

July 18, 2017

Gerard Poliquin
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3425

VIA: Electronic Mail

Dear Mr. Poliquin:

Re: Proposed Rules: Bylaws; bank conversions and mergers; and voluntary mergers of federally insured credit unions (12 CFR Parts 701, 708a, and 708b) (the Proposal)

While we support the proposed revisions, we believe more must be done to support both member-owner rights and their common financial interests when a solvent, sound institution — such as Miramar FCU in the case study below — decides to merge.

Member voting on a voluntary merger is a fundamental right for a cooperative owner. Democratic voting requires rules, procedures and information that provide participants the chance for an informed choice.

Almost all credit unions today have been active for at least three generations of members. All will have survived the market challenges of deregulation and two major financial crisis. All credit unions regardless of size have enormous franchise value. To obtain a new credit union charter today, requires years of effort and millions of donated capital even to be considered by regulators. A board decision to end a functioning charter and transfer control of all accumulated assets, net worth, member relationships and future earnings should only be done after thorough due diligence and consideration of all options.

The example below shows how the minimum time period in the current rule can be manipulated so that there is no meaningful opportunity for members to read, analyze, gather more information and to make an informed decision — other than the one recommended in the mailing for the merger. In this case the effective time allowed was less than 10 days from the mailing date to the close of voting. This was in a case where the board would have spent a minimum of four months on the process, not including time considering options prior to the Board's approval of the merger.

In addition to the changes in transparency proposed, we recommend the following be added to the merger process:

1. A Public Notice be required at the time any merger proposal is submitted to the NCUA so that the members learn such an option is being considered as soon as possible in the process;
2. That the members' Special Meeting be scheduled at a point in time in the period for voting so that members have an opportunity to learn from each other about the merger. For example, the requirement might be that a Special Meeting be held at a minimum of 10 days before the close of voting;
3. That NCUA require the members' Special Meeting be open to the public, including the media, and that there be an official recording of the meeting, and that all members have an opportunity to change their vote at the meeting or prior to the end of voting.

4. That members be allowed to deliver properly completed and signed ballots for other members at the meeting;
5. That all voting records be preserved until the merger has been completed;
6. That the NCUA reserve the right to attend and monitor the meeting for proper meeting procedure.

Thank you for your consideration.

Why a New Merger Rule Is Vital

(first published June 30, 2017 on creditunions.com)

Summary: A look at one recent merger shows how information shared and withheld can influence the outcome: the disappearance of yet another credit union with a proud, long history. Members were not given the opportunity to make an informed choice.

One of the critical factors motivating the NCUA's proposed merger rule is the systematic subversion of cooperative democracy that has occurred in some of the insider-arranged sale of credit unions described in earlier articles.

In theory, members of a federal credit union must approve a board/CEO-initiated merger by voting in an election by ballot or in person to approve the action. They're almost always approved, so democracy must be working, correct?

Manipulating The Voting Process

Just because members vote doesn't mean they've given their informed consent. The key word here is "informed". Let's review the recent merger of [Miramar Federal Credit Union](#) (\$173.2M, San Diego, CA) into [Pentagon Federal Credit Union](#) (\$22.4B, Alexandria, VA).

According to the meeting notice, Miramar's board approved a merger with PenFed on Oct. 19, 2016. As in most mergers, this decision to transfer the control of all a credit union's assets, its collective capital, and all future opportunities was done in secret.

The required forms are then sent to NCUA including the Notice of Special Meeting announcement. NCUA sends its approval subject to a positive member vote.

So far, only the board and the NCUA are involved. No input sought from members. No public announcements.

The first document describing this decision is a Member Ballot Booklet dated Jan. 14, 2017, proposing the merger. Along with it is the Notice of Special Meeting of Members. That notice informs members that they can vote by ballot, which is enclosed, or in person at the Jan. 27, 2017, special meeting.

The date on the mailing, Jan. 14, 2017, is a Saturday. The following Monday is a federal holiday with no mail delivery. So, the earliest a member might learn about this event by mail is Jan. 17. Ten days before the special meeting and the mailed ballots are due.

Ten days is the minimum timeframe under NCUA rules that members must be given notice and time to vote on a merger. Realistically, most members would have at most a week to receive, evaluate, and act on the proposal. Those members outside the area or deployed — this is, after all, a military-based credit union — may not have time to even reply with a mail ballot that must be received no later than “5:00 PM on January 27.”

The limited time provided made it extraordinarily difficult for any member to do any research, let alone connect with other members who might be skeptical, and to try to question, let alone oppose, the board’s decision to end Miramar FCU’s 65-year-old charter and its unique focus on Marine Corps Air Station Miramar.

The information presented to members 10 days before the vote did not include the fact that they would lose access to their ATM and shared-branch network, or a direct comparison of the other actual products and services they would lose from Miramar and gain with PenFed.

Miramar’s members were provided four pages of general information plus summary financial data and asked to transfer all the collective operations and resources to PenFed and end the credit union’s independent activity.

Here’s the explanation for the merger from the member booklet: “To ensure continuity of operations while seeking expanded product offerings and improve services, we have been diligently searching to find alternatives.”

