**LUSE GORMAN POMERENK & SCHICK**
A PROFESSIONAL CORPORATION
ATTORNEYS AT LAW

5335 WISCONSIN AVENUE, N.W., SUITE 400
WASHINGTON, D.C. 20015

TELEPHONE (202) 274-2000
FACSIMILE (202) 362-2902
www.LuseLaw.com

WRITER'S DIRECT DIAL NUMBER
(202) 274-2030

WRITER'S E-MAIL
RGarabedian@LuseLaw.com

April 30, 2008

**Via Hand Delivery and E-Mail**

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

**Re: Luse Gorman Pomerenk & Schick, P.C.**
**ANPR and Request for Comment**

This letter is in response to the Advance Notice of Proposed Rulemaking ("ANPR") issued by the National Credit Union Administration ("NCUA") with respect to, among other things, conversions of federally insured credit unions into mutual savings banks ("MSB Conversion") and mergers by federally insured credit unions into other types of financial institutions.

We appreciate this opportunity to comment on the ANPR. Luse Gorman Pomerenk & Schick's attorneys have successfully completed 15 charter conversions and have been involved with this process from its infancy; accordingly, we believe our perspective on the process will be valuable to the NCUA. We have also handled more capital raising transactions for former credit unions than any other firm in the country. In addition, our firm is the leading firm in raising capital for thrift institutions over the past seven years and one of the leading firms in representing banks and thrifts in merger transactions.

In addition, we represent dozens of publicly traded financial institutions. Almost every partner in our firm has either worked for the SEC, the IRS or one of the federal banking agencies. We are thus very familiar with the requirements of drafting meaningful disclosure for investors and shareholders in the context of mergers, capital formation and proxy statements. We also have extensive experience in counseling our clients, both in mutual and stock form, in matters of corporate governance and the fiduciary duties of a board of directors.

**General**

We believe the MSB Conversion process, based on *current* NCUA regulations, is unnecessarily burdensome and costly. If the ANPR results in additional regulations such action will in most cases increase the burden and the cost without a meaningful corresponding benefit. It also increases the burden on the NCUA which must police more and more regulation when its resources could be devoted to other areas of greater concern to the industry such as asset quality, profitability and modernization of the charter. Accordingly, in light of the limited number of MSB Conversions over the past 12 years we believe that no additional regulations are appropriate. The NCUA's existing authority is more than sufficient to address particular concerns if and when they arise. As noted below, there has been a paucity of documented cases where the MSB Conversion did not comply with the applicable rules.

Our impression is that the industry generally believes that the only reason a credit union would choose an MSB Conversion is for the self-enrichment of the directors and officers. We think that is wrongheaded. Why trade a tax-free charter for a taxable one is a fair question to ask. Much of that is answered in the Credit Union Regulatory Improvements Act ("CURIA") through which credit unions want to avail themselves of the same rules that banks and thrifts operate under. There is plenty of data available from the NCUA and the FDIC reports of condition that document that credit unions that have converted generally remain just as competitive as they did prior to conversion. It is counter-intuitive to think that an institution is going to raise fees and loan rates and lower deposit rates just because they pay taxes. Such a course of action would be ill-advised since consumers have many choices and can easily find another credit union or bank with which to establish a banking relationship.

In our experience, the institutions that have sought this strategic option have considered it carefully, in many cases over a period of years. As the NCUA is keenly aware, the credit union charter has certain disadvantages that are addressed through a charter change. In particular, credit unions have been seeking regulatory relief (in the form of the CURIA, among others) in a number of areas that are remedied through the regulatory framework that applies to state and federal thrift institutions (e.g., capital standards, member business loans, unrestricted customer base). Therefore, credit unions should have available to them a charter option that can be pursued in a timely fashion, under a reasonable set of rules and without undue financial burden. In particular, interference by trade groups and organizations such as the National Center for Member Trust, who are under no fiduciary obligation to the institution and under no legal obligation to comply with the disclosure requirements, is clearly an area that the NCUA needs to address. The recent experiences of credit unions seeking to accomplish an MSB Conversion clearly exemplifies this problem.

Under the current rules, institutions that would otherwise be able to take advantage of the national policy established by the Congress in H.R. 1151 are discouraged by the burden and high cost associated with an MSB Conversion. One must ask is it a better choice to engage in more risky lending practices (widely publicized in the press), suffer limited growth or even be merged out of existence rather than to be able to choose a charter to help the institution remain independent over the long term?

**Credit Union Membership Access Act**

As a background to the discussion regarding the ANPR and MSB Conversions, it is helpful to review the statutory authority underpinning the NCUA's rulemaking authority as provided in the Credit Union Membership Access Act ("CUMAA"). The CUMAA specifically addressed MSB Conversions in order to establish a national policy that MSB Conversions are a charter option for credit unions and to provide a regulatory framework for MSB Conversions.

