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NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Part 708a

RIN 3133-AD16

Conversion of Insured Credit Unions to Mutual Savings Banks

AGENCY: National Credit Union Administration.

ACTION: Final rule.

SUMMARY: The National Credit Union Administration (NCUA) is issuing final revisions to its rules regarding the conversion of insured credit unions to mutual savings banks or mutual savings associations. The final rule improves the information available to members and the board of directors as they consider a possible conversion. The final rule includes revised disclosures, revised voting procedures, procedures to facilitate communications among members, and procedures for members to provide their comments to directors before the credit union board votes on a conversion plan.

DATES: This rule is effective January 22, 2007.

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SUPPLEMENTARY INFORMATION

A. Background

Under the Federal Credit Union Act (FCUA), a federally insured credit union (credit union) may convert to a mutual savings bank or savings association in mutual form (collectively referred to as MSBs). 12 U.S.C. 1785(b)(2). NCUA has regulations on the conversion process. 12 CFR part 708a. In June 2006, the NCUA Board published proposed amendments to part 708a in the *Federal Register* for a 60-day public comment period. 71 FR 36946 (June 28, 2006).

As stated in the preamble to the proposal, the conversion from a credit union charter to a bank charter is a fundamental shift. The decision to convert belongs to the members. To make this decision, members must be fully informed as to the reasons for the conversion and have time to consider the advantages and disadvantages of conversion. They should also have an opportunity to

communicate their views to the credit union's directors and to communicate with other members about the proposed conversion. NCUA believes the current conversion process can be improved in these areas.

Briefly summarized, the proposal:

- Required a converting credit union to give advance notice to members that the board intends to vote on a conversion proposal and established procedures for members to share their views with directors before they adopt the proposal.

- Clarified that credit union directors may vote in favor of a conversion proposal only if they have determined the conversion is in the best interests of the members and required the board of directors to submit a certification to NCUA of its support for the conversion proposal and plan.

- Simplified the boxed disclosures that a credit union must provide to its members.

- Changed the current requirement for delivery of the boxed disclosures (i.e., with all written communications to members) to require that the disclosures need only be delivered with the 90-, 60- and 30-day member notices.

- Provided for the form of the member ballot and that the ballot must be sent only with the 30-day notice.

- Required the board of directors to set a voting record date not less than one hundred twenty days before the board notifies the members it is considering adopting a conversion proposal.

- Required that, after the board has approved an MSB conversion proposal and upon the request of a member, a credit union must disseminate information from that requestor to other members at the requestor's expense.

- Stated that members of federal credit unions (FCUs) may request and be granted access to the books and records of a converting credit union under the same terms and conditions that a state-chartered for-profit corporation in the state in which the FCU is located must grant access to its shareholders.

- Required the Regional Director to make a determination to approve or disapprove the methods and procedures for the membership vote within thirty calendar days of the receipt of the certification of the member vote and permitted a credit union dissatisfied with the determination to appeal to the NCUA Board.

- Required a credit union to complete a conversion within one year of NCUA's approval of the methods and procedures of the vote.

- Modified the voting guidelines to include information on the use of voting incentives such as raffles.

NCUA received 52 comment letters on the proposal from a variety of sources, including credit unions, credit union trade associations, bank trade associations, and individuals and entities associated with the conversion process. The final rule retains most of the proposed rule as described above but does include some changes in response to comments. For purposes of this preamble, the comments are divided into three categories: general comments on NCUA's rulemaking authority, comments addressed to particular sections of the rule, and other comments. The preamble addresses each of these categories in turn.

B. *Legal authority for the rulemaking*.

The FCUA grants the NCUA Board broad, general rulemaking authority over federal and federally-insured state-chartered credit unions:

> Powers of the Board and Administration personnel. – (a) The Board may prescribe rules and regulations for the administration of [the FCUA] (including, but not by way of limitation, the merger, consolidation, and dissolution of corporations organized under this chapter) . . . .

12 U.S.C. 1766(a). The FCUA contains numerous provisions governing credit union activities, including reorganizations and charter conversions. *See, e.g.*, 12 U.S.C. 1771 and 1785. Section 1785, in particular, addresses the conversion of credit unions to MSBs, including specific voting and notice requirements and limitations on benefits for directors and management. Section 1785 also charges NCUA with oversight of the membership vote:

> Oversight of member vote. The member vote concerning charter conversion under this paragraph shall be administered by the Administration, and shall be verified by the Federal or State regulatory agency that would have jurisdiction over the institution after the conversion. If either the Administration or that regulatory agency disapproves of the methods by which the member vote was taken or procedures applicable to the member vote, the member vote shall be taken again, as directed by the Administration or the agency.

12 U.S.C. 1785(b)(2)(G)(ii). The FCUA also gives the NCUA Board specific rulemaking authority over credit union conversions to MSBs as follows:

> (G) Consistent rules. (i) In general. Not later than 6 months after the date of enactment of the Credit Union Membership Access Act the Administration shall promulgate final rules applicable to charter conversions described in this paragraph that are consistent with rules promulgated by other financial regulators, including the Office of Thrift Supervision and the Office of the Comptroller of the Currency. The rules required by this clause shall provide that charter conversion by an insured credit union shall be subject to regulation that is no more or less restrictive than that applicable to charter conversions by other financial institutions.

12 U.S.C. 1785(b)(2)(G)(ii). The key rulemaking provisions, added by the Credit Union Membership Access Act (CUMAA) in 1998, are twofold. First, NCUA's rules must be "consistent with rules promulgated by other financial regulators, including the Office of Thrift Supervision and the Office of the Comptroller of the Currency;" and, second, NCUA's rules must be "no more or less restrictive than [those rules] applicable to charter conversions by other financial institutions." Id.

In the preamble to the proposed rule, the NCUA Board addressed NCUA's statutory rulemaking authority. 71 FR 36946, 36947-49 (June 28, 2006). The Board noted that, due to differences in the structure of different financial institutions and differences in the statutes that enable charter conversions, it would not be possible for NCUA to adopt conversion rules that were identical to those of all other financial regulators and, therefore, that Congress could not have intended such a result. After analyzing the FCUA enabling legislation at some length, the Board reached several conclusions about its statutory authority. The first conclusion, interpreting the FCUA's requirement that NCUA's rules be "consistent with rules promulgated by other financial regulators" was:

> NCUA's rules applicable to conversion from credit unions to MSBs should be compatible with the rules, if any, that govern conversions to new banking entities. In other words, a credit union that wishes to convert to a federally-chartered MSB ("FMSB") should not encounter insurmountable contradictions between NCUA's rules governing conversions to FMSBs and the existing Office of Thrift Supervision ("OTS") and Federal Deposit Insurance Corporation ("FDIC") rules governing the same . . . . Likewise, if a credit union wishes to convert to a state-chartered MSB, NCUA's rules should be compatible with the state regulator's rules, if any, governing the same conversion.

Id. at 36948. The Board next turned to the FCUA's "no more or less restrictive" requirement and, after demonstrating that this "no more or less restrictive" phrase could not mean "identical," analyzed the phrase in terms of its constituent pieces, that is, the meanings of "no . . . less restrictive" and "no . . . more restrictive."

The Board concluded that "no . . . . less restrictive than [those] applicable to charter conversions by other financial institutions" meant:

> [T]hat when NCUA is aware of a particular federal or state law that confines the choices or action of a converting institution, NCUA should consider if that restriction makes sense for a converting credit union in light of the underlying principles that inform NCUA's and other regulator's rulemakings . . . .

