

Converting from a Credit Union

FAX Update

Also consultants on matters pertaining to Business Lending * Regulatory Enforcement * Mergers * CUSO Organizations

News for those interested in remaining informed about credit union conversions;

Strategic Planning and Implementation Services for Progressive Credit Unions; CU Financial Services, Portland, Maine & San Francisco, CA Tel: 800-649-2741 WEB Site: www.cufinancial.com; Vol. 22 No. 1 February 7, 2002

CU Trades

Stop defections; Sell Hope

Standard operating procedure: (1.) Send a letter to Congress; (2.) Send a press release to the trade press about the letter to Congress; (3.) Have a conference about the letter and press release; (4.) Put dissidents on the conference committee.

Standard operating procedure: sell hope; buy another year. Today's hope: rekindle the "Renaissance Commission's" hope with the "Regulatory Relief" hope. Another year goes by. Meanwhile the risk of doing nothing increases.

Letters and press releases exclaim that the credit union charter has multiple impediments, and the facts prove that the "credit union charter" fails to support the modern day "mission" of a larger progressive credit union. Financial services have evolved, marketplace pressures intensify, and the needs of devoted members have changed. The "mission" has evolved. Management needs a "charter" that supports a modern day "mission".

For over 22 credit unions, the solution was obvious. Convert to a federal thrift / bank charter and obtain a charter that supports a modern day "mission". The thrift charter offers:

- an unlimited field of membership,
- support of real estate and business lending,
- capital raising options,
- lower regulatory capital requirements,
- corporate structure flexibility,
- a progressive regulator, and
- FDIC insurance.

Risk of doing nothing

State Credit Union Trap - Charter switch law

The exodus from the federal credit union charter to a state credit union charter in the states of California, Texas, and Florida validate claims that the federal credit union charter no longer supports the "mission" of many

credit unions. Many acknowledge, however, a move to a state credit union charter only provides temporary relief; and some predict that a move to a bank charter will soon be necessary.

Unfortunately, the path to convert from a state credit union charter to a bank charter, in many states, is unclear, making conversion impossible without a new state law. Two states just passed laws to make a conversion to a bank possible, but the state rules (influenced by the credit union lobby) make it more costly than conversion from a federal charter. Converting back to a federal credit union charter may be impossible because of narrow field of membership rules, hence state chartered credit unions may find themselves indefinitely, "trapped in a state credit union charter".

In addition, new state laws to provide for conversion to a bank charter would likely be opposed by state credit union trade associations, and onerous provisions are likely to be added to any attempted conversion bills.

Another possible scenario involves state CU Trade Associations bargaining with state legislatures to exchange credit union taxation for laws that would keep credit unions trapped in the state credit union charter. Consequently, state credit unions would be permanently faced with both growth limitations and taxation.

Avoiding a PCA Crises

Members provide more capital; join management in ownership

Organized in 1994, Allied Pilots FCU grew fast, demand for its innovative services was brisk. Pilots and crew members from outside the field of membership wanted to join. Prompt Corrective Action (PCA) would put the brakes on growth, while credit union rules prevented the expansion of services to new pilot groups. Then, the tragedy of September 11 strikes the airline industry, adding to capital and growth concerns.

Management, however, was ready. A plan to convert to a mutual savings bank had been executed just 11

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days before the terrorists acts, and a move to increase regulatory capital was underway. By the end of December 2001, members stepped up and purchased shares that qualified for regulatory capital.

Now the institution is in a position to more than double in size and to expand its innovative services to new pilot groups.

The net result of the move is to give both members and management a true equity stake in the organization, much like a worker and consumer owned cooperative. (See story below.)

Best of Both Worlds

Worker & Member Ownership

According to recent articles in the National Cooperative Business Association's monthly newsletter, many companies today are marketing their ownership status as a tool to attract and keep consumer business, and as a tool to keep employees. Brochures talk about the benefits of employee ownership; likewise, many cooperatives, credit unions included, boast about the benefits of member ownership. Surveys show that consumers endorse both marketing pitches.

In practice, the best of both worlds are "member owned" and "worker owned" businesses / cooperatives. But, how can this work with insured financial institutions? With the mutual thrift charter and a mutual holding company. The mutual thrift charter provides the option for organizing a progressive financial institution that benefits both consumers and workers (including directors). At the holding company level employees can share ownership directly, with equity options, or through an Employee Stock Ownership Plan (ESOP). For more information contact Alan D. Theriault at 800-649-2741.

Regulatory Relief

Unlikely for 2002 Session

Although the Republican regulatory relief bill, which is likely to include a few NCUA sponsored provisions, may pass the US House, no companion bill exists currently in the Democratic Senate. Furthermore, during an election year, Senate Democrats are unlikely to allow many Republican victories. Already a list of bills from the 2000 session, and several new initiatives as a result of the September 11 tragedy are stalled. Reality: another Congress, another year; more *hope*.

The "Cooperative" Banking Charter
A one day, economically priced (\$125) seminar designed to provide up to date information about the mutual bank charter and FDIC insurance.

- Charter differences and business opportunities
 - Expanding your boundaries
 - Why many are making the move
- Why the opportunity justifies the tax outlay
- Keeping the philosophy alive while serving the community & your members

Call 800-649-2741 for registration or details

February 27, 2002 * Washington, DC
(afternoon session)

April 17, 2002 * Boston, MA

May 13, 2002 * Chicago, IL

July 17, 2002 * Seattle, WA

September 5, 2002 * Philadelphia, PA

October 24, 2002 * Denver, CO

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Largest offering to date

Members prepare to acquire stock of Pacific Trust Bank

In a bid to continue to expand its rapidly growing San Diego franchise, Pacific Trust is planning to raise capital from its membership in an offering of equity which is expected to be well over twice the size of the largest offering by a former credit union. It will be the fifth former credit union to raise equity from its membership, after moves by IGA Federal, BUCS Federal, Affiliated Federal, and Allied Pilots.

Raising capital in a stock offering to membership is a way to solve Prompt Corrective Action (PCA) compliance issues. The first part of the solution comes from the lower capital requirements enjoyed by banks. Banks need only maintain a 5% capital ratio versus the 7% requirements imposed upon credit unions. In other words, to stay well capitalized a modeled credit union can only grow to \$70 million in assets while a bank can grow to \$100 million. The difference in earnings and expanded powers can easily pay the price of taxation.

Should more capital be needed, a mutual can convert to stock (as proposed by Pacific Trust) and in a typical scenario, more than double its current capital. If less capital is needed, partial offerings or debt offerings can be arranged.

Members of a mutual get the first chance to buy stock in a mutual to stock conversion. Stock may also be purchased by a member's retirement account. Well known financial analyst, Peter Lynch from the Fidelity Funds, in his book on investing says the initial public offering (IPO)

of the stock of a mutual institution is the common man's IPO because not just the big investors and institutions get to buy in at the bottom as is the case with many IPOs.

