank, the entity becomes a new institution with a new board of directors. (12 C.F.R. § 543.10). While in practical terms, many of the members of board may be the same, each mutual institution will

have the ability to decide to convert or not to convert to a stock bank based on the needs of the new institution, its operating strategy and its need for capital. When that vote is taken, it will be taken in accordance with OTS regulations, including the confidentiality requirement. In our view, all that NCUA's disclosure requirement does is inform members as to the true intent of the credit union directors at that moment in time when they voted for the conversion; legally, it does not necessarily speak to the intent of the mutual savings bank directors. Further, since OTS regulations require confidentiality until the vote by the MSB board, and NCUA disclosures are issued to members after the credit union board votes to convert, NCUA's rules are no less stringent than those of OTS. Also under OTS regulations, when an MSB wants to convert to a stock bank, it must seek permission from OTS; this is more restrictive than NCUA's rules. (12 C.F.R. § 543.8).

Litigation on Credit Union Conversions

In December of 2004, Community Credit Union (CCU) of Plano, Texas through its attorneys alerted NCUA of its intent to convert to a mutual saving bank. CCU subsequently sent NCUA its voting disclosure materials for NCUA approval. The NCUA Regional Director contacted CCU and indicated that its materials were not sufficient because they were not conspicuous due to the way that they were folded. NCUA contends that in discussions with CCU, NCUA emphasized the need to make sure that the "boxed disclosures" were the first thing that a member sees, instead of the rebuttal, which was on the outside, based on the way the paper was folded. After NCUA raised this issue, CCU sent out a third set of disclosures in accordance with NCUA's instructions. The first two sets of materials had individuals voting approximately

72.5% in favor of the conversion; the third set had members voting 51% against the conversion. NCUA was concerned that the members who voted in the first two sets of mailing had not been adequately informed, as they potentially would not have seen the “boxed disclosures” first. Accordingly, NCUA disapproved the vote to convert. CCU initiated litigation against NCUA, asserting that the agency’s action in disapproving the vote was arbitrary and capricious. NAFCU and CUNA filed an amicus brief regarding the case. OmniAmerican Credit Union joined the suit, due to NCUA disapproving its voting methods as well.

On August 18, 2005, a federal magistrate judge held that NCUA had no basis for rejecting the membership vote at CCU. Relying on the administrative record, which did not include sufficient evidence of the agreement that NCUA contended it had reached with CCU, U.S. Magistrate Judge Don Bush found that the credit union complied with NCUA’s rules and regulations in its handling of the proposed conversion. Bush found the NCUA acted in an “arbitrary and capricious” manner in rejecting the membership vote. OmniAmerican Credit Union was scheduled to have a separate hearing on August 31, 2005; however, on August 30, the parties executed a settlement agreement, which provided: (1) NCUA would approve the conversion votes of both Community CU and OmniAmerican FCU; (2) as a result of that approval, the legal proceedings initiated by Community CU and OmniAmerican FCU were made moot; and (3) Magistrate Judge Bush vacate his decision and recommendations dated August 24, 2005.

Community Credit Union completed its conversion to a mutual savings bank, becoming Viewpoint Financial Group on January 1, 2006. Just 108 days later on April 18, 2006, Viewpoint filed with the Securities and Exchange Commission to become a stock institution. As

part of that filing, Viewpoint disclosed that the former credit union board members and top executives will purchase approximately 200,000 shares of stock in the new institution in addition to being eligible for an employee stock ownership plan, restricted awards of stock and stock options. The disclosure also indicated that former Community CU CEO, and current Viewpoint President and Director, would stand to make approximately \$1 million with just a \$3 increase in the price of Viewpoint stock from its initial \$10 offering price. (See Appendix E: News Articles on Converted CU's)

Past Legislative Action on the Conversion Issue

In 1998, two Congressmen expressed separate concerns regarding the change to the FCUA in CUMAA regarding conversions. Former House Banking Committee Chairman James Leach (R-IA) recommended an amendment to CUMAA regarding conversions that prohibited any current or former (within the 5 years prior to the conversion) director, committee member or senior management officer from receiving an economic benefit as a result of the conversion. (See H.R. REP. NO. 105-472, at 9-10). Also under the proposal, a credit union that had already converted to a mutual savings bank could not convert to stock if the same individuals receive an economic benefit. Former House Banking Committee Ranking Member John LaFalce (D-NY) introduced a companion amendment and made remarks at the time CUMAA was passed regarding relaxing the minimum participation requirement needed to approve a charter conversion. (105 Cong. Rec. E1161 (June 18, 1989) (statement of Rep. LaFalce)). He highlighted the successful conversion of Eastman Savings and Loan in New York to a credit union (ESL FCU) even though its voting requirements were even more stringent than the

requirements for credit unions prior to CUMAA.² His amendment also would have retained the pre-CUMAA requirements for voting. (See Appendix C: Voting Record of Credit Union Conversions).

H.R. 3206 “*The Credit Union Charter Choice Act*”

Representative Patrick McHenry (D-NC) along with Representatives Edolphus Towns, Paul Gillmor, Peter King, and Sam Johnson, introduced the *Credit Union Charter Choice Act* on July 12, 2006. The bill would in effect make NCUA’s current regulations invalid. Specifically, the bill:

- prevents NCUA from requiring a credit union to provide information regarding future governance of the institution;
- prevents NCUA from disseminating “inaccurate” information;
- prevents NCUA from disseminating information that distorts the impact of conversion on members of the credit union;
- prevents NCUA from promulgating regulations that conflict with regulations of other regulators; and
- disallows disclosures that are attributable to the views of the NCUA Board.

Among other things, the NCUA Board would be barred from disapproving voting procedures post-election, and pre-approve conversion materials within 30 days of receipt.

² It is questionable whether a conversion would be successful today under those same requirements; at the time it converted to a credit union, ESL was a closely-held corporation with a small number of members.

NAFCU opposes H.R. 3206 as introduced, but recognizes its role in the ongoing debate about credit union conversions, and has sought to work with Representative McHenry to bring about changes to the legislation. We appreciate Representative McHenry's openness to having this dialogue with NAFCU.

Specifically, NAFCU has proposed a series of amendments that we believe should either be incorporated in any legislative action on conversions, or enacted through the regulatory process by NCUA, if permissible by law.

**NAFCU's Proposed Amendments to the Requirements Governing the Conversion of
Federally Insured Credit Unions to Mutual Savings Banks**

Following are NAFCU's proposed changes to the laws and regulations regarding conversions of federally insured credit unions to mutual savings banks, and subsequently, if applicable, to stock institutions. The changes are designed to preserve a credit union's right to convert to a mutual saving bank, but enhance a credit union's duties to make sure that the membership is informed at all steps in the conversion process.

In addition, NAFCU supports amending OTS rules and statutes to impose a 10-year minimum waiting period before a director or senior management official may receive any economic benefit in connection with a conversion of a mutual savings bank to a stock institution.

I. Conversion

NAFCU believes the FCUA should be amended to require a minimum participation level of 20% of the credit union membership. Under current law, there is no minimum participation requirement. Thus, a very small number of members may in reality be approving the conversion.

II. Advance Notice to Members of Conversion Proposal

NAFCU believes that a new section should be added to the FCU Act or NCUA regulations to require that members receive advance notice of the member vote on the conversion. This provision will provide credit union members with a more meaningful opportunity to engage in a dialogue with the credit union board about the conversion process and to comment on that process and the conversion plan. Under current rules, credit union members are not necessarily informed of the board of directors' decision to convert until called upon to vote on the conversion.

III. Notice of Special Meeting Requirements

NAFCU believes that new requirements should be created to direct the credit union board to provide each voting member with several discrete pieces of information, which taken together, provide members with notice of the special meeting described above and with meaningful information about the proposed conversion as it relates to credit union management and officers. These new requirements should also require notice to members of the date, time and location of the special meeting and let them know that they have the right to vote on whether to go forward

with the proposed conversion and that they may do so either in person or by submitting a written ballot. In addition, there should be notice to inform the member on how to obtain a copy of the approved proposal and a notice to members that they will be given an opportunity at the special meeting to comment on the proposal.

Furthermore, the FCUA or regulations should require the notice to members to provide a description of the purpose and subject matter of the conversion and must tell them that their voting rights may be affected by the conversion and what “yes” and “no” on the ballot mean. Any potential monetary gain by directors or senior management as a result of the conversion should be disclosed in order for members to judge what, if any, bearing the financial incentive has on the proposal. The disclosure of any plans that the board might have for the subsequent conversion of the mutual savings bank to a stock institution and what impact that might have on members, directors and senior management must be included in the notice to members, along with disclosure that they may potentially lose their ownership interests in the institution if the mutual savings bank converts to a stock institution and they do not become stockholders.

The notice to members should also disclose any conversion related benefits that directors or senior management may receive including any increase in compensation, an explanation of any foreseeable stock related benefits – including an approximate dollar amount – if the converting credit union were to become a stock institution after the waiting period.

IV. Required Notice of Conversion to NCUA

There needs to be a requirement that a credit union provide the NCUA Board, or its designee, for its review and approval, a copy of the notice, ballot and other written materials to be mailed to members as described, and that the board certify that it has undertaken sufficient due diligence to ensure that the conversion will not be detrimental to the interests of the credit union or its members.

Conclusion

NAFCU believes that credit unions should have the ability to convert their charters should it be in the best interest of the members. The only way to ensure that the conversion process is fair is to make sure the process is transparent so that members are adequately informed of the potential benefits and potential detriments that a conversion may have on the interests of the members. We believe that NCUA has an important role in this process, and will continue to work with Chairman Johnson and the NCUA Board to develop the best policy on credit union conversions, balancing the interest of the institution, while looking out for the interests of credit union members. While we oppose H.R. 3206 as introduced, we welcome the opportunity to engage in debate on the conversion process. We look forward to working with Representatives McHenry, Towns, Hensarling, Gillmor and King, and the Subcommittee on this matter, as we think it is safe to say that, at the end of the day, we all want sound public policy on credit union conversions. I would welcome your questions and discussion on this matter.

APPENDIX A: Credit Unions converting to MSBs

Credit Union	City	State	NCUA Conversion Date	OTS Approval Date	Bank Name	Mutual Holding Company Name	Current Corporate Form	Net Worth Ratio @ Conversion	Assets @ Conversion
Source: NCUA	NCUA	NCUA	NCUA	OTS	OTS/FDIC	Yahoo! Finance/web-sites	OTS/FFIEC	NCUA	NCUA
Washington's CU	Lynnwood	WA	3/31/2004		1st Security Bank of Washington		Mutual	10.22%	\$289,973,775
Affiliated Federal CU	Hurst	TX	1/23/1998		Affiliated Bank, FSB		Fed Stock SL	25.10%	\$8,320,128
Allied Pilots	Naperville	IL	9/1/2001		Allied First Bank	Allied First Bancorp	Stock	5.16%	\$82,195,436
Atlantic Coast FCU	Jacksonville	FL	11/9/2000	9/25/2000	Atlantic Coast Federal Savings Bank	Atlantic Coast Federal Corp	Fed Stock SL	9.42%	\$315,987,310
AWANE Credit Union	Peterborough	NH	5/24/1996	11/17/1995	Monadnock Community Bank	Monadnock Community Bancorp	Fed Stock SB	20.45%	\$10,210,841
"@LANTEC Financial FCU"	Virginia Beach	VA	1/12/2004	12/1/2003	Bank @LANTEC		Fed Mutual SL	14.38%	\$94,079,080
Beacon Federal CU	East Syracuse	NY	8/4/1999	9/14/1998	Beacon Federal		Fed Stock SB	10.15%	\$170,350,651
Caney Fork Coop	McMinnville	TN	1/5/2001		Beacon Federal		Fed Stock SB	23.10%	\$278,117
Professional Teachers' CU	McMinnville	TN	8/9/2001		Beacon Federal		Fed Stock SB	12.11%	\$1,123,844

APPENDIX A (continued)

Credit Union	City	State	NCUA Conversion Date	OTS Approval Date	Bank Name	Mutual Holding Company Name	Current Corporate Form	Net Worth Ratio @ Conversion	Assets @ Conversion
BUCS Federal CU	Owings Mills	MD	2/28/1999	9/23/1997	BUCS Federal	BUCS Financial Corp	Fed Stock SB	9.13%	\$57,532,268
Roper Employees FCU	Charleston	SC	3/29/2001	2/9/2001	Carolina Federal Savings Bank		Fed Mutual SB	35.34%	\$6,706,367
Sacred Heart of Charleston SC FCU	Charleston	SC	8/20/1999	4/21/1999	Carolina Federal Savings Bank		Fed Mutual SB	12.69%	\$17,717,278
Citizens Community	Albion	WI	12/18/2001	12/3/2001	Citizens Community Federal	Citizens Community Bancorp	Fed Stock SB	8.79%	\$109,181,417
Community Credit Union	Plano	TX	1/9/2006	5/13/2005	Viewpoint		PENDING	7.64%	\$1,433,757,086
Community Schools	Rochester Hills	MI	1/1/2002		Community Plus Savings Bank		Mutual	8.53%	\$40,655,878
AGE FCU	Albany	GA	7/11/2001	4/20/2001	Heritage Bank of the South	Heritage Financial Group/Heritage MHC	Stock	12.58%	\$268,816,906
I.G.A. Federal	Feasterville	PA	7/1/1998	6/30/1998	IGA Federal Savings Bank		INACTIVE	9.50%	\$159,987,270
Kaiser Permanente Federal CU	Pasadena	CA	11/1/1999	5/27/1999	Kaiser Federal	K-Fed Bancorp	Fed Stock SB	14.86%	\$184,795,705
Lusitania FCU	Newark	NJ	9/1/1995		Lusitania Savings Bank, FSB		Fed Stock SB	13.83%	\$55,195,398

APPENDIX A (continued)

Credit Union	City	State	NCUA Conversion Date	OTS Approval Date	Bank Name	Mutual Holding Company Name	Current Corporate Form	Net Worth Ratio @ Conversion	Assets @ Conversion
Ohio Central FCU	Dublin	OH	6/1/1998	12/4/1997	Ohio Central Savings	OC Financial, Inc	Fed Stock SL	9.05%	\$27,744,591
OmniAmerican CU	Fort Worth	TX	1/6/2006	7/7/2005	OmniAmerican Federal		PENDING	9.03%	\$1,078,454,579
Pacific Trust FCU	Chula Vista	CA	1/1/2000	9/18/2000	Pacific Trust Bank FSB	First PactTrust Bancorp, Inc	Fed Stock SB	11.08%	\$223,963,996
Rainier Pacific, A Community	Tacoma	WA	1/1/2001		Rainier Pacific Bank	Rainier Pacific Financial Group, Inc.	Stock	8.71%	\$383,127,468
Salt City Hospital FCU	Syracuse	NY	2/24/2003	1/24/2003	Salt City Interim Federal Savings Association		INACTIVE	6.51%	\$8,418,386
Share Plus FCU	Plano	TX	10/25/2004	4/16/2004	Share Plus Federal		Fed Mutual SL	10.18%	\$174,194,445
CU of the Pacific	Seattle	WA	5/19/2003	4/14/2003	Sound Community Bank		Fed Mutual SL	9.08%	\$134,494,859
Synergy	Cranford	NJ	4/30/1998		Synergy Bank	Synergy Financial Group, Inc	Fed Stock SB	9.36%	\$176,164,575
AAL CU	Appleton	WI	8/23/2001		Thrivent Financial Bank	Thrivent Financial for Lutherans	Fed Stock SB	0.00%	\$37,169,723
AAL Members CU	Appleton	WI	8/7/2001		Thrivent Financial Bank	Thrivent Financial for Lutherans	Fed Stock SB	6.86%	\$177,443,885

Source: National Credit Union Administration, Office of Thrift Supervision and Federal Deposit Insurance Corporation

APPENDIX B: Institutions Converting to a Credit Union

Credit Union	City	State	NCUA Conversion Date	Assets @ Conversion	Net Worth Ratio @ Conversion	Mutual Bank Name	Current Corporate Form
ESL	ROCHESTER	NY	2/1/1996	\$1,170,000,000	11.04%	Eastman Savings and Loan	CU

Source: National Credit Union Administration

APPENDIX C: Voting Record of Credit Union Conversions

CREDIT UNION NAME	ST	ASSETS	EVENT DATE	# MBRS	VOTED	% VOTED TO TOTAL	COMMENTS
LUSTANIA	NJ	54758839	9/30/1995				
AWANE	NH	8120209	5/31/1996				Information on voting not in files
BUCS	MD	57,532,268	2/28/1998	11,306	6632	58.66%	Information on voting not in files
SYNERGY	NJ	181,754,173	4/30/1998	23,380		0.00%	
I. G. A.	PA	159,967,270	7/1/1998	25,332	15,331	60.52%	Information on voting not in files
OHIO CENTRAL	OH	27,744,591	7/22/1998				
AFFILIATED	TX	8,264,877	7/27/1998	4,000	1232	30.80%	Information on voting not in files
BEACON	NY	170,350,651	8/4/1999	34,832	7750	22.25%	
SACRED HEART OF CHARLESTON SC	SC	17,717,278	8/20/1999	2,788	1557	55.85%	
KAISER PERMANENTE	CA	189,802,390	11/1/1999	34,099	5624	16.49%	
PACIFIC TRUST	CA	223,963,996	1/1/2000	28,039	4815	17.17%	
ATLANTIC COAST	FL	325,606,472	11/9/2000	39,616	4506	11.37%	
RAINIER PACIFIC, A COMMUNITY	WA	383,127,468	1/1/2001	31,461	5789	18.40%	
ROPER EMPLOYEES	SC	6,706,367	3/29/2001	2,226	490	22.01%	
AGE	GA	268,754,134	7/11/2001	40,082	5318	13.27%	
ALLIED PILOTS ASSOCIATION	IL	82,195,436	9/1/2001	6,508	2410	37.03%	
CITIZENS COMMUNITY	WI	108,082,980	12/18/2001	23,177	2676	11.55%	
COMMUNITY SCHOOLS	MI	40,655,878	1/1/2002	7,078	1625	22.96%	
SALT CITY HOSPITALS	NY	8,418,386	2/24/2003	3,786	732	19.33%	
CREDIT UNION OF THE PACIFIC	WA	140,524,148	5/19/2003	13,896	2094	15.07%	
@LANTEC FINANCIAL	VA	94,079,080	1/12/2004	14,228	2029	14.26%	
WASHINGTON'S	WA	289,973,775	3/31/2004	58,741	5938	10.11%	
LYNWOOD	TX	182,423,390	10/25/2004	18,379	2052	11.16%	
SHARE PLUS							

Source: National Credit Union Administration

APPENDIX D: Net Worth, Asset Growth and Member Business Loans to Total Loans of Converted Credit Unions

Credit Union	NCUA Conversion Date	Bank Name	Current Corporate Form	Assets @ Conversion	MBL/Total Assets @ Conversion	NW* Ratio @ Conversion	NW* Ratio-3 Years Prior	NW* Ratio-2 Years Prior	NW* Ratio-1 Year Prior	Net Worth Growth**	Asset Growth**
Atlantic Coast FCU	11/9/2000	Atlantic Coast Federal Savings Bank	Fed Stock SL	\$315,987,310	0.75%	9.42%	8.44%	8.53%	8.99%	18.04%	10.82%
Pacific Trust FCU	1/1/2000	Pacific Trust Bank FSB	Fed Stock SB	\$223,963,996	23.51%	11.09%	7.77%	9.71%	11.09%	45.27%	1.86%
Synergy Financial FCU*	4/30/1998	Synergy Bank	Fed Stock SB	\$176,164,575	0.00%	9.36%	7.92%	8.58%	9.34%	23.75%	5.02%
Beacon Federal CU	1/12/2004	Bank @LANTEC	Mutual SL	\$94,079,080	0.13%	14.38%	11.99%	12.10%	14.38%	52.45%	27.07%
Kaiser Permanente Federal CU	8/4/1999	Beacon Federal	Fed Stock SB	\$170,350,851	0.52%	10.15%	10.42%	10.48%	10.29%	29.76%	31.32%
AGE FCU	11/1/1999	Kaiser Federal Heritage Bank of the South	Fed Stock SB	\$184,795,705	0.00%	14.86%	14.06%	14.18%	14.04%	17.73%	17.88%
Share Plus FCU	10/25/2004	Share Plus Federal	Fed Mutual SL	\$268,816,906	13.89%	12.58%	12.53%	11.96%	12.58%	21.46%	20.96%
Affiliated Federal CU	1/23/1998	Affiliated Bank, FSB	Fed Stock SL	\$174,194,445	0.00%	10.16%	9.73%	10.39%	10.53%	29.80%	16.35%
Sacred Heart of Charleston SC FCU	8/20/1999	Carolina Federal Savings Bank Salt City Interim Federal Savings Association	Fed Mutual SB	\$8,320,128	6.89%	25.10%	23.55%	24.24%	25.10%	4.38%	-2.06%
Salt City Hospital FCU	2/24/2003	Inactive	Inactive	\$8,418,386	0.00%	6.51%	6.70%	6.26%	6.51%	4.12%	7.06%

APPENDIX D (continued)

Credit Union	NCUA Conversion Date	Bank Name	Current Corporate Form	Assets @ Conversion	MBL/Total Assets @ Conversion	NW* Ratio @ Conversion	NW* Ratio-3 Years Prior	NW* Ratio-2 Years Prior	NW* Ratio-1 Year Prior	Net Worth Growth**	Asset Growth**
BUCS Federal CU	2/28/1999	BUCS Federal Carolina Federal Savings Bank	Fed Stock SB	\$57,532,268	0.26%	9.13%	8.34%	9.14%	9.18%	21.01%	9.98%
Roper Employees FCU	3/29/2001	IGA Federal Savings Bank	Fed Mutual SB	\$6,706,367	2.82%	35.34%	29.38%	31.82%	35.34%	19.48%	-0.67%
I.G.A. Federal	7/1/1998	Savings Bank	Inactive	\$159,967,270	0.00%	9.50%	8.26%	9.08%	10.01%	17.64%	-3.00%
Lusitania FCU	9/1/1995	Lusitania Savings Bank, FSB	Fed Stock SB	\$55,195,398	20.18%	13.83%	11.96%	13.76%	13.76%	28.43%	11.59%
Allied Pilots Ohio Central FCU	9/1/2001	Allied First Bank	Stock Fed Stock SL	\$82,195,436	0.00%	5.16%	4.30%	4.89%	5.16%	28.41%	6.89%
Citizens Community	6/1/1998	Ohio Central Savings Citizens Community Federal	Fed Stock SL	\$27,744,591	0.95%	9.05%	8.54%	9.15%	9.05%	9.44%	3.20%
Community Schools	12/18/2001	Community Plus Savings Bank	Fed Stock SB	\$109,181,417	0.00%	8.79%	8.66%	8.87%	9.19%	17.94%	11.09%
AWANE Credit Union	1/1/2002	Community Plus Savings Bank	Mutual	\$40,655,878	0.00%	8.53%	8.10%	8.53%	8.53%	27.93%	21.46%
AAL CU	5/24/1996	Monadnock Community Bank	Fed Stock SB	\$10,210,841	25.14%	20.45%	18.36%	21.83%	20.45%	22.23%	9.79%
Rainier Pacific, A Community	8/23/2001	Thrivent Financial Bank	Fed Stock SB	\$37,169,723	0.00%	9.24%	9.42%	9.49%	9.24%	9.25%	11.26%
AAL Members CU	1/1/2001	Rainier Pacific Bank	Stock Fed	\$383,127,468	7.39%	8.71%	7.63%	8.46%	8.71%	30.34%	14.20%
	8/7/2001	Thrivent Financial Bank	Stock SB	\$177,443,885	0.00%	6.86%	7.55%	7.61%	7.20%	18.55%	31.47%

APPENDIX D (continued)

Credit Union	NCUA Conversion Date	Bank Name	Current Corporate Form	Assets @ Conversion	MBL/Total Assets @ Conversion	NW* Ratio @ Conversion	NW* Ratio-3 Years Prior	NW* Ratio-2 Years Prior	NW* Ratio-1 Year Prior	Net Worth Growth**	Asset Growth**
Community Credit Union	1/9/2006	Viewpoint	Pending	\$1,433,757,086	6.28%	7.64%	7.57%	7.41%	7.68%	19.77%	20.84%
Washington's CU	3/31/2004	1st Security Bank of Washington	Mutual	\$289,873,775	1.88%	10.22%	10.24%	10.97%	10.38%	13.57%	12.00%
Caney Fork Coop	1/5/2001	Beacon Federal	Fed Stock SB	\$278,117	0.00%	23.10%	17.08%	18.86%	20.58%	9.49%	-9.12%
Professional Teachers' CU	8/9/2001	Beacon Federal	Fed Stock SB	\$1,123,844	0.00%	12.11%	11.50%	12.08%	14.27%	32.23%	6.50%
CU of the Pacific	5/19/2003	Community Bank	Fed Mutual SL	\$134,494,859	9.44%	9.08%	8.82%	9.14%	9.22%	14.03%	9.09%
OmniAmerica n CU	1/6/2006	OmniAmerican Federal	Pending	\$1,078,454,579	7.94%	9.03%	7.33%	7.68%	8.00%	26.26%	15.60%

Note: * Net Worth, ** Net Worth and Asset Growth is accumulative for the 3 year period prior to conversion.

Source: National Credit Union Administration

Appendix E: News articles on converted CU's

CU Conversions, IPOs and The Local Rotary Club

FIFE, Wash. (04/17/06) - When shares of Rainier Pacific Savings Bank hit \$16.26 earlier this year there was celebrating in the boardroom of the ex-credit union, once known as Rainier Pacific CU, if not at the local Rotary Club. Because that's when 68,000 Rainier Pacific options granted directors and management became 'in the money,' that is, worth a premium. The insiders, at least five of whom are brothers in the local Rotary Club, engineered the January 2001 conversion from credit union and subsequent August 2003 initial public offering, one of the most lucrative yet for directors and managers of a converted credit union. The maximum allowable 50,000 shares subscribed by all but two of the directors and managers at the \$10 offering price has yielded them each paper profits of \$258,500, or 72%, so far, according to documents filed with the Securities and Exchange Commission. In an unusual sweetener, each of the former volunteer credit union directors was also paid 7,200 restricted shares, worth \$123,614 last week; and options to buy 4,000 shares at \$16.26 each. Particularly sweet was the return by Chairman Edward Brooke, past president of the Tacoma Narrows Rotary Club, who received almost twice as many restricted shares-13,400 worth \$230,764-and twice as many options-8,000-to go with the \$358,500 profit he's earned on his IPO shares in two years. That makes the ex-credit union's IPO even sweeter than most because in most conversions the directors-Rainier Pacific's are paid \$10,000 a year in fees as well-don't receive any restricted stock or options. But the sweetest of the benefits went to fellow Rotarian John Hall, president and CEO of the former credit union. Hall was paid almost \$600,000 in cash compensation in 2004 and 2005; as well as 60,000 shares of restricted stock valued at \$1 million; 140,000 options worth about \$140,000; and employee stock ownership shares worth \$55,287-easily five times his compensation the last year he ran a credit union. He receives full ownership of the restricted shares in five annual installments but maintains voting rights to and receives dividends on all of the shares immediately. Also receiving restricted shares were: Victor Toy, senior vice president, 40,000 shares worth \$686,900; and Joel Edwards, chief financial officer and former CEO of Washington CU Share Guaranty Association, the defunct private deposit insurer, 22,500 shares worth \$386,325. (CU Journal Online 4/17/06)

Former Community CU Executives Poised for Payout

DALLAS - The former executives, officers and board members of Community Credit Union, the \$1.4 billion credit union which converted to a mutual bank in 2005, are poised to cash in on the former CU's move.

According to documents filed with the Securities and Exchange Commission, the former board members and executives collectively will buy just under 200,000 shares of the

Viewpoint Financial Group, the company formed to make the stock offering, at the initial price of \$10.00 per share.

In addition, executives and directors of the new Viewpoint Bank will be eligible for an employee stock ownership plan, restricted awards of stock and stock options.

According to the SEC filing, the stock purchases will break down as follows.

- o Gary Base, CEO, director, 30,000 shares.
- o Gary Basham, director, 25,000 shares.
- o Jack Ersman, director, 25,000 shares.
- o James McCarley, director, 27,500 shares.
- o Karen O'Shea, director, 20,000 shares
- o Keith Sockwell, director, 16,000 shares.
- o Rosario (Rosie) Vela, director, 10,000 shares.
- o Kenneth Yarbrough, director, 20,000 shares.

Additionally, five other executives who are not directors have also purchased shares.

- o Mark Hord, general counsel to the CU, 7,500 shares.
- o Patti McKee, CFO for the CU, 5000 shares.
- o Patrick Ramsier, manager of commercial lending for the CU, 2000 shares
- o Donna Neal, chief lending officer for the CU, 1,500 shares

One other individual executive officer, unnamed, will take 10,000 shares the filing said. (Credit Union Times online 4/20/06)

Stock Rise Would Add to Base's Current \$624,000 Compensation Package

PLANO, Texas. - Viewpoint Bank, formerly Community Credit Union, has not yet set a date for its initial public offering, but documents filed with the Securities and Exchange Commission show that a \$3 per share "pop" or run up in the stock's price upon offering will make its former CU CEO, Gary Base, roughly \$100,000.

