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August 28, 2006

Via 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. - Comments on Proposed Revisions to 12 C.F.R. Part 708a

Dear Ms. Rupp:

We appreciate this opportunity to comment on the above-noted proposed rule of the National Credit Union Administration. Luse Gorman Pomerenk & Schick's attorneys have successfully completed 14 charter conversions and have been involved with the conversion process from its infancy. Moreover, Luse Gorman Pomerenk & Schick is one of the leading financial institutions law firms in the nation, and we have completed numerous charter conversions by commercial banks, savings banks and savings associations. Accordingly, we believe that we have unique insight into the feasibility and fairness of rules relating to financial institution charter conversions, including conversions of credit unions.

General

We believe the conversion process, based on the *current* NCUA conversion rules and our extensive experience with such rules, is unnecessarily cumbersome, time-consuming and expensive. Unfortunately, the proposed amendments to the conversion rules, rather than providing much-needed relief, would only exacerbate the problem by adding even more hurdles. Indeed, the cost of converting from a credit union to a savings bank far exceeds the cost of any other financial institution charter conversion. The proposed rule may have the effect of preventing credit union charter conversions, which is clearly contrary to the Congressional intent under the Credit Union Membership Access Act. As a result, we are disappointed with the NCUA's proposed rules, as they would clearly frustrate the conversion process. In practice, the NCUA's charter conversion rules, both existing and proposed,

present a snare for even the best-intentioned institutions. The rules suggest a clear and ongoing bias against savings bank charter conversions by a federal agency that should, instead, be neutral in this process. Accordingly, we recommend that the proposed rules be withdrawn.

We also believe that the NCUA should carefully re-examine its *existing* rules on conversions, especially in light of the recent federal court invalidation of the NCUA's enforcement of its current conversion rules. This judicial action suggests that the NCUA should work to make its existing rules simpler and fairer. In doing so, we believe that the NCUA must bear in mind the statutory mandate that its rules be consistent with and *no more restrictive* than the charter conversion rules of other financial institutions regulators. Unfortunately, rather than accept this statutory directive for what it is -- an invitation to benefit from the decades of experience of other *federal* regulators in overseeing charter conversions, the NCUA staff has treated this statutory mandate as a barrier to be overcome.

Specifically, instead of examining each and every charter conversion requirement in its existing rules against decades of practical experience by federal regulators like the Federal Deposit Insurance Corporation, the Office of Thrift Supervision and the Office of the Comptroller of the Currency, the NCUA references untested and/or novel regulations by state authorities in Michigan, Hawaii, Vermont and the like. This is directly contrary to the statutory mandate at 12 U.S.C. § 1785(b)(2)(G), which states that the NCUA:

> "shall promulgate final rules applicable to charter conversions described in this paragraph that are consistent with rules promulgated by other financial regulators, *including the Office of Thrift Supervision and the Office of the Comptroller of the Currency*. The rules required by this clause shall provide that [a] charter conversion 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." [emphasis supplied].

Further, in examining its charter conversion rules against those of sister federal regulators, the NCUA continues to focus on the wrong type of conversions. Specifically, for many years, the FDIC, OTS and OCC have administered state-to-federal charter conversions, federal-to-state charter conversions, commercial-bank-to-thrift charter conversions, and thrift-to-commercial-bank charter conversions. Yet the NCUA ignores, without explanation, these time-tested conversion rules in evaluating its own conversion rules. Instead, the NCUA focuses primarily on mutual-to-stock conversions, where the financial institution does not convert to another-type financial institution, but rather merely changes its ownership structure. Alternatively, the NCUA considers various state regulations on *credit union* charter conversions, contrary to the statutory mandate that the NCUA consider regulations on charter conversions by "other financial institutions" (i.e., *non*-credit unions).

Finally, rather than simply examine each hurdle in its existing rules to see if there is a counterpart in the FDIC's, OTS', and OCC's charter conversion rules, the NCUA presents a conclusory and unpersuasive analysis that fails to focus on the concrete rules of those sister federal agencies. The result is that ***no other federally chartered or insured financial institution faces as difficult a route to conversion as federally insured credit unions***. Very simply, that fact is evidence that the NCUA's existing rules fail the statutory mandate, and should be re-examined.

Unlike a case where a regulator has unbridled authority to adopt regulations as it may choose, the Congress has specifically limited the NCUA's authority to regulate the conversion of federally-insured credit unions, and the NCUA must craft regulations that are consistent with federal law. Although many credit union industry leaders may believe that the NCUA has a blank canvas on which it may paint, the statutory framework must be observed and not ignored. Clearly, those advocating more and cumbersome regulation do not grasp the Congressional mandate.

