Written Testimony Submitted for the Record

By:

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Consideration of *Credit Union Charter Choice Act*
H.R. 3206

Before the
Subcommittee on Financial Institutions and Consumer Credit
Committee on Financial Services
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Mr. Chairman and members of the Committee, my name is Alan D. Theriault. I am President of CU Financial Services. Our organization supports efforts to enact H.R. 3206, the *Credit Union Charter Choice Act.*

Since 1984, CU Financial Services has helped credit unions with strategic planning and other forward-thinking projects. In the last 12 years, our firm has had a hand in the majority of the more than two dozen credit union conversions to the mutual savings bank charter and the mutual holding company charter.

We also closely followed and supported the H.R. 1151 amendment by the U.S. Senate that ultimately reversed 1995 and 1997 rulemaking by the National Credit Union Administration (NCUA) that had been widely viewed as a self-serving attempt to stop credit union-to-mutual conversions.

<u>Conversion Statistics</u>

In the last 12 years, only 29 of 8,800 credit unions have elected the option to convert from a credit union charter. From the list, seven remain as pure, non-stock mutual institutions. Six have merged with other mutually owned institutions, allowing their members to benefit from a longer list of services and being part of a stronger and more competitive corporate family.

Nine others have elected to access the corporate flexibility of the mutual holding company (MHC) structure, allowing the institutions and their members to benefit from expanded revenue sources and access to secondary capital. *(The MHC structure involves reorganizing the mutual bank into a stock bank; however, the ownership of the stock bank remains under the control of a non-stock holding company which depositors control.)*

Members of just seven credit unions voted to convert to a full stock operation; three of these were institutions under $60 million in assets, and all were located in highly competitive metropolitan areas. *(The capital raised in the full stock conversion allows these institutions to address a highly competitive marketplace from a position of greater strength).* While the depositor control of the MHC structure has strong appeal for former credit unions, smaller institutions may find it harder to justify the fixed cost related to MHC reorganizations because of the lesser amounts of capital raised.

NCUA Overstepping Its Authority

The main point of this hearing is to address whether NCUA has been overstepping its authority in regulating conversions. To put its actions in perspective, NCUA is only supposed to be ensuring the vote is carried out fairly, not second-guessing motives and acting as an adversary against the credit union's leadership in order to guard member interests in some potential future transaction. I am sure these points will be expertly presented by others.

However, from their choice of witnesses, it is clear the credit union trade associations, which are closely allied with NCUA on this issue, are going to make an emotional, even tearful, appeal that conversions are all about greed and imply the leaders of converting credit unions can't be trusted to do what is best for their members.

For 30 years, similar allegations have been made relative to mutual savings bank conversions by a few with a vested interest in maintaining the status quo or who promote certain social-political ideals. I will leave it to the Office of Thrift Supervision (OTS), the Federal Deposit Insurance Corporation (FDIC), and the Securities and Exchange Commission (SEC) to defend how well these three respected government agencies protect the consumer. Needless to say, under their expert stewardship thrift conversions have not generated negative public policy issues.

In addition, the credit union witnesses may make a claim to this Subcommittee, as they have done in the trade press, that consultants experienced with credit union-to-mutual conversions have provided them with conversion briefings for their own credit unions that focused on insider benefits. Although we have been involved with the majority of conversions, I want to assure this Subcommittee that CU Financial Services is <u>not</u> the firm which has briefed these witnesses.

In our view, based on what we read in the industry press reports, these witnesses have their facts wrong. Attached to this submission are several articles from the CU Financial Services web site – a site which contains hundreds and hundreds of pages of educational material and which discusses the manifold member and community benefits in a conversion from a credit union. The attached selection of articles is a fair representation of our firm's views on what credit union executives should be considering when they explore the merits of charter change.

<u>Credit Unions Are at a Crossroads</u>

I would argue it is very important for credit unions to have the option of converting from a credit union. The credit union charter is a pressure cooker. Choking off the ability to exit the charter is like blocking a pressure release valve. It will increase the probability of systemic safety and soundness issues.

As of the end of 2005, over 280 credit unions were classified with Camel 4 and 5 ratings. This group represented over 1.1% of credit union insured deposits, the highest number in a decade. Almost 15% of credit unions lost money last year and nearly 50% earned less than 50 basis points. Just last week, the Colorado state credit union regulator had to take over a $300 million federally insured credit union. The credit union appears to be a victim of margin pressures on the credit union industry, which it apparently attempted to solve by becoming an aggressive indirect lender.