Id. at 36948. The Board then concluded the requirement that NCUA's rules be "no more . . . restrictive than [those] applicable to charter conversions by other financial institutions" meant that:

> [NCUA's] rule, taken in its entirety, should not confine a converting credit union's actions or choices more significantly than the rules of other financial regulators, taken in their entirety, confine the actions or choices of the converting institutions they regulate.

Id. at 36949.

As discussed above, the FCUA language "no . . . less restrictive than the rules governing charter conversions by other financial institutions" instructs NCUA to consider particular, procedural elements in other conversion rules and determine if those provisions make sense for a converting credit union in light of the underlying principles that inform NCUA's and other regulator's rulemakings. NCUA has discretion to adopt particular procedural provisions used by other regulators, or not adopt them, or establish new procedural provisions depending on whether those provisions make sense for credit unions and their members. The particular regulatory provisions considered by NCUA for this rulemaking, and their utility, are discussed in the preamble to the proposed rule. 71 FR 36946, 36949-60 (June 28, 2006).

The FCUA limits NCUA's discretion to adopt particular regulatory provisions through its requirement that NCUA's rule also be "no . . . more restrictive than the rules governing charter conversions by other financial institutions," meaning that NCUA's rule should not, when taken in its entirety, constrain a converting credit union's action or choice more significantly than the rules of other financial regulators taken in their entirety. Accordingly, NCUA compared its final rule to the charter conversion rules of other regulators, including, in particular, to the following conversion rules of the OCC and the OTS:

- OCC rules governing the conversion of state banks to national banks.
- OTS rules governing the conversion of state mutual savings banks to federal mutual savings banks; and
- OTS rules governing the conversion of mutual savings banks to stock

banks, including state to federal charter conversions.

NCUA believes these particular rules are appropriate for comparison to NCUA's rule because they have procedural protections that ensure informed decision making and that protect the interests of the relevant stakeholders.[1] These rules place various requirements on a converting financial institution, including:

- Director voting;
- Director certifications;
- Stakeholder voting and procedures;
- Disclosures;
- Public notice, comment, and meetings;
- Obtaining legal opinions;
- Procedures for communication among stakeholders using the resources of the converting institution, including proxy solicitations and other communication measures; and
- Regulatory compliance provisions, such as applications for insurance coverage, Community Reinvestment Act (CRA) compliance, and Qualified Thrift Lender Test (QTL) compliance.

The following chart summarizes those elements of each rule, including NCUA's final rule, that confine the converting institution's actions or choice:

[1] The relevant decision makers do vary among these conversion situations. In NCUA's rulemaking, directors and stakeholders (i.e., the members) make substantive decisions about the conversion, and NCUA, the regulator, administers the member vote and approves the methods and procedures of the vote. The conversion of state MSBs to federal MSBs and the associated OTS rule involve the directors and the regulator as the substantive decision makers. For the conversion of a state bank to a national bank and the conversion of mutual savings banks to stock banks and the associated OCC and OTS rules the decision makers are the directors, stakeholders, and regulators. Despite the variance in the decision makers among these NCUA, OTS, and OCC conversion situations, in all cases the applicable rules and the requirements placed on the converting institution by the rules ensure the decision makers make an informed decision. Accordingly, these OTS and OCC rules are appropriate precedent for NCUA's rule.

Regulatory Conversion Provisions[2]	NCUA (CU to MSB)	OCC (State Bank to National Bank)	OTS (State/ Federal MSB to Federal Stock Bank)	OTS (State MSB to Federal MSB)
Requires director approval of conversion plan	Yes	Yes	Yes. Two-thirds vote.	Yes
Requires director certifications	Yes	Yes	Yes	Yes
Requires legal or other third party opinions	No	Yes	Yes	Yes
Requires regulator approval	Methods and procedures only.	Yes	Yes	Yes
May require a regulator examination	No	Yes	No	No
May require a regulator meeting	No	Yes	Yes	Yes
Publication of notice of intent to convert	Yes	Yes	Yes	Yes
Solicitation of comments	Yes, member-to- director	Yes, public	Yes, public	Yes, public
May require a public meeting or hearing	No	Yes	Yes	Yes
Requires stakeholder approval	Yes	Yes	Yes	Yes
Sets a minimum level of stakeholder participation.	No. Simple majority of those who actually vote.	Yes. At least 51% of all voting stock must approve.	Yes. Majority of total outstanding votes must approve.	No.
Requires general disclosures to stakeholders or public	Yes	Yes	Yes	No

[2] OCC regulations applicable to the OCC conversions include 12 CFR part 5, §5.24(d) and the incorporated Comptroller's Licensing Manual. OTS regulations generally applicable to mutual-to-stock conversions include 12 CFR part 516, §§543.1, 543.8 through 543.14, 544.1 through 544.5, and the incorporated OTS Form AC. OTS regulations generally applicable to the conversion of a state MSB to a federal MSB include 12 CFR parts 516 and 563b and the incorporated §§420 and 430 of the OTS Applications Handbook.

Requires specific disclosures to stakeholders	Yes	No	Not currently, but may require (see, for example, OTS TB 58).	No
Provides a process for communication among stakeholders	Yes	Yes	Yes (two different methods)	Yes
Restricts date of record for stakeholder voting purposes	Yes	No	Yes	N/A
Provides deadline for completing conversion	Yes. 18 months	Yes. Six months.	Yes. 24 months.	Yes. 24 months.
Can add additional requirements on converting institution through policies incorporated into regulation	No	Yes	Yes	Yes
Other significant requirements.	No	Yes, e.g., business plan, subsidiaries, non-conforming assets, insider compensation.	Yes, e.g., detailed conversion plan, business plan.	Yes, e.g., business plan, CRA.

After comparing NCUA's final rule to these OCC and OTS rules, the Board believes NCUA's final rule, taken in its entirety, does not confine a converting credit union's actions or choice more than these OCC and OTS rules taken in their entirety. Accordingly, NCUA's final rule is "no more or less restrictive than the rules governing charter conversions by other financial institutions." 12 U.S.C. 1785(b)(2)(G)(i).

Several commenters suggested NCUA lacked legal authority for its proposed revisions to part 708a. Some of these commenters focused on the NCUA's reliance on particular provisions in the regulations of other regulators, including state regulations. These commenters made the following arguments:

- The FCUA requires NCUA to look only to the rules of other federal regulators, not state regulators, for precedent;

- The FCUA does not permit NCUA to consider the rules of non-bank financial regulators (e.g., the Securities and Exchange Commission or the Farm Credit Administration) as precedent;

- The FCUA requires NCUA to look only to the conversion regulations governing the loss of a converting institution, not the gain of a converting institution; and

- The FCUA prohibits NCUA from referring to the rules surrounding mutual-to-stock conversions as precedent because stock conversions are amendments to an existing charter, not charter conversions.