Why? “In today’s market of ever changing technology, low interest rate environment and increasing cybercriminal threats, our board ... foresaw the loss of financial viability in light of these continuing issues.” (*This is from a top-performing credit union. More on that below.*)

Both the cover letter from the board chair and the meeting notice put in bold type the statement: “After approval by Miramar FCU member vote, a one-time capital distribution equal to 5% of member regular shares as of Dec. 31, 2016 (approximately \$3,100,000) will be distributed pro rata to each eligible Miramar member prior to the merger.”

An obvious incentive to vote yes or lose out on a special dividend.

Now, 5% would appear generous until one realizes that it is being paid on only 42% of shares, so that the real return on member savings is closer to 2%.

The notice also says all employees will be given a three-year guarantee of employment and a retention bonus, upon approval, of a maximum of 10% of salary. The CEO receives a six-year employment guarantee and a 10% salary increase. At that point, in October 2016, the CEO had been there for just more than two years.

Miramar’s board recommended the members vote “yes” to approve the merger. There is no comparison of rates, specific products or services and even key performance indicators. This single member communication is designed to make a merger appear reasonable and considered.

The result? [PenFed announces on Jan. 27](#), the day of the vote, that members approved the merger by an “overwhelming margin.” What that margin was or even the number of votes, was not included in that prepared statement.

Were Members Properly Informed Before The Vote?

The information presented to members 10 days before the vote did not include the fact that they would lose access to the CO-OP ATM and shared-branch network, or a direct comparison of the other actual products and services they would lose from Miramar and gain with PenFed.

Directors have a fiduciary responsibility to present more than a one-sided, general marketing message in their duty to properly inform members. Otherwise, the process is democratic in name only; members are being asked to endorse a decision that they were not consulted on; a decision in which only one point of view is presented; and to do so in a time frame (10 days) that precludes any efforts to learn about options.

Certainly, merger was not the main point in the first, and only, edition of *Where Military Matters Newsletter* that the credit union published in the fall of 2016. There, CEO Paul Socia promises “to communicate to you, our members, on a quarterly basis what we are doing here at MFED.”

Then he asks the members to do two things “to help us become even a better credit union for you now and in the future.”

The two requests: help fight cybercrime. The second: tell family and friends “what a great credit union we really are!”

That newsletter also included a profile of Socia, who came to Miramar after seven years as CEO at a community bank in Michigan. The newsletter also highlights special products and the goal of the Chief Military Officer (C-MO) “to continue to build our reputation as San Diego’s CHOICE for our military.”

A month after this newsletter was sent to members, the board voted to merge.

Today’s capital-rich credit unions have financial capabilities that were created over generations. But that very success is what makes so many vulnerable to takeovers unless they’re defended by the same member commitment that created them in the first place.

A Sound, High Performing Credit Union

At December 2016, Miramar FCU had extraordinary numbers. It had a single office with \$175 million in assets, a 12.9% net worth ratio, 0.14% delinquency with an allowance coverage ratio of over 300%; an operating expense ratio of 2.5%, and an exceptionally low non-interest income/total revenue ratio of 7% (vs peer of 28.1%).

The credit union was a member of CO-OP’s 5,000 shared branch and 29,000 surcharge free ATM networks. More than 700 Miramar members used a shared branch at least once per month. There were seven shared branches and 93 ATMs within 20 miles of Miramar’s single office. PenFed has no branches in California and is not a member of the CO-OP network, although it does belong to the competing Allpoint network.

Additionally, Miramar offered products and services not available from PenFed, including Kasasa checking with up to 4% cash back on debit cards, HSA accounts, Popmoney to transfer funds electronically, and foreign currency exchange.

Miramar also offered a complete portfolio of business loans including commercial real estate, veterans and family business loans, SBA 7A loans, SBA 504 loans, and business lines of credit. PenFed offers no business loans. The CEO's success at growing the loan portfolio in 2015 was the subject of a January 2016 article on creditunions.com: [Trading Liquidity for Loans](#).

Members supported Miramar with high loyalty. The average share balance of \$21,500 and average loan balance of \$54,500 put Miramar in the 95th percentile in member relationships among all credit unions.

Additionally, Miramar's members are giving up control of all reserves accumulated since 1952 which PenFed values at \$21.4 million — this is after all the bonuses and special dividends have been paid from Miramar's balance sheet.

Two Additional Points

Two additional points also are cogent here: Any Miramar member who preferred PenFed's products or network could already join PenFed. They were already eligible. This wasn't pointed out in the pre-merger communications. This choice is now gone.

Secondly, PenFed is 120 times larger than Miramar. Its policies, underwriting, and corporate priorities will now control all of assets of Miramar members. Local control and influence are gone.

Why Reform Of Merger Rules Is Necessary

Miramar's fate is just the latest example of member-owners being treated like customers in these insider-arranged sales of cooperative charters. The members' rights and their collective capital have not been protected. Voting is a process without real substance.

Cooperatives were formed to empower members to collectively improve their financial opportunities. Their only resources were a sense of mission and the willingness to work together.

Today's capital-rich credit unions have financial capabilities that were created over generations. But that very success is what makes so many vulnerable to takeovers unless they're defended by the same member commitment that created them in the first place.

When checks and balances such as the democratic voting process become meaningless, then something much larger than a self-governing cooperative is gone. Member-owners have lost the ability to control their common property.

Miramar FCU's 7,000 members may not incur immediate harm; but they have lost an extraordinarily successful institution that they and their forebears created. And that is how freedom is lost, one small step at a time.

Submitted by:

Charles W. Filson, Chairman

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