



June 27, 2006

NCUA PROPOSAL ON CONVERSIONS

EXECUTIVE SUMMARY

- The NCUA is proposing to amend its rules on the conversion of insured credit unions to mutual savings banks or mutual savings associations.
- The amendments are primarily intended to improve the information available to a credit union's members and its board of directors as they consider a possible conversion.
- CUNA has a chart comparing NCUA's current rule to its proposal. (See [Appendix A](#))
- The proposal requires a converting credit union to give advance notice to members that the board intends to vote on a conversion proposal and establishes procedures for members to share their views with directors before they adopt the proposal.
- The proposal clarifies that credit union directors may vote in favor of a conversion proposal only if they have determined the conversion is in the best interests of the members and requires the board of directors submit a certification to NCUA of its support for the conversion proposal and plan.
- The "boxed" disclosures that a credit union must provide to its members are simplified and the current delivery requirements changed.
- Under the proposal, the member ballot must be sent only with the 30-day notice.
- Board of directors would be required to set a voting record date not less than one hundred twenty days before the board notifies the members it is considering adopting a conversion proposal.
- After the board has approved an MSB conversion proposal and upon the request of a member, the proposal requires a credit union to disseminate information from that requestor to other members at the requestor's expense.
- Members of federally-chartered credit unions ("FCUs") may request and be granted access to the books and records of a converting credit union.
- The proposal requires the NCUA Regional Director to make a determination to approve or disapprove the methods and procedures for the membership vote within thirty calendar days of the receipt of the credit

union's certification of the member vote and permits any credit union dissatisfied with the determination to appeal to the NCUA Board for a final agency determination.

- A credit union would be required to complete a conversion within one year of the date of receipt of final approval from NCUA of the methods and procedures of the vote.
- The voting guidelines are modified to include information on the use of voting incentives such as raffles.
- **Please submit your comments to CUNA by August 14, 2006. Comments are due to the NCUA by August 28, 2006.**

Please feel free to fax your responses to CUNA at 202-638-7052; or e-mail them to Deputy General Counsel Mary Dunn at MDunn@cuna.com; or Assistant General Counsel Lilly Thomas at lthomas@cuna.com; or mail them to Mary or Lilly c/o CUNA's Regulatory Advocacy Department, 601 Pennsylvania Avenue, NW, South Building, Suite 600, Washington, D.C. 20004. Click [here](#) for a copy of this proposed rule.

BACKGROUND

Under the Federal Credit Union Act (FCUA), federally insured credit unions (FICU) may convert to a mutual savings bank or mutual savings association (MSB). NCUA first adopted a rule specific to conversions in 1995 and included required voting procedures and disclosures to properly inform members. Two of the stated purposes of the rule were:

- To ensure that transactions take place only pursuant to an informed vote of the credit union's member-owners; and
- To prevent self-dealing and other abuses by individuals involved in the transactions.

Congress adopted the Credit Union Membership Access Act (CUMAA) in 1998 which contained several provisions on the MSB conversion process. Among its requirements, CUMAA states:

- That a majority of directors must approve a proposal to convert;
- That approval of the proposal shall be by the affirmative vote of a majority of the members of the credit union who vote on the proposal;
- That a credit union provide members notice of the vote 90 days, 60 days, and again 30 days before the vote, and also provide the NCUA Board notice of its intent to convert;
- That there be restrictions of directors' and senior management's ability to receive economic benefits in connection with the conversion.

CUMAA also requires that NCUA administer the membership vote on the conversion and empowers NCUA to disapprove the procedures applicable to the member vote or the methods by which the member vote was taken. NCUA must also adopt rules governing MSB conversions, which must be:

- Consistent with the charter conversion rules promulgated by other financial regulators; and
- No more or less restrictive than rules applicable to charter conversions of other financial institutions.

Since the enactment of CUMAA, NCUA has amended its conversion rules three additional times to address various issues related to conversions and to incorporate suggestions from interested parties.

DISCUSSION OF PROPOSAL

The NCUA is proposing to amend its rules on the conversion of insured credit unions to mutual savings banks or mutual savings associations (collectively MSBs). The current conversion rule requires a credit union board wishing to convert to approve a conversion proposal by a majority vote and set a date for a member vote. The members must approve the proposal by the affirmative vote of those members who vote on the proposal.

