



National Association of Federal Credit Unions

3138 10th Street North • Arlington, VA 22201-2149

(703) 522-4770 • (800) 336-4644 • Fax (703) 524-1082

www.nafcu.org • nafcu@nafcu.org

August 25, 2006

Mary F. Rupp
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314

RE: Comments on Proposed Rule Part 708a

Dear Ms. Rupp:

On behalf of the National Association of Federal Credit Unions (NAFCU), the only trade association that exclusively represents the interests of our nation's federal credit unions (FCUs), I am responding to the National Credit Union Administration's (NCUA) request for comment regarding proposed amendments to its rules regarding credit union conversions to mutual savings banks (MSBs). The revisions are intended to improve the information available to members and the board of directors. The proposed rule provides for revised disclosures, revised voting procedures, procedures to facilitate communications among members, and procedures for members to provide their comments to directors before the credit union board votes on a conversion plan.

As you may know, NAFCU has been following the issue of credit unions converting to mutual savings banks very closely. Last fall, NAFCU issued a white paper with recommendations for regulatory and legislative changes to the rules regarding conversions. NAFCU is pleased that NCUA incorporated several of our recommendations into the proposed regulations. NAFCU also recognizes the time and attention that NCUA has spent addressing the controversial issues surrounding conversions. NAFCU finds that the proposed rules overall are compatible with the rules of other regulators, and will greatly improve communication between the credit union board and its members. Specifically, NAFCU offers the following comments on the proposed rule outlined below.

708a.1 Definitions

The proposal adds to the current § 708a.1 a definition for the phrase "clear and conspicuous," which is defined as "text that is in bold type in a font at least as large as that used for headings, but in no event smaller than 12 point." The proposal also adds a definition for "regional director" to clarify that it means either the NCUA director for the region in which the

credit union's main office is located (for natural person credit unions), or the Director of NCUA's Office of Corporate Credit Unions (for corporate credit unions). NAFCU supports this clarification.

708a.3 Board of directors' approval and members' opportunity to comment

The proposed rule adds the requirements that the board (1) make a determination that the conversion is in the best interests of the members before it can approve a conversion proposal and (2) provide advance notice to the members of the board's intent to consider a conversion proposal.

Best Interest Determination

NCUA derived its best interest determination requirement in part from language in the FCUA implying a fiduciary duty on institution-affiliated parties, including directors. Specifically, the FCUA authorizes the NCUA Board to take adverse action against institution-affiliated parties if they have committed what amounts to "a breach of such party's fiduciary duty" and because of such action "the interests of the insured credit union's members have been or could be damaged." 12 USC § 1786(g)(1). The Board has issued enforcement actions based in part on the understanding that such a duty (i.e., to act loyally, in good faith, with due care and prudence) exists, and continues to believe that, much like directors of publicly-held corporations, directors may be held personally liable for a breach of such duty. Thus, in order to fulfill this duty in the context of a conversion, the directors need to review all aspects of the conversion that may implicate member interests, such as how it will affect rates and services, and how the regulatory differences between the two institutions (pre- and post-conversion) could affect member services.

NAFCU would like NCUA to clarify that its interpretation of fiduciary duty is not a departure from traditional interpretation of fiduciary duty. NAFCU believes that the directors deciding to act in the best interest of the members is a part of deciding whether the conversion is in the best interest of the institution.

Advance Notice

NCUA has indicated that it believes that providing advance notice of the decision to change from a credit union to a bank charter goes hand in hand with this fiduciary duty, in that the decision to convert rests ultimately with members, and advance notice plus an opportunity to comment ensures the members' best interests are being considered. NAFCU believes that the membership should have every opportunity to be informed regarding the conversion. NAFCU also believes that the directors of the credit union need to make a sound business decision regarding the conversion. We are concerned that members in favor of the conversion will not be as vocal as members against the conversion in expressing their views. Further, giving notice of the director's intent to consider a conversion prior to the director's conversion vote may make the institution more vulnerable to banks seeking to acquire credit unions.

Member Meeting

NAFCU believes that instead of having notice prior to the board voting, it is more appropriate that members should have the opportunity to meet with the directors at a special meeting after the directors vote on the conversion and prior to the membership vote, to discuss their concerns. Any member-to-member communications as permitted by 708a.4 would also be presented at the meeting.

708a.4 Disclosures and communications to members

Delivery of the ballot

The proposal retains the three notice requirement mandated by statute but adds an additional requirement that the conversion mail ballots be included *only* in the last notice, 30 days before the vote. This was changed from the previous “no less than 30 days before the vote” requirement in order to ensure the members fully consider the change before voting, which includes, as per the proposal, sharing their views with the rest of the membership before the vote. NAFCU supports this change and believes it will eliminate confusion.

