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Via Hand Delivery and E-Mail

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

Re: Luse Gorman Pomerenk & Schick, P.C.
Notice of Proposed Rulemaking

Our letter is in response to the Notice of Proposed Rulemaking ("NPR") issued by the National Credit Union Administration ("NCUA") with respect to, among other things, conversions of federally insured credit unions into mutual savings banks ("MSB Conversion") and mergers by federally insured credit unions into other types of financial institutions.

We appreciate this opportunity to comment on the NPR. Luse Gorman's attorneys have successfully completed 16 MSB Conversions and have been involved with this process from its infancy; accordingly, we believe our perspective on the process will be valuable to the NCUA. We have also handled more capital raising transactions for former credit unions than any other firm in the country. In addition, our firm is the leading firm in raising capital for thrift institutions over the past ten years and one of the leading firms in representing banks and thrifts in merger transactions.

In addition, we represent dozens of publicly traded financial institutions. Almost every partner in our firm has either worked for the SEC, the IRS or one of the federal banking agencies. We are thus very familiar with the requirements of drafting meaningful disclosure for investors and shareholders in the context of mergers, capital formation and proxy statements. We also have extensive experience in counseling our clients, both in mutual and stock form, in matters of corporate governance and the fiduciary duties of a board of directors.

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I. General

The credit union industry, like the banking industry, is facing considerable financial stress. Unlike the banks, however, credit unions (except for low-income and corporate credit unions) have no means to raise alternative capital and are subject to not only supporting the NCUSIF for the failure of natural person credit unions, but corporate credit unions as well. The likelihood of obtaining authority to issue alternative capital seems remote at best and the recent study by the NCUA does not provide a practical approach to the problem. The exact cost from the corporate credit union bailout is at best uncertain, but one thing is clear: it will impose a substantial cost on credit unions for years to come and potentially cause many credit unions to merge or perhaps even fail.

The current crisis presents a clear threat to the viability and longevity of the credit union industry and credit unions need and deserve an alternative to serve their members. If that means converting to a charter that has more tools for survival or merging with a bank, the NCUA should not impose unreasonable rules in the name of member protection. As some commentators and pundits have noted, is the NCUA trying to protect the members or trying to protect an industry that is in the throes of survival? This dilemma raises the policy question: Should the NCUA adopt rules that are so burdensome and expensive that they deter credit unions from taking measures that the institution's board believes will serve the best interests of the members and thereby potentially doom the institution to failure or a forced merger and all in the name of protecting the member? Or, should the NCUA allow credit unions to proceed through a conversion or merger process under reasonable rules and procedures that can ultimately protect the members? No other banking authority has constructed a charter conversion process that is so fraught with uncertainty and pitfalls that it amounts to a deterrent to the institution to ever attempt such a change. Perhaps that is its purpose.

The Advance Notice of Proposed Rulemaking ("ANPR") produced a flood of comments in general opposition to the subject matter of this NPR. The comments in opposition not only included large and small credit unions, but the two major trade groups as well. In light of this overwhelming negative reaction, one must ask why the NCUA feels compelled to proceed with a rulemaking that seeks to address historically rare transactions (whether a charter conversion or merger into a bank) that have raised very few incidents identified by the NCUA as problems.

It is interesting to note that the NCUA has apparently ignored, in its discussion under the "Background" discussion, the overwhelming trade opposition to the rule, while noting that members (which constituted a mere handful at best) and credit union-centric law firms supported the rule. Reliance on such a small minority to impose these additional rules is simply not supportable.