Should that come to pass, it will add to a total compensation package of roughly \$624,000 that Base received in 2005, according to the SEC filings. The filings indicate that Base's compensation was roughly 2.5 times the salary of the next highest paid executive whose 2005 compensation was disclosed.- (Credit Union Times online 4/20/06)



Testimony of
America's Community Bankers
on
"H.R. 3206, Credit Union Charter Choice Act"
before the
Subcommittee on Financial Institutions
and Consumer Credit
of the
Financial Services Committee
of the
United States House of Representatives
on
May 11, 2006
Laura Lee Stewart
President & CEO
Sound Community Bank
Seattle, Washington
and
Member, Credit Union Committee
America's Community Bankers
Washington, DC

Chairman Bachus, Ranking Member Sanders, my name is Laurie Stewart and I am the President and CEO of Sound Community Bank in Seattle, Washington. I currently serve on the Credit Union Committee of America's Community Bankers. More important to this discussion, in 2003 Sound Community Bank was created when CU of the Pacific converted from a credit union to a mutual savings association. Currently, Sound has \$214 million in assets and five offices in the Puget Sound area. We are proud of our dedication to the communities we serve and the people who reside there. As a mutual savings bank we take a long view towards our role in and contribution to the community.

I am pleased to be able to come before the Subcommittee today on behalf of ACB to discuss H.R. 3206, the Credit Union Charter Choice Act. ACB strongly supports this legislation, and we applaud Congressman McHenry and his cosponsors for introducing it. The issue of charter choice is important to the overall structure of our nation's financial services sector. ACB believes in charter choice for all financial institutions. This fundamental policy position applies to banks, thrifts, and credit unions alike. When an institution is able to change charters to the one that best fits the needs of its members and community, our financial system will be stronger and healthier. Institutions and their communities change over time. The charter that was best for an institution 50 years ago may not be the best choice now. By allowing charter conversions we allow our financial system to evolve and grow stronger. Unfortunately the National Credit Union Administration (NCUA) does not share this view. Its recent actions have significantly obstructed the ability of credit unions to convert to a mutual bank charter.

The History of NCUA Authority

The actions of the NCUA are clearly contrary to the intent of Congress as expressed in the 1998 Credit Union Membership Access Act (CUMAA). Prior to the passage of the CUMAA, the NCUA had the authority to approve a detailed plan of conversion and disclosures sent to members regarding a conversion vote.¹ On March 4, 1998, the NCUA amended its pre-CUMAA conversion regulations to require a converting credit union to print on the cover of its disclosure three disclosures drafted by the NCUA. These disclosures said: 1) the institution will no longer be controlled by a one-member, one-vote basis; 2) the institution would lose its tax exempt status and might incur increased costs; and 3) the board members of the institution may be compensated.²

Following years of obstruction of credit union conversions by the NCUA, in late 1998 Congress made it clear that credit unions should be allowed to convert to a mutual bank charter without interference from the agency. Congress was so concerned by the NCUA's behavior that it went to great lengths in the CUMAA to ensure that the NCUA could not obstruct future conversions by stripping its authority to approve the transaction and by limiting its powers in the conversion process. The new law limited the NCUA's authority, saying that the NCUA must write rules governing the conversion process that "are consistent with rules promulgated by other financial regulators...." In addition, Congress took the extra step to clarify that rules governing conversion votes "shall be no more or less restrictive than that applicable to charter conversions by other financial institutions." Unfortunately, as I will detail in my testimony, the NCUA seems

¹ Memorandum of Amici Curiae filed by America's Community Bankers, Independent Community Bankers of America, and State Associations in *Community Credit Union v. National Credit Union Administration*. August 9, 2006.

² *Id.*

to have ignored this mandate from Congress. The NCUA has promulgated rules that are not only more restrictive than those of other financial regulators, but actually conflict directly with the rules of the Office of Thrift Supervision (OTS) for conversions to stock form by mutual institutions.

In addition to the burdensome rules crafted by the NCUA, its behavior has proven to be an effective obstacle to converting credit unions. The NCUA's practice of essentially gagging converting credit unions from communicating with their members, while emboldening opposition groups, finding hyper technical reasons for not approving the process used by credit unions, and dragging the process out over unreasonably long periods of time has created a *de facto* barrier to successful credit union conversions. The NCUA's actions have taken the conversion process back to how conditions were prior to CUMAA's passage in 1998. That is why ACB believes that H.R. 3206 is a necessary and timely piece of legislation. It will restore balance, certainty and fairness to the conversion process for credit unions.

NCUA's Conversion Rules

One of the first and most critical parts of H.R. 3206 is that it forces the NCUA to re-examine its current conversion rules and revise them to conform to the requirements of the 1998 law. For the first five years after the passage of CUMAA the NCUA had conversion rules in place that allowed the small number of credit unions that wanted to convert to do so without great difficulty. Then, in less than a year's span, from February 2004 to January 2005, the NCUA promulgated rules that basically reinstated its March 1998 rules and made it increasingly difficult for the conversion process to be fair or achievable. The rules force credit unions to make essentially the same biased disclosures that were required in 1998. The new rules are not only

speculative, outside of the NCUA's jurisdiction, and in conflict with the charter conversion rules of other financial regulators, but also ensure that a credit union's members receive biased information.

The new rules even go beyond the 1998 regulations that Congress found were too onerous. In the 1998 rules the NCUA intentionally did not require a credit union to state whether it would convert to stock ownership. It stated at the time that "credit unions should not be required to include information that may not apply to their transaction."³ In 2004 the NCUA promulgated rules that affirmatively required a credit union to state whether or not it intended to convert to stock ownership, and in the process contradicted itself.

Among other things, the 2004 rules require a converting credit union to:

- 1) Disclose speculative information about any economic benefit a director or member of senior management would receive in connection with the conversion, including any potential stock benefit if the resulting mutual bank eventually converts to a stock institution;
- 2) Speculate that members could have lesser voting rights in the resulting mutual institution than the credit union and that members could lose their voting rights if the institution later converts to stock; and
- 3) Affirmatively state whether the resulting mutual institution plans to convert to a stock institution.

These rules are inherently flawed and violate the 1998 CUMAA because they are speculative and require the board of a credit union to comment on actions over which it will have no control and cannot have knowledge of because those decisions will be made by the resulting

³ Ibid. Pg 24

institution. Converting to a stock institution would be proposed by the board of directors of the mutual bank and voted upon by the members/depositors of that bank. The credit union board can have no knowledge of such a future action, or know how depositors in the resulting bank might vote. Furthermore, this disclosure directly violates a provision in the OTS rules - 563(b).120 - that prohibits disclosure of a proposed stock conversion until a conversion plan is adopted by a mutual bank's board of directors. That rule was put into place to protect members of a mutual bank from professional investors who would attempt to usurp the interests of long-time depositors. The rules imposed by the NCUA, requiring the credit union board to speculate on matters over which it has no control or knowledge, serve no purpose other than to bias the credit union's members against conversion.

Even more egregious are the requirements of the January 2005 conversion rules promulgated by the NCUA. Like those in 2004, the 2005 rules clearly violate the 1998 CUMAA because they have absolutely no parallel in OTS or OCC regulations. The 2005 rules require specific, boxed disclosure language to be included in all communications the credit union has with its members. The exact wording of the disclosure is dictated in the rulemaking. It says:

The National Credit Union Administration, the federal government agency that supervises credit unions, requires [insert name of credit union] to provide the following disclosures.

1. OWNERSHIP AND CONTROL. In a credit union, every member has an equal vote in the election of directors and other matters concerning ownership and control. In a mutual savings bank, **ACCOUNT HOLDERS WITH LARGER BALANCES USUALLY HAVE MORE VOTES AND, THUS, GREATER CONTROL.**

2. EXPENSES AND THEIR EFFECT ON RATES AND SERVICES. Most credit union directors and committee members serve on a volunteer basis. Directors of a

mutual savings bank are compensated. Credit unions are exempt from federal tax and most state taxes. Mutual savings banks pay taxes, including federal income tax. If [insert name of credit union] converts to a mutual savings bank, these **ADDITIONAL EXPENSES MAY CONTRIBUTE TO LOWER SAVINGS RATES, HIGHER LOAN RATES, OR ADDITIONAL FEES FOR SERVICES.**

3. **SUBSEQUENT CONVERSION TO STOCK INSTITUTION.** Conversion to a mutual savings bank is often the first step in a two-step process to convert to a stock-issuing bank or holding company. In a typical conversion to the stock form of ownership, **the EXECUTIVES OF THE INSTITUTION PROFIT BY OBTAINING STOCK FAR IN EXCESS OF THAT AVAILABLE TO THE INSTITUTION'S MEMBERS.**

4. **COSTS OF CONVERSION.** The costs of converting a credit union to a mutual savings bank are paid from the credit union's current and accumulated earnings. Because accumulated earnings are capital and represent members' ownership interests in a credit union, the conversion costs reduce members' ownership interests. As of [insert date], [insert name of credit union] estimates **THE CONVERSION WILL COST [INSERT DOLLAR AMOUNT] IN TOTAL.** That total amount is further broken down as follows: [itemize the costs of all expenses related to the conversion including printing fees, postage fees, advertising, consulting and professional fees, legal fees, staff time, the cost of holding a special meeting, conducting the vote, and any other expenses incurred].

This required disclosure is speculative, outside the jurisdiction of the NCUA, and serves little purpose other than to bias the credit union's membership against conversion. For example, rates will not necessarily change because the institution is no longer a credit union. There is no

reason to assume that all resulting mutual institutions will elect to lower savings rates and increase rates for loans and other services upon conversion. The required disclosure about rates is designed solely to create a bias in the minds of members. Furthermore the required disclosure that executives in a stock institution profit from gaining more stock than other members is not accurate. The OTS requires mutual institutions that convert to stock institutions to first offer shares to all eligible account holders as of a specified date. This means that members of a mutual bank have a priority to purchase all the stock they desire before other investors. In addition, OTS regulations limit the aggregate percentage of stock that may be purchased by an institution's officers and directors.

A credit union converting to a mutual bank has no control over a stock conversion. Such a conversion can only be approved by a vote of the mutual bank's depositors. Requiring speculation about a future conversion from a mutual to stock form serves no purpose other than to create a bias against conversion. Last year, in *Community Credit Union, et al. v. National Credit Union Administration*, a Texas federal magistrate found in his ruling that the NCUA rule requiring this disclosure contradicts current OTS regulations. A copy of this ruling is included as an appendix to this testimony.

The McHenry bill requires that NCUA regulations be based on fact, not speculation; pertain solely to areas where the NCUA has jurisdiction; and not conflict with the rules of other financial regulators. This is a common sense approach and ACB strongly supports it.

NCUA Gag Order

The McHenry bill also addresses the virtual gag order that the NCUA places on converting credit unions. Let me be clear, nowhere is there an explicit prohibition on credit unions communicating with their members. However, the NCUA has made it known that they

will treat communications with credit union members that are not approved by the NCUA as violations of the proper methods and procedures for a conversion vote, and therefore grounds to overturn a vote in favor of conversion. This was seen most recently in the attempted conversion of DFCU in Detroit, Michigan. Because of the NCUA's position on communication during a conversion, a credit union is left with both hands tied behind its back. The NCUA's system creates a one-sided debate where conversion opponents are free to attack the credit union, its management and its directors, while the credit union is unable to respond. When this gag order is combined with the unnecessarily long time the NCUA takes to approve disclosure, it results in a 90-day window where conversion opponents can mobilize a coordinated campaign to communicate with credit union members and bias them against conversion before the credit union leadership has even had a chance to explain why it supports changing to a mutual savings bank structure.

An appropriate analogy that might help members of the Subcommittee understand what the NCUA puts these credit unions through would be a Congressional campaign. Imagine that you were locked in a difficult campaign and your opponent was constantly taking out attack ads against you. Every day there would be new ads, mailings, billboards, and picketing. However, you would be required to have FEC approval before you can respond to any of your opponent's attacks. Imagine if they told you that they might be able to approve your ads or media comments within a few weeks, but they can't make any promises. In the meantime, you were forced to sit by helplessly while your reputation and character are attacked. That is what this process has become for converting credit unions.

In the most recent attempted conversion, DFCU was, in effect, prohibited from talking with its members while the Michigan Credit Union League and another activist groups waged a

public relations war. The NCUA blocked DFCU from telling its members about its desire to convert, leaving members confused and bewildered about why there was so much controversy. The NCUA relies on an overly broad interpretation of its own authority in order to advance its anti-conversion agenda. The McHenry bill fixes this by simply saying that the NCUA cannot require a converting credit union to submit all member or press communication for NCUA approval. We believe that it is appropriate for the NCUA to review balloting and other such materials; however, it should not be allowed to switch from credit union regulator to credit union censor during the conversion process.

Regulatory Foot Dragging

Another problem that we have seen in the past few years is that the time required to approve the necessary disclosures becomes increasingly long. When my credit union converted, the time to approve disclosures was roughly 30 days. However, with the conversions of two credit unions last year, and the attempted conversion of DFCU this year, the approval process took close to 90 days. This foot dragging, when combined with the virtual gag order put on converting credit unions, serves one purpose. It allows conversion opponents to spend more time attacking a credit union that is unable to defend itself. H.R. 3206 resolves this problem by simply putting a time limit on how long the approval process can take. In the past, a 30-day approval period worked well, and we think it is reasonable to use that timeline for future conversions.

Uncertainty

H.R. 3206 also addresses another principal method that the NCUA has been using to obstruct conversions. The NCUA has inserted uncertainty into the conversion process to such an

extent that most credit unions now believe the conversion process is not worth pursuing. Assuming that a credit union manages to run the gauntlet that the NCUA and conversion opponents have created, the NCUA has started to identify hyper technical reasons to overturn a successful vote. Last year in Texas, Omni American Credit Union and Community Credit Union both had conversion votes that topped 70% approval. The NCUA refused to approve the vote because it disagreed with how a single piece of paper was folded. Nowhere in the NCUA's rules did it specify how paper was to be folded; however, in order to prevent a conversion the NCUA fabricated new requirements and arbitrarily imposed them on these two credit unions after the initial mailings were sent. This was a blatant attempt to overturn a conversion because the NCUA had run out of options.

The Texas credit unions had the will and resources to fight the NCUA's protectionism. A federal magistrate found that the NCUA's "determination was not only inconsistent with its own regulations, but under all the circumstances, it was arbitrary and capricious." The threat of the NCUA creating a technicality to overturn months of work and hundreds of thousands of dollars in costs makes credit unions very hesitant to go through with a conversion. If there is no certainty that the affirmative vote of members will result in a conversion, there is little reason to go through the process. The Credit Union Charter Choice Act provides this certainty by establishing a minimum threshold in order for the NCUA to overturn a successful vote. This allows the agency to overturn a conversion based on fraud or knowingly false misstatements by the credit union, but not for hyper technical reasons.

The Conversion Process

I also want to take a moment to address some of the recent rhetoric I have heard about the

credit unions that want to convert, and the mutual bank structure to which they are converting. As the association that represents the vast majority of the mutual savings banks in the country, ACB believes it is essential that the Subcommittee have complete and accurate information regarding mutual institutions. The NCUA and critics of credit union conversions have depicted credit union executives who desire to convert as greedy insiders seeking to enrich themselves. This is simply not true. First, it is ironic that the credit union executives who are painted by the credit union trades as selfless and dedicated cooperative executives suddenly become fraudsters looking to fleece their members of millions of dollars. These executives, like me, are merely looking to find the charter that enables them to best serve their members. A mutual bank is also a cooperative structure focused on its members and communities.

The credit union portrayal of mutual institutions ignores three of the most important characteristics of the mutual charter – independence, commitment to service, and a focus on community stakeholders, not stockholders. Mutuals take a long view of what is best for their community, and their commitment to the best interests of the towns, neighborhoods and villages they serve is reflected in the wide variety of civic activities in which they engage.

I also want to deal head on with the credit union assertion that when a credit union switches to a mutual charter, members lose control over their institution. This is simply not true. The NCUA and conversion opponents have repeatedly and incorrectly implied that credit union members will automatically be disenfranchised upon conversion to a mutual savings institution. These assertions are not supported by fact or law. First, mutual savings institutions by their very nature are cooperatively organized and controlled by their members/depositors. Mutual savings associations have the freedom to adopt a one vote per member provision. This flexibility allows converting credit unions to retain their existing voting structure if the membership so desires.

Many mutual savings bank charters also provide one vote for every \$100 deposited with a cap on the total number of votes given to any one member.

Second, much like with credit unions, the net worth of a federal mutual savings association chartered by the OTS never belongs to the officers and directors of the federal savings association, except to the extent that person is a depositor in the institution.

Third, the members of a mutual savings association must approve all charter amendments and any subsequent conversion to the stock form of ownership. The OTS has established very detailed regulations regarding the conversion of mutuals to stock form. A conversion to stock requires the affirmative vote of a majority of the total outstanding votes of the mutual institution. This is a higher standard than the member vote required for the conversion of a credit union to a mutual savings institution.

The NCUA and credit union trade associations also like to assert that there is a tremendous windfall to the executives and directors of the resulting institution. This is not a true statement. The conversion from a credit union to a mutual institution involves no transfer of net worth to insiders. Furthermore, like credit union executives, the compensation of mutual executives will be determined by the institution's board of directors.

Furthermore, the NCUA also incorrectly presumes that a credit union's conversion to a mutual savings institution will inevitably be followed by a subsequent conversion to the stock form of ownership. This erroneous assumption is also reflected in the disclosure language that the NCUA requires all converting credit unions to provide to their members.⁴

Subsequent conversion to a stock institution is not certain, it is only an option. More than

⁴ The NCUA requires all converting credit unions to provide the following disclosure language, including capitalization and bold print: Conversion to a mutual savings bank is often the first step in a two-step process to convert to a stock-issuing bank or holding company. In a typical conversion to the stock form of ownership, the **EXECUTIVES OF THE INSTITUTION PROFIT BY OBTAINING STOCK FAR IN EXCESS OF THAT AVAILABLE TO THE INSTITUTION'S MEMBERS.**

two-thirds of credit unions that have converted remain in mutual form, just like Sound Community Bank. If a conversion from mutual to stock form is proposed, before it can occur a plan of conversion must be adopted by a two-thirds vote of the mutual institution's board of directors. In addition, the institution's members must approve the plan of conversion by a majority of the total outstanding votes.⁵

There are currently 750 mutual banks in this country, some of which are over 170 years old. We recognize the right of mutual banks to consider converting to a stock form. There are many reasons that the board of directors of a mutual institution may decide to convert to stock ownership. The reasons may include the need for capital to grow or add new products or services. If a conversion is proposed, the federal and relevant state banking regulators have a well-established conversion process that has evolved over the years. The bank regulators have adopted a process that provides safeguards against unjust enrichment of insiders and is fair to depositors of the mutual institution and the communities they serve.

Captive Regulator

I also want to address a concern raised by the financial motivation of the NCUA in credit union conversions. Because of the structure of the National Credit Union Share Insurance Fund (NCUSIF) the NCUA has a powerful motive to prevent credit union conversions. Currently, 60% of the NCUA's operating budget comes from interest earned on deposits held in the NCUSIF. According the National Association of State Credit Union Supervisors (NASCUS) the departure of the two Texas credit unions last year cost the NCUA \$850,000 in FY 2005 and will cost an estimated \$5.1 million during the typical term of an NCUA board member. The NCUA

⁵ 12 C.F.R 563b.125, 12 C.F.R 563b.225(a)-(b). State laws may prescribe a higher percentage of votes before a state chartered savings association may convert to stock form.

clearly has a material interest in preventing credit union conversions. We believe that common sense legislation, such as H.R. 3206, will reduce the ability of the NCUA to act in a self interested and abusive manner.

I also think that it is important to highlight an issue that should be of great concern to the Subcommittee. The behavior of the NCUA on the issue of credit union conversions is both unprofessional and troubling because it is indicative of a regulator that is highly conflicted and captive to its industry. The NCUA's string of recent defeats in federal court indicate that it is interested first and foremost in promoting the credit union industry, rather than being a safety and soundness regulator. One federal judge even said that the NCUA "cannot act like a rubber stamp or cheerleader" for credit unions. Such behavior threatens the safety and soundness of our financial system. The last time our nation saw a financial regulator behave in a fashion similar to the NCUA was the Federal Home Loan Bank Board in the 1980's, and we all know the costly result of that captive regulator.

I understand the implications of making such accusations of a financial regulator; however, ACB believes that this issue is too important to ignore. The comments and actions of the NCUA staff indicate that they have become too closely aligned with the credit union industry, and deserve close scrutiny from this Subcommittee. As an example, in the most recent conversion case the credit union media and trade associations allegedly received copies of letters addressed to DFCU and its attorneys before DFCU or its attorneys did. These leaks of what are intended to be confidential communications are a symptom of a regulator whose priority is aiding the credit union industry, not regulating it. Another example is the comments by NCUA staff responsible for overseeing the conversion process indicating that they believe all conversions are motivated by greed, and that "Without question, credit unions offer a better deal for consumers

than the banking industry....” Such a biased attitude cannot possibly allow NCUA staff to oversee conversions in a fair and impartial manner.

Conclusion

In conclusion, Mr. Chairman, ACB is a strong supporter of charter choice and the mutual form of ownership. Credit unions should have the ability to adopt the mutual charter if doing so meets the strategic interests of the institution and its members. We are concerned that the NCUA, through regulatory fiat, has effectively stopped credit union conversions. Under the guise of disclosure and consumer protection, it has made a credit union charter a prison sentence rather than a right, whereby no one can escape once they take a credit union charter. The actions of the NCUA have effectively stripped the credit union member of the right to vote on the conversion process. This is wrong, and we urge the Congress to pass H.R. 3206, which will ensure that like all other businesses in America, credit unions have the freedom to choose the charter that best fits the needs of their members and communities.

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APPENDIX

TO

TESTIMONY

of

America's Community Bankers

“H.R. 3206, Credit Union Charter Choice Act”

United States District Court
 EASTERN DISTRICT OF TEXAS
 SHERMAN DIVISION

COMMUNITY CREDIT UNION, ET AL.	§	
	§	
V.	§	CASE NO. 4:05CV285
	§	(Judge Schell/Judge Bush)
NATIONAL CREDIT UNION	§	
ADMINISTRATION, ET AL.	§	

REPORT AND RECOMMENDATION
OF UNITED STATES MAGISTRATE JUDGE

Community Credit Union (“CCU”) brought this action for preliminary injunction against the National Credit Union Administration (“the NCUA” or “Administration”) and others challenging the NCUA’s refusal to approve the balloting procedure implemented by CCU (and approved by the NCUA) to convert from a credit union to a mutual savings association. At oral argument, the NCUA represented that it had no objection to having the case determined as a final injunction on the merits. Therefore, CCU’s Motion to Advance Trial on the Merits (Docket #5) is GRANTED.

CCU’s complaint focuses on the NCUA’s refusal to certify CCU’s members’ votes converting CCU from a Texas chartered credit union to a federal mutual savings association, despite the fact, as it alleges, that the Texas Credit Union Department (“TCUD”) and the Office of Thrift Supervision (“OTS”) have approved the change. CCU alleges that its members voted overwhelmingly to convert the institution but that the NCUA refused to recognize the “will of a 71% majority.” CCU alleges that the gist of the action centers on how a piece of paper was folded in the mailings sent to its members. The NCUA contends that the issue is whether members received accurate information that was not misleading. However, the manner in which the agreed notice disclosure was folded is the only issue as to whether the required disclosure was in fact accurate and not misleading. The NCUA contends that the required notice should have been folded to insure that the first document members saw was the NCUA required disclosure rather than CCU’s rebuttal,

which was on the opposite side of the disclosure.

CCU filed this declaratory action and request for preliminary injunction contending the NCUA had violated the Federal Credit Union Act by enacting illegal regulations in violation of 12 U.S.C. § 1785(b)(2)(G)(i) because the Administration's regulations are not consistent with and are more restrictive in their design and implementation than rules enacted by other financial regulators. CCU also seeks a declaratory judgment that the actions of the NCUA were arbitrary and capricious. CCU further requests declaratory relief on other issues which the Court need not address in light of the ruling herein. CCU raises several grounds for jurisdiction, including jurisdiction pursuant to 28 U.S.C. §§ 1331 and 1346 and 28 U.S.C. § 1983 and 12 U.S.C. § 1789.

The NCUA's version of the facts and nature of dispute are set forth in its response to CCU's Motion for Preliminary Injunction. The NCUA contends that, by letter dated December 29, 2004, CCU, through its counsel Silver, Freedman & Taff, informed the NCUA that it intended to convert to a federally-chartered mutual savings institution (*See* CCU Admin. Rec. ("CCU/AR"), at 0760-0793). The letter requested that the NCUA review "the contents of the materials to be provided to the Credit Union's members and advise us (CCU) if there is a problem with the methods and procedures for the membership vote" (*Id.* at 0760). By letters dated December 29, 2004, CCU filed applications relating to the intended conversion with the Federal Deposit Insurance Corporation ("FDIC") and the OTS (*Id.* at 0759, 0757). By letter dated January 20, 2005, CCU forwarded the NCUA additional disclosure materials to supplement CCU's December 29, 2004 submission relating to the proposed conversion (CCU/AR at 0738-0742). CCU noted that "the additional materials are intended to comply with the requirements of Section 708a.4(e) of the new regulations adopted by [NCUA] on January 13, 2005 in connection with conversion of insured credit unions to mutual savings banks" (CCU/AR at 0738). With regard to new disclosure requirements, CCU noted:

[T]he credit union intends to insert the Section 708a.4(e) disclosure (and the Credit

Union's responses) immediately following the 'Notice of a Proposal to Approve a Plan of Mutual Charter Conversion and of a Special Meeting of Members' (the 'Notice'). . . . All of the NCUA required materials (Notice and 708a.4(e) disclosure) will precede the Credit Union's additional disclosure information.

(CCU/AR at 0738-0739). By letter dated January 28, 2005, NCUA responded to CCU's intended placement of the Section 708a.4(e) disclosures:

In the third paragraph it is proposed to insert the required Section 708a.4(e) disclosures immediately following the Notice of Proposal to Approve a Plan of Mutual Charter Conversion and of Special Meeting of Members" (Notice). This placement is not acceptable. The disclosure must be in a prominent place, and conspicuous to the credit union's members. Therefore, it must be included either as a separate document comprising the first page of the written communication, or incorporated into the text of the first page of the Notice.

(CCU/AR at 0718).

According to the NCUA, for the next several months, the NCUA and CCU continued to engage in discussions and negotiations before the notice documents were finalized (*See, e.g., Id.* at 0631-0709, 0614-0630; Cmpl. at ¶ 14). Many of these discussions were oral communications between the NCUA's and CCU's attorneys. (*See, e.g.,* CCU/AR at 0608, 0578). In particular, James Fleischer, an attorney for Silver, Freedman & Taff, contacted the Office of the General Counsel ("OGC") at the NCUA to discuss how CCU could comply with the "prominent and conspicuous" requirement regarding the boxed disclosures (CCU/AR at 0003). According to the NCUA, CCU requested to place the boxed disclosures immediately following an introductory letter to members (the "Dear Member" letter) and before the rest of the materials being sent (*Id.*). CCU also requested to place a rebuttal to the boxed disclosures, entitled "YOUR CREDIT UNION WANTS YOU TO KNOW THE FACTS," on the reverse side of the boxed disclosures (*Id.*). The NCUA claims that CCU's request raised concerns for the NCUA given that the boxed disclosures were central to the NCUA's conversion rules; in particular, the NCUA was concerned that CCU's requests could materially diminish the effectiveness of the disclosures in informing credit union members of critical

information about the conversion (*Id.*). The NCUA, however, agreed to CCU's request to include a rebuttal on the reverse side of the boxed disclosures, provided that the boxed disclosures were the first thing a member would see after the "Dear Member" letter (*Id.* at 0004). However, the Court notes that this specific requirement is not in the record prior to the NCUA's decision not to validate the vote. It is at best an after-the-fact attempt to bolster the NCUA's position on the issue which, in the Court's opinion, is suspect. Although the NCUA contends that its general counsel relayed this message to Mr. Fleischer on or about February 28, 2005, such does not appear in the record except in the post decision letter referenced above (*Id.*). By letter dated March 2, 2005, CCU submitted revised documents and stated:

[i]n response to the comments received from Frank Kressman, Esquire of the [NCUA] by telephone on February 28, 2005, enclosed are the following revised documents marked to show changes made to the prior documents submitted to your offices under cover letters from Silver, Freeman & Taff, L.L.P. dated February 4, 2005 and February 9, 2005.

(*Id.* at 0608). The NCUA contends that the "order of documents" is reflected in the attachments to the cover letter. The Court notes that there was no agreement as to the order but merely a notation of the documents that would be furnished to the members.

By letter dated March 31, 2005, the NCUA informed CCU that it was providing preliminary approval to the proposed methods and procedures applicable to the membership vote (CCU/AR at 0550-0551). Specifically, the NCUA stated:

The final revisions were received on March 16, 2005. Based on my review of these revised documents, I am granting preliminary approval for the proposed methods and procedures applicable to the membership vote. As previously indicated, NCUA continues to reserve its right to object to the conversion process at its conclusion should the actual documents provided to the members or the procedures used differ from those explained in your letters or if the vote is not conducted in a fair and legal manner.

(*Id.* at 0550).

On or about March 21, 2005, CCU sent out its first mailing to its members. (Cmplt. at ¶18).