Regrettably, there will be other credit unions in trouble, some possibly larger, even though these are pretty good economic times, and the banks and thrifts are doing great. I shudder to think what might happen in the credit union industry if we fell into recession.

Since 1969, the number of credit unions has plunged from over 23,500 to 8,800 today. By 2010, many analysts expect the number will be below 5,000. In contrast to the formation of over 640 new banks and thrifts in the last five years, only 42 new credit unions have opened for business, mostly community development credit unions with limited scope and scale. One is tempted to ask whether the credit union model is still viable for forward-thinking, fast-growing institutions. This is the question that gets progressive credit union managers thinking about their charter alternatives.

Contracting margins, increasing operating costs, restrictions on capital accumulation, political pressure to reduce overdraft fees, declining interchange revenues, financially troubled corporate sponsors, and demands to be more responsive to low- and moderate-income populations are among the pressures which challenge the status quo for progressive credit unions. As might be expected, responses to these very real pressures are varied.

Many credit unions have liquidated their credit card portfolios to boost capital and income as a short-term fix. Many just merge themselves out of existence – at the rate of one a day. Others are trying to retard margin contraction by aggressive diversification into higher yielding real estate loans, commercial loans, across-the-country commercial loan participations, and third-party-originated auto loans (both prime and non-prime). The percentage increases in these non-traditional types of lending are double digit, yet one wonders if NCUA is learning to regulate these new risks at a double digit rate. Clearly, NCUA has plenty to do in focusing its efforts on credit unions that want to stay credit unions, rather than spending its time, resources and political capital on trying to impede a few credit union conversions.

In conclusion,

- We are not asking you to tax credit unions, although doing so would ultimately take a lot of pressure off your fax machines generated by the industry's "grass roots" lobbying;
- We are not asking you to let state legislatures tax federal credit unions, although doing so would increase their sales tax revenues and takes some stress off state budgets;
- We are not asking you to combine NCUA with OTS – which one could argue should be done given the meteoric rise in mortgage lending and commercial loans at credit unions and NCUA's lack of regulatory experience with those types of lending, because its historic specialty is rooted in car loans; and
- We are not asking you to merge the National Credit Union Share Insurance Fund with FDIC, although some argue the move would improve productivity and reduce systemic risk.

What we *are* asking is to scale back NCUA's over-reaching administration of the conversion law in H.R. 1151, which has buried the law's intent under an avalanche of excessive and capricious rule-making.

NCUA has a 12-year history of opposing conversions. Congress had to rein the agency in with legislation in 1998. A federal court admonished NCUA in 2005. And now, here we are again. In our view NCUA is not ever going to get the message about sticking to the limited role Congress had intended for it in conversions; the opposition is ideological and deep-seated in NCUA's bureaucracy, which has no fear of Congressional reprimands. NCUA needs to be removed from the process, and H.R. 3206 is an important step in that direction.

Conversion Update

A current list (updated April 28, 2006) of credit unions converted or pending, plus credit unions merged with Mutual Savings Institutions.

		Credit Union	State	Current Corporate Form	Assets(millions) Pre-conversion	Assets(millions) 9/30/05	Annualized Asset Growth	Conversion Date
		Non Stock Institutions - (Pure Mutuals)						
1	*	@LANTEC Financial	VA	Mutual	85	106	14%	1/12/04
2	*	Carolina Federal	SC	Mutual	16	80	64%	8/1/99
3	*	Community CU	TX	Mutual	1,400	1,400		1/2/2006
4	*	OmniAmerican CU	TX	Mutual	1,200	1,200		1/2/2006
5	*	Share Plus	TX	Mutual	150	175	16%	10/1/04
6	*	CU of the Pacific	WA	Mutual	141	198	17%	5/19/03
7	*	Washington's CU	WA	Mutual	262	257	-2%	3/31/04
		Non-Stock MHC with Subsidiary Stock Thrift (Hybrid)						
		Depositors Own & Control the MHC (MHC/s = Institution has issued public shares)						
8	*	Atlantic Coast	GA	MHC/s	321	717	21%	11/1/00
9	*	AGE FCU	GA	MHC/s	269	345	7%	7/1/01
10	*	AWANE Bank	NH	MHC/s	10	77	70%	5/1/96
11	*	Beacon Federal	NY	MHC	155	473	32%	7/1/99
12	*	Citizens Community	WI	MHC/s	102	245	37%	12/10/01
13	*	Community Schools^ ^	MI	MHC	41	46	7%	1/1/02
14	*	Kaiser Federal	CA	MHC/s	190	684	43%	11/1/99
15		Lusitania SB, FSB	NJ	MHC	55	172	21%	9/1/95
16	*	Ohio Central Federal	OH	MHC/s	29	60	14%	6/1/98
		Full Stock Institutions						
		(Former CU Members have liquidation account)						
17	*	Affiliated Federal	TX	Stock	9	101	137%	6/1/98
18	*	Allied Pilots	IL	Stock	82	145	19%	9/1/01
19		BUCS Federal	MD	Stock	58	133	17%	3/1/98
20	*	I.G.A. Federal	PA	Stock	160	560	34%	7/1/98
21	*	Pacific Trust	CA	Stock	224	734	39%	1/1/00
22	*	Rainier Pacific	WA	Stock	383	787	22%	1/1/01
23		Synergy Financial	NJ	Stock	182	940	55%	5/1/98
		Credit Unions in the Process of Converting						
24	*	Pending ^		Mutual	150	150		Pending
25	*	Pending ^		Mutual	150	150		Pending
		Total (excl pending)			7,624	11,735		
		Credit Union Mergers with Banks						
26		AAL	WI		37	Merger		6/30/01
27		AAL Member	WI		177	Merger		6/30/01
28	*	Caney Fork Coop	TN		0	Merger		11/1/00
29	*	Professional Teachers	TN		1	Merger		7/1/01
30	*	Roper Employees	SC		7	Merger		3/1/01
31	*	Salt City Hospital	NY		8	Merger		3/1/03

