

Sent via email: regcomments@ncua.gov

May 6, 2010

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

***Re: SAFE Credit Union Comments on Notice of Proposed Rulemaking  
(Fiduciary Duties at Federal Credit Unions; Mergers and Conversions of  
Insured Credit Unions)***

Dear Ms. Rupp:

I appreciate the opportunity to present these comments to the members of the NCUA Board about the proposed rulemaking regarding duties of federal credit union directors, credit union conversion to mutual savings bank, merger of a credit union into a bank, credit union-to-credit union merger, and the termination of federal deposit insurance. The opinions in this comment letter represent SAFE Credit Union's input to the rule making process.

I am encouraged that NCUA is proposing rules to address the areas noted above. In summary, I offer the following comments with regard to each of the key areas of rule making:

**The Duties of Federal Credit Union Directors.**

The examination process that supports the CAMEL rating system should to be revised to ensure that NCUA can properly assess the quality of Federal Credit Union Board's of Directors and the degree to which they carry out the duties set forth in Part 701 of the rules. The current examination process provides very little oversight and exam time to the way in which the Board performs its duties. Board members are not interviewed by the examiners, very little time is spent on examining Board training, Board qualifications, the quality of Board meetings or even Board attendance at Board meetings.

**Credit Union Conversion to Mutual Savings Banks.**

Congress passed The Credit Membership Access Act in 1998 which enabled Credit Unions to convert to a mutual savings bank charter. NCUA has subverted and continues to subvert Congressional intent by placing unreasonable obstacles to prevent charter conversions. NCUA's current rules are onerous and unnecessary and it appears the proposed rules will create even more onerous conditions. The laws regarding the fiduciary duties of directors are already sufficient to ensure that Directors act in the best

interest of members. There are good and valid reasons for credit unions to convert to a mutual bank charter. NCUA's proposed regulations place NCUA officials in the position of usurping Board authority and placing NCUA in the position of deciding what to communicate to members. NCUA is doing what every Federal agency has ever done—protect its own existence. Credit Union Boards are elected by the members to act in the collective best interests of the members. Therefore the Board must have the ability to change charters when such a change will benefit the entire membership and other stakeholders (the community and the employees). In past charter conversions, members who have objected to the Boards actions have had their day in court. The courts provide members with adequate means to address any actions which are not in the best interests of members.

### **The Merger of a Credit Union into a Bank.**

I believe that NCUA has an opportunity to lower the costs to the insurance fund by including banks as potential merger partners or buyers of failed credit unions. NCUA proposed rules seek to limit mergers of credit unions into banks. The rules are contrary to the best interests of credit unions members, the solvency of the insurance fund and credit unions in general.

### **The Termination of Federal Deposit Insurance.**

I am not a supporter of conversion to private share insurance. However, credit unions must have the right to terminate Federal Deposit Insurance if the Board of Directors and the members of the credit union are in favor of such a conversion. The high share insurance premiums that have been levied on credit unions are a sign that NCUA has not adequately monitored and controlled the safety and soundness of credit unions. Credit Unions have very little influence on how NCUA manages the insurance fund or how it manages the safety and soundness of the credit union system to protect the insurance fund. Therefore the ability to terminate federal deposit insurance and move to private insurance or to convert to mutual savings bank charter is an important control to hold NCUA accountable for its performance as the regulator. Credit Unions must be able to terminate Federal Deposit Insurance and to convert to a mutual savings bank charter. There must be an exit strategy.

### **Credit Union Merger Regulations.**

The NCUA's proposed rule making for mergers where the merging credit union has higher net worth is unnecessary and unwise. NCUA should be encouraging credit union mergers. NCUA call report data clearly shows that larger credit unions are more efficient and provide a better return to their members. The advantages for individual members in a merger between two credit unions cannot be quantified in terms of net worth per member ratios. Members have no right to net worth other than liquidation. The entire net worth of the two credit unions is combined in the new entity. No member gains or loses anything with regard to net worth. Members from each of the two merging credit unions

will enjoy many merger advantages including; more convenience, greater financial efficiency, better loan and share rates and a safer and sounder financial institution.

