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National Credit Union Administration

12 CFR Part 708a

Conversion of Insured Credit Unions to Mutual Savings Banks; Proposed Rule

NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Part 708a

Conversion of Insured Credit Unions to Mutual Savings Banks

AGENCY: National Credit Union Administration (NCUA).

ACTION: Notice of proposed rulemaking with request for comments.

SUMMARY: NCUA proposes to amend its rules regarding the conversion of insured credit unions to mutual savings banks or mutual savings associations. The proposed revisions are primarily intended to improve the information available to members and the board of directors as they consider a possible conversion. The revisions include revised disclosures, revised voting procedures, procedures to facilitate communications among members, and procedures for members to provide their comments to directors before the credit union board votes on a conversion plan.

DATES: Comments must be received on or before August 28, 2006.

ADDRESSES: You may submit comments by any of the following methods (Please send comments by one method only):

- Federal eRulemaking Portal: *http://www.regulations.gov.* Follow the instructions for submitting comments.
- NCUA Web site: *http://www.ncua.gov/RegulationsOpinionsLaws/proposed_regs/proposed_regs.html.* Follow the instructions for submitting comments.
- E-mail: Address to *regcomments@ncua.gov.* Include ''[Your name] Comments on Proposed Rule Part 708a'' in the e-mail subject line.
- Fax: (703) 518–6319. Use the subject line described above for e-mail.
- Mail: Address to Mary Rupp, Secretary of the Board, National Credit Union Administration, 1775 Duke Street, Alexandria, Virginia 22314–3428.
- Hand Delivery/Courier: Same as mail address.

FOR FURTHER INFORMATION CONTACT: Jon J. Canerday, Trial Attorney; Moisette I. Green, Staff Attorney; Frank S. Kressman, Staff Attorney; Paul M. Peterson, Staff Attorney; or Gerard S. Poliquin, Trial Attorney, Office of General Counsel at the above address or telephone number: (703) 518–6540.

SUPPLEMENTARY INFORMATION:

A. Background

NCUA's Current Regulation

Under the Federal Credit Union Act (''FCUA''), a federally insured credit union (''credit union'') may convert to a mutual savings bank or savings association in mutual form (collectively referred to as ''MSBs'') subject to the FCUA and NCUA's implementing regulations. 12 U.S.C. 1785(b)(2); 12 CFR Part 708a. In 1995, NCUA first adopted a rule that specifically addressed conversion or merger of a credit union into an institution other than a credit union. 60 FR 12695 (March 8, 1995). Two of the stated purposes of the rule were: (1) To ensure that transactions take place only pursuant to an informed vote of the credit union's member-owners; and (2) to prevent self-dealing and other abuses by individuals involved in the transactions. *Id.* The rule included, among other things, required voting procedures and disclosures to properly inform members.

In 1998, Congress adopted the Credit Union Membership Access Act (''CUMAA''). CUMAA contains several provisions on the MSB conversion process. It states that a majority of directors must approve a proposal to convert, and 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. 12 U.S.C. 1785(b)(2)(B). It requires that a credit union provide members notice of the vote 90 days, 60 days, and again 30 days before the vote, 12 U.S.C. 1785(b)(2)(C), and also provide the NCUA Board notice of its intent to convert. 12 U.S.C. 1785(b)(2)(D). And it restricts the ability of directors and senior management to receive economic benefits in connection with the conversion. 12 U.S.C. 1785(b)(2)(F).

CUMAA also provides NCUA a role in the MSB conversion process. It requires that NCUA ''administer[]'' the membership vote on the conversion and empowers NCUA to ''disapprove[] of the methods by which the member vote was taken or procedures applicable to the member vote.'' 12 U.S.C. 1785(b)(2)(G). CUMAA further requires that NCUA adopt rules governing MSB conversions. *Id.* These rules must be: (1) Consistent with the charter conversion rules promulgated by other financial regulators; and (2) no more or less restrictive than rules applicable to charter conversions of other financial institutions. *Id.*

NCUA issued interim final rules shortly after the passage of CUMAA. 63 FR 65532 (Nov. 27, 1998). In the eight years since, NCUA has amended its conversion rules three additional times to address various issues related to conversions and incorporate suggestions from interested parties. 64 FR 28733 (May 27, 1999); 69 FR 8548 (Feb, 24, 2004); and 70 FR 4005 (Jan. 28, 2005). In all of these rulemakings, NCUA has been motivated by the same concerns it expressed during the first rulemaking in 1995: that members are entitled to make an informed decision on a conversion proposal and that they should be protected against the potential for self-dealing by credit union management and directors. Among other things, the current part 708a prescribes required notices to members of the conversion vote, contains mandatory disclosure language and a ban on inaccurate and misleading communications, prohibits certain benefits to directors and senior management officials in connection with the proposed conversion, and sets forth certain required voting procedures and supplemental guidance. 12 CFR part 708a.

Summary of NCUA's Proposed Amendments to the Current Regulation

NCUA continues to acquire information about the MSB conversion process and, based on this greater level of empirical experience, NCUA has determined that there are ways to improve part 708a to better fulfill its purposes. Particularly, NCUA believes the rule can be improved with regard to the flow of information between and among members and board directors concerning the conversion issue.

NCUA recognizes and fully supports the right of a credit union to change its charter to a bank charter. This change, however, is a fundamental shift. When a credit union becomes a bank, for example, the ownership rights of the members change. The statutory and regulatory framework under which the institution operates, including its tax-exempt status, will also change. The services supplied to the members, and the cost of those services to the members, may change as well.

The decision to change to a bank charter belongs to the credit union members. To make this decision, members must be fully informed as to the reasons for the conversion and have time to consider the pros and cons of the proposed conversion. They should have an opportunity to discuss the proposal with other members and to communicate their views to the credit union's directors. NCUA believes that the current conversion process can be improved to facilitate the quality and flow of information about the conversion.

For these reasons, NCUA proposes to make modifications and additions to part 708a. These changes are discussed in detail in the Section-by-Section Analysis that follows. Briefly summarized, 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.

• 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.

• Simplifies the ''boxed'' disclosures that a credit union must provide to its members.

• Changes the current requirement for delivery of the boxed disclosures (*i.e.*, with all written communications to members) to require that the disclosures need only be delivered with the 90-, 60- and 30-day member notices.

• Provides for the form of the member ballot and that the ballot must be sent only with the 30-day notice.

• Requires the board of directors 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.

• Requires that, after the board has approved an MSB conversion proposal and upon the request of a member, a credit union must disseminate information from that requestor to other members at the requestor's expense.

• States that the members of federally-chartered credit unions (''FCUs'') may request and be granted access to the books and records of a converting credit union under the same terms and conditions that a state-chartered for-profit corporation in the state in which the federal credit union is located must grant access to its shareholders.

• 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.

• Requires a credit union 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.

• Modifies the voting guidelines to include information on the use of voting incentives such as raffles.

NCUA's Rulemaking Authority

The FCUA, as amended by CUMAA, provides NCUA with general rulemaking authority over federally-insured credit unions and specific rulemaking authority over conversions of credit unions to MSBs. This section contains an analysis of NCUA's rulemaking authority and how it applies to this proposed rulemaking.

The FCUA provides the NCUA Board with broad, general rulemaking authority over federal and federally-insured state chartered credit unions:

> Powers of the Board and Administration personnel.—(a) The Board may prescribe rules and regulations for the administration of [the FCUA] (including, but not by way of limitation, the merger, consolidation, and dissolution of corporations organized under this chapter) * * *.

12 U.S.C. 1766a. The FCUA contains numerous provisions on the activities of credit unions, including reorganizations and charter conversions. *See, e.g.*, 12 U.S.C. 1771 and 1785. Section 1785, in particular, has provisions on the conversion of credit unions to MSBs, including establishing specific voting and notice requirements and limitations on benefits for directors and management. Section 1785 also charges NCUA with oversight of the membership vote:

> Oversight of member vote. The member vote concerning charter conversion under this paragraph shall be administered by the Administration, and shall be verified by the Federal or State regulatory agency that would have jurisdiction over the institution after the conversion. If either the Administration or that regulatory agency disapproves of the methods by which the member vote was taken or procedures applicable to the member vote, the member vote shall be taken again, as directed by the Administration or the agency.

12 U.S.C. 1785(b)(2)(G)(ii). The FCUA also gives the NCUA Board specific rulemaking authority over credit union conversions to MSBs as follows:

> (G) Consistent rules. (i) In general. Not later than 6 months after the date of enactment of the Credit Union Membership Access Act the Administration 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 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.

12 U.S.C. 1785(b)(2)(G)(ii). The key rulemaking provisions are twofold. First, NCUA's rules must be ''consistent with rules promulgated by other financial regulators, including the Office of Thrift Supervision and the Office of the Comptroller of the Currency;'' and, second, NCUA's rules must be ''no more or less restrictive than [those rules] applicable to charter conversions by other financial institutions.'' *Id.*

Because these two provisions contain general directions that do not require the NCUA to adopt specific rules and regulations of other regulators, those provisions are ambiguous on their face. Under established law, NCUA has significant authority to interpret the meaning of those provisions. In *Pauley* v. *BethEnergy Mines*, 501 U.S. 680 (1991), for example, the Supreme Court considered a challenge to a rulemaking initiated by the Department of Labor that empowered it to adopt regulations that ''shall not be more restrictive than'' rulemakings by the Department of Health, Education, and Welfare. The Court stated ''[w]ith respect to the phrase 'not * * * more restrictive than' Congress's intent is similarly clear: The phrase cannot be read except as a delegation of interpretive authority to the Secretary of Labor.'' [1]

NCUA's analysis of the two relevant statutory provisions follows.

a. ''Consistent with rules promulgated by other financial regulators.''

NCUA has carefully considered the meaning of this ''consistency'' language. The FCUA does not further define this provision. CUMAA's legislative history contains scant information on the MSB conversion provisions and provides no insight into the provisions governing NCUA's rulemaking authority over conversions.[2]

The Dictionary defines ''consistent'' as ''1. agreeing or concordant; compatible, not self-contradictory'' and ''2. constantly adhering to the same principles, course, form, etc.'' [3] Accordingly, NCUA views this requirement for consistency as a mandate that NCUA's rules be compatible with or adhering to the same

[1] *Id.* at 624. *See also Mowbray* v. *Kozlowski,* 914 F.2d 593 (4th Cir. 1990) (the court deferred to a state agency's interpretation of an ambiguous statutory scheme involving separate provisions providing that state medicaid eligibility rules should be both less restrictive and more restrictive than federal eligibility rules).

[2] The available legislative history discusses the conversion provisions in the House version of CUMAA. The conversion provisions ultimately included in CUMAA were from the Senate bill. These provisions appear to have been added late in the drafting cycle without accompanying legislative history.

[3] The Random House Webster's Unabridged Dictionary (2d ed. 2001), pg. 434.

principles as the conversion rules of other financial regulators.

A compatibility interpretation makes sense to NCUA. NCUA's rules applicable to conversion from credit unions to MSBs should be compatible with the rules, if any, that govern conversions to new banking entities. In other words, a credit union that wishes to convert to a federally-chartered MSB (''FMSB'') should not encounter insurmountable contradictions between NCUA's rules governing conversions to FMSBs and the existing Office of Thrift Supervision (''OTS'') and Federal Deposit Insurance Corporation (''FDIC'') rules governing the same. If NCUA's rules included requirements contrary to any OTS or FDIC rules governing the same conversion, the conversion could not take place.[4] Likewise, if a credit union wishes to convert to a state-chartered MSB, NCUA's rules should be compatible with the state regulator's rules, if any, governing the same conversion. NCUA believes the proposed rule satisfies this compatibility analysis, but invites commenters to address this topic and, if they disagree, to provide specific examples.

Alternatively, the requirement for consistency may mean a requirement for NCUA's rules to be informed by the same principles that inform the conversion rules of other regulators. As discussed previously, the principles behind NCUA's rulemaking include a desire for an orderly and fair conversion process that takes into account the rights of the credit union's owners (*i.e.*, the members) and ensures that they can make an informed conversion decision. NCUA believes these principles are, generally, the same principles informing the conversion rules of other state and federal regulators. Again, NCUA invites comment on this issue.

b. ''[N]o more or less restrictive than [rules] applicable to charter conversions by other financial institutions.''

NCUA has also carefully considered the meaning of this ''no more or less restrictive'' provision. An identical rule would satisfy this requirement, but it is not possible to fashion an identical rule for several reasons.

First, the FCUA contains certain procedural requirements for credit union to MSB conversions not found in the regulations governing the conversions of other financial institutions. So, for example, the requirement that credit union members receive three notices at 30-day intervals preceding the member vote has no counterpart in the OTS and OCC regulations governing thrift and bank conversions.[5] NCUA's rule, however, must reflect these three notices, and so cannot be identical to the OTS or OCC rules in this regard.

Second, all financial institutions have characteristics that are unique to that type of organization and which translate into different regulatory treatment.[6] For example, conversions of thrifts and banks involve the creation and transfer of securities and involvement of the Securities and Exchange Commission and associated regulatory provisions. Conversion rules governing credit unions cannot be identical to those governing banks or thrifts in this and similar regards.

Finally, the OTS rules for converting MSBs[7] and the Office of the Comptroller of the Currency (''OCC'') rules for converting national banks[8] are different from each other, so that if NCUA attempted to adopt a rule identical to the OTS' rule, then NCUA's rule would not be identical to the OCC's rule. Accordingly, it would be illogical to construe the phrase ''no more or less restrictive'' as meaning ''identical.''

