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

Re: Comment letter – Proposed Rule 12 CFR Part 708a

Dear Ms. Rupp:

I welcome the opportunity to provide my comments on the proposed amendments to Part 708a concerning the conversion of insured credit unions to mutual savings banks. While I do not normally comment on the National Credit Union Administration ("NCUA") proposed regulations on my own behalf, due to the importance of this regulation I feel compelled to file this comment letter.

As you know, my entire professional career, beginning in 1975, has been devoted to addressing the legal needs of credit unions first as an attorney in the NCUA Office of General Counsel and then as private legal counsel to the credit union community. It has been my experience that rightful thinking directors and chief executive officers ("CEO's") of those credit unions I have had the honor to represent understand that directors of credit unions have a fiduciary duty and are responsible and accountable to their members as directors of stock corporations are responsible to their stockholders.

The NCUA recognizes that the members are the credit union and that "members are entitled to make an informed decision on a conversion proposal and that they should be protected against the potential for self-dealing by credit union management and directors."[1] It is axiomatic that, but for, the members credit unions would not have undivided earnings and would not have the capacity to generate revenues. Therefore, it can properly be stated that the entire monetary value of a credit union (i.e., its net worth and going concern market value) is solely attributable to the participation of both past and current members. When one comprehends and appreciates these dynamics, it becomes clear as to why the members must be protected and why they must be given sufficient information so that they can understand the overall value (and importance) that they bring to the table.

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[1]71 FR 36946 (June 28, 2006).

We hear all too often that members of credit unions that become members/depositors of mutual savings banks that subsequently convert to stock banks are afforded the same opportunities as directors and executives to benefit from the conversion since they can subscribe to and purchase the newly issued stock at its subscription price the same way that directors and officials can. However, as a practical matter a very small percentage of the member/depositors avail themselves of this opportunity.[2] The consequence of such is that the member/depositors forever lose the chance to reap even a partial financial benefit from the undivided earnings that had been built up by the members over the years.

Unfortunately, the conversion process that Office of Thrift Supervision ("OTS") has regulated for the last several years is, as noted by the Federal Deposit Insurance Corporation ("FDIC"), "fundamentally flawed."[3] While the conversion procedures, including the appraisal process (*pro forma* valuation), worked reasonably well when the financial condition of mutual savings banks and associations was weak and they had little net worth or economic value, the integrity of the process has since been compromised as their net worth has increased.[4] This poses the vexing question: What are the true reasons and motivations for the conversions?

As noted in the preamble to the proposed rule, there have been numerous reports of the substantial financial benefits received by credit union "insiders" as a result of conversions to stock savings banks. In fact, even before going the full route to a stock conversion, there are personal financial incentives for credit union CEO's and directors to simply convert to a mutual savings bank. Those individuals and firms that peddle conversions to the credit union community are quick to point out that:

> "As a mutual savings institution, the ability to attract new managers and directors is enhanced. Although the gap is narrowing, bank officers generally are paid as much as 25 percent to 40 percent more than credit union managers."[5]

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[2] There are several reasons for this: depositors with sizeable funds on deposit tend to be risk adverse individuals and, therefore, such an investment does not garner their interest. Additionally, many depositors have insufficient funds available to them to purchase the stock and, pursuant to OTS regulation (12 CFR §563b.345(b)) the savings bank may not extend credit to the depositor to purchase the stock. This is to be contrasted with the "insiders" (i.e., directors and executives) who often have financing arranged through or by way of the consultants who help initiate and facilitate the conversion.

[3] 59 FR 30357, 30359 (June 13, 1994). The critical aspects of OTS' regulations concerning "*pro forma*" valuation and the repurchase of issued stock have remained substantially unchanged and if anything have exacerbated the problem. The FDIC's Notice and Request For Comments is a must read to facilitate a good understanding of the weaknesses and flaws in the conversion process as well as the reasons that conflicts of interest and insider abuse are able to flourish.

