NATIONAL CENTER FOR
MEMBER TRUST

August 25, 2006

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

RE: Comment on Proposed Rule 12 C.F.R. Part 708a, Conversion of Insured Credit Unions to Mutual Savings Banks

Dear Ms. Rupp:

Thank you for the opportunity to provide comments to the National Credit Union Administration on Proposed Rule 12 C.F.R. Part 708a, Conversion of Insured Credit Unions to Mutual Savings Banks. The National Center for Member Trust is a non-profit organization dedicate to educating the public, government officials, community leaders and others about the value and importance of cooperative ownership of financial assets. NCMT has over 70 supporters, including individuals, credit unions, charitable non-profits, and advocacy organizations, representing over two million consumers across the nation.

Summary

Overall, we strongly support the proposed regulation. The conversion of a cooperatively-owned, tax-exempt credit union to a mutually-held, tax-paying savings bank, coupled with the strong potential of a subsequent conversion to a stock bank, requires the highest level of scrutiny afforded a credit union and its voting procedures. Such a conversion, if approved, irrevocably alters the rights and opportunities of a credit union's shareholders – its member-owners. At the same time, NCMT proposes a handful of small enhancements to the proposed regulation that we believe strengthen its intentions to be clear and transparent, while providing procedural parity with similar legal events affecting for-profit institutions.

NCMT is very concerned with the growing trend of converting member-owned credit unions into for-profit banks. We are particularly distressed how the leadership of converting credit unions – elected and appointed to represent the member-owners – have used the current regulation governing conversions to stifle member communication and access to information. The extraordinary insider gain available to these elected and appointed leaders makes recent conversion campaigns all the more distressing. This lack of deference toward the shareholders of a credit union by their representatives damages the reputation of all credit unions and their leaders.

Boards of directors and management ought to exercise the authority to recommend a conversion with extraordinary deference toward ensuring that members are fully informed of their rights, and that members have the fullest opportunity to deliberate and discuss such a conversion.

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Through its statutory responsibility to oversee a conversion vote, NCUA has been entrusted by Congress to ensure that the board of directors of a credit union upholds the right of members to make a deliberate, considered decision on a proposed conversion. The opportunity afforded directors and management to receive private gain not available to regular members requires NCUA to be particularly cautious in overseeing a conversion vote, given the inherent conflict of interest thrust upon a credit union's leadership by such potential subsequent gain.

For this reason, we support the detailed changes proposed in Part 708a. These revisions bring clear guidance and increased transparency to the conversion process, such that boards of directors will understand their responsibilities clearly, and member-owners will have greater opportunity to be fully informed voters. We are particularly pleased that the proposal offers procedural changes that will help members better understand the conversion process, while reaffirming the singular responsibility of a credit union's board of directors to act solely in the interest of its member-owners.

As noted, we believe that NCUA's proposal needs to be enhanced to ensure that the rights of member-owners in a credit union conversion are comparable to those granted shareholders in for-profit institutions, and to ensure a fair election process, as follows:

- The public notice announcing the board's intent to vote on a conversion should be distributed to all members through mail and/or e-mail.
- Credit unions should be prohibited from offering incentives, such as raffles, for member-owners to participate in the election.
- Member-owners should be permitted to change their vote until such time as the balloting is closed.
- The inspector of elections should be prohibited from providing running tallies to anyone, including a credit union's board of directors and management.
- Credit unions should be prohibited from rebutting the required "boxed" disclosure, consistent with federal regulatory practice and law.
- The required affirmative statement of the board's intentions related to a subsequent conversion to a stock bank should be included in the "boxed" disclosure as a highlight of its importance.
- Credit unions should not be permitted to send written communications to members that exclude the "boxed" disclosure.
- Member-to-member communications should be at the expense of the credit union.

