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July 27, 2006

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

Re: Umholtz Comments on Proposed Rule Part 708a

Dear Ms. Rupp:

I appreciate having the opportunity to present my comments to the Members of the NCUA Board concerning Proposed Rule Part 708a regarding the Conversion of Insured Credit Unions to Mutual Savings Banks. My comments are intended to be candid and, where critical of NCUA, are not intended to be disrespectful.

My comments articulate a point of view founded on the concept that conversion rules should be reasonable and that such conversions should be accomplished with reasonable costs. Should a credit union's leadership determine that converting to a mutual savings bank charter is desired for strategic business reasons, the NCUA should readily facilitate rather than obstruct that conversion. It is the role of all regulators to minimize regulatory obstacles, reduce burden, and facilitate legitimate business decisions regarding charter choice made by a federally insured financial institution.

Despite the fact that NCUA is exceeding its statutory authority to promulgate these unreasonable rules, I will comment in more detail on some of them in the hope that the NCUA Board will at least adopt some improving modifications. The ultimate determination of their validity is likely to be made by a judicial ruling on the inevitable lawsuit these rules will generate. If you have any questions concerning my comments, please feel free to contact me for clarification or elaboration.

Unreasonable Conversion Rules Cause Unreasonable Costs

In 1998, Congress enacted the Credit Union Membership Access Act, which among other provisions gave credit unions the option to convert to a mutual savings bank under streamlined rules. The legislation, which replaced NCUA's problematic rules from prior years, gave growth-minded credit unions an important strategic option. In practice, however, under the NCUA's implementation, the conversion process has become a minefield of uncertainty. Clearly, NCUA has overstepped its bounds by imposing a host of perhaps well intentioned, but clearly ill advised rules on the conversion process in 2003 and 2005, and again in June 2006 with these proposed new rules.

Regardless of whether a credit union's leaders have plans to convert charters or simply want to preserve the strategic option for the future, they should be particularly disappointed in NCUA's regulatory over-reaching on a business decision best left to the leaders and members of individual credit unions. These complex rules will not stop a credit union that is determined to convert, but the rules will certainly increase the cost of doing so. Attorneys and conversion consultants will have the most to gain since they will be able to justify higher fees once these NCUA rules become final.

Congressional Fix or Lawsuit Needed to Ensure Balanced Rules

The NCUA's newly-proposed conversion rules are a clear indicator that only a Congressional fix or a judge's ruling in a lawsuit can provide any hope of giving independent-thinking, growth-oriented credit union leaders a true conversion option at a reasonable cost and under reasonable rules. These NCUA conversion rules are probably more accurately described as "anti-conversion rules." NCUA seems singularly unwilling to act in a fair and impartial way, as befitting a regulator. Despite attempts to justify NCUA's authority to impose these over-reaching rules, by adopting these rules NCUA will be exceeding the agency's statutory authority and inviting lawsuits.

If applied to other credit union membership votes about board member elections, converting to a different credit union charter, merging into another credit union, or liquidating the credit union voluntarily, these NCUA conversion rules would never pass the reasonableness test. Clearly under such a comprehensive application, credit union governance would become extraordinarily hindered, and perhaps even represent a threat to safety and soundness.

NCUA's conversion rules concerning member communications with other members are a huge "gift" to the anti-conversion agendas of interfering state credit union leagues, the inappropriately meddlesome National Center for Member Trust, and any other deep pocket outside agitators. These are people who prefer to substitute their judgment for that of a credit union's own leaders and members by funding the anti-conversion efforts of a handful of dissident members.

Conversion Rules Invite Disruption of Prudent Governance

These rules unequivocally create an unbalanced bias that heavily favors those forces desiring to halt conversions. No federally insured depository, including a credit union, should be exposed to the reputation risk caused by a handful of individuals' questionable socio-economic or political agendas. When coupled with the dangerously low number of members required to call a special meeting to recall directors under the federal credit union bylaws, these conversion rules invite reputation risk and disruption to prudent governance.

The proposed NCUA conversion rules also accomplish the previously assumed impossible feat of making the mandatory disclosures even more hypothetical and misleading than they were before, which had already prompted H.R. 3206, the Credit Union Charter Choice Act, proposed by Rep. Patrick McHenry (R-NC). Now we see the

insertion of additional alarmist generalizations and questionable conclusions about member ownership, potential insider dealings, and savings and lending rates. These NCUA-mandated disclosures do not provide any balancing disclosure about what may be gained by converting, clearly illustrating the NCUA's anti-conversion bias.