In particular, under CUMAA, the NCUA was required to "promulgate final rules that are consistent with the rules promulgated by other financial regulators, including the Office of Thrift Supervision and the Office of the Comptroller of the currency. The rules . . . shall provide that charter conversions by an insured credit union shall be subject to regulation that is no more or less restrictive that than applicable to charter conversions by other financial institutions." 12 U.S.C. §1785(b)(2)(G).

Further, the Congress established as a national policy that the (1) directors of a MSB may receive board fees (which is consistent with the ability of directors of existing MSBs to receive such fees and (2) that management officials of the former credit union may receive compensation and other benefits from the converted credit union in the ordinary course of business. Id. at §1785(b)(2)(F). In addition, since the Congress authorized the mutual to stock conversions of MSBs in the Home Owners' Loan Act, it well knew that a former credit union might convert to stock form or issue stock in a mutual holding company structure sometime in the future.

Under CUMAA and the NCUA's implementing regulations, the agency has oversight of the methods and procedures of an MSB Conversion. Specifically, the NCUA's regulation requires that the regional director determine "if the notices and other communications to members were accurate, not misleading and timely, the membership vote was conducted in a fair and legal manner and the credit union has otherwise complied with Part 708a." 12 C.F.R. §708a.8(a). Should the NCUA reach the conclusion that the communications and notices, or the manner in which the process was handled, did not comply with the noted standards it may disapprove the methods and procedures and may direct that another vote be taken. Id. at §708a.8(c).

**Conversions and Mergers into Other Institutions**

We believe that conversions into, or mergers with, institutions other than MSBs should be handled on a case by case basis until they become more commonplace. In any event, we believe that the NCUA has no jurisdiction to regulate subscription rights and stock benefits that apply to the surviving institution. The primary federal and state regulator of the surviving institution, whether it be the Office of Thrift Supervision, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Federal Reserve Board or the applicable state regulator, would be the determining body on such matters.

**Fiduciary Duty**

With respect to the question of adopting a federal standard of fiduciary duty, we believe there is no necessity for any action on the part of the NCUA to formulate a federal standard. First, imposing a federal standard upon state chartered credit unions is an undue intrusion into the state credit union regulatory authority and assumes that the NCUA posseses more expertise than the state regulator. The state regulator would be able to refer to precedent not only under its credit union code, but also look to its state corporate code and judicial precedent thereunder.

Second, a federal standard of fiduciary duty standing alone will lack a body of case law and judicial interpretation developed over many years. In the final analysis a board, as well as the NCUA, will most likely need to refer to state judicial precedent for guidance. With that perspective, we believe that a federal credit union would be better served by following existing state guidance. We do not see the risk of confusion among boards from state to state, as raised by the NCUA, since a particular federal credit union could easily obtain guidance from local counsel on the fiduciary duties that will apply.

**Insider Enrichment**

The NCUA expresses concern that with some MSB Conversions, credit union officials have pursued personal enrichment to the detriment of members. [1] In particular, the NCUA expresses concern that in connection with some MSB charter conversions family members of credit union officials have joined the credit union prior to the

[1] The NCUA noted, in the preamble to the most recent amendments to Part 708a, that "almost 90%" of the credit unions that have undergone an MSB Conversion have converted to a stock bank (which we interpret to mean that the former credit union either fully converted to stock form or utilized a mutual holding company to issue stock to the public). The actual number is about 50%. Even if the credit unions that merged into stock banks are counted (such as Nationwide FCU), the number is far below 90% and easily verifiable. An error of this nature should not be used to justify regulations (such as the boxed disclosure) that assume credit unions going through an MSB Conversion are preordained to issue stock.

conversion in order skew the membership vote or to share in the profits of any future stock offering. Thus, it requests comment on whether it should adopt a specific rule regarding the record date for members voting on a charter conversion or other transaction (although the NCUA does not provide any example outside the context of a MSB Conversion where this is a perceived problem).

In its most recent revisions to the charter conversion regulations, the NCUA set a voting record date in Section 708a.6(b) that must be at least one day prior to the notice to members regarding a possible conversion of the credit union. Thus, with respect to MSB Conversions the NCUA has already addressed this issue and we can see no further need for additional rules. The earlier this date is set, which is already at least five months before the vote is taken (well in excess of the time under general principles of corporate governance established under the rules of other federal or state banking agencies or state corporate codes), the greater the disenfranchisement of those members that joined the credit union after the voting record date.