NCUA in the proposed rule states, “Much of the consolidation in the credit union industry results from voluntary mergers of credit unions. The proposed amendments to part 708b will help assure that management’s decision to recommend a merger is based on sound business judgment reflecting the best interests of members.” Saying that most mergers are voluntary is only telling half the story. I believe many, if not most, mergers are driven by financial necessity rather than a voluntary decision. In many cases NCUA or the state regulator has forced the Board to find a merger partner. The sad truth is that although all of the financial data and much of the member service data supports the value and benefit of credit union consolidation, most mergers are not voluntary. Credit Unions usually wait far too long to consider a merger. During that time member service deteriorates and capital declines. I expect that if NCUA did a study of credit union mergers using both financial data and member service data before and after the merger, NCUA would be far more proactive in encouraging mergers. The NCUA proposed rule making is almost 180 degrees off in addressing the true nature of mergers. More often the continuing credit union absorbs negative equity in a merger or a lower equity per member because of merger adjustments and the poor financial condition of the other credit union. In too many cases, Credit Union Boards are presented merger offers and reject them without adequate due diligence or consideration of the best interests of the members. Ironically more members are hurt by a Board’s decision to reject a bona fide merger proposal than are harmed by a Board’s decision to merge with another credit union. The question is why would NCUA propose a rule that creates more hurdles for merger? Does NCUA have any evidence of members who have been harmed by mergers?

The issue of share adjustments is very short sighted. Again, members have no claim on net worth unless through liquidation. The net worth of the two merging credit unions is combined in the new entity. If NCUA objects to excess capital why did NCUA allow one credit union to build up so-called excess capital? Excess capital leads to a lower return on equity for an institution. A higher net worth in one credit union has nothing to do with the benefits that members will gain through a merger? Should the newly merged members have to reimburse the continuing credit union for the benefits they gain through merger? Should they pay for the additional branches? Should they pay for a higher level of member service? The calculation of share values and the determination of whether a share adjustment is necessary is an exercise without value, without meaning and in fact a hindrance to mergers which are in the best interests of members.

I applaud NCUA for proposing rules which make the merger transaction more transparent. The disclosure of compensation arrangements is helpful in that regard. I am aware that in many mergers a key negotiation is how senior management officials and Board members are treated. Senior management officials are often offered severance pay in order to facilitate the merger. NCUA should balance disclosure of such compensation arrangements with the overall expense reductions and other benefits of the merger. My credit union recently completed a merger with a \$220 million dollar credit union. We

paid severance pay to senior management officials. But the merger reduced operating expenses by two thirds over what they were before the merger. Members gained significant improvements in convenience, service levels improved, safety and soundness was increased and the return to members improved. I would rather see NCUA focus on the “big picture” and also disclose to members the full financial effect of the merger. Disclosing and emphasizing only compensation amounts may divert attention from the full story about the merger. I would suggest that NCUA only require disclosure of specific employees compensation benefits that exceed two times annual salary. I would suggest that members be given a pro forma showing the financial effects of the merger on the combined credit unions and show the overall changes to combined income and expense as well as balance sheets. This would show the effect not only on compensation but on all aspects of the credit union operations. The credit union can then illustrate the balance of paying some employees severance pay with the overall savings of the merger.

#### **Part 701.4**

I applaud the 701.4 (3) requirement for directors to have a working knowledge of basic finance and accounting practices. The Sarbanes Oxley Law provides that at least one person on the Board and the Supervisory Committee meets the definition of “financial expert”. The NCUA should extend that same standard to both the Board and the Supervisory Committee. The Supervisory Committee is a key control in the organizational structure of credit unions. Of course if NCUA adopts this rule, the examination should include steps to test whether the Board and Supervisory Committee comply with the rule.

The NCUA would be well advised to require an annual assessment of the credit union’s system of internal control by the Supervisory Committee. At one time NCUA had a form that the Supervisory Committee was required to complete as part of their annual duties. This form required the committee to determine if certain key controls were in place and operating properly.

#### **Part 701.33**

The rules for indemnification of directors in both for profit and non-profit businesses are well established in case law and state corporation laws. There is no need for any additional changes. The NCUA appears to be changing indemnification rule changes as another means to block or hinder charter conversions.

NCUA’s counsel, Bob Fenner, has already opined that the indemnification for Wescorp Directors was invalid. While I believe that opinion will be overturned in the courts, the effect of his opinion will cause many credit union directors to wonder if the risks of being a credit union director are too great. Directors are not paid for their time. Many of the Wescorp directors have to pay for their defense against an NCUA lawsuit out of their own pocket. NCUA’s position on indemnification is likely to have the unintended consequence of deterring qualified people from volunteering for credit union boards and supervisory committees.

#### **Part 708a.104**

NCUA under section (c) (4) is asking credit unions to forecast future events or to limit business options that are the prerogative of the Board of Directors. This is an unreasonable reach by NCUA into the prerogative of the Board to decide what is best for the members at the time, based on the facts and circumstances that cannot be foreseen at the time of merger.

NCUA under section (c) (5), (6) and (7) is creating a set of disclosure requirements that are not necessary and in fact make NCUA the final editor of credit union communications to members. Members have the right under current law to a full and complete description of the pros and cons of a charter conversion. Every business decision the Board makes has associated costs and benefits, yet the NCUA does not require the Board to communicate those to the members. Clearly the rule, as written, implies that there are no offsetting benefits to a charter conversion. The disclosures all require the credit union to disclose negative aspects of the charter conversion without consideration of the benefits. Any conversion process will be held hostage to NCUA officials who will have final say on what is communicated to the members. This is another NCUA attempt to block and hinder charter conversions.

