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To: _Regulatory Comments

Subject:

I am commenting on the proposed regulations to govern the merger of a federally insured credit union (FICU) or conversion to a financial institution other than a mutual savings bank.

The proposed regulation is intended to achieve the following goals;

- Protection of member interests in transactions where members have a great deal at stake because members have a great deal at stake because the transactions involve a fundamental change in their ownership or the structure of the credit union (change in charter or termination of federal account insurance).
- Address concerns regarding extinguishment of member ownership.
- Address concerns regarding member voting rights.
- Address concerns regarding the loss of federal deposit insurance.
- Improve members understanding of the risks and rewards of mergers and conversions.
- Provide flexibility, fairness and impose minimal regulatory burden on credit unions whose members choose to pursue any of these transactions.
- Protect the National Credit Union Share Insurance Fund (NCUSIF)

I will comment on each of the proposed goals.

- **Protection of member interests in transactions where members have a great deal at stake because members have a great deal at stake because the transactions involve a fundamental change in their ownership or the structure of the credit union (change in charter or termination of federal account insurance).**

The National Credit Union Administration (NCUA) is faced with a significant change in the financial services market place. In the years since credit unions were first created changes have occurred that require a much different type of organization to serve members than the original credit union. The first credit unions functioned very well as small organizations largely run by volunteers with minimal services (regular shares and limited loans) that operated in sponsor provided space or very small offices owned or rented by the credit union. The changes that have occurred over the years have created a much more complex operating environment with more significant risks, great member demands for service, less sponsor support, great competition from other service providers, many more delivery channels, computerized record keeping, internet delivery, a shift from sponsor supported to community fields of membership and a host of other changes. Today about half of all credit unions are probably too small to compete effectively in the today's market place and provide the level of services that members demand, meet the ever increasing requirements of risk management and operate at an efficient level that provides for both member value and safety and soundness.

The most fundamental member interest in a credit union is to obtain needed financial services at a reasonable price with reasonable convenience, with competent advice, reasonable member service, safety of deposits, safety of data, and competitive rates. Members do not have a legal right to the equity of the credit union except in liquidation. There is no clear ownership right. Most members have no understanding of what type of charter the credit union operates under—nor do they care. Most members never vote. Most credit union Board members are nominated and run without opposition. Most credit union annual meetings or meetings of members have only a handful of members attend. The bottom line is except in crisis situation members don't participate in the governance of their credit union. The members value their credit union as means to meet their financial service needs. They value the credit union as an institution that acts in their best interests.

The members interest in the credit union is not an ownership interest; members have a limited stake in the form of organization (charter) but members do have a vital interest in the quality of member service and clearly have a major interest in the type of share insurance.

The National Credit Union Administration has conflicting roles in helping to protect the member interests. The NCUA is both regulator and promoter of credit unions. These two roles conflict with each other. NCUA has played a major role in maintaining the status quo during a period of time when credit unions need to change. Thousands of credit unions need to consolidate or franchise or in some way achieve the scale and resources needed to meet member needs. NCUA in its role as promoter has made major initiatives to preserve and protect small credits. Ironically the NCUA is, in my opinion, acting against the best interests of members. Small credit unions are disappearing not because they are small but because they can't meet the financial service needs of their members. NCUA for years has used the CAMEL rating to determine safety and soundness in credit unions. The NCUA needs to add an S to the CAMEL for service. Member service is the most important determinant of financial success and ultimately determines safety and soundness because it determines how much revenue the credit union will have to support sound business practices. Member service is the primary interest that NCUA should protect.

NCUA should in fact be looking at making changes to the ownership and structure of credit unions rather than trying to preserve a status quo that is not meeting member needs. NCUA should be making changes to credit union ownership, structure, field of membership and broaden the ability of credit unions to merge, change charters or do whatever else is in the best interest of credit unions.

- **Address concerns regarding extinguishment of member ownership.**

And

- **Address concerns regarding member voting rights.**

What exactly do members own? They don't own the equity of the credit union. Members don't have a legal right to any of the assets of the credit union. So, what rights do members have? Members have a right to vote, one vote for each member regardless of their shares. NCUA should protect that right.