The Board does not find any support for these limitations in the text of the FCUA. The phrase "including the Office of Thrift Supervision and the Office of the Comptroller of the Currency (OCC)" modifies the phrase "other financial regulators" and is not a limitation. The word "including" references the OTS and the OCC by way of example and does not limit NCUA to considering only the rules of the OTS or OCC, or only the rules of federal regulators or banking regulators, or only the rules applicable to the loss, but not the gain, of a converting institution. Likewise, the plain language of the phrases "other financial institutions" or "other financial regulators" does not limit NCUA as suggested by these commenters. Further, the plain language of the statute does not direct NCUA to consider only the conversion regulations governing the loss of a converting institution. As discussed in the preamble of the proposed rule, there is no legislative history for these FCUA provisions, and so there is nothing in the legislative history that would support such narrow interpretations. _See_ 71 FR 36946, 36947 fn.3 (June 28, 2006).

Despite the absence of anything in the FCUA or legislative history that suggests NCUA should restrict its search for precedent as described above, some commenters argue that, because NCUA is regulating the conversion of an institution that is leaving NCUA's jurisdiction, it should look only to OTS and OCC rules that govern conversions where the OTS or OCC is also losing a regulated institution. The Board carefully considered this argument and concluded that reliance on these types of OTS and OCC rules as precedent would be inappropriate.

The Board first considered the conversion of a federal MSB to a state MSB. The OTS has rules applicable to this process, and the OTS would, in most of these cases, be losing regulatory authority over the converted institution to a state regulator. The OTS does not impose any significant procedural requirements on these conversions, which is understandable because there is no shift in ownership interests or rights when one MSB converts into another MSB. The NCUA Board believes, however, that the conversion from a credit union to an MSB is different because it involves a diminution of ownership rights. Some key differences between credit union and MSB membership are:

- FCU members exert control over the affairs of the institution through their voting power, not delegable by proxy. 12 U.S.C. 1760. MSB members not only can delegate their votes by proxy, but they can give them up forever in the form of running proxies. OTS staff has stated that "[t]he use of these proxies, coupled with the management's control over meetings of a mutual savings institution, attenuates the influence that depositors may have."[3]

- FCU members have the right to one-member, one-vote. MSBs, for the most part, give greater voting power to depositors with larger deposits.[4]

- The net worth of a credit union belongs to its members, and they may recognize it in a variety of ways, including lower loan rates and higher savings rates than banks (*See* 71 FR 36946, 36953 (June 28, 2006)) and the special dividends paid by many credit unions. *See, e.g.* *Loan Growth, Excess Capital Play Huge Role in Dividend Payouts*, Credit Union Times, January 4, 2006, at p. 1.

- Ownership is measured not only in terms of possible rewards, but also in terms of the assumption of risk – and credit unions and MSBs are different in this regard as well. Dividends on FCU shares are not a contractual right, as is interest on a bank certificate of deposit, but may only be paid if the FCU has sufficient retained earnings. 12 U.S.C. 1763; NCUA OGC Legal Opinion 96-0917 (January 22, 1997), located at www.ncua.gov. In the event of a credit union liquidation, unsecured creditors have priority over members to the extent of the members' uninsured shares,12 CFR 709.5(b)(5) and (6), unlike bank depositors who take equally with unsecured creditors to the extent of uninsured deposits. See, e.g., 12 CFR 360.3(a)(6).

- As discussed below, credit union directors have a fiduciary duty to act in the best interests of credit union members. While MSB directors have a fiduciary duty to act in the best interests of the institution, there is no apparent duty to act in the best interests of the MSB members, at least for federal MSBs.[5] The shift in fiduciary duty when a credit union converts to

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[3] D. Smith and J. Underwood, Memorandum: Mutual Savings Associations and Conversion to Stock Form, p. 17 (Office of Thrift Supervision, Business Transactions Division, May 1997)(OTS Conversion Memorandum).

[4] Some credit unions converting to MSBs have announced that they intend to maintain the one-member, one-vote method of voting. Even so, NCUA believes that, with the use of running proxies, the directors of an MSB could easily change the MSB's charter to establish account balance voting.

[5] The Home Owners' Loan Act does not describe any duty to act in the best interests of a federal MSB's member-depositors. 12 U.S.C. §§1461 *et seq*. OTS regulations refer only to the director's duty to act in the best interests of the institution. See 12 CFR 563.200 (Conflicts of Interest) and 563.201 (Corporate Opportunities). The OTS Thrift Activities Handbook makes numerous references to the fiduciary duties of MSB directors, but none of these state a duty is owed to the members. One state case refers to a director's fiduciary duty to the members of a state-chartered MSB. *Appeal of Concerned Corporators of the Portsmouth Savings Bank*, 525

an MSB, and the associated loss of focus on the members, diminishes the member's ownership rights.

The diminution in ownership interests when a credit union converts to an MSB make this conversion fundamentally different than an MSB to MSB conversion. Credit union members need the procedural protections afforded by NCUA's rule, while MSB members need little or no protection when converting from one form of MSB to another. Accordingly, the NCUA does not believe the particular OTS rules associated with conversions from a federal MSB to a state MSB are appropriate precedent for NCUA's rule.

The Board also considered the OCC process for converting a national bank to a state bank, where the OCC loses jurisdiction over the converted bank. Two provisions in OCC regulations and federal law work in tandem to provide significant protection to the ownership interests of the converting bank's stockholders. First, the conversion requires the approval of two-thirds of all the outstanding stock. 12 CFR 5.24(e); 12 U.S.C. 214a. Second, those stockholders who dissent to the conversion have the right to an appraisal and a cash payment in exchange for their ownership interests. 12 CFR 5.24(e); 12 U.S.C. 214c. Together, these two provisions ensure that no conversion takes place unless a significant majority of the ownership interests support conversion and also that minority ownership interests are protected through the right to cash out their ownership interests. NCUA, however, cannot adopt a similar approach to protect the ownership interests of credit union members. The FCUA establishes the voting threshold for MSB conversions as "the affirmative vote of the majority of the members of the insured credit union who vote on the proposal." 12 U.S.C. 1785(b)(2)(B). This FCUA provision not only does not protect the members in the manner a supermajority would, it hypothetically would allow the directors of a credit union to convert it to an MSB even if only a handful of members approve. Accordingly, NCUA does not believe the OCC process for converting national banks to state banks is appropriate precedent for NCUA's rulemaking. The better approach is to ensure that, through the various notice, disclosure, and communication channels in this final rule, the directors and members will make a careful and informed conversion decision. The approach in this final rule is similar to the approach taken by the OTS and OCC in other charter conversions, such as the OTS mutual-to-stock charter conversion rules, the OTS state MSB to federal MSB conversion rules, and the OCC state bank to national bank conversion rules discussed above.

The Board disagrees with commenters who state OTS rules governing mutual-to-stock conversions are not relevant to NCUA's rulemaking because these are not "charter" conversions. These commenters state that, because the OTS may

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A.2d 671 (N.H. 1987). OTS staff, in reviewing the *Portsmouth* case, stated "the court's decision was based primarily upon the fact that the depositors' rights in this transaction were specifically provided for in the savings bank's charter, a special charter granted by the state legislature in 1823. Since charters of most savings institutions, including those of federal mutual institutions, do not have the unique provisions of the New Hampshire savings bank's charter, the *Portsmouth* decision is of limited precedential value." OTS Conversion Memorandum, *supra* note 3, at 23.

technically amend the existing charter when a federal mutual bank converts to a federal stock bank, and not issue a new charter, it is not a charter conversion. First, NCUA notes that the FCUA does not define the term charter conversion, and that NCUA has significant discretion to define and interpret the FCUA, both in general and in terms of its specific authority to administer the conversion vote as discussed above. In the Board's view, a mutual-to-stock conversion is a *de facto* charter conversion because the mutual-to-stock conversion results in a fundamental restructuring of ownership interests and, usually, a wholesale change in owners. The Board also notes that OTS rules on mutual-to-stock conversions cover not only federal-to-federal stock conversions, but also state-to-federal stock conversions. 12 CFR 563b.430. In a state-to-federal stock conversion, OTS will not amend the state charter, but will issue a new federal charter. In both form and substance, this is a charter conversion.