**Distribution of Equity**

We believe that the amount, if any, of a merger dividend in the context of a credit union to credit union merger is best vested in the discretion of the board of directors and the negotiations between the merging credit unions. The formulation of a merger dividend is an art, not a science, and it only rewards depositors not borrowers. It is borrowers, however, that largely generate the earnings that build the credit union's capital. Although depositors do supply funding for loans, there are other sources of funding such as Federal Home Loan Bank advances. Further, a saver for one day can receive a windfall whereas a long-term depositor with a small deposit balance may not get any greater recognition. Vesting this decision in the board of directors rather than through some regulatorily imposed mathematical process unduly intrudes into the board of directors decision making process. The NCUA cites no documented cases where the board may have acted improperly in connection with a merger transaction. Furthermore, the agency is free to ask questions regarding a dividend during the merger application process.

The NCUA also notes the distribution of equity (with a small premium) that occurred in the Nationwide FCU merger with Nationwide Bank and implies that that may be a good model to require a distribution of equity with an MSB Conversion. The Nationwide transaction is clearly inapposite to an MSB Conversion for a number of reasons: (1) the members of the credit union did not, and could not, continue as members in Nationwide Bank, a stock form institution, (2) the merger was in essence a liquidation since the members' capital could not be abrogated by the stock form institution and had to be distributed to the residual "owners" of Nationwide FCU, (3) it intrudes into the capital sufficiency jurisdiction of the chartering authority and the FDIC and (4) requiring

such a distribution clearly exceeds the authority of the NCUA under the CUMAA standards.

The NCUA also implies, as a basis for requiring a distribution of equity in the context of an MSB Conversion, that "many" of the converting credit unions "seek to convert when their net worth is high." Further, "[i]n in some instances the conversion appears timed to occur after a period when the credit had purposefully acted to increase its net worth." The NCUA does not discuss what constitutes "many" or what "high" means or how it measures high (i.e., as a ratio or in absolute dollars).

We believe this concern is misplaced. The level of a credit union's capital is one of the primary factors reviewed by the chartering authority and the FDIC in acting upon an MSB Conversion. Under the FDIC's statement of policy regarding the granting of federal deposit insurance to de novo institutions (which applies in many respects to converting credit unions), an institution must have at least an 8% tangible equity ratio throughout the three year business plan submitted with the application. Further, an institution may require more capital depending upon its growth and business plans. If a credit union has no plans to raise equity in the near term following an MSB Conversion, it may require much more capital than the regulatory minimums. In sum, as with a merger of credit unions, this decision should be vested in the discretion of the board of directors.

**Communication to Members**

The NCUA has requested comment on whether it should adopt additional rules regarding communications to members in the context of a MSB Conversion. This includes prohibiting the credit union from stating or implying that NCUA has endorsed the charter change as well as ensuring that the statements to members are accurate and not misleading. The NCUA cites a few examples regarding the changes that may affect the operations of the credit union following an MSB Conversion, such as continued access to shared branching, surcharge free ATMs or office space. Under current regulations the NCUA has oversight of the methods and procedures of an MSB Conversion and established disclosure standards. Under the authority noted above, the NCUA reviews all communication materials to the members and has the opportunity to ask questions about any of these items as well as to provide suggested disclosure. Id. at §708a.5.

Although we can only speak with regard to the MSB Conversions that this firm has handled, we do not believe that our disclosure documents state or imply that the NCUA or any other agency has endorsed the MSB Conversion. The NCUA is free to comment upon any disclosure that implies or states that the NCUA is endorsing the MSB Conversion. During this process the NCUA is also free to enquire about any issues,

whether it is shared branching, access to free ATMs or use of existing office space. In short, we believe additional disclosure standards are not necessary. If the board of directors has properly done its due diligence it should know the answers to questions concerning shared branching and the like without the necessity of additional rules.

Against this backdrop it is interesting to note that to the best knowledge of this firm that since the passage of the CUMAA the NCUA has only in one case disapproved an MSB Conversion under the noted standards. We are also not aware of any cases prior to the passage of CUMAA where the NCUA disapproved an MSB Conversion based upon similar considerations. Thus, the need for additional regulation to require full and accurate information would appear redundant and unnecessary since it has been the exception to the rule where the NCUA concluded that the methods and procedures failed to comply with the applicable standard set forth in the regulation. Id. at §§708a.4(e), 708a.8.

**Member Voting**

As background to the NCUA's solicitation of comment on various aspects of the member voting process, a review of member participation in MSB Conversions is warranted. In our experience with MSB Conversions, and observing other MSB Conversions as well, an overwhelming majority of the credit union members do not vote. Thus, despite three notices of the special meeting mailed to the members, reports in the press and other media and the efforts of opposition groups, members remain disinterested, apathetic and unmotivated. It is hard to understand this level of participation when despite these efforts voter turnout remains low. One explanation is that the members either agree with the change or do not care what type of charter their institution has as long as the institution provides good rates and services. Human nature is such that an individual who opposes something usually speaks out. This pattern should be of no surprise to the industry and is easily documented through the NCUA's own records of MSB Conversions.