* Advised by one or several conversion network members

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Solid Benefits & "CU Handcuffs" Lead Some to a Bank Charter

By Alan D. Theriault, President, CU Financial Services

The federal mutual savings institution charter offers capital and corporate structure advantages and removes limits on certain products, potential customers and marketing effectiveness.

Credit unions convert to a bank charter because of pain or opportunity. Capital issues, product limits, and poor consumer awareness create pain. Expanding service to a growing community, filling voids left by banks and credit unions, and maximizing personnel and infrastructure potential provide opportunities.

Conversion applicants correctly reason that the credit union's members and the future growth of the institution requires an unrestricted customer base and expanded products that will include an increased emphasis on real estate lending and business lending. The federal mutual bank charter encourages both and offers capital and corporate structure advantages. Some also convert to remove marketing impediments related to the credit union charter and to avoid the public relations and political risks of staying in the credit union system.

Many credit unions, especially community chartered ones, are now facing the impact of limits on business loans and the fact that PCA requires them to carry 40% more capital than banks. As operating margins narrow - credit unions must grow in order to generate the earnings to pay the bills - during these low interest rate times the issue is magnified.

The following benefits prove that a bank charter is a solution - available now - for credit unions that want to better serve their members, communities, and grow their franchise:

Capital Advantage - It's been said that credit unions pay a hidden tax which is evident by the fact that to be well capitalized a credit union must maintain a 7% capital ratio versus a bank's requirement of only 5%. Competition and economic conditions are putting pressure on margins while increasing costs will shrink the bottom line. The future will require utilizing more leverage (asset growth) in order to maintain member benefits. To illustrate the disadvantage, consider that a bank with $50 million in capital can grow to $1 billion and be well capitalized, while a credit union must stop growing at around $700 million. The bank's $300 million asset advantage not only translates into earnings to handle the tax obligation, but the community benefits from the impact of more lending and services. Directors, management, and staff benefit from higher growth opportunities and greater compensation tied to asset size.

In addition to retaining earnings, banks have many ways to increase regulatory capital empowering them to expand services to members and the community, including loans, branches, employment, and deposits products. For example, in August, Pacific Trust Federal, a former credit union, raised almost $65million in regulatory capital in a member approved IPO. The additional capital allows it to grow from $300 million to $2 billion, thus seeding a significant boost to the local community. As a credit union - even if other impediments were lifted - growing to this level of service would require over a decade of retained earnings.

Consumer Awareness - Consumers understand the business of a bank, but most are confused about credit union capabilities. Credit union sponsored studies on both sides of the country prove that much needs to be done to improve consumer awareness. Consequently, gaining solid market share and correcting these negative perceptions could take decades. Meanwhile, as credit unions become more active within communities, they need to serve municipalities, nonprofit corporations, immigrants, business owners, and other legal entities. These customers provide valuable demand deposits to support emerging business models, however, many just refuse to do business with a credit union.