Again, the FCUA and CUMMA legislative history do not provide any definition for ''no more or less restrictive''. NCUA staff engaged in extensive legal research to identify other uses of the phrase. As far as staff could determine, there is no other federal statute that employs the phrase, nor does the phrase appear in any existing federal regulation. The phrase is not used in any existing state code or regulation. While the term appears in a few judicial opinions, the context of those opinions provides no helpful guidance.[9]

As the FCUA charges NCUA with promulgating a rule, NCUA must develop an interpretation of the phrase ''no more or less restrictive.'' We start first with the meaning of ''restrictive.'' According to the dictionary, the definition of ''restrictive'' is ''tending or serving * * * to confine or keep within limits, as of space, action, choice, intensity, or quantity.''[10] In the context of regulatory action, that can be further refined as ''tending to confine action or choice.'' We subdivide this statutory language into its two constituent parts: (1) ''no * * * less restrictive'' and (2) ''no more * * * restrictive.'' We interpret and apply each in turn.

*1. ''No less * * * restrictive than [rules] applicable to charter conversions by other financial institutions.''*

The FCUA states that NCUA's rules should be ''no * * * less restrictive'' than the rules of other regulators. Again, this cannot mean that NCUA must include every restriction found in every regulators' rule. NCUA interprets this phrase as meaning that when NCUA is aware of a particular federal or state law that confines the choices or action of a converting institution, NCUA should consider if that restriction makes sense for a converting credit union in light of the underlying principles that inform NCUA's and other regulators' rulemakings. In accordance with this interpretation, NCUA researched different regulatory provisions adopted by other financial regulators. These provisions are discussed where applicable as part of the Section-by-Section Analysis. NCUA believes that the rule, as proposed, satisfies this element of the FCUA.

*2. ''No more * * * restrictive than [those rules] applicable to charter conversions by other financial institutions.''*

According to the dictionary, the ''no more * * * restrictive'' phrase means NCUA's rulemaking should not tend to confine the converting credit union's actions or choices more than rules of other financial regulators. Which

[4] Current OTS rules on conversion from credit unions to MSBs are found in 12 CFR 543.8 through 543.12. So, for example, if the NCUA required a conversion disclosure that was contrary to a prohibition existing in the OTS rules at the time NCUA promulgated its rules, that could render NCUA's rules inconsistent with the OTS rules. Since the consistency passage refers to the rules of other financial regulators ''including'' both the OTS and OCC, NCUA interprets this requirement to extend to other entities that can regulate a credit union conversion to an MSB. The FDIC has rules regarding application for its insurance which a credit union converting to an MSB must comply with. For conversions to state chartered MSBs, the credit union must also comply with the rules of state regulators.

[5] *Compare* 12 U.S.C. 1785(B)(2)(C) *with* 12 CFR 5.24.

[6] The U.S. Department of Treasury found that ''[a]lthough credit unions have certain characteristics in common with banks and thrifts, (*e.g.*, the intermediation function), they are clearly distinguishable from these other depository institutions in their structural and operational characteristics.'' U.S. DEPT. TREAS., COMPARING CREDIT UNIONS WITH OTHER DEPOSITORY INSTITUTIONS, pg. 6 (Jan. 2001).

[7] 12 CFR parts 563b (Conversions from Mutual to Stock Form) and 575 (Mutual Holding Companies).

[8] 12 CFR 5.24(f) (Conversion of a National Bank to a Federal Savings Association).

[9] *See, e.g., Vermef* v. *Noble*, 2002 LEXIS Wa. Tax 22, (Washington Board of Tax Appeals, January 20, 2002). As far as NCUA can determine, the phrase is not discussed in any major secondary source, including law review articles and Words and Phrases.

[10] This is actually the combination of two definitions. ''Restrictive'' means ''tending or serving to restrict.'' ''Restrict'' means ''to confine or keep within limits, as of space, action, choice, intensity, or quantity.'' Random House Webster's Unabridged Dictionary (2d. ed. 2001), pg. 1642.

actions or choices and which regulators is not clear. In some areas, for example, the OTS has significant limitations on action or choice where the OCC has none. As discussed previously, the FCUA also requires a series of three notices; and this is a restriction that is not found in either the OTS or OCC rules. NCUA concludes that Congress does not intend for NCUA to undertake a ''no more restrictive'' analysis on a provision-by-provision basis or as to every other regulator's rule. Instead, NCUA believes Congress intended NCUA to compare its rule generally against the conversion rules of other like regulators. To meet the ''no more * * * restrictive'' standard, NCUA concludes that its rule, taken in its entirety, should not confine a converting credit union's actions or choices more significantly than the rules of other financial regulators, taken in their entirety, confine the actions or choices of the converting institutions they regulate.

NCUA examined the rules of various financial institution regulatory agencies, including state regulators, the OTS, OCC, and Farm Credit Administration.

The Board first notes that a majority of the states have credit union statutes and regulations that are silent with regard to MSB conversions; apparently meaning that their state charters have no authority to convert to MSBs. Clearly, NCUA's rules are not more restrictive than these state rules and cannot be more restrictive, as the FCUA specifically permits conversions from credit unions to MSBs.

With regard to the state laws and regulations permitting conversions, and the laws and regulations governing conversions overseen by the OTS and OCC, these laws and regulations all share similarities. They all establish procedures for the conversion. They all require certain disclosures be made to the members or stockholders of the converting institution. They all require votes by both the directors and the members or stockholders. And they all require that the converting institution provide certain information to the regulator for purposes of evaluating the conversion or conversion process. These are similarities that NCUA's rule shares with virtually every other regulator's rules, and in this sense NCUA's rules are no more restrictive than other regulators' rules.

The other state and federal laws and regulations that expressly allow for conversions apply a variety of specific requirements to the conversion. Many of those requirements are cited in the Section-by-Section Analysis below as precedent for particular provisions in NCUA's proposal and, in many cases, the NCUA proposal is not more restrictive than the cited precedent. For example, § 708a.5 of both the current and proposed rules requires a credit union to provide NCUA with notice of its intent to convert before the date of the membership vote. NCUA's notice requirements are fairly simple. Several states require much more specificity or analysis in the notification requirements for their converting institutions than the NCUA requires in § 708a.5.[11]

A comparison of the OTS conversion rules[12] to the proposed NCUA rules demonstrates that the OTS rules, not the NCUA rules, are in many ways more restrictive. For example, within the OTS rules there are types of requirements that do not appear in the NCUA rule.[13] These include the requirement to prepare and submit to OTS a three-year post conversion business plan and various requirements related to the issuance of stock, including making a valuation of the bank, determining subscriber rights, and making various stock-related filings.

NCUA's proposed rule is also purely procedural. It contains no substantive restrictions or burdens. This is not true for the rules that affect other conversions. For example, a member of an Iowa credit union that converts to an MSB is entitled to a pro rata distribution of all unencumbered credit union retained and undivided earnings in excess of regulatory required reserves. Iowa Admin. Code r. 189–3.4(8). Similarly, the OCC conversion rule for conversion of a national bank to a mutual savings bank obligates the institution to payoff shareholders who dissent from the conversion.[14] The Iowa rule and OCC rule, not NCUA's rule, are more restrictive in this particular sense as well.

In sum, NCUA believes this proposed rule is well within its statutory rulemaking authority. The rule carries out NCUA's statutory responsibility for oversight and administration of the voting process. The rule ensures that the member vote is fair and legal and the members who vote are informed of important aspects of the conversion. The rule is consistent with rules promulgated by other financial regulators, including the OTS and the OCC. It is also ''no more or less restrictive'' than the rules generally applicable to charter conversions by other financial institutions.

B. Section-by-Section Analysis

708a.1 Definitions

The current § 708a.1 contains definitions for the terms credit union, mutual savings bank, savings association, federal banking agencies, and senior management official.

The proposed § 708a.1 maintains these same definitions. The proposal adds an additional definition for the phrase ''clear and conspicuous,'' meaning ''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.'' NCUA invites comment on this definition. The proposal also adds a definition for ''regional director'' to clarify that, for natural person credit unions, it means the NCUA director for the region where the credit union's main office is located and, for corporate credit unions, it means the Director, NCUA Office of Corporate Credit Unions.

708a.2 Authority To Convert

The current § 708a.2 recites the authority of a federally insured credit union to convert to a mutual savings bank or savings association as provided for in the FCUA. The proposed § 708a.2 maintains this same recitation.

708a.3 Board of Directors' Approval and Members' Opportunity To Comment

The current § 708a.3 provides that, if the board of directors of a credit union desires to convert, it must 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.

The proposed rule retains the same requirement for a board vote on the conversion proposal but 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 proposal also contains a new requirement for advance notice to the members of the board's intent to consider a conversion proposal. It retains the requirement for the member vote, although that provision has been moved to § 708a.6 of the proposed rule.

[11] *See* Mich. Comp. Laws 490.373(1)(b), 490.374(1)(b); 2005 Vt. Acts & Resolves 16; Conn. Gen. Stat. § 36a-469c(a)(3); Utah Admin. Code R337–2–3; Fla. Stat. ch. 655.411(1)(a); and Me. Rev. Stat. Ann. tit. 9–B, 343(1).

[12] Governing conversions of MSBs to stock banks.

[13] 12 CFR part 563b. OTS rules include additional requirements if the conversion involves the creation of a mutual holding company structure. 12 CFR part 575.

[14] ''Rights of dissenting stockholders. A shareholder of a national banking association who votes against the conversion * * * or who has given notice in writing to the bank at or prior to such meeting that he dissents from the plan, shall be entitled to receive in cash the value of the shares held by him, if and when the conversion, merger, or consolidation is consummated * * *.'' 12 U.S.C. 214a(b), incorporated by cross reference into 12 CFR 5.24(f) (the OCC conversion rule).

Determination by the Board of Directors That 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. The FCUA specifically provides that the Board may take adverse action against institution-affiliated parties, including directors, of a federally-insured credit union, if they have ''committed or engaged in any act, omission, or practice, which constitutes a breach of such party's fiduciary duty * * * [and by reason of such action] * * * the interests of the insured credit union's members have been or could be damaged.'' 12 U.S.C. 1786(g)(1). The NCUA Board itself has previously stated:

> It is well accepted law that officers and directors of depository institutions are held by a strict fiduciary duty to act in the best interest of * * * its shareholders. * * * As an officer of the credit union, Respondent had a duty to act in the institution's best interest and that of its members.[15]

The fiduciary duties directors owe to credit union members are similar to those owed to corporate shareholders because, like shareholders who are the owners of a corporation, members own the credit union.[16] These fiduciary duties include the duty to act loyally, in good faith, with due care and prudence.[17] A director may be held personally liable for a breach of fiduciary duty to the credit union and its members.

The 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 interests. Directors should review all aspects of a conversion to an MSB, including, for example, how the conversion will affect rates and services available to members and how regulatory differences between the two institutions, such as lending restrictions imposed under the qualified thrift lender test, could affect member service. 12 U.S.C. 1467a(m); *see also* OTS Thrift Activities Regulatory Handbook, Section 270 (June 2002). Directors should not limit themselves to information presented by management or by conversion consultants, but should ensure that they have all of the information necessary to make a fully informed decision. In deliberating over a conversion proposal, officials' decisions must be free of self-interest and compliant with their duties of care and loyalty to the members.

Advance Notice of Board Meeting To Consider Conversion Proposal.

The proposal amends § 708a.3 to add a new requirement: The credit union's board of directors must publish public notice indicating its intent to hold a board meeting for purposes of voting on a conversion proposal. Ultimately, the decision to change from a credit union charter to a bank charter rests with the members, and the Board believes the conversion process will better inform the members and enable board members and officers to fulfill their fiduciary duties if members are involved early in the process and have an opportunity to interact with the board of directors before the directors formally commit to a conversion.

The proposed rule requires the board of directors consider, adopt, and publish a notice of its upcoming meeting. The board must 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 board of directors must review the member comments before it votes on the conversion proposal. If the credit union maintains a website, the credit union must also post the comments in a clear and conspicuous fashion.

NCUA believes these proposed amendments will benefit both the members and the board of directors. Advance notice of a pending conversion affords members additional time to educate themselves about the future path of their institution. For those members who want to discuss their views with other members, it gives them additional time to make contact and initiate dialogue. It also gives members an opportunity to discuss the issue with their board before it has committed itself to pursue a conversion.

This advance notice is also beneficial for the board. The credit union's directors have a fiduciary duty to act in the best interests of the credit union's members, and it is reasonable to assume that the members may have some insight into their own best interests. By notifying members of the board's intentions and receiving member comments, the board is better able to understand the desires of its member-owners. Early feedback from the members will also help the board gauge if the membership is likely to vote against a conversion proposal. In some cases, the board may determine that the majority of members will oppose the conversion and, if they will, the board may decide against adopting the conversion proposal and so avoid incurring some considerable expense.