Members owning stock in their bank are also known to be strong supporters of bank programs, much like credit union owners support their institution. Those members that fail to buy stock in the IPO continue to maintain "liquidation rights" in the institution. The rights have value similar to the value of the liquidation rights they "owned" as members of the mutual or credit union.

Former CU

Heritage forms Mutual Holding Company

Heritage Bank of the South, (GA) (formerly AGE FCU) which converted from a credit union July 1, 2001, recently formed a federal mutual holding company to facilitate business acquisitions and to be better positioned to execute combinations with credit unions and mutuals. The move to a holding company structure involved organizing a new depositor owned (mutual) federal corporation and converting the bank into stock form. All of the stock of the bank is owned by the mutual holding company and the ownership interests of depositors are unchanged.

Since Heritage Bank's regulatory capital exceeds 14% (to be well capitalized a bank need only maintain a 5% capital ratio, while a credit union must maintain 7%), millions of dollars of capital were left at the

Credit Unions Converted to a Bank Charter				
	CU Name	Assets	Members	Status
	* Merged	Mil. est.		Mar 1, 2002
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2	AGE Federal (GA)	300	41000	Bank 7/1/01
3	Atlantic Coast (GA)	376	41000	Bank 11/01/00
4	AAL Member (WI) *	172	58714	Bank 6/30/01
5	AAL (WI) *	38	8000	Bank 6/30/01
6	Allied Pilots FCU (IL)	92	7500	Bank 9/1/01
7	AWANE Bank (NH)	38	2200	Bank 5/1/96
8	Beacon Federal (NY)	223	34000	Bank 7/1/99
9	BUCS Federal (MD)	85	11306	Bank 3/1/98
10	Carolina Federal (SC)	49	2756	Bank 8/1/99
11	Caney Fork Coop (TN) *	0.3	186	Bank 11/28/00
12	Citizens Community (WI)	113	25000	Bank 12/10/01
13	Community Schools (MI)	35	12316	Bank 2/1/02
14	I.G.A. Federal (PA) *	179	25000	Bank 7/1/98
15	Kaiser Federal (CA)	248	34254	Bank 11/1/99
16	Lusitania SB, FSB (NJ)	126	6517	Bank 9/1/95
17	Ohio Central Federal (OH)	49	16337	Bank 6/1/98
18	Pacific Trust (CA)	309	31223	Bank 1/2/2000
19	Profess. Teachers CU (TN) *	1	536	Bank 7/31/01
20	Rainier Pacific (WA)	464	29900	Bank 1/2/01
21	Roper Employees FCU (SC) *	7	2500	Bank 3/1/01
22	Synergy Federal (NJ)	297	20100	Bank 5/1/98
	Totals	3248.3	411,595	

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holding company level to be available to execute business strategies which are off limits to credit unions and banks, like investing in the stock of other banks, and to boost the capital of credit unions which choose to partner with Heritage under the holding company umbrella. The holding company can invest in operating companies, like insurance firms or broker / dealers, which do business with the general public and which can also sell products to bank depositors. Some holding companies even invest in SBIC's, which are venture capital firms, subsidized by the US Small Business Administration.

The primary opportunity that comes with the holding company structure is the growth and savings that result when credit unions or banks merge to generate operating efficiencies. The savings that result can be passed on to depositors, the community, be used to improve the compensation plans, and to improve working conditions of employees. Often services like marketing, internal audit, human resources, data processing, and plant and equipment management can be shared among the subsidiaries. Compensation programs and management contracts can be strengthened by the holding company entity.

Heritage joins \$1.8 billion Guaranty Bank (WI) and \$7 Billion Third Federal Capital (OH) in offering credit unions an alternative to the typical credit union to credit union merger. The merger models of these progressive mutuals include guarantees that the "credit union" philosophy which applies to members, employees, and the community will be retained. In addition, programs are designed to keep former credit union directors involved and to compensate them in accordance with Bank director compensation and retirement programs.

CU Financial Services and the advertisers in this newsletter are advisors to these progressive institutions. For more information please call Alan Theriault @ 800-649-2741.

Coast to Coast Services

Guaranty Bank is seeking to partner with credit unions

Guaranty Bank is an \$1.8 billion mutual savings bank in Milwaukee, Wisconsin with a national lending operation. Fifty four branches in Illinois and Wisconsin deliver competitive deposit and loan services to the communities covered. Four subsidiaries operate in 32 states providing first mortgage and home equity products. For example, a satellite office in California originates over \$1.3 billion in mortgages, while an office in Massachusetts brings in over \$600 million. A skilled team of secondary market professionals work daily to hedge a mortgage pipeline larger than the lending volume of credit unions and banks many times Guaranty's size. The unique lending and deposit acquisition programs are successful because of the focus on the member and the entrepreneurial spirit of the employees.

As validated by the recent merger announcement of the second and third largest credit unions in Canada, (see *related story on page 3*) Guaranty's management expects merger interest among credit unions on this side of the border will increase. Therefore, programs are being put in place to help facilitate discussions with credit unions large and small. In addition, programs and joint ventures are being designed to help deliver quality loan products, like mortgages, home equity loans, and business loans to credit union members.

Guaranty's holding company structure will permit a credit union to combine with Guaranty, tap the products, services, capital, and support structure, yet remain an independent entity retaining its own name, management, and board of directors. The holding company provides a structure for raising regulatory capital, without becoming a publicly owned bank.

<p>Silver Freedman & Taff 1700 Wisconsin Avenue, N.W Washington, DC 20007 202-295-4502 * Fax: 202-337-5502</p> <p>Robert Freedman, Esq.</p> <p>The firm represents credit unions on a variety of matters, including advising them on charter options.</p>	<p>Keefe, Bruyette & Woods, Inc 211 Bradenton Avenue Columbus, OH 43017 614-766-8400 * FAX: 614-766-8406</p> <p>Patricia McJoynt</p> <p>Provides investment banking and financial advisory services to financial institutions including credit unions.</p>	<p>GS Financial Printing, Inc. A Georgeson Shareholder Communications Company</p> <p>2300 Computer Ave. Ste I-10 Willow Grove, PA 19090 Tel: 888-805-6300</p> <p>Steven M. Begley</p> <p>Graphic Design * Financial Typesetting * Annual Meeting Materials * Conversion Disclosure Printing & Mailing</p>
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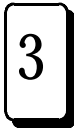
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Strategic Planning and Implementation for Progressive Credit Unions



CU Trades

Do they define your mission correctly?

Dan Mica says that banks and Congress have “defined” a mission for credit unions that restricts growth and leads to taxation. So, credit union lobbyists are busy trying to “redefine” the mission and reverse the impact. Thus, the political “spin” argues that credit unions exist to serve the low income and that directors should not be paid. What are the consequences of the CU trade “spin”?