Product Flexibility - Banks are able to offer a wider range of products - including real estate and business lending - products in high demand by our communities. The bank regulators understand this type of lending, encourage it, and field examiners are experienced at addressing such concentrations. Credit unions, however, face portfolio restrictions and a capital haircut because of real estate and business lending, as well as inexperienced examiners since NCUA, historically, has been focused on examining consumer loans - like car loans and unsecured loans. Investment flexibility is also a benefit with a bank charter - a wider range of permitted investments helps boost yields and provides better service to local communities by diversification into municipal bonds and tax advantaged investments.

Corporate Governance Issues - Just 1,000 credit unions control 75% of credit union assets. Many over $100 million in assets are complex fast growing institutions. The bank charter supports the risk taking and growth with a director compensation and retirement plan structure that attracts a motivated and sophisticated directorate. As banks and credit unions consolidate, in addition to being able to offer compensation to directors of target credit unions, other consolidation and expansion tools are provided, like holding companies, operating subsidiaries, service corporations (like CUSOs), real estate investment trusts, and trust preferred securities. Although some criticize the director compensation plans that are available after conversion, it is worthy to note that many cooperatives and non-profits - like charities and hospitals - compensate their directors.

Unlimited Field of Membership - The bank charter offers an unlimited field of membership which helps make marketing efforts more effective and supports bank and branch acquisitions and mergers with credit unions and banks. The federal charter also supports nationwide activities.

Public Relations and Political Risks - The unmeasured risk of political and public relations fallout also factors into the bank conversion decision process. Although safeguards exists, the failure of a large credit union, whether linked to a sponsor bankruptcy, loan or investment concentration issue, or an internal control failure will have negative ramifications for all credit unions, much like the impact of recent credit union debacles in Mexico, Japan, and Korea. The fact that some credit unions are not federally insured is a blemish in the minds of those that remember the collapse of private insurance in Rhode Island and other states.

On another note, NCUA is working overtime to make credit unions look like the savior of the inner city and the economic partner of low income and disadvantaged people. The flip side of the NCUA public relations bet, however, could lead to credit unions being viewed as a group that is merely exploiting those in “need” in order to profit from a tax subsidy. Consumer groups and community activists have their eyes on credit union capital and obtaining credit union funding will be part of their business plans. If NCUA’s threats fails to get credit unions to respond to the call to “serve the underserved” you can bet these groups will put credit unions in the headlines.

In addition, unlike 1998 when HR-1151 was being debated, massive budget deficits prevail, and many powerful credit union allies have retired from Congress. Increasing revenues and closing tax loopholes will be a popular topic in Washington, DC and in state capitals. Tax advocates are likely to picture decaying grammar school buildings next to shinny new credit union office buildings as teachers appeal for more money and argue that large credit unions should pay taxes to benefit both schools and homeland security. Although nobody likes to pay taxes, management of credit unions in Canada and Australia and at $274 billion TIAA-CREFF, a college professor retirement organization, argue the benefits gained by accepting this social duty is worth the cost. Taxes are managed like any other business expense.

Although efforts are being made to correct charter impediments, hope is not a sound business strategy and building a business model that depends on a tax subsidy is risky. The CU trades promise reg relief, new powers, a better informed regulator, and want to educate consumers about the credit union model; but competitive pressures will not allow a progressive institution to be complacent and live by the status quo. One session of Congress is like a lifetime in the financial services business and the snail's pace that bankruptcy reform moved will look like lightning compared to new credit union legislation. And, when the Bill hits the President's desk, credit unions may only gain a few new powers, but face taxes and be handcuffed to an out dated charter with new markings of a social service agency.

Switching charters is a common practice among financial institutions as their mix of business or goals change, or when a more supportive charter or chartering state is uncovered. Competitive pressures and member requirements demand efficiency and flexibility. A focus on providing quality services to members and communities rather than wasting energy debating field of membership issues and making excuses for a tax exemption is imperative. A. progressive institution must seek a charter that supports its mission rather than modify a mission just to fit a charter. Converting solves many problems, relieves the pain, and provides dynamic new opportunities.

For more information about the mutual bank charter, the stock bank charter, raising regulatory capital, bank holding companies, and other progressive growth strategies contact the authors, Alan D. Theriault, President, CU Financial Services, at 800-649-2741; or Robert Freedman, Esq., Silver, Freedman, & Taff, at 202-295-4502.

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The Mutual Holding Company Option

A Capital Idea

In this article by Lee Bettis, former CEO of AGE Credit Union, subsequently Heritage Bank of the South, you'll learn why the mutual holding company structure delivers the best of both worlds—raising much-needed capital while retaining member control.

No one would argue that failure to achieve a business plan brings with it all sorts of problems. But success – in the form of faster growth – carries its share of problems, too.