The FCUA links NCUA's rulemaking authority to the rules promulgated by other financial regulators. Accordingly, NCUA notes there is precedent for NCUA's proposal to engage the membership early in the conversion process. In Michigan and Vermont, a state credit union's board of directors must send written notice to each member, without any other mailing, at least 30 days before the board votes on a plan of conversion from a credit union to an MSB. Mich. Comp. Laws 490.373(1)(a) and (1)(i)(ii); 8 Vt. Stat. Ann. Tit. 8, § 35102 (2006). The notice must address why the board is considering conversion, discuss the positive and negative effects of the proposed conversion, and request member comments. *Id.* Members send their comments to the credit union, which later provides copies to the state supervisory authority. Texas also requires a similar notice to members at least 30 days before a credit union board

[15] *In re Majette*, Final Dec. & Order, p. 9 (NCUA Bd., Mar. 18, 1999), copy available at *www.ncua.gov.*

[16] ''The directors of a non-profit membership corporation have a duty to act in the best interest of the corporation's members. * * *'' *Baring* v. *Watergate East, Inc.*, 2004 Del. Ch. Lexis 17. *See also Bourne* v. *Williams*, 633 S.W.2d 469 (Tenn. App. 1981); *Kirtley* v. *McClelland*, 562 N.E. 2d 27 (Ind. Ct. App. 1990). As for the ownership rights of credit union members, ''it seems clear that the members of a credit union are, in the same sense as the shareholders of an ordinary business corporation, the owners of the entity.'' *Anheuser-Busch Employees Credit Union* v. *Federal Deposit Insurance Corporation*, 651 F.Supp. 718, 724 (W.D. Mo. 1986) (comparing rights of corporate shareholder to credit union member). Credit union members exert control over the affairs of the institution through their voting power, not delegable by proxy. 12 U.S.C. 1760. The net worth of the credit union belongs to the members, and they may recognize it in a variety of ways, including low loan rates and high savings rates (See discussion at notes 23–26 and accompanying text), voluntary liquidation (12 CFR part 710), and the special dividends paid by many credit unions. *See, e.g. Loan Growth, Excess Capital Play Huge Role in Dividend Payouts,* Credit Union Times, January 4, 2006, at p. 1. There are several additional aspects of credit union membership that distinguish members from both debtors of the credit union and from bank depositors. For example, by law membership shares in an FCU are equity. 12 U.S.C. 1757(6). Dividends on FCU shares are not a contractual right, as is interest on a bank certificate of deposit, but may only be paid if the FCU has sufficient retained earnings. 12 U.S.C. 1763; NCUA OGC Legal Opinion 96–0917 (January 22, 1997), located at *www.ncua.gov.* And, in the event of a credit union liquidation, unsecured creditors have priority over members to the extent of the members' uninsured shares, 12 CFR 709.5(b)(5), (6), unlike bank depositors who take equally with unsecured creditors to the extent of uninsured deposits. *See, e.g.*, 12 CFR 360.3(a)(6).

[17] 19 C.J.S. Corporations, §§ 477, 478 (1990).

votes on a plan of conversion.[18] These state law provisions impose a greater burden on a credit union in comparison with NCUA's proposal, which requires notice only by publication and not direct notice to each member.[19]

In addition to the publication of notice in newspapers, in credit union offices, and on the credit union's Web site there are other potential vehicles for notifying members of the pending decision to adopt a conversion proposal. For example, many credit unions send information to members in the form of statement stuffers with periodic statements of account. Other credit unions may have an extensive e-mail list for member contact. The Board invites comment on whether the final rule should allow for the use of these communication channels, or others not mentioned, in addition to or in lieu of those communication methods described in the proposed rule text.

708a.4 Disclosures and Communications to Members

Section 708a.4 of the current rule, entitled Voting procedures, provides for a member vote on the conversion at a special meeting or by mail and describes the notices that must be provided to members 90, 60, and 30 days before the vote. It prescribes certain information and disclosures that must be in the notices. It also requires the vote must be by secret ballot and conducted by an independent entity.[20]

The proposal contains several changes to § 708a.4. It provides that the ballot must be sent with the 30-day notice. It modifies the mandatory disclosures the board of directors must give to members once the board has approved a proposal to convert. It establishes procedures for members to share their views with other members during the 90-day notice period before the membership vote. The proposal also retitles the section to reflect its additional purposes and relocates portions of the original § 708a.4 to § 708a.6.

Delivery of the Ballot to the Members.

The FCUA and NCUA's conversion rule require a converting credit union to submit notice of its intent to convert to each member eligible to vote three times before the date set for the membership vote on the proposal. 12 U.S.C. 1785(b)(2)(C); 12 CFR 708a.4. The credit union must submit the notice 90, 60, and 30 days before the vote. *Id.* The member notice must adequately describe the purpose and subject matter of the vote on conversion. 12 CFR 708a.4(c).

The proposed rule's paragraph (a) maintains the statutory three notice requirement but requires a credit union to include conversion mail ballots only with the 30-day notice. This requirement replaces the provision in the current rule that simply requires the ballot be submitted to members no less than 30 calendar days before the vote. 12 CFR 708a.4(b).

NCUA believes this change benefits members because it allows them time to consider the advantages and disadvantages of a conversion proposal before voting. If members receive a ballot with their 90-day or 60-day notice, as permitted by the current rule, they may vote before having the benefit of all the information they may need to make an informed decision. Under the proposal, members who want to share their views with the membership will have time to express their opinions before the credit union includes the mail ballot with the 30-day notice. As discussed below, the proposed rule gives members the opportunity to share their views about a conversion proposal once their credit union's board of directors has approved a proposal to convert. The proposal gives members at least two full months to fully debate whether the credit union should change its charter and provides members an adequate amount of time to consider such a significant decision before casting their votes.

NCUA notes that in several states converting state-chartered credit unions must include mail ballots 30 days before the membership vote on a conversion to a mutual savings bank and may not send ballots earlier than 30 days before the special meeting. Iowa Admin. Code r. 180–3.4(1); Mich. Comp. Laws 490.373(1)(f); N.Y. Banking Law 487–A; and 2005 Vt. Acts & Resolves 16.

Proposed § 708a.4(b)(4) discusses the content of the ballot. The ballot must 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.

Required Disclosures to Members

Section 202 of CUMAA requires NCUA to: (1) Administer and approve or disapprove the methods by which a member vote on a conversion proposal is taken, and (2) promulgate rules governing charter conversions that implement the statutory directive that credit unions provide notice to their memberships about proposed conversions. 12 U.S.C. 1785(b)(2)(C), (G)(ii). NCUA's conversion rule and the proposed amendments are designed to ensure that a credit union's member-owners have the ability to make an informed choice about their credit union's future. Officials must give members full and fair disclosure regarding any conversion plan.

Full and fair disclosure is important because the FCUA gives credit union members the responsibility for making the final decision regarding the future of their member-owned credit union. Due to the cooperative structure of credit unions, the FCUA and NCUA's implementing regulations afford a significant role to member-owners to participate in major decisions affecting both Federally-chartered and state-chartered credit unions. In addition to MSB conversion votes, credit union members (depending on their chartering statute) may have the right to vote on converting to a different credit union charter, terminating or converting federal share insurance, merging into another credit union, and liquidating the credit union voluntarily. 12 U.S.C. 1771(a), 1786(a)(1); 12 CFR 708b.106(b), 708b.201(c), 710.3(b). Each of these transactions is subject to regulatory requirements imposed by NCUA or SSAs to ensure that members are given adequate notice before the vote is taken. Member notices must convey important information in an impartial manner so the membership can make an informed decision.

Like the termination of Federal share insurance, the conversion to an MSB is a significant transaction that affects

[18] 7 Tex. Admin. Code § 91.1007(b) (Final rule adopted by Texas Credit Union Commission on June 9, 2006).

[19] There are other situations where law and regulation requires some public notice of pending conversions beyond the formal written notice sent directly to members. The OTS requires any entity desiring to organize or reorganize as a federal MSB, including a credit union, to publish public notice of its pending OTS application. 12 CFR 543.2(d) and part 516. The notice informs the public of the application, provides for public inspection rights, and solicits public comment. In Maine, a conversion plan must be presented to members at a special informational meeting in each county where there is a branch office before a meeting is held to vote on a plan, if the state supervisory authority (''SSA'') has not waived the requirements. Me. Rev. Stat. Ann. tit. 9–B, § 344(3). A state savings association that proposes to convert to a bank in New Hampshire must publish public notice in a newspaper having general circulation in each city or town with an office. N.H. Code Admin. R. Ann. Banks 519.04. The notice must indicate the savings association's application and plan are available for public inspection at the bank commissioner's office and that the commissioner will accept written comments from the public. *Id.*

[20] These confidentiality requirements are similar to those imposed by the Farm Credit Administration on the elections of the financial institutions it regulates. 12 CFR 611.330.

various aspects of a member's interests and, therefore, requires full and fair disclosure to the membership. The board of directors will explain to the members why it desires to convert and provide reasons in support of conversion. The required disclosures contained in NCUA's current rule, including the attendant changes in membership ownership interests and voting rights, whether the MSB plans to change from mutual to stock form, conversion benefits that flow to management, and the implications of thrift lending limits, ensure that the information provided by the board is complete and comprehensive.

Paragraphs (b), (c), and (d) of the proposed § 708a.4 maintain 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. To assure that a conversion vote is conducted in a fair and legal manner, all information communicated to members by the credit union must be accurate and not misleading. Under the current rule, 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 economic benefits to officials. NCUA has retained these additional disclosure requirements because members should have notice that their fundamental rights as credit union members will change if the credit union converts to an MSB.

In addition to the disclosures above, the proposed rule requires 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. The proposal also requires all three notices to disclose the impact of the qualified thrift lender test, established under 12 U.S.C. 1467a(m), on the institution if it converts to an MSB. NCUA believes officials should disclose to members 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 current § 708a.4(e) requires that each written communication it sends to its members include specific disclosure language about the effects of a conversion. These disclosures include changes in ownership and control, the potential for changes in rates and fees, the possibility and effects of a subsequent stock conversion, and the costs of the conversion. NCUA believes these disclosures are important information that a member must see, read, and consider before the member decides how to vote. The current rule requires that these disclosures be ''boxed,'' that is, that they be offset by a border and are otherwise made more conspicuous than other information provided with the member notices. The disclosures also use plain English and basic concepts to help members comprehend the transaction before they vote on a conversion.

The proposed boxed disclosures retain the current disclosures related to the potential for profits by directors and senior management and the possibility of changes in rates following conversion.[21] A detailed justification for the truth of these particular disclosures and their importance to the members is set forth later in this preamble.

The proposed boxed disclosure also contains a new disclosure that sets forth in plain language the effects of a member voting ''FOR'' a conversion: That the credit union will become a bank. The disclosure states the converse: That a vote ''AGAINST'' the conversion means that the credit union will remain a credit union. Some credit union members may not understand this. Often, these simple but important facts go unrecognized until the conversion has been approved.

NCUA is further concerned that, in past conversions, not all members have seen and read the boxed disclosures required by § 708a.4. Accordingly, the proposal amends the delivery requirements for these important disclosures to ensure that members are aware of these disclosures. Specifically, paragraph 708a.4(c) of the proposal requires that these essential disclosures be delivered on a separate sheet of paper with no other text. The paper must be placed immediately after the credit union's cover letter and before any other information included with the notice. The current rule requires the credit union provide the boxed disclosures with all written communications to members. The proposal, however, provides that these disclosures need only go out to the members with the 90-day, 60-day, and 30-day notices.[22]

The boxed disclosure language and delivery requirements in this proposed rule will increase the likelihood that members will read and comprehend these important disclosures. A discussion of the particular boxed disclosures and disclosures required elsewhere in the member notices follows.

Required Boxed Disclosure: Loan and Savings Rates

Credit union members can make an informed decision about a proposed MSB conversion only if they understand, among many other things, that the conversion may result in their paying higher loan rates and receiving lower savings rates post-conversion than pre-conversion. Accordingly, the proposal retains NCUA's disclosure language that, after conversion, a member may experience adverse changes in rates.

NCUA engaged the services of Datatrac Corporation for purposes of gathering and analyzing data on historic loan and savings rates. Datatrac is a market research, information technology company specializing in the financial services industry. It has been an independent source of deposit and lending product information for more than 15 years, advertising that it manages the most comprehensive database of deposit and lending data in the industry.[23]

[21] The proposed letter does not contain specific disclosure language about changes in ownership rights or the costs of conversion. The proposed rule still requires the credit union to disclose this information as part of the credit union's member notice. The proposed rule also does not include language that informs members that, due to field of membership restrictions, members may not be eligible to join another credit union if the conversion succeeds. This language is true but, because some credit unions may have community-based fields of membership, the possibility of obtaining membership in another credit union depends largely on where a member lives.

[22] Previously, some converting credit unions were not sure what communications constituted member communications, and the proposal eliminates this issue. Although the proposal contains no specific disclosures for member communications outside the member notices, those communications still must be accurate and not misleading. *See* 12 CFR 740.1 and proposed § 708a.8(a).

[23] Datatrac information and a link to the Datatrac Web site are available online at the Web site of the American Bankers Association (ABA). The ABA and Datatrac have partnered together to bring Datatrac resources to ABA members and users of ABA's Web site. Additionally, the following information can be found on the ABA's Web site:

Datatrac is the exclusive provider of deposit & loan interest rate data to the American Bankers Association (ABA), Credit Union National Association (CUNA), National Association of Federal Credit Unions (NAFCU), Bank Administration Institute (BAI) and Financial Managers Society (FMS). Datatrac's rate information has been quoted in newspapers, television and Web sites nationwide, including USA Today, CBS MarketWatch, Consumers Digest, Kiplinger's Personal Finance, the American Banker, the Chicago Tribune, the Los Angeles Times and the Milwaukee Journal Sentinel. Since 1988 the

NCUA asked Datatrac to provide data on over 20 distinct loan and savings products offered by thousands of banks and credit unions. These products included automobile loans; fixed and variable rate mortgage products; credit cards; and savings products, such as short and long term CDs and savings, checking, and money market accounts. Datatrac broke each of these products down into average rates for all institutions over several years, including rates as of year-end for 2002 through 2005.

The Datatrac data was clear: The historic consumer loan and savings rates offered by credit unions are better for members than those same rates offered by banks of all types, including, specifically, MSBs.[24] This table illustrates the difference for two particular products (60-month certificates of deposit (CD) and 60-month new-auto loans) at year-end of 2005:

Product	Average CU rate	Average MSB rate	CU rate advantage[25]
60-Month CD	4.58	4.20	9% greater.
60-Month New Auto Loan	5.57	7.04	21% less.

Recently, researchers at Fiscal and Economic Research Center at the University of Wisconsin—Whitewater also 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 (hereinafter Heinrich). The Heinrich study considered loans and savings rate data from 175 large credit unions and banks, including some banks that had converted from credit unions. The study's findings were consistent with NCUA's analysis of its Datatrac data, including, specifically, that ''[c]redit unions offer significantly higher interest rates on all savings products examined and charge lower interest rates on three of four loans products compared to converted credit unions after accounting for all other variables.'' [26] The other variables accounted for included salary payment differences, size differences (economies of scale), and differences in market concentration. Id. at 3.