National Center for Member Trust Supports the Proposed Regulation

The proposed changes will help the board of a credit union better inform the member-owners on their rights and the ramifications of remaining a credit union or becoming a bank. It also removes much of the subjectivity that exists in the current regulation. In particular, we support the following proposed changes:

708a.3 Board approval and advanced notice for member comment

We believe that clearly stating that the board of directors must propose and support a conversion only if they have determined the conversion is in the best interest of the members clarifies the fundamental responsibility of a credit union's board to act only in the interest of the member-

owners. We assume that no board of directors would object to such a provision clarifying the purpose of a proposed conversion.

The board of a credit union is elected by the members to represent the fiduciary interest of the members in the credit union. As such, the board of directors of the credit union has the fiduciary responsibility to protect the members' interests, while ensuring that the credit union's net worth – which belongs to the members, collectively – is utilized to serve those same members. We are concerned that many directors, when presented with the inherent conflict of interest presented by a conversion, may not always defer to this fundamental duty to guard the members' interest. As such, this regulation will help reaffirm the duty directors owe to their members, and help remove the cloud of suspicion that a conflicted director may vote his/her personal interests prior to those of their members'.

We also agree with NCUA's position that soliciting member feedback prior to a formal board vote to recommend conversion will help a board of directors to make a more informed decision itself as to whether a charter conversion truly benefits the membership. As noted above, we do recommend that credit unions' ensure that all members receive the advanced notice via more robust communications methods (described below).

708a.4(a) Delivery of ballots
Limiting ballot mailings until 30 days prior to the special member meeting to consider conversion creates an environment where the member-owners can gather information about the future of their credit union without the false pressure to vote quickly. It is our experience that credit union member-owners, like other voters, make more informed choices when given the opportunity to consider all viewpoints and information prior to voting.

708a.4(f) Member communications with other members
We strongly support NCUA's recommendation to explicitly authorize member-to-member communications. This proposal represents a significant improvement in the effort to strike a balance in the conversion process, and is quite consistent with the rights afforded shareholders of public companies during a proxy election. Under the current rules, the member-owners simply cannot communicate effectively with each other, all but ensuring that the board of directors will dominate the debate. As stated above, we also recommend that NCUA require the board to fund such member-to-member communications to ensure more even communications between members, consistent with the rights of shareholders of public companies (described below).

At the same time, we agree with the recommendation in 708a.4(f)(5) that authorizes the Regional Director to determine the suitability of the member communication in the case of a dispute between the board and member. Member communications should be held to the same standard of being "accurate and not misleading" that NCUA maintains when reviewing conversion communications from a credit union to its member-owners.

708a.4 Member disclosure
Credit union conversion to a mutual savings bank should always be a transparent process for every member-owner, with measured oversight to ensure fully informed decisions based on fair, objective and honest information. The information communicated in disclosures and the manner

in which the information is sent are vital to achieving this goal. We believe that NCUA's proposal improves the flow of accurate information in a simple and straightforward manner. In particular, we support the following components of 708a.4, as proposed:

> *708a.4(c)(1) Member voting rights.* Like NCUA, we believe that one member-one vote is one of the core bases to the democratic control and ownership of credit unions. It is a practice that prevents excessive influence from being concentrated in the hand of a few account holders and ensures that a credit union operates in the best interests of all its members. So long as mutual savings bank rules allow for voting in proportion to mutual members' deposits, NCUA should require credit unions to disclose this potential diminution in member rights.
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> *708a.4(d)(1) Required boxed disclosures.* We support the proposed changes to the required boxed disclosures. In particular, we believe the simplification of the "Loss of Credit Union Membership" section is a critical change that provides member-owners, as voters, with a clear understanding of the outcome of their voting options. In addition, we strongly support the required disclosure on "Potential Profit by Officer and Directors". The history of credit union-to-mutual savings bank conversions conclusively demonstrates that, almost without exception, converted credit unions engage in a subsequent conversion to a stock savings bank, which provides significant opportunity for insider gain, much of which NCUA has documented in the commentary of the proposed regulation.

708.12 Access to books and records

The decision to convert a credit union to a tax-paying, non-cooperative financial institution is the most important decision a credit union's board of directors and member-owners will ever make. Therefore, maximum transparency is required. In order to make an informed decision, we agree that it is appropriate for members to be able to review the materials that a board of directors has reviewed in its due diligence on such a conversion proposal. Well-informed member-owners are well-informed voters.

