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Mary Rupp, Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, Virginia 22314-3428

Re: Umholtz Comments on Proposed Rule Part 708b, Disclosure of Merger Related Compensation

Dear Ms. Rupp:

I appreciate having the opportunity to present my comments to the Members of the NCUA Board concerning Proposed Rule Part 708b regarding the Disclosure of Merger Related Compensation. My comments are intended to be candid and, where critical of NCUA, are not intended to be disrespectful. If you have any questions concerning these comments, please feel free to contact me for clarification or elaboration.

Minimize Regulatory Obstacles, Reduce Burden, and Facilitate Mergers
My comments articulate a point of view founded on the concept that merger rules should be reasonable and that such mergers should be accomplished with reasonable costs. Should a credit union's leadership determine that merging is desirable for strategic business reasons, the NCUA should readily facilitate rather than obstruct that merger. It is the role of all regulators to minimize regulatory obstacles, reduce burden, and facilitate legitimate business decisions regarding mergers made by a federally insured financial institution.

Despite the fact that NCUA has selected to receive comments on this section governing a single element of the merger regulations, it has publicly stated its intent subsequently to revisit many other regulatory aspects of the merger process. I believe merger regulation must be considered within the context of the broader issues of credit union governance, the rights and limitations inherent in credit union membership, and a credit union's responsibilities to the larger community in which it operates. Therefore, I urge the NCUA Board to present all remaining merger related proposed regulatory changes in a comprehensive manner rather than piecemeal.

Additionally, all the regulatory elements affecting mergers should recognize the compelling need for the industry to consolidate in order to improve its overall safety and soundness, as well as preserve the integrity of the National Credit Union Share Insurance Fund. NCUA regulations should support an individual credit union's right to implement its own strategic business decision to merge with another financial institution. NCUA should avoid promulgating any new impediments to rapid consolidation of the credit union industry, as well as remove any existing impediments.

Merger Related Compensation Disclosure Has Merit

Generally, reasonable disclosure of merger information, including compensation of key credit union officials, is good public policy. The recent merger between Nationwide Federal Credit Union, Nationwide Bank, and Nationwide Financial Services, Inc. serves as an example of a merger vote implemented with the utmost transparency. In addition to providing significant member-focused information on its web site, Nationwide FCU posted a copy of the merger plan and agreement. This was a commendable effort on their part that provided the maximum disclosure to those who were asked to vote on the merger.

Since it was available via the Internet, any interested media reporter and any individual member of the general public also had full access. The result of this transparency was a 40% eligible-voter participation level and an overwhelming 89% approval of the merger. It also resulted in widespread acceptance of the merger within the larger credit union industry and the affected local communities.

The NCUA Board should expand access to the merger related compensation disclosure and supporting records beyond just the credit union's membership. Media reporters, industry consultants, competitors, and the general public should be allowed access. This expansion would demonstrate NCUA's responsiveness to Congressional calls for increased transparency, accountability, and verifiability.

Member Review of Merger Related Compensation Records

The NCUA Board Action Memorandum for Part 708b regarding merger related compensation states, "NCUA notes that the creation of a member inspection right in the context of merger related compensation arrangements is specific to these limited circumstances…In accordance with settled rules of construction, a more specific provision in a rule takes precedence over a broader provision of general applicability… The proposed rule would permit a member to review merger related compensation records without making or retaining copies at 'an' office of the credit union, including branch office locations."

Ironically, the NCUA Board proposes a much more reasonable access to records regulation for merger related compensation than it does for the companion proposal regarding 12 CFR §701.3, "Member Inspection of Credit Union Books, Records and Minutes." Specific comments about that proposed regulation are provided to the NCUA Board under separate cover.

The more limited rules governing access to merger related compensation records should be the model for the broader application of member access to credit union records regulation. In addition, the credit union should be allowed to require a signature on a confidentiality agreement prior to allowing an individual member to review the merger related compensation records detailing the arrangement. Few other industries would open up proprietary or competitive information to its customers without such an agreement.

NCUA Over-reaching Feared for Merger Regulations

There is abundant cause for concern about how NCUA would implement the merger related compensation disclosure provision based upon its recent ill treatment of credit unions under the agency's regulations concerning credit union conversions to the mutual savings bank charter. It became quite clear in those rules that NCUA intended to substitute its judgment as to what constitutes a "fully informed" member for that of a credit union's leaders. In the NCUA Board Action Memorandum prepared for 12 CFR Part 708b concerning merger related compensation, NCUA states the same "fully informed" expectation.

Also, recent history suggests that NCUA would substitute its judgment as to which "...merger decisions are based upon the best interests of the members…" Rather than NCUA, each of the credit union's members should decide for himself or herself what is in their own best interests. This will also protect NCUA from inadvertently imposing a misguided socio-political interpretation about what credit union members want. Let members vote on the merger plan and agreement as presented to them by the merging and continuing credit unions' leaders. There is no need for the inappropriate enforcement of 'movement philosophy' that NCUA appears to champion despite the lack of a statutory mandate. As it applies to mergers, NCUA should be a hands-off, arms-length regulator that does not force its own concept of what is best for members on the industry.