This information supports NCUA's belief that credit union members must be made aware that a conversion to an MSB may result in less advantageous rates. Informed credit union members may still decide to vote in favor of conversion in light of this information. NCUA's obligation under the FCUA is to provide regulations that ensure that members cast informed votes and, accordingly, the proposed disclosure reads as follows:

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.

NCUA specifically invites comments on how rates, fees, and service levels may have changed in particular credit unions that have converted to banks. NCUA also invites comments on NCUA's proposed disclosure language.

Proposed Boxed Disclosure: Benefits to Directors and Senior Management

NCUA is concerned that the directors and officers of a credit union considering conversion to an MSB may be motivated by the potential for personal financial gain and not by concerns for the best interests of credit union members. Most of the benefit for directors and officers occurs when the MSB converts to a stock bank within a few years after the conversion to an MSB. Accordingly, the boxed disclosures currently required by § 708a.4 include the following:

SUBSEQUENT CONVERSION TO STOCK INSTITUTION. 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. In a typical conversion to the stock form of ownership, the EXECUTIVES OF THE INSTITUTION PROFIT BY OBTAINING STOCK FAR IN EXCESS OF THAT AVAILABLE TO THE INSTITUTION'S MEMBERS.

NCUA is aware that some do not agree that the credit union's directors and officers benefit as a result of a credit union to MSB to stock conversion process and have challenged NCUA's required disclosure language as being potentially misleading.[27] In response, NCUA has examined this issue in greater depth. As discussed below, the evidence available to NCUA indicates that directors and officers do, in fact, profit from a conversion, in part by obtaining stock in excess of that available to the members. A discussion of this conversion process and the benefits that accrue to directors and officers at the institution follows.

Twenty-nine credit unions have converted or merged into an MSB since 1995. Twenty-one of these 29 have since become a stock bank or merged into an existing stock institution.[28] Some

company has combined technology, research and strategic services to enable financial institutions to make timely, competitive pricing and marketing decisions. With over 5 million retail deposit and lending interest rates and products updated annually for over 14,000 financial institutions, Datatrac manages the most comprehensive financial products database in the industry. For more information, please visit *http://www.datatrac.net/*.

[24] In automobile lending and in long term savings, the credit union rates were far superior to bank rates. For two of the twenty products examined, mortgage lending and passbook savings, bank and credit union rates were almost identical, but there was no product of the twenty examined where banks rates were clearly better than credit unions rates. This data is average data; and rates will vary by particular financial institution and particular product. NCUA believes that average data over thousands of institutions is more reliable than individual institutional data because average data removes the effects of short-term promotional rates. Additional information about this data is available on NCUA's Web site at *http://www.ncua.gov*.

[25] Determined by dividing the CU rate by the MSB rate.

[26] *Heinrich* at 1.

[27] For example, in a letter to Representative Spencer Bachus, dated June 15, 2005, Ms. Casey-Landry, the President of the America's Community Bankers, wrote: ''The NCUA also is ill-informed regarding stock subscription rights when a mutual institution converts to stock form. The NCUA suggests that credit union managers use charter conversions as a way to get rich at the expense of account holders. * * * This erroneous belief is also reflected in the disclosure language the NCUA requires to be given to all members of a converting credit union.'' In June 2005, Mr. Riccobono, then the acting OTS Director, also signed an order stating that NCUA's required disclosures about access to stock by directors and officers were ''potentially misleading.'' OTS Order 2005–23, June 29, 2005. Mr. Riccobono stated, in part, that ''[OTS] regulations strictly limit the amount of stock any executive may purchase in a conversion. * * * In addition, executives cannot purchase any more stock in the conversion than any other member.'' Neither Ms. Casey-Landry nor Mr. Riccobonno address director and officer access to stock in the case of an oversubscription to the initial public offering; nor do they mention the millions of dollars in free stock that the directors and officers—but not rank-and-file members—can and do receive following conversion through stock benefit plans. This is discussed further, *infra*.

[28] Some of these stock conversions have been full stock, that is, 100% of the stock is publicly held.

Continued

recently converted MSBs have indicated an intent to convert to a stock bank, but the OTS requires these new MSBs to wait at least a year before applying with the OTS to convert to a stock banks.[29] In some cases, credit unions that converted to MSBs waited multiple years before completing a stock conversion.[30] Accordingly, to understand the likelihood of a credit union ultimately becoming a stock bank one must look to older MSB conversions. There were 24 credit union to MSB conversions that occurred from 1995 through the end of 2003, and 21 of those 24 converted credit unions, or about 87%, ultimately assumed a stock charter. These statistics suggest members of a credit union converting to an MSB should anticipate a follow-on conversion to a stock charter at some point in the future.

The information collected by NCUA suggests that a mutual to stock conversion permits directors and officers to obtain significant financial benefits from the conversion, in part through the acquisition and control of stock. The ownership of the stock gives the directors and officers ownership of a portion of the net worth of the institution, and control of the stock voting rights also allows directors and officers to increase their compensation more easily. The directors and officers obtain ownership and control of stock in several different ways. While other members of the converting MSB have access to stock, none of them have nearly the access that the directors and officers do.

Directors and officers acquire significant amounts of stock through management stock benefit plans and stock option plans, and (for the officers but not the directors) employee stock ownership plans. In fact, the rules governing federal mutual savings bank to stock conversions were specifically crafted to ''enhance the ability of officers, directors and employees of an institution to acquire stock when their institution converts, through various types of employee stock benefit vehicles * * * [so as to] * * * provide a means for officials and employees of converting institutions to acquire larger ownership stakes in their institutions upon conversion * * *''[31] A summary of these stock plans follows.

The converting bank may establish an Employee Stock Ownership Plan (ESOP).[32] The ESOP may participate directly in the initial stock subscription and may hold up to 10% of the total conversion stock offering.[33] The bank funds ESOP purchases and so ESOP stock costs the employee beneficiaries nothing. Members of the credit union who become depositors of the subsequent bank and who are not employees cannot participate in the ESOP.

Shortly after a stock conversion, a converted bank may establish two additional stock benefit plans for its directors and officers: A management stock benefit plan and a stock option plan.[34] The management stock plan holds stock for the benefit of managers and directors and may own and hold up to 4% of the outstanding stock.[35] Again, the bank funds the management stock benefit plan so the stock costs the managers and directors nothing.[36] A stock option plan permits the bank to grant employees options to purchase stock and a stock option plan may hold up to 10% of the outstanding stock issued in a conversion.[37] Members of the credit union who become depositors at the subsequent bank and who are not officers or directors cannot participate in the management stock benefit plan or stock option plan.

In addition to the various stock plans available to officers and directors, the officers and directors may also purchase between 25% and 35%, in the aggregate, of the initial public offering (''IPO'') of stock.[38] The converting institution typically sets the purchase price of each share of stock at ten dollars. On the day of the IPO, however, the value of this stock is likely to increase markedly over its purchase price, in some cases as much as seventy percent. This increase, known in the trade as the ''IPO pop,'' is pure profit to those who subscribe to and participate in the IPO.[39] This pop represents part of the transfer of the value of the institution from its members as a whole to those individuals who subscribe to the IPO.

While all depositors (as of a certain date) of the converting institution technically have equal subscription IPO rights, if the IPO is oversubscribed, meaning there are more requests for stock than the amount of stock being offered, then the depositors with larger account balances will be able to buy more stock than those depositors with small account balances. The institution's directors and officers know in advance the date of record for subscription rights, and so may increase their account balances at an appropriate time to ensure maximum subscription

Others have been conversions into mutual holding company (MHC) form, where 49% of the stock is publicly held and the other 51% is held by an MHC. Whether an MSB converts to full stock or MHC, the directors and officers have access to stock that other members do not. The Board notes that the MHC structure was first introduced during the demutualization of the insurance industry in the 1990s. For a discussion of some of the issues particular to an MHC conversion, including the diminution of member-owner rights, see *Note: No Longer Your Piece of the Rock: The Silent Reorganization of Mutual Life Insurance Firms,* 73 N.Y.U.L. Rev. 999 (1998).

[29] ''Credit unions are not authorized to convert directly to a Federal stock savings institution. A credit union may convert to a Federal stock savings institution subsequent to its conversion to a Federal mutual savings institution, pursuant to 12 CFR part 563b. OTS will generally require the converted credit union to operate as a Federal mutual savings institution for at least one year before entertaining an application to convert to the stock form of organization.'' OTS Applications Processing Handbook, Section 430.1 (February 5, 2002).

[30] For example, Beacon Federal took over four years to convert from an MSB to a stock bank (July of 1999 to January of 2004) and Atlantic Coast Federal took over two years to convert from an MSB to a stock bank (November of 2000 to January of 2003).

[31] 51 FR 40127 (November 5, 1986) (Preamble to final Federal Home Loan Bank Board rule on federal mutual savings bank stock conversions).

[32] 12 CFR 563b.380. The ESOP is voted on and approved by the MSB members as part of the extensive materials constituting the plan of conversion. The existence and details of the ESOP are not placed conspicuously or highlighted for thrift members in the same manner that NCUA requires for the disclosures to credit union members under this rule.

[33] In practice, rules limiting the aggregate amount of stock held by both management stock plans and the ESOP may limit the ESOP to 8% of the total conversion stock offering.

[34] 12 CFR 563b.500(a). These plans are voted on and approved by the bank stockholders. At the time of this vote, the directors and officers generally control a large percentage of the votes through stock acquired by them in the initial public offering (IPO) or held for their benefit in the ESOP.

[35] 12 CFR 563b.500(a)(3). The management benefit plan is restricted to 3% of the stock if the converting institution has less than ten percent capital, which would be rare for converting MSBs that were former credit unions. Also, the aggregate amount of stock in the management stock benefit plan and the ESOP cannot exceed 12%.

[36] According to one press report, this management stock benefit plan is perhaps the most lucrative of the various stock acquisition options and often means millions of dollars in free stock for only a handful of senior executives. Credit Union Journal, February 24, 2004. The report, quoting an official from SNL Financial, states that ''[i]n some cases that can increase compensation by 10 to 20 times.'' *Id.*

[37] 12 CFR 563b.500(a)(2). Stock options may not be granted at less than the market price at time of grant. *Id.* at (a)(9). Also, there are restrictions on how the benefits in these plans may be divided between the officers and directors. No individual may receive more than 25% of the stock in any plan, and directors are limited to 5% (individually) and 30% (as a group) of the stock in any plan. 12 CFR 563b.500(a)(5) and (a)(6).

[38] 12 CFR 563b.375. This aggregate limit increases from 25% to 35% on a sliding scale as the size of the institution declines meaning the smaller the institution the more the officers and directors may buy. Any individual officer or director may purchase up to a limit established by the thrift, but generally no more than 5%. The OTS may approve a higher limit. 12 CFR 563b.385.

[39] The stock of Rainier Pacific Financial Group, formerly the Rainier Pacific Credit Union, popped 69.9% on the day of its IPO. IPO pops vary, but investors can generally expect a pop well into the double digits. For a list of some historical IPO pops, see SNL Conversion Watch, Sept. 1, 2005, P. 4.

rights.[40] Other depositors who are not directors or officers will not have this information. There is also anecdotal evidence suggesting many depositors of a converting institution do not exercise the IPO rights they have, either because they are not well informed about the value of the stock subscription or because they do not have the resources to purchase the stock and take advantage of the IPO pop.[41] The depositors' failure to exercise their IPO rights also benefits the directors and officers.

This stock conversion structure permits the directors, officers, and employees of the bank and the benefit plans created for those persons to obtain a substantial portion of the shares and the associated net worth of the institution. Consultants who advise credit unions to pursue conversions make specific claims about the magnitude and extent of the financial benefits available to the directors and officers at converting credit unions. One newsletter article prepared by such a consultant states that:

- Bank CEOs typically receive much greater compensation than credit union CEOs, with the bank CEOs receiving from 20% to 57% more for institutions of similar assets size.[42]
- Bank directors typically earn between $2,500 to over $50,000 annually, in addition to travel and expense allowances, while credit union directors are typically uncompensated.[43]
- The gap in pay can be much wider at individual banking institutions that utilize stock compensation programs. For example, assuming a credit union with $50 million in capital converts to a stock bank with an IPO amount of $100 million, directors would share a $2 million grant of stock, and management would receive an equal grant. Each member of a five director board would get $400,000 in stock, vested over five years, at the IPO value.[44]

This article continues by detailing various other opportunities for a credit union-turned-bank executive to accrue wealth, and concludes with ''[t]he reward for performance could lead to a $10 million plus, ownership stake for a capable CEO. * * * If the conversion is not made during the current tenure, the next CEO in charge may very well realize the value.'' [45]

The financial trade press has reported on the specific benefits that directors and officers of credit unions obtain from their access to stock following a mutual to stock conversion. In one converted credit union, the officers and directors set aside $5 million in free stock for themselves through stock benefit plans [46] and made several million more dollars in profits on the IPO pop.[47] At another converted credit union, the officers and directors amassed more than $14 million in stock and cash benefits during the three-year period following stock conversion, with the CEO alone receiving $3 million in stock.[48] At another converted credit union, the officers and directors made approximately $1 million in profits on the IPO pop and set aside another $3.5 million for themselves in free stock.[49] At another converted credit union, the CEO made $600,000 on the IPO, received rights to another $1 million in free stock, and received additional stock option benefits.[50]

NCUA has analyzed publicly available financial documents at the Securities and Exchange Commission related to these press reports and believes the numbers above are generally accurate.[51]

In sum, the NCUA believes there is ample evidence to support its conclusion, as set forth in the currently required boxed disclosures, that ''[i]n a typical conversion to the stock form of ownership, the executives of the institution profit by obtaining stock far in excess of that available to the institution's members.'' NCUA also believes that banking regulations are structured to facilitate stock ownership by directors and officers. Credit union members have a right to know this before they vote on an MSB conversion. Accordingly, NCUA's proposed boxed disclosure retains language about profits by directors and officers. NCUA modified the proposed language slightly 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

[40] While the OTS restricts the ability of directors and officers to increase account balances and, thus, subscription rights within the year before the date of record, 12 CFR 563b.360, these individuals may act to increase their account balances just before this one year period. NCUA is aware that some credit union boards hire consultants and begin deliberations on potential conversion to an MSB and then a stock bank multiple years before they adopt a formal proposal to convert to an MSB.