Accordingly, NCUA is satisfied that the proposed rule, and this final rule as adopted, are well within the rulemaking authority provided by Congress to NCUA.

C. ***Section by Section Analysis***

708a.1 Definitions.

The current §708a.1 contains definitions for the terms credit union, mutual savings bank, savings association, federal banking agencies, and senior management official. The proposal added a definition for "clear and conspicuous," meaning "text that is in bold type in a font at least as large as that used for headings, but in no event smaller than 12 point." The proposal also added a definition for "regional director" to clarify that, for natural person credit unions, it means the NCUA director for the region where the credit union's main office is located and, for corporate credit unions, it means the Director, NCUA Office of Corporate Credit Unions.

One commenter thought the use of bold text at least as large as that used for headings but in any event no smaller than 12 point would not necessarily be clear and conspicuous. This commenter recommended a definition of "clear and conspicuous" like NCUA uses for its privacy rules at 12 C.F.R. 716(3)(b). Another commenter stated that NCUA should define what it means by headings.

Upon consideration of these comments, the Board has modified the definition of clear and conspicuous to mean "text in bold type in a font size at least one size larger than any other text used in the document (exclusive of headings), but in no event smaller than 12 point." The Board believes that this definition will be easier for converting credit unions to apply, particularly if there are multiple headings with different font sizes, while ensuring members notice the information. The Board notes that if the document contains multiple passages that must be clear and conspicuous all these passages would be the same font size.

708a.2 Authority to convert.

The current §708a.2 recites the authority of a federally insured credit union to convert to a mutual savings bank or savings association as provided in the FCUA. The proposed §708a.2 maintained this same recitation. NCUA received no public comments on this section, and the section is adopted as proposed.

708a.3 Board of directors' approval and members' opportunity to comment.

The current §708a.3 provides the board of directors must approve a conversion proposal by a majority vote and set a date for a member vote. Members must approve the proposal by the affirmative vote of those members who vote on the proposal.

The proposed rule retained the same requirement for a board vote on the conversion proposal but clarified that directors may vote in favor of a conversion proposal only if they have determined that the conversion is in the best interests of the members. The proposal also contained a new requirement for advance notice to members of the board's intent to consider a conversion proposal. The board must publish a notice in a local area newspaper and on the credit union's website, as well as post a notice in the credit union's offices, no later than 30 days before the directors meeting. Directors must consider the comments before voting on the conversion proposal. The proposal also required that, if the credit union maintains a website, the credit union must post any comments received on its website.

The fiduciary duty of the board of directors (public comments).

Proposed §708a.3(c) required the directors adopting a conversion proposal to determine that the conversion is in the best interests of the members. A related provision in proposed §708a.5 required directors to certify to NCUA that the conversion is in the best interests of the members. NCUA received many comments on this issue of the fiduciary duty of the board of directors to its members.

One commenter felt the fiduciary duty of the board of directors to act in the best interests of members was self-evident and needed no reference in the rule.

One commenter asked NCUA to clarify that its interpretation of fiduciary duty, that the officers and management must act in the best interests of the members, is not a departure from traditional interpretations of fiduciary duty. This commenter believes the directors' deciding to act in the best interests of members is part of deciding whether the conversion is in the best interests of the institution.

One commenter noted the concept of fiduciary duty is discussed only in the preamble to the proposed rule, and the rule itself should state the credit union officials have fiduciary duties and should define fiduciary duty as "[a] legal obligation directors and senior management have in their capacity as officials of

the credit union to place the interests of the credit union's membership ahead of their own personal financial interests." This commenter felt the proposed voting guidelines should be further expanded to include a discussion of the obligations of credit union officials to act with due care and prudence, with loyalty to the membership, and in good faith.

Another commenter suggested NCUA include guidance to directors on how this determination is to be made. This commenter gave an example: If a credit union is seeking to convert in order to increase its member business lending activity, how has the board assessed whether members are interested in obtaining more loans of this nature?

One commenter suggested the rule require a board to obtain an opinion from an unbiased third party to validate the directors' determination that a conversion was in the members' best interests. Another suggested the board should obtain an opinion from counsel that discusses the board's compliance with applicable legal requirements. This commenter thought the opinion should be made available to members upon request.

One commenter expressed concern that, in some states, the officials of a state-chartered credit union may not have a fiduciary duty that runs to the members of the credit union, citing *Save Columbia CU Committee v. Columbia Community Credit Union*, 139 P.3d 386 (2006).

The fiduciary duty of the board of directors (discussion).

The FCUA has numerous references to the duty to act in the best interests of the credit union's members, including:

- The NCUA Board may act to remove or prohibit any institution-affiliated party at a federally-insured credit union if that action meets certain requirements, including that the "interests of the insured credit union's members have been or could be prejudiced." 12 U.S.C. 1787(g)(1)(B).

- Credit unions applying for federal account insurance must agree to maintain such special reserves as the NCUA Board may require "for protecting the interests of the members." 12 U.S.C. 1781(b)(6).

- The NCUA Board must review the application of any individual to become a director or senior manager at a newly chartered or troubled federally-insured credit union, and disapprove that application, if acceptance of the applicant would not be in the best interests of the depositors (members). 12 U.S.C. 1790a.

- When acting as the conservator or liquidating agent of a federally-insured credit union, the NCUA Board may take any action it determines is in the best interests of the credit union's account holders (members). 12 U.S.C. 1787(b)(2)(J)(2).

- A voluntary liquidation of an FCU must be in the best interests of the members. 12 U.S.C. 1766(b)(2).

Most of these FCUA provisions on the duty to act in the best interests of the members refer specifically to the NCUA Board. A closer look at how the cited provisions function, however, connects them to the directors. Specifically, the best interests of the members will dictate the Board's actions when removing or prohibiting a director, approving the appointment of a director, operating a conserved credit union in the role of the board of directors, and reviewing the propriety of a board of directors' decision to pursue a voluntary liquidation. If the best interests of the members standard guides the conduct of the Board, it must also guide the conduct of directors.

NCUA believes it is important for the directors of every credit union to understand the duty to act in the best interests of the members. It is particularly important, however, that the directors recognize this duty and act upon it when considering a proposal to convert a credit union to a bank.

First, there is a financial incentive, as discussed in the preamble of the proposed rule, for the directors of a converting institution to put their own personal financial interests ahead of the interests of their members. 71 FR 369546, 36953-56 (June 28, 2006).

Second, there may be a tendency by directors of a converting credit union to focus solely on the projected growth of the converting institution and acquiring new customers and not to focus, as the best interests of the members standard suggests, on the financial services existing members want and how the conversion will affect the quality, rates, and fees associated with these services. NCUA's boxed disclosure on the relative rates at banks and credit unions is relevant to this issue, and converting credit unions should be able to explain how and why their institution will be different than the average bank in this regard.