Does your credit union fit the mission that’s being defined by Dan Mica? Will the rhetoric lead to more scrutiny of your operations by nonprofit groups looking for your support (funds)? Do your members agree that their credit union’s mission is to serve low income people and neighborhoods? Would paying your directors lead to more or less benefits for members and management? Is business lending within the fabric of the credit union mission? Is NCUA equipped to supervise the credit union push into commercial lending? Do consumers fail to understand credit unions because of the name? Is your capital sufficient to support growth and seize opportunities? These questions are being asked.

For decades, commercial banks were known for commercial loans and deposits, thrifts for their community focus and real estate lending, and credit unions for unsecured lending and payroll deduction. Today missions overlap and product lines are blurred, but success follows a clear definition of “mission”; and an institution should seek a charter that supports its mission.

Progressive financial institutions recognize that a “charter” or business license should follow an institution’s mission and business. That’s why thrifts convert to commercial bank charters and commercial banks to thrift charters. That’s also why credit unions convert to thrift charters. *(Since bank directors are compensated, and credit union directors are not - the occasional bank to a credit union conversion is an aberration.)* Rather than investing political effort on “charter renaissance”, banks just jettison the inappropriate charter for one that better supports its mission.

Should your institution be paying its directors, making more business and real estate loans, expanding its geography, increasing regulatory capital, buying banks, benefiting from the merger wave, or getting more mileage for your marketing efforts? If so, maybe your mission is better supported by a bank or thrift charter. To learn more, call Alan Theriault @ 800-649-2741.

Starts with Education

Webinar - Get the facts from the phone and your computer

Although the mutual charter may not be appropriate for every credit union, education is the first step to learning whether the charter might work for your institution. By utilizing a high speed Internet connection and a voice conference call, CU Financial can bring to your management team or board of directors the information and talent needed to get up to speed regarding this emerging credit union charter option.

The “Webinar” as it is called by some, is a multimedia / interactive seminar that brings the presenters to your offices in a cost effective way. The typical configuration involves gathering your participants in a conference room equipped with a data projector, computer, high speed Internet access, and a conference phone. Prior to the meeting, CU Financial provides you with a secure web link via e-mail, and delivers handouts by express mail. The link takes you to a computer in the offices of CU Financial. A telephone call connects your participants with the voices of a CU Financial executive, a Washington attorney experienced with the conversion process and, if desired, an executive from a converted mutual. You learn the facts - your questions get answered - you connect with those that can help you act. Simple. To schedule your private “Webinar”, call Alan Theriault at 800-649-2741.

Sign of the times

Giant Canadian CU Merger

Directors of the second and third largest credit unions in Canada just announced their agreement to merge driven, in part, by the need to generate competitive efficiencies and increase market share. The resulting institution will have combined assets of around CA\$6 billion.

Although US rules prohibit merging most healthy US credit unions, the economics driving the merger trend are the same in the states. US credit unions are also no stranger to mergers as the number of credit unions are expected to drop below 10,000 this year after peaking at around 22,000 just over two decades ago.

US credit unions of any size, however, are permitted to merge with mutual savings banks, and four such mergers have occurred; others are being contemplated. Credit unions that would consider a merger with a mutual include those with multi-state operations which face diminishing returns from serving their primary sponsor and select employee groups. Also, those wanting to more efficiently break into serving their

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Strategic Planning and Implementation for Progressive Credit Unions

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community by improving consumer awareness are interested in the trend.

For credit union managers that recognize a merger is inevitable, making a deal with a mutual enhances benefits for members, employees, and directors. The healthy credit union can deal from a position of strength and negotiate benefits for membership, plus an assumption of more liberal employee compensation plans. The compensation and retirement plans enjoyed by the directors at the mutual may also be assumed by the credit union directors; hence providing another tool for getting a merger proposal off the board room table.

CU Financial Services can help evaluate the feasibility of a charter change, including a review of all charter options. Multimedia presentations and interactive financial modeling help educate directors, employees and members about the options and the wisdom of a change. Should you decide to proceed with a charter change the staff of CU Financial can handle the details, allowing management to continue its focus on serving the members.

Contact: Alan D. Theriault: 800-649-2741

Are you prepared

Growth Can Be Nonlinear

We've all seen the charts with the positively sloped line depicting steady consistent asset growth. However, the fastest growing institutions often grow very differently. For these institutions being ready to take advantage of an opportunity, be it a merger or expansion into a new area, results in a leap that lifts the growth line to a new level.

So it can be for credit unions making the move to the mutual thrift charter. The thrift charter permits acquisitions of banks and bank branches and mergers with other mutuals and credit unions. It also permits alternative capital which can support nonlinear growth. It also permits the holding company structure which is similar to the structure employed by Canadian credit union Caisse Populaire des Desjardins in Quebec, Canada. This \$75 billion assets credit union is several times larger than the largest credit union in the US, and it even operates a federally chartered thrift in the United States.

CUNA's Bill Hampel explained during a recent debate reported by CUNA's "News Now" that, "..., our (credit unions') competitive advantage does not derive power from our tax exempt status." The former credit union managers that moved to a mutual charter and assumed the tax obligation along with many managers of taxable credit unions in Canada and Australia would agree with Hampel. Some would argue that the tax exemption was actually a hindrance. Canadian credit unions enjoy a significantly higher market share vs. their US counterparts, validating the claim that US credit unions pay a "hidden tax". The preoccupation with the tax exemption, in the eyes of some, is a crutch that ultimately supports mediocre linear performance. Building a business model dependent on a tax subsidy is risky business, they argue.

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Looming?

CU Public Relations Debacle & State Taxation Threat

Is it anti-American for Enron to avoid taxes by setting up offshore corporations? Or, a company, like Ingersoll-Rand to reincorporate in Bermuda to avoid taxes on foreign income? Some think so according to a recent article in Institutional Investor. "I find it appalling. I think the term 'Benedict Arnold' is appropriate," said Jack Bogle, founder of Vanguard Group, the country's second largest mutual fund company. "Companies can rationalize the moves legally. They can rationalize them financially. But some critics say there are greater values and principles at stake than saving a few million in taxes," the article continued.

With many states struggling to find revenues to fund "homeland security" and education costs; and to replace revenues because of bankruptcies and taxation limitations, state chartered credit unions are listed as potent sources of tax revenue, according to recent reports in the Credit Union Times and CUNA News Now. Massachusetts and Texas are among the states targeting state credit unions. In the past, some Utah legislators have said that state credit unions are failing to do their share to fund education, forcing teachers to use their own money to buy school supplies. Abundant levels of capital and rhetoric about wanting to serve the under-served are also attracting the attention of social groups looking for their slice of credit union prosperity.

Some directors of credit unions that converted to

the thrift charter considered the ethics of retaining a tax exemption given the changes in the financial services business. They reasoned that taxes, like any other business expense, are manageable. Many believe that the US credit union tax exemption is part of the reason US credit unions have captured only a tiny market share, while Canadian credit unions, which are taxed, enjoy a much higher market share. Indeed, US credit unions face a "hidden tax".

