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

Re: Marvin Umholtz Comments on Advanced Notice of Proposed Rulemaking for Parts 708a and 708b Regarding Mergers, Conversion from Credit Union Charter, and Account Insurance Termination

Dear Ms. Rupp:

I appreciate having the opportunity to present these comments to the members of the NCUA Board about the advance notice of proposed rulemaking (ANPR) regarding mergers, conversion from credit union charter, and account insurance termination. The opinions in this comment letter represent my point of view and are not necessarily the views held by any of my clients or by any organization with which I may be affiliated.

This is not the first time that I have commented to the NCUA Board concerning 12 C.F.R. Parts 708a and 708b, or related issues. The NCUA Board is encouraged to review my input from the following comment letters that I believe is relevant to the NCUA Board's current considerations.

- *Comments on Federal Credit Union Bylaws*, June 2007
- *Comments on NCUA Proposed Rule Part 708b, Disclosure of Merger Related Compensation*, May 2007
- *Comments on NCUA Proposed Rule 701.3, Member Inspection of Credit Union Books, Records, and Minutes,* May 2007
- *Comments on NCUA Proposed Rule Part 708a: Conversion of Insured Credit Unions to Mutual Savings Banks,* July 2006

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Modernize, Repeal, or Rollback Existing Regulations

This correspondent encourages the NCUA Board to resist the temptation to over-regulate in the manner described in the ANPR and further entreats the NCUA Board to not promulgate any new regulations. The NCUA Board should instead modernize, repeal, or rollback the counterproductive structure and governance regulations that are already in place.

The ANPR suggests that the NCUA Board intends to further implement a regulatory policy direction that does not meet its own stated objectives. The suggested policy does not provide flexibility and fairness. It does not impose a minimal regulatory burden on credit unions whose members choose to pursue any of the contemplated structural transactions. And the policy introduces new risks that may jeopardize the National Credit Union Share Insurance Fund.

The following comments are shared in the hope that should the NCUA Board decide to promulgate additional regulations as suggested in the ANPR, that these regulations will not significantly impede credit union-to-credit union mergers. The NCUA Board should not establish merger requirements that function similar to existing NCUA regulations that already inappropriately obstruct conversions to other financial institution charters or conversions to alternative share insurance.

NCUA Regulations Based Upon Flawed Assumptions

The NCUA Board is to be applauded for recognizing the existing regulatory inconsistencies governing credit unions choosing to convert to the mutual savings bank charter and other structural changes like mergers, share insurance changes, and board elections, among others. However, since these NCUA rules that apply to charter conversions are based upon flawed assumptions about the nature of a member's ownership of the credit union, extending similar rules to these other strategic business choices is definitely not advised.

The NCUA Board's continued insistence on the for-profit ownership interpretation applying to shared cooperative "ownership" places the credit union charter at increased risk for governance instability and severely restricts each credit union's strategic options.

Credit unions often provide members with great service and products, but hardly anyone joins a credit union so they can vote for the board of directors, attend the annual meeting, or cash in on their theoretical equity ownership by liquidating the credit union. Credit union members are more like federally insured financial institution depositors (customers) with limited voting privileges than they are like at-risk equity owners of for-profit companies.

In cases like the Texas-based Community Credit Union conversion to ViewPoint Bank, only 2% of the credit union membership had any interest in "owning" their financial institution by subscribing to shares at the initial offering. The minimum subscription required only ten shares at $25 each, so ownership affordability was within reach for all but the poorest members if it had been important to them.

Any NCUA regulations based upon the notion that most individual members care whether they own the credit union's equity represent a real stretch of the imagination

rather than a foundation in fact. Members care about great service, affordable pricing, good rates on loans and savings, and convenience, not equity ownership.

The NCUA Board should not mandate that credit unions provide member payouts as part of every merger. The NCUA Board should also not mandate that members share in the distribution of cash, free stock, or transferable stock subscription rights as compensation for their "equity interest" in the credit union.