[41] See Mario F. Cattabiani, Jennifer Lin & Craig R. McCoy, *A Fast-moving and Enriching Merger; Fumo's Bank Aimed to Merge Quickly with a Former Credit Union, But Ran Into Regulatory Yellow Lights,* THE PHILADELPHIA INQUIRER, May 16, 2005, at A1. This article discusses the conversion of IGA FCU into an MSB and ultimately into a stock bank. The article notes that, although executives of the former credit union stated the 1999 stock conversion was intended to benefit the working class individuals who built the credit union, less than five percent of the former credit union members actually bought any stock. *See also, Documents Show Insider Dealing Started Early At CU-Turned-Bank,* Credit Union Journal, May 23, 2005. NCUA is not aware of any regulatory requirements that an MSB converting to stock form inform its members about the possibility of this IPO pop.

[42] Theriault, Alan D., *CEO & Directors: Salary Imbalance is Corrected by Converting to a Bank,* CONVERTING FROM A CREDIT UNION FAX UPDATE, Sept. 16, 2002, available at *http://www.cufinancial.com/pdfs/NL2002.pdf.*

[43] *Id.*

[44] *Id.*

[45] *Id.* at 2–3.

[46] ''On Feb. 17, directors of [Rainier Pacific Financial Group, the parent of Rainier Pacific Savings Bank], known until 2000 as Rainier Pacific CU, approved a lucrative post-conversion compensation for both themselves and managers. Under the plan, disclosed in documents filed with the Securities and Exchange Commission, top executives and directors of Rainier Pacific will be granted a total of 288,500 shares of stock valued at almost $5 million, to be vested over the next five years. The largest recipients will be [the President and CEO], who will receive 60,000 shares valued at almost $1 million, and [the Senior Vice President], who will receive 40,000 shares valued at more than $650,000. But directors also voted themselves a share in the so-called management recognition stock plan, with each of the eight non-employee directors in line for 10,000 shares valued at $165,000 over the next five years. That's on top of the $13,750 each of the once-volunteer directors now earn each year to serve on the board. But that's not all. The group, as well as other employees will share in a pool of options to buy 680,000 bank shares at a discount over the next five years. Officials of Rainier Pacific did not return phone calls last week to comment.'' *Taking It to the Bank; Filings Show How CEOs, Boards at Converts Have Cashed In,* Credit Union Journal, March 29, 2004, p. 1. *Hereinafter, Taking It to the Bank.*

[47] *See* the Credit Union Journal Daily, October 22, 2003, located at *www.cujournal.com* (discussing the conversion of Rainier Pacific Credit Union).

[48] See *Excessive Compensation Charged at Convert CU,* Credit Union Journal Daily, February 6, 2006 (Discussing SEC proxy filings involving the converted Synergy Federal Credit Union).

[49] ''The biggest winners at Kaiser [Federal Credit Union] were [the CEO] who bought the maximum allowable 30,000 shares, netting her $108,000 in IPO profits. Four directors and two other top execs also subscribed to the maximum 30,000 allotment. In all, the four top managers and six non-management directors earned $918,000 of profits on their 265,000 shares in last week's IPO. The ex-CU has also set aside another 255,000 shares, worth $3.5 million, as free stock grants to be awarded to the same individuals over the next five years.'' Credit Union Journal, April 5, 2004, p. 1.

[50] See *Taking It to the Bank, supra,* note 23 (Discussing the conversion of Pacific Trust Credit Union), and the Credit Union Journal, February 25, 2004. Four years after the IPO, the CEO had received stock grants and stock options of a total value of about $3.8 million. Credit Union Journal, April 14, 2006.

[51] The press report numbers are rounded. Also, some of the cited stock benefits are subject to vesting requirements or holding periods prior to resale. For example, stock awarded as part of a management or employee stock benefit plan may not vest more rapidly than 20 percent a year. 12 CFR 563b.500(a)(11). In addition, officers, directors, and their associates who make direct purchases of stock during the conversion must hold the shares for at least one year before resale. 12 CFR 563b.505(a).

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.

The NCUA specifically invites comments on the changes in compensation for directors and management that have occurred in credit unions that have converted to banks and also the form of NCUA's proposed disclosure.

Disclosures: Member Voting Rights

The proposed rule retains the current requirement that converting credit unions explain to members how the conversion from a credit union to a mutual savings bank will affect members' voting rights and if the mutual savings bank intends to base voting rights on account balances.[52]

Voting rights in credit unions and MSBs are different in two important ways: how many votes each member gets and the use of proxy voting. Federal credit union members have the purest form of democratic government: One-person, one-vote. Federal MSBs are allowed to dilute this through voting based on account balances so that depositors with larger account balances may obtain up to 1000 votes while members with smaller balances may only have one vote.[53] That means that members of lesser means lose voting power in a conversion from credit union to MSB. Directors and officers and other members of greater means gain increased voting power.

The NCUA has seen converting credit unions put statistical information in their member notices that imply the difference between one vote and one thousand votes is meaningless. NCUA believes that no vote is meaningless under any circumstances. In certain situations, the ability to cast one thousand votes instead of only one vote can carry huge weight. For example, in elections with low voter turnout or in very close elections the person with the greater voting power can control the outcome of the election.[54]

Federal MSBs are also permitted voting by proxy. 12 CFR 569. At some point in time, usually account opening, MSB depositors may sign a proxy statement that gives their voting rights to the MSB's board of directors. Typically, these proxies are perpetual or ''running,'' meaning that, except on a vote to convert to a stock charter, the MSB's board of directors, or a committee appointed by the board, will vote the proxy shares indefinitely unless the depositor takes some affirmative action to revoke the proxy.[55] This isolates the MSB depositor from the oversight of the MSB; MSB directors can even elect themselves indefinitely through the use of perpetual proxies.

An OTS Deputy Chief Counsel has characterized the effect of perpetual proxies at MSBs as follows:

> An important custom that perpetuates management control is the use of perpetual proxies that accountholders typically grant to management at the time they open a savings account. The OTS regulations permit a mutual institution's management to solicit proxies that are of unlimited duration. The use of these proxies, coupled with the management's control over meetings of a mutual savings institution, attenuates the influence that depositors may have.

D. Smith and J. Underwood, Memorandum: Mutual Savings Associations and Conversion to Stock Form, p. 17 (Office of Thrift Supervision, Business Transactions Division, May 1997).[56]

In contrast, the FCUA specifically prohibits proxy voting. 12 U.S.C. 1760. FCU members exercise their voting rights directly on all issues requiring a member vote, including the election of directors and fundamental organizational changes.

Disclosures: Regulations Applicable to Other Financial Institutions

Other financial regulators impose disclosure requirements upon charter conversions. State-chartered institutions in Hawaii must state the purpose of the meeting, describe the transaction and include a copy of the conversion plan. Haw. Rev. Stat. 412:3–605(a). In both Iowa and Texas, if a credit union's conversion will ultimately lead to the credit union becoming a stock institution, the board must fully and accurately disclose its intention. Iowa Admin. Code r. 180–3.2(533); 7 Tex. Admin. Code 91.1004(d)(1). Iowa also requires a state-chartered credit union proposing to convert to an FCU to make particular disclosures if the true purpose of the conversion is to convert to an MSB. Under the Iowa regulation, a credit union must disclose: Any loss of ownership interest in the credit union; that voting rights under a mutual savings bank structure are usually one vote per $100; and, that, if the MSB converts to stock, depositors will lose ownership interests and voting rights. Iowa Admin. Code r. 180–3.4(6). Three SSAs require that credit unions provide notice in boldface type to members when converting from a state to Federal credit union charter that the issue will be decided by a majority of the members who vote. Iowa Admin. Code r. 180–3.4(2); Tenn. Code Ann. 45–4–1902; 7 Tex. Admin. Code 91.1004(d)(3).

The OTS also has rules concerning disclosures in connection with depositor votes. It requires the financial institutions it regulates to provide accurate and non-misleading information in connection with depositor voting on matters relating to conversion. OTS also prohibits the use of proxy statement materials that contain any statement that, under the circumstances:

> Is false or misleading with respect to any material fact * * * Omits any material fact that is necessary to make the statements not false or misleading * * * or * * * Omits any material fact that is necessary to correct a statement in an earlier communication that has become false or misleading.

12 CFR 563b.285.

Member Communications With Other Members.

Proposed 708a.4(f) establishes 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

[52] The proposed boxed disclosures no longer include a discussion of change in voting rights, but a converting credit union must address these changes elsewhere in the member notice as required by the proposed 708a.4(c)(2).

[53] An FMSB may adopt a range of voting rights, from one-person one-vote to one vote per $100 account balance up to 1000 votes. NCUA believes, however, that all credit unions that have converted to FMSBs to-date have adopted bylaws allowing one vote per $100 account balance up to 1000 votes.

[54] For example, one credit union that recently went through the MSB conversion process reported to NCUA that, typically, fewer that one hundred of its members had participated in past elections. NCUA determined, based on call report data, that the *average* account balance at that credit union post-conversion would be about $8,200, and so the average MSB depositor would have about 82 votes. Some depositors, of course, would have balances in excess of $100,000, and so would have 1000 votes. Accordingly, in future elections, if the MSB continues to have about one hundred depositors vote in its annual election of directors, including its 13 incumbent directors, and the incumbents each have the maximum of 1000 votes, the incumbents could reelect themselves even if all the other 87 depositor-voters (assuming average account balances) opposed the reelection. This example does not take into account the incumbent board's ability to exercise proxies on behalf of other depositors, which further amplifies control by the board and management.

[55] ''In practice, members delegate voting rights and the operation of federal mutual savings associations through the granting of proxies typically given to the board of directors (trustees) or a committee appointed by a majority of the board.'' OTS Thrift Activities Regulatory Handbook, Section 110.2 (Dec. 2003).

[56] Available at *http://www.ots.treas.gov.*

members at the expense of the requestor.

The proposal requires a credit union, at the member's request, to send a communication by mail. The proposal also requires a credit union, at the member's request, to send the communication by e-mail to those members who have agreed to accept communications electronically from the credit union.[57] This is an effective method for a requestor to reach some members quickly and affordably. The proposal also requires a credit union to provide members an opportunity to post their opinions on a credit union's Web site free-of-charge if the credit union itself posts conversion-related materials. If the credit union's resources are used to promote a conversion, members should have an opportunity to express their views as well, whether for or against the conversion, in a similar format so that the issue may be openly debated before the membership vote.

Once a credit union sends the 90-day notice, the conversion process will move rapidly toward completion of the member vote. To ensure that member-to-member communications can be delivered in a timely fashion, and, in particular, before members receive the ballot with the 30-day notice, the proposal requires that any member desiring to communicate with other members deliver the communication to the credit union within 35 days (five weeks) after the date of the 90-day notice. A credit union then will 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. The proposal requires a requesting member to provide a credit union with an advance payment toward the reimbursable costs. This advance payment serves two functions. First, it will screen out requestors who may not have the resources or the intent to reimburse the credit union for its costs of delivery. Second, it will streamline the member-to-member communication process and avoid unnecessary delay. A credit union that receives the advance payment must deliver the communication first and work out any details concerning 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 will 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. NCUA invites comment on whether these advance payment amounts are reasonable or whether they should be adjusted.

A member that requests to communicate with other members will need to know the total number of credit union members eligible to vote on the proposed conversion so that the requestor can calculate the amount of the advance payment (for delivery by regular mail). The requestor will also need to know how many credit union members have agreed to receive electronic communications so that the requestor can decide about sending the communication to those members alone. The proposed § 708a.4(b)(3) requires that the 90-day and 60-day notices include the number of credit union members eligible to vote on the conversion proposal and how many members have agreed to accept communications from the credit union in electronic form.[58]

The proposed member communication must be conversion-related and proper. Improper communications include communications that are impracticable to deliver, relate to personal gain or grievance, or are otherwise false or misleading with respect to any material fact.

NCUA is concerned that a credit union and a requesting member may not be able to agree on whether a particular communication is proper and, accordingly, the proposed rule contains a procedure for resolving disputes. If a credit union believes that a particular communication is not proper, it must forward that communication to the Regional Director within seven days of receipt. The credit union must include with its transmittal letter a statement as to why it believes the communication is not proper and a recommendation for modifying the communication, if possible, to make it proper. The Regional Director will review the communication and respond to the credit union within seven days with a determination on the propriety of the communication. If necessary, the Regional Director will coordinate with the requesting member. After completion of the Regional Director's review, the credit union must mail or e-mail the material to the members if directed by the Regional Director.

NCUA intends this timeline to allow members sufficient time to prepare their desired communications, provide them to the credit union, obtain resolution of any disputes, and have the communications delivered before the 30-day notice and the ballot. Specifically, in the most time-sensitive situation, a member will wait the full 35 days after the 90-day notice to deliver a communication to the credit union, the credit union will challenge it as improper and deliver it to NCUA a full seven days after that, and NCUA will then return the communication to the credit union to with instructions to deliver the communication, with any necessary modifications, seven days after that. This still leaves the credit union with at least eleven days to deliver the member communication to other members before delivery of the 30-day notice. If a credit union cannot forward a member communication to other members for receipt before the date they receive the 30-day notice and associated ballot, the proposed rule requires the credit union to postpone mailing the 30-day notice until members receive the communication. If a credit union postpones the mailing of the 30-day notice, it must also postpone the special meeting by the same number of days.