Public outcry about Enron's and Ingersoll-Rand's, effort to avoid taxes by setting up offshore corporations created public relations "nightmares" in the corporate boardroom. Will credit union directors unwittingly be labeled as "anti-American" during the struggle to justify keeping the credit union exemption? Banks, thrifts, and business cooperatives consider it part of their "social mission" to support the country's infrastructure by paying taxes. In some credit union boardrooms, the patriotic values and principles at stake by remaining a credit union and avoiding taxation are being visited during the deliberations about converting to the mutual charter.

Myths vs reality

Alternative Capital for CUs?

Fast growing credit unions, large and small, are anxiously following developments related to alternative capital for credit unions. Credit unions hovering around 7% capital levels are learning that NCUA must act decisively to sanction violations - its the law. Banks only need 5% to be well capitalized and the difference results in a competitive disadvantage - a "hidden tax". Credit Union trade associations continue to offer "hope" that "alternative capital" is a possibility, despite NCUA's insistence that under federal law it is not.

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	* Merged	Mil. est.		Apr 10, 2002
1	Affiliated Federal (TX)	47	1250	Bank 6/1/98
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20	Rainier Pacific (WA)	464	29900	Bank 1/2/01
21	Roper Employees FCU (SC) *	7	2500	Bank 3/1/01
22	Salt City Hospitals FCU (NY) *	8	4000	Pending
23	Synergy Federal (NJ)	297	20100	Bank 5/1/98
	Totals	3256.3	415,595	

Even if "alternative capital" was a possibility for credit unions, a critical questions remains unanswered. Who would buy these uninsured investments in the regulatory capital of a credit union? Members? Other credit unions? Corporates? The answer is none of the above.

Members: offering the investment to members, likely would only be possible by following strict disclosure rules established by the Securities and Exchange Commission (SEC). Offerings of this sort are likely to be economical for only the largest credit unions, say over \$100 million, because of cost and liquidity considerations, and only to the wealthiest members. During the savings and loan crises a certain California thrift, that failed, offered "alternative capital shares" to depositors and many unsophisticated investors suffered. Congress is unlikely to set the stage for a replay. Even if it did, credit union directors and CEOs may want to think long and hard about the risks of this scheme. The CEO of the unnamed California thrift spent time behind bars.

Other Credit Unions & Corporates: No again. The Federal Reserve Board would come "unglued" by a NCUA sponsored program to "daisy chain" insured deposits into capital of credit unions. Banks are prohibited from such activities because of the systemic risk to the insurance fund.

Potential sources might include, public investors, insurance companies, foundations, trusts, mutual funds, etc. However, they are often prohibited from owning more than 5% of any single investment offering with the dollar amount limited to no more than 5% of the investor's funds; minimum investment levels and industry concentration limitations might also apply. Consequently, obtaining suitable amounts of investment capital, from these sources, will involve a significant distribution effort; and since credit unions remain largely unknown and misunderstood among investors, the amount of lifting to go from the concept of "alternative capital" to the reality could be paramount.

What about mutual banks?

Mutual banks currently have the ability to increase regulatory capital in a number of ways. Size and structure limitations do exist and finding investors remains an issue, but today its being done. As a mutual bank, subordinated debt may be offered, but it only counts as capital to meet the risk based capital requirement - not the "core" minimum of 5%. A mutual bank, however, may form a subsidiary (REIT) funded with mortgages and offer investments in the subsidiary with the result of generating "core" capital. From a cost, liquidity, and marketing perspective, the minimum size offering Wall Street pays attention to is \$20 million; and since the offering generally can't exceed 25% of resulting "core" capital, only the near billion dollar credit unions could play in this game.

The route that works for smaller mutuals is to form a mutual (non-stock) holding company (*a couple of former credit unions [with the help of CU Financial Services] have done this*) which would own all the stock of the subsidiary stock bank. The holding company could then get a "commercial loan" from a bank, insurance company, wealthy investor, or pension fund (*by pledging the stock of the subsidiary bank*) and the money could then be down streamed into the bank, thus boosting "core capital". Some limitations exist, but the dollar amounts of borrowing would be more manageable - even in the million dollar range.

For holding companies of larger institutions, an alternative is to form a "trust" funded by loans. The "trust" offers shares to institutional investors, and down streams the proceeds to a subsidiary bank creating "core" regulatory capital. Also, for large and small mutual holding companies, stock can be offered to members and the mutual (member ownership) structure is retained as long as the holding company retains 51% of the stock. Variations of the above mentioned techniques exists as well as a couple less popular alternatives.

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In conclusion, if your institution is expecting "alternative capital" to be a part of the solution for your future development, you should take steps to convert to the mutual charter now. The process of going from a credit union to the marketplace for regulatory capital requires sound strategic planning, experienced advisors, and time to execute. To get the facts about these and other opportunities for your institution, including joining a "federation" of former credit unions with economies of scale and ready access to capital, please call Alan D. Theriault at (800) 649-2741.

Not so fast

"I'll convert just before retirement?"

The CEO of a credit union recently joked that right before retirement she would convert the credit union to a stock institution and "cash-out"; implying conversion is a "get rich quick scheme" for management. In fact, management benefits may take as long as 7 to 10 years to phase in (*and must be disclosed and voted on by the membership*) before the benefits of a stock conversion are maximized. Furthermore, much of the value must be earned by increasing the performance of the institution.

After converting to stock, your neighbors, friends, and credit union members are the stockholders. This means they start being more concerned about the price of the stock than the cost of designer checks. (*They also recognize that the more business they give the institution (which they own) the better the stock price.*) Your salary becomes public information. Your directors start reading the meeting materials and miss fewer meetings. Some will even ask questions. All will ask where the stock is trading.

The mutual charter or the stock banking charter may not be appropriate for all credit unions. Misinformation about these strategic options is sometime circulated by groups that fear the loss of revenues when a credit union converts. Before casually discounting the effort, the risks, or the benefits, and criticizing those that have, please be informed. You may be

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surprised that your membership will value your pioneering efforts, and thank you for helping to make a significant contribution to their net worth. If you want to learn more call Alan Theriault @ (800) 649-2741.

Cost Cutting

OTS Moves to Streamline Examinations

CU Financial Services, because of its experience in advising a majority of those converting to the thrift charter, was recently asked by The Office of Thrift Supervision (OTS) for ways to streamline the process of a credit union conversion to a mutual charter.

In addition to improving the credit union conversion process, the OTS, the primary regulator of most converting from the credit union charter, is planning to combine its consumer-compliance exam with its overall examination. Thrifts will perform their own "self-evaluation" on compliance issues before the official OTS examiner completes the general exam for safety and soundness. The OTS has kept the compliance and safety-and-soundness exams separate for over 10 years. The new move is part of a cost-cutting effort at OTS. However, depending on conversion volume, the time table for converting is not expected to increase.