The second mailing was sent on April 22, 2005 (*Id.* at ¶ 19). By letter dated May 13, 2005, the NCUA informed CCU that it had failed to provide members with required disclosure materials in compliance with 12 C.F.R. § 708a.4(e) (January 28, 2005) (CCU/AR at 0437-0440). The NCUA further informed CCU that if the violation was left uncorrected, the NCUA would disapprove the methods and procedures applicable to the member vote under 12 C.F.R. § 708a.7 and would direct a new vote (CCU/AR at 0437). In the same letter, the NCUA informed CCU that it had investigated and confirmed member complaints that the rebuttal was enclosed on the front side and the required disclosures on the back for both the first and second set of mailings sent by CCU (*Id.* at 0438). As a result of the violation of Section 708a.4(e), the NCUA declared that all ballots received from the members were invalid as the product of the improper disclosures, and that to remedy the violation, CCU would have to “1) begin anew the notice mailing process making certain it satisfies the “prominent and conspicuous” requirement and other aspects of §708a.4(e), and 2) discount all ballots associated with the improper disclosures and begin the voting process again” (CCU/AR at 0438).

In response to this communication, on the third ballot, CCU folded the disclosure document in the reverse manner in which it had folded the document before. Notwithstanding the NCUA’s order to change the mailing procedure, the NCUA refused to honor the election. On June 29, 2005, the OTS issued an Order approving the conversion. In its order, the OTS verified that CCU followed the methods and procedures applicable to the member vote. On June 29, 2005, CCU submitted its request for the NCUA’s approval of its members’ vote approving CCU’s plan to convert to a federal mutual savings bank. (CCU/AR at 0016-0037; Cmpl. at ¶ 27). CCU presented its certification which stated that out of 36,042 members who participated in the vote, 71.5% voted in favor of the conversion (CCU/AR at 0016). On July 5, 2005, TCUD, the state regulatory agency, approved CCU’s application to convert to a mutual savings bank, subject to OTS’s issuance of a mutual savings bank charter (CCU/AR at 0011-0015; Cmpl. at ¶ 28). In its Conclusions of Law, TCUD

found that “[NCUA] has furnished evidence that the NCUA was agreeable to the proposal for conversion” (CCU/AR at 0014). However, the NCUA had not yet issued any decision regarding the methods and procedures applicable to the member vote at the time TCUD issued its own approval (*Id.* at 0001-0010). By letter dated July 11, 2005, the NCUA informed CCU that the NCUA disapproved the methods and procedures applicable to the member vote and directed a new vote be taken pursuant to 12 C.F.R. § 708a.7(b) (CCU/AR at 0001-0010). The basis for the decision was that CCU failed to follow the NCUA’s directive and place the required Section 708a.4 disclosures in a prominent place with each of its written communications to its members and in a manner where they would be conspicuous to the members (CCU/AR at 0001-0010). The NCUA determined that CCU’s actions resulted in a flawed vote and, pursuant to its statutory and regulatory authority, directed that a new vote be taken (*Id.* at 0009).

As CCU points out, the NCUA’s new disclosure rules require that certain disclosures be placed inside a boxed area and contain capital letters with bold-faced type. The disclosures cover such issues as ownership and control by the members, the effect of certain expenses on rates and services, the possibility of a subsequent conversion to a stock issuing bank, and costs of conversion. *See Conversion of Insured Credit Unions to Mutual Savings Banks*, 70 Fed. Reg. 4,005 (2005) (to be codified at 12 C.F.R. pt. 708a). The NCUA interprets its responsibility to review the methods and procedures of the member vote to include determining that the member notice and other materials sent to the members are accurate and not misleading. *Id.* The NCUA’s authority to promulgate final rules regarding charter conversions is limited to rules that are: “(1) consistent with the Credit Union Membership Access Act, Public Law 105-21; (2) consistent with the charter conversion rules promulgated by other financial regulators; and (3) no more or less restrictive than rules applicable to charter conversions of other financial institutions.” *Id.* The manner in which the disclosure was folded is the gravamen of the NCUA’s action irrespective of its spin that the real issue is one of

conspicuousness. At the time the current disclosure rules were enacted, the NCUA published the following comments:

A converting credit union can provide information to its members regarding any aspect of the conversion *in any format it wishes*, provided all communications are accurate and not misleading. NCUA only requires that certain minimal information be provided in the notice to members....NCUA will continue to allow a converting credit union to communicate with its members as it sees fit, but will require that members receive a short, simple disclosure prepared by the NCUA...A converting credit union must include this disclosure in a prominent place with each written communication and must take specific steps to insure that the disclosure is conspicuous to its members.

Id. at 4006 (emphasis added). The NCUA approved the format of the disclosure with the disclosure on one side of the paper and the response on the other side of the paper. The disclosure was, in effect, modified with the consent of the Administrator as provided. *Id.* Even the Administrator admits there were no folding requirements (CCU/AR at 00004. At argument, the Administrator stipulated that, but for the “folding issue,” the requirement of prominence and conspicuousness were met as to the notice. Prominent is defined as readily noticeable. MERRIAM WEBSTER’S COLLEGIATE DICTIONARY, 10th Ed. 1998). Conspicuous is defined as obvious to the eye or mind. *Id.* Sample mailings were included in the record. Regardless of how the paper was folded, once unfolded, CCU’s response pointed the reader to the NCUA’s required disclosure: “The disclosures provided on the reverse side are required by the NCUA.” In addition, CCU addresses each of the four categories required by the NCUA disclosure. Each category is separately listed in a smaller font than that of the NCUA’s required disclosure. The NCUA format is also enclosed in a box, which is not the case for the CCU response. On the surface, it appears that the NCUA’s disclosure was more prominent and conspicuous than CCU’s response. There is nothing in how the disclosure was folded which would make it less obvious than CCU’s response. The NCUA’s position that, by unfolding the document, the reader would first see CCU’s response does not render the disclosure less conspicuous or prominent. The disclosure is in a bolder font, enclosed in a box and referenced

on the opposite side of the page for the reader's review. It is a disclosure in a format pre-approved by the NCUA --a disclosure on one side of a two sided document.

The Court notes that neither the OTS nor the Comptroller have promulgated regulations requiring disclosures about the impact of a charter conversion to the public. *Compare generally* 12 C.F.R. pt. 708a with 12 C.F.R. pt. 563b.135; 12 C.F.R. pt. 563b.180; 12 C.F.R. pt. 516.50-80; 12 C.F.R. pt. 563b.235; 12 C.F.R. pt. 552.2-1; 552.2-6; 12 C.F.R. pt. 552.2-7 and 12 C.F.R. pt. 563.22; 12 C.F.R. pt. 5.8; 12 C.F.R. pt. 5.32; and 112 C.F.R. pt. 303.160 *et. seq.* CCU contends that 12 U.S.C. § 1785(b)(2)(G)(i) only allows the NCUA to disapprove "the methods by which the member vote was taken or procedures applicable to the member vote." There is no regulation on how the boxed disclosures must be folded or where they must be placed among the other disclosures provided.

The Court has reviewed the briefs and materials, including a number of amici briefs filed by those with interests in the outcome of the Court's ultimate decision. The parties have also presented their respective positions by oral argument. At oral argument, the parties agreed that the Court should confine its review of the agency's action to the record. 5 U.S.C. § 706 provides for this Court's review of agency action. The statute, in part, states that "The reviewing court shall: (1) compel agency action unlawfully withheld or unreasonably delayed; and (2) hold unlawful and set aside agency actions, findings, and conclusions found to be--(A) arbitrary, capricious, and abuse of discretion, or otherwise not in accordance with law...."

As previously noted, the Administration gave its preliminary approval for the process which has generated so much controversy. Tab 19 to the record (CCU/AR at 0550) is the letter sent by the Administration to CCU. The Administration's Regional Director, Jane Walters, states: "Based on my review of the revised documents, I am granting preliminary approval for the proposed methods and procedures applicable to the membership vote. As previously indicated, the NCUA continues

to reserve its right to object to the conversion process at its conclusion *should the actual documents provided to the members or the procedures used differ from those explained in your letters* or if the vote is not conducted in a fair and legal matter” (CCU/AR at 0550) (emphasis added). On May 13, 2005, Walters notified CCU that it had failed to provide members with required disclosure materials in compliance with Section 708a.4(e) of the Administration’s regulations. According to Walters, the “boxed disclosure” requirements were folded improperly so members would not see the Administration’s notice first but rather would see CCU’s informational response to the boxed disclosure notice. Both items were contained on a single sheet of paper with the respective notices on the opposite page. There seems to be no dispute that CCU complied with the regulation except, as the NCUA argues, in the manner in which the compliant notice was folded. The Administration contends that the notice was not prominent or conspicuous because a member would not see its required notice first. The specific regulation involved provides as follows:

(e) A converting credit union must include the following disclosures with each written communication it sends to its members regarding the conversion. The disclosures must be offset from the other text by use of a border and at least one font size larger than any other text (exclusive of headings) used in the communication. Certain portions of the disclosures must be capitalized and bolded. A converting credit union may modify the disclosure with the prior consent of the Regional Director and, in the case of a state credit union, the appropriate state regulatory agency.

The unmodified form of disclosure reads as follows:

The National Credit Union Administration, the federal government agency that supervises credit unions, requires [insert name of credit union] to provide the following disclosures.

1. **OWNERSHIP AND CONTROL.** In a credit union, every member has an equal vote in the election of directors and other matters concerning ownership and control. In a mutual savings bank, **ACCOUNT HOLDERS WITH LARGER BALANCES USUALLY HAVE MORE VOTES AND, THUS, GREATER CONTROL.**

2. **EXPENSES AND THEIR EFFECT ON RATES AND SERVICES.** Most credit union directors and committee members serve on a volunteer basis. Directors of a mutual savings bank are compensated. Credit unions are exempt from federal tax and most state taxes. Mutual savings banks pay taxes, including federal income tax. If

[insert name of credit union] converts to a mutual savings bank, these ADDITIONAL EXPENSES MAY CONTRIBUTE TO LOWER SAVINGS RATES, HIGHER LOAN RATES, OR ADDITIONAL FEES FOR SERVICES.

3. SUBSEQUENT CONVERSION TO STOCK INSTITUTION. Conversion to a mutual savings bank is often the first step in a two-step process to convert to a stock-issuing bank or holding company. In a typical conversion to the stock form of ownership, the EXECUTIVES OF THE INSTITUTION PROFIT BY OBTAINING STOCK FAR IN EXCESS OF THAT AVAILABLE TO THE INSTITUTION'S MEMBERS.

4. COSTS OF CONVERSION. The costs of converting a credit union to a mutual savings bank are paid from the credit union's current and accumulated earnings. Because accumulated earnings are capital and represent members' ownership interests in a credit union, the conversion costs reduce members' ownership interests. As of [insert date], [insert name of credit union] estimates THE CONVERSION WILL COST [INSERT DOLLAR AMOUNT] IN TOTAL. That total amount is further broken down as follows: [itemize the costs of all expenses related to the conversion including printing fees, postage fees, advertising, consulting and professional fees, legal fees, staff time, the cost of holding a special meeting, conducting the vote, and any other expenses incurred].

12 C.F.R. 708a.4.

The evidence in the record indicates considerable correspondence from not only CCU but from the state regulatory agency noting the desire to comply with the boxed language requirements of the cited regulation. The Court notes that the boxed language requirement called for in the Regulation was copied almost verbatim in the notice sent out by CCU and included the required notations.

In its letter dated May 13, 2005, the Administration states that it has determined that CCU failed to provide disclosure materials in compliance with Section 708a.4(e). (CCU/AR at 000437). The Administration states that *if the violation is left uncorrected*, it will disapprove the methods and procedures (*Id.*) (emphasis added). The Administration also states that it made it clear to the attorneys representing CCU that the boxed disclosures had to be on the "front" side so that the boxed disclosures are seen by members before the rebuttal side (*Id.*). The Court notes that this requirement appears nowhere in the letters exchanged by the parties nor is there any specific rule which addresses

the folding requirement. Later on in the letter, the Director goes on to state that the Administration has determined that all ballots received are invalid notwithstanding its prior statement that it would only disapprove if the violation was left uncorrected (CCU/AR at 000438). As noted, on the third ballot the disclosure was folded differently, and the NCUA argues this resulted in a reduced percentage of those voting who favored conversion. The Administration takes this as proof supporting its position regarding disclosure.

Under the Administrative Procedures Act, for the Court to have jurisdiction, the “final agency action” must be “an identifiable action or event.” *Lujan v. Nat’l Wildlife Fed’n*, 497 U.S. 871, 899 (1990). The NCUA’s letter dated July 11, 2005 qualifies as such an event or action (CCUAR/000001).

Arbitrary and capricious review focuses on whether an agency articulated a rational connection between the facts found and the decision made, and “[i]t is well-established that an agency’s action must be upheld if at all, on the basis articulated by the agency itself.” *Motor Vehicle Mfrs. Ass’n v. State Farm Mut. Auto Ins. Co.*, 463 U.S. 29,42-43 &50 (1983). The Court must determine whether the agency action was based upon consideration of the appropriate factors. *Id.*, at 42-43.

Where Congress has delegated authority to an agency to make rules carrying the force of law and the agency’s interpretation of its governing statute was promulgated in the exercise of that authority, the Court applies the familiar two-step inquiry established by *Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837, 842-43 (1984); *United States v. Mead Corp.*, 533 U.S. 218, 226-27 (2001). Under *Chevron*, the Court will not defer to an agency’s interpretation that contravenes Congress’ unambiguously expressed intent. *Chevron*, 467 U.S. at 842-43, 104 S.Ct. 2778. On the other hand, the Court must defer to a reasonable agency interpretation when the question is one to which the statute does not speak directly. *See Id.* Otherwise, the Court’s review

of agency action is governed by the familiar deferential standard established by the Administrative Procedure Act, 5 U.S.C. §§ 701-706(APA): the Court must set aside any agency action that is “arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law.” 5 U.S.C. § 706(2)(A). Under this standard, the Court must assure itself that the agency considered the relevant factors in making the decision, its action bears a rational relationship to the statute’s purposes, and there is substantial evidence in the record to support it; but, the Court cannot substitute its judgment for that of the agency. *Texas Oil & Gas Ass’n v. EPA*, 161 F.3d 923, 934 (5th Cir.1998). The Court must uphold an agency’s actions if its reasons and policy choices satisfy minimum standards of rationality. *Id.*

Under the first Chevron threshold analysis, the Court finds that the agency’s interpretation of its regulation contravenes Congress’ unambiguous expressed intent. Although the rules applicable to charter conversion shall be promulgated by the Administrator, such rules must be consistent with rules promulgated by other financial regulators and such rules shall be no more or less restrictive than those applicable to charter conversions by other financial institutions. 12 U.S.C. § 1785 (G)(I). The statutory amendments granted by the Credit Union Membership Access Act in 1998 did not empower the NCUA to govern the conversion of mutual savings banks. That is a field already fully occupied by another regulator, the OTS. The OTS has its own mandated disclosures. The NCUA may prescribe rules and regulations for the administration of Federal Credit Unions including, but not by way of limitation, the merger, consolidation, and dissolution of corporations organized under its jurisdiction. 12 U.S.C. § 1766. The Act also provides that an insured credit union may convert to a mutual savings bank without the prior approval of the Board subject to the requirements and procedures set forth in the laws and regulations governing mutual savings banks and savings associations. 12 U.S.C. § 1785 (2)(A).

In approving CCU’s vote, the OTS noted that the “disclosures” required by the NCUA were

potentially misleading (CCU/AR 000360). However, the OTS noted that the Administration's misstatements were cured by CCU's response on the opposite page of the required disclosure (*Id.*). For all purposes, there is no dispute as to how the vote was conducted, how and when voting materials were distributed, how disclosures were formatted, and the information provided. There is no dispute as to how the disclosure was folded. The Administration's newly enacted regulation on disclosure has no counterpart regulation in the OTS. The conversion is subject to OTS approval. 12 USC § 1785. The OTS approved the conversion. Once a conversion is completed, the credit union is no longer subject to Board authority. 112 USC § 1785 (2)(E). Thus, CCU finds itself in a Catch 22 position. An agency with no power to disapprove of the conversion prevents the conversion even when the regulatory agency responsible for approving the conversion has approved it. However, the NCUA's power is limited to disapproving the methods by which the member vote was taken or procedures applicable to the vote. 12 U.S.C. § 1785(G)(ii). The methods by which the vote was taken were approved by the NCUA. The procedure for the vote was also approved. The required statutory notices were given. The vote was conducted in secret and verified by an independent party. The Court "must, of course, set aside [agency] decisions which rest on an erroneous legal foundation." *NLRB v. Brown*, 380 U.S. 278, 291-92 (1965) (citation and quotation marks omitted); *cf. FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 133 (2000).

Here, the agency gave preliminary approval, reserving its right to object if the actual documents provided to the members or the procedures used differed from those explained by CCU's counsel in prior letters which are part of the record. At the hearing, all parties agreed that the actual documents and language used did not differ from those approved and sent out. The Administrator's letter dated March 15, 2005 underscores the fact that the methods had been approved subject to the actual documents being sent. Since the actual documents were sent, any other construction or objection by the NCUA is simply erroneous and silly. If the NCUA wished to micro-manage the

procedure to address how a single page should be folded, it could have either addressed that issue early on or complied with its statutory duties and administered the election rather than delegating its statutory duty to a third party. The statute is clear that the Administration shall administer the vote. *See* 12 U.S.C. § 1785 G(ii). Here, the NCUA relied on CCU to administer the vote through a third party while CCU was operating under what it perceived to be the ground rules based on extensive correspondence with the NCUA. Since the NCUA did not administer the vote, it should not be allowed to complain about the process.

The record demonstrates that the NCUA first noticed the “folding issue” when it conducted an audit in early May. However, this was after the first two ballots had been sent out. Had the Administration been doing what it was statutorily charged to do early on in the process, it could have saved all parties, including CCU, much trouble, time and expense to correct a problem created by the NCUA. The Director has reserved to herself the right to “disapprove *the actual methods and procedures applicable to the membership vote* if the credit union fails to conduct the vote in a *fair and legal manner.*” 12 C.F.R. 708a.5(c) (emphasis added). It would appear from a literal interpretation of the regulation that once the vote is conducted in a fair and legal manner, the director, contrary to her assertion, has no authority or discretion to disapprove of the methods or procedures used in the vote.

Section 708a.11 provides for voting guidelines. Members cannot be improperly excluded. 12 C.F.R. 708a.11 Membership lists should be accurate. *Id.* Members must be allowed to vote by written ballot or at a special meeting in person. 12 C.F.R. 708a.11. Special meetings for voting should accommodate those who wish to attend. *Id.* A credit union must also conduct its meeting under appropriate statutory or parliamentary guidelines. *Id.* CCU conducted the election in a fair and legal manner, and met every pre-mailing requirement imposed on it. The NCUA should not be allowed to disapprove a vote due to a situation caused by its own ineptness, which, when reviewed

from the entire record, is much ado about absolutely nothing.

In the alternative, the Court finds that the action by the Administration is arbitrary and capricious. Although the Administration spends considerable time in its rejection letter on the positioning of the boxed disclosure, in final analysis, the NCUA's position is that CCU failed to provide members with required disclosure materials in compliance with Section 708a.4(e) (CCU/AR/000006). The record indicates that nothing could be further from the truth. The regulation provides that the credit union must include the required disclosure with each written communication. CCU complied. The disclosures must be offset from the other text by use of a border and at least one font size larger than any other text (exclusive of headings) used in the communication. CCU complied. Certain portions of the disclosures must be capitalized and bolded. CCU complied.

In the review process, the Director takes it upon herself to determine whether the notice to members is accurate and not misleading. There is nothing in the Director's letter dated July 11, 2005 that makes any determination that the notice was inaccurate or misleading. The agency's determination was not only inconsistent with its own regulations, but under all the circumstances, it was arbitrary and capricious.

To prevail on a motion for preliminary injunction, a party must show: (1) a substantial likelihood of success on the merits; (2) a substantial threat that the movant will suffer irreparable injury if the injunction is denied; (3) that the threatened injury outweighs any damage that the injunction might cause the defendant; and (4) that the injunction will not dis-serve the public interest. *Affiliated Prof'ls Home Health Care Agency v. Shalala*, 164 F.3d 282 (5th Cir. 1999); *Sunbeam Prods., Inc. v. West Bend Co.*, 123 F.3d 246 (5th Cir. 1997). At the hearing, the parties agreed that the case should be determined as a final injunction on the merits. The standard for a final, permanent

injunction is the same as that for a preliminary injunction except that the Plaintiff must actually succeed on the merits. *Amoco Prod. Co. v. Village of Gambell*, 480 U.S. 531, 546 n.12 (1987).

The Court finds that Plaintiff's request for final injunction should be granted. At the hearing, Plaintiff succeeded on the merits by demonstrating, to the Court's satisfaction, that the NCUA acted arbitrarily and capriciously in failing to certify the member vote. CCU further demonstrated a risk of irreparable harm due to the fact that, without the NCUA's certification, CCU cannot fairly promote itself or compete in an extremely competitive market as either a credit union or a mutual savings bank. The Court finds that the harm caused to CCU outweighs any damage that may stem from an injunction. Finally, the Court finds that an injunction best serves the public interest by upholding the CCU membership decision, reached in a democratic manner and in compliance with all statutes and regulations, to convert to a mutual savings bank.

RECOMMENDATION

Based upon the foregoing, the Court finds that Plaintiff's Motion for Final Injunction should be GRANTED. The Court RECOMMENDS that Defendants be finally enjoined from requiring Plaintiff to conduct any further votes and that Defendants be ordered to certify the prior member vote for CCU's conversion to a mutual savings bank.

Within ten (10) days after receipt of the magistrate judge's report, any party may serve and file written objections to the findings and recommendations of the magistrate judge. 28 U.S.C.A. § 636(b)(1)(C).

Failure to file written objections to the proposed findings and recommendations contained in this report within ten days after service shall bar an aggrieved party from *de novo* review by the district court of the proposed findings and recommendations and from appellate review of factual findings accepted or adopted by the district court except on grounds of plain error or

manifest injustice. *Thomas v. Arn*, 474 U.S. 140, 148 (1985); *Rodriguez v. Bowen*, 857 F.2d 275, 276-77 (5th Cir. 1988).

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Testimony of

Edward L. Yingling

On Behalf of the

AMERICAN BANKERS ASSOCIATION

Before the

Subcommittee on Financial Institutions and Consumer Credit

Of the

Committee on Financial Services

United States House of Representatives

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Mr. Chairman and members of the Subcommittee, my name is Edward L. Yingling. I am President & CEO of the American Bankers Association (ABA). ABA, on behalf of the more than two million men and women who work in the nation's banks, brings together all categories of banking institutions to best represent the interests of this rapidly changing industry. Its membership – which includes community, regional and money center banks and holding companies, as well as savings associations, trust companies and savings banks – makes ABA the largest banking trade association in the country.

Thank you for the opportunity to present the views of the ABA on the issue of the ability of credit unions to choose the charter most appropriate to their current and future lines of business. The current conversion process is totally out of balance, with the balance tilted to those groups that oppose any conversion from a credit union for any reason. The Credit Union Charter Choice Act (HR. 3206), introduced by Congressman Patrick McHenry with Representatives Gillmor, Johnson, King and Towns as original cosponsors, takes important steps to try to restore the necessary balance – a balance that Congress sought to achieve when it enacted the conversion provisions of the Credit Union Membership Access Act of 1998 (CUMAA).

Many credit unions today have determined that it is in their interests to branch out into banking activities and exercise broader banking powers. Unless the mission and the credit union charter are to be dramatically distorted to accommodate these credit unions, a fair and workable path for credit union conversion to mutual banking charters must be clearly established. That path is not workable today.

Despite clear Congressional intent, the National Credit Union Administration (NCUA) has implemented rules that make it extremely difficult for credit unions to consider converting to a mutual

savings bank charter. Moreover, there now is an organized group that opposes *any* conversion, regardless of its merits and the express intent of the elected Board of Directors of the credit union. This group has little or no connection to any particular credit union wishing to convert. The result is wide-scale confusion among credit union members.

The ABA believes that balance once again needs to be restored to the credit union conversion process. The process must be straightforward and predictable, while providing credit union members with the information they need to make an informed decision. We commend the efforts of Congressman McHenry and support the goals and objectives of his proposed legislation.

The existence of charter options is particularly important now as many credit unions have strayed from the central purpose of their charter—serving people of modest means—and are now focused on pursuing lines of business identical to mutual savings banks and commercial banks. We must never forget that credit unions were established for the specific purpose to serve people of modest means. This is not a parenthetical duty; it is their legal focus and mission. This is why credit unions have their special federal privileges. But with these privileges, there also come limitations. Distinct from traditional credit unions, a new-breed of credit unions has emerged that wants to serve a broad customer base, to do complex business lending, and to offer asset management services targeted at wealthier customers. Fortunately, there are other charters, such as a mutual savings bank charter, that provide greater flexibility with the effective and experienced supervision of traditional banking regulators, while at the same time preserving the mutual-member focus that credit unions find desirable. Unfortunately, the current skewed process makes it difficult for any conversion to take place and denies credit union customers the expanded products and services that would be available prudently under a bank charter.

In my statement today, I would like to make three points:

- **The mutual savings bank charter may be a more appropriate option today for some credit unions**, particularly for those that want to expand service to broader customer bases and offer business and commercial real estate financing.
- **Balance must be restored in the credit union conversion process.** Today, the power is skewed to those groups that oppose any conversion, and NCUA, in particular,

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has a history of impeding conversion through misleading and confusing disclosures. The Credit Union Charter Choice Act would help to restore the balance that Congress intended and customers need.

- **As credit unions evolve and seek new lines of business, it is even more critical that a straightforward and predictable conversion process is in place.** It is clear that some credit unions are evolving. They want to serve a broader customer base, to do more complex business and commercial real estate lending, and to offer insurance and brokerage services.

The choice before Congress is either to destroy the basic concept and mission of credit unions by amending the law to expand the credit union charter beyond recognition and prudential bounds, or instead, facilitate the conversion of expansive credit unions to mutual savings banks. We believe this second option to be more consistent with preserving the traditional role of credit unions and maintaining a safe and well supervised financial system.

I will discuss these points in more detail.

I. The Mutual Savings Bank Charter May Be a More Appropriate Option for Some Credit Unions

Boards of directors of financial institutions have many options for charters. It gives them the ability to select the charter that best meets its future business plans and needs of its customers. All charters have different rights and responsibilities that need to be carefully weighed.

Congress envisioned that credit unions would play a special role in today's financial marketplace in meeting the financial needs of people of modest means. Congressman Bill Thomas, Chairman of the House Ways and Means Committee, reiterated this fundamental responsibility in a recent hearing:

I am going to interpret the tax preferred structure as meaning servicing those who are unable, either through the structure that is present or geography, to get their

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basic financial needs met. Today, that means low-income, minorities, racial, women, and so on; and not some “modest means” that can’t be defined.¹

In order to make sure that the federal subsidy is focused on the right people, there are additional limitations on the credit union charter, including restrictions on business lending and field of membership. Moreover, the cooperative, mutual structure of credit unions means that they raise capital through retained earnings; they cannot raise capital from outside investors. Such a capital structure is fundamental to the credit union charter and is an integral part of the original credit union philosophy: a close-knit group where members’ savings support other members’ borrowing.

Congress reemphasized the need for different charters during the debate on CUMAA. For example, Senator Craig Thomas (R-WY) commented: “As with every other federally chartered organization or institution, Federal credit unions must serve within that niche that is prescribed for them by law. I have told my friends in the credit unions that there are certain advantages to the way they are structured, certain advantages go to them as being cooperatives and being member-owned. On the other hand, there have to be, then, some limitations to the kind of things they can do.”² As Senator John Kerry (D-MA) stated from the Senate floor, credit unions “were never intended to be simply alternative, tax-exempt commercial banks.”³ And speaking from the Senate floor during the debate on the Credit Union Membership Access Act, Senator Robert Bennett (R-UT) commented that his support for an amendment to limit credit union business lending “would send the public policy message that says: We want credit unions to remain in their traditional niche in the financial services area.”⁴

Recognizing that different charters enable different approaches to serving customers, Congress also made the way clear for credit unions to choose a new charter if they wanted to pursue activities that extended beyond the bounds of the traditional credit union charter.

¹ Review of Credit Union Tax Exemption, Hearing before The Committee on Ways and Means, U.S. House of Representatives, November 3, 2005, pp. 190.

² Congressional Record, July 28, 1998, S 9019.

³ Congressional Record, July 28, 1998, S 9095.

⁴ Congressional Record, July 28, 1998, S 9013.

Mutual Savings Bank Charter Option

Mutual savings banks, on the other hand, have the flexibility to define their customer base more broadly, pursue greater business lending, and, through the creation of a mutual holding company, raise outside capital to support growth. However, with this expanded scope of activities available under this charter, comes the enhanced and experienced supervision of federal banking regulators. Mutual savings banks do not consider this to be inappropriate. Rather, mutual savings banks have done exceedingly well in meeting the needs of their customers and communities. These savings banks include those credit unions that have converted to a mutual savings bank charter. For converting credit unions, the new business and customer service opportunities more than pay for the tax obligation and the more rigorous supervision program they take on.

With respect to ownership and control and the rights of members, mutual savings banks and credit unions are basically similar. Credit union members and the depositors at federal mutual savings banks have —

- The right to vote
- The right to amend bylaws
- The right to nominate and elect directors
- The right to request special meetings
- The right to communicate with other members
- The right to inspect the corporate books
- The right to share pro rata in the assets following liquidation.

