AMERICAN BANKERS ASSOCIATION

1120 Connecticut Avenue, NW
Washington, DC 20036

1-800-BANKERS
www.aba.com

World-Class Solutions, Leadership & Advocacy Since 1875

C. Dawn Causey
GENERAL COUNSEL
Phone: (202) 663-5434
Fax: (202) 663-7523
E-Mail: dcausey@aba.com

December 1, 2003

Ms. Becky Baker
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428

Re: National Credit Union Administration; 12 CFR Parts 708a Conversion of Insured Credit Unions to Mutual Savings Banks; 68 Federal Register 56589 (October 1, 2003)

Dear Ms. Baker:

The American Bankers Association ("ABA") is responding to the proposed rule published by the National Credit Union Administration ("NCUA") concerning amendments to its conversion regulations. ABA supports the mutual depository industry and its right to choose the charter appropriate for its marketplace and community. The proposed NCUA rule mandates a series of disclosures that contradict and violate the regulations of other financial regulators in contravention of the Credit Union Membership Access Act ("CUMAA") that directed the NCUA to permit insured credit unions to convert to mutual savings banks "subject to the requirements and procedures . . . governing mutual savings banks and savings associations."[1] By proposing rules that are inconsistent with those governing mutual savings banks and savings associations, the NCUA improperly intrudes into the jurisdiction of other, more experienced, financial regulators for which it has no basis in statute and exceeds its authority. The proposal also demonstrates NCUA's lack of support of the concept of mutuality and its ability to adapt and provide quality and innovative services.

The ABA brings together all categories of banking institutions to best represent the interests of this rapidly changing industry. Its membership—which includes community, regional, and money center banks and holding companies, as well as savings associations, trust companies, and savings banks—makes ABA the largest banking trade association in the country.

Background

In 1998, CUMAA was enacted, among other items, to clarify the steps required for a credit union to convert to a mutual savings bank. Section 202 of CUMAA amended the provisions of the Federal Credit Union Act ("Act") and required NCUA to allow an insured credit union to convert to a mutual savings bank or savings association

[1] 12 USC 1785(b)(2)(A).

"subject to the requirements and procedures set forth in the laws and regulations governing mutual savings banks and savings associations."[2] Further, NCUA was empowered to require an insured credit union that proposed to convert to a mutual savings bank or savings association to submit a notice to the NCUA of its intent to convert during the 90-day period preceding the date of the completion of the conversion.[3] Once the conversion is completed, "the credit union shall no longer be subject to any of the provisions of the [Federal Credit Union Act]."[4]

The NCUA in its interpretation of these CUMAA provisions has previously promulgated rules concerning the method by which the credit union member vote on conversion to a mutual savings bank or savings association is administered. NCUA's rules require a converting credit union to provide its members with written notice of its intent to convert in accordance with CUMAA.[5] It also specifies that the member notice must adequately describe the purpose and subject matter of the vote on conversion.[6] In addition, a converting credit union must notify NCUA of its intent to convert. The credit union must provide for NCUA's review a copy of the member notice, ballot, and all other written materials the credit union has provided or intends to provide to its members in connection with the conversion.[7]

The Proposal

NCUA proposes to require a converting credit union to disclose that the conversion from a credit union to a mutual savings bank could theoretically lead to members losing their ownership interests in the credit union if the mutual savings bank subsequently converts to a stock institution and the mutual depositors do not exercise their subscription right to purchase stock in the newly chartered institution. According to NCUA, a credit-union-to-mutual-savings-bank charter conversion is a "sophisticated transaction with consequences that might not surface for a number of years." Because of these concerns and in an effort "to achieve full disclosure and transparency," the NCUA proposes that converting credit union disclosures to depositors "must" include:

(d)(1)(i) a disclosure that the conversion from a credit union to a mutual savings bank could lead to members losing their ownership interests in the credit union if the mutual savings bank subsequently converts to a stock institution and the members do not become stockholders;