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Phantom CAP **CUs Face CRA without Rules**

Despite CAP's repeal, credit unions are now facing an unwritten regulation that has replaced CRA "lite" and the result could lead to an imposition greater than banks face with CRA. The impact could lead to lower CAMEL ratings for those that fail to follow the NCUA Board's unwritten cues and field examiner guidance, which some complain is inconsistent.

The "Phantom CRA" rules were recently stated by CUNA's Mica who said the repeal of CAP "in no way diminishes the responsibility credit unions have, and one we readily accept, to serve all within our entire fields of membership, including those with low and moderate incomes." In a separate statement, NCUA's Dollar warned that credit unions, "have to put their money where their mouth is by establishing and maintaining a physical presence" in the dozens of low-income communities they have added to their FOMs over the past two years.

In contrast with bank CRA, a body of regulation and practice is in place so that an institution can self-evaluate compliance, and even the most negative rating does not affect a CAMEL rating. (Only a tiny fraction of banks fail CRA tests.) The rhetoric by credit unions to defend their CRA performance also is raising the antenna of social groups looking for their slice of credit union prosperity.

List exceeds two dozen **Two more file to convert to a mutual savings bank**

Two credit unions, one on the West Coast and one on the East Coast recently filed to convert to a federal mutual savings bank. The list of credit unions making the move now exceeds two dozen. Both of the credit unions making the move, \$125 million Credit Union of the Pacific (WA) and \$25 million Northeastern Engineers Federal Credit Union (NY) are active real estate lenders seeking to maintain a

successful lending philosophy, increase services, and expand their geography.

A credit union conversion to a bank charter is still a pioneering move although many expect it will become a contagious idea. As advisor to the majority of credit unions making the move, staff of CU Financial Services are often asked: why aren't more credit unions converting? The answer is best explained by what sociologists call the diffusion model, which, "according to the authors of "The Tipping Point", is a detailed, academic way of looking at how a contagious idea or product or innovation moves through a population.

The authors use the example of a new corn seed introduced in Iowa in 1928. Although superior to seed used by farmers for decades before, it took many years for the new seed to be widely accepted. First the "Innovators", the adventurous ones, led the way followed by the "Early Adopters", or opinion leaders, those respected, thoughtful people who watched and analyzed what those wild "Innovators" were doing, then followed suit. Then came, the "Early Majority" and the "Late Majority", the deliberate and skeptical mass, who would never try anything until the most respected of the farmers had tried it first. They caught the seed virus and passed it on, finally, to the "Laggard", the most traditional of all, who see no urgent reason to change. Plotted on a graph, the corn seed example formed a perfect epidemic curve - starting slowly, tipping just as the "Early Adopters"

started using the seed, then rising sharply as the "Majority" catches on, and falling away at the end when the "Laggards" come struggling in.

The book and the corn seed research does a good job explaining innovations that find their way into credit union practice from checking accounts to business lending. However, unlike the corn farmers, the credit union "Majority" may face the risk that the bank conversion innovation gets derailed by credit union trade associations and others, like NCUA, who fear their jobs are on the wrong side of the curve. The memory of NCUA's 1995 onerous conversion

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regulations should be a lesson about what some will do to protect their economic turf.

Reg Relief

CUNA Says Pay Volunteers - Allow the Public to Invest

In an about face, CUNA lobbyists are now arguing that credit union directors should be paid and that the public should be able to invest in the equity of credit unions. During the HR-1151 debates, a few years ago, CUNA claimed that volunteer directors and the prohibitions against equity capital justified the credit union tax exemption. It is what makes credit unions different than banks was the claim. A few state laws permit a modest payment to directors.

Today, CUNA's new positions validate the actions of the 22 credit unions that converted to a bank charter. Bank directors are paid and mutual savings banks may access alternative capital. Credit unions, however, remain at a competitive disadvantage because they must operate at higher capital levels and because they are penalized for real estate and business lending. Some describe these limitations as: the "hidden" credit union tax.

CUNA's arguments in favor of alternative capital and director compensation mirror the reasons banks pay directors and tap the capital markets. The lobbying should help silence the few critics who claim that conversion to the bank charter is motivated by greed. Meanwhile, members continue to approve conversion to the bank charter and subsequent capital raising efforts.

The House Regulatory Relief Bill which proposes these bank-like revisions to the Federal Credit Union Act must still get approval from the full House of Representatives. Even with the approval, the bill lacks a companion measure in the Senate and the credit union provisions are opposed by some former credit union allies and others, including smaller

credit unions. In brief, as reported in the February edition of this newsletter, "Regulatory Relief" is a dead issue for this Congress. Key credit union allies oppose CUNA's position. The Democrat controlled Senate lacks an interest in the measure. The Senate is unlikely to support anything which might look like a Republican victory.

Unfortunately, even if efforts to pay credit union directors succeed, some aging credit union directors will lose out. The bill proposes allowing a mandatory retirement age and limits compensation to only those directors that are gainfully employed.

On the Defense

Preparing to Compromise

In what is promoted as a victory for credit unions, CUNA recently hired a tax specialist who used to work for the ABA. The hiring is an indication that CUNA may be preparing to compromise about taxation. The weakening economy and increasing state and federal deficits and costs puts credit union net income on the political radar making its defense difficult both politically and morally. In some states, school teachers are lobbying to tax credit union profits in order to help improve student welfare. Police chiefs are likely to be lobbying for funding to better protect and defend against terrorist action.

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Capitol Hill is the land of compromise. Compromise may bring some surprises for growing credit unions. For example: if credit unions are taxed, some say the major advantage of the credit union charter will disappear causing a mass exodus to the mutual bank charter. Knowing this, CUNA, NAFCU, and NCUA are likely to promote a moratorium on conversions in order to protect the insurance fund and their jobs. Greater credit union powers may result, but these powers will not match bank powers, and the consumer confusion and awareness related to credit unions will remain. Furthermore, how then will a credit union justify its conversion to a bank charter once any apparent advantages disappear? At that point the argument that the move to a bank is motivated by greed becomes easier to substantiate. Who will lobby for the progressive credit union's right to become a bank? The bank lobbyists will consider credit union taxation a victory, and the loss of dues revenues from a credit union turned bank will be the sacrifice. Hence, the credit union team that expects to evolve into a bank will be trapped in a credit union charter. The lesson: the "right moment" to convert may never arrive.

Alternative capital critical for some 42% of NAFCU Members Would Need to Raise Capital

A recent survey of NAFCU members concluded that an astounding 42% expect to need capital soon in order to maintain growth, to meet Prompt Corrective Action Requirements (PCA), and for various other reasons, the Credit Union Times reported. CUs must maintain a higher capital ratio than banks and are prevented from accessing the capital markets without converting to a bank charter, a move a few credit unions have made.