Credit Unions That Have Converted are Strong, Profitable and Growing

Nearly thirty credit unions have converted to a mutual savings bank charter in the last 10 years.³ As mutual savings banks, these institutions can continue to serve their existing markets — and seek new ones — while preserving the mutual structure, providing competitive loan and savings rates, and expanding the quality and variety of services they offer. The members, after conversion, continue to have the same mutuality rights as they had before conversion.

³ This total includes 6 credit unions that were merged into an existing mutual savings bank.

Moreover, these former credit unions are thriving. *The success of the conversions is easily observed as the median annualized asset growth rate since their conversions is 21 percent.* The fact that these converted credit unions pay taxes under the savings bank charter and are subject to more rigorous bank regulation has not hampered their success in meeting customer needs. Moreover, mutual savings banks remain member-focused.

Herb Moltzan, CEO of BUCS Federal Bank, which converted to a mutual savings bank charter in March 1998, confirmed the value to customers of their bank conversion. He wrote that after the conversion “we were able to add services with no changes to our rate and fee philosophy and were, in fact, so successful that we grew rapidly and needed to raise additional capital.”⁶

Charter choice gives financial institutions the ability to select the charter that best meets their future business plans and the needs of their customers. For credit unions that want to go beyond their legal mandate while retaining their mutual structure — the choice is a mutual savings bank charter.

I would note that this door should swing both ways. While credit union to bank charter conversions have attracted a lot of attention, there have been several mutual savings banks that have converted to credit union charters, including Wisconsin-based Employees’ Mutual Saving Building & Loan Association to EMSBLA CU in 1997 and New York-based Eastman Savings & Loan to ESL FCU in 1996. These institutions made their decisions based upon what they believed best met the future needs of their customers. Neither their regulators nor the banking industry blocked their right to choose this charter.

II. Balance Needs to Be Restored in the Conversion Process

The Credit Union Charter Choice Act (H.R. 3206) would help to restore the balance that Congress intended. This bill reaffirms that credit union members have the right to choose the charter that best fits their financial needs, if a majority of voting members believes the change is in their best interest. The bill would amend the Federal Credit Union Act to enable credit unions to speak freely to members, the general public, and the media regarding any conversion to a mutual savings institution, and prevent the National Credit Union Administration (NCUA) from requiring any notice that contains statements or information that is speculative, including assertions of possible future options of the converted financial institution that may or may not ever be exercised and that are beyond the

⁶ Op-ed in *Credit Union Times* on July 13, 2005.

responsibility or competence of the NCUA. Restoring balance is critical, as the NCUA has skewed the process heavily against conversions. H.R. 3206 will make the process fairer – by limiting the NCUA’s ability to exploit supervision of the conversion process to insert itself into the conversion debate of a particular credit union or stifle the ability of elected credit union officials to communicate with their members.

The decision of a credit union to convert its charter is extremely important. To make an informed decision, members need to have sufficient information on the merits of the proposed charter conversion. That information must be neither false nor misleading. Congress acted in 1998 to ensure that members are adequately informed, that appropriate disclosures are made (consistent with disclosures required by banking regulations), that voting requirements are reasonable, and that there are safeguards against insider abuse.⁷ In spite of these statutory standards and in clear disregard of Congressional intent, NCUA rulemaking and procedure continue to impede the process and add confusion instead of clarity, speculation rather than factual information.

NCUA has a History of Impeding Conversions, Subverting the Democratic Process

Overturned Voting Rule

Prior to the enactment of the Credit Union Membership Access Act (CUMAA), NCUA required a majority of all credit union members to vote in favor of a conversion, not just a majority of members voting. Under NCUA regulations, if a member did not exercise his or her right to vote, NCUA treated this as a “no vote.” This rule established a hurdle that made conversions extremely difficult for smaller credit unions, effectively impossible for larger ones. Under a one-shareholder/one-vote rule, few companies in America would be able to get a majority of persons to respond to an organizational question. With voter turnout rates in our public elections often below 50 percent, how many electoral contests would be nullified by such a standard? Congress in 1998 decided that such a

⁷ Section 202 of CUMAA amended the provisions of the Federal Credit Union Act (“Act”) and required NCUA to allow an insured credit union to convert to a mutual savings bank or savings association “subject to the requirements and procedures set forth in the laws and regulations governing mutual savings banks and savings associations” [12 USC 1785(b)(2)(A)]. Further, NCUA was empowered to require an insured credit union that proposed to convert to a mutual savings bank or savings association to submit a notice to the NCUA of its intent to convert during the 90-day period preceding the date of the completion of the conversion [12 USC 1785(b)(2)(D)]. Once the conversion is completed, “the credit union shall no longer be subject to any of the provisions of the [Federal Credit Union Act]” [12 USC 1785(b)(2)(E)].

threshold was too onerous. It changed the requirement for conversions to a simple majority of the members who vote.

Proper Notice to Members

Congress was also concerned that members be adequately informed. That is why Congress in 1998 required a converting credit union to send three mailings of the ballot and disclosure notices to all members eligible to vote. “The first notice of the proposal shall be given to each member who is eligible to vote, 90 days prior to the date of the vote on conversion. Additional notices must be given to each member eligible to vote, 60 days prior to the vote and again at 30 days prior to the vote.”⁸ We believe that in addition to timely notice, credit union members are entitled to proper information in the notice, information that lays out the relevant facts, free from requirements for unsubstantiated speculation on future actions or unfounded assertions of motives.

Safeguards from Insider Abuse

Anti-conversion advocates would have people believe that credit union conversions to mutual savings bank charters are for insider enrichment. In fact, there is no transfer of net worth to insiders from conversions from a credit union to a mutual savings bank. Furthermore, the compensation of senior management remains a responsibility of the board of directors of the mutual just as it was with the credit union.

To ensure that insider abuse does not occur, Congress put in place safeguards to protect the interests of members of the converting credit union. Section 202 of the Credit Union Membership Access Act “limits the economic compensation of any director or senior management official of an insured credit union that converts to a mutual savings bank or mutual savings association to director fees and compensation and other benefits paid in the ordinary course of business in connection with the conversion from a credit union to a mutual savings bank or mutual savings association.”⁹

Whether a mutual savings association later elects to convert to a stock-based ownership structure—and most converted credit unions have not—is a matter of review for the Office of Thrift Supervision (OTS), not the NCUA. I would note that, if a mutual savings bank decides to issue stock,

⁸ Senate Report, 105-193, p. 9.

⁹ Senate Report, 105-193, p. 9.

the Office of Thrift Supervision carefully regulates the process to protect depositors'/members' interest, and that regulatory review has been increased in recent years. Specifically,

- The Office of Thrift Supervision reviews the business plan of the converting institution, overseeing who is eligible to exercise rights to buy stock, and working to ensure no preferential treatment is given to management and insiders.¹⁰

- The OTS has full authority to delete any provision from the business plan that it views as being either "... inequitable or detrimental to (the institution's) accountholders."¹¹ Dividends are limited and also subjected to supervisory oversight.¹² No one person or group may purchase a controlling interest in the converted institution.¹³

- Depositors control the fate of their institution. Depositors must approve the business plan (including how the subscription rights will be divided among accountholders, board members and staff),¹⁴ are entitled to subscription rights to purchase stock in the institution,¹⁵ and are kept informed by an extensive process of disclosures that provide ample opportunity for their input.¹⁶

Conversions No More or Less Restrictive Than Rules Applied to Other Institutions

Perhaps nowhere has the abuse by NCUA been more blatant and had a more chilling effect on conversions than the onerous rules on disclosures – rules that go well-beyond those that apply in other conversions of financial institutions. These onerous rules are in direct contradiction of the law and clear Congressional intent. In particular, Congress instructed "the NCUA to promulgate rules ... applicable to charter conversions that are consistent with rules promulgated by other financial

¹⁰ 12 C.F.R. § 563b.115 (2005).

¹¹ 12 C.F.R. § 563b.130 (2005).

¹² 12 C.F.R. § 563b.520 (2005).

¹³ 12 C.F.R. § 563b.370 (2005).

¹⁴ 12 C.F.R. § 563b.225 (2005).

¹⁵ 12 C.F.R. § 563b.360 (2005).

¹⁶ 12 C.F.R. § 563b.300-563b.310 (2005).

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regulators including the Office of Thrift Supervision and the Office of the Comptroller of the Currency. The rules for charter conversions by insured credit unions must be no more or less restrictive than those rules that apply to charter conversions by other financial institutions.¹⁷ [emphasis added]

Since the enactment of CUMAA, NCUA has interjected itself directly into the conversion debate. It attempts to substitute its judgment for those credit union members under the patronizing proposition that credit union members do not appreciate the effect a conversion may have on their ownership interests and voting rights and that if they did, ipso facto, they would never vote in favor of a conversion.¹⁸

Rather than improving transparency, however, NCUA's regulations foment confusion, raise unsubstantiated concerns, present subjects outside of the NCUA's jurisdiction, and raise allegations about matters not at issue in the vote. Harold Lowman, chairman of DFCU Financial Federal Credit Union's Board of Directors, in announcing the credit union withdrawal of its application to convert, stated that "the limitations of the process have made it impractical to fully inform members. Further, the result has been unnecessary confusion and concern among our members."

Under the guise of "education" NCUA requires a that "a converting credit union must include a disclosure prepared by NCUA in a prominent place with each written communication it sends to its members regarding the conversion and must take specific steps to ensure that the disclosure is conspicuous to the member."¹⁹ This also applies to web site postings.

¹⁷ Senate Report, 105-193, p. 9.

¹⁸ In February 2004, NCUA amended part 708a to require a converting credit union to disclose additional information to its members to better educate them regarding the conversion. 69 Federal Register 8548, Feb. 25, 2004.

¹⁹ 70 Fed. Reg. 4005, Jan. 28, 2005.

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The National Credit Union Administration, the federal government agency that supervises credit unions, requires [insert name of credit union] to provide the following disclosures:

1. **OWNERSHIP AND CONTROL.** In a credit union, every member has an equal vote in the election of directors and other matters concerning ownership and control. In a mutual savings bank, **ACCOUNT HOLDERS WITH LARGER BALANCES USUALLY HAVE MORE VOTES AND, THUS, GREATER CONTROL.**
2. **EXPENSES AND THEIR EFFECT ON RATES AND SERVICES.** Most credit union directors and committee members serve on a volunteer basis. Directors of a mutual savings bank are compensated. Credit unions are exempt from federal tax and most state taxes. Mutual savings banks pay taxes, including federal income tax. If [insert name of credit union] converts to a mutual savings bank, these **ADDITIONAL EXPENSES MAY CONTRIBUTE TO LOWER SAVINGS RATES, HIGHER LOAN RATES, OR ADDITIONAL FEES FOR SERVICES.**
3. **SUBSEQUENT CONVERSION TO STOCK INSTITUTION.** Conversion to a mutual savings bank is often the first step in a two-step process to convert to a stock-issuing bank or holding company. In a typical conversion to the stock form of ownership, the **EXECUTIVES OF THE INSTITUTION PROFIT BY OBTAINING STOCK FAR IN EXCESS OF THAT AVAILABLE TO THE INSTITUTION'S MEMBERS.**
4. **COSTS OF CONVERSION.** The costs of converting a credit union to a mutual savings bank are paid from the credit union's current and accumulated earnings. Because accumulated earnings are capital and represent members' ownership interests in a credit union, the conversion costs reduce members' ownership interests. As of [insert date], [insert name of credit union] estimates **THE CONVERSION WILL COST [INSERT DOLLAR AMOUNT] IN TOTAL.** That total amount is further broken down as follows: [itemize the costs of all expenses related to the conversion including printing fees, postage fees, advertising, consulting and professional fees, legal fees, staff time, the cost of holding a special meeting, conducting the vote, and any other expenses incurred].

These disclosures violate and contradict the regulations of other financial regulators, in contravention of CUMAA. This intrusion by the NCUA into the jurisdiction of other federal regulators, with no basis in statute or other applicable authority, is remarkable, in that no bank regulator requires similar disclosures for charter conversion questions involving its supervised institutions. Moreover, the subjective format and tone of the disclosures does little to promote thoughtful consideration of facts by credit union members. The effect of the box, the highlights, the capitalized, bold language, is to achieve one purpose, to encourage credit union members to vote against any conversion proposal, rather than encourage an unbiased, fair review. This is directly inconsistent with the will of Congress that conversion be a viable option.

Furthermore, the mandatory disclosures are themselves misleading. For example, consider the first bullet on ownership and control. As OTS noted in its certification of the Community Credit Union, Plano, Texas, conversion: "While it is true that the standard federal mutual charter provides for one vote for each \$100 (or portion thereof) of deposits up to a maximum of 1000 votes, it is extremely unlikely that even a depositor with 1000 votes will have any semblance of "control" of the institution." OTS notes that in this particular case with over \$1 billion of deposits, "a single account holder will have less than 1/10,000 of the institution's voting power."

Additionally, the bullet is misleading regarding the potential *subsequent* conversion to a stock institution. Sixteen of 23 converted credit unions are still mutuals. The very requirement to discuss any single potential future action—when there are any number of potential future actions that can have an

impact on current credit union members—is speculative and deceptive in itself. Moreover, the OTS wrote in its Community Credit Union certification, the “OTS’s regulations strictly limit the amount of stock any executive may purchase in a conversion. In addition, executives cannot purchase any more stock in the conversion than any other member.”

In short, rather than doing its duty to ensure a fair process, the NCUA has involved itself in the very debate and guaranteed an unfair process. Any credit union that published such a deceptive notice—except under direct mandate from the NCUA—could be vulnerable for providing misleading information to its members.

Bear in mind that the statute requires that the NCUA look to other agencies in order to provide for a comparable process. The report of the U.S. Magistrate Judge in the Community Credit Union conversion suit against NCUA concluded that, “The Administration’s [NCUA’s] newly enacted regulation on disclosure has no counterpart regulation in the OTS.” Thus, NCUA is clearly not following the intent of Congress which mandates that the rules for charter conversions by insured credit unions must be no more or less restrictive than those rules that apply to charter conversions by other financial institutions.

Neither the OTS nor the Comptroller of the Currency (OCC) has such disclosure requirements for conversions of charter types (whether from a credit union or commercial bank to a federal mutual savings association or to or from a national bank charter).²⁰ Comparing the rules promulgated by NCUA with those of the banking agencies clearly shows that the NCUA – by design – makes it more difficult and less likely for a conversion to take place.

NCUA has Considerable Power to Prevent Conversions by Not Certifying the Vote

Although NCUA is not an unbiased observer – and would suffer financially if a conversion occurs, particularly of a large credit union – it alone determines if any notice to members is accurate and not misleading (12 CFR 708a.7(c)) and can refuse to certify a vote.²¹ The credit union could

²⁰ See 12 C.F.R. SS 543.8 - .89 and 12 C.F.R. S 5.24(d).

²¹ NCUA’s operations are funded through examination/supervision fees and transfers from the National Credit Union Share Insurance Fund (NCUSIF). Moreover, all federally-insured credit unions are required to hold an investment in the NCUSIF equal to one percent of insured deposits. If a credit union converts, they get back their one percent investment. This reduces the size of the insurance fund, though does not increase exposure as the converted credit union would become insured by FDIC, not NCUSIF. It does, however, affect NCUA’s budget, and potentially the level of its supervisory, legal, and administrative staff. For this reason, it is not in the interest of the NCUA to allow credit unions to convert their charters.

undertake a new vote, but the costs of doing so are often so substantial that it would rarely occur. Thus, management will want approval by NCUA of any written communication to members, because of the real fear that NCUA might not certify the vote.

NCUA can also delay conversions by dragging its feet. The management of credit union conversion candidates Lake Michigan Credit Union and DFCU Financial were unable to respond to reporters or provide press information in a timely fashion, as they waited for NCUA approvals during the conversion process. Comments by credit union officers made without prior NCUA approval have reportedly been met with letters from NCUA criticizing the communication. These cases have had a chilling effect on any communication to members. Simply put, these credit unions were held hostage to an agency that drags its feet since it is not generally inclined to support any conversion.

Meanwhile, parties that have a strong vested interest in opposing conversion have little restriction on the timing, frequency, or substance of their communications. This includes organized groups, that may not even be members of the credit union. With the management unable to respond to misinformation in a timely fashion, credit union members are left without adequate information to decide whether opponents' allegations are true.

Know When to Hold 'Em, Know When to Fold 'Em

Nowhere was the NCUA's improper use of its power more apparent than in 2005 when the agency tried to invalidate the conversion of two Texas credit unions, where an overwhelming majority of the members voted for the conversions. All the NCUA mandated disclosures were provided. All of the notice deadlines were set. NCUA's objection was to the way the disclosure statement was *folded*. As Congressman Hinojosa (D-TX) commented in testimony before this Subcommittee on June 9, 2005: "I find it odd that NCUA nullified the vote by [Community Credit Union] members to switch charters based upon how a document was folded, especially since there are no rules, regulations or guidance on how to fold such document." Congressman Frank (D-MA), in a June 16, 2005 letter to JoAnn Johnson, Chairman of NCUA, wrote: "This sees to me a hyper-technical interpretation of your agency's conversion regulations, and that strikes me as an inappropriate basis to invalidate these elections." Many others expressed the same sentiment.

A Texas magistrate agreed that NCUA was being unreasonable regarding the two Texas credit union conversions and stated that parts of NCUA's regulation, adopted earlier in 2005, went beyond the authority of NCUA to regulate conversions from credit unions.

III. As Credit Unions Evolve, a Straightforward and Predictable Conversion Process is Critical

As the credit union industry evolves, a blurring of the line between banks and credit unions has developed. In fact, a new breed of credit union has emerged that does not fulfill the traditional mission of serving people of small means, often focusing on above median-income people and commercial businesses, both of which have many options for financing. The common bond, where people save for and lend to one another, is often forsaken for rapid growth in members. Preserving the values of the traditional credit union charter has been a long-term priority for the Congress. Credit unions that seek greater product and service authority and want greater options to raise capital to support these expanded activities can and should choose a mutual savings bank charter, with the broader authority and experienced bank supervision that comes with it; this is the reason a straightforward, fair, and predictable conversion process is so important.

The evolution of credit unions raises important policy questions. Are new-breed credit unions fulfilling their mandate to serve people of modest means? Do these non-traditional credit unions qualify for their special treatment, despite the fact that they no longer serve the purposes of their charter? If credit unions are not meeting the responsibilities Congress created for their charter, why should Congress give them more authority to expand business lending and other activities through the proposed Credit Union Regulatory Improvement Act to depart even further from their mandate? At what point do some credit unions cease to be the type of institution deserving of preferential treatment?

We would respectfully suggest that the answers all point to a credible, fair, workable process whereby a credit union that wants to exercise bank powers should be able to convert to a bank charter. Without such a process, the only response to today's new breed of credit unions is to allow them to continue to abandon people of modest means while distorting the credit union charter into something unrecognizable by the original authors of the credit union concept.

Coalition for Credit Union Charter Options

Written Testimony of

Lee Bettis
Executive Director
Coalition for Credit Union Charter Options

**Consideration of the *Credit Union Charter Choice Act*
H.R. 3206**

Before the

Committee on Financial Institutions and Consumer Credit
United States House of Representatives

May 11, 2006

Coalition for Credit Union Charter Options
500-5301 Wisconsin Avenue N.W.
Washington, DC 20015

Introduction

Chairman Bachus, Vice-Chairman Jones, and Members of the Committee, the Coalition for Credit Union Charter Options appreciates the opportunity to provide written testimony to your Subcommittee. Our organization is wholeheartedly in favor of H.R. 3206, *The Credit Union Charter Choice Act*.

The Coalition is an education and advocacy group formed to represent the interests of credit unions that want to preserve charter choice under reasonable rules and at a reasonable cost. We promote and defend the right of credit unions to choose the type of financial services charter and organizational structure that best suits the needs of their customers and the communities they serve.

Our membership includes credit unions, former credit unions that have since converted to mutual savings banks, companies serving credit unions and banks, and individuals.

Containment or Freedom of Choice

Bank trade associations say they want to contain credit unions and hence they oppose the expansion of credit union powers. Likewise, credit union trade associations and NCUA, whose interests have come to appear indistinguishable, also want to contain credit unions by keeping them from converting.

Yet, the credit union charter has no capital raising powers and faces other limitations. Thus, credit unions that want to grow face a legislative stalemate.

As you know, Congress enacted H.R. 1151, the *Credit Union Membership Access Act*, in 1998, authorizing the conversion of a credit union to a mutual savings bank under streamlined rules. The legislation replaced NCUA's self-serving rulemaking of prior years. As a result, forward-thinking, growth-minded credit unions that do not want to be 'contained' have an escape route.

Or should we say, HAD an escape route.

NCUA Impediments to Conversions

After five years of mostly even-handed supervision of conversions, NCUA, in 2003, began a campaign of excessive rule-making, capricious administration of the rules, and public relations antics which have undermined H.R. 1151. Effectively, NCUA has put a chill on consideration of conversion as a strategic option for credit unions.

For example, some of you may recall that last summer, despite your objections, NCUA invalidated the conversion vote at two Texas credit unions because of the way a single piece of paper was folded. The credit unions were forced into court and thank goodness they prevailed. The federal judge said NCUA was “arbitrary,” “capricious,” “silly,” and “inept.” Had the parties not settled, the judge would likely have invalidated NCUA’s entire set of over-reaching conversion regulations.

One would think that after fierce criticism from Congress and a federal judge, NCUA would have learned its lesson about lacking objectivity and independence.

Unfortunately, it only learned how to better maneuver its bureaucratic red tape and public relations tactics to once again stop a conversion attempt. This spring, a \$1.8 billion credit union in Michigan was forced to withdraw its conversion application because of NCUA’s posturing against the credit union, its encouragement of a dissident member group, and quite frankly, its lack of objectivity and independence.

Conflict of Interest at NCUA

Money may be what is clouding NCUA’s judgment.

For example, in January, NCUA had to write a check to the two Texas credit unions for \$17 million. This is the amount of their deposits in the National Credit Union Share Insurance Fund (NCUSIF), which NCUA administers. Today, NCUA keeps 60% of the interest earned on that money for its operating budget – about \$500,000 for 2005, in the case of the two Texas credit unions.

The Michigan check would have been \$10 million. In addition, because this is a federal credit union, NCUA would have lost its \$250,000 annual assessment – a potential \$500,000 hit, in total.

This, we think, is clear evidence that NCUA is *conflicted*. The agency also seems to be *confused*, since the law established by Congress in 1998 calls for conversion regulations to be “no more or less restrictive than rules applicable to charter conversions of other financial institutions.”

Regrettably, that is not what we have today.

Excessive Regulation

For example, NCUA unwisely imposed speculative disclosure language in 2003, including statements about possible future equity offerings which violate Securities and Exchange Commission and Office of Thrift Supervision rules. Then, in early 2005, it added its infamous ‘boxed language,’ which the OTS has called “potentially misleading.”

NCUA has a long history of opposing conversions. Congress had to rein the agency in with the 1998 legislation. For example, your 1998 law eliminated other ‘boxed language’ that NCUA had imposed on conversions in 1997. Yet, here is the same issue, back again, eight years later. Despite periodic changes among the members of the NCUA board, the meddling and lack of objectivity continue, which points strongly to intransigence on the part of its career bureaucrats.

When a federal court admonished NCUA last summer, it was just the latest example of a third party looking closely at what's going on in the credit union industry with charter conversions and finding the behavior outrageous.

Here is a quick synopsis of NCUA's poor behavior in past conversions:

- *Lusitania (1995)*

NCUA invalidated a majority approval in the first round of voting and subsequently required non-material changes to clear the disclosures it demanded for a second round of voting.

- *Affiliated (1998)*

NCUA's regional director delayed action for almost nine months before responding to the application, claiming the region was too busy to address conversions.

- *Citizens Community (2001)*

Citizens' first conversion vote was invalidated, although it received an overwhelming majority vote in favor, because not all the ballots were received within NCUA's arbitrarily imposed, 30-day voting period. NCUA refused to permit a meeting adjournment, typical in many corporate situations, to allow more time for the ballots to arrive. Within a few days following the closing of the 30-day window, a sufficient number of additional ballots had arrived to meet the quorum requirement. NCUA also prevented the credit union from sending reminder notices to members, in order to improve participation, during the 30-day voting window.

- *Columbia (2003-04)*

NCUA invalidated the majority vote of this state-chartered credit union based in part on NCUA's claim that some additional members should have received ballots – a matter subject to state law. NCUA's ruling was contrary to a legal opinion from a local attorney who acts for state-chartered credit unions throughout Washington state.

- *Lake Michigan (2004)*

NCUA stonewalled the clearance of a set of answers prepared by the credit union to respond to a television media inquiry, eventually leading to a damaging, one-sided story.

- *Community (2005)*

NCUA invalidated a majority vote based on how a piece of paper was folded in the member mailing.

- *OmniAmerican (2005)*

Just as it did with Community, NCUA invalidated a majority vote based on how a piece of paper was folded in the member mailing. Plus, after the Texas federal judge's decision in the Community case, NCUA raised an additional issue pertaining to voting eligibility at OmniAmerican, similar to the Columbia case. The inquiry was dropped when the Justice Department pushed NCUA to settle both cases.

- *DFCU Financial (2005-06)*

NCUA refused to clear the credit union's proposed Q&A language for member and media inquiries; postured about alleged inaccurate statements in the disclosures on post-conversion access to shared branches, after previously clearing them; claimed media statements by the credit union's CEO were inconsistent with the disclosures; and contradicted DFCU's statements about a potential recall of the entire board by declaring the Supervisory Committee would become an interim board – an outcome that many believe is not permitted under the Federal Credit Union Act.

NCUA's Unnecessary Role in Conversions

If NCUA is unable or unwilling to implement Congress' legislation properly, then isn't time to turn complete responsibility for conversions over to the OTS and FDIC? If NCUA won't get the message, doesn't it need to be removed from the process? After all, credit union-to-mutual savings bank charter changes are the only type of conversion not handled entirely by the *successor* agency.

Besides, the OTS and FDIC have much more experience with transactions requiring full and fair disclosure. Both have securities divisions which deal with such issues on a daily basis.

NCUA and its friends at the credit union trade associations will tell you that money clouds the judgment of credit union executives who seek to convert to the mutual savings bank charter. They would have you believe that, without NCUA guarding members' interests, the management and directors of converting credit unions will be free to help themselves to excessive compensation. These critics ignore the 30 years of management compensation rules in place at the OTS and the FDIC, both highly respected regulators. These are the same rules that apply to respected companies like Washington Mutual and World Savings. Quite frankly, the critics' attacks on compensation are without merit and self-serving.

There are all kinds of misleading arguments put forth by vested interests in the credit union industry on why charter conversions are bad for members. The fact is, they are bad for those vested interests. Generally speaking, they are *good* for members and their communities.

It is ironic, actually. While arguing to Congress that credit unions are handicapped by charter limitations, the anti-conversion bureaucrats ignore the positive member and community benefits that flow from a conversion to the mutual charter – results that stem from the very powers they are lobbying to get for their own credit unions, such as higher business lending limits and more flexible capital standards.

It is an indisputable mathematical fact that a mutual savings bank can hold more assets, accept more deposits, make more loans for its members, and do more for its community, than a credit union with an equal amount of net worth.

Nonetheless, the real issue is freedom of choice. The members should be allowed to decide for themselves about a charter conversion, which is what *didn't* happen in Michigan last month.

Denying the Members Their Democratic Rights

One of NCUA's anachronistic bylaws permits the calling of a special meeting on just 500 signatures, regardless of the size of the credit union. It allows a strident minority to run roughshod over the rights of the full membership. That is exactly what happened in Michigan as a small group led by former employees and directors, and financed by outside interests, launched an effort to remove the board of directors prior to the completion of the conversion voting. The Michigan credit union has 160,000 members who were effectively denied the opportunity to vote yes or no to a conversion.

NCUA had a chance to modernize this bylaw, which is a throwback to the days of small, all-volunteer credit unions, at its most recent meeting last month. But it chose instead to leave it in place, making only an immaterial adjustment, thereby preserving the recall of a board of directors as a 'secret weapon' in the fight to undermine conversions.

Shouldn't members of modern credit unions, with hundreds of millions of dollars in assets and professional management, be protected from minority groups that rely on sponsorship from outsiders to promote extremist agendas?

Such outdated governance, like the 'secret weapon' special meeting bylaw, can lead to safety and soundness concerns: and it is simply more evidence that some credit unions have outgrown their skin. We would propose a solution that many state-chartered credit unions have adopted, which requires at least 10% of the total membership to sign a petition for a special meeting.

Conclusion

In conclusion, forward-thinking, growth-minded credit unions – that do not want to be ‘contained’ – have become trapped by NCUA’s arbitrary and capricious rulemaking and its draconian influence over the conversion process.

Converting credit unions, and those credit unions that want to keep the conversion option open, are stranded. Facing the unfortunate prospect of being contained both by the banks *and* NCUA, these ‘orphans’ have no one to turn to.

The Coalition for Credit Union Charter Options supports H.R. 3206 and is appealing to this Committee to take action. The adoption of H.R. 3206 as presented will go a long way toward creating a fair and reasonable conversion process. Additionally, we would ask the committee to address the anachronistic federal credit union bylaw provision for special meetings and consider entirely removing a conflicted NCUA from the credit union-to-mutual savings bank conversion process.

We urge you to protect the rights of these credit unions, and their members, from NCUA’s efforts to impede, and ultimately stop, conversions.

Thank you for the opportunity to present our testimony to the Subcommittee on Financial Institutions and Consumer Credit.