One of the biggest problems facing successful credit unions is a chronic shortage of capital. A 2002 survey of NAFCU members concluded that an astounding 42% expect to need capital soon in order to maintain growth, to meet Prompt Corrective Action (PCA) requirements, or other reasons. Exacerbating the problem is the 7% core capital ratio CUs must maintain, compared to 5% for banks. CUs also take a 'capital haircut' because of concentrations in real estate loans, business loans, and certain investments. And they have no access to the capital markets without converting to a bank charter. In addition, the NCUSIF is likely to have problems keeping up with the growth rates of large credit unions, thus leading to the need to charge premiums, an unpopular subject especially with smaller credit unions already faced with earnings problems.

The Trend to Mutual Holding Companies

Far from the inevitable stock conversions being decried by the likes of the NCUA, the facts are these: Of the 29 conversions done (or in the pipeline), only seven have raised capital by moving – sooner or later -- to full stock through an IPO. Six merged with other 'like-minded' mutuals. Another eight have formed, or are in the process of forming, a mutual holding company.

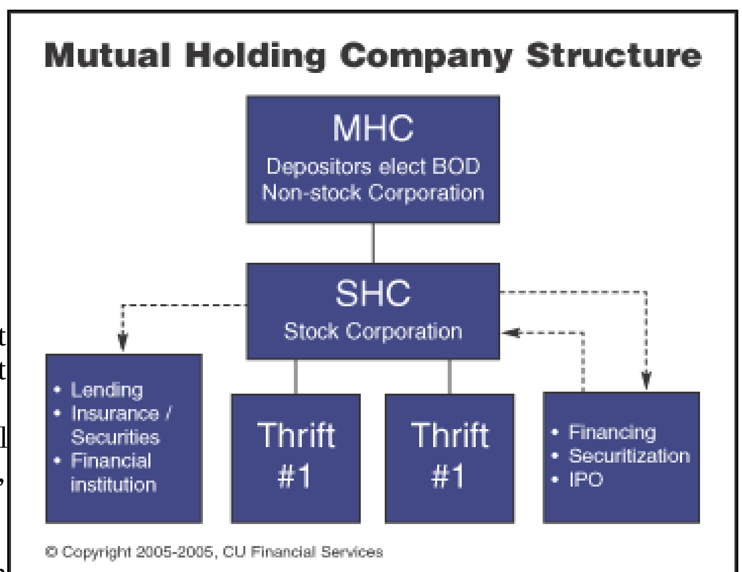
Mutual banks can raise capital in a number of ways. One obvious way is a public offering of shares, to which the former credit union's members have first right of refusal up to a certain limit. But because not all members will choose to participate, or participate to the same degree, the ownership composition of the institution will be immutably changed.

What may make more sense for some credit unions contemplating a charter change is the mutual holding company (MHC). Under this option, the members' ownership rights in the credit union are converted to ownership rights in a non-stock holding company.

The MHC, in turn, will own the shares of a bank holding company, which can sell stock to members of the institution and the community up to 49% of the capitalization. It is this stock-based holding company that would own the stock-based operating thrift, plus any number of subsidiaries for mortgage lending, insurance, securities or other businesses permitted and fitting the institution's objectives. In the same way a credit union owns a CUSO, which is stock-based, the co-operative operating philosophy is filtered downward. Control is maintained.

Without selling any stock, the MHC can raise capital in other ways. It can arrange a commercial loan at the stock holding company level or organize a non-voting trust to offer shares to institutional investors. The proceeds are pushed downstream to create core capital in the subsidiary bank and for the support of its operating companies.

Keeping the voting rights at the top level -- still in the hands of the original members -- allows the institution to retain its co-operative philosophy, community focus, management team, directors and culture.



"It's really the best of both worlds," claims Alan Theriault president of CU Financial Services, a credit union consulting firm specializing in charter conversions. "The mutual holding company is depositor-owned and non-stock, allowing the members to keep control. Two levels down, management can raise all the capital it needs to pursue its business strategy and opportunities, without the same burden faced by managers of public companies in answering to stockholders. Stock-based compensation programs transition this hybrid into a member and employee-owned cooperative, thus capitalizing on superior consumer attitudes toward both of these co-operative business structures."

In conclusion, expansion-minded credit unions exploring a charter conversion have four primary options: community credit union; mutual savings bank; stock-based bank; and mutual holding company. The community charter addresses the field of membership problem. But it still leaves the CU stuck with severe limits on its powers and forced to build capital at a snail's pace. The mutual savings bank option lifts the limits on activities such as real estate and commercial lending. But building core capital is mostly limited to increasing retained earnings and other capital strategies efficient for large institutions only.