(ii) a disclosure that the conversion from a credit union to a mutual savings bank could lead to members having lesser voting rights in the mutual savings bank than they had in the credit union; and

(iii) a disclosure of any conversion related economic benefit a director or senior management official may receive including receipt of or an increase in compensation

---

[2] 12 USC 1785(b)(2)(A).
[3] 12 USC 1785(b)(2)(D).
[4] 12 USC 1785(b)(2)(E).
[5] 12 USC 1785(b)(2)(C).
[6] 12 CFR 708a.4.
[7] 12 CFR 708a.4.

and any foreseeable stock related benefits associated with a subsequent conversion to a stock institution.

(d)(2) In connection with the disclosures required by paragraphs (d)(1)(i)-(iii) of this section, the converting credit union must include an affirmative statement, that at the time of conversion to a mutual savings bank, the credit union does or does not intend to:

(i) convert to a stock institution;

(ii) provide any compensation to previously uncompensated directors or increase compensation or other conversion related benefits, including stock related benefits, to directors or senior management officials; and

(iii) base member voting rights on account balances."

ABA's Position

ABA is a longtime supporter of the mutual savings bank and savings association industry. Our membership rolls have long listed mutual savings banks, including the oldest mutual savings bank in active and continuous operation.[8] Mutuality is a choice that mutual savings banks make – it is a charter that reflects the values of its community and historical roots. Many mutual savings banks have charters that were first granted just after the Civil War. Mutuality is not the first step on a march to stock form. It is a choice and a form that remains vigorous, competitive, and innovative.

The NCUA's proposal ignores this long history and the approximately 700 mutual savings banks and savings associations that are active participants in the financial services industry. NCUA's proposal, based on limited experience, assumes that the entire mutual savings industry is merely waiting for the opportunity to convert to stock form. This is most certainly not the case. It is ironic that the NCUA, a champion of the mutual depository form, does not extend its support of mutuality to the mutual savings bank and savings association charter. It appears that rather than supporting all types of mutual charters, the NCUA only extends its support of mutuality to the charter that it regulates. There can be no other explanation for NCUA's attempt through this proposal to put in place disclosures that contradict the rules promulgated by the Office of Thrift Supervision ("OTS"), the Federal Deposit Insurance Corporation ("FDIC") and the state banking commissioners who all regulate mutual savings banks and savings associations and have overseen the conversion process for a considerable period of time. The multi-decade experience of these regulators significantly outweighs the NCUA's experience.[9] It was this greater experience that prompted Congress to require the NCUA to permit a credit union to convert to a mutual savings bank "subject to the requirements and procedures set forth in the laws and regulations governing mutual savings banks and

[8] The Bank of Newport in Providence, Rhode Island, opened its doors for business in 1819.
[9] The OTS has had supervisory authority for the mutual-to-stock conversion process since the mid-1970s.

savings associations."[10] Nothing in this proposal is consistent with the rules of the more experienced financial regulators.

Turning to the specifics of the rules, ABA has the following comments:

Voting Rights.

The NCUA proposed mandatory disclosure on voting rights is factually inaccurate. The OTS regulations, for example, give depositors greater voting rights, not fewer. The federal mutual charter grants depositors one vote per $100 of deposits with an upward cap of 1,000 votes.[11] The NCUA states that this will result in fewer votes rather than more votes. The facts do not bear out NCUA's assertion. Under NCUA's regulatory regime, depositors, no matter how large their deposits, receive only one vote. For the vast majority of credit union depositors, conversion to a federal mutual charter would significantly increase their voting power.

Notwithstanding this fact, the NCUA would require converting credit unions to mislead depositors in contravention of OTS rules and in violation of the spirit of Sarbanes-Oxley corporate governance goals of fair and accurate disclosure by requiring a disclosure that is simply not true. While mutual institutions are technically not subject to Sarbanes-Oxley provisions, the other regulators of mutual depository institutions have applied Sarbanes-Oxley principles that are consistent with the Federal Deposit Insurance Corporation Improvement Act and good corporate citizenship to mutuals. Requiring a factual incorrect statement under the guise of "full disclosure and transparency" does not reform the inaccuracy.