The members' representatives on the credit union board of directors should negotiate all components of the merger deal. It is certainly feasible that many excellent mergers will be approved by the members based upon enhanced convenience, increased services, or other factors that have nothing to do with the distribution of equity.

Avoid Complex and Costly Regulatory Requirements for CU-to-CU Mergers

During any given year only a handful of credit unions will consider the option to convert to a mutual savings bank charter. Mergers with other types of financial institutions are even less common. Additionally, those state chartered credit unions that prefer state-authorized alternative primary share insurance remain limited in number.

However, hundreds of federally insured credit unions engage in mergers each year and hundreds more consider mergers to be an important future strategic option for growth and/or survival. Applying new and complex regulations to the credit union-to-credit union merger process will do a great disservice to the industry as well as to the individual consumer members it serves.

Equalizing these onerous regulations to apply to all circumstances that affect member rights and ownership interests, especially to CU-to-CU mergers, will serve only to impede mergers. Under this over-regulated scenario, the NCUA Board will likely require complex disclosure and voting procedures, as well as over-reaching procedures to facilitate communications about the merger among members.

Will the required merger disclosures be as alarmist as the ones NCUA now requires for charter conversions? Will there be required boxed disclosures to members prior to a merger vote? Will door prizes, raffles, and similar incentives be prohibited for merger votes? Will improper ballot folds cause a revote?

If equalized, these anticipated new rules will also require that members be allowed to provide their comments to directors before their credit union board votes on a merger plan. And during the merger balloting process dissident members will have access to a multitude of governance information and access to records that add costs and strategic risk with little benefit to the majority of members.

The NCUA has a long history of imposing its own narrow interpretation of what constitutes a "fully informed member" who is able to "consider the advantages and disadvantages" of a structural change. The current practice among merging credit union boards to develop a fair plan of merger is greatly preferred to a situation in which the NCUA substitutes its judgment concerning what is best for the merging credit unions' members.

Protect Alternative Share Insurance Choice For State Chartered CUs
Ironically, if the U.S. Treasury's recently revealed "Blueprint for a Modernized Regulatory Structure" is ever enacted into law, the alternative primary share insurance chosen by some state chartered credit unions might end up being the only strategic option that allows for a credit union to remain a traditional credit union. Under the Treasury Plan, there would be a one-size-fits-all federal charter that would likely blur the difference between credit unions, thrifts, banks, and any other federally insured financial institutions.

Advocating and protecting the option to be a state chartered, alternatively share insured credit union may be the only practical way to preserve the benefits the industry now derives from a healthy dual chartering system. The NCUA Board has a poor track record in this area and has largely undermined the state-authorized share insurance option. At the very least, the NCUA Board should remove any inappropriate obstacles to making this strategic business choice and certainly should not add unnecessary new regulatory hurdles.

Current NCUA regulations already make it disproportionately difficult for federally insured and alternatively insured credit unions to merge. Applying the new regulations suggested in the NCUA ANPR would further jeopardize this strategic option that could become critical to the survival of a distinct credit union charter if the U.S. Treasury Plan gets any traction.

NCUA Should Leave So-Called "Hostile" Merger Proposals Alone
There is no such thing as a "hostile" credit union merger proposal since the membership of any merging credit union must vote in favor before the deal can be made. The NCUA Board need not take any specific targeted action to "protect" credit unions and their members from such proposals. The NCUA Board should do everything that it can to encourage consolidation within the credit union industry.

Any credit union that receives a merger proposal, whether solicited or not, should be flattered that they are seen as a desirable acquisition. Consider the alternative of being too unappealing to attract a suitor. Receipt of a merger proposal becomes a true test of a credit union's success and opportunities in the marketplace. From a practical standpoint, which credit union is the surviving or merging credit union may not be relevant to either institution's members, as long as they receive great products, desirable services, and convenience.