The weak stock market and the war against terrorism generated a flood of deposits into progressive credit unions causing capital ratios to drop into the caution area. Also the accelerating trend of member migration from smaller credit unions to larger credit unions, in order to obtain enhanced services, puts pressure on the capital ratios of the larger, many of which are NAFCU members.

A few credit unions solved the capital problem by converting to a bank charter and by asking members to invest in an Initial Public Offering (IPO). Others converted and organized a holding company which is authorized to borrow money that could be downstreamed as regulatory capital.

Like the adage that money is easy to borrow when you don't need it - capital is easy to get when you don't need it. The process of converting to a bank and accessing the capital markets takes time to prepare and execute. Best to Call CU Financial Services today if you suspect that you may need regulatory capital in the next few years.

Starts with Education

Webinar - Get the facts from the phone and your computer

Although the mutual charter may not be appropriate for every credit union, education is the first step to learning whether the charter might work for your institution. By utilizing a high speed Internet connection and a voice conference call, CU Financial can bring to your management team or board of directors the information and talent needed to get up to speed regarding this emerging credit union charter option.

The "Webinar" as it is called by some, is a multimedia / interactive seminar that brings the presenters to your offices in a cost effective way. The typical configuration involves gathering your participants in a conference room equipped with a data projector, computer, high speed Internet access, and a conference phone. Prior to the meeting, CU Financial provides you with a secure web link via e-mail, and delivers handouts by express mail. The link takes you to a computer in the offices of CU Financial. A telephone call connects your participants with the voices of a CU Financial executive, a Washington attorney experienced with the conversion process and, if desired, an executive from a converted mutual. You learn the facts - your questions get answered - you connect with those that can help you act. Simple. To schedule your private "Webinar", call Alan Theriault at 800-649-2741.

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- Increased marketplace credibility
 - Use of 1% deposit
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Former CU: Pacific Trust

Over \$60 Million Raised in IPO

\$300 million Pacific Trust Bank, a federal credit union until January 2000, recently tripled its capitalization in an oversubscribed offering. Like other converting credit unions, the stock promptly traded at a 20% premium generating a good gain for participating members.

The \$60 million in new regulatory capital raised allows the former credit union to grow to four times its former size as a credit union - to over \$1 billion in assets. Pacific Trust Bank is a community-oriented federal savings bank operating through eight full service offices located in San Diego and Riverside Counties in California. The community benefits of fresh capital can be measured in many ways including expanded locations, more loans for businesses and developers, and additional growth opportunities for existing and new employees.

The shares of First PacTrust Bancorp, Inc., a holding company organized to facilitate the offering and the growth of the business, is traded on the NASDAQ National Market System under the symbol "FPTB". The subscription offering was managed by Keefe, Bruyette, & Woods, Inc. Silver, Freedman & Taff, L.L.P. acted as special counsel to the Bank. CU Financial Services was advisor to Pacific Trust FCU during its conversion from a credit union.

In a public statement, the Board of Directors, Officers and Employees of Pacific Trust Bank and First PacTrust Bancorp, Inc. expressed their gratitude for the overwhelming support for the offering by their customers, pledged their best efforts toward the opportunities ahead, and looked forward to serving the needs of their customers and new stockholders.

CEO & Directors:

Salary imbalance is corrected by converting to a bank

Currently, for the same reasons banks pay directors and tap the equity markets, credit union lobbyists are pushing for changes to the credit union paradigm (and laws) that prevent appropriate officer and director compensation and access to the capital markets. These efforts validate the efforts by the two dozen credit unions that converted to a bank charter, those that are planning the move, and the dozens which moved or are planning to move to private insurance.

Across all peer groups, salary surveys report that credit union CEOs are paid much less cash compensation than Bank CEOs. For example, according to numbers reported in Credit Union Magazine, the CEO of a \$100 million credit union earns 39% less compared to a Bank CEO; for credit unions over \$1 billion in assets the number is 57%. The gap (about 20%) is smaller for credit unions between \$100 million and \$1 billion. Similar comparisons apply to other senior managers, and the gap widens when comparing retirement benefits.

Poor market share and an industry preoccupied with addressing political issues like field of membership overlaps or generating the appearance of serving the underserved, to retain a tax exemption, are in part the consequence of these compensation gaps. In contrast, according to credit union industry reports, banks control over 97% of deposits and dominate the mortgage market, a key service demanded by younger members. In addition, banks are expert in service to low and moderate income groups with over 98% obtaining "satisfactory" or "outstanding" ratings after CRA examinations.

Correcting the compensation imbalance will require a broad based

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paradigm shift, starting with director compensation; after all, getting a raise from an unpaid director is destined to meet with resistance. Credit union regulators too may put up barriers. Daily talk about the "nonprofit structure" and "service to members" influence a culture that promotes an artificial ceiling on management compensation. Rather than fight current credit union paradigms and risk getting trapped in a charter that fails to address a current mission, (see related story) or the future needs of members, some management teams have converted their institution to a mutual bank or stock bank charter. As a stock bank, long time credit union members are given the opportunity to capitalize on the equity build up, while continuing to have an ownership stake. Management, including directors, get to be compensated like bankers and executives from other industries. As a mutual bank, the cooperative ownership structure remains, but the competitive disadvantages of credit unions, like consumer awareness, lack of access to capital, penalties for real estate and business lending, and the statutory requirement to hold more capital go away. Compensation methodologies can mirror what's in place at stock banks, thus correcting an imbalance.

Members vote to convert to a stock bank because they are able to significantly increase their net worth by purchasing shares as part of the initial public offering (IPO). Directors and management are also able to access the IPO shares on the same basis as members.

EDITORS NOTE: Feb. 2006 - The above is a single article within the context of nine years of newsletters posted on this web site containing hundreds of additional pages of educational material related to conversions. Parts of this article have on occasion been taken out of context, altered, and reprinted (without permission) by critics of the conversion process. Therefore, I have withdrawn the paragraphs often misused. The context of this article should be viewed in light of discussions and press reports, at the time of the

writing and among credit union leaders, related to safety and soundness concerns because of the inability of some credit unions to pay directors. Federal credit unions are permitted to pay only one member of the board of directors, although some federal credit unions will rotate the position so over time every member can be paid. State chartered credit unions in at least 12 states are allowed to pay their directors. Credit union leaders were complaining about how difficult it was to attract talented (unpaid) replacement directors because of the increasing complexity and risks involved in running a credit union. Also, some complained that many of these unpaid directors failed to recognize how difficult it is to attract management talent because credit unions lack the compensation tools available to banks. Currently, a national credit union trade association is seeking to change the rules so federal credit unions can pay their directors.

That being said, the critics of conversion are hoping to generate the illusion that this firm uses this article like a carrot - luring the donkey to the conversion table. It is reprehensible that these critics would insult and

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even defame their peers by such ridiculous assertions. Maybe the critics are the ones so easily misled?]