The member right to vote needs protection but it also needs to be reinvigorated. Most members do not vote. The right to vote for the Board—the most important vote is often denied to the members. Most Boards nominate only one member for each open Board position and the nominee is elected by acclamation. There are rarely members who run by petition. The attendance at credit union annual meeting is very low—mainly staff and volunteers.

If NCUA is serious about member ownership the following should be considered;

- Require a member vote for each Board position—regardless of how many Board members are elected to each position.
- Require an annual report is available to each member on the credit union's web site; at all member branches and in the member newsletter.
- Allow credit union's to offer capital shares that count as additional capital and represent an ownership interest in the credit union. Owners pay attention to what is happening.

The credit union system is broken to the extent that when members needs are not met, then their only practical option is to move their account to another institution. In the banking world when a bank fails to meet the needs of its customers, its stock price declines. The decline in the value of the bank prompts the owners or interested buyers to make changes. The credit union system doesn't have that mechanism. The lack of that mechanism is the biggest challenge to the member's interests.

The economic data supports the conclusion that there are thousands of credit unions that are losing members, losing shares, losing loans and in reality are self liquidating. The self-perpetuating Boards, the lack of member participation in the voting process and the lack of a clear ownership interest lead to the only solution the member sees—move to some other institution that will offer the needed services.

NCUA should be more concerned with how well a credit union is serving its members. A credit union charter is subsidized by the tax advantage. Boards and management should be accountable for how well they serve their members. That accountability is lost because the members are not engaged in monitoring the performance of credit union management and the Board in the same way that bank owners monitor their management and Board performance.

- The most important problem with member voting rights is that members are not using them. Members are not monitoring the performance of Board and management. Members are not holding anyone accountable for the performance of the credit union. Members vote with their feet. NCUA needs to create an ownership interest. It is lacking and it is a significant weakness in assuring credit union success and safety and soundness.

- **Address concerns regarding the loss of federal deposit insurance.**

I believe that federal deposit insurance is the best deposit insurance solution for members. But I respect the right of states and credit unions in those states that allow private insurance to make that choice. NCUA again has a conflict of interest given that half of their operating budget is paid for by the federal deposit insurance fund. NCUA should remove that conflict of interest.

Any credit union that converts to private insurance or merges into a credit union with private insurance must be required to fully disclose the benefits and risks of such a change.

I would recommend that NCUA make the following changes;

- NCUA should eliminate the conflict of interest with regard to federal deposit insurance. The best way to do that is to have the cost of examination fully paid for by fees assessed to Federal credit unions and Federally insured state chartered credit unions. The overhead transfer from the insurance fund to pay for NCUA's safety and soundness examination and the agency operating costs is both unfair and a conflict of interest.
- NCUA should require the credit unions to hire an independent third party (I recommend a CPA firms) to analyze the risks and benefits of the loss of federal deposit insurance and disclose those risks to the members as part of the credit unions disclosure during a merger, charter change or insurance conversion.
- **Improve members understanding of the risks and rewards of mergers and conversions.**

The merger process is process that involves the Board and management but largely excludes the membership from much of the facts and considerations that lead up to the members vote on the final choice. The membership has the right to vote but only after the merger partner has been selected. There is no member notice that a merger offer has been rejected. Members need to have access to more of the information that the Board considered in making the final choice of merger partner or in deciding to reject a merger.

The credit union movement was rocked by debate regarding the “hostile takeover” of one credit union by another. The debate ignored the other side of the issue. The other side of the issue is that many credit union boards fail to provide their members with the level of service that meets their needs. One can say the other side of the problem is “hostile retention” in which the Board and management hold on to control regardless of performance or member satisfaction. That leaves members with the alternative of unseating the board or moving their account. The fact is most members just move their accounts to some other institution.