In our experience, credit unions that have sought the mutual savings bank strategic option have considered it thoughtfully and deliberately, in many cases over a period of years. As the NCUA is keenly aware, the credit union charter has certain disadvantages that can only be addressed through a charter change. As evidence, we need only point to efforts by credit unions to improve their charter through the legislative process in a number of areas where the thrift charter is superior (e.g., capital standards, member business loans). 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 credit union trade groups and other commentators that have no fiduciary obligation to credit union members and are under no legal obligation to comply with the disclosure requirements is most troubling. It clearly is an area that the NCUA needs to address but has failed to do so.

Specific Comments

Our specific comments are as follows:

Section 708a.3 - Advance Notice of Board Action

The NCUA proposes that members receive advance notification of a board's consideration of a charter conversion through publication on its website, appropriate newspaper notice and posting in the branches. Comments received from members must be posted on the credit union's website if it maintains one. We see no statutory basis for this proposal and, indeed, Section 205(b)(2)(B) of the Federal Credit Union Act states that a proposal to convert "shall *first* be approved ... by a majority of the directors." [Emphasis supplied]. The proposed rule attempts to evade this statutory requirement by mandating that a board of directors first notify members before voting on a charter conversion.

The rationale for this proposal appears to be an attempt to provide a basis for a more informed board and membership regarding a proposed conversion. However, requiring notice of a potential significant corporate transaction before the board acts on it would be unprecedented under general principles of corporate governance and federal/state corporate law. Moreover, there is no counterpart in the conversion regulations of the NCUA's sister federal regulators.

The NCUA proposal takes the governance of a credit union from the board of directors and places it in the members' hands. The NCUA proposal is likely to be unworkable and, in practice, discourage candid and informed discussion by a board of directors. The existing rules provide credit union members far more time to consider a charter conversion than that allowed by any other bank regulatory agency or allowed to stockholders in connection with complex corporate transactions such as mergers and reorganizations. The proposal would only serve to allow activist members (who are often financed by credit union trade groups) to disrupt the conversion process and intimidate boards through actual or threatened litigation.

The board is elected by the members to make decisions in the best interests of the members. Imposing an advance notice requirement makes the assumption that a board of directors does not have an understanding of the issues facing the credit union and the needs of the members (which can be ascertained through any number of methods, including surveys, newsletters, direct personal contact and hotlines). It is important to remember that members are most likely interested in one thing – affordable and convenient financial services, regardless of the type of charter. The complexity of running a financial institution and ensuring its future success is not their concern, but that of the board.

If a board believes preliminary member input would be useful, it should have the option, but not the obligation, to seek member input. As noted above, there are any number of decisions that a board makes that may have far more financial or other significance than a charter conversion, yet the board is under no legal obligation to seek member input for those decisions (e.g., merger, new branches, new data processor, etc.).

Although the NCUA notes that the OTS requires publication of a newspaper notice, this notice is required *following board action*. The proposed rules impose a requirement that is more restrictive than any rule of the OTS or the OCC, since neither agency has a requirement that shareholders or members be told in advance of a proposed charter conversion.

In practice, this proposal also would be burdensome for credit unions, as well as the NCUA, and would cause additional delays in the already lengthy and cumbersome charter conversion process. Since the notice requires a statement of the reasons for the conversion and the negative and positive impact of the transaction (which will reflect the opinion of the board), it is likely to cause disputes as to whether the notice was sufficient. In light of this potential, it is likely that institutions will seek NCUA's review of the notice to members *before it is published*, since the failure to post a compliant notice places the institution at risk to restart the process.

Comments received from members must also go through the same screening process in the proposed Section 708a.4(f)(5), again engendering delay and imposing additional costs and management burdens upon the institution. Under current regulations, each member already receives 90 days notice of the special meeting, far more time than is required under general principles of corporate governance. For those members who have a sufficient interest to reach out to other members, three months would seem sufficient.

We are aware of only one attempted conversion where this process was required. According to the meeting materials used in the attempted charter conversion of Lake Michigan Credit Union, the credit union had 81,000 members at the time of the attempted conversion and received comments from 474 members, or 0.6% of the outstanding membership. Although this case would not necessarily reflect what may occur in future charter conversions, one must ask whether the additional notice (which under Michigan law was sent to each member), serves any meaningful purpose when the response in the Michigan case was clearly immaterial. The apparent apathy of the members could have been due to any number of things, such as the members' lack of interest, failure to notice the mailing or agreement with the proposal.

Section 708a.4(a) - Ballot Delivery

The proposed rules provide that the ballot may only be delivered with the 30-day notification. The basis of this rule change is to allow the members "time to consider the advantages and disadvantages of a conversion proposal before voting." 71 Fed. Reg. 36951 (June 28, 2006). We believe that this proposal has the unintended consequence of reducing the opportunity to vote for a number of reasons. It also assumes, without any empirical or anecdotal support by the NCUA, that a member needs 60 days to consider his or her vote before actually casting it.