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

**FDIC and Private Insurance
Defections Raise NCUSIF
Concerns**

Some credit unions with NCUSIF insured deposits are leaving the NCUSIF for private insurance or FDIC insurance. Recently, members of \$2.8 billion Patelco Credit Union (CA) voted to abandon NCUSIF making the credit union the largest defection to date. Others are expected to follow. Almost two dozen credit unions have converted to FDIC insurance by moving to a bank charter. The conversion to private insurance (or FDIC) facilitates mergers, a move to a commercial bank charter, and/or the issuance of capital stock since NCUA loses its jurisdiction over an institution once it is privately (or FDIC) insured.

Defections from the NCUSIF fund reduce NCUA revenues and may weaken or destabilize NCUSIF. Some claim the moves also help make the case for taxing credit unions. NCUA Board Member Deborah Matz criticized Patelco's move and implied that private insurers might not be able to cover large losses. She said, "I am not sure depositors fully understand the distinction between private insurance and having the backing of the full faith and credit of the U.S. Government." Most states require credit unions and banks be federally insured.

Many claim that if credit unions are taxed, a flood of conversions to banks would occur. Unfortunately, larger credit unions, which are the most likely to be taxed and the first to convert, also provide the core financial support to the NCUSIF. Hence, to prevent destabilizing NCUSIF, taxation may arrive with a moratorium on conversions - thus trapping many in a taxpaying credit union charter. Faced with the prospect of taxation - credit union trade associations are likely to argue in favor of preventing bank conversions to "protect" NCUSIF. Bank trade associations are unlikely to invest much effort to prevent such a moratorium; therefore, those hoping to convert to a bank may be disappointed. A precedent restricting switching insurance funds has its roots in the old

savings and loan fund, which for many years prevented savings banks from moving to the "bank insurance fund" and ultimately required payment of high premiums and expensing a 1% recapitalization deposit.

**State and Federal Deficits
Taxation? More NCUA Scrutiny**

State chartered credit unions across the country are facing the prospect of state taxes and more scrutiny by NCUA. Also, federal budget deficits because of reduced tax revenues and spending pressure for military activities and homeland defense, make all large credit unions a target for federal income taxes. Those seeking tax revenues from credit unions view efforts to retain a tax exemption as unpatriotic and claim that school children are being deprived of needed resources as well. The publicity may result in embarrassment for some credit union directors.

NCUA has made it clear that it intends to make sure state chartered credit unions continue to be supervised in the face of state budget cuts. Speaking to a group of state chartered credit unions and regulators, NCUA Director Deborah Matz expressed concern about the impact budget shortfalls in the states could have on the dual chartering system. Many states are facing budget cuts, Matz said, but that should not keep state regulators from continuing to examine state-chartered credit unions as in the past. She asked state regulators to "do what you can within your state bureaucracy to keep every penny that credit unions contribute for regulatory oversight and to work closely with NCUA." She emphasized that NCUA examiners are "ready, willing, and able" to help "when state treasuries are low." Some believe that NCUA's efforts to justify the overhead transfer rate and handle over staffing will result in greater NCUA involvement during the examination process of state chartered credit unions.

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CU of Pacific **Members Overwhelmingly Support Bank Conversion**

Typical of the almost two dozen bank conversions to date, members of Seattle based CU of the Pacific overwhelmingly approved a move to the bank charter. Eighteen percent of the members voted: result 77% in favor. Compared to many member referendums the response was strong. Clearly a poll of 18% of the members provides a sound indication of the will of the membership. Frequently, political commentators declare the will of the voters by a sample smaller than 1%.

Nevertheless, credit union trade associations are pushing a few members of Congress to require a minimum quorum of as high as 50% - the level imposed by NCUA in 1995. In 1998, as part of HR-1151, Congress decided it was sound public policy to allow credit unions to convert to banks, thus providing the flexibility to escape credit union growth & product restrictions and assume a tax obligation. In addition, legislation is being sought to prevent compensation to directors after converting to a bank. Since banks typically compensate their directors, such restrictions would handicap those seeking to execute mergers or accelerate their service to the community by tapping the capital markets to fund expansion.

Large CUs Only: **Mica Calls for D.C. Meeting**

The CEOs of large credit unions are expected to travel to Washington, DC in early November for a special CUNA briefing, and likely an appeal for unity, constraint, and money. During the 2003 session, large credit unions will be a target on Capitol Hill and in many state

capitals. Consumer groups, bankers, and the IRS will question whether larger credit unions are doing enough to justify their tax exemption. Hence, certain members of Congress are sending signals that they are likely to introduce credit union legislation during the 108th session. In the Senate, Banking Committee Chairman, Paul Sarbanes, D-Md, recently ordered a GAO study of credit unions, a signal that the Senate may consider a bill.

Clearly, large state chartered and federally chartered credit unions are under the microscope of both banks and consumer groups. Large community chartered credit unions continue to grab members from smaller credit unions accelerating their demise as the total number of credit unions now falls below 10,000. Taxation, however, is viewed, by the CU trades as the number one threat to the credit union system, despite the fact that credit unions in other countries pay taxes and are thriving, and that smaller credit unions would continue to be tax exempt. Among the legislative risks faced for progressive credit unions includes taxation, few new powers, and being forced to remain in the NCUSIF fund. (See related story below.)

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Is a Bank Charter in Your Future? GAO Study may lead to Conversion Moratorium

In September the Senate Banking Committee Chairman Paul Sarbanes, D-Md, ordered the Government Accounting Office (GAO) to conduct a study of credit unions. Some believe the study could be a first step toward a Senate bill to re-characterize large credit unions in order to gain tax revenues and appease bankers. In contrast to the tax discussions during the budget surplus year of 1998, when HR-1151 was debated, the next Congress faces deficits. Congress and many state legislatures are likely to be turning over every stone in search of tax dollars.

According to political observers, a proposal resulting in taxes affecting just 10% of the credit unions is likely to surface. Although numbering only 1,000, these credit unions are the most profitable and fastest growing. Controlling about 75% of credit union assets, their profile deviates from the median credit union. Many are capturing market share from the smaller 9,000 credit unions, alienating that group. Without the support of the 9,000; and, facing banking groups efforts to "limit competition"; this small group of fast growing credit unions (*likely re-characterized as "credit associations"*) may end up getting squeezed into a box resulting in taxation and only modest new powers. Mutual savings banks had to wait over 20 years after being taxed before gaining any significant new powers.