With regard to mergers I would recommend the following actions by NCUA;

- NCUA should require credit unions to submit their due diligence review to NCUA as part of their application for merger approval. NCUA should provide guidance on appropriate due diligence procedures to assure that the Board has considered the best interests of the members.
- The merging credit union should be required to share with the members which credit unions submitted merger proposals and why they selected the proposed merger partner.
- Credit Union Boards should be required to disclose to members which merger offers they rejected and why the merger offers were rejected.
- NCUA should not prohibit dividend bonuses or other inducements to members as part of the merger process. If the two Boards agree to a dividend payout as part of the merger they should have the right to do that. A merger can reduce costs. Merging credit unions should have the ability to share those savings with members.
- NCUA should include member service as a part of the CAMEL review. A credit union which has low levels of member satisfaction or shows other evidence of not meeting member needs is as much a problem as a credit union which has capital problems, asset quality problems, management problems or liquidity problems. A credit union charter comes with the responsibility to promote thrift and provide access to credit in return for a right to conduct business as a tax exempt credit union.
- I assume laws already exist at the state and national level to make it illegal for a Credit Union Board member or management official to violate their fiduciary responsibility to members. In a merger or conversion Board members and management must act in the member’s best interest. If the current laws are not adequate to assure that the process is conducted in a way that assures the member’s best interests are served, then the NCUA and state credit union regulators should adopt regulations to that effect and ask that Congress and the State legislatures adopt laws to make it a crime to make false statements in order to induce members to merge, change charters, convert to private share insurance or any other transaction which would harm the member’s interest. Again this is an area where NCUA has a conflict. NCUA is harmed by charter changes, private share insurance or conversions to a non-credit union charter and is therefore in conflict as to whether or not to approve such changes. The best solution is to have the legal system address those cases where members were misled or in which management and the Board violated their fiduciary responsibility
- **Provide flexibility, fairness and impose minimal regulatory burden on credit unions whose members choose to pursue any of these transactions.**

Charter conversions to a mutual savings bank charter are essentially impossible given the hostile climate within the credit union industry and NCUA’s apparent opposition to such charter changes. Congress was clear in its intent to allow credit unions to make charter changes to mutual bank charters. I don’t disagree that the banking industry helped facilitate the law so that credit unions would disappear. But we lost that fight with Congress. NCUA can’t be a regulator and judge in disputes between members and their credit union. We have a strong legal system. If members have been harmed they can go to court. NCUA should allow the courts to deal with misdealing, misstatements or any other deceptions made by Boards, management or third parties that cause mergers, charter changes or changes to private insurance. If Congress and the state legislatures need to pass laws then NCUA can help lobby for such laws. NCUA has clear conflict—mergers, charter changes and private share insurance all impact NCUA’s budget and scope. NCUA has to make sure that it too is acting in the best interest of members, credit unions and the nation.

- NCUA should be careful not to appear to be obstructing conversions to mutual savings bank charters.
- The members are not fully engaged in their credit union’s governance. NCUA could change that

by allowing some form of member contributed capital and member ownership. The best protection for members is their engagement in the credit union's governance.

- NCUA could also increase member involvement in credit union governance by requiring a member vote on all Board members even when the Board member is unopposed for election.
- NCUA could require an independent third party—such as a CPA firm to render their opinion on the representations made by management and the Board in mergers, charter changes and private share insurance.

- **Protect the National Credit Union Share Insurance Fund (NCUSIF).**

The best way to protect the share insurance fund is create a vibrant and successful credit union system. The system is under threat because many credit unions no longer meet the needs of their members. The CAMEL rating system is based on a series of trailing indicators of credit union success. The leading indicator of credit union success is member satisfaction and a measure of how well the credit union is meeting the needs of members.

- Add an S to the CAMEL rating for member service.
- NCUA should remove any obstacles that would limit consolidation within the credit union system. Consolidation is probably best achieved by a cooperative solution such as the “ACE Hardware” model in which thousands of independent hardware stores formed a cooperative to better serve their customers. NCUA should create an environment that welcomes such solutions. But NCUA must also welcome mergers. More importantly NCUA must require that credit unions that have a charter meet a reasonable standard of member service. The biggest risk to the insurance fund would be if credit unions become irrelevant to their members.
- Allow broad fields of membership. Diversity of members, diversity of geographic areas and diversity of demographics is one of the best ways to protect the credit union from many operational risks.

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