The NCUA's existing conversion rules and the proposed new rules do not meet the statutory tests included in the Credit Union Membership Access Act of 1998. These NCUA rules are not consistent with the charter conversion rules promulgated by other financial regulators. The NCUA's rules also do not meet the statutory test to be "no more or less restrictive than rules applicable to charter conversions of other financial institutions."

Empowering Dissidents at the Expense of the Majority

Among the most egregious change evidenced in these new rules is the addition of numerous requirements with the net effect of delaying the majority memberships' vote on the plan of conversion. This delay disproportionately empowers a single dissident member to disrupt the conversion voting process. Such a dissident is provided with additional time and opportunities by NCUA to engage the financial support of outside agitator groups with questionable socio-economic or political objectives. History has demonstrated that it is these groups' mission to disrupt and obstruct membership votes, as especially evidenced at Columbia Community Credit Union and DFCU Financial.

It is quite clear in these rules that NCUA intends to substitute its judgment as to what constitutes a "fully informed" member for that of the credit union's leaders, and even for that of the individual member. The rules requiring advance notice of the credit union board meeting to consider the conversion proposal, the communications to members, the delivery of ballots to members, the required disclosures, and especially the member communications with other members, all contribute to an environment designed to empower dissidents, undermine credit union board governance, and derail the conversion vote.

The NCUA's rules appear founded on the prejudiced premise that a credit union charter is the best federally insured depository institution charter and that no other charter choice can be made by a "fully informed" membership. It would be more appropriate for a federal regulatory and insuring agency like NCUA to demonstrate its support of the efforts of any federally insured depository institution to organize under the charter that bests suits its business plan and operating strategy. These NCUA conversion rules will add more substance to the criticism that the agency is a cheerleader for the credit union industry rather than an even-handed safety and soundness regulator.

Advance Notice of Board Meeting to Consider Conversion Proposal is Extreme

It seems a bit extreme for a limited membership organization to be required to provide public notice in a general circulation newspaper concerning a credit union board agenda item prior to that governing body's consideration. After all, this is not a publicly traded company and it is not the general public's business. Even the requirements that the credit union announce the board agenda item on its website and with posters in the branches

seem immaterial and inappropriate. Should the agenda for all credit union board meetings that involve a membership vote topic like merger or board elections also require similar mandatory notice? Logic and consistency would suggest these same requirements should be imposed if it is made mandatory for conversions. However, ensuring that the requirements that NCUA imposes in section 708a.3 are voluntary and not mandatory better serves public policy.

NCUA's requirement in section 708a.4 that the conversion plan ballot only go out with the 30-day notice rather than at 90, 60 and 30 days has the practical effect of providing dissidents and obstructionists with an additional opportunity to disrupt and intimidate the institution, its officials, and its members. Anti-conversion forces contend that credit union members voting early in the process tend to vote for the conversion plan in greater numbers than those who vote during the last 30-day ballot. This provision inappropriately embraces that belief and seeks to skew the election results.

Despite its stated rationale, NCUA appears to be pandering to these few anti-conversion elements in the credit union industry by making the 30-day only ballot mandatory in an apparent attempt to influence the outcome of the vote negatively. Surely the vast majority of credit union members are intelligent enough to make up their minds decisively and vote with the 90-day first ballot, or either of the subsequent ballot opportunities. Once again, public policy would be better served by allowing this option for a single ballot at 30 days on a voluntary rather than mandatory basis.

Misleading Disclosures and CU Board Censorship Undermine Impartiality

Regarding section 708a.4(b)(4), NCUA states that the ballot may also indicate whether the credit union board recommends a vote for or against the proposal, but may not contain any other information. This censorship of the credit union board seems quite inconsistent with NCUA's stated objective to increase the amount of information available to members. This gagging of the duly elected board, in its communication to the members it represents about a significant business decision for the institution, seems counter to good public policy. When coupled with the misleading NCUA-required disclosures, there can be no doubt that the members' interests are not being served fairly. The net effect is that neither the NCUA-required ballot nor the NCUA-required disclosures meet the agency's intent that "Member notices must convey important information in an impartial manner so the membership can make an informed decision."

The NCUA conversion rules in section 708a.4 concerning the "boxed disclosures" have been severely criticized as misleading and speculative even before the new proposed changes. The proposed disclosures continue to be highly speculative and unnecessarily alarmist about changes in ownership and control, the potential for changes in rates and fees, the possibility and effects of subsequent stock conversion, the potential for profits by directors and senior management, and the costs of the conversion. The NCUA boxed disclosures should require an additional disclaimer that "The content of these NCUA-mandated disclosures are speculative about conversions in general and are based upon averages and incomplete industry-wide data at a certain moment in time. None of the

disclosures may apply to your financial institution specifically, should it convert its charter."