Third, as discussed previously, a conversion to an MSB dilutes the ownership interests of the members. Further, if the MSB subsequently converts to a stock bank, as about ninety percent of converting credit unions ultimately do, the vast majority of the former credit union members will likely not subscribe to the stock offering.[6] This, in turn, either deprives former credit union owners of any ownership interest, or, in the case of a mutual holding company structure,

[6] There is significant anecdotal information supporting the conclusion that member participation in IPOs is extremely low. "Long-time members of IGA FCU were mostly left out of the money when IGA became the first credit union convert to sell stock . . . . [F]ewer than 5% of the 22,200 members of the credit union shared in the profits from the sale of the institution." Credit Union Journal, November 13, 2000, p. 1. "All who had their subscriptions filled were depositors-but only 5% of all depositors subscribed." FDIC Review, Mutual-to-Stock Conversions of State Nonmember Savings Banks, 59 FR 30357, 30359 (June 13, 1994). And, in just the past few months, "about 3,500 depositors at ViewPoint Bank, the former Community Credit Union, subscribed to [the IPO] . . . . The 3,500 members represent 1.56% of the [CU's] 223,000 members . . . ." Credit Union Times, October 4, 2006, at www.cutimes.com.

creates a competing minority stock ownership class that can, and does, result in benefit to the minority stockholders at the members' expense.[7]

Some converting credit unions, and law firms that advise them, have written NCUA suggesting that, because credit union members cannot force a distribution of credit union assets, or transfer or pledge their interest in the credit union for value, the members have little or no real ownership interest in the credit union. This view ignores the fiduciary duty that credit union directors owe to their members. The duty owed by credit union directors is analogous to the duty owed by a trustee to the beneficiaries of a trust. In a typical family trust, the trustees have discretion in the management and distribution of the trust assets. Many family trusts also have provisions forbidding the beneficiaries from pledging, selling, or otherwise alienating their interests in the trust. The inclusion of these provisions in the trust agreement, however, does not result in any loss or diminution of the beneficiaries' ownership interest in the trust. On the contrary, any trustee who might manage trust assets other than in the interest of the beneficiaries, including using the trust assets for his or her own personal gain or attempting to take personal ownership of trust assets, would be guilty of a gross breach of fiduciary duty.

All these factors make it imperative that the board of directors of a converting credit union understand they must act in the best interests of their members. A conversion from a credit union to a bank should only take place after the board has completed its due diligence, including consideration of the above factors, and an informed membership has approved the conversion. Directors should question the assertion of any consultant that minimizes the ownership rights of members or their fiduciary duty to members.

NCUA believes this delineation of a board's fiduciary responsibility to members restates existing law without change or modification. In the normal course of business when a board acts in the bests interests of the credit union it is also furthering the interests of the members. But the duty to act in the best interests of members is primary, and, if there is any divergence or conflict between the interests of the institution and the interests of members, the latter takes precedence.[8]

The Board has considered the views of commenters who believe the rule should provide additional information on the fiduciary duty standard and how compliance with that standard is measured in the conversion context. The Board offers the following additional guidance.

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[7] FDIC Review of Mutual-to-Stock Conversions of State Nonmember Savings Banks, 59 FR 30357, 30363 (June 13, 1994).

[8] One situation in which the best interests of the institution and the members may diverge is the possible voluntary liquidation of a healthy credit union. The FCUA provides that the decision to undertake a voluntary liquidation is determined by the best interests of the members and not the best interests of the institution. 12 U.S.C. 1766(b)(2).

The Board believes that members want their depository institution to provide the types of financial services that they need. They want those services to be convenient and of high quality. And they want those services to be provided at a good price, meaning good rates and low fees. Accordingly, when directors consider a conversion to the bank they should, as part of their due diligence and in consonance with the duty to act in the best interests of the members, answer the following questions: What financial services do the majority of my members want? How do I know this? Can the institution best provide these services to its members as a credit union or a bank? If the credit union converts to a bank, how will that affect the rates and fees that the institution charges the members for these services? And if the credit union converts to a bank, will it be able to offer members (now customers) something in the way of services or value that existing banks in the area are not offering?

Mere assertions that a charter change is needed to facilitate growth are not, by themselves, sufficient to establish that the change is in the best interests of the members.[9] While post-conversion growth may possibly result in profits and dividends payable to the bank's future stockholders, it does not necessarily follow that the credit union's members also benefit.[10] Accordingly, if the directors rely on growth as a reason for conversion, they should establish specifically how accelerated growth will benefit the members in terms of providing services the members want, higher quality services, and better pricing on those services.

This guidance is provided by way of example and is not intended to be all inclusive of a director's due diligence. The nature of the due diligence required may vary somewhat from credit union to credit union depending on each credit union's particular circumstances.

NCUA has also carefully considered the decision of the Washington state appellate court in *Save Columbia CU Committee v. Columbia Community Credit Union*, 139 P.3d 386 (Wash. Ct. App. 2006)(*Save Columbia*) and how it affects the proposed certification requirement. One of the issues considered by the court in *Save Columbia* was if members of the Columbia Community Credit Union, a state-chartered credit union, had standing to bring a breach of fiduciary duty claim against the directors. In reversing the trial court, the appellate court ruled that the Committee (i.e., the members) had no private action to sue for a breach of fiduciary duty and that such duty must be enforced by the state regulator. While NCUA does not necessarily agree with the holding or reasoning of the state court, any inference that the directors owed no duty to the members of the credit union was dicta and not necessary to the holding. NCUA also believes it unlikely that under Washington state law, or the laws of any other state, the directors of a state-chartered credit union owe no fiduciary duty to their members.

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[9] The only time that growth, by itself, would be sufficient to justify a charter change would be in the highly unusual case where the credit union cannot survive as a credit union and so the continued existence of the institution requires a charter change.

[10] As discussed above, *supra* note 7 and associated discussion, historic data suggests only a tiny fraction of the credit union's members will become future stockholders.

The *Save Columbia* court did not consider how the FCUA might apply to the facts in that case. When a state-chartered credit union applies for, and receives, federal account insurance, it is bound by those portions of the FCUA applicable to federally-insured credit unions. 12 U.S.C. 1781 *et seq*. (Title II). Four of the five FCUA citations to the duty to act in the best interests of members are found in Title II of the FCUA and so are applicable to all federally-insured credit unions, including state charters. Accordingly, the FCUA imposes a duty to act in the best interests of the members on the directors of all federally-insured state-chartered credit unions regardless of whether state law also imposes such a duty.

Advance notice (comments).

Most commenters supported the advance notice requirement, and some commenters suggested additional ways a credit union should provide the advance notice, including the use of statement stuffers, newsletters, and e-mails or a notice on the quarterly periodic statement preceding the meeting. Many commenters felt a credit union should be required to send an advance notice directly to members, either by mail or e-mail. One commenter believed that, in addition to the advance notice, the portion of the directors' meeting on the conversion proposal should be open to the membership or, alternatively, the directors should be required to hold a town hall style meeting immediately after they adopted the conversion plan. Another commenter made a similar suggestion but suggested the meeting be a special meeting of the members.

One commenter suggested the rule require 60 days notice instead of 30 days; another suggested 120 days. These commenters believe the additional time would allow for better communications between members and directors without adversely affecting the conversion process.