Converting to a publicly traded, stock-based institution offers broad powers for product diversification and opens the doors wide to capital. But it strays from co-operative roots, and some critics feel that demutualization amounts to disenfranchisement of some members.

On the other hand, moving to a mutual holding company – a hybrid structure that combines co-operative ownership with capital-raising powers -- is a neat balancing act. You can serve your members and build the strength to serve the community at large. Mergers and acquisitions are also facilitated.

Mutual Holding Company Features

- Maintains mutuality
- Activity diversification
- Capital raising flexibility
- Enhanced D&O protections
- Maintains control
- Ease of formation
- One regulator
- Minimal regulatory reporting
- Compensation flexibility
- No holding company capital requirements

This scenario held true for HeritageBank of the South, a $340 million-asset bank that started life as AGE Credit Union of Albany, GA. After a successful conversion in 2001, the new bank's growth blossomed, particularly in mortgage lending and commercial banking. In 2002, it reorganized under the mutual holding company structure. Len Dorminey is president and CEO of Heritage Financial Group, a stock holding company (owned by a non-stock MHC) that owns 100% of the stock of the bank. A strategy of measured, well-grounded growth has given Heritage a strong foundation for future expansion in people, systems and infrastructure. Len explains: "We've built tried and true best practices and we know they work. We have a lot of expertise we can replicate and share, if others want to join us."

With 9% capital, and access to more, Heritage Financial is well-equipped to explore mergers with credit unions attracted by the possibilities of a mutual bank charter. And this course of action is a bold new alternative to the typical CU-to-CU merger. On top of their operating efficiencies and deep talent pool, progressive mutuals like Heritage allow the merging entity to retain its board of directors, corporate identity and co-operative philosophy.

Across the credit union system today, there is an abundance of news and comment about conversions past, present and future. Unfortunately, there is much misinformation, some of it politically motivated. For any credit union contemplating a conversion to mutual savings bank status, which I believe is one of the most revolutionary and exciting opportunities ever made available to CUs for achieving successful growth, it pays to deal with experienced professional advisors. If you think you'll need regulatory capital in the next few years, call CU Financial Services at 800-649-2741 today.

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Members and the Community Are the Ones to Gain from Conversion to a Bank

Community / Member Benefit Illustration

	Financial Data (Dollars in thousands)	A Credit Union	B Mutual Savings Bank	C Mutual Holding Company
1	Capital / Assets ratio to manage to	7%	5%	5%
2	Assets	$ 714,285	$1,000,000	$ 2,500,000
3	Capital	$ 50,000	$ 50,000	$ 125,000
4	Investments	$ 171,428	$ 240,000	$ 600,000
5	Loans	$ 501,142	$ 710,000	$1,775,000
6	Additional capacity for new community loan origination	NA	$ 202,858	$1,267,858
7	Increased loan revenue NIM (3% estimate)	NA	$ 6,086	$ 38,036
8	Increased Yield on Investments (2% estimate)	NA	$ 4,057	$ 12,000
9	Additional earnings available for taxes, member benefits, incidental costs, and stock dividends	NA	$ 10,143	$ 50,036
10	After Tax ROA @ 1.0%	$ 7,143	$ 10,000	$ 25,000
11	Additional earnings (line 9) available for taxes, member benefits, incidental costs, and stock dividends plus regular ROA (Line 10)	$ 7,143	$ 20,143	$ 75,036
12	Performance difference between a mutual and a credit union (Column "B") and between a MHC and a credit union (Column "C"). These earnings are available above and beyond current activity to increase retained earnings and to expand member benefits; like branches / technology / yields	**NA**	**$ 13,000**	**$ 67,893**

Economic Conditions Require a Progressive Response
Taxation is Managed like Every Other Business Expense
Converting Allows Growth and Member Benefits to Continue
Proposed Legislation: A Risky Accounting Gimmick - Secondary Capital Unlikely

Footnotes:

- The table illustrates the huge differences possible by converting to a mutual savings bank. Column "A" illustrates a hypothetical credit union with $50 million in regulatory capital. Column "B" indicates that with the same level of capital a non-stock mutual savings bank can outgrow credit union assets by almost $300 million because bank regulations support higher levels of growth per dollar of capital; Column "C" illustrates $1.5 billion more growth possible by utilizing the mutual holding company structure (MHC) and a $75 million minority member stock offering. Members continue to control the non-stock mutual holding company. The MHC structure preserves the ownership and control of the institution. A MHC cannot be sold or taken over. It can, however, merge with another mutual or MHC and it may acquire banks or merge credit unions. This opportunity is not available to a credit union.