Too many small credit unions fall very short of being full service, are failing to remain competitive, and are short-changing their existing baby boomer and senior members while remaining unattractive to younger potential members. Too many of these credit unions are already on the path of self-liquidation through negative earnings, rapidly depleting capital, and eroding membership numbers. And if all credit unions that were non-compliant with the Bank Secrecy Act were forced to close by their regulators, there wouldn't be many left open.

Additionally, many healthy credit unions of all sizes believe that becoming larger through merger is essential to their long-term strategic plan. There is much research that supports the added value that larger credit unions can bring to their members.

An affordable, simple, and straightforward merger process should be retained so that these institutions can readily merge. The boards of directors of these merging credit unions should be entrusted to negotiate a merger plan that provides value to the membership as they define it, not how the NCUA defines it.

Each credit union should be able to choose any type of financial institution as a merger partner without undue interference from NCUA. The credit union's local community and its participating members, and not the NCUA Board, the NCUA regional director, or outside activists, should have the final say about what's good about the merger.

Board Duty of Care and Loyalty Already Adequate

Every credit union board member already has the duties of care and loyalty to the institution and to its members. Directors must perform their duties in good faith and in a manner the director reasonably believes to be in the best interests of the credit union. This fiduciary responsibility would mandate that any credible merger proposal be given the utmost due diligence and consideration. The refusal to do so could be viewed as dereliction of duty, subjecting the board to member criticism, regulatory scrutiny, or legal action.

Taken a step further, if credit union leaders truly believe that the members own the institution, then the credit union's board should always put any credible merger proposal before its membership. Whether voted up or down, the will of the membership will prevail. Logically, if the credit union's members "own" it, they should also be entitled to sell it at a profit regardless of whether the sale is accomplished through a merger, voluntary liquidation, or conversion to a mutual savings bank charter and subsequent IPO.

As the recent battles over credit union charter conversions have shown, it takes merely 750 FCU-member petition signatures to force a special membership meeting to remove a board of directors. That includes a board that might block a merger vote. Every credit union board is better off addressing a merger proposal head on with maximum transparency and allowing the members to decide for themselves what is in their own best interests. Regardless of the outcome of governance battles, credit union members always have the option to vote with their feet and take their business down the street.

The NCUA Board should leave well enough alone and not create a federally mandated definition of fiduciary duty or standard of care that credit union directors owe to members.

Credit Union Charter Should Be Politically Neutral

There are many within the credit union industry, including this correspondent, who appreciate and admire the fact that the credit union charter is useable by diverse types of people from all varieties of socio-political persuasions. That includes those who are way left of the political center, as well as those more numerous individuals within the industry who are politically centrist and mainstream in their thinking.

The credit union charter itself is politics-neutral. Unfortunately there are also those individuals whose thinking is far outside the industry mainstream who have abused the flexibility of the credit union charter to promote their own politics. By doing so, they blatantly flout the principles of economic independence and self-determination for which the credit union charter has long stood.

If the NCUA Board pursues the public policy course suggested by this ANPR, it will have the net effect of making it easier for these fringe groups to disrupt credit union mergers and other structural changes that require membership votes. These activists' tactics are clearly designed to force their narrow point of view on others, including on credit unions thousands of miles away from the activists' own communities.

These dissident activists represent a small minority within the credit union industry. Unfortunately, the mainstream majority's complacency has allowed the activist minority to flourish and dominate the entire industry's public policy. This creates a dysfunctional disconnect between the mainstream majority's expectations for the charter and the industry's perceived left of center political agenda concerning that charter.

NCUA ANPR Certain to Lead to Dissident Member Mischief

These ill-advised activists openly fund small groups of insurgent members to foment conflicts at other credit unions that make business decisions about which the activists do not approve. What does this in-your-face interference have to do with "not for profit, not for charity, but for service?" It doesn't. How do these disruptive assaults on other credit unions' governance processes demonstrate "people helping people?" They don't.