This proposal clarifies that a credit union's directors may vote in favor of a conversion proposal only if they have determined that the conversion is in the best interests of the members. The directors and officers of a credit union have a fiduciary duty to act in the best interests of the credit union members and a director may be held personally liable for a breach of that fiduciary duty. The NCUA Board believes that credit union directors must faithfully fulfill their fiduciary duties to members by closely examining whether a charter conversion is in the members' best interest by reviewing all aspects of a conversion to an MSB.

The proposal contains several changes to the existing rule on conversions.

Notice and Ballot

- The current rule requires that a notice must be provided to members 90, 60, and 30 days before the vote. The proposal would require that the voting ballot be sent only with the 30-day notice.
- A new requirement is included regarding advance notice to the members of the board's intent to consider a conversion proposal. The credit union's board of directors would be required to publish a public notice indicating its intent to hold a board meeting for purposes of voting on a conversion proposal.
- The board would be required to publish the notice in a local area newspaper and on the credit union's website as well as post a notice in the credit union's offices no later than 30 days before the meeting. The notice will inform members that they may provide comment to the board before it votes to approve the conversion proposal.
- The credit union board would be required to review the member comments before it votes and if the credit union maintains a website, the credit union would also be required to post the comments in a clear and conspicuous fashion.
- The voting ballot would only be required to be sent with the 30-day notice. This provision differs from the current rule, which simply requires the ballot be

submitted to members no less than 30 calendar days before the vote. The ballot would set forth the proposal that the members are voting on and inform the members clearly and conspicuously that a vote for the proposal means the credit union will become a bank while a vote against the proposal means that the credit union will remain a credit union.

- The ballot may also indicate whether the board recommends a vote for or against the proposal, but may not contain any other information.

Disclosures

The proposal maintains the current disclosure requirements, namely, that:

- the notices to members must adequately state the purpose and subject matter of the proposal and inform members that they may vote either in person at the meeting or by submission of a written ballot;
- all information communicated to members by the credit union must be accurate and not misleading;
- in addition to disclosing the purpose, subject matter, date, time, and place of the special meeting, the three notices submitted to members must make certain disclosures relating to members' ownership interests and voting rights, as well as a disclosure regarding any conversion-related benefits to officials
- In addition to the disclosures above, the proposed rule would require that the 90-day and 60-day notices state in bold type, in at least 12-point font, that a written ballot will be mailed together with the 30-day notice.
- All three notices would disclose the impact of the qualified thrift lender test on the institution if it converts to an MSB. The disclosure should state, in a manner members can easily understand that, upon conversion to an MSB, an institution's focus may shift from providing a full array of consumer loan products to the more limited financing of mortgages and other qualified thrift investments.

Required Boxed Disclosures

- The NCUA Board is proposing to retain the disclosures required to be offset by borders ("boxed disclosures"), related to the profit potential by directors and senior management and the possibility of changes in rates.
- The proposed boxed disclosure contains a new disclosure in plain language that sets forth the effects of a member voting "FOR" a conversion: That the credit union will become a bank. A vote "AGAINST" the conversion means that the credit union will remain a credit union.
- Additionally, the delivery requirements are amended by requiring these boxed disclosures be delivered on a separate sheet of paper with no other text. The paper would be placed immediately after the credit union's cover letter and before any other information included with the notice.
- These disclosures would only need to go out to the members with the 90-day, 60-day, and 30-day notices. This is different than the current rule, which requires the credit union provide the boxed disclosures with all written communications to members.

Required Boxed Disclosures: Loan and Savings Rates

After engaging in the services of Datatrac Corporation¹ for gathering and analyzing data on historic loan and savings rates and reviewing a study by the Fiscal and Economic Research Center², the NCUA Board determined that members must be made aware that a conversion to an MSB may result in less advantageous rates. Therefore, it is proposing the following disclosure:

RATES ON LOANS AND SAVINGS. If your credit union converts to a bank, you may experience adverse changes in your loan and savings rates. Available historic data indicates that, for most loan products, credit unions on average charge lower rates than banks. For most savings products, credit unions on average pay higher rates than banks.