Congress, by requiring a credit unions membership to approve a credit union's conversion, expressly intended for this decision to be treated differently from other decisions regarding a credit union's business operations, virtually all of which are delegated solely to the board. It is hard to imagine the member-owners making an informed decision on this issue without having the opportunity to review the same information the board reviewed, given that the board's action (recommendation) is actually more temporal than the member-owners decision (approval/denial).

In seeking consistency with state corporate law governing for-profit corporations, the proposed regulation provides clarity and consistency across corporation types.

National Center for Member Trust Recommends the Following Enhancements

We also believe that NCUA should make a number of modest changes to this regulation to make the voting process even-handed and to create uniformity regarding the voting rights and communication opportunities afforded owners of various corporations, non-profit or for-profit.

Increase distribution of advance notice to members

While we strongly support the requirement in 708a.3 for the board of directors to provide advance notice to the member-owners of their intent to consider a conversion, we believe such notice should be afforded the same priority as subsequent member mailings on the issue. As such, this notice to member-owners should be provided via mail or e-mail to all member-owners, in addition to being posted on a credit union's website, in the branches and an area newspaper.

Members visit branches and websites for a purpose – to engage in transactions. Just as many members look past existing posted disclosures related to funds availability, fair lending and the like, we do not believe that most members will see, read and understand an advanced notice disclosure if it is only provided as ancillary information during a normal visit to their credit union's branch or website. At the same time, many members go more than a month between visits to their credit union branch or website, and therefore, would not even receive the opportunity to be informed of the potential conversion. Finally, in an era of increasing use of electronic media, we do not believe the traditional method of newspaper notice will have a meaningful impact on ensuring all members are made aware of the advanced notice.

Ban raffles and other vote incentives

We believe that incentives are an inappropriate and unnecessary part of the voting process and, as such, we strongly support a complete ban on incentives in the voting process. Imagine someone trying this in a public election. Suppose a candidate for public office says, "I really want your vote. I believe I am the best candidate for this position and will serve you well. I think my opponent is a weak leader. However, I believe so strongly in democracy itself that I will give anyone who votes $20, regardless of whether they vote for me. Just show me the stub from your ballot, and the $20 is yours." Such a candidate would be denounced, if not charged with a crime!

The board of directors of a credit union plays two roles in a conversion vote. First, the directors are the equivalent of a board of elections. In this capacity, they establish the ground rules for the election by interpreting law, regulation, bylaws and credit union practice in order to select the day and time of the vote, distribute the ballots, select the teller, etc. Second, by endorsing the conversion (a required precursor to the member vote), the board of directors, along with senior management, is the strongest, most well organized group of member-owner advocates in favor of the conversion. These two roles are in inherent conflict with each other. The first role calls for impartiality and full disclosure to the voters. The second calls for campaigning for a specific position.

When a board, in its electoral oversight capacity, offers substantial prizes to member-owners for exercising their right to vote, it is hard for some members to distinguish the capacity in which the board is offering the prizes – as electoral oversight body or primary advocate for, and financial beneficiary of, conversion. The size of such incentives in conversion votes, combined with the fact that the board of directors is both overseeing the election and advocating for the conversion, is particularly inappropriate.

We acknowledge that many credit unions, including some of our own supporting credit unions, offer small incentives for members to participate in other voting activities, most notably annual meetings. Typically, these incentives are small – a free dinner, $25 deposited into the member's

share account, etc. The heightened importance of a credit union converting its charter, and thereby diminishing its member-owners rights and altering their opportunities, requires a higher standard of fairness than other member decisions.

We believe that many raffles are designed to encourage members to vote quickly, prior to fully examining the proposed conversion, and in particular, discussing the issue with other member-owners. Therefore, if NCUA deems it appropriate to allow incentives, it must expressly prohibit raffles that are not available to all voting members, e.g., any incentive that is only available to those who vote quickly.

