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# Fury Over Bailout of Big CUs May Spark Conversion Surge

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By Anthony Malakian

The pace of credit unions converting to mutual savings banks has slowed in recent years, largely because some that wanted to switch charters encountered resistance from their members or their regulator.

But industry experts say that a confluence of events brought on by the mortgage market meltdown — particularly the multibillion-dollar bailout of the nation's corporate credit unions — could be setting the stage for a surge of conversion applications this year.

Alan Theriault, a consultant in Portland, Maine, who helps guide credit unions through the conversion process, estimated that 25 of them are looking "in a very serious way" at switching to savings bank charters, including several with more than $1 billion of assets.

That's significant, considering that only eight credit unions have made the switch since 2004, and only three had more than $1 billion of assets.

Richard Garabedian, a lawyer in Washington, said that, among credit unions he represents, the number looking into changing charters is roughly twice what it was this time last year.

The cost of recapitalizing the corporate credit unions, which have taken massive writedowns on investments in mortgage-backed securities, is the main reason for the increased interest in conversions, these observers say.

Industry executives are so furious over individual credit unions being forced to rescue the corporates that some who had been on the fence about conversions could be pushed into action, Theriault said. The recapitalization plan will collectively cost credit unions at least $5.9 billion, and the National Credit Union Administration has said the price tag could rise to as much as $16 billion.

"NCUA is asking essentially all the credit unions to chip in to bail out the corporate network," Theriault said.

Among those steaming is the $13 billion-asset Pentagon Federal Credit Union in Alexandria, Va. Its board reportedly asked the management team to start looking into converting about two months ago. Officials there have declined to comment.

But soon after the NCUA announced the corporate bailout, Frank Pollack, Pentagon Federal's president and chief executive officer, called the estimated $80 million charge to his credit union "confiscatory" and said he would explore every option to limit the cost to his members.

Credit union officials are particularly upset with the NCUA's March 20 decision to seize the nation's two largest corporates, U.S. Central Federal Credit Union and WesCorp Federal Credit Union. Those takeovers added at least $1.2 billion to the overall cost of rescuing the corporates.

Tempers ran so high that one of the two national trade groups, the Credit Union National Association, briefly threatened to sue the NCUA unless it made public the report the agency used as the basis of the takeovers. In a letter to the NCUA, Daniel Mica, CUNA's chief executive officer, said that the group's members "have lost confidence and trust in their regulator and feel that our request for additional data, information, communication and cooperation is being ignored."

Beyond the outrage over the bailout, some credit unions might be looking to convert because they see a window of opportunity.

The NCUA has long been viewed as a chief obstacle to so-called charter choice, but observers say it is too preoccupied with saving the corporates to devote much energy to challenging conversions.

By law, the NCUA cannot reject a credit union's application, but it can impose obstacles, such as forcing an institution to conduct another vote after it has already won its members' approval to switch. In recent years several credit unions have abandoned conversions after run-ins with the NCUA over the voting process.

"Credit unions had almost stopped trying, because it is so expensive and so difficult to get it through the NCUA," said Lee Bettis, a former credit union executive who now heads a group that advocates for charter choice.

The NCUA did not return calls for comment.

A group organized in Raleigh for the purpose of blocking credit union conversions also appears to have been weakened by the mortgage crisis, according to sources. The group, which calls itself the National Center for Member Trust, has successfully thwarted several attempted conversions by rallying credit union members to vote against switching to a savings bank charter. But its war chest could be running low, because some of its primary backers, which include several of the nation's largest credit unions, are reeling from losses on real estate loans.

Fred Becker, the CEO of the National Association of Federal Credit Unions, said some members of his trade group are frustrated with the cost of the rescue.

But, he said, any impulse to switch charters is likely to subside. "While there's an emotional reaction, over time as people sit back and look at this and think of it from a long-term strategic position, it doesn't make a lot of sense" to convert.

Credit unions' biggest competitive advantage over banks is that they do not pay federal taxes, and they can pass the savings on to members in the form of higher interest rates on deposits and lower rates on loans, said Keith Leggett, senior economist at the American Bankers Association.

But there are also some distinct disadvantages to credit union charters, including restrictions on business lending and limited options for raising capital.

One of the most vocal opponents of conversions is Wendell "Bucky" Sebastian, the CEO of GTE Federal Credit Union in Tampa, who also heads the National Center for Member Trust.

Sebastian, whose credit union lost $27.5 million last year and recently agreed to merge with another Tampa credit union, said that while credit union executives and boards may cite the restrictions on business lending and raising capital as reasons for converting, their real motivation is personal enrichment.

Credit unions that convert often go public later, resulting in large paydays for those that can most afford to get in on the public offering — executives and directors — Sebastian said. If the profits went to depositors instead, "not one" conversion would happen.

Of the 34 credit unions that have converted since 1995, seven have remained mutual savings banks, according to Theriault's CU Financial Services. The rest either went public later or merged with other institutions.

But if directors and officers are only in it for personal gain, then now is not a good time to consider converting, since there is little investor demand for initial public offerings by thrifts these days.

Garabedian, a partner at Luse Gorman Pomerenk & Schick, said conversion critics ignore the legitimate business reasons for converting. Chief among them: "The credit union industry as a whole has a negative net interest margin; the banking industry does not."

Still, he said, even if a credit union wants to convert, approval is hardly guaranteed.

Earlier this year the $190 million-asset Beehive Credit Union in Salt Lake City abandoned its plan to become a mutual savings bank. The conversion had been approved by the NCUA, but banking regulators rejected it after Beehive's financial condition deteriorated.

"If you're weak, there's no way" a bank regulator "is going to take you," Garabedian said.

*Anthony Malakian is senior associate editor at U.S. Banker.*

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