#### **Part 708a.113**

Clearly every credit union that conducts a member vote will attempt to contact every member and communicate with that member regarding the proposal. One of the main duties of credit union staff is to communicate credit union services, policies, proposals and other issues that affect a member's account. It is absurd for NCUA to suggest that a credit union not use its staff to communicate with members. The very essence of the staff to member relationship is that staff members are one of the key communication channels with the member. Every employee and volunteer of the credit union has an obligation to act in the best interest of members. Our credit union has clear policies regarding ethical behavior. We clearly define the employee and volunteer duty to act in the member's best interest. I reject NCUA's suggestion completely. NCUA has adequate power, and I encourage them to use it, to take action against any credit union or credit union employee that is not acting in a member's best interest. We don't need to use a third party to solicit member votes.

#### **708a.305**

NCUA requires, "A clear and conspicuous disclosure that if the merger is approved the members will lose all of their ownership interests in the institution, including the right to vote, the right to share in the value of the institution should it be liquidated, the right to share in any extraordinary dividends, and the right to have the net worth of the institution managed in their best interests."

Such a notice would be misleading to members. Memberships do not have an ownership interest in the credit union in the traditional sense of ownership. Members do not own a share of the credit union. Yes, they have voting rights and they can have a share in liquidation (an extremely remote situation). But members do not have a right to extraordinary dividends unless the Board grants them and in general the members have no special right to have the net worth managed in their best interest. The Board manages net worth in the best interest of the collective membership.

The issue of who owns credit union net worth is a very clear. The net worth is not owned by any individual member. Net Worth is managed for the collective good of the membership. Congress has clearly stated that if it is in the member's best interest the Board can convert the credit union and its net worth into a mutual savings bank charter. NCUA is confusing the premise of "acting in the member's best interest" with member ownership rights of the net worth. There is no such ownership interest. I have been a member of the credit union for 30 years. During that time most of the credit unions net worth was accumulated. I do not own any of that net worth even though my shares and loans helped build a portion of that net worth. There is no case other than liquidation when a member will get a share of the net worth.

NCUA, in this rule, also proposes that members in a merger have some right to extraordinary dividends to somehow equalize net worth per member. This is also a faulty concept. In almost every merger I am aware of, the merging credit union member gains due to the higher net worth of the continuing credit union. That is because in most cases, troubled credit unions merge into healthy credit unions. Does NCUA propose that the troubled credit union member make up the deficit in capital they bring with them? I certainly would not propose that. But it is a similar fallacy to suggest that somehow a merger should require a refund of net worth because one credit union has a higher net worth ratio than the other. It is a fallacy because members do not have a tangible share of net worth. It is fallacy because after the merger the new members may gain other benefits that far exceed the amount of their total equity. It is a fallacy because after the merger, all members are equal in the new credit union and their rights to the combined net worth can only occur in one instance – liquidation. It is a fallacy because the member's main value proposition is great service, great rates, convenience and the safety and soundness of their credit union.

I would argue that credit unions would be stronger and better institutions if members had a greater stake in the credit union and more of an ownership interest. Most members do not have that sense of ownership. Very few directors are elected in a contested election. When elections are held, very few members actually vote. Members love their credit union because of the service they get, the good rates, the convenient access, the member orientation of policies and the safety and soundness of the credit union. Members think of the credit union as a service provider, not as an entity that they own. It is a dilemma that credit unions have to deal with. Members do not have a tangible ownership stake. Each member is equal in their rights but they do not own any of the credit union in a legal sense. I believe some members would pay more attention to the credit unions

performance if they were equity owners—but then the credit union would be a mutual savings bank and not a credit union.

Credit Unions and not NCUA have to encourage more member participation in the credit union. The means to do that are already in place. Credit unions should hold contested elections. They should encourage members to vote and participate. They should share more of the credit unions financial performance with the members. NCUA could help by making examination results public by examining the governance of the credit union during examinations to see that elections are held and that good governance practices and good financial transparency is in place.

On the whole this proposed regulation is flawed. It restricts the right of credit unions to convert charters. NCUA is contradicting Congressional intent with this proposed regulation. NCUA's role is not to protect its turf but rather to assure safe and sound credit unions and a safe and sound insurance fund. This proposed rule doesn't do either.

Henry Wirz  
President/ CEO  
SAFE Credit Union  
3720 Madison Avenue  
North Highlands, CA 95660

Direct Line: 916-971-2201