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It's the Members' Capital. The NCUA, as it has done in the past, has emphasized the ownership interest of the members of a credit union, however limited it may be. By imposing burdensome and costly rules in connection with MSB Conversions, which clearly violate the Credit Union Membership Access Act ("CUMAA"), the NCUA is forcing credit unions to spend more of the members' capital than they should otherwise be required to do so. As a result of these rules the costs have at least doubled if not tripled in the past few years. Yet, despite these efforts and a few limited exceptions, the members remain largely indifferent and disinterested as documented in the NCUA's own records of membership turnout in a MSB Conversion proposal. Now, the agency is proposing that the costs of the conversion be disclosed to the members but without any indication of how the agency's own rules have substantially contributed to that cost. For most credit unions, however, that cost is probably much less than the impending one year special assessment that is likely in 2010. For example, a \$300 million credit union would pay approximately \$1.2 million in a 40 basis point special assessment. In addition, the agency is unable to cite to one banking authority that requires a disclosure of costs in the conversion from a national to a state or a state to a national charter.

As we stated in response to the ANPR, we believe the MSB Conversion process, based on *current* NCUA regulations, is unnecessarily burdensome and costly. If the NPR results in additional regulations such action will in most cases increase the burden and the cost without a meaningful corresponding benefit. It also increases the burden on the NCUA, which must police more and more regulation when its resources could be devoted to other areas of greater concern to the industry. Accordingly, in light of the limited number of MSB Conversions over the past 14 years we believe that no additional regulations are appropriate. The NCUA's existing authority is more than sufficient to address particular concerns if and when they arise. As noted below, there has been a paucity of documented cases where the MSB Conversion did not comply with the applicable rules.

Our impression is that the industry generally still believes that the only reason a credit union would choose an MSB Conversion is for reasons other than the best interests of the members. We think that is wrongheaded. Why trade a tax-free charter for a taxable one is a fair question to ask. Much of that is answered in the Credit Union Regulatory Improvements Act ("CURIA") through which credit unions want to avail themselves of the same rules that banks and thrifts operate under. There is plenty of data available from the NCUA and the FDIC reports of condition that document that credit unions that have converted generally remain just as competitive as they did prior to conversion. It is counter-intuitive to think that an institution is going to raise fees and loan rates and lower deposit rates just because it pays taxes. Such a course of action would be ill-advised since consumers have many choices and can easily find another credit union or bank with which to establish a banking relationship.

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In our experience, the institutions that have sought this strategic option have considered it carefully, in many cases over a period of years. As the NCUA is keenly aware, the credit union charter has certain disadvantages that are addressed through a charter change. In particular, credit unions have been seeking regulatory relief (in the form of the CURIA, among others) in a number of areas that are remedied through the regulatory framework that applies to state and federal thrift institutions (e.g., capital standards, member business loans, unrestricted customer base). Therefore, credit unions should have available to them a charter option that can be pursued in a timely fashion, under a reasonable set of rules and without undue financial burden. In particular, interference by trade groups and organizations such as the National Center for Member Trust, who are under no fiduciary obligation to the institution and under no legal obligation to comply with the disclosure requirements, is clearly an area that the NCUA needs to address but never has, according to some commentators, since their actions help to deter conversions.

Credit Union Membership Access Act. As a background to the discussion regarding the NPR and MSB Conversions, it is helpful to review the statutory authority underpinning the NCUA's rulemaking authority as provided in the CUMAA. The CUMAA specifically addressed MSB Conversions in order to establish a national policy that MSB Conversions are a charter option for credit unions and to provide a regulatory framework for MSB Conversions.

In particular, under CUMAA, the NCUA was required to "promulgate final rules that are consistent with the rules promulgated by other financial regulators, including the Office of Thrift Supervision and the Office of the Comptroller of the currency. The rules . . . shall provide that charter conversions by an insured credit union shall be subject to regulation that is no more or less restrictive than that applicable to charter conversions by other financial institutions." 12 U.S.C. § 1785(b)(2)(G).

Further, the Congress established as a national policy (1) that the directors of a MSB may receive board fees (which is consistent with the ability of directors of existing MSBs to receive such fees) and (2) that management officials of the former credit union may receive compensation and other benefits from the converted credit union in the ordinary course of business. *Id.* at § 1785(b)(2)(F). In addition, since the Congress authorized the mutual to stock conversions of MSBs in the Home Owners' Loan Act, it well knew that a former credit union might convert to stock form or issue stock in a mutual holding company structure sometime in the future.