Several commenters objected to the advance notice requirement. Some did not think NCUA had the authority to require advance notice, stating variously that the FCUA limited the notices to members to three and that a fourth notice violated this limitation or that the advance notice was contrary to the FCUA provision that a proposal to convert "shall first be approved . . . by a majority of the directors." Other objections to the advance notice included statements that it would:

- Not provide meaningful information to credit union members or a credit union's board of directors;
- Fuel the spread of misinformation;
- Generate submissions only from dissenters and those would lack value because they would be based on incomplete information about the proposal;
- Interject member participation at a very early stage in a manner unlike most other corporate governance situations;

- Constitute a member vote before the board vote;

- Lead to an ill-informed director vote based on limited input;

- Undermine the authority of the board of directors because the members elect their board of directors to study and make all types of business decisions on behalf of the members;

- Be costly and burdensome for the credit union;

- Impair the ability of a board to act quickly and decisively on a conversion proposal; and

- Discourage candid and informed discussion among the directors.

Some commenters stated the credit union should not have to post views of nonmembers on its website. One commenter suggested NCUA should provide additional guidance on posting of member comments, including whether the comments must be put in an particular order; how long the comments must remain on the website; whether a credit union has the right to respond to comments and in what manner may it respond; whether the credit union is responsible for any misinformation in the postings; and whether there are any privacy concerns that must be addressed when posting member comments.

Advance notice (discussion).

NCUA does not believe the language of the FCUA prohibits an advance notice requirement. The 90-, 60-, and 30-day notice requirements enumerated in the FCUA are not exclusive, and, in any event, relate only to the notice of the member vote and so are different than the proposed advance notice of a directors meeting to adopt a conversion proposal. The advance notice is also not an approval requirement, so that the notice requirement does not contravene the FCUA provision that the conversion proposal must first be approved by the board of directors.

As stated in the preamble to the proposed rule, NCUA intends the advance notice requirement to facilitate the flow of information between members and directors. NCUA does not believe information provided by a member to directors undermines the directors' authority, discourages candid discussion among the directors, or otherwise impedes their ability to make an appropriate and timely decision. Directors should welcome member input and are free to consider any particular member's point of view and reject it. Directors are also free to obtain additional information from their members, beyond the input received as a result of the advance notice, by using member surveys, questionnaires, or other collection techniques.

NCUA has, however, reconsidered the proposal to require posting of the member's comments on the credit union's website. The intent of the advance notice is to inform members that a credit union is considering a conversion and to facilitate member-director contact, not member-member contact, in the period of time preceding the directors' decision on the conversion proposal. As noted by some commenters, posting member comments does not directly further the stated purposes of the advance notice, and the posting does impose some burden on the converting credit union in determining the propriety of particular postings. Accordingly, the final rule does not require the converting credit union to publicize comments received before the adoption of a conversion proposal. As discussed below, this final rule does include other procedures to facilitate member-to-member contact in the period of time following the directors' adoption of a conversion proposal.

NCUA also considered alternatives suggested by commenters for communicating the advance notice to the members. NCUA believes its proposal for publication and posting in the credit union's branch offices and on its website minimizes the burden on the credit union while ensuring that members have a reasonable chance to learn of the proposal and provide input to directors. One commenter suggested that the rule be clarified to require the advance notice be posted in the lobby of a converting credit union. NCUA agrees with this clarification and has made the suggested change to the final rule. Converting credit unions are, of course, free to use additional methods of communicating, including mailings, statement stuffers, newsletters, and e-mails.

Accordingly, and except as described above, NCUA adopts §708a.3 as proposed.

708a.4 Disclosures and communications to members.

Section 708a.4 of the current rule, entitled Voting procedures, provides for a member vote on the conversion at a special meeting or by mail and describes the notices that must be provided to members 90, 60, and 30 days before the vote. It prescribes certain information and disclosures that must be in the notices. It also requires the vote must be by secret ballot and conducted by an independent entity.

The proposal contained several changes to §708a.4. It modified the mandatory boxed disclosures the board of directors must give to members once the board has approved a proposal to convert to read:

IMPORTANT REGULATORY DISCLOSURE ABOUT YOUR VOTE

The National Credit Union Administration, the federal government agency that supervises credit unions, requires [insert name of credit union] to provide the following disclosures:

1. LOSS OF CREDIT UNION MEMBERSHIP. A vote "FOR" the proposed conversion means your credit union will become a mutual savings bank. A vote "AGAINST" the proposed conversion means your credit union will remain a credit union.

2. RATES ON LOANS AND SAVINGS. If your credit union converts to a bank, you may experience changes in your loan and savings rates. Available historic data indicates that, for most loan products, credit unions on average charge lower rates than banks. For most savings products, credit unions on average pay higher rates than banks.

3. POTENTIAL PROFITS BY OFFICERS AND DIRECTORS. Conversion to a mutual savings bank is often the first step in a two-step process to convert to a stock-issuing bank or holding company structure. In such a scenario, the officers and directors of the institution often profit by obtaining stock in excess of that available to other members.

The proposal required that these boxed disclosures be sent only with the three written notices and not with all written communications as under the current rule. The proposal also established procedures for members to share their views with other members during the 90-day notice period preceding the membership vote. The proposal further stated that the ballot must be sent only with the 30-day notice and may not contain any information other than a statement of the proposition being voted on, a short statement of the board's recommendation, and voting instructions.

Proposed boxed disclosure #1 (Loss of Credit Union Membership).

Most commenters supported the disclosure as written. These commenters thought members need to know precisely what a FOR vote and an AGAINST vote mean.

Some commenters thought the title line, "LOSS OF CREDIT UNION MEMBERSHIP," was unnecessarily negative and should be changed or eliminated. The Board disagrees that there is anything negative about the title. In every conversion, the converting credit union will emphasize why it wants to convert including what it perceives are the positive aspects of the conversion. Nothing in NCUA's rule prohibits such statements, as long as they are accurate and not deceptive. 12 CFR 740.2.

A few commenters also suggested that this proposed box disclosure on the effect of a "FOR" vote might be misinterpreted by a member as indicating that the

member's vote, by itself, would determine the outcome of the vote. To clarify this, the final rule amends this disclosure to read:

1. LOSS OF CREDIT UNION MEMBERSHIP. A vote "FOR" the proposed conversion means you want your credit union to become a mutual savings bank. A vote "AGAINST" the proposed conversion means you want your credit union to remain a credit union.

Proposed boxed disclosure #2 (Rates on Loans and Savings).

Most commenters strongly supported this disclosure. These commenters thought this disclosure highlighted a fundamental difference between banks and credit unions. Some of these commenters stated credit unions generally charge fewer and smaller fees than banks and recommended the disclosure should also address differences in fees. One such commenter suggested that, if NCUA did not have data on the fees banks and credit unions charge, it should commission a study. One commenter suggested that, in addition to the discussion of historic averages, the boxed disclosure should include actual examples of specific rate disparities. One commenter noted that, in addition to the data and studies cited by NCUA in the preamble to the proposed rule, a study by University of North Carolina Economist William Jackson, entitled *The Benefits of Credit Unions to North Carolina Consumers of Financial Services*, also supports this disclosure.

Several commenters thought the proposed boxed disclosure was misleading. One thought it implies rates on existing loans and deposits established by contract could be changed post-conversion. Another commenter thought the proposed language was not representative of the actual transaction being voted on: "the conversion to a mutual savings bank."