Over the last several years, the NCUA Board has consistently adopted regulatory policies that disproportionably empower the activists and insurgents. The NCUA has also been ineffective in regulating the dissidents' defamatory outbursts and their intentional misinformation about charter conversions. The NCUA is not likely to effectively protect the merger voting process from similar abuses. Additionally, should the NCUA Board choose to mandate dissident access to merger vote recounts or interim tallies, then at minimum the dissidents should be required to pay up front for the costs of providing that access.

It is easy to imagine the potential disruptions caused by activists and dissidents multiplied by the hundreds of mergers that occur each year. Such widespread systemic disruption is certain to cause reputation risk for the credit union charter. The NCUA Board also apparently plans to prohibit certain voting practices that are sure to raise the costs for such voting without any substantial gain in the integrity of the process.

NCUA Board Policies Empower Anti-Merger Dissidents

The NCUA Board is currently engaged in a regulatory process as outlined in the ANPR that will extend the insurgents' power to interfere in other credit union's business decisions well beyond just conversions to the mutual savings bank charter. Credit union-to-credit union mergers, conversion to alternative share insurance, and just about every other structure change will become exposed to these insurgent-driven conflicts should the NCUA Board continue its misguided regulatory direction.

If the interfering activists win the battle, credit union economic independence and self-determination will become the first casualties. Those in the mainstream who seek a modernized, independent, member-centric credit union charter will feel the pain of this loss the most. Under the worst-case scenario, only those few mergers that both the activists and NCUA deem to be "politically correct" will be allowed, and even those few mergers will be costly and complicated.

Voluntary mergers between healthy credit unions may become a distant memory due to the NCUA's formidable regulatory hurdles. Only regulatory-driven mergers will occur where the merging credit union is troubled. Regulatory-driven mergers are largely controlled by NCUA as the regulator or conservator. Whether intended by NCUA or not, these will become the dominant type of credit union-to-credit union merger. This correspondent certainly hopes that seizing this control over the vast majority of mergers is not the NCUA's intent even though it is the likely outcome.

Credit Unions Need More Strategic Options, Not Micro-Management
The NCUA Board should not succumb to those who cultivate fears of catastrophes like "hostile takeovers" or who mouth dubious catch phrases like "fully informed members" as excuses for expanding government supervision of other people's lives. As suggested by this ANPR, the NCUA Board is contemplating a dramatic "mission creep" into business decisions best left to the duly elected boards at each independent credit union. The NCUA Board should resist the federal government's interventionist proclivities and instead use its bully pulpit to encourage credit unions to proactively take charge of their own independent destinies.

What credit unions need now are more strategic marketplace options, not NCUA's micro-management and over-regulation. The competitive reality that credit unions face is extremely daunting and will only grow more challenging over time. Creating additional obstructions to mergers, share insurance conversions, or charter changes without providing access to alternative capital or new growth and revenue opportunities is an evolutionary path leading to a dead end for the industry. Credit unions need a charter and business model suited for 2008, not 1938.

The NCUA Board would be doing a great service for the industry by dropping plans to promulgate more complex and costly regulations governing Parts 708a and 708b. Additionally, it should streamline and simplify its current anachronistic and obstructionist regulations affecting credit union structure and governance. More NCUA time and resources should be spent monitoring the credit union industry's safety and soundness rather than dictating misguided notions of political correctness.

If you have any questions concerning these comments, please feel free to contact me for clarification or elaboration.

Sincerely,

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Marvin Umholtz is President & CEO of Umholtz Strategic Planning & Consulting Services based in Olympia, Washington south of Seattle. 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. Umholtz also helps credit union boards and CEOs with strategic issues like growth, board governance, charter conversions, proactive mergers, voluntary liquidations, regulatory advocacy, and the growing conflict about the future role of credit unions in the financial services industry.