Member Communications: Regulations Affecting Other Financial Institutions

Generally, in a conversion from an MSB to the stock form of ownership, both the MSB and its depositors may engage in proxy solicitations for the meeting to vote on the plan of conversion. In that context, OTS requires the MSB to mail a depositor's proxy solicitation under conditions similar to those in § 708a.4(f) of the proposed rule. OTS also regulates how quickly the mailing must occur and the information that may be in the proxy solicitation. 12 CFR 563b.280, 563b.285.

OTS regulations also establish general procedures for communication between depositors of an FMSB that are independent of the conversion context. 12 CFR 544.8. For example, OTS requires an FMSB to forward depositor communications to other depositors if the requesting depositor agrees to defray the costs and the communication is not

[57] NCUA is not certain how difficult it may be for a credit union to take its member e-mail list and separate the eligible voters from others who may not be eligible to vote. Accordingly, the credit union may, at its option, send the e-mail to all members who have agreed to accept communications electronically or just to those members eligible to vote.

[58] NCUA will also use this information for another purpose. In at least one previous conversion to an MSB, it was not clear if the credit union had correctly identified all eligible voters and given them their opportunity to vote. NCUA will compare the number of eligible voters set forth in the 90-day notice with the number of members the credit union has identified in past call reports to ensure that the count is accurate and that every member eligible to vote on the conversion proposal is provided the opportunity to do so.

''improper.'' The NCUA Board has patterned parts of its proposed § 708a.4(f) after § 544.8 of the OTS rule, including the scope of an improper communication.

NCUA solicits comments on this proposed method of member-to-member communication. NCUA specifically requests comment on whether NCUA should apply this method to all member communications, not just those communications made in the context of a pending conversion to an MSB. In that regard, commenters should be aware that while NCUA regulations and FCU bylaws do not currently address member-to-member communications, if the state corporation law where the FCU is located requires that a corporation facilitate shareholder-to-shareholder communications, the FCU would be bound to follow such a requirement for their member communications. See the discussion of proposed § 708a.12 in the Section-by-Section Analysis below.

Member Communications: Alternative Approaches

NCUA also solicits comment on whether there may be other, better alternatives for facilitating communication among members than the procedure outlined in proposed § 708a.4(f).

For example, in addition to the procedures outlined in proposed § 708a.4(f), should members also be allowed to request that a communication be sent electronically to those members who have agreed to receive communications electronically and have the communication sent by regular mail to those members who are eligible to vote that have not agreed to accept communications electronically? The Board seeks additional information on the difficulties faced by a credit union to organize this multiple-method communication under the timelines prescribed for delivering the member communications.

Another alternative might be to permit members to ask the converting credit union to send other members the requestor's contact information only. That is, the converting institution would mail to its members the name and contact information (e.g., website or e-mail address) of requesting members, along with a statement that the requestor wishes to discuss the conversion and an indication whether the requestor generally supports, opposes, or is neutral on the conversion. A second alternative would be to require members desiring to make substantive statements to other members to prepare the mailing materials themselves, including packaging and sealing the envelopes and affixing the requisite postage. The converting credit union would then simply attach the address labels and mail the materials. Both of these alternatives have the potential advantage that they would not require a determination as to the accuracy of substantive communications made by the requesting member. A third alternative would be not to have a special procedure but to defer to general state corporate law for member access to membership mailing lists, as recognized in the proposed § 708a.12. NCUA also solicits comment on whether any of these alternative approaches, alone or in combination, are better for facilitating member contact than the procedures outlined in proposed § 708a.4(f). NCUA also solicits comment on any other alternatives not mentioned here.

Electronic Voting

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. NCUA solicits comment on this option.

708a.5 Notice to NCUA

The current § 708a.5 requires that converting credit unions notify NCUA of the 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 NCUA with certain information about the laws and regulations it intends to follow with regard to the conversion. The current § 708a.5 also permits a credit union, if it chooses, to provide notice to NCUA more than 90 days before the member vote, and to request a preliminary determination as to the proposed methods and procedures of the conversion.

Certification Requirement

The proposal amends § 708a.5 to require a board of directors to submit to NCUA a certification of its support for the conversion proposal and plan. Each director who votes in favor of the conversion proposal must sign the certification.

The certification must 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. It must include a description of all materials submitted to the Regional Director with the certification and a statement that these materials are true, correct, current, and complete as of the date of submission. Finally, it must include an acknowledgement that federal law prohibits any misrepresentations or omissions of material facts in connection with the conversion. 18 U.S.C. 1001.

The NCUA believes it vitally important that the directors of a converting credit union understand and acknowledge their fiduciary duties. NCUA intends the proposed certification requirement to impress upon directors their responsibility to conduct a thorough and complete analysis of the proposed conversion transaction and to make a decision in the best interests of the members.

Certification: Regulations Affecting Other Financial Institutions

At least three states require some form of certification during the conversion process. Hawaii requires that an institution submit the certification of two executive officers that the meeting and vote were valid; a copy of the conversion resolution that is certified to be true and correct; or certification that the institution has complied with all federal laws and regulations relating to conversion if applicable. Haw. Rev. Stat. 412:3–608(b), *see also* 606, 607. Michigan and Vermont require that a converting credit union file certified copies of all records of all conversion-related proceedings held by the governing body and the credit union's members. Mich. Comp. Laws 490.373(1)(i); 2005 Vt. Acts & Resolves 16. The OTS requires directors and other management officials associated with the de novo chartering of an MSB to file a Biographical and Financial Report which includes a certification. 12 CFR 543.3(e). The OTS also requires that, after the depositors' meeting on a conversion to a stock bank, the MSB must file a certified copy of each adopted conversion resolution, data regarding the votes cast and a legal opinion that the MSB conducted the depositors' meeting in compliance with all applicable state or federal laws and rules. 12 CFR 563b.240(a). NCUA's proposed certification requirement is similar to, but less onerous than, these states' and the OTS'' requirements.

Section 708a.5(b) retains a credit union's right to request NCUA make a preliminary determination regarding the intended methods and procedures applicable to the membership vote. The proposal expands that right to allow a credit union also to 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. Under the

proposal, the NCUA Regional Director will make a determination on the request within 30 calendar days unless more time is required to review the submission or obtain additional information.

708a.6 Membership Approval of a Proposal To Convert

The current § 708a.6 provides that the board of the converting credit union must certify the results of the member vote to NCUA within ten days of the member vote. The board must also certify that the materials actually provided to the members were the same as those previously submitted to NCUA or provide an explanation for any differences.

As noted previously, the proposed § 708a.6 includes the requirements found in the current § 708a.4 that: (1) Members must approve the proposal by affirmative vote of the majority of members who vote; and (2) the vote must be by secret ballot conducted by an independent entity.

Proposed § 708a.6(b) requires the board of directors to set a date to determine member eligibility to vote. The voting date of record must be at least one hundred twenty days before the board of director's publishes the § 708a.3 notice of intent to consider conversion. NCUA is aware that professional depositors may attempt to join a credit union to profit from a conversion to a mutual savings bank. NCUA believes this proposed one hundred twenty day cut-off will help deter such activity and ensure that credit union members who are not professional depositors have an undiluted voice in the conversion decision.

The OTS rule governing conversions from MSBs to stock form states that voter eligibility is determined by a voting record date not more than 60 days nor less than 20 days before the depositor meeting. 12 CFR 563b.230. State law applies if a state-chartered MSB is converting. *Id.* The OTS rule is comparable to the provision for fixing the record date in the model MSB bylaws, which sets the record date for those eligible to receive notice or vote at not more than 60 days or less than 10 days before the date depositors are to take action. OTS Form 1577, OTS Applications Handbook, Section 410.29 (April 2001). While NCUA's proposed restriction on the voting record date is somewhat different than that set by OTS, NCUA believes it is reasonable.

708a.7 Certification of Vote on Conversion Proposal

Proposed § 708a.7 retains the requirement, currently located in § 708a.6, that the board of directors certify the results of the membership vote to NCUA. The proposal does not make any changes to this requirement.

708a.8 NCUA Oversight of Methods and Procedures of Membership Vote

The current 708a.7 provides that the Regional Director will issue a determination to approve or disapprove a credit union's methods and procedures for the membership vote within 10 calendar days of the receipt of the credit union's certification of the member vote.

The proposal lengthens this time period to 30 calendar days and relocates this provision from § 708a.7 to § 708a.8. Based on past NCUA experience, 10 days does not provide adequate time for the Regional Director to review all of the written materials provided to members, particularly if the credit union amended them in the process, and verify all of the information necessary to make the required determination.

Section 708a.8(d) of the proposal also contains a new provision that permits a credit union dissatisfied with a determination issued by the Regional Director to appeal to the NCUA Board for a final agency determination. Any appeal must be filed by the credit union within 30 calendar days after receipt of the Regional Director's determination.

708a.9 Other Regulatory Oversight of Methods and Procedures of Membership Vote

Proposed § 708a.9 retains the requirement, currently located in § 708a.8, that the entity that will regulate the credit union following conversion must verify the vote and may direct that a new vote be taken. The proposal does not make any changes to the requirement or its language.

708a.10 Completion of Conversion

This section retains the provisions in the current § 708a.9 stating that, once the credit union has received the approvals required in the current §§ 708a.7 and § 708a.8, it may complete the conversion. NCUA will then cancel its account insurance and, if it is a federal credit union, its charter.

The proposal amends 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 under proposed § 708a.8. NCUA believes in the normal course of events one year is more than enough time to complete a conversion, and, if it is not finalized in that time, problems may arise. For example, the credit union examination process, which involves detailed planning and resource allocation months in advance, becomes disrupted and uncertain, while the financial condition of a credit union may change rapidly. In addition, the composition and views of credit union membership change over time. At some point, the membership vote to approve conversion may no longer represent the views of the membership and so the vote becomes stale. Additionally, those individuals who join the credit union during this time period do not know if they are really joining a credit union or are becoming members of a potential bank. Accordingly, if the conversion process is not completed within a year, the process should end. The credit union should return to its normal examination cycle and, if the board of directors still desires to convert, it should reinitiate the conversion process at an appropriate time.

Conversion Completion: Regulations Affecting Other Financial Institutions

NCUA notes that the OTS rule for conversions from MSBs to stock form also includes a regulatory completion date. 12 CFR 563b.420. An MSB must complete its conversion not later than 24 months from the date of the membership's approval of the conversion. *Id.* While the completion time frame under the NCUA proposal is shorter than the OTS completion time, an MSB to stock conversion needs the additional time. Before an MSB can complete its stock conversion, there are numerous prerequisites. For instance, the OTS must first approve of the conversion, authorize the MSB's proxy statement, and declare the offering statement effective. Then the MSB must distribute order forms to eligible account holders and voting members. 12 CFR 563b.325(a), 563b.335.

708a.11 Limit on Compensation of Officials

Proposed § 708a.11 retains the limit on compensation for officials currently found in § 708a.10. The proposal does not make any modifications to this limit.

708.12. Member Access to Books and Records

The proposed rule includes a new provision on member access to the books and records of the converting credit union. The proposal states that members may request access to the books and records of a 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 of directors. The proposal also states that federal credit unions will grant access under the same terms and conditions that a state-chartered for-profit corporation in the state in which the federal credit union is located must grant access to its shareholders.

This is not new law. NCUA's longstanding opinion is that the internal governance of federal credit unions, to the extent a matter is not addressed in federal statutes, regulations, or bylaws, should be determined by reference to the law governing for-profit corporations in the state in which the federal credit union is located. *See* NCUA OGC Legal Opinion 96–0541 (June 14, 1996). NCUA believes it is helpful to restate this position explicitly in part 708a.

Member access to the books and records of a state-chartered credit union is determined by applicable state law.

708a.13 Voting Guidelines.

Section 708a.11 of the current conversion rule contains some guidelines to assist converting credit unions in conducting their member vote. The current guidelines discuss the interplay between state and federal law affecting the vote, the determination of who is eligible to vote, and the time and place of the special meeting at which the members will cast their ballots.

The proposal moves the voting guidelines to § 708a.13. It retains the existing guidance and adds additional guidance on the use of voting incentives. It also renumbers the paragraphs.

In the past, some converting credit unions have offered incentives to members, such as entry to a prize raffle, to encourage participation in the conversion vote. Credit unions must exercise care in the design and execution of such incentives. The proposed voting guidelines state that credit union should ensure that the incentive complies 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.

NCUA has received some informal complaints in past MSB conversions that these voting incentives distract voters from the issues surrounding the conversion. Some have even suggested that NCUA prohibit these incentives. At this time, NCUA is not inclined to prohibit these incentives. NCUA invites commenters to provide specific information on whether and how such incentives detract from the fairness of the vote.

C. Request for Public Comment

NCUA's goal is to promulgate clear and understandable regulations that impose minimal regulatory burden. We request public comments on whether the proposed rule is understandable and minimally intrusive. We also seek specific suggestions to improve the content of the rule.

D. Regulatory Procedures

Regulatory Flexibility Act

The Regulatory Flexibility Act requires NCUA to prepare an analysis to describe any significant economic impact a rule may have on a substantial number of small credit unions, defined as those under ten million dollars in assets. This proposed rule amends the procedures an insured credit union must follow to convert to an MSB. Based on past experience with MSB conversions, NCUA does not anticipate any future conversions by credit unions with less than ten million dollars in assets. Accordingly, the proposed amendments would not have a significant economic impact on a substantial number of small credit unions, and, therefore, a regulatory flexibility analysis is not required.

Paperwork Reduction Act

Part 708a contains information collection requirements. As required by the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)), NCUA has submitted a copy of this proposed regulation as part of an information collection package to the Office of Management and Budget (OMB) for its review and approval of a revision to Collection of Information, Conversion of Insured Credit Unions to Mutual Savings Banks, Control Number 3133–0153.