Delivering the ballot with the 30-day notice actually reduces the opportunity for the member to exercise his or her voting right to about three weeks because it fails to account for delivery time to the member and back to the institution. Thus, members who may be away from home, distracted by events in their lives, stationed in a foreign country or simply overwhelmed by the volume of mail, may not focus on the need to act promptly until the time for action has passed. In short, the rule clearly penalizes those members that fail to pay attention to the conversion process for another two months after receiving the initial notice of the special meeting.

We know of no similar requirement under general principles of corporate governance or state/federal corporate law that asks a shareholder or an owner to vote on a matter and then deprives the shareholder of the ability to vote for 60 days. This delay makes no practical sense and is likely to encourage indifference, inattention or mocking the process ("You ask for my vote and you expect me to wait another 60 days!"). We recognize that a few states have taken this approach; however, we do not believe that this is a model worth pursuing.

Under the current process the members are free to vote either as quickly or as deliberately as they choose, which is clearly their right. That is, each member normally receives a ballot with the 90-day mailing and has *a full 90 days in which to decide how to vote.* The NCUA should not presume that a member needs more time to vote in the absence of any documented evidence to the contrary, particularly where reducing the voting window clearly has a negative impact without a demonstrable benefit.

Section 708a.5 - Notice to NCUA

In proposed Section 708a.5(a)(2), the NCUA requires the board of directors to undertake a number of actions that would undermine the integrity of the board of directors, and is unprecedented.

Section 708a.5(a)(2)(i) requires each director to certify he/she supports the conversion and believes that it is in the best interests of members. The stated purpose of this proposed rule is to prevent board action motivated by personal enrichment. It is self-evident that the board should only make a decision to undertake a conversion if it is in the best interests of the members of the credit union (a standard that applies to any and all decisions made by the board of directors). What is in the members' best interests is also a subjective determination of the board, as some members may want the expanded services offered by a savings bank and others may be indifferent to such additional services. To require this certification is redundant and any board resolution adopting a plan of charter conversion would certainly cover this basic principle. If credit union board members were motivated by personal enrichment, would not there have been far more than the handful of charter conversions that have occurred over the past ten years?

Further, there is no counterpart in the conversion regulations of the NCUA's sister federal regulators, or even cited by the NCUA. As noted above, the statute authorizing the proposed rules mandates that the proposed rules be consistent with those of other financial institutions regulators. Yet the NCUA, in its proposed rulemaking, does not even attempt to justify this certification requirement by comparison to certifications required by other financial regulators. Indeed, the certifications required by other financial regulators that are referenced by the NCUA either are: (i) not certifications by *directors*, but rather by *officers*; or (ii) are certifications that having nothing to do with a board's fiduciary duties. In fact, *no* other federal or state regulator, to our knowledge, requires a board to certify that it has fulfilled its fiduciary duties as required by the NCUA's proposed rule.

Finally, the summary of the proposed rule does an excellent job of showing (by reference to case law) that board members of credit unions owe no more and no less a fiduciary duty as board members of other institutions, financial and otherwise. Yet, for unexplained reasons, only credit union directors need to certify that their actions comport with their fiduciary duties, and only with respect to one board decision-- the decision to convert to a mutual savings bank. Implicit in the NCUA's proposal is that the decision by a board to convert to a savings bank

charter is tantamount to the completion of the conversion and that members cannot decide for themselves whether to approve or reject a board's decision.

Section 708a.5(b)(2)(iv) requires that each director acknowledge that federal law prohibits any misinterpretations or omissions. If NCUA adopts this type of certification, which we believe is unnecessary, it should be amended to reflect the statutory qualifier that a violation of the noted section (which is a criminal statute) only occurs if the noted actions are made "knowingly and willfully" by the person. As the certification is proposed, it will require a director to be held responsible for a violation of the certification whether or not any information was made "knowingly or willfully" in the materials by the director, clearly not what we believe is intended by NCUA. We also note that the criminal sanctions of 12 U.S.C. §1001 apply whether or not any certification is provided by the directors.

Section 708a.4(b)(4) – Ballot

The proposed disclosure on the ballot in Section 708a.4(b)(4)(iii) appears duplicative of 708a.4(b)(4)(i). If the credit union changes to a mutual savings bank, it is no longer a credit union. That should be clear to the member from the language in Section 708a.4(b)(4)(i).

Section 708a.4(b)(4)(iii) also provides that "A vote FOR the proposal means that the credit union will become a bank." [emphasis supplied]. This language should read that the "credit union will become a mutual savings bank." In the conversion, the credit union is not converting to a bank but a mutual savings bank or savings association.