Further, deliberately misleading depositors would be a violation of the Federal Trade Commission rules (and the state FTC rules) that prohibit unfair and deceptive practices. Inaccurate disclosures that deliberately mislead are by their nature deceptive. The NCUA proposal places converting credit unions in a Hobson's choice -- follow the rule and violate other laws and regulations or violate the proposed rule and remain in compliance with other laws and regulations. The only purpose for such a conundrum is the NCUA's goal to indirectly prohibit credit unions from converting, a result beyond the statutory authority of the NCUA and a "takings" under the Fifth Amendment. For these reasons and others, the NCUA was directed by Congress to permit credit union conversions "subject to the requirements and procedures set forth in the laws and regulations governing mutual savings banks and savings associations."[12]

Forward Looking Statements

The NCUA also proposes to require converting credit unions to disclose to depositors if management intends to convert to stock form. While the language of the proposal states "at the time of conversion to a mutual savings bank," the incorporated references to the prior disclosures all impact the converting credit

[10] 12 USC 1785(b)(2)(A).
[11] 12 CFR 544.1.
[12] 12 USC 1785(b)(2)(A).

union's potential second conversion from mutual to stock form. A prudent member of management of a credit union would wisely interpret the two disclosure sections to set no time limit on the period covered by the mandated disclosures. Further, there is no provision for qualifying the disclosure to take into account future circumstances, *i.e.*, supervisory conversions, market conditions, or need to serve the community.

Once again, the NCUA contradicts the rules of more experienced, sister financial regulators. And those regulators have specific and detailed regulations that govern the type, timing and content of the disclosures given at the time of a mutual to stock conversion. For instance, under OTS regulation 12 CFR 563(b).120, a federal mutual that intends to adopt a plan of mutual to stock conversion cannot announce that fact until the plan of conversion is actually adopted by a two-thirds vote of the board of directors. If and when, a plan of conversion is adopted, the OTS requires extensive disclosures, including proxy statements and prospectus materials that are reviewed by the agency before they are sent to depositors. These disclosures set forth historical financial information on the institution, compensation for senior management and the board, and an explanation of the process of conversion and how a depositor may exercise his or her voting rights.

This process has been tested by the courts and represents over thirty years of experience with conversions in both difficult and favorable financial cycles. The availability of the mutual-to-stock conversion allowed certain institutions to weather the difficult decade of the 1980s by raising needed capital. The conversion process as administered by the other financial regulators is a tried and tested process. Because of the experience of other financial regulators in overseeing the operations of mutual institutions and administering the mutual-to-stock process, Congress expressly stated that the conversion from a credit union to a mutual savings bank would be "subject to the requirements and procedures set forth in the laws and regulations governing mutual savings banks and savings associations."[13] NCUA's attempt to influence or intercede into the conversion of a mutual savings bank from mutual form to stock is beyond its authority and jurisdiction. NCUA cannot promulgate a rule that extends into the jurisdiction of another financial regulator in a manner that is inconsistent with and violates the rules of another regulator.

Relatedly, requiring the disclosure of whether management intends to convert to a stock institution places the institution in litigation harm's way. If the institution states that it will not convert, yet may be required through a supervisory action to convert, for example, the institution, no longer regulated by the NCUA, would be at risk for depositor suit because of the conversion. If the converting credit union decides to disclose that it may convert to stock form in order to provide the greatest operational flexibility for the benefit of the community and the depositors, the mutual is at risk for litigation because it has not converted. Mutual savings banks have successfully fought depositor lawsuits seeking to force management to undertake a conversion or failing that action, trying to force the payment of the

[13] 12 USC 1785(b)(2)(A).

mutual savings bank's capital to depositors.[14] The threat and expense of defending frivolous litigation is real and the NCUA's proposal actually harms mutual institutions rather than protecting them or enhancing their opportunities.