[4] See, *Id*. at 30358. The "IPO pop" discussed in the preamble to NCUA proposed rule is but one indicia of the failure of the appraisal system. Additional evidence of such failure can be seen in the increasing amount and timing of stock repurchases relatively soon after being sold by the savings bank. To add insult to injury, the stock buybacks are typically and prices significantly higher than the issuing price received by the bank.

[5] Community Banker (May 2000): "Discovering Mutuality" by Alan D. Theriault.

The potential presented for such increased compensation, in itself, is a powerful inducement for a credit union CEO and directors[6] to convert to a mutual savings bank. In an analogous situation, the inducement presented by such "extremely generous compensation and benefit packages" caused the OTS to address the matter because of its concern that officers and directors of mutual savings banks were converting to stock savings banks by way of mergers due to their self serving interests rather than the best interests of the accountholders. In a former OTS Policy Statement on such mergers[7] it noted that:

> "compensation, including deferred compensation to officers, directors and controlling persons of a merging association may not be in excess of that which is reasonable and commensurate with their duties and responsibilities. ... an increase in compensation in excess of the greater of 15% or $10,000 gives rise to presumptions of unreasonableness...." (Emphasis added.)

The problem of these merger conversions was so severe that OTS imposed a moratorium[8] on healthy savings associations (i.e., well capitalized) from entering into such mergers because even with its rules on limiting excessive compensation, there was "still an issue as to whether management is opting for a merger conversion instead of a standard conversion [converting from mutual to stock without merging into another existing stock savings bank] based upon the best interests of the association and its depositors or in response to the level of benefits offered to management by the acquiring entity."[9] Before OTS imposed the moratorium it attempted to remedy the situation with the adoption of Thrift Bulletin 58 (April 19, 1993)[10] which established increased disclosure requirements to be included in the proxy statements that were given to the depositors of the mutual when they were asked to vote to approve the conversion merger. Thrift Bulletin 58 stated, in pertinent part, that:

> "...merger conversions provide more opportunities than standard conversions for insiders of the converting association to abuse their position as part of the process of agreeing to the merger conversion. All these considerations heighten the need for accountholders to receive full, fair, accurate and pertinent disclosures when they consider and vote on these transactions.
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> To provide accountholders with sufficient information to vote to approve or Reject a merger conversion by their savings association, the OTS requires Converting associations in merger conversion transactions to provide expanded Disclosures in the following areas:

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[6] Directors of mutual savings banks, unlike those of FCU's can be compensated.
[7] Formerly 12 CFR 571.5 (reference to this policy statement can be found at 59 FR 22725, 22729).
[8] Today merger conversions are limited, for the most part, to supervisory mergers where the merging mutual is having financial difficulties. See, 12 CFR 546.2(a)(4)(i) and 12 CFR 552.12(c)(4).
[9] 59 FR 22725, 22729.
[10] Rescinded April 18, 2001.

- The association must provide detailed reasons for the association entering into the proposed transaction. Institutions must discuss the costs, benefits, drawbacks, and other alternatives to the proposed transaction in the context of explaining why the proposed transaction is preferable.
- The disclosure must discuss whether management believes the proposed transaction is in the best interests of accountholders and the association and, if so, detailed reasons why.
- The disclosure must (1) include a discussion of the specific fiduciary duties owed to accountholders by the directors and officers and (2) specify under what basis and why, in considering the proposed transaction and in the exercise of those fiduciary duties, the directors determined to undertake a merger conversion. This discussion should include a statement that management believes that the Plan of Conversion is equitable to the accountholders and to the institution and the basis for that belief.

* * * *

- The compensation and other benefits that will be received by the directors and executive officers of the resulting institutions should be discussed and compared, in tabular form, with current compensation, and benefits. The reasons for any increases or changes should be thoroughly explained."

Although OTS Thrift Bulletin 58 is no longer in effect since such conversions have been significantly limited, as previously discussed, the concerns which it attempted to remedy are the same type of self-dealing concerns which the NCUA is attempting to address in the proposed rule. The specific disclosure requirements mandated by the OTS should be incorporated into the proposed rule as discussed below.