A few commenters objected to the disclosure because credit unions do not always have more favorable rates than banks. One commenter objected to the disclosure because it implies a credit union's current pricing is more attractive than the competition and its future pricing will be less attractive than the competition. This commenter also stated that, in a free market economy, the market place determines pricing, and that requiring this disclosure suggests otherwise.

One commenter dismissed the method by which NCUA uses the economic data, stating that it focused on one particular year (2002-2003) and particular data points rather than a more extensive and complete analysis including regional and market differences, market trends, and a full spectrum of products and services.

None of the commenters disputed the accuracy of the data supporting the disclosure. Contrary to the comments above, the data did not focus on one particular year or point in time, but covered three separate years of rates for thousands of banks and credit unions. The data were clear that for most loan and savings products credit union rates are, on average, significantly better than banks. While this is not true of *all* products surveyed, what is true is that for no

particular product was the average bank rate significantly better than the credit union rate. The boxed disclosure makes no statement about particular credit union rates, only average rates. Also, in this disclosure the generic word "bank" is more appropriate than the phrase "mutual savings bank." The disclosure is true of all banks, including both mutual and stock banks – and most converting credit unions convert to mutual banks and then to stock banks. Accordingly, the Board has determined the disclosure is not misleading.

NCUA requested data from DATATRAC on credit unions that had previously converted to banks, but DATATRAC had only incomplete data on them. NCUA also asked, in the preamble to the proposed rule, for comments on the rates at converted credit unions. NCUA received no comments responsive to this request. This lack of data on converted credit unions, however, is not critical. Looking at just the small number of previous credit union to bank conversions could, if one or more of the new banks ran promotional rates, skew the real effect of the conversion on rates. NCUA believes that averaging rates over a large number of banks and credit unions is the best way to remove the effects of occasional promotional rates. NCUA also has no reason to believe that the average rates at banks that were formerly credit unions will be different than banks that have always been banks, particularly with the passage of time following the conversion.

Accordingly, the Board does not believe this disclosure, as proposed, was misleading in any way, and the final rule adopts this disclosure as proposed.[11] The Board would also like to address a few of the other comments related to this disclosure.

First, the Board disagrees with the commenters who stated that the "marketplace" dictates the prices of loan and savings products, implying that credit unions and banks have no control over prices because prices are predetermined solely by external market forces. Clearly, depository institutions have some control over their prices, since competing depositories in a given market area can and do offer different prices for the same product. While external forces play a part in determining prices, internal factors such as how much of the product the depository wishes to sell and what margin it desires also play a part in setting prices. In particular, the cost of offering a product, including expenses, figures into the profit margin calculation and the pricing determination. Credit unions may also offer better prices than banks because lower loan rates and higher savings rates return value directly to the credit union's member-

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[11] NCUA compared average rates for banks and credit unions for 20 savings and loan products over a three year period. Recently, the General Accounting Office (GAO) completed a similar comparison of average bank and credit union rates for 15 savings and loan products over a five year period. The NCUA and GAO reached the same conclusion that, while there was virtually no difference between banks and credit unions in mortgage rates, the data "indicate(s) that credit unions offer more favorable rates on average than similarly sized banks for a number of savings products and consumer loans." *Greater Transparency Needed on Who Credit Unions Serve and on Senior Executive Compensation Arrangements*, U.S. General Accounting Office Report GAO-07-29, p. 57.

owners while, at least for stock banks and mutual holding companies, the bank may seek higher margins through higher pricing to benefit the bank's stockholders.

NCUA does not intend for these disclosures on savings and loan rates to keep a converting credit union from providing its views on the rate issue. On the contrary, NCUA wants members and directors to think about and discuss this issue, and for the directors to fully explain why their bank, after conversion, will differ from the average bank. In this regard, one commenter who objected to the proposed disclosure as bad policy gave the following reasons:

- The studies cited by NCUA do not compare the rates for converted credit unions pre-conversion and post-conversion, and the growth rates for converted credit unions are much higher after conversion than before conversion; and

- The NCUA makes comparisons using products, such as 60-month certificate of deposit (CDs), that typically do not compose a large proportion of a mutual bank's balance sheet.[12]

This comment raises important issues. If the converted credit union will charge less favorable rates to its members as a result of its growth, the Board questions how the conversion is in the best interests of the members or how members benefit from the growth, particularly if the bank converts to stock and the vast majority of members do not become stockholders, as historic data indicates. Also, if the converting credit union plans to reduce the availability of its term savings products after conversion, it should tell its members and explain why the members do not need the product. If the converting credit union plans to offer a 60-month CD, but at lower rates as is suggested by the average historic data, it should tell its members that as well.

Proposed boxed disclosures (Potential Profits by Officers and Directors).

Most commenters supported the proposed disclosure. One suggested an "actual, worst-case" example be provided. One suggested NCUA replace the word "often" in the phrase "often the first step in a two-step process to convert to a stock-issuing bank or holding company structure" with an actual percentage based on historical data.

The NCUA Board does not believe an example is appropriate. In addition, the use of an actual historical percentage would quickly become out of date as a result of future conversions.

[12] NCUA does not know if this comment about the proportion of a bank's balance sheet devoted to certificates of deposit is accurate. The DATATRAC data analyzed by NCUA included thousands of banks offering 60-month CDs. For example, the DATATRAC data for year-end 2005 included 60-month CD rates offered by 4,824 banks.

Several commenters objected to the proposed boxed disclosure and stated variously:

- The disclosure is speculative because the stock conversion may not take place and NCUA should not assume it will;
- The disclosure is misleading and inflammatory;
- OTS regulations ensure that officials are not enriched at the expense of depositors;
- NCUA does not have authority to require disclosures about transactions outside of its jurisdiction;
- The disclosure suggests unreasonably that stock option and stock benefit plans are unfair and unethical; and
- The disclosure is not balanced and should include statements about the benefits of such stock plans.

As discussed in the preamble to the proposed rule, a credit union that converts to an MSB converts to a stock bank almost ninety percent of the time.[13] An event that occurs about ninety percent of the time is not speculative. In addition, no commenter challenged the accuracy of the past insider benefits as discussed in the preamble.[14] Accordingly, the Board does not believe the proposed box disclosure is inaccurate or misleading. Additionally, if a credit union does not plan to convert to stock, it is free to tell its members. Of course, it may change its mind after conversion to a mutual, and credit union members should be aware that a converting credit union still could convert to stock.

OTS regulations do not purport to ensure that officials are not enriched, and the disclosure does not suggest that stock plans are unfair or unethical. As discussed above, credit union directors have a fiduciary duty to their members and so should inform their members when they might acquire ownership interests that otherwise belong to their members.

NCUA is not the only financial regulator to have recognized the benefits that officials gain in a stock conversion or to raise issues concerning conflicts of

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[13] 71 FR 36946, 36954 (June 28, 2006).