The current rule requires an insured credit union intending to convert to a mutual savings bank or savings association to provide notice and disclosure of its intent to convert to its members and NCUA and requires the credit union to provide additional information to NCUA at various points in the conversion process. These collection requirements are necessary to insure safety and soundness in the credit union industry and protect the interests of credit union members in the charter conversion context. NCUA previously estimated that the ten credit unions would convert each year and that the burden associated with the collection would amount to no more than 20 hours per credit union, for an aggregate burden of 200 burden hours annually.

The proposed modifications to part 708a will help ensure that credit union members receive sufficient information to enable them to make an informed decision regarding a vote on conversion to a mutual savings bank and will promote the likelihood the vote will be conducted in a fair and legal manner. The proposed modifications will also help ensure that NCUA has sufficient information to fulfill its statutory obligation to administer the member vote on conversion.

To achieve these goals, the proposal increases the collection requirements for converting credit unions. Specifically, the credit union must collect, post, and retain the comments of members sent to directors before directors vote on a conversion proposal. NCUA estimates that up to one hundred members may comment on a conversion proposal with an associated burden of 50 hours per converting credit union. NCUA also estimates that, after a credit union's board votes to adopt a conversion proposal, perhaps five members will request to communicate with other members through the credit union. Although the expense of this request is the responsibility of the requesting member, and so will keep the number of such requests down, NCUA estimates that the associated burden at the credit union for each request is about 50 hours, for an aggregate of about 250 hours for each converting credit union. The total burden for each credit union would then be 20 hours from the requirements retained from the original rule, plus an additional 300 hours from the proposed changes, for a total of 320 hours.

Based on recent history, NCUA now estimates that about three credit unions will seek to convert per year. Accordingly, the aggregate total collection burden is three times 320, or 960 hours, an increase of about 760 hours over the current rule.

Organizations and individuals that wish to submit comments on this information collection requirement should direct them to the Office of Information and Regulatory Affairs, OMB, Attn: Mark Menchik, Room 10226, New Executive Office Building, Washington, DC 20503, with a copy to Mary Rupp, Secretary of the Board, National Credit Union Administration, 1775 Duke Street, Alexandria, Virginia 22314–3428.

The NCUA considers comments by the public on this proposed collection of information in:

- Evaluating whether the proposed collection of information is necessary for the proper performance of the functions of the NCUA, including whether the information will have a practical use;
- Evaluating the accuracy of the NCUA's estimate of the burden of the proposed collection of information, including the validity of the methodology and assumptions used;
- Enhancing the quality, usefulness, and clarity of the information to be collected; and
- Minimizing the burden of collection of information on those who are to respond, including through the use of appropriate automated, electronic, mechanical, or other technological collection techniques or other forms of information technology; *e.g.*, permitting electronic submission of responses.

The Paperwork Reduction Act requires OMB to make a decision concerning the collection of information contained in the proposed regulation between 30 and 60 days after publication of this document in the **Federal Register**. Therefore, a comment to OMB is best assured of having its full effect if OMB receives it within 30 days of publication. This does not affect the deadline for the public to comment to the NCUA on the proposed regulation.

Executive Order 13132

Executive Order 13132 encourages independent regulatory agencies to consider the impact of their actions on state and local interests. In adherence to fundamental federalism principles, NCUA, an independent regulatory agency as defined in 44 U.S.C. 3502(5), voluntarily complies with the executive order. The proposed rule would not have substantial direct effects on the states, on the connection between the national government and the states, or on the distribution of power and responsibilities among the various levels of government. NCUA has determined that this proposed rule does not constitute a policy that has federalism implications for purposes of the executive order.

The Treasury and General Government Appropriations Act, 1999—Assessment of Federal Regulations and Policies on Families

The NCUA has determined that this proposed rule would not affect family well-being within the meaning of section 654 of the Treasury and General Government Appropriations Act, 1999, Public Law 105–277, 112 Stat. 2681 (1998).

List of Subjects in 12 CFR Part 708a

Charter conversions, Credit unions.

By the National Credit Union Administration Board on June 22, 2006.

Mary F. Rupp,

Secretary of the Board.

For the reasons stated above, NCUA proposes to revise 12 CFR part 708a as follows:

PART 708a—CONVERSION OF INSURED CREDIT UNIONS TO MUTUAL SAVINGS BANKS

Sec.

708a.1 Definitions.
708a.2 Authority to convert.
708a.3 Board of directors' approval and members' opportunity to comment.
708a.4 Disclosures and communications to members.
708a.5 Notice to NCUA.
708a.6 Membership approval of a proposal to convert.
708a.7 Certification of vote on conversion proposal.
708a.8 NCUA oversight of methods and procedures of membership vote.
708a.9 Other regulatory oversight of methods and procedures of membership vote.
708a.10 Completion of conversion.
708a.11 Limit on compensation of officials.
708a.12 Member access to books and records.
708a.13 Voting guidelines.

Authority: 12 U.S.C. 1766, 12 U.S.C. 1785(b).

§ 708a.1 Definitions.

As used in this part:

Clear and conspicuous means 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.

Credit union has the same meaning as insured credit union in section 101 of the Federal Credit Union Act.

Federal banking agencies have the same meaning as in section 3 of the Federal Deposit Insurance Act.

Mutual savings bank and *savings association* have the same meaning as in section 3 of the Federal Deposit Insurance Act.

Regional director means the director of the NCUA regional office for the region where a natural person credit union's main office is located. For corporate credit unions, *regional director* means the director of NCUA's Office of Corporate Credit Unions.

Senior management official means a chief executive officer, an assistant chief executive officer, a chief financial officer, and any other senior executive officer as defined by the appropriate federal banking agencies pursuant to section 32(f) of the Federal Deposit Insurance Act, 12 U.S.C. 1831i(f).

§ 708a.2 Authority to convert.

A credit union, with the approval of its members, may convert to a mutual savings bank or a savings association that is in mutual form without the prior approval of the NCUA, subject to applicable law governing mutual savings banks and savings associations and the other requirements of this part.

§ 708a.3 Board of directors' approval and members' opportunity to comment.

(a) A credit union's board of directors must comply with the following notice requirements before voting on a proposal to convert.

(1) No later than 30 days before a board of directors votes on a proposal to convert, it must publish a notice in a general circulation newspaper, or in multiple newspapers if necessary, serving all areas where the credit union has an office, branch, or service center. It must also post the notice in a clear and conspicuous fashion in the credit union's home office and branch offices and on the credit union's Web site, if it has one. If the notice is not on the home page of the Web site, the home page must have a clear and conspicuous link, visible on a standard monitor without scrolling, to the notice.

(2) The public notice must include the following:

(i) The name and address of the credit union;

(ii) The type of institution to which the credit union's board is considering a proposal to convert;

(iii) A brief statement of why the board is considering the conversion and the major positive and negative effects of the proposed conversion;

(iv) A statement that directs members to submit any comments on the proposal to the credit union's board of directors by regular mail, electronic mail, or facsimile;

(v) The date on which the board plans to vote on the proposal and the date by which members must submit their comments for consideration, which may not be more than 5 days before the board vote;

(vi) The street address, electronic mail address, and facsimile number of the credit union where members may submit comments and the Web site address where the public and members may view others' comments; and

(vii) A statement that, in the event the board approves the proposal to convert, the proposal will be submitted to the membership of the credit union for a vote following a notice period that is no shorter than 90 days.

(3) The board of directors must approve publication of the notice.

(b) The credit union must collect member comments and retain copies at

the credit union's main office until the conversion process is completed. If the credit union maintains a Web site, the credit union must post the comments in a clear and conspicuous fashion. If the credit union believes a particular member submission is not proper for posting, it will provide that submission to the Regional Director for review as described in § 708a.4(f)(5).

(c) The board of directors may vote on the conversion proposal only after reviewing and considering all member comments. The conversion proposal may only be approved by an affirmative vote of a majority of board members who have determined the conversion is in the best interests of the members. If approved, the board of directors must set a date for a vote on the proposal by the members of the credit union.

§ 708a.4 Disclosures and communications to members.

(a) After the board of directors has complied with § 708a.3 and approves a conversion proposal, the credit union must provide written notice of its intent to convert to each member who is eligible to vote on the conversion. The notice to members must be submitted 90 calendar days, 60 calendar days, and 30 calendar days before the date of the membership vote on the conversion. A ballot must be included in the same envelope as the 30-day notice and only in the 30-day notice. A converting credit union may not distribute ballots with either the 90-day or 60-day notice, in any other written communications, or in person before the 30-day notice is sent.

(b)(1) The notice to members must adequately describe the purpose and subject matter of the vote to be taken at the special meeting or by submission of the written ballot. The notice must clearly inform members that they may vote at the special meeting or by submitting the written ballot. The notice must state the date, time, and place of the meeting.

(2) The notices that are submitted 90 and 60 days before the membership vote on the conversion must state in a clear and conspicuous fashion that a written ballot will be mailed together with another notice 30 days before the date of the membership vote on conversion. The notice submitted 30 days before the membership vote on the conversion must state in a clear and conspicuous fashion that a written ballot is included in the same envelope as the 30-day notice materials.

(3) For purposes of facilitating the member-to-member contact described in paragraph (f) of this section, the 90-day and 60-day notices must indicate the number of credit union members eligible to vote on the conversion proposal and how many members have agreed to accept communications from the credit union in electronic form.

(4) The member ballot must include:

(i) A brief description of the proposal (*e.g.*, ''Proposal: Approval of the Plan Charter Conversion by which (insert name of credit union) will convert its charter to that of a federal mutual savings bank.'');

(ii) Two blocks marked respectively as ''FOR'' and ''AGAINST;'' and

(iii) The following language: ''A vote FOR the proposal means that the credit union will become a bank. A vote AGAINST the proposal means that the credit union will remain a credit union.'' This language must be displayed in a clear and conspicuous fashion immediately beneath the FOR and AGAINST blocks.

(5) The ballot may also include voting instructions and the recommendation of the board of directors (*i.e.*, ''Your Board of Directors recommends a vote FOR the Plan of Conversion'') but may not include any further information without the prior written approval of the Regional Director.

(c) An adequate description of the purpose and subject matter of the member vote on conversion, as required by paragraph (b) of this section, must include:

(1) A clear and conspicuous 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;

(2) A clear and conspicuous disclosure of how a conversion from a credit union to a mutual savings bank will affect members' voting rights and if the mutual savings bank intends to base voting rights on account balances;

(3) A clear and conspicuous disclosure of any conversion-related economic benefit a director or senior management official will or may receive including receipt of or an increase in compensation and an explanation of any foreseeable stock-related benefits associated with a subsequent conversion to a stock institution or mutual holding company structure. The explanation of stock-related benefits must include a comparison of the opportunities to acquire stock available to officials and employees with those opportunities available to the general membership;

(4) A clear and conspicuous disclosure of how the conversion from a credit union to a mutual savings bank will affect the institution's ability to make non-housing-related consumer loans because of a mutual savings bank's obligations to satisfy certain lending requirements as a mutual savings bank. This disclosure should specify possible reductions in some kinds of loans to members; and

(5) An affirmative statement that, at the time of conversion to a mutual savings bank, the credit union does or does not intend to convert to a stock institution or a mutual holding company structure.

(d)(1) A converting credit union must provide the following disclosures in a clear and conspicuous fashion with the 90-, 60-, and 30-day notices its sends to its members regarding the conversion:

IMPORTANT REGULATORY DISCLOSURE ABOUT YOUR VOTE

The National Credit Union Administration, the federal government agency that supervises credit unions, requires [insert name of credit union] to provide the following disclosures:

1. LOSS OF CREDIT UNION MEMBERSHIP. A vote ''FOR'' the proposed conversion means your credit union will become a mutual savings bank. A vote ''AGAINST'' the proposed conversion means your credit union will remain a credit union.

2. RATES ON LOANS AND SAVINGS. If your credit union converts to a bank, you may experience 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.

3. 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.

(2) This text must be placed in a box, must be the only text on the front side of a single piece of paper, and must be placed so that the member will see the text after reading the credit union's cover letter but before reading any other

part of the member notice. The back side of the paper must be blank. A converting credit union may modify this text only with the prior written consent of the Regional Director and, in the case of a state-chartered credit union, the appropriate state regulatory agency.

(e) All written communications from a converting credit union to its members regarding the conversion must be written in a manner that is simple and easy to understand. Simple and easy to understand means the communications are written in plain language designed to be understood by ordinary consumers and use clear and concise sentences, paragraphs, and sections. For purposes of this part, examples of factors to be considered in determining whether a communication is in plain language and uses clear and concise sentences, paragraphs and sections include the use of short explanatory sentences; use of definite, concrete, everyday words; use of active voice; avoidance of multiple negatives; avoidance of legal and technical business terminology; avoidance of explanations that are imprecise and reasonably subject to different interpretations; and use of language that is not misleading.

(f)(1) A converting credit union must mail or e-mail a requesting member's proper conversion-related materials to other members eligible to vote within seven days of receiving such a request if:

(i) A credit union's board of directors has adopted a proposal to convert;

(ii) A member makes a written request that the credit union mail or e-mail materials for the member;

(iii) The request is received by the credit union no later than 35 days after it sends out the 90-day member notice; and

(iv) The requesting member agrees to reimburse the credit union for the reasonable expenses of mailing or e-mailing the materials and also provides the credit union with an appropriate advance payment.

(2) A member's request must indicate if the member wants the materials mailed or e-mailed. If a member requests that the materials be mailed, the credit union will mail the materials to all eligible voters. If a member requests the materials be e-mailed, the credit union will e-mail the materials to all members who have agreed to accept communications electronically from the credit union. The subject line of the e-mail will be ''Proposed Credit Union Conversion—Views of Member (insert member name).''