- Row 6 illustrates the much higher bank lending capacity in the amount of $203 million and $1.3 billion respectively. Invested in the community infrastructure, these loans would have a powerful impact on job creation and related community benefits, like home ownership and small business development.

- Row 7 & 8 illustrates the additional revenues from higher loan volumes per dollar of net worth (capital); and the impact of a bank's historical investment portfolio yield advantage. Added together (line 9) they illustrates that substantial revenues become available for paying taxes, adding member benefits, managing incidental costs and contingencies (like conversion cost), and to pay stock dividends. Row 7 does not consider the more profitable loan mix possible as a bank, which would result in higher revenues.

- Row 10 illustrates managing an institution to a 1.0% after-tax ROA.

- Row 11 illustrates the $20.1 million annual additional member benefit as a mutual and an additional $75 million annual benefit as a MHC. These additional benefits are available to pay taxes, incidental costs, stock dividends, increase retained earnings, and expand and improve branches, technology, and delivery systems or for member distribution in the form of higher yields or lower loan rates. Row 12 illustrates the net financial benefit from a conversion to a mutual or a MHC.

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Economic Conditions Require a Progressive Response

The mandate of a community chartered credit union is to serve the entire community. Some market areas served are facing increasingly sober news including weak employment numbers, layoffs, factory closings, and slow economic growth. In order to maximize their contribution to turn these communities around, a few credit unions are proposing a conversion to a mutual savings bank, or thrift charter, and even the additional step, which requires another vote of depositors, to raise equity capital by providing the opportunity for members to invest in a minority stock offering.

The credit union charter has supported the growth of many institutions. But many credit unions can do a lot more. These communities need everybody to do their part – to be their best. The additional investments that can be made, in new loans, is a way for progressive conversion candidates to serve communities to the very best of their abilities – something that they can't do under current credit union regulations. The reorganization as a mutual savings bank unlocks substantial additional lending ability because bank regulations and bank convention permits higher loan volumes per dollar of net worth. Credit unions are handcuffed by punitive net worth requirements that affect their competitiveness in this area. Also, credit unions are prohibited from accessing the capital markets in order to increase net worth (capital), while banks do this on a regular basis.

Switching to a thrift charter would mean giving up the state and federal income tax exemption enjoyed by credit unions. Critics point to taxable status as a disadvantage, without considering the growth in revenue and profit that can come from an expanded market opportunity, product line, and capital access. The vast majority of financial institutions in this country pay taxes and achieve a return on equity far in excess of most credit unions, while delivering value that results in market share domination. Income taxes, like any other cost of doing business, are manageable. Credit Unions in other countries pay taxes. Some non-profits (like $300 billion TIAA-CREF) have relinquished their tax exemption in exchange for modern powers.

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Taxation is Managed Like Every Other Business Expense

Contrary to the view that converting to a taxable institution would mean injury for members and the community, financial modeling shows that, as a future thrift, a hypothetical credit union with $50 million in net worth would be able to offer members and future members more than $1.3 billion in new loans. Not only is increased loan activity a real benefit to the community, the earnings from that business – coupled with investment yields far superior than historically possible for credit unions – would produce net profits for members greater than what is now possible as a tax-exempt credit union. Credit unions historically earn much lower yields on the investment component of their balance sheet compared to banks. Recent NCUA and FDIC data indicates the yield disadvantage is greater than 2%. (See Table "B") A better performing investment portfolio along with higher levels of loans outstanding, at a minimum, neutralizes the impact of taxation. Member service levels and returns are thus preserved.

Investment Yield Hidden Tax			
Table B			
	2000	2001	2002
CU	5.66%	4.22%	3.07%
Thrifts	6.02%	6.08%	5.21%
Thrift Advantage			2.14%
Source: NCUA and FDIC Data			

Therefore, converting to a bank charter allows a former credit union to be in a better position to serve its members and its communities while retaining high levels of service, a member oriented philosophy, and independence. The benefits of being able to make more loans, provide more employment opportunities, build more branches, and serve all types of depositors and borrowers generate economies of scale that causes a former credit union to be more productive. The move is clearly a win for the community and the membership.