It is important to encourage members to vote. In an effort to encourage the members to vote, institutions hold informational meetings, call members and also use door prizes. In sum, the NCUA should not adopt any rules that discourage an institution from encouraging its members to vote. Furthermore, the recent efforts of the NCUA to provide more disclosure and communication among members does not seem to have counteracted the malaise among the membership. With regard to the NCUA's specific questions on this topic, we submit the following comments.

**Recount.** The NCUA requests comment on providing the members the right to request a recount and under what circumstances and criteria a recount should be undertaken, as well as the procedures for doing so. In support of this request, NCUA

cites a number of circumstances where improper procedures were used. As noted above, to the best of our knowledge, the NCUA has only ruled in one case that the methods and procedures utilized by the credit union failed to comply with the applicable standards. This is not to say that a recount may not be warranted, but it should only be granted if it would affect the outcome and if a sufficiently large number of members request that a recount be taken. We believe this threshold should be at least 5% of the members (with no maximum) and be coupled with a documented case rather unfounded allegations and heresay. Due to the costs involved in conducting a recount it is imperative that a fair process be used.

**Employee Solicitations.** A credit union, as is the case with any corporate entity, can only act through its authorized representatives, such as employees. Prohibiting employees from soliciting the votes has serious shortcomings. First, we agree that employees should not be pressured or required to solicit members to vote whether in person or by telephone. Again, the NCUA references that this has occurred with "some" credit unions and yet the agency has only once, to the best of our knowledge, invalidated a vote where this apparently occurred. Should it occur in an MSB Conversion or other transaction, the agency would otherwise have the power to take the appropriate action to remedy the infraction.

Second, communication by employees with the members, whether in person or by telephone, is critical in the conversion process to encourage voting. Where does one draw the line between answering questions or soliciting a vote? How can it be practically enforced? Can the employees speak to members in a branch? The variations are limitless. If an institution does not communicate with its members on a topic such as an MSB Conversion, they will think the institution has something to hide. Further, in light of the propensity of dissident groups to spread false and misleading information with impunity not only about the institution, but the personal character of the board and management, direct personal contact is essential. Why the NCUA has continued to overlook this conduct deserves to be addressed. Certainly if a member is going to provide a link to the National Center for Member Trust's website in a member to member communication, the content of that website must be regulated since it is tantamount to sending that information to the member. An institution must be able to communicate one-on-one with a member and should not be limited to impersonal mass communication. In this regard, we would be happy to discuss with the NCUA these websites, such as the one sponsored by the National Center for Member Trust, to point out the information that clearly fails the standards in the NCUA's member-to-member communication process.

Lastly, any initiative to prevent employee solicitation clearly exceeds the NCUA's rulemaking authority under CUMAA since such a prohibition, to the best of our knowledge, does not exist among any other federal or state regulator.

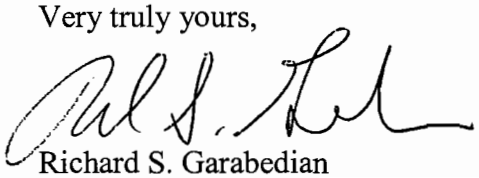
**Interim Tallies and Voting.** With respect to interim vote tallies, the NCUA noted in the preamble to the current rule that the 30 day ballot requirement mitigates any advantage that may be gained through interim reporting. 71 Fed. Reg. 77164. To date three MSB conversions have proceeded under the new rule. We question what has changed since the adoption of the rule that would support a regulation prohibiting interim tallies? In addition, without the tallies and knowing whether a member has voted or not, the institution is going to spend considerable resources by unnecessarily calling members that may have already voted. There is no good reason to impose this burden upon the membership or the institution through multiple phone calls or mailings. Releasing interim tallies to the membership taints the voting process by discouraging members from voting by giving the impression that their vote will not have an impact. Again, we are not aware of an rule of a federal or state regulator that would prohibit the financial institution from obtaining interim tallies or requiring interim tallies to be released to the membership.

With respect to the recent MSB Conversions the voting and balloting procedures handled by this firm (and likely by others) were submitted to the NCUA and authorized for use. These procedures included use of interim tallies, member solicitation and the method of handling member ballots. The NCUA's discussion seems to imply this process was not disclosed to the agency.

**Handling Member Ballots.** When a credit union handles a member's ballot it may raise concerns about the integrity of the vote if not handled properly. To avoid any issues in this regard, we believe the more prudent course of action is for the credit union to not handle ballots. We also believe, depending upon the nature of the specific credit union, that it be addressed on a case by case basis through the methods and procedures that are typically submitted by the credit union to the NCUA as part of its conversion submission.

We hope our comments are helpful in the NCUA's analysis of these issues. If you have any questions about this submission, please do not hesitate to contact Robert Pomerenk (x2011) or me.

Very truly yours,



Richard S. Garabedian