Proposed Boxed Disclosure: Benefits to Directors and Senior Management

The NCUA Board proposes to modify the boxed disclosures on benefits to directors and senior management to make it less subjective and easier to understand. The proposed disclosure language reads as follows:

POTENTIAL PROFITS BY OFFICERS AND DIRECTORS. Conversion to a mutual savings bank is often the first step in a two-step process to convert to a stock-issuing bank or holding company structure. In such a scenario, the officers and directors of the institution often profit by obtaining stock in excess of that available to other members.

Member Communications with Other Members

- The NCUA Board is proposing to establish a process for a member to communicate directly with other members after a board has approved an MSB conversion proposal to share information and views about the proposal.
- The rule permits members to submit written requests to the credit union requesting dissemination of information to other members at the expense of the member making the request.

¹ Information is available online at the American Bankers Association website, which states the following: Datatrac is the exclusive provider of deposit & loan interest rate data to the American Bankers Association, Credit Union National Association, National Association of Federal Credit Unions, Bank Administration Institute, and Financial Managers Society.

² Researchers at Fiscal and Economic Research Center at the University of Wisconsin – Whitewater examined the differences in loan and savings rates between credit unions and banks. J. Heinrich and R. Kashian, Credit Union to Mutual Conversion: Do Rates Diverge?, February 22, 2006.

- The member communication must be conversion-related and proper. Improper communications include those that are impracticable to deliver, relate to personal gain or grievance, or are otherwise false or misleading with respect to any material fact.
- The credit union would be required to send a communication by mail, or e-mail to those members who have agreed to accept electronic communication from the credit union at the member's request.
- The credit union would also be required to provide members an opportunity to post their opinions on a credit union's Website free-of-charge if the credit union itself posts conversion-related materials.
- Members would be required to deliver their request to communicate with other members within 35 days (five weeks) after the date of the 90-day notice. The credit union would have seven days to deliver the communication to its membership or, in the case of a dispute, to NCUA.
- The member must agree to reimburse the credit union for the reasonable costs of delivering the communication to other members and would be required to provide a credit union with an advance payment toward the reimbursable costs. When a credit union receives an advance payment, it would be required to first deliver the communication, and then work out any details regarding reimbursement of actual costs after delivery.
- The amount of the advance payment depends on how the requestor wants the communication delivered. For deliveries by regular mail, the payment would be fifty cents times the number of eligible voters. For deliveries by e-mail, the payment will be two hundred dollars regardless of the number of recipients.
- The proposed rule would require that the 90-day and 60-day notices include the number of credit union members eligible to vote and how many members agreed to accept electronic communications from the credit union.
- If a credit union believes a communication is not proper, it would be required to forward the communication to the Regional Director within seven days of receipt. The credit union would be required to include with its transmittal letter a statement as to why the credit union believes the communication is not proper and a recommendation for modifying the communication, if possible, to make it proper.
- The Regional Director would respond to the credit union within seven days with a determination on the propriety of the communication. After the Regional Director's review, the credit union must mail or e-mail the material to the members if directed.
- If the credit union cannot forward a member communication to other members before the date they receive the 30-day notice and associated ballot, the proposal requires the credit union to postpone mailing the 30-day notice until members receive the communication and postpone the date of the special meeting by the same number of days.

Notice to NCUA

- Currently, credit unions must notify NCUA of its intent to convert within 90 days of the member vote. The credit union must provide NCUA with copies of the notice and material it has or will send to the members.
- State chartered credit unions must provide certain information about the laws and regulations it intends to follow with regard to the conversion.
- The NCUA Board is proposing to require a credit union board to submit a certification of its support for the conversion proposal and plan signed by each supporting board member.
- The certification would include a statement that each director signing the certification supports the proposed conversion and believes that the proposed conversion is in the best interests of the members of the credit union.
- A description of all materials submitted to the Regional Director would be included with the certification and a statement that these materials are true, correct, current, and complete as of the date of submission as well as an acknowledgment that federal law prohibits any misrepresentations or omissions of material facts in connection with the conversion.
- A credit union can currently request NCUA to make a preliminary determination regarding the intended methods and procedures applicable to the membership vote.
- This proposal expands that right to allow a credit union to also request review of all of its proposed notices, including the public notice it intends to publish before the board of directors votes on a conversion proposal.
- The NCUA Regional Director would make a determination on the request within 30 calendar days unless more time is required to review the submission or obtain additional information.