Yours truly,

COALITION FOR CREDIT UNION CHARTER OPTIONS

Lee Bettis

Lee Bettis
Executive Director

Appendix

The attached table documents the actions of NCUA in the conversion application by DFCU Financial of December 2005, leading up the withdrawal of that application in April 2006.

That history is preceded in the table by a selection of events over the previous 24 months summarizing the actions of NCUA and Congress in connection with charter conversions, including the invalidations by NCUA of two Texas votes in 2005 which prompted the drafting of H.R. 3206.

The Coalition for Credit Union Charter Options offers this record of events and outcomes in the history of conversions, together with our comments, as additional written testimony in support of the *Credit Union Charter Choice Act*, H.R. 3206.

**Coalition for Credit Union Charter Options
NCUA Actions to Impede Conversions 2003-06**

Date	Entity	Action	Impact/Outcome	Comment
<i>Background</i> Late 2003	NCUA	Over the objections of many credit unions, NCUA Chairman Dennis Dollar authors new regulations that call for inclusion of speculative statements in the standard conversion disclosures, including statements about possible future equity offerings. The new rulemaking is announced with much fanfare in the trade press on the day \$650 million-asset Columbia Credit Union (WA) issues its first mailing to members regarding its plan to convert to a mutual savings bank.	Press reports of NCUA's announcement ring of insiders; and that present disclosures are inadequate, and false and misleading. The new disclosures add to the regulatory burden, contrary to Congress' explicit instructions that NCUA should establish conversion rules that are "no more or less restrictive than rules applicable to charter conversions of other financial institutions." For example, they ask the credit union to announce future intentions that have not yet been decided, by a board that doesn't yet exist, and which have to be approved by a future membership that is not yet constituted.	Alter five years of even-handed administration of conversion votes, the new regulations set the stage for an era of proactive interference by NCUA in conversions. The new rules are similar to NCUA's pre-H.R. 1151 conversion rule requirement, which was rejected by Congress when it streamlined conversion regulations in 1998. Many believe the new disclosures are also illegal because they violate OTS and SEC rules.
Mid-2004	NCUA	After invalidating the membership approval of the Columbia conversion, NCUA sets the stage for a recall petition by SaveCCU, a dissident member group, to remove sitting directors. NCUA's spurious objection letter was released to the dissidents and the press before the state regulator or the credit union could comment. Some have called the board recall petition NCUA's "secret weapon" in the battle against conversions.	NCUA's invalidation was based primarily on a federal interpretation of voting eligibility, an issue governed under state law since Columbia was a state-chartered credit union. NCUA overrode a local legal opinion on voting rights – provided by counsel to most Washington state credit unions. Consequently, Columbia's board became mired in a lawsuit brought by the dissident group, built on the back of the NCUA investigation and objections.	NCUA released its spurious objection letter, overturning the affirmative vote, to the dissident group before even sending it to the credit union. Columbia, once a community leader in performance and prestige, is now frozen in time as new board members deal with internal conflicts, driven in part by left-of-center social-political ideals.

Background (cont.)	
January 2005	<p>On the eve of the mailing of disclosures by \$1.4 billion-asset Community Credit Union (TX) and \$1.1 billion-asset Omni-American Credit Union (TX), and despite objections from many credit unions and banking trade groups, NCUA approves yet another new set of regulatory requirements for conversion disclosures, which became commonly known as the "boxed language."</p> <p>NCUA is invited to testify at a hearing of the Subcommittee on Financial Institutions and Consumer Credit of the Committee on Financial Services. Rep. Patrick McHenry famously refers to NCUA's objections over how a document in the mailing was folded as "re-freaking-diculous." OTS Acting Director Richard Riccobono called NCUA's invalidation decision "terrible."</p> <p>Ranking Member Rep. Barney Frank wrote Chairman Johnson following the June 15 Subcommittee hearing calling the "fold" decision a "hyper-technical interpretation" that serves to "encourage those who seek to place further restraints on NCUA's authority..."</p> <p>Chairman Johnson responds with a letter to Rep. Frank defending the agency's actions and criticizing the TCUD for its handling of the Texas conversions on several grounds, including biased judgment.</p>
June 15, 2005	<p>NCUA continues to imply conversions are motivated by insiders rather than driven by economic conditions and credit union charter limitations. And the misleading "boxed disclosure" makes it impossible for the credit union to communicate fairly with its members.</p> <p>NCUA's efforts to invalidate the Community and Omni-American votes are seen by some as an attempt to deny the members their right to have a say on the conversion.</p>
June 16, 2005	<p>The OTS declares NCUA's boxed language to be "potentially misleading." For example, NCUA implies members will have no subsequent vote on any conversion to stock ownership but the OTS points out in its June 2005 certification of the Community vote that members must approve such a conversion under a more rigorous vote requirement than the credit union-to-initial savings bank conversion.</p> <p>The hearing was supposed to be about regulatory relief but questioning of NCUA Chairman JoAnn Johnson is mostly focused on its actions to invalidate the voting in the Texas conversions.</p> <p>Rep. Frank's advice to "rescind or reject any decision or recommendation invalidating these [Texas] elections" was ignored by NCUA, which had to be taken to court by the two credit unions.</p>
June 22, 2005	<p>This prompts a scathing letter from TCUD Commissioner Harold Feeney addressing each specious complaint, confirming that it is his duty "to enforce and apply the statutes adopted by the Texas legislature and the corresponding rules promulgated by the Texas Credit Union Commission in a fair and reasonable manner."</p> <p>NCUA ignored their request and proceeded with the invalidation, forcing the matter to the courts. The Congressmen's concerns were vindicated by a Texas federal judge's ruling that NCUA's actions were "arbitrary," "capricious" and "silly."</p>
June 29, 2005	<p>Mr. Feeney went on to add "I believe NCUA has a similar duty on the federal level."</p> <p>The Congressmen had asked NCUA to "consider the implications of excessive regulatory interference in the process."</p>

Background (cont.)		
July 2005	NCUA	In a speech at the NAFCU annual conference, Chairman Johnson criticized members of Congress, saying they "haven't a clue" about credit unions.
July 2005	Congress	Rep. Patrick McHenry circulates a bill (H.R. 3206) that would strip NCUA of much of its authority over charter conversions.
December 13	Congress	Rep. Jeb Hensarling issues a letter to the GAO requesting it investigate whether NCUA is obstructing conversions.
		Not only does NCUA continue to exceed its statutory authority in conversions, it seems prepared to taunt its superiors and flaunt its disobedience.
		NCUA reacts predictably and blamelessly, taking no responsibility for having precipitated this move to rein the agency in.
		The GAO is asked specifically to report on whether NCUA's actions "conform with, or exceed the powers granted" in H.R. 1151, whether its rules are "no more or less restrictive" than those applicable to other financial institutions ("as required by law"), and whether NCUA's behavior "acts as an undue hindrance on the ability of credit unions to convert."
		In the same speech, Johnson accused Community's leadership of not being open, fair and consistent with the membership in their disclosures. But it is NCUA's capricious actions that have made the goal of full disclosure a moving target over the past two years. NCUA learned nothing from its Texas misadventure.
		Rep. Hensarling suggests "a bias against credit union conversions may exist at the NCUA" which could "obstruct the ability of credit union members to decide freely and fairly the future of the credit union."

The DFCU Episode		
December 14, 2006	DFCU	\$1.8 billion-asset DFCU Financial files an application with NCUA to convert, including a draft disclosure package and other materials.
December	NCUA	NCUA refuses to clear supplemental DFCU materials for use with members and the media – claiming they are "forward-looking and subject to speculation."
		DFCU is the largest-ever credit union to attempt a charter conversion, and one of the nation's top-performing and most efficient credit unions. DFCU has received numerous local awards for exemplary customer service, for providing a highly rated employee work environment, and for civic activity – in particular for providing grants to elementary schools.
		DFCU avoids making substantive remarks to the media and its members while disclosure materials are awaiting clearance from NCUA.
		DFCU immediately draws fire from the credit union industry.
		DFCU is effectively silenced by the NCUA's ability to force revisions to the disclosures and/or invalidate the vote over anything the agency unilaterally deems is a discrepancy in other communications with members.

The DFCU Episode (cont.)	
January 12	<p>NCUA</p> <p>After 30 days of review, NCUA issues a letter to DFCU refusing to clear the disclosure materials and raising numerous issues about which it later admitted it had no authority to regulate. NCUA also confirmed in the letter its refusal to clear basic communication materials which addressed questions typically raised.</p> <p>NCUA's January 12 letter to DFCU, containing 10 pages of comments on an 8-page draft disclosure statement, is released to CUNA and its contents find their way into the trade press on this day. The letter twice raises the specter of overturning the vote if NCUA's concerns are not addressed.</p>
January 27	<p>NCUA</p> <p>NCUA's general counsel Bob Fenner claims in a trade press report that DFCU has made a "gross overstatement" when it said NCUA's opinion on written communications to members precludes it from talking to members until the disclosures are approved. On February 23, he said it was "egregious" and "outrageous" for a credit union to blame NCUA for not talking to its members.</p>
March 1	<p>NCUA</p> <p>NCUA finally clears DFCU's disclosures for mailing but "recommends" the credit union wait for the outcome of a NCUA-mandated investigation by DFCU's supervisory committee, handled by special counsel, over a complaint filed by the ex-DFCU chairman. NCUA now admits it had no authority to regulate certain issues raised in its previous comment letter in January.</p>
	<p>MCUL CEO David Adams and the credit union trade press claim DFCU is trying to hide something because it is not immediately mailing information about the conversion to members.</p> <p>The trade press reports include details of DFCU's plans and NCUA comments on areas of inquiry that are outside the agency's authority. NCUA rejects DFCU's conversion plan and is "questioning" the institution's due diligence.</p> <p>Without the ability to counter through its own rebuttal the claims in the "boxed language" (which the OTS has found to be "potentially misleading" and which NCUA has ruled must accompany all written communications to members), DFCU continues to stand down on member communications while its opponents have a field day making defamatory and misleading statements that bear no regulatory scrutiny whatsoever.</p> <p>Member disclosures are further delayed. NCUA's March 1 letter opens the door for more hijinks by the DOU dissident group, a small group of DFCU ex-employees, ex-directors, and members opposed to the conversion, by pointing to supervisory committee integrity, past representations about insider benefits, and board due diligence as areas of concern. In citing areas of "concern" (over which it has no jurisdiction), NCUA raises suspicions, setting the stage for shenanigans by opponents and pointing them in specific directions.</p>
	<p>The disclosure materials submitted for clearance were substantially similar to the materials cleared during the two Texas conversions in 2005, which NCUA had testified in federal court were "complete" except for the way a single piece of paper was folded.</p> <p>In failing to protect confidential information, NCUA allows the negotiation on disclosure content to be conducted in the media. Conversion opponents take NCUA's letter and imply the federal regulator suspects DFCU of wrong-doing related to the conversion plan.</p> <p>With his published remarks, Fenner is disingenuously inviting DFCU to compromise its own interests by speaking for the record before its disclosures are cleared. At the same time, NCUA warns DFCU in a letter "it could be very costly and time-consuming...if the notification process must be reinitiated."</p> <p>NCUA's March 1 letter was also released into the public domain. This allows matters of conjecture about the DFCU board's internal deliberations to carry the weight of allegations, and they begin to take on a life of their own as the charges are repeated by opponents and reinforced by stories in the press, including the Detroit mass media.</p>

The DFCU Episode (cont.)	
March 1	<p>NCUA waives SFT in the March 1 clearance letter that "NCUA reserves the right to disapprove the actual methods and procedures applicable to the membership vote if the credit union fails to conduct the vote in a fair and legal manner," which continues to threaten DFCU's ability to make public statements in defending itself against allegations by DOU and MCUL.</p> <p>As chairman of the Committee on Ways and Means, Rep. Bill Thomas writes NCUA Chairman Johnson to take issue with public statements by a member of her board.</p> <p>With the supervisory committee investigation now complete, DFCU mails its disclosure package to members.</p> <p>MCUL's Adams writes NCUA suggesting "NCUA would have cause to disallow this vote based on the unfairness and inaccuracy of [DFCU's] public statements," referring to remarks made by Shobe to the news media, and to DFCU advertisements encouraging members to vote on the conversion.</p> <p>On March 28, NCUA issues a legal opinion confirming that only 500 signatures are needed to compel the meeting, and that electronic signatures are eligible. DOU begins petitioning members to force a special meeting to remove all nine directors on the DFCU board.</p>
March 22	<p>Rep. Thomas, admonishing NCUA to "be mindful of your proper role as an independent and objective regulator," affirms he has requested the GAO to investigate NCUA's independence and objectivity.</p> <p>Members finally get the full story, including reasons for the conversion, after more than three months of NCUA deliberations.</p> <p>Adams declares Shobe's statement "was incomplete at best and evasive, if not deceitful, at worst," thereby implying Shobe is lying to the public and his membership.</p> <p>NCUA clears the way for the petition to succeed. It could result in a wholesale dismissal of the board and ultimately threaten management stability at a top-performing credit union.</p>
March 23	<p>Rep. Thomas, admonishing NCUA to "be mindful of your proper role as an independent and objective regulator," affirms he has requested the GAO to investigate NCUA's independence and objectivity.</p> <p>Members finally get the full story, including reasons for the conversion, after more than three months of NCUA deliberations.</p> <p>Adams declares Shobe's statement "was incomplete at best and evasive, if not deceitful, at worst," thereby implying Shobe is lying to the public and his membership.</p> <p>NCUA clears the way for the petition to succeed. It could result in a wholesale dismissal of the board and ultimately threaten management stability at a top-performing credit union.</p>
March 29	<p>Rep. Thomas, admonishing NCUA to "be mindful of your proper role as an independent and objective regulator," affirms he has requested the GAO to investigate NCUA's independence and objectivity.</p> <p>Members finally get the full story, including reasons for the conversion, after more than three months of NCUA deliberations.</p> <p>Adams declares Shobe's statement "was incomplete at best and evasive, if not deceitful, at worst," thereby implying Shobe is lying to the public and his membership.</p> <p>NCUA clears the way for the petition to succeed. It could result in a wholesale dismissal of the board and ultimately threaten management stability at a top-performing credit union.</p>
April 4	<p>Rep. Thomas, admonishing NCUA to "be mindful of your proper role as an independent and objective regulator," affirms he has requested the GAO to investigate NCUA's independence and objectivity.</p> <p>Members finally get the full story, including reasons for the conversion, after more than three months of NCUA deliberations.</p> <p>Adams declares Shobe's statement "was incomplete at best and evasive, if not deceitful, at worst," thereby implying Shobe is lying to the public and his membership.</p> <p>NCUA clears the way for the petition to succeed. It could result in a wholesale dismissal of the board and ultimately threaten management stability at a top-performing credit union.</p>

The DFCU Episode (cont.)	
April 13	<p>NCUA</p> <p>Taking its cue from MCUL's March 29 letter, and a follow-up complaint by the credit union's chairman, NCUA issues a new letter to DFCU taking issue with the accuracy of the already-in-the-mail, pre-approved disclosure and ballot. One matter, addressing the continued availability of the shared branching network after conversion, is cited for investigation. NCUA also takes issue with public statements by Stobbe, as reported in the local media.</p> <p>The NCUA letter contains some of the same language from its May 13, 2005 letter to Community ordering the voting to be halted. Although the April 13, 2006 letter stopped short of invalidating the vote at DFCU at that point in time, NCUA made it clear DFCU was at risk and that a comprehensive response would be necessary before the next mailing, just a few days away.</p> <p>NCUA is setting DFCU up for an excuse to rescind the votes collected to date and re-start the process, similar to the 'fold' excuse in Texas in 2005. In the same letter, NCUA makes statements about insider benefits similar to those raised by MCUL in its March 29 letter to NCUA, which illustrates how the agency takes instructions from industry trade associations. Again, the trade media and opponent groups are given copies of this new letter from NCUA, raising more public suspicions about the conversion plan and DFCU's communication.</p>
April 17	<p>DFCU</p> <p>DFCU withdraws its application, citing "unnecessary confusion and concern among our members" stemming from "misinformation" and "communication constraints."</p> <p>Believing NCUA intends to disallow the vote, and frustrated with the one-sided nature of a public relations battle in which it cannot defend itself, DFCU gives up.</p> <p>DFCU's gambit to obviate the board recall by withdrawing its application fails, as DOU persists with its punitive petition despite the withdrawal.</p>

Epilogue	
April 17	<p>ABA</p> <p>ABA CEO Ed Yingling states "this process has been completely skewed by the NCUA and some in the credit union industry, both of which have a clear and public bias against conversions."</p> <p>The withdrawal sends a chilling message to other credit unions contemplating conversion, which would have to run a gauntlet of ugly public relations battles, strident member minorities, and inconsistent rule-making from a biased regulator, in order to win approval.</p>
April 18	<p>ACB</p> <p>ACB issues a release about the DFCU decision to withdraw its application.</p> <p>ACB asserts that NCUA "should act as an honest broker in the process" and "should not be gaming the system in a manner that prevents credit union members from deciding for themselves what is in their best interest."</p> <p>Gamesmanship prevails, undermining Congress' intent that the conversion option should be available to credit unions on terms no more or less restrictive than those for other financial institutions.</p> <p>In the wake of the withdrawal, NCMT's Bucky Sebastian proudly declares "Democracy has prevailed." On the contrary, democracy was never given a chance in Dearborn.</p>

<i>Enigogue (cont.)</i>	
April 20	<p>NCUA</p> <p>At its most recent board meeting, NCUA addressed federal credit union bylaws, preserving the board recall petition with only a modest increase in the signature threshold from 500 to 750.</p> <p>NCUA has already announced its intention to conduct another round in its relentless rule-making for conversions, adding among other things a 30-day comment period for member input prior to the filing of an application.</p> <p>Opponents of this bylaw had asked that the threshold for calling a special meeting to remove directors be increased to a percentage of the overall membership, to ensure that a small minority could not impose its extremist agenda on a large membership.</p> <p>The comment period will provide advance notice of the intention to convert, offering extra time up-front for dissident groups to organize.</p> <p>NCUA left the "secret weapon" in force at a time when its use could not be more contentious. The bylaw renders most of NCUA's rule-making moot, since future conversions are unlikely even to get to a vote anymore.</p> <p>This additional time frame would extend by 30 days what is typically a 90+-day period during which opponents can make inaccurate, misleading, defamatory, injurious, and unsubstantiated claims. The credit union is powerless to defend itself under current rules and practices because of the NCUA "chill" on communications to members.</p>
April 20	<p>NCUA</p> <p>NCUA has already announced its intention to conduct another round in its relentless rule-making for conversions, adding among other things a 30-day comment period for member input prior to the filing of an application.</p> <p>Opponents of this bylaw had asked that the threshold for calling a special meeting to remove directors be increased to a percentage of the overall membership, to ensure that a small minority could not impose its extremist agenda on a large membership.</p> <p>The comment period will provide advance notice of the intention to convert, offering extra time up-front for dissident groups to organize.</p>

Acronym Legend

- ABA: American Bankers Association
- ACB: America's Community Bankers
- CCUCO: Coalition for Credit Union Charter Options (see background information below)
- CFA: Consumer Federation of America
- CFS: Committee on Financial Services, U.S. House of Representatives
- Columbia: Columbia Credit Union, Vancouver, WA (a 2003-04 conversion applicant whose favorable vote was overturned by NCUA)
- Community: Community Credit Union, Plano, TX (one of two Texas credit unions that converted in 2005)
- CRA: Community Reinvestment Act
- CUNA: Credit Union National Association
- DFCU: DFCU Financial Credit Union
- DOU: DFCU Owners United (a group of members opposed to the DFCU conversion)
- FDIC: Federal Deposit Insurance Corporation
- GAO: Government Accounting Office
- LMCU: Lake Michigan Credit Union, Grand Rapids, MI (a 2004 conversion applicant with a 60% favorable vote, short of Michigan's 66-2/3 super-majority requirement)
- MCUL: Michigan Credit Union League
- NAFCU: National Association of Federal Credit Unions
- NASCUS: National Association of State Credit Union Supervisors (a body representing regulators of state-chartered credit unions)
- NCMT: National Center for Member Trust (an anti-conversion advocacy group comprised of credit union CEOs)
- NGRC: National Community Reinvestment Coalition
- NCUA: National Credit Union Administration

NCUSIF: National Credit Union Share Insurance Fund
OmniAmerican: OmniAmerican Credit Union, Fort Worth, TX (one of two Texas credit unions that converted in 2005)
OTS: Office of Thrift Supervision
SEC: Securities and Exchange Commission
SFT: Silver Freedman & Taft (DFCU's law firm)
TCUD: Texas Credit Union Department

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About the Coalition

The Coalition for Credit Union Charter Options is an education and advocacy group formed to represent the interests of credit unions that want to preserve charter choice under reasonable rules and at a reasonable cost. We promote and defend the right of credit unions to choose the type of financial services charter and organizational structure that they believe best suits the needs of their customers and the communities they serve.



**Submitted Statement
of
Camden R. Fine
President and CEO
Independent Community Bankers of America**

**On behalf of
Independent Community Bankers of America
Washington, DC**

“H.R. 3206, Credit Union Charter Choice Act”

May 11, 2006

**United States House of Representatives
Committee on Financial Services, Subcommittee on
Financial Institutions and Consumer Credit**

The Independent Community Bankers of America¹ is pleased to submit this statement regarding H.R. 3206, the Credit Union Charter Choice Act. We commend Rep. Patrick McHenry for taking a leadership role on this issue and appreciate Chairman Bachus's willingness to hold this hearing.

Summary

ICBA strongly supports the right of a financial institution to choose the type of type of charter under which it operates. Recent actions by the National Credit Union Administration are nothing more than attempts to obstruct the right of a credit union to convert to a mutual savings bank. Credit unions should be free to convert and not be intimidated by an agency that seems to be intent on placing obstacles in front of institutions that seek to convert their charters.

The McHenry bill seeks to prevent NCUA from improperly blocking credit union conversions by limiting the agency's ability to require biased information to be included in a disclosure to credit union members. It would list the information that would be included, such as the reasons the credit union's board are considering conversion and a "brief statement of the material effects of the conversion..." The notice could not be "speculative with respect to the future operations, governance, or form of organization ... that will result from the conversion..."² Thus; the bill addresses NCUA actions taken during the first half of last year. However, ICBA believes that, given NCUA actions taken since then, it may be necessary to further restrict the agency's role in the conversion process.

Credit Unions Should be Able to Convert

Financial institutions' ability to choose their charter is one of the key strengths of our nation's diverse economy. Unlike other countries, we do not have a one-size-fits-all financial system. Our depository institutions have the ability to choose a national or state charter, as well as the ability to choose the type of charter. Each of these charters has their advantages and limitations, though all must meet safety and soundness and consumer protection standards.

For years, the credit union industry has been attempting to retain its advantages – its tax exemption and its exemption from the Community Reinvestment Act –

¹ The Independent Community Bankers of America represents the largest constituency of community banks of all sizes and charter types in the nation, and is dedicated exclusively to representing the interests of the community banking industry. ICBA aggregates the power of its members to provide a voice for community banking interests in Washington, resources to enhance community bank education and marketability, and profitability options to help community banks compete in an ever-changing marketplace. For more information, visit ICBA's website at www.icba.org.

² Section 2(a)

while systematically breaking down its limitations – especially limits on lending powers and the field of membership.

Despite these efforts, a number of credit unions decided that they could better serve their customers if they operated under a mutual bank charter. As a representative of mutual banking institutions in thirty-five states, ICBA strongly supports the right of a financial institution to choose this charter. It is an option that all mutual institutions should be able to adopt without undue interference—it is a community charter that reflects the historical roots and community values of our nation.

The fact that some credit unions have determined that a mutual bank charter is the best for their circumstances, despite the fact that they had to give up their tax and regulatory advantages, speaks volumes about its viability.

NCUA Has Improperly Blocked Conversions

Unfortunately, credit unions that are seeking to convert to another charter type face an unusual circumstance – a regulator intent on thwarting their business plans. **Last year, in order to successfully convert their charters, two Texas credit unions had to hire lobbyists to make their case in Congress and law firms to take their cases before the Federal courts.** The issue centered on how they had folded disclosure documents required by the NCUA. The actual content of the disclosures were not at issue. Only after a federal magistrate determined that the NCUA had no justification for blocking the conversions did the NCUA relent and settle the case.

Requiring credit unions that wish to convert undergo this sort of process makes no sense at all. Banks and thrifts frequently change charters without the aid of Washington lobbyists and high-powered litigation counsel. They simply follow the appropriate regulatory and internal corporate procedures. The chartering authority that they are exiting may not be pleased, but they do not interfere with individual transactions.

ICBA believes that NCUA is exceeding its authority under Credit Union Membership Access Act (CUMAA) to oversee conversions by insured credit unions. Section 202 of CUMAA limits NCUA's role in conversions to overseeing the "methods by which the member vote was taken or the procedures applicable to the member vote."³ Congress did not intend for the NCUA to review and monitor information presented to credit union members concerning the vote or to insure that certain information concerning the vote is disclosed to the member in a certain manner. Instead, Congress wanted the NCUA to oversee the actual vote to make sure that it was conducted fairly. The converting credit union's new regulator would have ample authority to determine whether or not the proper disclosures were made.

³ 12 U.S.C. 1785(b)(2)(G)(ii)

NCUA's action and restrictions violate the CUMAA requirement that any rules that are promulgated cannot be any more restrictive than those applicable to charter conversions by other financial institutions. We know of no instance of a banking agency imposing the kinds of rules NCUA has imposed or taking this type of action against an institution seeking to change its charter and its primary regulator.

For example, the Office of Thrift Supervision rules on converting from a mutual to a stock form of ownership do not require an independent entity experienced in conducting corporate elections to conduct the conversion vote.⁴ NCUA's requirement to have a third party teller responsible for all phases of the voting process is a costly requirement and one that will discourage credit unions from converting. The OTS rules also do not require that an updated, itemized account of the conversion costs be included in boldface in each and every written communication that is sent to a member.

NCUA has not adequately explained why it is necessary that the proposed disclosures be a series of dire warnings of possible higher fees, higher loan rates, loss of voting control, and executives profiting from stock options at the expense of members. None of these disclosure requirements permit a converting credit union to list the benefits that can occur to a member upon a conversion such as additional products and services. NCUA concedes that often the disclosure information is overwhelming and that all it is doing is trying to further inform credit union members. But instead of informing credit union members, NCUA appears to be frightening them into voting against a conversion.

For instance, the disclosure that executives typically profit from conversions by obtaining stock far in excess of that available to the members is not only misleading but an effort to play on the fears and emotions of credit union members that credit union executives are conspiring against them in an effort to enrich themselves. Similarly, the requirement that the converting credit union disclose an updated and itemized list of its conversion expenses every time it sends a written communication to its members is onerous and unjustified. The warning that additional post conversion expenses may result in higher fees or higher loan rates is another example of NCUA intimidating the credit union members into voting against a conversion.

⁴ See 12 CFR Sec. 563b.240. The rules do require the submission to the OTS of an opinion of counsel that the meeting was conducted in compliance with all applicable state or federal laws and regulations.

These disclosure requirements are an attempt by the NCUA to obstruct the right of a credit union to convert to a mutual institution. The NCUA appears to believe that, in every case, mutuality is the first step in a corporate transformation that eventually results in a stock charter and that credit union members must be warned of this in a conversion. The mutual charter remains a vigorous, competitive, and innovative option for hundreds of banks in the United States who are very content with their choice of charter and have no desire to change it.

NCUA's Power Over Conversions Should be Limited

Under CUMAA, NCUA's oversight role is to be shared with, and verified by the Federal or State regulatory agency that would have jurisdiction over the institution after the conversion.⁵ Once the conversion is complete, CUMAA says that the provisions of the Federal Credit Union Act no longer apply.⁶ All of the federal banking regulators have adopted regulations that are applicable to conversions of institutions. In most instances, the federal agency that will supervise the surviving entity following the conversion and that receives the conversion application is the agency that reviews the disclosures to determine if inaccurate or misleading information was communicated during the conversion process. Therefore, when a credit union intends to convert to a federal savings association charter or a savings bank, the agency that receives the application and that will supervise the resulting financial institution is the one that should review the adequacy of disclosures. **The NCUA's role should be limited to monitoring the voting process.**

Instead of concentrating on the disclosures of converting credit unions that would only affect a dozen or so conversions every year, the NCUA should focus on improving the transparency and quality of the disclosures routinely given by federal credit unions. For example, credit unions should be required to file a Form 990 like other not-for-profit organizations, disclosing the compensation of their highest-paid senior managers. This would assist both credit union members with voting on slates of directors and potential members who are choosing a credit union. It would certainly have much greater overall impact than the proposed required disclosures for converting credit unions.

H.R. 3206 Should be Strengthened

H.R. 3206 addresses the problems that were apparent when it was introduced. By eliminating speculative and inflammatory "disclosures" and requiring the NCUA to approve a conversion "unless the Board determines that the conversion is being made to circumvent a pending supervisory action," the bill would have reduced the need for the converting credit unions in Texas to incur extraordinary lobbying and litigation expenses.

⁵ 12 U.S.C. 1785(b)(2)(G)(ii)

⁶ 12 U.S.C. 1785(b)(2)(E)

However, the NCUA is adjusting its tactics. Recently, Dearborn Federal Credit Union withdrew its application to convert to a mutual bank as opponents of the application began to publicly agitate against it, and NCUA prohibited the credit union from responding to any of the charges unless each response included the speculative and inflammatory disclosures it had already made. NCUA also posed a long series of “questions” about the application documents, making clear that a vote on the conversion would take place only after opponents had ample time to poison the well.