The boxed disclosures concerning benefits to directors and senior management should include additional language to make it more balanced. The proposed NCUA-required disclosure language reads as follows, "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 structure. In such a scenario, the officers and directors of the institution often profit by obtaining stock in excess of that available to other members." This language is a modest improvement over the currently mandated disclosure, but still does not provide an accurate picture.

The following language should be substituted for the last sentence, "If your institution subsequently converts to the stock form of ownership, it is also in every employee's, director's and member's best interest to buy as many shares as they can afford in order to profit from owning marketable stock individually in a well-run and growing financial institution. In a stock conversion, typically the member/depositors that invest in the stock receive excellent returns on their ownership investment. An individual's stock ownership can be converted to cash at a time chosen by the stock owner, unlike a collectively-owned credit union in which an individual member typically receives a fair market value of zero for his or her share of ownership."

More Balance in Mandatory Disclosures Required or None At All

Apparently, in NCUA's effort to provide simple and concise boxed disclosures, the agency has in effect denied members full explanations that provide a balanced, impartial perspective on the benefits of being a member/depositor of a mutual savings bank or of being an owner of stock in a subsequent initial public offering. Since the agency appears unable to provide a balanced boxed disclosure that sufficiently describes the potential transaction as it affects the specific converting credit union and specific member, public policy would be better served by requiring a much more informative disclosure or no disclosure at all.

Public policy would also be better served by NCUA disclosures that were more accurate and less alarmist. Conversion critics' attacks on a converting credit union's management and board members are without merit. There is no such thing as "unjust enrichment" in the highly regulated conversion process. The Office of Thrift Supervision (OTS) and the Federal Deposit Insurance Corporation (FDIC) have been safeguarding members' interests in mutual-to-stock conversions for more than 30 years with no negative impact on public policy.

Should a mutual savings bank decide to convert to the mutual holding company structure, all member/depositors, not just officials, have equal access to the stock offering. As with the pay of credit union executives, the institution's board of directors determines the compensation for mutual savings bank executives. But before any director or officer can receive any stock options, restricted stock or other forms of stock compensation, the

members must first approve a charter change and any subsequent stock offering must be approved by the member/depositors.

The OTS and FDIC govern all subsequent steps with strict rules that protect the interests of the member/depositors. For management, charter conversion and a minority stock issue bring a whole new level of accountability that the credit union charter currently lacks.

The newly proposed rules concerning the packaging and delivery of the boxed disclosures also do not appear to address the infamous "fold" issue that embarrassed the NCUA in court during 2005. Dropping the requirement that these disclosures go out with every communication is a productive move, despite the continued flaws in the disclosures themselves. However, the historical evidence suggests that the agency will continue being nitpicky and excessively bureaucratic in its review of notices and ballot procedures, thereby increasing cost and complexity for the converting institution and its members.

Requiring Member Communications with Other Members Invites Risk

There is no other way to describe the new requirements in section 708a.4(f) concerning member communications with other members as anything but wrong-headed and dangerous to the governance stability of federally insured credit unions. I cannot believe that this is NCUA's intent, but it will surely be the result.

I am a member of four federally insured credit unions located in three different states. I have chosen to do business with these financial institutions rather than with others, despite intense competition for my business. I have given these institutions access to my contact and financial information because I believe they need it to serve my personal financial services needs and desires properly. I did not provide that information in anticipation of having my credit union forced to disseminate to me questionable socio-economic or political dogma from crackpot anti-conversion dissidents.

According to NCUA, the new rules mandate that a converting credit union permit members to submit written requests to the credit union to disseminate information to other members at the expense of the requestor. The credit union is required to send any individual member's conversion-related message to the entire membership via postal mail or email. The member will be required to pay for such communications in advance, but NCUA places a maximum cost of 50 cents per snail mail item and $200 in total on email communications to members regardless of their number or the staff time involved in facilitating such communication. Recognizing that there are a handful of individuals and organizations within the credit union industry with the stated objective to derail all credit union conversions, there should be no lack of funding for any dissident member who opposes a specific credit union's conversion.

Member-to-Member Communications Equivalent to Junk Mail and Spam

For the vast majority of credit union members (customers), these conversion-related messages from other members (customers) are the functional equivalent of junk mail and spam—certainly unwelcome. In addition to their likely irritation with receiving these

unwanted communications, there is also the risk that these unwanted communications will create doubts concerning the governance stability of the credit union, the credit union's commitment to keeping personal information confidential, the credit union's reputation for safety and soundness, or the credit union's interest in maintaining a trusted business-like relationship between the institution and its individual member (customer).