NCUA Should Avoid Alarmist Language and Improper Folds

The proposed regulation raises concerns that NCUA would require misleading and alarmist "boxed language" about a merger related compensation arrangement or disqualify mergers due to "improper folds" in the compensation disclosure materials. According to the NCUA Board Action Memorandum, "The proposed rule would simply require a description of these arrangements in the merger plan and, in the case of a merging federal credit union, disclosure of their existence to the membership before their vote on approving the merger." Let's hope that this stated expectation for simplicity is taken literally by the NCUA Board and regional directors, and does not instead provide a platform to obstruct mergers at the whim of individual agency personnel.

The NCUA Board Action Memorandum states, "…the Board notes it does not intend to substitute its business judgment for that of the boards of the merging and continuing credit unions on marketplace demands and reasonable compensation arrangements." Despite its history of inappropriate interference on similar matters, it is hoped that NCUA will make good on this promise when it comes to actual merger related compensation. Unless the merger related compensation is so excessive that it is a safety and soundness concern, it is none of NCUA's business.

CU Responsibility to Achieve Best Merger Related Compensation Deal
The NCUA Board Action Memorandum states, "The NCUA Board is concerned that prospective merger partners may seek to improperly influence the outcome of deliberations by a board of directors of the merging credit union." Although it was probably not intended, this statement is an insult to the volunteer board members and senior management at the nation's credit unions. A merging credit union deserves to get the best deal from the continuing credit union that it can, including member payouts and executive compensation and/or severance. To do less would be shirking the board's fiduciary duty to look out for the best interests of the credit union, its membership, and their future. Regardless of these credit union leaders' influences or motivations, it is their job to decide on their merger partner and the details of the merger plan and agreement, not NCUA's.

Both the NCUA Board and the industry that it regulates have a vested interest in ensuring that mergers occur expeditiously. The NCUA Board has a responsibility to ensure the safety and soundness of individual institutions and guarantee the share insurance fund's ability to keep credit union members' savings intact. The credit union industry's very existence is contingent upon ensuring healthy and viable individual credit unions. Currently there are a large number of NCUSIF-insured institutions with zero or negative growth, growing delinquencies, and rapidly eroding capital. This does not bode well for NCUA or the industry. More mergers are the cure for this malady.

As some pundits have observed, many credit unions are in the process of "self-liquidating." The industry would be better served if these credit unions consolidated their assets and members with larger, financially healthy, full-service institutions. To ensure an industry-saving vigorous rate of consolidation, merger incentives are essential. This deal-making factor is especially needed if NCUA intends to obstruct the alternative tactic of unsolicited or so-called "hostile takeover" mergers, as appears to be the case.

Credit Union Industry Must Consolidate to Remain Relevant
In its own 2006 year-end analysis, NCUA reports, "There is a distinct difference in the performance among the different [federally insured credit union] asset groups. Net worth ratios are solid among all asset groups with the largest percentages being reported in the under $10 million asset group. The highest return on average assets, loan growth, and loan to asset ratio is noted in the over $500 million asset group, with this group being *the only one to report positive share, asset, and membership growth for 2006.*" [Emphasis added.]

The $500 million and greater asset peer group has just 287 credit unions representing 54% of all assets. The $10 million and under peer group includes 3,805 credit unions representing 2.0% of assets. Despite relatively healthy capital levels, this smaller peer group's asset quality and long-term sustainability are questionable. There are 7,162 credit unions under $100 million in assets representing 18.1 % of assets.

$100 million is the size at which a credit union begins to reach the ability to thrive in a highly competitive environment. The 1,200 credit unions with over $100 million in assets representing 81.9% of total assets are the industry's best hope for future marketplace relevance and survival as a unique industry.

NCUA Should Facilitate All Mergers and Stay Out of the Way

NCUA's appropriate role in the merger process is a simple one: protect the safety of credit union members' savings while staying out of the way of strategic business decisions made by individual credit unions. Every regulation governing mergers should reflect this expectation. Additionally, the anachronistic FCU bylaw requirements governing membership votes, the low thresholds for calling special meetings by disruptive dissidents, and the supposed legal rights ascribed to credit union member "ownership" of the institution, should be revised in order not to undermine mergers. It is long past time that these structure, ownership, and governance rules reflected the needs of 2007 rather than 1937.

Your questions concerning these comments and any requests for additional information are welcome.

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Marvin Umholtz is President & CEO of Umholtz Strategic Planning & Consulting Services based in Castle Rock, Colorado south of Denver. He is a 30-year credit union industry veteran who has held many leadership positions with credit union organizations and financial services industry vendors during those years. An accomplished speaker and former association executive, he candidly shares his credit union industry knowledge and insight with public policy makers, financial industry executives, and vendor companies. In collaboration with GRFI/The Frerichs Group www.grfiltd.com, he provides credit unions with merger evaluation and targeting services. Umholtz also helps financial institution boards and CEOs with strategic issues like growth, technology, charter conversions, regulatory compliance, media advocacy and vendor management. Additionally he serves as membership director for the Coalition for Credit Union Charter Options www.ccuco.org.