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 <u>employee ownership</u>; likewise, many cooperatives, credit unions included, boast about the benefits of <u>member ownership</u>. 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*.

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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.

Credit Unions Converted to a Bank Charter

	CU Name	Assets	Members	Status
	* Merged	Mil. est.		Mar 1, 2002
1	Affiliated Federal (TX)	47	1250	Bank 6/1/98
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	

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 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.

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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 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.

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'a "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.

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	* Merged	Mil. est.		Apr 10, 2002
1	Affiliated Federal (TX)	47	1250	Bank 6/1/98
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
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8	Beacon Federal (NY)	223	34000	Bank 7/1/99
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11	Caney Fork Coop (TN) *	0.3	186	Bank 11/28/00
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14	I.G.A. Federal (PA) *	179	25000	Bank 7/1/98
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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	Salt City Hospitals FCU (NY) *	8	4000	Pending
23	Synergy Federal (NJ)	297	20100	Bank 5/1/98
	Totals	3256.3	415,595	

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.

2 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.

Consultant to credit unions considering conversion to a mutual savings institution charter.
CU Financial crafted the first state chartered credit union conversion, and is advisor to many subsequent applicants.
Alan D. Theriault, at 800-649-2741; E-Mail: atheriault@cufinancial.com; Web site: www.cufinancial.com

CU Financial Services * P.O. Box 1053 * Portland, Maine 04104 * Telephone: 800-649-2741 * Fax: 202-478-0935

Strategic Planning and Implementation for Progressive Credit Unions

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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 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 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.

3 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.