Most members (customers) did not sign up with their credit union so they could receive communications from other members (customers). They signed up to receive financial services from the credit union. Despite contentions that members (customers) own and democratically control their credit union, typically 99% of members (customers) do not even participate in the election of their board members and are unlikely to have an interest in something as esoteric as a charter conversion. Receiving unwanted communications from other customers could serve as a significant incentive to many members (customers) to move their business elsewhere. In a worst-case scenario in which reckless or alarmist communications about the potential conversion are coercively shared with the full customer base, this exodus could turn into a run on the institution. These NCUA requirements empowering a single customer to disrupt the business plans of a federally insured credit union are ill advised and should not be promulgated.

Customer Comments on Web Sites Should Be Voluntary

The new NCUA rules mandate that any member (customer) with an opinion, whether well thought out or crackpot in nature, be allowed to post their conversion-related remarks on the credit union's web site free of charge and that the NCUA Regional Director will be the final judge of what's appropriate to post on the web site. With the recent history of bureaucratic nitpicking and obstructionism by NCUA Regional Directors involved in conversions, I believe that giving the RDs the final say is not appropriate. The impartiality of the process would be better served by the disallowed member (customer) deciding whether or not the credit union's denial of an inappropriate message merited going to court. A judge is much more likely than an RD to be impartial and fair.

Although I oppose the mandatory requirement that a credit union post member (customer) comments about the conversion on its web site free of charge, at least this communication method is less invasive than an unwanted personal email or letter. If as a member (customer) I want to view another member's (customer's) comments about conversion, I can voluntarily choose to visit the site. Although there would be some staff and operational costs to the credit union involved in screening the comments for inappropriate language and applicability to the conversion question, it is anticipated that such a communication method would be more operationally manageable. I believe that some converting credit unions would voluntarily choose to do this, but they should not be required to do so.

Customer Opinion Equivalent to Board Governance is Flawed NCUA Premise

I am also greatly concerned about NCUA's remarks in its supplementary information to the proposed new conversion rules that, "If the credit union's resources are used to promote a conversion, members should have an opportunity to express their views as

well, whether for or against the conversion, in a similar format so that the issue may be openly debated before the membership vote." Such a statement appears premised upon the belief that a single credit union customer's opinion on conversion is the functional equivalent to the business decision made by a federally insured credit union's duly elected leadership who are statutorily authorized to handle the vast majority of the credit union's operations and business affairs. Placing the individual customer on the same level as the credit union's governing body is counterproductive if the agency wants its regulated and insured institutions to remain stable and viable.

Please clarify that this NCUA statement is inaccurate and does not represent the official position of the NCUA Board. Where in the Federal Credit Union Act does it state that any single member (customer) has an inherent right to communicate with other members (customers) using the credit union's contact information and delivery systems? Please keep in mind that although credit union members (customers) have an individual ownership interest in their credit union in the event of a liquidation, their actual day-to-day relationship is more like that of a customer than like an owner of marketable stock. Since they are organized without capital stock, the applicability of laws designed for stock and other for-profit companies may not appropriately address the credit union relationship with its member (customer).

I suggest that the NCUA Board Members read docket number 32858-5-II from the State of Washington Court of Appeals Division II filed 7/25/06. This Washington Appeals Court ruling in the case of Save Columbia CU Committee *et al*, Appellants v. Columbia Community Credit Union *et al*, Respondents confirms that credit union members are more like customers than stockholders. The Court said, "Columbia's members resemble depositors at a bank more than corporate shareholders." The issues addressed by that Court and its rulings are contrary to many provisions of these proposed NCUA conversion rules. I suggest that the Court's points be carefully considered before NCUA finalizes these proposed conversion rules. It certainly makes a stronger case for eventual litigation should NCUA proceed as proposed.

The NCUA Board specifically asks whether the agency should apply this proposed member-to-member communication method to all types of member communications, not just those communications made in the context of a pending conversion to a mutual savings bank. Logic and consistency would dictate that if the NCUA applies these proposed communication rules to conversions, they should also be applied to other membership vote situations like mergers and board elections. I strongly advise against applying these customer-to-customer communication methods under any circumstances. The federal credit union bylaws already provide a mere handful of motivated members (customers) with the ability to hijack the credit union. Please take no additional steps that would further undermine the governance stability of a federally chartered or federally insured credit union.