Section 708a.4(f) – Communication Among Members

This section is likely to result in a protracted and costly process for both the credit union and the NCUA in policing the process, and also disrupt and delay the conversion, which cannot be the NCUA's intention. Clearly, requiring a converting credit union to post member comment letters on the credit union's website would suffice, if the NCUA determines to adopt this rule, and would be a cost-effective method of communication. Although we recognize that the OTS does have a process for member communication it is not limited to conversion transactions, and the OTS rule was adopted before Internet communication became widespread. Further, the savings association member must bear the complete cost, unlike the proposal which imposes a limit. Subsidizing members' communications only increases the risk of frivolous comments. Having followed many of the comments issued in previous conversions this proposal is ripe with the potential for protracted delay and expense. Under the current rules the members are free to communicate as they wish without the involvement of the NCUA and the institution. In any event, we do not agree with any of the alternatives suggested by the NCUA since they may, among other things, allow the member to place materials in an envelope that would otherwise violate the informational standards set forth in the regulation.

708a.4(d)(1) – Boxed Disclosures

We think the boxed disclosures should be eliminated because it implies a one-size-fits-all standard. We have the following comments on the boxed disclosures:

2. Rates of Loans and Savings – this disclosure provides in part in the first sentence "If your credit union converts to a *bank* [emphasis added]." The conversion does not involve a change to a commercial bank, it involves the conversion to a mutual savings bank and the language should reflect that to be correct.

3. Potential Profits by Officers and Directors – this disclosure also uses the word "bank" when it should reflect "savings bank" in the first sentence.

Section 708a.12 – Access to Books and Records

We are aware of the NCUA's position that members of a federal credit union are in a position analogous to the shareholders of a for profit stock corporation and, therefore, a federal credit union should look to state corporate law on questions of corporate governance in the absence of any federal law to the contrary. We certainly do not agree that the ability of a credit union member to gain access to confidential corporate documents should be based on the rights of a shareholder of a stock corporation. To grant a member of a credit union the same legal rights and privileges as a stockholder of a corporation ignores substantial differences between the attributes of a stockholder and a credit union member. A member has essentially a creditor /debtor relationship with a credit union. The member has no ability to transfer his or her ownership interest and has put no capital at risk. A deposit by a member, on the other hand, is typically insured by the NCUSIF and is not at risk. Moreover, the member has an interest in the retained earnings of the credit union that were generated by former and current members.

To allow a member access to such documents in a vacuum without the benefit of the discussion that occurred in the deliberations raises the real risk that the member will be mislead and misinformed. Without the benefit of the experience possessed by the board that was used to evaluate the information, as well as the discussions among the board and its advisors, a member is simply not going to have a full and complete appreciation of the issues. The reality is that the typical member probably does not understand the significance of net interest margin, the dynamics of running an institution and what it takes to ensure that the institution continues to provide service and value to the members.

In addition, allowing a member to copy sensitive documents raises a substantial reputational risk since such documents can be easily copied or even altered at will and used in any fashion that suits the member. It is important to keep in mind that unlike an ordinary stock corporation, or even a farming or food cooperative, what is at risk here is the reputation of a federally insured institution with the backing of the NCUSIF and ultimately the United States Government. At most, a credit union should have the option, but not the obligation, to allow the

examination of documents under its own procedures to ensure confidentiality is maintained. In short, the proposed regulation is only likely to lead to protracted and expensive litigation.

We assume that the proposed access to corporate records does not include a member's name and address since release of that information raises a host of privacy concerns and potential liability that a federal credit union should not be subjected to under any circumstance.

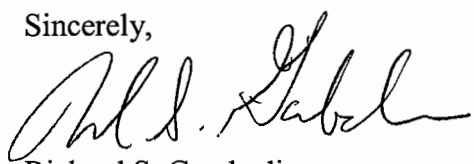
Relationship to Other Transactions

As a general matter there are a number of provisions in the proposal that if adopted, should apply equally to all material transactions undertaken by a credit union, such as mergers, conversion to a state or federal charter, liquidation or the relinquishment of federal deposit insurance. For illustrative purposes, a merger of a federal or state credit union should be required to follow the same procedures in Sections 708a.3, 708a.4(d)(1) (appropriately modified), 708a.4(f) and 708a.5(a)(2). A merger has a number of characteristics that NCUA should be as concerned about as it is with a conversion to a savings bank charter. In this regard, unlike a charter conversion, in a merger the target credit union ceases to exist, the members lose their institution and their board of directors and financial incentives may be offered to the target's executive officers. Thus, the need for members to be fairly and fully informed is equally applicable.

* * * * *

We hope this comment letter is helpful in evaluating the proposed rule, and we appreciate having the opportunity to offer our input on these important matters. Please do not hesitate to contact the undersigned at (202-274-2030), Robert B. Pomerenk (202-274-2011) or Eric Luse (202-274-2002) of this office should you have any questions regarding this letter.

Sincerely,



Richard S. Garabedian

Cc: Eric Luse, Esq.
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