We are further concerned with the proposed language in 708a.13(d)(2). Where other provisions of the proposed regulation provide clarity as to the appropriate means for a credit union to convert to a mutual savings bank, the statement in 708a.13(d)(2) that the "incentive should not be unreasonable in size" is ambiguous and, by introducing a highly subjective standard, invites controversy into the process. We all have learned from recent conversion controversies that ambiguous regulations open up a subjectivity that creates unnecessary debate among credit unions, members, regulators and courts. An outright ban on such incentives would remove all subjectivity.

Members should have the right to change their vote so long as balloting is still open
While we support NCUA's proposal to limit the distribution of ballots to members to the 30-day mailing, we believe that credit union member-owners should be allowed to change their vote up until the ballot box is closed at the special meeting. This is consistent with the shareholder rights of for-profit companies and Robert's Rules of Order, the most widely accepted authority on parliamentary procedure.

We believe that a clear statement from NCUA authorizing members to change their vote prior to the finish of the special member meeting would provide clarity for all involved and create parity with for-profit companies. In fact, we find no legal authority for the decision to prohibit a member from changing his or her vote prior to the announcing of the final results.

The current 708a.11(d), which NCUA has not proposed changing, other than its location within the regulation, states:

> "A credit union should conduct its meeting in accordance with applicable federal and State law, its bylaws, Robert's Rules of Order or other appropriate parliamentary procedures."

Robert's Rules of Order, confirms the general corporate standard that a member may change his or her vote while balloting is open, in "Voting VIII", which states:

> "A member has the right to change his vote up to the time the vote is finally announced. After that, he can make the change only by permission of the assembly, which may be given by general consent; that is, by no member's objecting when the chair inquires if any one objects. If objection is made, a motion may be made to grant the permission, which motion is undebatable."

State corporate law typically allows similar vote changing rights. The case law in various states as well as corporate law principles confirm that a shareholder of a corporation, including a cooperative, can change his or her vote until the time that the result is announced.[i] For example, in the case of *Salgo v. Matthews*[ii] the Court of Appeals wrote:

> "In the absence of any controlling bylaw, agreement or other binding provision concerning earlier closing of the polls, a stockholder has the right to change his vote so long as the result has not been finally announced. Zierath Combination Drill Co. v. Croake, 21 Cal. App. 222, 131 P. 335 (1913); Zachary v. Milin, 294 Mich. 622, 293 N.W. 770 (1940); State ex. rel. David v. Dailey , 23 Wash.2d 25, 158 P.2d 330 (Wash. 1945); 5 Fletcher, Cyclopedia Corporations s 2017 at 104 (perm. ed. 1967)."[iii]

NCUA's directive to follow Robert's Rules of Order, combined with its statutory requirement, and regulatory intent, to provide parity with other corporations, effectively requires the agency to expressly authorize open balloting until such a time as the ballot box is closed at the end of the special member meeting to consider conversion. Absent such an express statement from NCUA, we believe credit unions will use false procedural excuses to deny members their actual right to change their vote.

Eliminate interim vote tally reporting

The teller tallying the votes should be prohibited from sharing interim tallies with the board and management. Given that the board of directors, in voting to support conversion, has clearly expressed their support for one of the two options presented to voters, it is inappropriate to afford them a one-sided report on the vote count. The public as a fraud would roundly denounce providing interim votes on "early" voters or "early" precinct totals to a candidate for public office or the advocates for a specific ballot initiative. This one-sided information sharing creates a perception of unfairness, reminding us of efforts in corrupt democracies when the incumbent officeholder holds back a few boxes of votes for the eleventh hour in case election officials tell him he is about to lose!

Given that the board and management select and compensate the teller of elections, we imagine that such interim reporting has occurred, or will occur. NCUA's silence on this issue provides incentives for directors and managers to seek these reports so that they can adjust their campaign efforts according to the votes as reported.

If NCUA deems it appropriate to authorize interim tally reporting, the agency should require any credit union that receives interim tallies to update the vote totals on a daily basis on its website so that <u>all</u> member-owners are provided the same information.