(3)(i) A converting credit union may, at its option, include the following statement with a member's material:

On (date), the board of directors of (name of converting credit union) adopted a proposal to convert from a credit union to a mutual savings bank. Credit union members who wish to express their opinions about the proposed conversion to other members may provide those opinions to (name of credit union). By law, the credit union, at the requesting members' expense, must then send those opinions to the other members. The attached document represents the opinion of a member of this credit union. This opinion is a personal opinion and does not necessarily reflect the views of the management or directors of the credit union.

(ii) A converting credit union may not add anything other than this statement to a member's material without the prior approval of the Regional Director.

(4) The term ''proper conversion-related materials'' does not include materials that:

(i) Due to size or similar reasons are impracticable to mail or e-mail;

(ii) Are false or misleading with respect to any material fact;

(iii) Omit a material fact necessary to make the statements in the material not false or misleading;

(iv) Relate to a personal claim or a personal grievance, or solicit personal gain or business advantage by or on behalf of any party;

(v) Relate to any matter, including a general economic, political, racial, religious, social, or similar cause, that is not significantly related to the proposed conversion;

(vi) Directly or indirectly and without expressed factual foundation impugn a person's character, integrity, or reputation;

(vii) Directly or indirectly and without expressed factual foundation make charges concerning improper, illegal, or immoral conduct; or

(viii) Directly or indirectly and without expressed factual foundation make statements impugning the stability and soundness of the credit union.

(5) If a converting credit union believes some or all of a member's request is not proper it must submit the member materials to the Regional Director within seven days of receipt. The credit union must include with its transmittal letter a specific statement of why the materials are not proper and a specific recommendation for how the materials should be modified, if possible, to make them proper. The Regional Director will review the communication, communicate with the requesting member, and respond to the credit union within seven days with a determination on the propriety of the materials. The credit union must then immediately mail or e-mail the material to the members if so directed by NCUA.

(6) A credit union must deliver to its members all materials that meet the requirements of § 708a.4(f) on or before the date the members receive the 30-day notice and associated ballot. If a credit union cannot meet this delivery requirement, it must postpone mailing the 30-day notice until it can deliver the member materials. If a credit union postpones the mailing of the 30-day notice, it must also postpone the special meeting by the same number of days.

(7) The term ''appropriate advance payment'' means:

(i) For requests to mail materials to all eligible voters, a payment in the amount of fifty cents times the number of eligible voters, and

(ii) For requests to e-mail materials only to members that have agreed to accept electronic communications, a payment in the amount of two hundred dollars.

(8) If a credit union posts conversion-related information or material on its Web site, then it must simultaneously make a portion of its Web site available free of charge to its members to post and share their opinions on the conversion. A link to the portion of the Web site available to members to post their views on the conversion must be marked ''Members: Share your views on the proposed conversion and see other members views'' and the link must also be visible on all pages on which the credit union posts its own conversion-related information or material, as well as on the credit union's homepage. If a credit union believes a particular member submission is not proper for posting, it will provide that submission to the Regional Director for review as described in paragraph (f)(5) of this section.

(9) A converting credit union must inform members with the 90-day notice that if they wish to provide their opinions about the proposed conversion to other members they can submit their opinions in writing to the credit union no later than 35 days from the date of the notice and the credit union will forward those opinions to other members. The 90-day notice will provide a contact at the credit union for delivery of communications, will explain that members must agree to reimburse the credit union's costs of transmitting the communication including providing an advance payment, and will refer members to this section of NCUA's rules for further information about the communication process. The credit union, at its option, may include additional factual information about the communication process with its 90-day notice.

§ 708a.5 Notice to NCUA.

(a) If a converting credit union's board of directors approves a proposal to convert, it must provide the Regional Director with notice of its intent to convert during the 90 calendar day

period preceding the date of the membership vote on the conversion.

(1) A credit union must give notice to the Regional Director of its intent to convert by providing a letter describing the material features of the conversion or a copy of the filing the credit union has made or intends to make with another federal or state regulatory agency in which the credit union seeks that agency's approval of the conversion. A credit union must include with the notice to the Regional Director copies of the notices the credit union has provided or intends to provide to members under §§ 708a.3 and 708a.4. The credit union must also include a copy of the ballot form and all written materials the credit union has distributed or intends to distribute to members. The term ''written materials'' includes written documentation or information of any sort, including electronic communications posted on a Web site or transmitted by electronic mail.

(2) As part of its notice to NCUA of intent to convert, the credit union's board of directors must provide the Regional Director with a certification of its support for the conversion proposal and plan. Each director who voted in favor of the conversion proposal must sign the certification. The certification must contain the following:

(i) A statement that each director signing the certification supports the proposed conversion and believes the proposed conversion is in the best interests of the members of the credit union;

(ii) A description of all materials submitted to the Regional Director with the notice and certification;

(iii) A statement that each board member signing the certification has examined all these materials carefully and these materials are true, correct, current, and complete as of the date of submission; and

(iv) An acknowledgement that federal law (18 U.S.C. 1001) prohibits any misrepresentations or omissions of material facts, or false, fictitious or fraudulent statements or representations made with respect to the certification or the materials provided to the Regional Director or any other documents or information provided to the members of the credit union or NCUA in connection with the conversion.

(3) A state-chartered credit union must state as part of the notice required by § 708a.5(a) if its state chartering law permits it to convert to a mutual savings bank and provide the specific legal citation. A state-chartered credit union will remain subject to any state law requirements for conversion that are more stringent than those this part imposes, including any internal governance requirements, such as the requisite membership vote for conversion and the determination of a member's eligibility to vote. If a state-chartered credit union relies for its authority to convert to a mutual savings bank on a state law parity provision, meaning a provision in state law permitting a state-chartered credit union to operate with the same or similar authority as a federal credit union, it must:

(i) Include in its notice a statement that its state regulatory authority agrees that it may rely on the state law parity provision as authority to convert; and

(ii) Indicate its state regulatory authority's position as to whether federal law and regulations or state law will control internal governance issues in the conversion such as the requisite membership vote for conversion and the determination of a member's eligibility to vote.

(b) If it chooses, a credit union may seek a preliminary determination from the Regional Director regarding any of the notices required under this part and its proposed methods and procedures applicable to the membership conversion vote. The Regional Director will make a preliminary determination regarding the notices and methods and procedures applicable to the membership vote within 30 calendar days of receipt of a credit union's request for review unless the Regional Director extends the period as necessary to request additional information or review a credit union's submission. A credit union's prior submission of any notice or proposed voting procedures does not relieve the credit union of its obligation to certify the results of the membership vote required by § 708a.6 or eliminate the right of the Regional Director to disapprove the actual methods and procedures applicable to the membership vote if the credit union fails to conduct the membership vote in a fair and legal manner consistent with the Federal Credit Union Act and these rules.

§ 708a.6 Membership approval of a proposal to convert.

(a) A proposal for conversion approved by a board of directors requires approval by a majority of the members who vote on the proposal.

(b) The board of directors must set a voting record date to determine member voting eligibility that is at least one hundred twenty days before the publication of notice required in § 708a.3.

(c) A member may vote on a proposal to convert in person at a special meeting held on the date set for the vote or by written ballot filed by the member. The vote on the conversion proposal must be by secret ballot and conducted by an independent entity. The independent entity must be a company with experience in conducting corporate elections. No official or senior management official of the credit union or the immediate family members of any official or senior management official may have any ownership interest in or be employed by the independent entity.

§ 708a.7 Certification of vote on conversion proposal.

(a) The board of directors of the converting credit union must certify the results of the membership vote to the Regional Director within 10 calendar days after the vote is taken.

(b) The certification must also include a statement that the notice, ballot and other written materials provided to members were identical to those submitted to NCUA pursuant to § 708a.5. If the board cannot certify this, the board must provide copies of any new or revised materials and an explanation of the reasons for any changes.

§ 708a.8 NCUA oversight of methods and procedures of membership vote.

(a) The Regional Director will review the methods by which the membership vote was taken and the procedures applicable to the membership vote. The Regional Director will determine: If the notices and other communications to members were accurate, not misleading, and timely; the membership vote was conducted in a fair and legal manner; and the credit union has otherwise complied with part 708a.

(b) After completion of this review, the Regional Director will issue a determination that the methods and procedures applicable to the membership vote are approved or disapproved. The Regional Director will issue this determination within 30 calendar days of receipt from the credit union of the certification of the result of the membership vote required under § 708a.7 unless the Regional Director extends the period as necessary to request additional information or review the credit union's submission. Approval of the methods and procedures under this paragraph remains subject to a credit union fulfilling the requirements in § 708a.10 for timely completion of the conversion.

(c) If the Regional Director disapproves the methods by which the membership vote was taken or the procedures applicable to the membership vote, the Regional Director may direct that a new vote be taken.

(d) A converting credit union may appeal the Regional Director's determination to the NCUA Board for a

final agency decision. The credit union must file the appeal within 30 days after receipt of the Regional Director's determination. The NCUA Board will act on the appeal within 90 days of receipt.

§ 708a.9 Other regulatory oversight of methods and procedures of membership vote.

The federal or state regulatory agency that will have jurisdiction over the financial institution after conversion must verify the membership vote and may direct that a new vote be taken, if it disapproves of the methods by which the membership vote was taken or the procedures applicable to the membership vote.

§ 708a.10 Completion of conversion.

(a) After receipt of the approvals under § 708a.8 and § 708a.9 the credit union may complete the conversion. The credit union must complete the conversion within one year of the date of receipt of NCUA approval under § 708a.8. If a credit union fails to complete the conversion within one year the Director will disapprove of the methods and procedures. The credit union's board of directors must then adopt a new conversion proposal and solicit another member vote if it still desires to convert.

(b) After notification by the board of directors of the mutual savings bank or mutual savings association that the conversion has been completed, the NCUA will cancel the insurance certificate of the credit union and, if applicable, the charter of a federal credit union.

§ 708a.11 Limit on compensation of officials.

No director or senior management official of an insured credit union may receive any economic benefit in connection with the conversion of a credit union other than compensation and other benefits paid to directors or senior management officials of the converted institution in the ordinary course of business.

§ 708a.12 Member access to books and records.

Members may request access to the books and records of a converting credit union for purposes of 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 of directors. Federal credit unions will grant access under the same terms and conditions that a state-chartered for-profit corporation in the state in which the federal credit union is located must grant access to its shareholders.

§ 708a.13 Voting guidelines.

A converting credit union must conduct its member vote on conversion in a fair and legal manner. NCUA provides the following guidelines as suggestions to help a credit union obtain a fair and legal vote and otherwise fulfill its regulatory obligations. These guidelines are not an exhaustive checklist and do not by themselves guarantee a fair and legal vote.

(a) *Applicability of state law.* While NCUA's conversion rule applies to all conversions of federally insured credit unions, federally insured state-chartered credit unions (FISCUs) are also subject to state law on conversions. NCUA's position is that a state legislature or state supervisory authority may impose conversion requirements more stringent or restrictive than NCUA's. States that permit this kind of conversion may have substantive and procedural requirements that vary from federal law. For example, there may be different voting standards for approving a vote. While the Federal Credit Union Act requires a simple majority of those who vote to approve a conversion, some states have higher voting standards requiring two-thirds or more of those who vote. A FISCU should be careful to understand both federal and state law to navigate the conversion process and conduct a proper vote.

(b) *Eligibility to vote.* (1) Determining who is eligible to cast a ballot is fundamental to any vote. No conversion vote can be fair and legal if some members are improperly excluded. A converting credit union should be cautious to identify all eligible members and make certain they are included on its voting list. NCUA recommends that a converting credit union establish internal procedures to manage this task.

(2) A converting credit union should be careful to make certain its member list is accurate and complete. For example, when a credit union converts from paper record keeping to computer record keeping, some member names may not transfer unless the credit union is careful in this regard. This same problem can arise when a credit union converts from one computer system to another where the software is not completely compatible.

(3) Problems with keeping track of who is eligible to vote can also arise when a credit union converts from a federal charter to a state charter or vice versa. NCUA is aware of an instance where a federal credit union used membership materials allowing two or more individuals to open a joint account and also allowed each to become a member. The federal credit union later converted to a state-chartered credit union that, like most other state-chartered credit unions in its state, used membership materials allowing two or more individuals to open a joint account but only allowed the first person listed on the account to become a member. The other individuals did not become members as a result of their joint account, but were required to open another account where they were the first or only person listed on the account. Over time, some individuals who became members of the federal credit union as the second person listed on a joint account were treated like those individuals who were listed as the second person on a joint account opened directly with the state-chartered credit union. Specifically, both of those groups were treated as non-members not entitled to vote. This example makes the point that a credit union must be diligent in maintaining a reliable membership list.

(c) *Scheduling the special meeting.* NCUA's conversion rule requires a converting credit union to permit members to vote by written mail ballot or in person at a special meeting held for the purpose of voting on the conversion. Although most members may choose to vote by mail, a significant number may choose to vote in person. As a result, a converting credit union should be careful to conduct its special meeting in a manner conducive to accommodating all members wishing to attend, including selecting a meeting location that can accommodate the anticipated number of attendees and is conveniently located. The meeting should also be held on a day and time suitable to most members' schedules. A credit union should conduct its meeting in accordance with applicable federal and state law, its bylaws, Robert's Rules of Order or other appropriate parliamentary procedures, and determine before the meeting the nature and scope of any discussion to be permitted.

(d) *Voting incentives.* Some credit unions may wish to offer incentives to members, such as entry to a prize raffle, to encourage participation in the conversion vote. The credit union must exercise care in the design and execution of such incentives.

(1) The credit union should ensure that the incentive complies with all applicable state, federal, and local laws.

(2) The incentive should not be unreasonable in size. If the board desires to use such incentives, the cost of the incentive should be included in the directors' deliberations and

determination that the conversion is in the best interests of the credit union's members.

(3) The credit union should ensure that the incentive is available to every member that votes regardless of how he or she votes. All of the credit union's materials promoting the incentive to the membership should make clear to the member that they have an equal opportunity to participate in the incentive program regardless of whether they vote for or against the conversion.

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