The following are my suggestions for possible revisions to the proposed rule:

Section 708a.3

The notice should also be required to be included as a "statement stuffer" or a notice on the quarterly statements mailed to members prior to the meeting the board will vote on the conversion proposal.

Section 708a.4

(i) Disclosure

Subsection (c) should be amended to include the disclosures discussed above in OTS Thrift Bulletin 58, appropriately modified for purposes of this rule. It is imperative that the board of directors be cognizant of their fiduciary duties to the members, and in

such light, address why the proposal to convert is in the best interest of the members. Also, the benefits and draw backs should be fully examined and presented to the members. While Section 708a.4(c)(3) requires disclosure of increased compensation the tabular form required in OTS Bulletin 58 and the discussion of the reasons justifying such increased compensation, would provide additional transparency to the members.

(ii) Fiduciary Duty

In addressing fiduciary duties, NCUA needs to include in this section or elsewhere in the NCUA Rules and Regulations its position on the law to look to when determining the standards for fiduciary duty for an FCU's directors and officers.[11] Should it be the law (statutory or common law) of the state in which the FCU has its principal (i.e., home) office or can it also be the state(s) in which the FCU has a branch office(s) (either individually owned or shared with other credit unions)?

(iii) Boxed Disclosures – use of the word "often"

Some of the language contained in the boxed disclosures mandated in this section of the proposed rule generated criticism by some members of Congress and by officials at the OTS as well as other persons and groups in the banking community because of the use of the word "often" in disclosure 3. So that there is no longer a basis for criticism, I suggest that NCUA prepare and post on its website the current percentage of all credit unions that convert to mutual savings banks that subsequently converted to a stock-issuing bank or holding company structure. and require that a credit union preparing this disclosure use the posted percentage rather the stating "often". The number should speak for itself and the critics should be silenced.

(iv) Boxed Disclosures – Rebuttal

NCUA provided an exhaustive discussion in the preamble to this proposed rule which clearly supports the required boxed disclosure statements. It appears counter productive and somewhat illogical to permit a credit union to prepare a rebuttal to the required disclosure that can be included immediately thereafter or elsewhere in the mailed disclosures. This approach is akin to the Board of Governors of the Federal Reserve permitting lenders required to provide the "Schumer Box" to include a written disclosure accompanying the disclosure that disputes the validity or accuracy of the items required to be disclosed in the box. Given NCUA's first hand experience of the methods by which such authority can be abused by a converting credit union, it would appear that such rebuttal should be precluded.

Section 708a.6

In a recent attempted conversion of a FCU, NCUA permitted the credit union to obtain a weekly tally of the number of members that had voted for and against the conversion from the independent entity conducting the voting. However, this

[11] See, e.g., Gully v. NCUA, 341 F.3d 155 (2nd Cir 2003).

information was not available to member groups that were opposed to the conversion. One could argue that credit unions should not be permitted to access this data during the voting process since it could then be used by the credit unions to influence the vote of those members that had not yet voted through additional expenditures of credit union funds on advertising, direct solicitations, etc. A membership group opposed to the conversion, not having access to such information could not take steps to get out the votes against the conversion, and unless required by this regulation, would not have credit union funds available to solicit member votes in opposition to the conversion. NCUA needs to ensure that there is a level playing field if this practice is allowed to continue.

Section 798a.12

I support the inclusion of this provision in the rule. The statement is reflective of the several legal opinions prepared by the Office of General Counsel on the issue of member access to the books and records. The rule will now be the source of legal authority upon which a member may rely when determining his/her rights to access an FCU's books and records. However, this provision needs further clarification as to the meaning of "located". As previously discussed in this letter, the rule should make clear whether "located" extends beyond the situs of the FCU's principal office and would include laws of those states or other jurisdictions in which the FCU has a physical presence through it's own branch or a shared branch.

I hope that this will provide the NCUA Board with additional support and perspective on how to ensure that the conversion process is conducted in good faith and with full disclosure to the members.

Sincerely,

Steven R. Bisker

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