Obviously, the NCUA was not chastened by its embarrassing loss in the Texas conversion cases. Instead, it will take earlier and more subtle – but just as effective – steps to block any conversion. Simply raising the lobbying and litigation costs may be enough in some instances. Bureaucratic delay will be just as effective in others. And, courts generally give agencies very wide latitude in interpreting their own statutes and in following their own procedures.

Therefore, ICBA recommends that Congress consider taking additional action to that contemplated in H.R. 3206, including removing NCUA’s veto power over a conversion. This would provide treatment comparable to thrift and bank conversions. The Office of Thrift Supervision cannot block a Federal savings and loan association from converting to a state savings bank. Similarly, a state banking commissioner cannot stop a state bank from obtaining a national bank charter. ICBA believes that the law should not require both the NCUA and the new regulator to approve the conversion. NCUA should also not have the ability to veto a credit union conversion to a mutual bank charter.

Conclusion

ICBA commends Rep. McHenry for introducing H.R. 3206 and Chairman Bachus for holding a hearing on this important issue. **This legislation is necessary to enforce the nation’s commitment to providing a choice of charters for depository institutions while maintaining safety and soundness and consumer protection standards.** The National Credit Union Administration has repeatedly thrown up unjustifiable roadblocks against credit unions seeking the right to select the charter type that enables them to best serve their customers. In fact, since H.R. 3206 was drafted, NCUA has further hardened its stance. Therefore, ICBA recommends further strengthening of the bill to circumscribe NCUA’s role in the conversion process.

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Written Testimony Submitted for the Record

By:

Alan D. Theriault
President
CU Financial Services

**Consideration of *Credit Union Charter Choice Act*
H.R. 3206**

Before the
Subcommittee on Financial Institutions and Consumer Credit
Committee on Financial Services
United States House of Representatives

May 11, 2006

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Mr. Chairman and members of the Committee, my name is Alan D. Theriault. I am President of CU Financial Services. Our organization supports efforts to enact H.R. 3206, the *Credit Union Charter Choice Act*.

Since 1984, CU Financial Services has helped credit unions with strategic planning and other forward-thinking projects. In the last 12 years, our firm has had a hand in the majority of the more than two dozen credit union conversions to the mutual savings bank charter and the mutual holding company charter.

We also closely followed and supported the H.R. 1151 amendment by the U.S. Senate that ultimately reversed 1995 and 1997 rulemaking by the National Credit Union Administration (NCUA) that had been widely viewed as a self-serving attempt to stop credit union-to-mutual conversions.

Conversion Statistics

In the last 12 years, only 29 of 8,800 credit unions have elected the option to convert from a credit union charter. From the list, seven remain as pure, non-stock mutual institutions. Six have merged with other mutually owned institutions, allowing their members to benefit from a longer list of services and being part of a stronger and more competitive corporate family.

Nine others have elected to access the corporate flexibility of the mutual holding company (MHC) structure, allowing the institutions and their members to benefit from expanded revenue sources and access to secondary capital. *(The MHC structure involves reorganizing the mutual bank into a stock bank; however, the ownership of the stock bank remains under the control of a non-stock holding company which depositors control.)*

Members of just seven credit unions voted to convert to a full stock operation; three of these were institutions under \$60 million in assets, and all were located in highly competitive metropolitan areas. *(The capital raised in the full stock conversion allows these institutions to address a highly competitive marketplace from a position of greater strength).* While the depositor control of the MHC structure has strong appeal for former credit unions, smaller institutions may find it harder to justify the fixed cost related to MHC reorganizations because of the lesser amounts of capital raised.

NCUA Overstepping Its Authority

The main point of this hearing is to address whether NCUA has been overstepping its authority in regulating conversions. To put its actions in perspective, NCUA is only supposed to be ensuring the vote is carried out fairly, not second-guessing motives and acting as an adversary against the credit union's leadership in order to guard member interests in some potential future transaction. I am sure these points will be expertly presented by others.

However, from their choice of witnesses, it is clear the credit union trade associations, which are closely allied with NCUA on this issue, are going to make an emotional, even tearful, appeal that conversions are all about greed and imply the leaders of converting credit unions can't be trusted to do what is best for their members.

For 30 years, similar allegations have been made relative to mutual savings bank conversions by a few with a vested interest in maintaining the status quo or who promote certain social-political ideals. I will leave it to the Office of Thrift Supervision (OTS), the Federal Deposit Insurance Corporation (FDIC), and the Securities and Exchange Commission (SEC) to defend how well these three respected government agencies protect the consumer. Needless to say, under their expert stewardship thrift conversions have not generated negative public policy issues.

In addition, the credit union witnesses may make a claim to this Subcommittee, as they have done in the trade press, that consultants experienced with credit union-to-mutual conversions have provided them with conversion briefings for their own credit unions that focused on insider benefits. Although we have been involved with the majority of conversions, I want to assure this Subcommittee that CU Financial Services is not the firm which has briefed these witnesses.

In our view, based on what we read in the industry press reports, these witnesses have their facts wrong. Attached to this submission are several articles from the CU Financial Services web site – a site which contains hundreds and hundreds of pages of educational material and which discusses the manifold member and community benefits in a conversion from a credit union. The attached selection of articles is a fair representation of our firm's views on what credit union executives should be considering when they explore the merits of charter change.

Credit Unions Are at a Crossroads

I would argue it is very important for credit unions to have the option of converting from a credit union. The credit union charter is a pressure cooker. Choking off the ability to exit the charter is like blocking a pressure release valve. It will increase the probability of systemic safety and soundness issues.

As of the end of 2005, over 280 credit unions were classified with Camel 4 and 5 ratings. This group represented over 1.1% of credit union insured deposits, the highest number in a decade. Almost 15% of credit unions lost money last year and nearly 50% earned less than 50 basis points. Just last week, the Colorado state credit union regulator had to take over a \$300 million federally insured credit union. The credit union appears to be a victim of margin pressures on the credit union industry, which it apparently attempted to solve by becoming an aggressive indirect lender.

Regrettably, there will be other credit unions in trouble, some possibly larger, even though these are pretty good economic times, and the banks and thrifts are doing great. I shudder to think what might happen in the credit union industry if we fell into recession.

Since 1969, the number of credit unions has plunged from over 23,500 to 8,800 today. By 2010, many analysts expect the number will be below 5,000. In contrast to the formation of over 640 new banks and thrifts in the last five years, only 42 new credit unions have opened for business, mostly community development credit unions with limited scope and scale. One is tempted to ask whether the credit union model is still viable for forward-thinking, fast-growing institutions. This is the question that gets progressive credit union managers thinking about their charter alternatives.

Contracting margins, increasing operating costs, restrictions on capital accumulation, political pressure to reduce overdraft fees, declining interchange revenues, financially troubled corporate sponsors, and demands to be more responsive to low- and moderate-income populations are among the pressures which challenge the status quo for progressive credit unions. As might be expected, responses to these very real pressures are varied.

Many credit unions have liquidated their credit card portfolios to boost capital and income as a short-term fix. Many just merge themselves out of existence – at the rate of one a day. Others are trying to retard margin contraction by aggressive diversification into higher yielding real estate loans, commercial loans, across-the-country commercial loan participations, and third-party-originated auto loans (both prime and non-prime). The percentage increases in these non-traditional types of lending are double digit, yet one wonders if NCUA is learning to regulate these new risks at a double digit rate. Clearly, NCUA has plenty to do in focusing its efforts on credit unions that want to stay credit unions, rather than spending its time, resources and political capital on trying to impede a few credit union conversions.

In conclusion,

- We are not asking you to tax credit unions, although doing so would ultimately take a lot of pressure off your fax machines generated by the industry's "grass roots" lobbying;
- We are not asking you to let state legislatures tax federal credit unions, although doing so would increase their sales tax revenues and takes some stress off state budgets;
- We are not asking you to combine NCUA with OTS – which one could argue should be done given the meteoric rise in mortgage lending and commercial loans at credit unions and NCUA's lack of regulatory experience with those types of lending, because its historic specialty is rooted in car loans; and
- We are not asking you to merge the National Credit Union Share Insurance Fund with FDIC, although some argue the move would improve productivity and reduce systemic risk.

What we *are* asking is to scale back NCUA's over-reaching administration of the conversion law in H.R. 1151, which has buried the law's intent under an avalanche of excessive and capricious rule-making.

NCUA has a 12-year history of opposing conversions. Congress had to rein the agency in with legislation in 1998. A federal court admonished NCUA in 2005. And now, here we are again. In our view NCUA is not ever going to get the message about sticking to the limited role Congress had intended for it in conversions; the opposition is ideological and deep-seated in NCUA's bureaucracy, which has no fear of Congressional reprimands. NCUA needs to be removed from the process, and H.R. 3206 is an important step in that direction.

Conversion Update

A current list (updated April 28, 2006) of credit unions converted or pending, plus credit unions merged with Mutual Savings Institutions.

Credit Union	State	Form	Current		Annualized		Conversion Date
			Corporate	Assets(millions)	Asset	Growth	
			Pre-conversion	9/30/05			
Non Stock Institutions - (Pure Mutuals)							
1 *	@LANTEC Financial	VA	Mutual	85	106	14%	1/12/04
2 *	Carolina Federal	SC	Mutual	16	80	64%	8/1/99
3 *	Community CU	TX	Mutual	1,400	1,400		1/2/2006
4 *	OmniAmerican CU	TX	Mutual	1,200	1,200		1/2/2006
5 *	Share Plus	TX	Mutual	150	175	16%	10/1/04
6 *	CU of the Pacific	WA	Mutual	141	198	17%	5/19/03
7 *	Washington's CU	WA	Mutual	262	257	-2%	3/31/04
Non-Stock MHC with Subsidiary Stock Thrift (Hybrid)							
Depositors Own & Control the MHC (MHC/s = Institution has issued public shares)							
8 *	Atlantic Coast	GA	MHC/s	321	717	21%	11/1/00
9 *	AGE FCU	GA	MHC/s	269	345	7%	7/1/01
10 *	AWANE Bank	NH	MHC/s	10	77	70%	5/1/96
11 *	Beacon Federal	NY	MHC	155	473	32%	7/1/99
12 *	Citizens Community	WI	MHC/s	102	245	37%	12/10/01
13 *	Community Schools^^	MI	MHC	41	46	7%	1/1/02
14 *	Kaiser Federal	CA	MHC/s	190	684	43%	11/1/99
15	Lusitania SB, FSB	NJ	MHC	55	172	21%	9/1/95
16 *	Ohio Central Federal	OH	MHC/s	29	60	14%	6/1/98
Full Stock Institutions							
(Former CU Members have liquidation account)							
17 *	Affiliated Federal	TX	Stock	9	101	137%	6/1/98
18 *	Allied Pilots	IL	Stock	82	145	19%	9/1/01
19	BUCS Federal	MD	Stock	58	133	17%	3/1/98
20 *	I.G.A. Federal	PA	Stock	160	560	54%	7/1/98
21 *	Pacific Trust	CA	Stock	224	734	39%	1/1/00
22 *	Rainier Pacific	WA	Stock	383	787	22%	1/1/01
23	Synergy Financial	NJ	Stock	182	940	55%	5/1/98
Credit Unions in the Process of Converting							
24 *	Pending ^		Mutual	150	150		Pending
25 *	Pending ^		Mutual	150	150		Pending
Total (excl pending)				7,624	11,735		
Credit Union Mergers with Banks							
26	AAL	WJ		37	Merger		6/30/01
27	AAL Member	WI		177	Merger		6/30/01
28 *	Caney Fork Coop	TN		0	Merger		11/1/00
29 *	Professional Teachers	TN		1	Merger		7/1/01
30 *	Roper Employees	SC		7	Merger		3/1/01
31 *	Salt City Hospital	NY		8	Merger		3/1/03

* Advised by one or several conversion network members



Solid Benefits & "CU Handcuffs" Lead Some to a Bank Charter

By Alan D. Thensuit, President, CU Financial Services



The federal mutual savings institution charter offers capital and corporate structure advantages and removes limits on certain products, potential customers and marketing effectiveness.

Credit unions convert to a bank charter because of pain or opportunity. Capital issues, product limits, and poor consumer awareness create pain. Expanding service to a growing community, filling voids left by banks and credit unions, and maximizing personnel and infrastructure potential provide opportunities.

Conversion applicants correctly reason that the credit union's members and the future growth of the institution requires an unrestricted customer base and expanded products that will include an increased emphasis on real estate lending and business lending. The federal mutual bank charter encourages both and offers capital and corporate structure advantages. Some also convert to remove marketing impediments related to the credit union charter and to avoid the public relations and political risks of staying in the credit union system.

Many credit unions, especially community chartered ones, are now facing the impact of limits on business loans and the fact that PCA requires them to carry 40% more capital than banks. As operating margins narrow - credit unions must grow in order to generate the earnings to pay the bills - during these low interest rate times the issue is magnified.

The following benefits prove that a bank charter is a solution - available now - for credit unions that want to better serve their members, communities, and grow their franchise:

Capital Advantage - It's been said that credit unions pay a hidden tax which is evident by the fact that to be well capitalized a credit

union must maintain a 7% capital ratio versus a bank's requirement of only 5%. Competition and economic conditions are putting pressure on margins while increasing costs will shrink the bottom line. The future will require utilizing more leverage (asset growth) in order to maintain member benefits. To illustrate the disadvantage, consider that a bank with \$50 million in capital can grow to \$1 billion and be well capitalized, while a credit union must stop growing at around \$700 million. The bank's \$300 million asset advantage not only translates into earnings to handle the tax obligation, but the community benefits from the impact of more lending and services. Directors, management, and staff benefit from higher growth opportunities and greater compensation tied to asset size.

In addition to retaining earnings, banks have many ways to increase regulatory capital empowering them to expand services to members and the community, including loans, branches, employment, and deposits products. For example, in August, Pacific Trust Federal, a former credit union, raised almost \$65 million in regulatory capital in a member approved IPO. The additional capital allows it to grow from \$300 million to \$2 billion, thus seeding a significant boost to the local community. As a credit union - even if other impediments were lifted - growing to this level of service would require over a decade of retained earnings.

Consumer Awareness - Consumers understand the business of a bank, but most are confused about credit union capabilities. Credit union sponsored studies on both sides of the country prove that much needs to be done to improve consumer awareness. Consequently, gaining solid market share and correcting these negative perceptions could take decades. Meanwhile, as credit unions become more active within communities, they need to serve municipalities, nonprofit corporations, immigrants, business owners, and other legal entities. These customers provide valuable demand deposits to support emerging business models, however, many just refuse to do business with a credit union.

Product Flexibility - Banks are able to offer a wider range of products - including real estate and business lending - products in high demand by our communities. The bank regulators understand this type of lending, encourage it, and field examiners are experienced at addressing such concentrations. Credit unions, however, face portfolio restrictions and a capital haircut because of real estate and business lending, as well as inexperienced examiners since NCUA, historically, has been focused on examining consumer loans - like car loans and unsecured loans. Investment flexibility is also a benefit with a bank charter - a wider range of permitted investments helps boost yields and provides better service to local communities by diversification into municipal bonds and tax advantaged investments.

Corporate Governance Issues - Just 1,000 credit unions control 75% of credit union assets. Many over \$100 million in assets are complex fast growing institutions. The bank charter supports the risk taking and growth with a director compensation and retirement plan

structure that attracts a motivated and sophisticated directorate. As banks and credit unions consolidate, in addition to being able to offer compensation to directors of target credit unions, other consolidation and expansion tools are provided, like holding companies, operating subsidiaries, service corporations (like CUSOs), real estate investment trusts, and trust preferred securities. Although some criticize the director compensation plans that are available after conversion, it is worthy to note that many cooperatives and non-profits - like charities and hospitals - compensate their directors.

Unlimited Field of Membership - The bank charter offers an unlimited field of membership which helps make marketing efforts more effective and supports bank and branch acquisitions and mergers with credit unions and banks. The federal charter also supports nationwide activities.

Public Relations and Political Risks - The unmeasured risk of political and public relations fallout also factors into the bank conversion decision process. Although safeguards exists, the failure of a large credit union, whether linked to a sponsor bankruptcy, loan or investment concentration issue, or an internal control failure will have negative ramifications for all credit unions, much like the impact of recent credit union debacles in Mexico, Japan, and Korea. The fact that some credit unions are not federally insured is a blemish in the minds of those that remember the collapse of private insurance in Rhode Island and other states.

On another note, NCUA is working overtime to make credit unions look like the savior of the inner city and the economic partner of low income and disadvantaged people. The flip side of the NCUA public relations bet, however, could lead to credit unions being viewed as a group that is merely exploiting those in "need" in order to profit from a tax subsidy. Consumer groups and community activists have their eyes on credit union capital and obtaining credit union funding will be part of their business plans. If NCUA's threats fails to get credit unions to respond to the call to "serve the underserved" you can bet these groups will put credit unions in the headlines.

In addition, unlike 1998 when HR-1151 was being debated, massive budget deficits prevail, and many powerful credit union allies have retired from Congress. Increasing revenues and closing tax loopholes will be a popular topic in Washington, DC and in state capitals. Tax advocates are likely to picture decaying grammar school buildings next to shiny new credit union office buildings as teachers appeal for more money and argue that large credit unions should pay taxes to benefit both schools and homeland security. Although nobody likes to pay taxes, management of credit unions in Canada and Australia and at \$274 billion TIAA-CREFF, a college professor retirement organization, argue the benefits gained by accepting this social duty is worth the cost. Taxes are managed like any other business expense.

Although efforts are being made to correct charter impediments, hope is not a sound business strategy and building a business model that


depends on a tax subsidy is risky. The CU trades promise reg relief, new powers, a better informed regulator, and want to educate consumers about the credit union model; but competitive pressures will not allow a progressive institution to be complacent and live by the status quo. One session of Congress is like a lifetime in the financial services business and the snail's pace that bankruptcy reform moved will look like lightning compared to new credit union legislation. And, when the Bill hits the President's desk, credit unions may only gain a few new powers, but face taxes and be handcuffed to an out dated charter with new markings of a social service agency.

Switching charters is a common practice among financial institutions as their mix of business or goals change, or when a more supportive charter or chartering state is uncovered. Competitive pressures and member requirements demand efficiency and flexibility. A focus on providing quality services to members and communities rather than wasting energy debating field of membership issues and making excuses for a tax exemption is imperative. A progressive institution must seek a charter that supports its mission rather than modify a mission just to fit a charter. Converting solves many problems, relieves the pain, and provides dynamic new opportunities.

For more information about the mutual bank charter, the stock bank charter, raising regulatory capital, bank holding companies, and other progressive growth strategies contact the authors, Alan D. Theriault, President, CU Financial Services, at 800-649-2741; or Robert Freedman, Esq., Silver, Freedman, & Taff, at 202-295-4502.


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The Mutual Holding Company Option

A Capital Idea



In this article by Lee Bettis, former CEO of AGE Credit Union, subsequently Heritage Bank of the South, you'll learn why the mutual holding company structure delivers the best of both worlds—raising much-needed capital while retaining member control.

No one would argue that failure to achieve a business plan brings with it all sorts of problems. But success – in the form of faster growth – carries its share of problems, too.

One of the biggest problems facing successful credit unions is a chronic shortage of capital. A 2002 survey of NAFCU members concluded that an astounding 42% expect to need capital soon in order to maintain growth, to meet Prompt Corrective Action (PCA) requirements, or other reasons. Exacerbating the problem is the 7% core capital ratio CUs must maintain, compared to 5% for banks. CUs also take a 'capital haircut' because of concentrations in real estate loans, business loans, and certain investments. And they have no access to the capital markets without converting to a bank charter. In addition, the NCUSIF is likely to have problems keeping up with the growth rates of large credit unions, thus leading to the need to charge premiums, an unpopular subject especially with smaller credit unions already faced with earnings problems.

The Trend to Mutual Holding Companies

Far from the inevitable stock conversions being decried by the likes of the NCUA, the facts are these: Of the 29 conversions done (or in the pipeline), only seven have raised capital by moving – sooner or later – to full stock through an IPO. Six merged with other 'like-minded' mutuals. Another eight have formed, or are in the process of forming, a mutual holding company.

Mutual banks can raise capital in a number of ways. One obvious way

http://www.cufinancial.com/mutual_holding_company.shtml 5/5/2006

is a public offering of shares, to which the former credit union's members have first right of refusal up to a certain limit. But because not all members will choose to participate, or participate to the same degree, the ownership composition of the institution will be immutably changed.

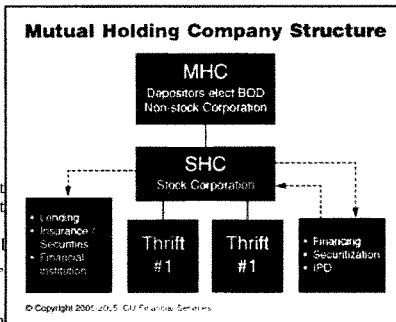
What may make more sense for some credit unions contemplating a charter change is the mutual holding company (MHC). Under this option, the members' ownership rights in the credit union are converted to ownership rights in a non-stock holding company.

The MHC, in turn, will own the shares of a bank holding company, which can sell stock to members of the institution and the community up to 49% of the capitalization. It is this stock-based holding company that would own the stock-based operating thrift, plus any number of subsidiaries for mortgage lending, insurance, securities or other businesses permitted and fitting the institution's objectives. In the same way a credit union owns a CUSO, which is stock-based, the co-operative operating philosophy is filtered downward. Control is maintained.

Without selling any stock, the MHC can raise capital in other ways. It can arrange a commercial loan at the stock holding company level or organize a non-voting trust to offer shares to institutional investors. The proceeds are pushed downstream to create core capital in the subsidiary bank and for the support of its operating companies.

Keeping the voting rights at the top level -- still in the hands of the original members -- allows the institution to retain its co-operative philosophy, community focus, management team, directors and culture.

"It's really the best of both worlds," claims Alan Theriault, president of CU Financial Services, a credit union consulting



firm specializing in charter conversions. "The mutual holding company is depositor-owned and non-stock, allowing the members to keep control. Two levels down, management can raise all the capital it needs to pursue its business strategy and opportunities, without the same burden faced by managers of public companies in answering to

stockholders. Stock-based compensation programs transition this hybrid into a member and employee-owned cooperative, thus capitalizing on superior consumer attitudes toward both of these co-operative business structures.”

In conclusion, expansion-minded credit unions exploring a charter conversion have four primary options: community credit union; mutual savings bank; stock-based bank; and mutual holding company. The community charter addresses the field of membership problem. But it still leaves the CU stuck with severe limits on its powers and forced to build capital at a snail’s pace. The mutual savings bank option lifts the limits on activities such as real estate and commercial lending. But building core capital is mostly limited to increasing retained earnings and other capital strategies efficient for large institutions only.

Converting to a publicly traded, stock-based institution offers broad powers for product diversification and opens the doors wide to capital. But it strays from co-operative roots, and some critics feel that demutualization amounts to disenfranchisement of some members.

On the other hand, moving to a mutual holding company – a hybrid structure that combines co-operative ownership with capital-raising powers – is a neat balancing act. You can serve your members and build the strength to serve the community at large. Mergers and acquisitions are also facilitated.

Mutual Holding Company Features	
• Maintains mutuality	• Ease of formation
• Active diversification	• One regulator
• Capital raising	• Mutual regulatory protection
• Flexibility	• Compensation flexibility
• Enhanced D&O policies	• No holding company capital requirements
• Mandatory control	

This scenario held true for HeritageBank of the South, a \$340 million-asset bank that started life as AGE Credit Union of Albany, GA. After a successful conversion in 2001, the new bank’s growth blossomed,

particularly in mortgage lending and commercial banking. In 2002, it reorganized under the mutual holding company structure. Len Dorminey is president and CEO of Heritage Financial Group, a stock holding company (owned by a non-stock MHC) that owns 100% of the stock of the bank. A strategy of measured, well-grounded growth has given Heritage a strong foundation for future expansion in people, systems and infrastructure. Len explains: “We’ve built tried and true best practices and we know they work. We have a lot of expertise we can replicate and share, if others want to join us.”

With 9% capital, and access to more, Heritage Financial is well-equipped to explore mergers with credit unions attracted by the possibilities of a mutual bank charter. And this course of action is a bold new alternative to the typical CU-to-CU merger. On top of their

operating efficiencies and deep talent pool, progressive mutuals like Heritage allow the merging entity to retain its board of directors, corporate identity and co-operative philosophy.

Across the credit union system today, there is an abundance of news and comment about conversions past, present and future. Unfortunately, there is much misinformation, some of it politically motivated. For any credit union contemplating a conversion to mutual savings bank status, which I believe is one of the most revolutionary and exciting opportunities ever made available to CUs for achieving successful growth, it pays to deal with experienced professional advisors. If you think you'll need regulatory capital in the next few years, call CU Financial Services at 800-649-2741 today.

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Members and the Community Are the Ones to Gain from Conversion to a Bank

Community / Member Benefit Illustration

Financial Data (Dollars in thousands)	A	B	C
	Credit Union	Mutual Savings Bank	Mutual Holding Company
1 Capital / Assets ratio to manage to	7%	5%	5%
2 Assets	\$ 714,285	\$1,000,000	\$ 2,500,000
3 Capital	\$ 50,000	\$ 50,000	\$ 125,000
4 Investments	\$ 171,428	\$ 240,000	\$ 600,000
5 Loans	\$ 501,142	\$ 710,000	\$1,775,000
6 Additional capacity for new community loan origination	NA	\$ 202,858	\$1,267,858
7 Increased loan revenue NIM (3% estimate)	NA	\$ 6,086	\$ 38,036
8 Increased Yield on Investments (2% estimate)	NA	\$ 4,057	\$12,000
9 Additional earnings available for taxes, member benefits, incidental costs and stock dividends	NA	\$ 10,143	\$ 50,036
10 After Tax ROA at 1.0%	\$ 7,143	\$ 10,000	\$ 25,000
11 Additional earnings (line 9) available for taxes, member benefits, incidental costs, and stock dividends plus regular ROA (Line 10)	\$ 7,143	\$ 20,143	\$ 75,036
12 Performance difference between a mutual and a credit union (Column "B") and between a MHC and a credit union (Column "C"). These earnings are available above and beyond current activity to increase retained earnings and to expand member benefits, like branches / technology / yields	NA	\$ 13,000	\$ 67,893

**Economic Conditions Require a Progressive Response
Taxation is Managed like Every Other Business Expense
Converting Allows Growth and Member Benefits to Continue
Proposed Legislation: A Risky Accounting Gimmick - Secondary Capital Unlikely**

Footnotes:

- The table illustrates the huge differences possible by converting to a mutual savings bank. Column "A" illustrates a hypothetical credit union with \$50 million in regulatory capital. Column "B" indicates that with the same level of capital a non-stock mutual savings bank can outgrow credit union assets by almost \$200 million because bank regulations support higher levels of growth per dollar of capital; Column "C" illustrates \$1.5 billion more growth possible by utilizing the mutual holding company structure (MHC) and a \$75 million minority member stock offering. Members continue to control the non-stock mutual holding company. The MHC structure preserves the ownership and control of the institution. A MHC cannot be sold or taken over. It can, however, merge with another mutual or MHC and it may acquire banks or merge credit unions. This opportunity is not available to a credit union.
- Row 6 illustrates the much higher bank lending capacity in the amount of \$203 million and \$1.3 billion respectively. Invested in the community infrastructure, these loans would have a powerful impact on job creation and related community benefits, like home ownership and small business development.

- Row 7 & 8 illustrates the additional revenues from higher loan volumes per dollar of net worth (capital); and the impact of a bank's historical investment portfolio yield advantage. Added together (line 9) they illustrate that substantial revenues become available for paying taxes, adding member benefits, managing incidental costs and contingencies (like conversion cost), and to pay stock dividends. Row 7 does not consider the more profitable loan mix possible as a bank, which would result in higher revenues.
- Row 10 illustrates managing an institution to a 1.0% after-tax ROA.
- Row 11 illustrates the \$20.1 million annual additional member benefit as a mutual and an additional \$75 million annual benefit as a MHC. These additional benefits are available to pay taxes, incidental costs, stock dividends, increase retained earnings, and expand and improve branches, technology, and delivery systems or for member distribution in the form of higher yields or lower loan rates. Row 12 illustrates the net financial benefit from a conversion to a mutual or a MHC.

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Economic Conditions Require a Progressive Response

The mandate of a community chartered credit union is to serve the entire community. Some market areas served are facing increasingly sober news including weak employment numbers, layoffs, factory closings, and slow economic growth. In order to maximize their contribution to turn these communities around, a few credit unions are proposing a conversion to a mutual savings bank, or thrift charter, and even the additional step, which requires another vote of depositors, to raise equity capital by providing the opportunity for members to invest in a minority stock offering.

The credit union charter has supported the growth of many institutions. But many credit unions can do a lot more. These communities need everybody to do their part – to be their best. The additional investments that can be made, in new loans, is a way for progressive conversion candidates to serve communities to the very best of their abilities – something that they can't do under current credit union regulations. The reorganization as a mutual savings bank unlocks substantial additional lending ability because bank regulations and bank convention permits higher loan volumes per dollar of net worth. Credit unions are handcuffed by punitive net worth requirements that affect their competitiveness in this area. Also, credit unions are prohibited from accessing the capital markets in order to increase net worth (capital), while banks do this on a regular basis.