Under CUMAA and the NCUA's implementing regulations, the agency has oversight of the methods and procedures of an MSB Conversion. Specifically, the NCUA's regulation requires that the regional director determine "if the notices and other communications to members were accurate, not misleading and timely, the membership

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vote was conducted in a fair and legal manner and the credit union has otherwise complied with Part 708a.” 12 C.F.R. § 708a.8(a). Should the NCUA reach the conclusion that the communications and notices, or the manner in which the process was handled, did not comply with the noted standards, it may disapprove the methods and procedures and may direct that another vote be taken. *Id.* at § 708a.8(c). Rather than continue to layer on more and more burdensome rules, the agency should rely on its general powers to require a new vote if an abuse occurs.

II. MSB Conversions

We have the following comments on the proposed changes to the MSB Conversion rules.

Communication to Members

The NCUA has proposed additional rules in Section 708a.104 regarding communications to members in the context of an MSB Conversion. This includes prohibiting the credit union from stating or implying that NCUA has endorsed the charter change as well as disclosing changes that may affect the operations of the credit union following an MSB Conversion, such as continued access to shared branching, ATM networks and office space. Under current regulations the NCUA has oversight of the methods and procedures of an MSB Conversion and established disclosure standards. Under the authority noted above, the NCUA reviews all communication materials to the members and has the opportunity to ask questions about any of these items as well as to provide suggested disclosure. *Id.* at § 708a.5.

Although we can only speak with regard to the MSB Conversions that this firm has handled, we do not believe that our disclosure documents state or imply that the NCUA or any other agency has endorsed the MSB Conversion. The NCUA is free to comment upon any disclosure that implies or states that the NCUA is endorsing the MSB Conversion. During this process the NCUA is also free to ask about any issue, whether it is shared branching, access to free ATMs or use of existing office space. In short, we believe additional disclosure standards are not necessary since they reflect what should otherwise be disclosure of material changes to the operations of the credit union. If the board of directors has properly done its due diligence it should know the answers to questions concerning shared branching and the like without the necessity of additional rules.

Against this backdrop it is interesting to note that, to the best knowledge of this firm, since the passage of the CUMAA the NCUA has only in one case disapproved an MSB Conversion under the noted standards. We are also not aware of any cases prior to the passage of CUMAA where the NCUA disapproved an MSB Conversion based upon

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similar considerations. Thus, the need for additional regulation to require full and accurate information would appear redundant and unnecessary, since it has been the exception to the rule where the NCUA concluded that the methods and procedures failed to comply with the applicable standard set forth in the regulation. *Id.* at §§ 708a.4(e), 708a.8.

Member Voting Participation

As background to the NCUA's proposed Section 708a.101, a review of member participation in MSB Conversions is warranted. In our experience with MSB Conversions, and observing other MSB Conversions as well, an overwhelming majority of the credit union members do not vote. Thus, despite three notices of the special meeting mailed to the members, reports in the press and other media and the efforts of opposition groups, most members remain disinterested, apathetic and unmotivated. It is hard to understand this level of participation in light of this background. One explanation is that the members either agree with the change or do not care what type of charter their institution has, as long as the institution provides good rates and services. Human nature is such that an individual who opposes something usually speaks out. This pattern should be of no surprise to the industry and is easily documented through the NCUA's own records of MSB Conversions.

It is important to encourage members to vote. In an effort to encourage the members to vote, institutions hold informational meetings, call members and also use door prizes. In sum, the NCUA should not adopt any rules that discourage an institution from encouraging its members to vote or that impair the ability of members to vote. Furthermore, the recent efforts of the NCUA to provide more disclosure and communication among members does not seem to have counteracted the malaise among the membership.