Prohibit rebuttal of boxed disclosures

The proposed regulation states that the "boxed" disclosures must be on a separate sheet of paper with nothing on the backside of the disclosures. We approve this new requirement. However, the proposal does not explicitly prohibit a credit union from "rebutting" the required disclosures, as has happened with every conversion disclosure we have seen since NCUA created the required "boxed" disclosure in early 2005. NCUA must expressly prohibit such rebuttal. The approval in

recent conversion disclosures of rebuttals of these required disclosures dilute the effectiveness of these critical disclosures. Equally important, rebutting a required disclosure runs contrary to regulatory practice and law.

Attempts to disguise or disclaim federally required disclosures have traditionally resulted in such disclosures being held to be defective and legally insufficient as a matter of law. *See e.g. Stevenson v. TRW Inc.* 987 F.2d 288, 296 (5th Cir. 1993) (holding reverse side disclosures to be defective under the Fair Credit Reporting Act), *See also Jenkins v. Landmark Mortgage Corp.* 696 F.Supp. 1089 (W.D.Va. 1988) (holding that accurate Truth-in-Lending disclosures were rendered defective when coupled with a misleading and seemingly contradictory cover letter.)

Relocate subsequent stock conversion plans to boxed disclosure
While we agree with the recommended box disclosures, we believe that item 3 in the boxed disclosures, "Potential Profit by Officers and Directors," does not address whether the board and management of the specific credit union seeking to convert plan to engage in a subsequent conversion, which would clearly increase the likelihood of such potential gains. Therefore, for credit unions that affirmatively plan a second step conversion, we believe that section 3 should read (emphasis added):

3. POTENTIAL PROFIT BY OFFICERS AND DIRECTORS. Conversion to a mutual savings bank is often the first step in a two-step process to convert to a stock-issuing bank or mutual holding company structure. *We intend to take the second step in our conversion by conducting a stock offering.* In such a scenario, the officers and directors of the institution often profit by obtaining stock in excess of that available to other members.

It is our experience that very few credit union members, like other consumers, read the more dense, non-boxed disclosures, and as such, will not be aware of the board's statement regarding a subsequent conversion to a stock bank, which provides critical information regarding the likelihood of the profit opportunity being exercised.

The boxed disclosures should go out with any written communication to members
While we understand the concern that some converting credit unions have expressed about the definition of "member communication," we believe limiting the boxed disclosure to the 90-day, 60-day and 30-day notice affords credit unions too much leeway in providing other information to member-owners. We are concerned that some credit unions will use this exemption as justification to send out substantial information on a regular basis to member other than the required 90-day, 60-day and 30-day mailings that will dilute the impact of the boxed disclosures with information about the great benefit of a vote for conversion, without any information about the benefits of remaining a credit union. At the same time, we believe that holding non-required member communications to the standard of "accurate and not misleading" is open to subjectivity that will ultimately lead to substantial debate and disagreement among credit unions, their member-owners and NCUA.

To clarify the requirement, we propose that NCUA require credit unions to provide the boxed disclosure with any written notice on the proposed conversion. By stating that the required disclosure only need go out in written communications, the regulation would still permit credit

unions to speak publicly and answer member questions, assuming they are held to the "accurate and not misleading" standard for these non-written communications. On the other hand, any written communications should have the required disclosure, in order to be consistent and avoid subjectivity, and to prevent gaming of the system through additional member mailings that are intended to overwhelm the intended impact of the boxed disclosures with other information.

Member-to-member communication should be at the expense of the credit union

The proposed changes for 708a.4(f) are a substantial improvement over the existing communications regime between member-owners of a credit union. We believe that it makes significant strides toward ensuring that member-owners of a credit union can converse with each other regarding this fundamental debate about the very existence of the institution they own. However, we believe NCUA should go one step further and require the credit union to fund the member-to-member communications of dissident member-owners, just as public companies are required to distribute dissident positions in proxy elections.

To date, every converting credit union has put substantial funds toward the role of advocate and very little toward the role of impartial arbiter of elections. As advocate, the board is able to draw on the resources of all the members, ensuring that maximum resources are put toward promoting that position. Any individual member, or group of members, can only draw on a subset of the members' money to fund any communication with their fellow members.