Switching to a thrift charter would mean giving up the state and federal income tax exemption enjoyed by credit unions. Critics point to taxable status as a disadvantage, without considering the growth in revenue and profit that can come from an expanded market opportunity, product line, and capital access. The vast majority of financial institutions in this country pay taxes and achieve a return on equity far in excess of most credit unions, while delivering value that results in market share domination. Income taxes, like any other cost of doing business, are manageable. Credit Unions in other countries pay taxes. Some non-profits (like \$300 billion TIAA-CREF) have relinquished their tax exemption in exchange for modern powers.

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Taxation is Managed Like Every Other Business Expense

Contrary to the view that converting to a taxable institution would mean injury for members and the community, financial modeling shows that, as a future thrift, a hypothetical credit union with \$50 million in net worth would be able to offer members and future members more than \$1.3 billion in new loans. Not only is increased loan activity a real benefit to the community, the earnings from that business – coupled with investment yields far superior than historically possible for credit unions – would produce net profits for members greater than what is now possible as a tax-exempt credit union. Credit unions historically earn much lower yields on the investment component of their balance sheet compared to banks. Recent NCUA and FDIC data indicates the yield disadvantage is greater than 2%. (See Table "B") A better performing investment portfolio along with higher levels of loans outstanding, at a minimum, neutralizes the impact of taxation. Member service levels and returns are thus preserved.

Investment Yield Hidden Tax			
Table B			
	2000	2001	2002
CU	5.66%	4.22%	3.07%
Thrifts	6.02%	6.08%	5.21%
Thrift Advantage			2.14%
Source: NCUA and FDIC Data			

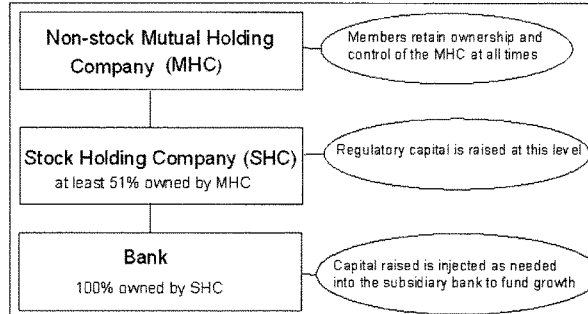
Therefore, converting to a bank charter allows a former credit union to be in a better position to serve its members and its communities while retaining high levels of service, a member oriented philosophy, and independence. The benefits of being able to make more loans, provide more employment opportunities, build more branches, and serve all types of depositors and borrowers generate economies of scale that causes a former credit union to be more productive. The move is clearly a win for the community and the membership.

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Converting Allows Growth and Member Benefits to Continue

As a credit union, many are currently faced with slowing growth to stay in compliance with the higher credit union capital requirements. The slow down would not be necessary as a bank. Slowing growth involves reducing rates on deposit accounts and has the undesirable effect of encouraging members to move banking relationships elsewhere. Although increasing loan rates and fees helps mitigate the need to slow growth, a credit union's competitiveness and new account acquisition strategies would suffer. These strategies underwrite adding member conveniences, like new branches, as well as support ongoing high levels of member responsiveness. Branch development requires account and deposit acquisition to cover operational costs and helps make services more cost effective for all members. But, branch expansion must be supported by capital. Lack of capital slows growth and delays branch development, thus reducing convenience for existing members, and delays the hiring of new employees and infrastructure development which supports economic recovery.

Remaining a credit union and living with capital constraints will mean putting a stop to growth, turning away new members, lowering the rates offered on deposits and raising the rates charged on loans. Moreover, the facts challenge the assertion that credit unions have an inalienable pricing advantage over banks, as some observers would have you believe. Many banks and other financial institutions charge no fees whatsoever on basic products like checking accounts, or offer savings yields well in excess of the average credit union.



The credit union capital disadvantage is widely acknowledged by credit union industry leaders. For example, Dan Mica, President of Credit Union National Association, recently wrote, "***Credit unions are indeed burdened by an inappropriate system of prompt corrective action, which requires them to hold even more capital than a bank despite their typically lower risk profile.***" John Annaloro, president of the Washington Credit Union League, said in a press release that recent (bank) conversions are representative of the "***fundamental weaknesses in the overall national credit union charter that needlessly restrict capital accumulation and business lending.***" Mica remarked that he was "heartened" by legislation proposed to reform PCA.

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Proposed Legislation: A Risky Accounting Gimmick - Secondary Capital Unlikely

Despite Mica's optimism, the proposed legislation regarding PCA is viewed by some as an accounting gimmick that fails to provide a safe and solid solution for fast growing credit unions. The tinkering supported by this proposed legislation is not a long term solution. It does not add a single dollar of actual (tangible) capital - it merely leverages the credit union's existing capital across more assets. The legislation has mixed support among credit union leaders and generates serious concerns for the 8,000 smaller credit unions experiencing slow growth. The bill, designed to fuel the rapid growth of large credit unions, increases systemic risks and the liability of directors who might utilize its provisions. The growth would force NCUSIF to charge insurance premiums, thus hurting the earnings of the smaller credit unions already pressured by plunging investment yields and rapid member defections to larger credit unions. The Bill's passage is unlikely. Efforts, dating back to 1999, to enact laws to allow secondary capital, opposed by many credit unions large and small, are also likely to fail.

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May 10, 2006
National Association of State Credit Union Supervisors
Statement for the Record
To the House Financial Services
Subcommittee on Financial Institutions and Consumer Credit
Hearing on Credit Union Conversions to Mutual Savings Banks

NASCUS¹ appreciates the opportunity to provide a Statement for the Record to the House Subcommittee on Financial Institutions and Consumer Credit about credit union conversions to mutual savings banks. NASCUS firmly believes that full and complete disclosure to credit union members is essential in any credit union conversion. We also firmly believe that state law and regulations should define the processes necessary for state credit union conversion.

Chartering Authority vs. Insurance Oversight

NASCUS strongly believes that state law should dictate the conversion process for state-chartered credit unions. There are many reasons that support our position.

The chartering authority for a state credit union is determined by state law. State law dictates the powers granted to a state credit union including approval authority for a conversion to another charter type. Further, state law determines the necessary processes for a conversion. A conversion is a function of a credit union's original charter, separate from insurance oversight.

In the Federal Credit Union Act, §205 (12 U.S. Code 1785) (the Act) Congress provides notice requirements and broad authority to the National Credit Union Administration (NCUA) to determine generally how a federally insured credit union converts to a mutual savings bank. Using this authority, NCUA promulgated Regulation Part 708a, a regulation detailing the process by which a federally insured credit union converts to a mutual savings bank.

Congress may have provided NCUA unnecessary overreach authority in this area. NCUA has the authority to supervise state-chartered credit unions with federal insurance to ensure safety and soundness. However, conversion procedures of these institutions exist with the original chartering authority, which in the case of state-chartered credit unions is determined by state law. NCUA's interest in a state credit union conversion should be limited to assurance that the members are fully informed about the future status of insurance provided for members' deposits.

¹ NASCUS is the professional association of the 48 state and territorial credit union regulatory agencies that charter and supervise the nation's 3,800 state-chartered credit unions.

This point may be further illustrated by the different roles of the regulatory and insurance functions. The state regulator is responsible for and oversees the chartering function for state-chartered credit unions. The National Credit Union Share Insurance Fund (NCUSIF) is managed by the NCUA, the federal credit union regulator, and provides insurance to the majority of state-chartered credit unions. For a federally chartered credit union, the chartering authority is the federal regulator, which is also the insurer. As the original chartering authority, in the case of state-chartered corporations, it is the role of the state law and regulations to determine proper procedure and disclosure for state-chartered credit union conversions.

Regulatory burden

While state credit union regulators and the NCUA agree on many procedural aspects of a state credit union conversion, this double oversight creates a regulatory burden for state credit unions. For example, to demonstrate how this is problematic for state-chartered credit unions, an action may be allowed in the Act and prohibited under state law or vice versa. This requires a state credit union to comply with two different laws that may be conflicting. Specific state laws and regulations that allow credit union conversions have been well thought out by state legislatures or regulators to encompass the intricacies of a credit union in an individual state. NASCUS believes it is a regulatory burden for state-chartered credit unions to follow both state and federal laws in the conversion process.

When state law or regulation allows for charter conversions, state-chartered credit unions have the right under those laws to convert to a different charter. Our records indicate that 21 states allow state-chartered credit unions to convert to another type of financial institution.² Conversions of a state credit union to a different charter type are not allowed in all states. When states allow for conversions, state law should determine the process of a conversion. Conversion rules and procedures should reside with the proper governmental chartering agency.

Going forward

NASCUS supports the rights of state legislatures and state regulators to determine the authorities granted to its state institutions. It is paramount that any new legislation being considered by Congress clearly recognizes the rightful authority of the states to determine chartering decisions for state-chartered credit unions. Until then, state credit unions are required to follow both state and federal laws, making the conversion process a regulatory burden for state-chartered credit unions.

NASCUS firmly believes that full and complete disclosure to credit union members is essential to any credit union conversion. Disclosure allows members to make an informed decision about a proposed conversion. When a state allows for credit union conversions, state law should dictate the necessary procedures.

We encourage this Subcommittee to analyze the laws that determine a conversion for state credit unions. Any process should uphold a state's right to determine the conversion process for its state credit unions while ensuring safety and soundness. Regulatory relief is needed in the state-chartered credit union conversion process.

² *NASCUS Profile, 2003-2004 Edition*



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**Questions for Tom Dorey
May 11, 2006 Hearing on
H.R. 3206, *The Credit Union Charter Choice Act***

Q: Do you know why Dearborn Federal Credit Union decided to withdraw its application for conversion, especially since this transaction was favored by the directors and senior management?

A: It is CUNA's understanding that a group of credit union members called DFCU Owners United was formed in opposition to the conversion, and led a grassroots campaign to educate other members about the impact of a conversion on their member-owner status. DFCU Owners United circulated a petition, garnering over 2,000 signatures, to call for a membership meeting to review the conversion proposal to ensure that the conversion decision was based solely on the benefit to the credit union and its members, and not for the personal interested of the directors. The members specifically requested:

1. To inspect portions of the minutes of board meetings in which the conversion was discussed; and
2. To inspect reports, studies, graphical presentations, and all other documents in which there was discussion and/or analysis concerning the proposed conversion

The Board flat out rejected requests to furnish documentation despite the fact that the request was not unreasonable, and was consistent with the rights of the members as stated by NCUA and both federal and state law. The petition subsequently became an effort to call for the removal of the credit union board, which clearly was no longer aligned with the credit unions' original mission and philosophy of "People Helping People."

Among other things, the DFCU situation illustrates the need for improvements in the conversion rule that clarify the ability of the board and management to communicate with the membership separately from the required notice and ballot mailings.



Q: Do you think that the conversion of credit unions is a trend that we'll see in the future?

A: CUNA does not believe the number of conversions will grow. In a recent case, we have found that once they are informed, members tend to oppose conversions. So long as no new laws limit members' ability to be informed, and members can be informed of the real consequences, I believe the number of new conversions will decline.

CUNA is not really concerned about the impact of conversions on the credit union system. To date, conversions have accounted for less than 1% of the assets of the entire movement. CUNA is more concerned about the impact on the former members of those credit unions that have lost their ownership of their credit unions.

Q: CUNA urges NCUA to consider possible conversion rule changes. Would you tell us what those changes are and why you recommend them?

A: CUNA believes that the changes made by NCUA in 2004, and again in early 2005, were helpful in improving the overall transparency of the conversion process. The additional disclosures, with specific information required to be prominently featured, were designed to make disclosure more meaningful and to prevent important or needed information from being lost in small print.

CUNA believes additional measures are needed to enhance the ability of members to fully understand and participate in all aspects of the conversion debate. In particular, CUNA would urge NCUA to consider possible rule changes that would:

1. Require that all disclosures relating to a conversion proposal be given in plain language that can be easily read and understood by credit union members.
2. Clarify the fiduciary obligation of credit union directors and managers to present factual and objective information to document how a proposed conversion would serve the best interests of members.
3. Clarify the ability of the management to communicate with the membership regarding the possibility of conversion well in advance of the board vote and permit a public comment period on conversion proposals in advance of the distribution of ballots to members
4. Establish a process or mechanism for members opposing a conversion proposal to communicate with the full credit union membership regarding a conversion proposal.
5. Require the board of a credit union to provide an advance notice to its membership that it is considering a possible conversion to a mutual savings bank several months before the board actually votes. This would allow a more open process of discussing the pros and cons of a possible conversion.

Suggested changes in the law:

- CUNA heartily supports that Congress should enact a law to restrict the ability of directors and senior management of a converted credit union from being able to personally benefit due to any subsequent conversion from a mutual thrift to a partial or full stock institution.
- CUNA also feels there is a hole in the OTS' duties to protect the members of a credit union that has converted from the unjust enrichment of insiders. The FCU Act specifically states that "no director or senior management official of an insured credit union may receive any economic benefit in connection with a conversion," but this prohibition simply evaporates the moment the credit union converts to a bank.
- It is interesting that there are no processes in place for the OTS to handle a conversion from a mutual thrift to a credit union. If a tax-exempt credit union is just like a mutual savings bank, as is often alleged, it seems that mutual thrifts would be seriously considering conversion to credit unions. Moreover such a process is necessary if a credit union converts to a mutual savings bank and decides the charter doesn't really work. OTS seems to lack a process for allowing the intuition to take steps to return to its credit union charter.

Q: You suggest that Congress should direct the OTS to enforce the current prohibition against credit union directors or senior managers receiving excessive compensation or other economic benefit related to a conversion. What is the problem with such enforcement?

A: I would view OTS as taking exactly the opposite role that NCUA is accused of -- placing few, if any, requirements or restrictions on credit unions wanting to convert to mutual charters and even encouraging these conversions. In several recent conversions, serious questions were raised about the circumstances of a conversion vote, or the format or content of the information sent to members regarding the vote, OTS appears to have put greater effort into criticizing NCUA's actions than in exercising its own oversight responsibilities.

Clearly, OTS' supervisory universe has been reduced, declining by almost 70% since 1989. OTS Director John Reich commented last summer that he was giving "top priority" to fixing the agency's declining funding. Let's hope that OTS has more in mind to reverse the thrift industry's fortunes than merely converting as many credit unions as possible to mutual charters.

My concern about OTS is that its conversion rules utterly fail to consider that the issues presented by a credit union conversion to a thrift charter are different from those presented by thrifts' conversion from mutual to stock. In numerous court rulings and

regulator decisions over the years, the idea of member ownership of a mutual thrift has been reduced to a technicality.

In credit unions, by contrast, the idea of member ownership is very much alive. In fact, that idea is the defining characteristic of credit unions. As a result, you will not find any court decision or NCUA statements minimizing the concept of members' ownership at credit unions. But there is nothing in OTS' rules acknowledging that extinguishing real member ownership is a problem or a concern. In fact, overall, OTS' regulations can be said to encourage conversion to stock form and even to encourage unjust enrichment as an incentive toward conversion. Not only is this wrongheaded, but I think OTS' rules on conversions are arbitrary and capricious as applied to credit union member equity.

Q: Some allege that conversions are motivated by hopes of private financial gain. What has been your experience with this as a motivation for credit union managers to convert?

A: I am not implying that all conversion have been motivated by hopes of private gain. But the ability of insiders to profit from conversions is constantly emphasized by consultants who specialize in this effort. As do many of my peers who manage large credit unions, I receive regular mailings from these consultants (similar to the quantity of credit card mailings the average person receives).

At Suncoast, we engaged a reputable law firm that that specializes in many different types of conversions to analyze what would result from a conversion to a mutual, followed by a conversion to a stock-owned thrift. They determined we would have an \$850 million stock offering, based on acceptable OTS guidelines, and a conservative increase in stock price. I as CEO would realize a personal gain of approximately \$35 million, and that does not include annual compensation.

Clearly, the concept of converting a not-for-profit credit union to a for-profit bank is something that has not been given sufficient attention or deliberation by lawmakers. The fundamental nature of the institution is altered, and ownership rights and economic benefits are at risk.

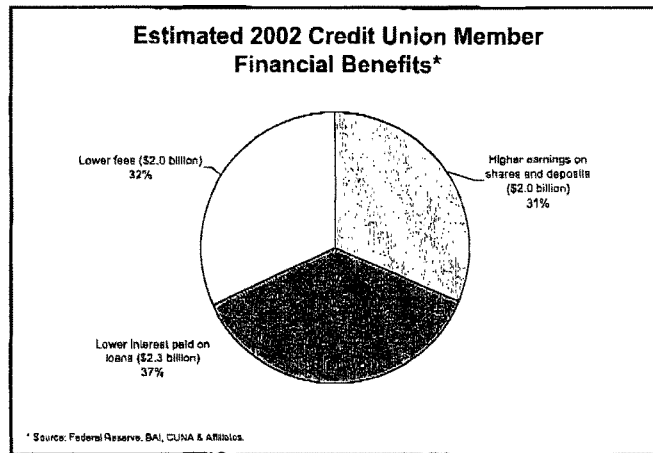
RESEARCH & POLICY WHITE PAPER

THE BENEFITS OF CREDIT UNION MEMBERSHIP

Credit union members benefit in a number of ways from their access to services from a cooperative, not-for-profit financial institution. Some of these benefits are not financial, such as the ability to directly participate in the governance of a financial institution as an owner, a sense of belonging, and a higher level of service as documented by annual *American Banker* consumer surveys. Credit union members also benefit financially as members. Credit unions are less likely to charge service fees than are for-profit banks and savings institutions (hereafter, banks), and when they do charge, the fees tend to be lower than at banks. Credit unions also pay, on average higher dividend and interest rates on savings, and charge lower interest rates on loans.

MEMBERS BENEFIT BY \$6.3 BILLION

The combined effect of these savings to credit union members is estimated to have been \$6.3 billion in 2002. That is the sum of the additional fees and loan interest, and lower savings return that credit union members would have paid and earned had they conducted all their business with banks instead of credit unions. The estimates are based on differences in national average pricing at credit unions and banks. The \$6.3 billion figure works out to \$76 per year per member, or \$149 per year per member household.



Overall, \$2 billion or 31% of the \$6.3 billion total benefit represents the greater yield on savings that members receive from credit unions compared to bank interest rates. The 2002 credit union interest rate advantage ranged from a high as 0.51 percentage points (51 basis points) on money market accounts to 0.20% (20 basis points) on share draft accounts. Had credit union members held all the funds they held in

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credit unions in banks instead, in the same kinds of accounts, they would have received \$2 billion less in bank interest than they in fact received in credit union dividends and interest. The interest rate data for the analysis is from *Datatrak*.

It is interesting to observe the banker response to this credit union benefit. While bankers complain that credit unions don't pay federal income taxes, they conveniently ignore the fact that credit union members pay income taxes on the additional dividends that they earn on their higher-earning credit union savings accounts. The additional federal income taxes credit union members paid last year on their higher dividends and interest from credit unions amounted to approximately \$480 million.

Another \$2.3 billion (37%) of the member benefit comes from the lower rates that credit unions charge on loans compared to banks. Excepting slight bank advantages on second mortgage-related loans, the credit union rate advantages range from a high of 170 basis points on vehicle loans to 4 basis points on first mortgage loans. Had credit union members paid bank loan rates on all the balances they owed to credit unions in 2002, they would have paid an additional \$2.7 billion in interest. Some of the longer-term loans on the books in 2002 were actually extended in earlier years. The analysis assumes the spreads between bank and credit union rates were similar to 2002 spreads when the loans were made. All loan rate data is from *Datatrak*.

The other \$2 billion of the credit union advantage is because of lower service fees at credit unions compared to banks. Most of the savings are from routine checking account and credit card fees, with smaller amounts from checking overdraft and loan fees. The data sources for most of the major items are the Federal Reserve's *Annual Report to Congress on Retail Fees and Services of Depository Institutions* for banks and CUNA's *Credit Union Executive's 2002 Credit Union Fees Survey Report* for credit unions. For some fee items not covered by these surveys, the data source is the Federal Reserve's Functional Cost Analysis program. For those fee items for which no data is available, no difference is assumed between bank and credit union fees.

While state-level fee and interest rate differentials may vary from these national averages it is nevertheless possible to use the national norms to obtain a rough estimate of state-level member benefits. For example, the above analysis suggests that total 2002 credit union member benefits are equal to \$1.15 million per \$100 million in average credit union assets (\$360,000 per \$100 million in higher earnings on shares and deposits, \$424,000 per \$100 million in lower interest payments on loans, and \$367,000 per \$100 million in lower fees).

WHERE THE \$6.3 BILLION COMES FROM

Banks and credit unions have very different product mixes. Credit unions are engaged almost entirely in the provision of retail financial services. In addition to retail services, banks provide substantial depository institution services to the business sector. Banks also generate a significant and growing amount of revenue from off-balance sheet activities such as funds management, and a wide variety of securities services. Because these different product mixes make comparisons of bank and credit union net operations imprecise, it is difficult to exactly isolate the reasons why credit unions are able to offer their members such a better deal than retail bank customers receive from their banks. However, we get a strong indication of the source of the savings from the following:

OPERATING EFFICIENCY. Despite their smaller size, credit unions have lower expense-to-asset ratios than do banks. In the past, much of this expense advantage was due to sponsor subsidies of credit unions. Such subsidies are today much less than they once were. But other factors also come in to play. Some of the banks higher expense ratios are due to the expenses of

off-balance sheet activities in which credit unions do not engage. However, part of the credit union advantage is due to lower staff salaries. Salaries and benefits per employee at credit unions average about 72% of the comparable figure for banks. Also, almost all credit union directors are unpaid volunteers. If credit union directors were paid at the bank average rate, the total cost would be \$625 million. That is \$625 million that credit unions do not have to recover from members with higher fees and loan rates and lower dividend rates. Our source for bank director payments is the *BAI Bank Key Executive Compensation Survey*, with data adjusted for inflation.

STOCKHOLDER DIVIDENDS. During 2002, the banking industry's dividend payout rate averaged 72% of net income. Applying that figure to credit union net income in 2002 of \$5.7 billion means credit union members did not have to fund \$4.1 billion of such dividends. That money was directly distributed to members in the form of more attractive loan, saving and service pricing.

LOAN LOSSES. Credit unions incur lower loan losses than do banks. Much of the difference is found in credit cards, which are so profitable for banks that they blanket the market with solicitations in an attempt to get more cardholders. The result is many borrowers take on more debt than they can handle. Credit unions are less aggressive in loan marketing, while attempting to meet all legitimate and supportable member borrowing needs. In 2002 banks with less than \$10 billion in assets reported loan loss provisions averaging 39 basis points of assets. This compares to provisions of 35 basis points at credit unions. That generates a saving for credit union members of \$0.23 billion per year.

Banks have argued that the source of the credit union pricing advantage is the credit union tax exemption. The credit union tax exemption amounted to \$1.6 billion in 2002, which represents only about a quarter of the \$6.3 billion credit union member benefit. As we've seen from the above information, much of the credit union advantage is accounted for by other reasons, which are tied to how credit unions operate as not-for-profit, financial cooperatives. Also, as mentioned above, almost a third of the tax exemption is made up for by taxes paid by members on the greater dividends and interest they earn from credit unions.

BENEFITS TO NONMEMBERS

In addition to the non-financial and financial benefits to credit union members, numerous studies reveal that those who don't belong to credit unions also benefit from the existence of credit unions. For example, a recent study by the National Economic Research Associates points out that the availability of attractive pricing from credit unions pressures other financial institutions to provide attractive rates and services.

It is impossible to quantify the benefit to bank customers of the existence of credit unions. However, the magnitude to the savings is suggested by the amount of business U.S. households transact with commercial banks. Banks hold almost \$4 trillion of household deposits, and have on their books about \$650 billion of consumer installment credit. For each 10 basis points that credit union competition might influence bank pricing, bank customers save \$4.7 billion. In addition, most of the \$95 billion per year that banks collect in non-interest income is likely not from retail customers. However, a significant portion is. Even fractional reductions in bank fees due to credit union competition provide consumers with substantial savings.

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Estimated 2002 Benefits of Credit Union Membership by State							
Estimated Value of CU Benefit (\$ millions) Arising From...							
State	Number of Credit Unions	Average 2002 Assets (\$ billions)	Higher CU			All Three Sources	
			Interest/Dividends on Shares and Deposits	Lower CU Loan Interest Rates	Lower CU Fees		
Alabama	174	\$8.3	\$30.0	\$35.4	\$30.6	\$95.9	
Alaska	13	\$3.1	\$11.3	\$13.3	\$11.5	\$36.1	
Arizona	66	\$8.4	\$30.2	\$35.7	\$30.8	\$96.7	
Arkansas	75	\$1.4	\$4.9	\$5.7	\$5.0	\$15.5	
California	610	\$82.0	\$294.8	\$347.7	\$300.4	\$942.9	
Colorado	162	\$10.2	\$36.5	\$43.1	\$37.2	\$116.9	
Connecticut	176	\$5.7	\$20.6	\$24.3	\$21.0	\$65.9	
Delaware	40	\$1.2	\$4.2	\$5.0	\$4.3	\$13.5	
District Of Columbia	70	\$4.3	\$15.6	\$18.4	\$15.9	\$49.9	
Florida	241	\$27.3	\$98.3	\$116.0	\$100.2	\$314.6	
Georgia	212	\$10.5	\$37.6	\$44.4	\$38.4	\$120.4	
Hawaii	102	\$5.2	\$18.8	\$22.2	\$19.2	\$60.3	
Idaho	71	\$2.1	\$7.5	\$8.8	\$7.6	\$23.9	
Illinois	544	\$18.6	\$66.9	\$78.9	\$68.2	\$214.1	
Indiana	240	\$12.3	\$44.1	\$52.0	\$44.9	\$141.0	
Iowa	178	\$4.3	\$15.5	\$18.3	\$15.8	\$49.7	
Kansas	126	\$2.5	\$9.1	\$10.8	\$9.3	\$29.2	
Kentucky	119	\$3.7	\$13.2	\$15.6	\$13.5	\$42.2	
Louisiana	276	\$5.0	\$18.1	\$21.3	\$18.4	\$57.8	
Maine	78	\$3.2	\$11.6	\$13.7	\$11.8	\$37.0	
Maryland	126	\$10.5	\$37.7	\$44.5	\$38.5	\$120.7	
Massachusetts	274	\$17.7	\$63.6	\$75.0	\$64.8	\$203.5	
Michigan	444	\$26.2	\$94.3	\$111.2	\$96.1	\$301.6	
Minnesota	180	\$10.4	\$37.5	\$44.3	\$38.2	\$120.0	
Mississippi	119	\$2.1	\$7.4	\$8.7	\$7.5	\$23.7	
Missouri	179	\$7.0	\$25.0	\$29.5	\$25.5	\$80.1	
Montana	73	\$1.9	\$7.0	\$8.2	\$7.1	\$22.3	
Nebraska	80	\$2.1	\$7.6	\$9.0	\$7.8	\$24.4	
Nevada	29	\$3.3	\$12.0	\$14.2	\$12.2	\$38.4	
New Hampshire	32	\$2.7	\$9.7	\$11.5	\$9.9	\$31.1	
New Jersey	262	\$7.8	\$28.2	\$33.3	\$28.8	\$90.2	
New Mexico	55	\$3.5	\$12.6	\$14.9	\$12.9	\$40.5	
New York	602	\$27.8	\$99.9	\$117.8	\$101.8	\$319.5	
North Carolina	157	\$16.3	\$58.6	\$69.1	\$59.7	\$187.5	
North Dakota	62	\$1.2	\$4.4	\$5.2	\$4.5	\$14.2	
Ohio	562	\$14.1	\$50.8	\$59.9	\$51.8	\$162.5	
Oklahoma	92	\$5.5	\$19.7	\$23.2	\$20.1	\$63.0	
Oregon	106	\$8.9	\$32.0	\$37.8	\$32.7	\$102.5	
Pennsylvania	730	\$18.9	\$68.0	\$80.2	\$69.3	\$217.6	
Rhode Island	35	\$2.8	\$10.2	\$12.0	\$10.3	\$32.5	
South Carolina	95	\$5.3	\$19.0	\$22.4	\$19.4	\$60.8	
South Dakota	80	\$1.2	\$4.4	\$5.2	\$4.5	\$14.0	
Tennessee	227	\$9.1	\$32.6	\$38.5	\$33.2	\$104.3	
Texas	683	\$39.8	\$143.3	\$169.0	\$148.1	\$458.4	
Utah	127	\$7.3	\$26.3	\$31.0	\$26.8	\$84.1	
Vermont	38	\$1.2	\$4.5	\$5.3	\$4.5	\$14.3	
Virginia	243	\$32.8	\$118.1	\$139.3	\$120.4	\$377.8	
Washington	156	\$16.9	\$60.6	\$71.5	\$61.8	\$194.0	
West Virginia	124	\$1.9	\$6.9	\$8.2	\$7.1	\$22.2	
Wisconsin	310	\$11.3	\$40.5	\$47.8	\$41.3	\$129.7	
Wyoming	34	\$0.9	\$3.3	\$3.9	\$3.4	\$10.6	
Total	9869	\$538.0	\$1,934.9	\$2,282.5	\$1,972.2	\$6,189.6	

Source: CUNA & Affiliates. Based on data from the Federal Reserve, Bank Administration Institute, NC

Tax Credit Unions? It Doesn't Add Up	
Estimated annual increase in federal income tax revenue arising from credit union taxation (a direct tax on 87 million credit union member-owners)	+ \$1.5 billion
Estimated annual decline in credit union member benefits arising from change in tax status and subsequent operational changes ¹	- \$6.3 billion
Estimated annual decline in bank customer benefits arising from greatly reduced influence of credit union competition ²	- \$4.3 billion
Net annual economic impact of credit union taxation	- \$9.1 billion

¹ Hampel, Bill and Schenk, Mike, CUNA Research & Policy Analysis. "The Benefits of Credit Union Membership". http://www.cuna.org/member/download/whpaper_membership.pdf

² Feinberg, Robert, M. American University. "An Analysis of the Benefits of Credit Unions to Bank Loan Customers". September 2004. http://www.cuna.org/member/download/ba_benefits.pdf. Togle, Robert J., Idaho State University. "An Estimate of the Influence of Credit Unions on Bank CD and Money Market Deposits in the U.S." http://www.cuna.org/member/download/ba_influence.pdf.