Membership Approval

- Currently, the credit union board of a converting credit union must certify the results of the member vote to NCUA within ten days of the member vote and certify that the materials actually provided to the members were the same as those previously submitted to NCUA or explain the differences.
- This proposal would require the credit union board to set a date to determine member eligibility to vote.
- The voting date of record must be at least one hundred and twenty days before the credit union board publishes the notice of intent to consider conversion.

NCUA Oversight

- A Regional Director currently must issue a determination to approve or disapprove a credit union's methods and procedures for the membership vote within ten calendar days of the receipt of the credit union's certification of the member vote.
- The NCUA Board is proposing to lengthen this time period to 30 calendar days.
- A credit union dissatisfied with the determination would be permitted to appeal to the NCUA Board for a final agency determination.

- An appeal would be filed within 30 calendar days after receipt of the determination.

Completion of Conversion

The NCUA Board is amending the current rule to require a credit union to complete the conversion transaction within one year of the date of receipt of its approval from NCUA.

Additional Proposed Amendments

- The proposed rule includes a new provision stating that members may request access to the books and records of the converting credit union for purposes such as facilitating contact with other members about the conversion or obtaining copies of documents related to the due diligence performed by the credit union's board.
 - Member access to books and records of state-chartered credit unions is determined by applicable state law.
 - A credit union would be required to grant access under the same terms and conditions that a state-chartered for-profit corporation in the credit union's state must grant access to its shareholders.
- Credit unions offering incentives to members, such as entry to a prize raffle, to encourage participation in the conversion vote, must exercise care in the design and execution of such incentives.
 - The proposed voting guidelines state that credit unions should ensure that the incentive comply with all applicable state, federal, and local laws; that the incentive should not be unreasonable in size, and that all materials promoting the incentive to members should make clear that they have an equal opportunity to participate in the incentive program regardless of whether they vote for or against the conversion.
- The proposal also adds two additional definitions in its conversion rule.
 - The proposed definition for the phrase "clear and conspicuous," would be "text that is in bold type in a font at least as large as that used for headings, but in no event smaller than 12 point."
 - The second proposed definition clarifies that the term "regional director" for natural person credit unions means the NCUA director for the region where the credit union's main office is located and for corporate credit unions means the Director, NCUA Office of Corporate Credit Unions.

QUESTIONS REGARDING THE PROPOSAL

1. The proposal requires the credit union board to publish a public notice in a local area newspaper, on the credit union's website and in the credit union's offices indicating its intent to hold a board meeting for purposes of voting on a conversion proposal. Do you believe these communication channels are

appropriate? Should other communication channels be used in addition to or in lieu of these channels? Please explain.

2. The proposal is retaining disclosure language that, after conversion, a member may experience adverse changes in rates. Do you agree with the proposed disclosure language? Please provide any comments on how rates, fees, and service levels may have changed in credit unions that have converted to banks. Please explain.

3. NCUA's proposed 'boxed disclosure' retains, but modifies the disclosure language about profits by directors and officers. Do you agree with the proposed disclosure language? Please provide any comment on compensation changes occurring in credit unions converting to banks. Please explain.

4. Do you believe that the amount of advance payment required from a member requesting to send a communication to other members is reasonable? Please explain.

5. Do you believe that the method of member-to-member communication is appropriate? Are there better alternatives for facilitating communication among members, such as:
- a. Sending an electronic communication to those members who have agreed and by mail to those who have not agreed to receive electronic communications? Please provide information on the burdens to credit unions to organize a multiple-method communication under the prescribed timelines.
 - b. Sending the members the requestor's contact information along with a statement that the requestor wishes to discuss the conversion with an

indication whether the requestor generally supports, opposes or is neutral on the conversion.

- c. Requiring the requesting member to prepare the mailing materials themselves, including packaging and sealing and posting the envelopes.
- d. Referring to state corporate law for member access to membership mailing lists.
- e. Any other alternative method for facilitating communication.

6. Should NCUA apply this method to all member communications and not just to those communications regarding a pending conversion to an MSB? Please explain.

7. The current rule requires converting credit unions to accept ballots either by mail or in-person. NCUA is considering amending the rule to permit credit unions, if they wish, to accept member ballots electronically. Do you support this amendment? Please explain.

8. Do you believe offering incentives to members, such as entry to a prize raffle, to encourage participation in a conversion vote detracts from the fairness of the vote? Please explain.

9. Please provide any additional comments.

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