Therefore, we believe the credit union should fund the distribution of information opposing a conversion, as prepared by member-owners who wish to serve as a counterweight in the election as advocates for remaining a credit union. In this way, the board can fulfill its duty as impartial arbiter – the board of elections – without interfering with its position as advocate for conversion. Without such funding, the democratic nature of a credit union becomes very undemocratic – whereby the pro-conversion campaign is paid for out of the members' money, while opponents must organize their own campaign out of individual funds. The public equivalent would be state-owned media that allow the incumbent to have free advertising while charging a market advertising rate to her challenger.

As noted above, there is precedent for requiring a shareholder-owned institution to fund shareholder-to-shareholder communications. The Securities and Exchange Commission, under 17 CFR 240.14a, requires public companies to distribute shareholder proposals in proxy solicitations to all shareholders. If NCUA is concerned about the cost this could create for a credit union, it could clarify 708a.4 (f) to state that the member-requested communication should also be sent out as part of any and all written communications to members subsequent to the member request, e.g., the 90, 60 and/or 30-day mailing. For example, if 80 days prior to the special member meeting, a member requested that her statement opposing the conversion be distributed to the members, the credit union would be required to include that statement in the 60 and 30-day mailings. If the proposal came 45 days prior to the special member meeting, it would only go out with the 30-day mailing. In such a scenario, NCUA might only require the member to cover the cost of the mailing if he wished to send a communication separate from, or in addition to, the credit union's own written communications.

Conclusion

Given the emotional debate regarding this issue, and the billions of dollars of net worth at stake, we appreciate NCUA's willingness to craft a regulation that increases transparency, member communication and clarifies the roles and responsibilities of directors, managers and member-owners. NCMT does not seek to stop credit union-to-bank conversions. We seek to ensure that member-owners and the public are fully informed of the impact of such conversions, so they can make a fully informed decision regarding their right to convert to a bank or remain a credit union. We believe that NCUA's proposals would greatly assist in this goal, and that the modest enhancements we propose would improve the process further still.

Sincerely,

Bucky Sebastian
Chairman

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[i] CORPORATIONS:CASTING OF BALLOTS AFTER CLOSING OF POLLS, s 2, 41 A.L.R.3d. 234 (2004). See also cases cited in ALR article; Am. Jur.2d, Corporations s 839, CORRECTING BALLOT ORIGINALLY CAST (2004) (a shareholder has the right to make the desired correction in order to express the true intent); Am. Jur.2d, Corporations s 1197, VOTING OR CHANGING OF VOTE AFTER CLOSING OF POLLS (shareholder has the right to change his or her vote as long as the result has not been finally announced); 18 C.J.S., Corporations s 375, RIGHT TO VOTE GENERALLY (shareholders have the right to have all pertinent and material information whenever called upon to vote); In Practicing Law Institute, October 29, 1987, Balotti and Bodnar, CONDUCTING A CRITICAL STOCKHOLDERS' MEETING, the authors stated:

> "Other courts have held that stockholders may change their votes prior to the announcement of the final vote on a question. Zachary v. Miln, 293 N.W. 770 (Mich. 1940); Salgo v. Matthews, 497 S.W.2d 620 (Tex. Civ. App. 1973); Missouri ex rel Lawrence v. Mcgann 64 Mo. App. 225 (Mo. App. 1895); Zierath Combination Drill Co. v Croake, 131 P. 335 (Cal. App. 1913)."

See also FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS (2004 update), Chapter 13: Shareholder Meetings and Elections, V: Conduct of Meeting and Elections ("a shareholder or member may change a vote at any time before the result is finally announced [FN 29], and before that time it is proper to permit a correction to the ballot so that it will express the shareholder's rule intention [FN30].") See cases cited in Fletcher.

[ii] Salgo v. Matthews, 497 S.W.2d 620 (Tex. Civ. App.-Dallas, 1973). writ refused n.r.e. (1974).
[iii] Id. at 630-31.