Q1. In 1998, Congress acted to ensure that credit union members are adequately informed, appropriate disclosures are made, voting requirements are reasonable, and there are safeguards against insider abuse. In implementing the law, there is concern that NCUA has gone beyond Congressional intent. Could you explain how you are complying with and not regulating beyond the Credit Union Membership Access Act?

A1. The Credit Union Membership Access Act (CUMAA) sets out a statutory framework for conversion from insured credit union to mutual savings bank. CUMAA also directs NCUA to promulgate rules that are "consistent" with the rules of other regulators and "no more or less restrictive." NCUA has reviewed the rules of other financial regulators and crafted its regulations to satisfy statutory requirements and congressional intent. It is important to understand, however, that CUMAA also requires NCUA to administer the methods and procedures of the member vote on conversion. This additional responsibility is one that other regulators generally do not have. As a result of this and the fact that credit union to mutual savings bank conversions are somewhat different from other kinds of conversions, it is understandable that NCUA's regulations are not and cannot be identical to other conversion rules. Nevertheless, NCUA's rules are consistent with and no more or less restrictive than those of other regulators and therefore comply with CUMAA.

Q2. Congress instructed NCUA to promulgate rules that are consistent with other financial regulators. Can you tell us how your regulations regarding charter conversion are consistent with or differ from the rules promulgated by other financial regulators?

A2. As noted in Answer 1 above, NCUA's conversion rules are consistent with those of other regulators. Examples of some similarities include: the requirement that the board of directors adopt or approve a proposal or plan of conversion; members must receive notice of the plan or proposal; and members are entitled to vote on the plan or proposal. Most differences between NCUA's rules and those of other regulators are due to statutory requirements in CUMAA. For example, CUMAA requires credit unions to send their members three notices of the transaction 90, 60, and 30 days prior to the vote. Other regulators may have a different notice provision as they are not subject to CUMAA. As noted, CUMAA also requires NCUA to administer the methods and procedures of the member vote, a responsibility other regulators generally do not have. As a result, NCUA's rules may be somewhat different in order to fulfill that statutory responsibility. There are also some instances where NCUA's rules are somewhat less burdensome than those of other regulators. For example, NCUA does not require a credit union's board of directors to meet with NCUA before approving a proposal to convert as do some regulators. Also, NCUA does not require a credit union to provide it with a written strategic plan of conversion for review as do some regulators. See Answer 1 for further information.

Q3. You state that NCUA has refined its conversion rules three times in eight years and that you believe further changes to clarify and improve those rules are

warranted. Don't these "refinements" and "changes" give some credence to the complaint that there is little uniformity from one NCUA-approved conversion to the next? Is the NCUA raising the bar to discourage credit unions from converting?

A3. NCUA's primary objective in processing conversions is to ensure appropriate consumer protection for credit union members. A conversion by nature is a complex and sophisticated transaction not easily understood by credit union members, especially if the credit union is not providing accurate and complete information to its members. The form of these transactions has evolved over time. For example, the trend in recent conversions has been to ultimately convert to the mutual holding company (MHC) structure. The MHC structure involves the creation of a stock bank owned by a stock bank holding company owned by a MHC. NCUA has grown concerned over time that converting credit unions have not always provided their members with complete and accurate information so that members can understand the transaction and its ramifications and make an informed decision. Complete and accurate information is necessary for consumer protection. NCUA has amended its rules 3 times in 8 years primarily to require enhanced disclosures to better inform members. These changes have not raised the bar to discourage credit union conversions nor have they caused a lack of uniformity in the conversion process. Rather, they demonstrate a responsible regulatory response to require adequate consumer protection to members in the face of evolving and more complex conversion transactions.

Q4. You state that NCUA's primary mission is to ensure the safety and soundness of federally insured credit unions. Does NCUA see any safety and soundness concerns when a credit union converts to a mutual savings bank? If so, what are they?

A4. NCUA's primary mission is to ensure the safety and soundness of federally insured credit unions. NCUA also has responsibility pursuant to the Federal Credit Union Act to protect the interests of credit union members. And, indeed, member confidence in the integrity of the system is an important safety and soundness factor. In the conversion context, NCUA strives to protect the rights of a converting credit union's member/owners and to provide consumer protection by requiring that members receive complete and accurate information so they may cast informed votes. Once a credit union converts to an MSB, however, it is no longer within NCUA's jurisdiction and, therefore, the safety and soundness of the institution is no longer NCUA's responsibility.

Q5. Why does NCUA insist on including disclosures about insider stock benefits that may occur post-conversion?

A5. Good consumer protection dictates that members must receive complete and accurate information about a conversion. That means members need to understand the entire conversion transaction, not just part of it. There are certain factual realities that are part of the transaction. For example, it is a reality that the vast majority of

credit union to MSB conversions include a second conversion to a stock bank. That is especially true in conversions intending from the start to use the MHC structure, which allows for the more immediate sale of stock. It is also a reality that credit union management and insiders have the ability to realize economic benefit from the stock-related aspect of the conversion far in excess of that available to members. Insiders are generally better positioned to participate in the initial public offering than other members, and insiders realize stock through various plans not available to other members, such as management retention plans, stock option plans and employee stock ownership plans. To be complete and accurate, disclosures made to members must include the fact that credit union managers and insiders, the individuals who put forth the conversion proposal and who are vigorously encouraging members to convert, are the very same people who stand to reap the greatest economic benefit from the conversion. Given complete and accurate information, members can vote however they choose.

Q6. One complaint is that credit union conversion candidates have difficulty responding to member questions, press reports, and accusations made by hostile parties. The concern is that NCUA may deem the communication inappropriate and eventually not certify the vote. Can you understand the frustration that management experiences when they feel they cannot respond in a timely manner to hostile statements?

A6. NCUA does not limit communications in any way. NCUA prioritizes good consumer protection by requiring that members receive complete and accurate information so they may cast informed votes. The more complete and accurate the information the better. Accordingly, NCUA's conversion rules are designed to encourage greater communications between the converting credit union and its members. Simple disclosures are required to accompany only written communications to members that are made after the board has decided to convert. No disclosures are required to accompany oral statements of the credit union. No disclosures are required in connection with press releases, advertising and the like. Converting credit unions are completely free to communicate with their members as much and as often as they like. Of course, those communications must be accurate and not misleading. So long as credit union management's statements meet that standard, they should have no concerns about providing information to their members and addressing criticism from member groups, trade groups, and others who believe members are better off keeping their credit union a credit union.

Q7. It has been nearly a year since NCUA attempted to invalidate the ballot of Community Credit Union over how the disclosure was folded. Do you still believe that NCUA was correct to invalidate the vote?

A7. The Community CU case involved much more than a dispute over the way a piece of paper was folded. NCUA staff believed they had negotiated in good faith about the placement of NCUA's disclosures. When that agreement was not kept, NCUA insisted

on a new vote. Ultimately, the Magistrate Judge, in his recommended decision, did not see it NCUA's way, and we settled the lawsuit. It is interesting to note that in the third and final mailing, NCUA's disclosures were properly placed and 51% of the ballots returned after that mailing were against the conversion.

Q8. NCUA mandates a number of disclosures, such as whether the resulting mutual institution will convert to stock, whether its board of directors will be compensated, and disclosure of stock related compensation associated with conversion to a stock institution. If the credit union has no say in any of those decisions because they are made by the resulting savings bank, and if conversion to stock is contingent upon a vote of the bank's membership, how can those disclosures be made? Aren't those disclosures speculation and conjecture because the board and membership of the resulting institution would consider them?

A8. As stated in the answer to Question #5, the vast majority of credit union to MSB conversions include a second conversion to a stock bank. In fact, recent conversions all have used the MHC structure in order to raise capital quickly, and the converting credit unions readily acknowledge their intent to sell stock. It is a reality that credit union management and insiders have the ability to realize economic benefit from the stock-related transaction far in excess of that available to members. Consumer protection requires the disclosure of complete and accurate information including relevant information about the loss of member ownership interests and stock benefits to insiders when a credit union converts to an MSB in route to converting to a stock bank.

Without being informed that the credit union to MSB conversion is only the first step in a multi-step transaction, a member does not adequately understand the conversion transaction and cannot cast an informed vote.

Q9. NCUA has spoken about the "ownership" of a credit union and its equity, and how they will be lost if the credit union converts to a mutual savings institution. Credit union ownership rights are very limited. A credit union member can't just walk in, close his account, and demand his share of the credit union's equity because he owns it. However, aren't the structures of mutual savings banks and credit unions and the rights of their members very similar?

A9. Congress, in the Federal Credit Union Act, has stated that member shares represent equity. Equity, by definition, means ownership. Not only do members own their credit union in a legal sense, they own it in a practical sense as well. Credit union members vote directly on numerous important credit union decisions, including the election of directors, voluntary liquidation, and conversion. Unlike MSB depositors, federal credit union members cannot give up that right by giving the directors or anyone else voting proxies.

Credit union ownership is also demonstrated through the issuance of dividends. If the credit union does well, members get the financial rewards, including excellent loan and savings rates and low fees. A credit union that does particularly well may return its excess earnings to its members in the form an extraordinary dividend. Credit union members bear more risk than bank depositors if a credit union does poorly. Projected dividends on shares at credit unions are not contractual obligations and are payable only if the credit union has sufficient retained earnings to pay such dividends. In addition, to the extent of their uninsured shares, credit union members bear more risk than mutual savings bank depositors in the event of insolvency. Credit union members with uninsured shares get only what is left of the credit union assets after unsecured general creditors get their due. Depositors at banks, however, take from the assets equally with unsecured creditors. In the event of a voluntary liquidation, credit union members, as the owners of the credit union, are entitled to share in a pro rata distribution of any and all of the credit union's liquidated assets after the credit union's obligations have been paid.

Q10. ACB, in their testimony, states that you place a virtual gag order on converting credit unions, whereby communications with members not approved by NCUA are treated as violations. Does NCUA restrict management's ability to communicate and seek input from their members?

A10. NCUA does not limit communications. NCUA has stated on numerous occasions, and demonstrated in its conversion rules, that it strives only to provide consumer protection to credit union members by encouraging converting credit unions to provide complete and accurate information to their members. Under NCUA's rules, a credit union can communicate with its members in any way it likes whenever it likes so long as the information is accurate and not misleading. Written communications that are sent to all members and that post-date the board decision to hold a membership vote on conversion must include NCUA's simple boxed disclosure. The NCUA Board will be considering proposed rule changes in the near future that may, among other changes, limit the boxed disclosure requirement to the 90, 60, and 30 day statutory notices. See Answer 6 for further details.

Q11. What is the history of Dearborn Federal Credit Union's conversion attempt and the status of efforts by some members to change the makeup of the credit union's board of directors?

A11. Dearborn FCU's (DFCU's) management approved a conversion proposal and voluntarily submitted materials it intended to send to its members to NCUA for review. NCUA reviewed the documentation. After working with the credit union's lawyers to effect some suggested revisions, NCUA approved the documents. DFCU then began mailing the approved documentation to their members. Sometime after sending the statutorily required 90-day notice to members but before sending the 60-day notice DFCU announced the withdrawal of its conversion proposal. This had nothing to do with any NCUA action. At the time DFCU withdrew the proposal, there was mounting

opposition to the conversion by groups of DFCU members who did not want their credit union to become a bank. Some in the industry have speculated that DFCU's managers and directors knew, based on their access to the running tally of the vote, that they were losing the conversion vote at the time they withdrew the proposal. However, NCUA does not know for certain the reason for the withdrawal.

Since then, a group of members, who apparently believe some or all of the DFCU board members have failed in their responsibility to the credit union and its members, have filed a petition with the credit union to hold a special meeting to recall individual board members. The credit union has denied the members their special meeting and the members have had to sue the credit union to enforce their right to a special meeting. That lawsuit is pending.

We also note that DFCU management spent approximately \$1.4 million of the members' equity trying to convince the members to convert. The members opposing the conversion used personal funds to make their opinions known.

Q12. ACB, in their testimony, states that "NCUA has inserted uncertainty into the conversion process to such an extent that most credit unions now believe the conversion process is not worth pursuing." Is this a valid criticism?

A12. We do not believe this is a valid criticism. NCUA's rules are clear and are no impediment to any credit union that wants to convert so long as the credit union treats their members fairly by providing complete and accurate disclosure information. Also see Answer 10 for further details.

Q13. ABA, in their testimony, states that "the effect of the (disclosure) box, the highlights, the capitalized, bold language, is to achieve one purpose, to encourage credit union members to vote against any conversion proposal." What is the purpose of this highlighted box in the notice?

A13. NCUA believes the brief boxed disclosures serve to provide factually accurate information about the ramifications of a conversion to a bank. These disclosures provide members with important information they otherwise are unlikely to receive from the credit union's pro-conversion management. Members need to know both the pros and cons of converting in order to cast informed votes. NCUA's disclosures are intended only to ensure members receive complete and accurate information.

**QUESTIONS FOR HEARING ON H.R. 3206,
THE CREDIT UNION CHARTER CHOICE ACT
May 11, 2006**

Marcus Schaefer – Truliant Federal Credit Union

- Chairman Johnson has suggested that NCUA is considering changing its conversion rules to enhance disclosures and address issues raised by recent conversions. Would NAFCU support this effort and do you believe that additional disclosures are needed?

A charter conversion from a credit union to a mutual savings bank fundamentally alters the nature of a member's relationship to the new financial institution, wherein the member may experience diminished rights with regard to voting privileges and ownership of the former credit union's capital. NAFCU believes that the best financial decisions can only be made with complete knowledge of the benefits and risks of a conversion. Therefore, it is imperative that a credit union's members receive full disclosure of the board's conversion plan, its associated benefits and risks, the opportunity for board member and management financial gain associated with any subsequent conversion to a stock institution. NAFCU strongly supports regulatory changes to NCUA's conversion rules to enhance disclosure requirements. NAFCU believes that additional disclosures are needed as we have outlined below in response to question three, and in our written testimony.

- What is NAFCU's position on legislation to require that at least 20% of the members vote to approve a conversion?

NAFCU believes that a minimum of 20% of a credit union's members eligible to vote should cast a ballot in the vote taken to convert and a majority of those credit union members must vote in favor of the conversion.

- NAFCU's testimony outlines policy changes to the laws and regulations to protect credit union membership. Would you explain these changes, the reasons for them, and how they improve the conversion process?

I. Minimum Participation

NAFCU believes the FCUA should be amended to require a minimum participation level of 20% of the credit union membership. Under current law, there is no minimum participation requirement. Thus, a very small number of members may in reality be approving the conversion. Because a conversion potentially changes the rights of the membership, we believe that a stronger participation requirement will better reflect the will of the entire credit union membership.

II. Advance Notice to Members of Conversion Proposal

NAFCU believes that a new section should be added to the FCU Act or NCUA regulations to require that members receive advance notice of the member vote on the conversion. This provision will provide credit union members with a more meaningful opportunity to engage in a dialogue with the credit union board about the conversion process and to comment on that process and the conversion plan. Under current rules, credit union members are not necessarily informed of the board of directors' decision to convert until called upon to vote on the conversion. NAFCU believes that giving members the opportunity to discuss the conversion plan with each other and with the board will result in a more informed decision on the part of the membership.

III. Notice Requirements

NCUA has existing regulation regarding the notice that credit unions should provide to members regarding the conversion. NAFCU believes that these may be refined even further to make sure that the information being given to the membership is presented in a clear manner. In particular, the regulations should require the notice to members to provide a description of the purpose and subject matter of the conversion and must tell them that their voting rights may be affected by the conversion and what "yes" and "no" on the ballot mean.

Furthermore, any potential monetary gain by directors or senior management as a result of the conversion should be disclosed in order for members to judge what, if any, bearing the financial incentive has on the proposal. The disclosure of any plans that the board might have for the subsequent conversion of the mutual savings bank to a stock institution and what impact that might have on members, directors and senior management must be included in the notice to members, along with disclosure that they may potentially lose their ownership interests in the institution if the mutual savings bank converts to a stock institution and they do not become stockholders.

The notice to members should also disclose any conversion related benefits that directors or senior management may receive including any increase in compensation, an explanation of any foreseeable stock related benefits – including an approximate dollar amount – if the converting credit union were to become a stock institution after the waiting period. In addition, NAFCU supports amending OTS rules and statutes to impose a 10-year minimum waiting period before a director or senior management official may receive any economic benefit in connection with a conversion of a mutual savings bank to a stock institution.

Informing members of the potential benefit to management that could occur if the institution converts to a stock institution is material to the decision as to whether the institution should convert. NAFCU has provided statistics that demonstrates that the vast majority of credit unions that convert subsequently convert to stock institutions. Because of the ownership interest of the credit union members, it is vital to inform them that it is probable that in the near future their ownership interests will be eliminated unless they have the ability to purchase stock in the institution.

IV. Due Diligence

There needs to be a requirement that a credit union provide the NCUA Board, or its designee, for its review and approval, a copy of the notice, ballot and other written materials to be mailed to members as described, and that the board certify that it has undertaken sufficient due diligence to ensure that the conversion will not be detrimental to the interests of the credit union or its members. Directors have a fiduciary duty to the institution and the members and need to make careful decisions. Members can not make an informed decision to convert if they unaware of potential detriments to their membership interest.

Overall, these regulatory and legislative changes will result in the credit union membership being more informed and make decisions that are representative of the membership, and will make sure that directors are making unbiased decisions.

- Do you believe that senior management and the board should be able to profit from the conversion of their credit union or should there be a prohibition against such profit?

NAFCU believes that directors and/or senior management of a converted credit union should not be able to benefit financially from the transaction until at least 10 years after the initial conversion has taken place. Furthermore, there should be full disclosure of the potential maximum benefit a director or senior management could receive if the converting credit union were to convert to a stock bank after the 10 year period has passed. This would include an approximate amount in dollars that the director could potentially receive based on the size of the institution.

- What is your opinion of the voting requirements that a credit union must achieve to convert? Are they too lax? Do you think they should they be rolled back to the way they were prior to 1998?

I would refer you to my written statement on this matter. We believe the current requirements are too lax, as a handful of members can make a major decision impacting thousands of others-. I would note that NAFCU believes that a minimum of 20% of a credit union's members eligible to vote should cast a ballot in the vote taken to convert and a majority of those credit union members must vote in favor of the conversion for a conversion to take place.

Responses to questions from H.R. 3206 hearing**Question#1**

You contend that a “new-breed of credit unions has emerged” and that unless the credit union charter is “dramatically distorted,” a fair and workable path for conversion of those credit unions to thrifts must be established. Would you explain what you mean by a new-breed and why the conversion option is particularly important for them?

The credit union charter, by statute, has certain benefits and limitations. One of the greatest benefits is that credit unions are tax-exempt. This preferential tax treatment exists because of the traditionally limited nature of the credit union charter (with regard to products and membership) and the mandate to serve people of “modest means.” Moreover, the cooperative, mutual structure of credit unions means that they can only raise capital through retained earnings; they cannot raise capital from outside investors. Such a capital structure is fundamental to the credit union charter and is an integral part of the original credit union philosophy.

However, with the liberalization of the credit union field of membership coupled with a broader array of products and services, a new-breed of aggressive credit unions has emerged virtually indistinguishable from taxpaying banks. According to the Government Accountability Office (2005),

“as the credit union industry has evolved, the historical distinction between credit unions and other depository institutions has continued to blur. Since 1992, the number of credit unions has declined, but total assets of the industry have grown. The consolidation in numbers and concentration in assets have resulted in two distinct groups of credit unions: a few relatively large credit unions providing a wide range of services that resemble those offered by banks of similar size, and a number of smaller institutions that provide basic financial services. Among the more significant changes that have occurred in the credit union industry over the past two decades have been the weakening or blurring of the common bond that traditionally existed between credit union members.”

These new breed credit unions are pushing into commercial lending, funding luxury hotels and commercial real estate projects.

For credit unions that want to do more business lending, serve a broader customer base and have the ability to raise external capital, the mutual savings bank charter provides them with a better option to serve their members. Mutual savings banks have the flexibility to define their customer base more broadly, pursue greater business lending, and, through the creation of a mutual holding company, raise outside capital to support growth. However, with this expanded scope of activities available under this charter, comes the enhanced and experienced supervision of federal banking regulators. For converting credit unions, the new business and customer service opportunities more than pay for the tax obligation and the more rigorous supervision they take on. Rather than relying on fundamental changes to the

federal credit union charter through often *arbitrary and capricious* regulatory actions by National Credit Union Administration (NCUA), new-breed credit unions should be afforded the option available to other financial institutions. Conversion to a charter that better serves their business model and their members/customers' needs is a straightforward process for all financial institutions except credit unions.

Question #2

You mention that “mutual savings banks have done exceedingly well in meeting the needs of their customers and communities.” Why do you think some credit unions will give-up their tax exemption to become savings banks? Why, as OTS points out, did 42 banks opt to convert to thrifts, between 2000 and 2005?

Mutual savings banks have a long history of serving their customers and communities. As mutual savings banks, these institutions can continue to serve their existing markets — and seek new ones — while preserving the mutual structure, providing competitive loan and savings rates, and expanding the quality and variety of services they offer. The members, after conversion, continue to have the same mutuality rights as they had before conversion. Charter choice gives financial institutions the ability to select the charter that best meets their future business plans and the needs of their customers. For credit unions that want to go beyond their legal mandate while retaining their mutual structure — the choice is a mutual savings bank charter.

Institutions choose the charter that best meets their business plans and customers' needs. Between 2000 and 2005, 42 banks have opted for an OTS regulation. The reasons for changing to a federal thrift charter include:

1. easier branching;
2. mortgage specialization;
3. simpler and less complicated CRA rule;
4. more efficient Mutual Holding Company (MHC) rules including ability to have a double MHC; and
5. federal preemption.

What is also telling is that, during that same time period, 90 OTS regulated institutions opted for another depository institution charter and that OTS did not obstruct these conversions.

Question #3

You state that a “fair and workable path for credit union conversion to mutual banking charters must be clearly established.” Can you explain how the process is presently “unfair” and “unworkable?”

The current conversion rules administered by the NCUA are unfair and unworkable. NCUA is not an unbiased observer. Since the enactment of the Credit Union Membership Access Act (CUMAA), NCUA has interjected itself directly into the conversion debate. It substitutes its judgment for those credit union members under the patronizing proposition

that credit union members do not appreciate the effect a conversion may have on their ownership interests and voting rights and that if they did, ipso facto, they would never vote in favor of a conversion.

Rather than improving transparency, NCUA's regulations foment confusion, raise unsubstantiated concerns, present subjects outside of the NCUA's jurisdiction, and raise allegations about matters not at issue in the vote.

Under the guise of education, NCUA requires a that "a converting credit union must include a disclosure prepared by NCUA in a prominent place with each written communication it sends to its members regarding the conversion and must take specific steps to ensure that the disclosure is conspicuous to the member." This also applies to web site postings.

The National Credit Union Administration, the federal government agency that supervises credit unions, requires [insert name of credit union] to provide the following disclosures:

1. **OWNERSHIP AND CONTROL.** In a credit union, every member has an equal vote in the election of directors and other matters concerning ownership and control. In a mutual savings bank, ACCOUNT HOLDERS WITH LARGER BALANCES USUALLY HAVE MORE VOTES AND, THUS, GREATER CONTROL.
2. **EXPENSES AND THEIR EFFECT ON RATES AND SERVICES.** Most credit union directors and committee members serve on a volunteer basis. Directors of a mutual savings bank are compensated. Credit unions are exempt from federal tax and most state taxes. Mutual savings banks pay taxes, including federal income tax. If [insert name of credit union] converts to a mutual savings bank, these ADDITIONAL EXPENSES MAY CONTRIBUTE TO LOWER SAVINGS RATES, HIGHER LOAN RATES, OR ADDITIONAL FEES FOR SERVICES.
3. **SUBSEQUENT CONVERSION TO STOCK INSTITUTION.** Conversion to a mutual savings bank is often the first step in a two-step process to convert to a stock-saving bank or holding company. In a typical conversion to the stock form of ownership, the EXECUTIVES OF THE INSTITUTION PROFIT BY OBTAINING STOCK FAR IN EXCESS OF THAT AVAILABLE TO THE INSTITUTION'S MEMBERS.
4. **COSTS OF CONVERSION.** The costs of converting a credit union to a mutual savings bank are paid from the credit union's current and accumulated earnings. Because accumulated earnings are capital and represent members' ownership interests in a credit union, the conversion costs reduce members' ownership interests. As of [insert date], [insert name of credit union] estimates THE CONVERSION WILL COST [INSERT DOLLAR AMOUNT] IN TOTAL. That total amount is further broken down as follows: [itemize the costs of all expenses related to the conversion including printing fees, postage fees, advertising, consulting and professional fees, legal fees, staff time, the cost of holding a special meeting, conducting the vote, and any other expenses incurred].

But these disclosures violate and contradict the regulations of other financial regulators, in contravention of CUMAA. Congress instructed "the NCUA to promulgate rules ... applicable to charter conversions that are consistent with rules promulgated by other financial regulators including the Office of Thrift Supervision and the Office of the Comptroller of the Currency. The rules for charter conversions by insured credit unions must be no more or less restrictive than those rules that apply to charter conversions by other financial institutions." The report of the U.S. Magistrate Judge in the Community Credit Union conversion suit against NCUA concluded that, "The Administration's [NCUA's] newly enacted regulation on disclosure has no counterpart regulation in the OTS."

This intrusion by the NCUA into the jurisdiction of other federal regulators, with no basis in statute or other applicable authority, is remarkable; no bank regulator requires similar disclosures for charter conversion questions involving its supervised institutions. Moreover, the subjective format and tone of the disclosures does little to promote thoughtful consideration of facts by credit union members. The effect of the box, the highlights, the capitalized, bold language, is to achieve one purpose – to encourage credit union members

to vote against any conversion proposal. Furthermore, these mandatory disclosures are themselves misleading.

NCUA alone determines if any notice to members is accurate and not misleading (12 CFR 708a.7(c)). If it determines that any member communication is inaccurate, it can refuse to certify a vote and require a new vote at considerable expense to the converting credit union. Thus, management will want approval by NCUA of any written communication to members, because of the real fear that NCUA might not certify the vote. Unfortunately, NCUA has a history of dragging its feet in approving communications to members. This has prevented management from providing the media with timely information. Moreover, comments by credit union officers made without prior NCUA approval have reportedly been met with letters from NCUA criticizing the communication. These cases have had a chilling effect on any communication to members. Therefore, the process does not allow a converting institution to communicate with its members in a timely manner.

Finally, nowhere was the NCUA's improper use of its power more apparent than in 2005 when the agency tried to invalidate the conversion of two Texas credit unions, where an overwhelming majority of the members voted for the conversions. All the NCUA mandated disclosures were provided. All of the notice deadlines were set. NCUA's objection was to the way the disclosure statement was folded. NCUA's decision to invalidate the ballot, according to a Texas magistrate, was arbitrary and capricious and an abuse of its authority.

Question #4

NCUA requires certain disclosures each time a credit union seeking to convert sends a written communication to its members regarding the conversion. You object to the mandatory disclosure. It seems to me this is no different than dozens of other disclosures mandated by federal law. The material is purposefully duplicative in order to ensure that as many members as possible read the information. Why is it that you think this disclosure is so much worse than any number of other disclosures required by the law?

The decision of a credit union to convert its charter is extremely important. To make an informed decision, members need to have sufficient information on the merits of the proposed charter conversion. That information must be neither false nor misleading. Congress acted in 1998 to ensure that members are adequately informed and that appropriate disclosures are made (consistent with disclosures required by banking regulations).

However, NCUA's mandatory disclosures are misleading or speculative. The subjective format and tone of the disclosures does little to promote thoughtful consideration of facts by credit union members. The effect of the box, the highlights, the capitalized, bold language, is to achieve one purpose – to encourage credit union members to vote against any conversion proposal. The required disclosures do not encourage an unbiased, fair review.

We believe that credit union members are entitled to timely notices and to proper information in the notices that lays out the relevant facts, free from requirements for unsubstantiated speculation on future actions or unfounded assertions of motives.

Question #5

Having a choice of which charter a financial institution wishes to embrace and the ability to change to another is essential for competition and innovation ultimately providing better services for the members or returns for the shareholder. Should we be concerned that credit unions will forgo a change in their charter not based on what is best for their members, but rather because of overly burdensome regulations imposed by the NCUA?

The conversion process as it is now administered by the NCUA has cast a chilling effect on future credit union conversions. Comparing the rules promulgated by NCUA with those of the banking agencies clearly shows that the NCUA – by design – makes it more difficult and less likely for a conversion to take place. While it is a relatively easy process to switch between other financial institution charters, the NCUA seems more concerned with preventing conversions and distorting the credit union charter rather than allowing credit union members to determine what business model best fits their future needs. Simply put, credit unions are being held hostage by NCUA through its overly burdensome regulations.