Required disclosures

Under the proposal, the ballot must set forth the proposal that is being voted on and inform the members “clearly and conspicuously” that an affirmative vote means conversion while a negative vote means nothing will change. The board can indicate their recommendation one way or the other, but cannot provide any additional information. Also, all three notices must disclose the impact of the qualified thrift lender test (as established by 12 USC § 1467a(m)) on the credit union if it converts to a MSB. This is because members need to be informed that, upon conversion, their loan choices may be limited by the change.

The 90 and 60-day notices must also include the number of credit union members eligible to vote on the conversion proposal and how many members have agreed to accept communications from the credit union in electronic form. This is so members desiring to communicate with the rest of the membership can estimate the costs of doing so, and so NCUA can compare the number of eligible voters with the number of members the credit union has identified in past call reports.

In general NAFCU supports these provisions, however we urge NCUA to make a clarification in the technical language of the disclosure. A “yes” vote indicates that the institution will convert if a majority of the votes cast are in favor of the conversion. It appears from the draft language that a “yes” will guarantee conversion.

Required boxed disclosures

While the required “boxed” disclosures need only be included with the 90, 60, and 30-day notices, proposed § 708a.4(c) provides these must be placed on a separate sheet of paper

immediately following the cover letter and before any other included information. The proposed disclosures must set forth the effects of voting for or against conversion (i.e., that the credit union will, or will not, become a bank) in plain language, the potential effect on loans and savings rates, and the potential for conversion to a stock bank and the consequences for director and officer compensation.

NCUA employed an outside research firm to conduct an analysis of over 20 different loan and savings products offered by credit unions and banks, and discovered that historic consumer loan and savings rates offered by credit unions are, on average, better (i.e., savings rates are higher and loan rates are lower) than comparable products offered by banks. Because NCUA is obligated under the FCUA to ensure members cast informed votes, the proposed language on rates on loans and savings under § 708a.4(d)(1) indicates the above-mentioned conclusions from the historic data.

Similarly, NCUA has modified the disclosure to the effect that MSB conversion is often an intermediate step to a stock bank conversion, in which case officers and directors often profit by obtaining stock in excess of that available to other members. NCUA bases this on the fact that twenty-one out of the twenty-nine credit unions that have converted or merged into an MSB since 1995 have since become a stock bank or merged into an existing stock institution. NCUA has also collected information that shows the increased ability of directors and officers to obtain financial benefits from conversion, in part through the acquisition and control of stock. Such acquisition and control is made cheaper and easier through various management stock benefit plans and stock option plans. Directors and officers tend to take advantage of these plans and may profit from initial public offerings, when they occur.

NAFCU has made similar findings to those outlined by NCUA in the proposed rule. NAFCU believes that historical data will provide members with meaningful information and will not conflict with any other rule promulgated by the other banking regulators.

Member communications with other members

After a conversion proposal is approved by the board of directors, a credit union is also required under proposed § 708a.4(f) to send a member's communication forwarded to them within seven days by mail or email if certain requirements are met. If the credit union posts conversion-related materials on their website, they must also allow members to post their opinions without charge. When the credit union's resources are used to promote a conversion, members should have an opportunity to express their supporting or opposing views in a similar format. Communication that a member wishes a credit union to deliver to other members must be delivered to the credit union within 35 calendar days after the date of the 90-day notice, after which the credit union must deliver the communication within seven days to the membership or to NCUA if there is question as to its appropriateness.

Inappropriate communications include those that are not conversion-related, false or misleading, impracticable to deliver, or related to personal gain or grievance. There are also specific procedures for dispute resolution of purportedly improper communications.

Members seeking delivery must agree to reimburse the credit union for reasonable costs incurred, and provide an advance payment of either \$0.50 per recipient (equal to the number of eligible voters) or \$200 depending on whether the delivery is mail or email, respectively. Credit unions must postpone the delivery of the 30-day notice, and by extension the special meeting in which the vote takes place, if it cannot forward a member communication deemed proper to other members for receipt before the date they receive the 30-day notice. In the worst case scenario, i.e., when a member waits until right before the 35 day period is expired to send the communication to the credit union and there is a dispute about the communication's appropriateness, there would still be eleven days left to deliver the member communication to the other members before delivery of the 30-day notice after all the relevant dispute resolution procedures are followed.

NCUA consciously mirrored its requirements facilitating member-to-member communication after OTS regulations regarding MSB conversion to a stock form of ownership. A federal MSB is also required to forward depositor communications to other depositors if the communication is proper and the depositor has agreed to defray the costs. Outside of the conversion context, credit unions are not currently required to facilitate member communications, except that where state corporation law requires the facilitation of shareholder-to-shareholder communications, credit unions are bound to those same procedures.