In addition, because the group provides substantial support for NCUA and the NCUSIF, the legislation may include prohibitions on leaving the NCUSIF, in order to preserve the safety and soundness of the fund. (*The precedent: savings banks were prevented from leaving the Savings Association Insurance Fund (SAIF).*) Already NCUA is expressing significant concern about \$2.8 billion Patelco Credit Union's (CA) shift to private insurance. Consequently, the many credit union executives that threaten to convert to a bank, if taxed, may find themselves trapped in a less desirable "credit union like" charter. Who will argue their case for conversion to a bank? Credit union trade associations and the NCUA will be content with the status quo. Smaller credit unions, with the pressure for taxation gone, will have no incentive to defend the larger. Bank trade associations are unlikely to lobby for the right of the 1,000 to convert to a bank; it would seem self serving, and may be opposed by bankers that resent helping former credit unions. Arguing on your own behalf will be met with accusations of "Enron" like greed and the belief that the few new powers bargained for are sufficient for now.

Since HR-1151 streamlined the process of converting to a bank charter, members have overwhelmingly supported the move, regulatory approvals have been swift, and the

pioneering institutions have prospered. (*The voting process is simpler than converting to private insurance since only a majority of members voting need to approve of the move; and the NCUA board's approval is not required.*) Congress, during the HR-1151 debates, recognized that significant restrictions were being placed on credit union growth by the bill; so a streamlined escape route was crafted for those institutions seeking to shed credit union restrictions. Critics, however, recognizing the legislation "*opened the barn door*" want to make the process more difficult. Should legislation be introduced during 2003, critics are likely to attach amendments to make conversion to a bank charter more difficult. Unfortunately for those planning a conversion *someday*, such a bill could result in a bank conversion moratorium, since bank regulators are reluctant to act on new applications if pending legislation might change the application process. It appears the window of opportunity may be closing. Advice: file an application before the Bill is introduced.

In addition to complacency, the desire to amass more tax free capital keeps some from taking the conversion step. However, \$300 million Pacific Trust Bank, a former credit union, just completed an IPO raising over \$60 million in regulatory capital, tripling its net worth. The capital boost, and FDIC's lower capital requirements, allows the institution to leap

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to another level of community service and grow to over \$1.5 billion in assets. As a credit union it would take over a dozen years of retained earnings to match the potential of Pacific Trust.

Advice from Stephen R Covey's book: "**First Things First**" may apply for some facing the bank conversion decision: (1.) "Let go of paradigms that are popular and pleasing, but based on illusion". (2.) "Let go of extrinsic sources of security".

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.

Debate Topics

Bank Charter; Capital; Taxation; Small CU vs. Large

Debates provide a forum for listeners to learn about options. Today credit union CEOs and CU Trade association executives are debating the need for regulatory capital, conversion to a bank charter, taxation, and the value of small credit unions versus large. In reality the needs of individual credit unions and unique communities are varied. One choice may not serve all.

Regarding the choice of a bank charter, an institution's charter should follow its mission. Many credit unions face diminishing returns from serving select employee groups - survival may demand a switch to serving a broader community, access to more investment products, loan offerings, and the acquisition of customers typical of a bank and better served by a bank charter. Director compensation may be needed to attract and maintain a slate of directors willing to invest the time and take the risks required of community based institutions, again an option with a bank charter.

Since banks are allowed to operate with less regulatory capital than credit unions, the value of the tax exemption is diminished. Likewise, an aging membership may see diminishing value in a credit union charter or even a mutual bank charter as a member's needs evolve toward building capital. Members may vote to withdraw their ownership equity by converting to stock, rather than allow others to "inherit" their earned capital. The choice to make a switch needs to be preserved.

Access to the capital markets can provide tremendous benefits to a community because of the leverage designed into the banking system. For an institution that has growth opportunities and the talent to execute, a regulatory capital

injection provides the structure to multiply loans, investments, jobs, and access. The community benefits of deploying this extra capital can be enormous. For example, in the mid-eighties, \$60 million Peoples Heritage Bank (ME) converted from a mutual institution to the stock form, and just over 25 years later it is over \$22 billion in assets and employs hundreds of people within the community that originally voted for the conversion. Many community depositors have become wealthy, in part, because of their participation in the original IPO.

Some credit unions pay a price for their tax exemption, and the price may be increasing as NCUA's directors lobby credit union executives to accept new obligations by serving under served areas and to fund charitable organizations or groups promoting economic initiatives. Maintaining higher levels of capital also has a cost, especially when net interest margins shrink. The result is a credit union limited to providing a consumer value proposition very similar to a tax paying bank.

Lastly, the debate about small versus large is also typical to the banking world. By virtue of their size and efficiencies, small banks share many of the same struggles of small credit unions, including the challenges of regulation, technology, and staffing. Nevertheless, those that want to survive will find a way, the others will merge or go out of business.

The flexibility to decide what is best for your credit union is important to preserve. Debates are sometimes orchestrated by critics in an effort to protect their subsidy. A wise listener will always study the motivations of the speakers and the organizers of the forum. The facts will speak loudly and should always be acquired, validated, and viewed independent from the critics and promoters. For those studying the merits of a bank charter, The "Conversion Guide to the Cooperative Banking Charter" is one resource that can help provide the facts. For a copy contact: Alan D. Theriault at 800-649-2741.

CU Financial Services

can help evaluate the feasibility of a charter change, including a review of all charter options. Multi-media presentations and interactive financial modeling help educate directors, employees and members about the options and wisdom of a change. Should you decide to proceed with a charter change our staff can handle the details, allowing management to continue to focus on serving the members.

Contact: Alan D. Theriault at (800) 649-2741

For More information, or to receive a free subscription to "[Converting from a Credit Union](#)", please contact:

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Questions - lead to options

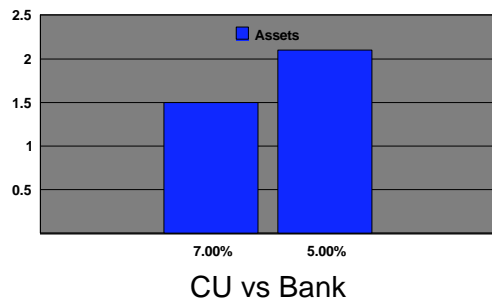
- Have member needs changed since the CU act - model?
 - ▲ Different world: payroll deduction - 401 K (tax law) - equity investments - developed middle class - more options (suppliers) - equity (net worth) growth vs. consumption
- How will the "blending" of banking - insurance - investments & regulation affect members? the future? 5 years - 10 years - 15 years
- How do members - the public - employees - trade associations view our mission? ownership? What's important?
- Do members benefit from growth?
- What comes first the "charter" or the "mission"?
- How important is the tax "subsidy"?
- Can our "vision" & "mission" extend to all consumers?



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Why many are acting now?

- Business involves change - the bigger you get the farther ahead you must look - know your destination - strategic
- Waiting in Line
- NCUA Deposit?
- FDIC entrance fee? - Merrill Lynch
- Future conversion restrictions
 - ▲ Larger vote requirement - NAFCU
 - ▲ Director compensation restrictions - Reg. Relief
 - ▲ IRS treatment of conversion - (offshore corporations)
- Opportunity cost; momentum