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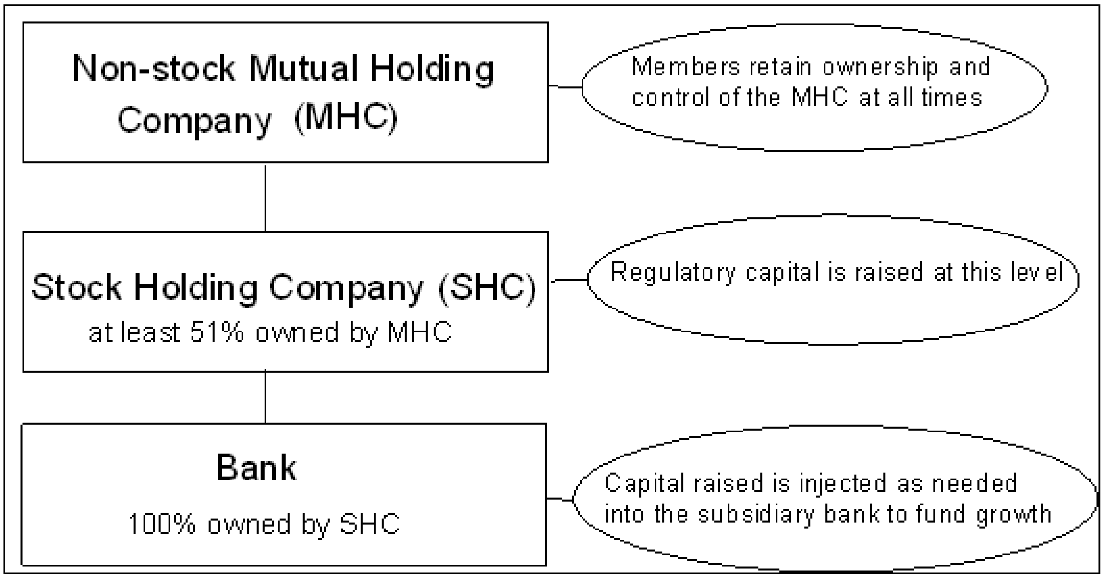
Converting Allows Growth and Member Benefits to Continue

As a credit union, many are currently faced with slowing growth to stay in compliance with the higher credit union capital requirements. The slow down would not be necessary as a bank. Slowing growth involves reducing rates on deposit accounts and has the undesirable effect of encouraging members to move banking relationships elsewhere. Although increasing loan rates and fees helps mitigate the need to slow growth, a credit union's competitiveness and new account acquisition strategies would suffer. These strategies underwrite adding member conveniences, like new branches, as well as support ongoing high levels of member responsiveness. Branch development requires account and deposit acquisition to cover operational costs and helps make services more cost effective for all members. But, branch expansion must be supported by capital. Lack of capital slows growth and delays branch development, thus reducing convenience for existing members, and delays the hiring of new employees and infrastructure development which supports economic recovery.

Remaining a credit union and living with capital constraints will mean putting a stop to growth, turning away new members, lowering the rates offered on deposits and raising the rates charged on loans. Moreover, the facts challenge the assertion that credit unions have an inalienable pricing advantage over banks, as some observers would have you believe. Many banks and other financial institutions charge no fees whatsoever on basic products like checking accounts, or offer savings yields well in excess of the average credit union.



The credit union capital disadvantage is widely acknowledged by credit union industry leaders. For example, Dan Mica, President of Credit Union National Association, recently wrote, ***"Credit unions are indeed burdened by an inappropriate system of prompt corrective action, which requires them to hold even more capital than a bank despite their typically lower risk profile."*** John Annaloro, president of the Washington Credit Union League, said in a press release that recent (bank) conversions are representative of the ***"fundamental weaknesses in the overall national credit union charter that needlessly restrict capital accumulation and business lending."*** Mica remarked that he was "heartened" by legislation proposed to reform PCA.

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Proposed Legislation:
A Risky Accounting Gimmick - Secondary Capital Unlikely

Despite Mica's optimism, the proposed legislation regarding PCA is viewed by some as an accounting gimmick that fails to provide a safe and solid solution for fast growing credit unions. The tinkering supported by this proposed legislation is not a long term solution. It does not add a single dollar of actual (tangible) capital - it merely leverages the credit union's existing capital across more assets. The legislation has mixed support among credit union leaders and generates serious concerns for the 8,000 smaller credit unions experiencing slow growth. The bill, designed to fuel the rapid growth of large credit unions, increases systemic risks and the liability of directors who might utilize its provisions. The growth would force NCUSIF to charge insurance premiums, thus hurting the earnings of the smaller credit unions already pressured by plunging investment yields and rapid member defections to larger credit unions. The Bill's passage is unlikely. Efforts, dating back to 1999, to enact laws to allow secondary capital, opposed by many credit unions large and small, are also likely to fail.