Member Access to Credit Union Books and Records is Ill Advised

In its comments concerning section 708a.12, NCUA asserts that the proposed rule includes a new provision on member access to books and records of the converting credit

union. The proposal states that members (customers) may request access to the books and records of a converting credit union for purposes such as facilitating contact with other members (customers) about the conversion or obtaining copies of documents related to the due diligence performed by the credit union's board of directors. The proposal also states that federal credit unions will grant access under the same terms and conditions that a state chartered for-profit corporation in the state in which the federal credit union is located must grant access to its shareholders.

NCUA further states that it is NCUA's longstanding opinion that the internal governance of federal credit unions, to the extent a matter is not addressed in federal statutes, regulations or bylaws, should be determined by reference to the law governing for-profit corporations in the state in which the federal credit union is located. A reference is provided to NCUA OGC Legal Opinion 96-0541 (June 14, 1996).

Despite its assertions, NCUA is ill advised to incorporate this legal opinion into the conversion rules. The opinion itself is highly vulnerable to judicial reversal. Including its substance in the proposed rules becomes an invitation to lawsuits by those opposed to the rules. The previously mentioned Washington Appeals Court case points out why credit union members (customers) have no claim on the credit union's records and goes on to rule, "The state's extensive regulatory oversight of Columbia, coupled with the fundamental differences between shareholders of a corporation and members in a credit union, compel the conclusion that Columbia's members do not have the right to inspect the organization's books and records…. Thus, the trial court did not err in dismissing Save CU's access to records claim, insofar as that claim related to records other than bylaws or amended bylaws."

Credit unions are not-for-profit financial institutions organized cooperatively without capital stock. The rules for for-profit institutions in which individuals can have marketable ownership should not apply to credit unions. As mentioned in previous paragraphs, the relationship between a member and the credit union is more like that of a customer and service provider than it is to a shareholder and a for-profit entity. It may be more logical for NCUA to apply consumer protection laws in the conversion process rather than to apply state for-profit corporation laws to this issue of access to records.

An individual customer should have no right of access to a credit union's books and records under any circumstances. A customer should not have access to the credit union board's due diligence records and similar strategically sensitive information. A customer should not be given either direct or indirect access to confidential information about other customers. The net effect of including this provision in the NCUA conversion rules is to encourage customer's fishing expeditions designed to unearth potential governance details with which to sue and/or disrupt the credit union by second-guessing the governing board's due diligence. Additionally, it might be used by a competing financial institution executive, who is also a credit union member (customer), to gain strategically significant knowledge about the credit union under the protective cover of a conversion-related purpose.

Raffles as Conversion Vote Participation Incentive None of NCUA's Business

The NCUA Board is to be commended for its decision not to prohibit raffles or similar incentives that encourage conversion vote participation. Unfortunately, even NCUA's comments and advice on the subject are presumptive and inappropriate in themselves. What constitutes an incentive that is "unreasonable in size?" Would NCUA really want to expend its resources determining that a raffle prize such as a lease on a Mercury Sable was acceptable, but a lease on a Lincoln LS was unreasonable in size? As long as such incentives, especially those that involve chance, are conducted in a lawful manner, the agency has no business getting involved. To include or not include such voter participation incentives in a conversion vote should remain a decision made by each credit union's elected leadership and management. It is none of NCUA's business.

Conclusions and Recommendations

Neither the existing or proposed NCUA conversion rules represent good public policy. They make a credit union's choice to covert to a mutual savings bank charter unreasonably complex and unreasonably costly. They exceed the authority given the agency by statute and are certain to be challenged in court.

I strongly encourage the NCUA to adopt substitute rules that are consistent with and anticipatory of the enactment of H.R. 3206, the Credit Union Charter Choice Act, that ensure appropriate procedures for conversion without the anti-conversion skew evidenced in NCUA's current and proposed rules. Enacting rules based upon H.R. 3206 will demonstrate the agency's commitment to uphold a federally insured credit union's right, with member approval, to pursue whatever charter best meets its business strategy and needs.

Consistent with the provisions of H.R. 3206, the NCUA rules should require 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 bank or savings association.

Additionally, the NCUA rules should not require a credit union 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.

The NCUA's review and approval process regarding conversion materials submitted by a converting credit union should be streamlined to ensure that the conversion process is conducted under reasonable rules and at a reasonable cost. The conversion vote should be conducted by secret ballot, with an independent inspector of elections appointed by the credit union to receive and tally votes. NCUA should not have 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.

I welcome your questions concerning these comments and any requests for additional information.

Sincerely,

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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 and banks 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.