Employee Solicitations

A credit union, as is the case with any corporate entity, can only act through its authorized representatives, such as employees. Prohibiting or discouraging employees from soliciting the votes has serious shortcomings. First, we agree that employees should not be pressured or required to solicit members to vote, whether in person or by telephone, and advise our clients accordingly (any institution doing so is only going to engender negative reaction from employees). As stated in the ANPR, the NCUA references that this has occurred with "some" credit unions and yet the agency has only once, to the best of our knowledge, invalidated a vote where this apparently occurred. Should it occur in an MSB Conversion or other transaction, the agency would otherwise have the power to take the appropriate action to remedy the infraction.

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Second, communication by employees with the members, whether in person or by telephone, is critical in the conversion process to encourage voting, and the NCUA should not adopt rules, such as proposed Section 708a.113, to discourage the use of employees to solicit membership voting. In support of this proposal, the NCUA cites one case where employees were distracted (and perhaps were not given appropriate guidance as to how to allocate their time). If an institution does not communicate with its members on a topic such as an MSB Conversion, they will think the institution has something to hide. Further, in light of the propensity of dissident groups to spread false and misleading information with impunity not only about the institution, but the personal character of the board and management, direct personal contact is essential. Why the NCUA has continued to overlook this conduct deserves to be addressed. Certainly if a member is going to provide a link to the National Center for Member Trust's website in a member to member communication, the content of that website must be regulated since it is tantamount to sending that information to the member. An institution must be able to communicate one-on-one with a member and should not be limited to impersonal mass communication. As we stated in our comment letter on the ANPR, we are available to discuss with the NCUA these websites, such as the one sponsored by the National Center for Member Trust, to point out the information that clearly fails the standards in the NCUA's member-to-member communication process.

Lastly, any initiative to discourage employee solicitation clearly exceeds the NCUA's rulemaking authority under CUMAA since such a prohibition, to the best of our knowledge, does not exist among any other federal or state financial regulator.

Interim Tallies and Voting

In our opinion, the NCUA's revisions to the conversion regulations over the past few years have, instead of encouraging membership participation, actually fostered a lack of voter participation and the proposed rules will continue that trend. First, the NCUA reduced the voting period to 30 days (contrary to the intent of the statute) by requiring the ballot to be sent only with the last notice of the special meeting. This requirement reduces the voting period to effectively three weeks when the outbound and inbound delivery times are taken into consideration. Second, with the proposal to ban the inspector of election from opening the ballots until after the special meeting, the institution loses the opportunity to notify a member that their ballot was not properly completed since they either did not indicate their vote or neglected to sign the ballot. Our clients always made the effort to contact the member and ask them if they wanted another ballot in the event they failed to properly complete the first ballot.

We support the proposal permitting the institution to track those members who voted in order to avoid additional costs and time in reaching out to members who already cast their vote, but question the prohibition on interim vote tallies. We also support the

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use of lockboxes (as used by Coastway Credit Union and Beehive Credit Union) to facilitate another convenient voting method for the members and providing blank ballots to members who need a ballot.

With respect to interim vote tallies, the NCUA noted in the preamble to the current rule that the 30 day ballot requirement mitigates any advantage that may be gained through interim reporting. 71 Fed. Reg. 77164. To date three MSB conversions have proceeded under the new rule. We question what has changed since the adoption of the rule that would support a regulation prohibiting interim tallies? Imposing this restriction on the institution will likely cause it to continue to solicit votes, **and spend the members' capital**, even though the vote outcome may be likely in one direction or the other due to the one-sided nature of the response, which would otherwise be known to the institution without the proposed rule's restriction. This rule is clearly in violation of CUMAA since we are not aware of any rule of a federal or state regulator that would prohibit the financial institution from obtaining interim tallies. The NCUA also references credit union conversions where it uncovered employees being pressured to only solicit members likely to vote in favor of the conversion. Again, we are only aware of one or two situations where the NCUA investigated allegations of improper voting process.

We hope our comments are helpful in the NCUA's review of the proposed rule. If you have any questions about this submission, please do not hesitate to contact me.

Very truly yours,

Richard S. Garabedian