Accept Your Fate, Or Get Out While You Still Can?

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By Alan D.Theriault

The Jan. 31, 2011 publisher's column reminisced about the days when "charter conversion" headlines helped sell newspapers. In the past year, the headlines have been about "unfair assessments wiping out earnings and decimating balance sheets, even at well managed institutions" and the "lack of access to capital."

While acknowledging the NCUSIF assessments are "unfair," the publisher implies readers should accept their fate because "you already know what your mother told you about life" (it's unfair), and "that's life inside a cooperative industry." Well, my mother always told me that if you smell smoke in the movie theater, get out, because "where there's smoke, there's fire."

Let's get one thing straight: as one of the publisher's so-called "charter conversion clan," I am not the one yelling "fire," as one critic claimed several years ago. Today, credit union leaders see the smoke for themselves. The trade papers, trade associations, legacy industry consultants, and NCUA are doing a fine job publishing the manifold industry woes.

In truth, for more than a dozen years-well before the current economic crisis-our firm has provided up-to-date, factual information and the tools for credit union executives to evaluate the feasibility of charter conversion and, if appropriate, implement the switch to a bank charter. Nevertheless, the publisher could not resist taking a swipe at our firm, calling us "profiteers" busy working the phones and sending e-mails with "sales pitches" about conversions.

He also took a swipe at the intelligence of hundreds of credit union board members. Under NCUA's new rule which requires board members to "demonstrate basic financial literacy skills," he implies such skills are absent at credit unions whose boards have concluded that a better and more secure future for members is possible with a bank charter. When critics can't produce facts their only weapon is hurling insults.

The NCUA's relentless anti-conversion rulemaking, supported by credit union trade associations, is perhaps the best indicator of their insecurity about the future of the credit union charter and the unflagging interest in charter conversions. They've been building a wall around the industry to create a sanctuary.

In addition to the publisher's rancorous column, CUNA's economists recently went on record making unsupportable claims about conversions, FDIC premiums, and bank stocks. The anti-conversion dogma is hitched to the decade-long ruse that Congress will provide a solution to current day problems with relaxed capital standards, secondary capital, and regulatory relief.

The table at right sets the record straight on what's really going on with charter conversions, the FDIC fund, and the banking industry.

In conclusion, it is widely acknowledged that the credit union charter is facing daunting challenges. Well-capitalized and profitable credit unions continue to be called upon to subsidize the rest of the industry. Local control and independence will be sacrificed as many of the industry's "thought leaders" push hard for more costly "cooperative alliances," sacrificing the strong for the sake of the common good.

It is almost inevitable that Congress will be forced to act to clean up the credit industry mess, as it did during the S&L crisis of the 1980s. Such action may further limit the options now available to healthy credit unions and undermine what capital they have. For those credit unions moving forward with a charter conversion, their strategy is simple and compelling. Escape while you can.

Alan D.Theriault is president of CU Financial Services in Portland, Maine. The firm has been advisor to the majority of credit unions converting to the bank charter. Alan can be reached at 800-649-2741, or at atheriault@cufinancial.com

A Look at Dueling Charter Conversion Philosophies

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ANTI-CONVERSION	CONVERSION REALITY
The slowdown in conversions in the past few years implies that conversion to a bank is no longer a strategic option being considered.	The reasons to convert to a bank charter are still valid. What's more, they are amplified by current economic conditions and the problems plaguing the credit union industry. The economic meltdown of 2007-09 slowed all financial transactions such as mergers, IPOs, private equity capital issuance, and new bank organizations. During 2010, deals started to happen again. Conversions to the bank charter will also resume. Today, more credit unions than ever are looking seriously at becoming a bank. CUNA should know that, as their economists are occasionally called into board meetings to defend the credit union charter.
NCUSIF deposit insurance will be less costly than FDIC insurance. NCUA will not have to increase its reserve ratio to the 2 to 2.5% range announced by the FDIC.	NCUA has told credit unions to budget 25 to 35 basis points annually for NCUSIF deposit insurance. The FDIC says to budget 5 to 9 basis points (pre-tax). The FDIC explains that the big bank failures are all behind us. NCUA continues to practice forbearance, and more losses related to the failure of large credit unions are still expected. NCUA will be forced by marketplace and political pressure to follow FDIC's lead in increasing the reserve ratio, leading to higher assessments than are currently projected.
The merger of the Office of Thrift Supervision (OTS) into the Office of the Controller of the Currency (OCC) makes conversion more difficult and less desirable.	Conversion has never been a way out for a weak credit union. OTS and FDIC eligibility exams have always been a part of the conversion process. Some converting CUs were required to correct problems before conversion could proceed. The OTS charter requires a focus on real estate investments. This presented a strategic challenge for credit unions invested primarily in consumer loans and auto loans. The OCC charter does not require specific concentrations and its examiners are experienced in reviewing all types of lending activity. Thus, as part of the conversion process, transitioning to the broader OCC charter can be planned with more certainty. Bringing healthy credit unions into the FDIC fund means more capital and more buyers for problem assets, thus reducing resolution costs. Bank regulators have recently chartered new banks just for this reason.
Investor demand for bank stocks is weak. Thus, this is a bad time to be raising capital after conversion to a bank.	Banks have raised almost $400 billion in capital in the last few years. Bank stocks continue to be in high demand. In fact, in the last year, former credit unions have raised over $400 million in capital. Rather than diminishing the demand for bank stocks, currently depressed bank valuations make this a perfect time for a mutual-to-stock conversion since members can buy the stock in the range of 50% of book value, thus reducing risk; while the full amount of capital raised can be profitably deployed.
"Bank" is a four-letter word; banks alone were the cause of the recent crisis; and asking members to convert to a bank will generate opposition that could get the CEO fired.	Banks control over 90% of the market for financial services. The consumer has spoken. Although the giant banks are still struggling with public relations problems, community banks remain respected, healthy businesses. Members still describe their activity as, "I'm going to the bank." Surveys show members do not care about the "ownership" distinctions of the credit union charter. CUNA has also overlooked the fact that credit unions were a part of the sub-prime mortgage problem; corporate credit unions funded tens of billions of dollars in mortgage loans. Last, it was not rank-and-file members of credit unions who generated the opposition to some past conversions. The opposition was led and funded by credit union trade associations and their bedfellows, with the help of a complicit NCUA. No CEO has been fired because of a conversion, or conversion attempt.
Recent state laws and NCUA regulations have	NCUA's illegal and deliberately obstructionist anti-conversion rulemaking has increased the cost and time to complete a conversion. The rules do not prevent conversions; with proper guidance conversions will still be

made conversion rules "clearer."	accomplished. However, because of the costs, smaller credit unions will not be able to afford a conversion. In the past, certain states did not have enabling conversion legislation. Changes to state law are providing a path for a state chartered credit union to convert, thus facilitating the conversion process.
Congress will solve the credit union industry's problems by reducing net worth requirements and providing access to supplementary capital.	The Treasury Department, banking committees, and banking regulators have been pushing for more capital, not less. Debt-based capital, such as trust preferred stock, has been a disaster for the banking industry. Neither the Democrats nor Republicans will support lowering capital requirements or counting debt as capital in order to solve the credit union problem. In the current environment, it is no doubt shocking to members of Congress to have received the recent letter from NCUA appealing for capital relief and authority to accept weaker forms of capital. This ill-advised request may lead to unintended consequences for the industry.