In addition to the above disclosure about the potential of conversion to stock form, the proposal would require disclosure of benefits paid out of the conversion to senior management and members of the board. Again, such disclosure at the time of conversion to a mutual savings bank or savings institution is in violation of sister financial regulatory requirements. Both the FDIC and the OTS require a six-month waiting period after conversion to stock form before the board of directors may adopt a stock option plan, restricted stock plan or any other stock related benefits other than an ESOP plan, which by its very definition, is a qualified retirement plan that benefits all employees. Adoption of any of these plans requires a shareholder vote. Notwithstanding these specific requirements, NCUA would require a converting credit union to gaze into the future and disclose compensation for which there is no authority, and indeed is prohibited until the regulatory waiting period is complete.

Given the regulatory impossibility of the forward looking disclosures proposed by the NCUA, the proposal fails to meet any corporate governance disclosure standard whether contained in Sarbanes-Oxley, sister financial regulator requirements, or auditing standards. There is no basis in statute, regulation, or practice for such requirements. In fact, CUMAA simplified the conversion process[15] to avoid this result. It appears that the sole purpose of the proposed disclosures is the obstruction of the conversion of insured credit unions into mutual savings banks and savings institutions.

Improve Federal Credit Union Corporate Disclosures

Rather than attempt to extend its reach into the jurisdiction of other more experience financial regulators, NCUA should focus its regulatory efforts on its own regulated population and improve the transparency of the disclosures given by federal credit unions to their depositors in the spirit of Sarbanes-Oxley compliance. Among the disclosures ABA suggests that NCUA consider for federal credit unions are the following:

Require annual disclosures of all senior management's compensation and benefits to credit union members and a positive vote of the board's independent (not members of senior management) members to approve such compensation.
Whether or not the board of directors is independent from credit union management, the number of "inside" or senior management officials that serve on

[14] The latest lawsuits include an action filed this year against a Connecticut institution's plan of conversion and the 2001 lawsuit successfully defended by Gorham Savings Bank, Gorham, Maine. Notwithstanding the consistent findings by the courts of the appropriateness of the conversion process as administered by the states and the OTS, depositors continue to file lawsuits.

[15] Prior to the enactment of CUMAA, a majority of all members had to vote for the conversion. Effectively, NCUA treated non-votes as a proxy vote against the conversion – increasing the costs of converting to a bank charter. CUMAA lowered the threshold by requiring a simple majority of the members voting to approve the conversion.

the board of directors, and the qualifications of board members including whether or not anyone with financial expertise is a member of the board.
Disclose all benefits received by credit union board of directors.
The availability of NCUA required financial statements electronically or maintained in each branch or shared branch of the credit union, and whether the credit union is audited by an independent auditor and the availability of that audit to credit union members.
The capital ratios of the credit union both with inclusion of the NCUSIF contribution and without.
Regulatory actions that are active and in force taken against the credit union, its employees or management.

Such disclosures would begin to bring the federal credit unions into parity with their other federal depository regulators and improve the transparency of credit union management, including the board of directors. Such knowledge would allow credit union members to vote in an informed manner for board members and provide a basis for choosing among credit unions. Informed depositors choosing financially strong credit unions reinforces the NCUA's regulatory effectiveness.

Conclusion

ABA urges the NCUA to withdraw the proposed rule. It improperly invades the jurisdiction of other financial regulators, violates the CUMAA and other statutes and regulations, and contravenes basic corporate governance principles. In short, it is a proposal based on a desire to prevent credit unions from exercising their ability to choose their charter of choice – an authority and power denied the NCUA.

Thank you for the opportunity to comment. If you have any questions regarding our comment letter, please feel free to contact me.

Sincerely,

C. Dawn Causey