NAFCU supports this aspect of the proposal. Communication between members should be a fundamental right of membership. At present, NAFCU members believe that a prepayment rate of \$.50 for regular mail and \$200 for email is sufficient to cover credit union costs. NAFCU urges NCUA to monitor how the sharing of information works in practical terms going forward and suggests that NCUA make changes to the procedures outlined above if they prove to be too burdensome to credit unions.

708a.6 Membership approval of a proposal to convert

The proposed rule amends § 708a.6 to require the board of directors to set a voting record date to determine member eligibility to vote, which must be 120 days before the § 708a.3 notice is published. This is meant to restrict the ability of professional depositors to join a credit union in order to profit from a conversion. Although NCUA's 120 day period is more than what is required by OTS (which allows for voter eligibility determinations by voting record date of not more than 60 days or less than 20 days before the depositor meeting), NAFCU believes this is reasonable in the context of credit union conversions.

708a.8 NCUA oversight of methods and procedures of membership vote

This provision amends and moves 708a.7 to provide that the Regional Director will issue a determination approving or disapproving of the credit union's methods and procedures for the membership vote within 30 calendar days of the receipt of the credit union's certification of the same. The proposed rule under § 708a.8(d) also allows for an appeal to the NCUA Board for a final determination within 30 calendar days of receipt of the Regional Director's determination.

NAFCU believes that this change is positive and will ensure that credit unions can rely on a consistent conversion process.

708a.10 Completion of conversion

This section amends and moves current § 708a.9 to require a credit union to complete the conversion transaction within one year of the date of receipt of its approval from NCUA. After the one year period has expired, the conversion process will have to be reinitiated. This requirement was added so the examination process does not become disrupted, and to secure the expectations of current and incoming membership. Although this is shorter than the Office of Thrift Supervision's two year limit for MSB conversions, there are requirements particular to MSBs that require additional time. NAFCU supports this change.

708a.11 Limit on compensation of officials

The proposed rule contains the same restriction as is in the current rules regarding directors not receiving any economic benefit from the conversion. NAFCU understands that NCUA does not have regulatory authority regarding the conversions from mutual savings banks to stock banks, but still has significant concerns regarding directors benefiting from those transactions. NAFCU supports a legislative change limiting the benefit that directors can receive from mutual to stock conversions and supports any bylaw changes that an institution chooses to adopt to prevent such benefit from occurring.

708a.12 Member access to books and records

This provision permits members to request access to the books and records of a converting credit union for purposes such as facilitating contact with other members about the conversion or obtaining copies of documents related to the due diligence performed by the credit union's board of directors. The level of access is to be in parity with the access that state chartered for-profit corporations in the state in which the federal credit union is located must grant access to its shareholders. NCUA believes that to the extent that federal statutes and regulations are silent on the subject, the internal governance of federal credit unions should be determined by reference to the law governing for-profit corporations in the state in which the federal credit union is located. *See* NCUA OGC Legal Opinion 96-0541 (June 14, 1996).

In regards to this provision, state law dealing with for profit corporations may be too vague and therefore could be applied too broadly when applied to credit union records. As noted above, the proposed regulation does restrict the access to the books and records of a converting credit union to "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." However, certain states' laws may provide different requirements. For instance in Pennsylvania, it appears that shareholders have the right to examine "for a proper purpose" the following: 1) the share register (names and addresses of shareholders and number & class of shares held by each); 2) books and records of accounts; 3) records of the proceedings of the incorporators, shareholders, and directors. "Books and records" do not necessarily include proposed contracts to acquire

another corporation or records of the target corporation. This could inadvertently result in the release of personal information. The conversion is the focus of the regulation, not granting members the ability to review almost all records that a credit union maintains. NAFCU suggests that NCUA revise their regulation to specify exactly what books and records will be made available to members.

708a.13 Voting guidelines

NCUA believes that while credit unions are allowed to use incentives to encourage conversion vote participation, they must exercise care in the design and execution of such incentives to ensure that they comply with any applicable state, federal and local laws. The incentives should not be unreasonable in size, and the cost of such incentives should be accounted for in the preliminary determination that the conversion is in the best interests of the members. Promotional materials should make it clear that members have an opportunity to participate in the incentive program regardless of whether they vote for or against the conversion. NAFCU supports this change.

Additional Concerns

Finally, NAFCU would like to indicate that we remain concerned with the continued trend of mergers and conversions of credit unions. The recent proposed "merger" of Nationwide Federal Credit Union and Nationwide Bank raises a host of issues of what rules should apply to these types of transactions. NAFCU urges NCUA to consider this matter carefully should these types of "mergers" occur more frequently in the future.

NAFCU would like to thank you for this opportunity to share its views on these proposed amendments to the agency's conversion rules. Should you have any questions or require additional information please call me or Carrie Hunt, NAFCU's Senior Counsel and Director of Regulatory Affairs, at (703) 522-4770 or (800) 336-4644 ext. 234.

Sincerely,



Fred R. Becker, Jr.
President/CEO

FRB/crh