[14] The preamble to the proposed rule also contains a discussion of what management and officials at former credit unions obtained in stock and other benefits as a result of the stock conversion. *Id*. at 36954. Since the proposed rule was issued for comment, Viewpoint Bank, another former credit union, has converted to stock inside a mutual holding company structure. Based on the Viewpoint prospectus and other publicly available information, it appears that senior officials at Viewpoint made more than $1 million in profits on the IPO pop. The bank also set aside $13.9 million in free stock for its employees in the Employee Stock Ownership Plan, and intends to set aside another $7.8 million in free stock for senior officials in its restricted stock plan and another $3.1 million in stock for senior officials in its stock option plan.

interest and fiduciary duties. In 1994, the Board of Directors of the Federal Deposit Insurance Corporation (FDIC) ordered the publication of a review, authored by several senior members of the FDIC staff, of mutual-to-stock conversions by state nonmember banks.[15] This FDIC review stated that the mutual-to-stock conversion process was "fundamentally flawed." The review noted that the mutual-to-stock conversion process was designed to recapitalize struggling thrifts, not healthy ones, and that when a healthy thrift converted it typically resulted in a jump, or "pop," in the value of the stock at the initial public offering (IPO). The review then observed that the vast majority of member-depositors do not subscribe to and obtain the benefit of the IPO because of lack of knowledge, lack of resources, or both. As a result, the review stated, professional depositors and insiders obtain large ownership interests in the value of the IPO and the institution's stock. The FDIC review stated, "[w]e believe that for individuals who control the conversion transaction to lay any claim, in their capacity as managers and trustees, to a portion of the value being transferred creates a conflict of interest."[16]

The NCUA Board feels it important to also respond to suggestions that this boxed disclosure, or any of the boxed disclosures, lack balance. The FCUA requires membership approval of the conversion, and so the credit union has an incentive to advocate for conversion. In every conversion reviewed by NCUA, the converting credit union has set forth its reasons supporting the conversion at some length in the member notice. NCUA's past experience is that converting credit unions do not, however, want to present to their members the important information in the boxed disclosures. Accordingly, the disclosures, as written, create the balance that would otherwise be lacking. If the directors of a converting credit union believe the information about stock plans is unbalanced, they are free to include whatever accurate information they want in the notices about the perceived benefits of stock plans. Credit unions should explain to members why the conversion and important aspects of the conversion such as stock plans are in the best interests of members.

Proposed boxed disclosures (general).

[15] Review of Mutual-to-Stock Conversions of State Nonmember Savings Banks, 59 FR 30357, 30362-63 (June 14, 1994).

[16] *Id.* at 30361. The FDIC review proposed a solution that involved issuing stock purchase rights to stakeholders, including depositors. The stakeholder rights would be valued, in the aggregate, at the amount of capital the bank needed, and if the IPO produced additional capital, those stakeholders who had not exercised their stock purchase rights would be given the excess capital. Following publication of the review, the FDIC was inundated with more than 1000 comments from the banking industry. Five months later, the FDIC dropped its proposal with the statement that "[a]ny fundamental re-design of the conversion process should involve the appropriate legislative bodies, Congress or State legislatures." 59 FR 61233, 61235 (November 30, 1994). These issues of a large IPO pop, tiny participation by member-depositors, and windfalls to senior officials, remain today. *See supra* notes 5 and 10 and the accompanying text on the recent IPO of Viewpoint Bank.

Several commenters objected to requiring the boxed disclosures be sent only with the three formal notices and not with all written communications, as in the current rule. These commenters believe these disclosures are very important and a converting credit union may mislead members by failing to include this information with other written communications.

The boxed disclosure language is designed to accompany the notices to members of the member vote. The disclosure language does not necessarily fit well with other communications, such as communications that precede the adoption of a proposal to convert. Further, NCUA does not want the boards of converting credit unions to use the required disclosures as an excuse not to communicate with their members.

Several commenters suggested NCUA prohibit a converting credit union from disputing or refuting the boxed disclosures. Some of these commenters stated the boxed disclosures present facts, not opinion, and should not be subject to interpretation or rebuttal. One of these commenters stated NCUA approval of rebuttals of these required disclosures dilutes the effectiveness of these critical disclosures. This commenter believes attempts to disguise or disclaim federally required disclosures have traditionally resulted in disclosures being held to be defective and legally insufficient. This commenter analogized such rebuttals to allowing a rebuttal to the Annual Percentage Rate (APR) disclosure required by the Truth-in-Lending Act and Regulation Z.

NCUA's disclosures are not analogous to the APR disclosure required by Federal Reserve Board's Regulation Z. The APR calculation is a standardized numerical calculation meant to facilitate comparisons. NCUA wants to encourage communication and discussion, not discourage it. As discussed previously, if a converting credit union wants to make statements about its intent with regard to post-conversion rates or post-conversion stock benefits, it is free to do so.

Several commenters felt the disclosure relating to diminution of voting rights following conversion to an MSB should be retained as part of the boxed disclosures. NCUA believes this disclosure is important, and so must be made by the converting credit union in the body of the member notice. Including too much information in the boxed disclosures, however, reduces the probability a member will read and comprehend the disclosures. Accordingly, the final rule does not include this particular disclosure as a boxed disclosure.

A few commenters suggested other changes to the disclosures. One commenter that supports the proposed boxed disclosures believes the key language in the disclosures should be capitalized, as in the existing rule. The Board believes the disclosures are adequate without additional capitalization. One commenter suggested an additional disclosure informing members they may contact the appropriate NCUA regional office if they feel officials are not acting in the best interests of members. NCUA believes that members who are dissatisfied with the credit union's actions may use the NCUA complaint process that exists for all member complaints and that no specific notice of that process is necessary.

Some commenters suggested the boxed disclosure be expanded to include what those commenters perceive as advantages of the thrift charter over the credit union charter. A converting credit union is free to explain what it believes are the advantages of the thrift charter in the notice to the members.

One commenter thought the proposed requirement that the disclosures be placed immediately after the cover letter was "unworkable" because the credit union cannot control what its printer does or how a member opens an envelope. This commenter suggested NCUA only require best efforts in that regard. NCUA disagrees. A converting credit union can control the order in which the documents are placed in the envelope. When members pull out the materials, they will see the cover letter prepared by the directors, and the other documents should be placed in the appropriate order behind that cover letter.

Other required disclosures (general).

The current rule requires a converting credit union to disclose other information about the conversion, and the proposal retained these disclosures, including whether the converting credit union intends to convert to a stock entity; any conversion-related benefits to directors and senior management; and the effect of conversion on products and services, including the effect, if any, of the Qualified Thrift Lender (QTL) test applicable to federal MSBs.

Several commenters stated that disclosure of the intent to convert to a stock institution would violate the confidentiality requirement in §563b.120 of the OTS regulations.[17] Some of these commenters stated that requiring a credit union to state its conversion intentions would cause these decisions to be fueled by professional investors.

NCUA does not believe its required disclosure violates either the letter or the spirit of the OTS provision at 12 CFR 563b.120. The disclosure requirement does not violate the letter of §563b.120 because it applies only to the converting institution while it is a credit union, and the OTS rule applies only to the converting institution after it becomes an MSB. Accordingly, the institution can

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[17] 12 CFR 563b.120. This section reads as follows:

"May I discuss my plans to convert [to a stock institution] with others?
(a) You may discuss information about your conversion with individuals that you authorize to prepare documents for your conversion.
(b) Except as permitted under paragraph (a) of this section, you must keep all information about your conversion confidential until your board of directors adopts your plan of conversion.
(c) If you violate this section, OTS may require you to take remedial action. For example, OTS may require you to take any or all of the following actions:
(1) Publicly announce that you are considering a conversion;
(2) Set an eligibility record date acceptable to OTS;
(3) Limit the subscription rights of any person who violates or aids a violation of this section; or
(4) Take any other action to assure that your conversion is fair and equitable."

reference its intent before it converts and then remain silent about its further intent after it converts.

Moreover, the NCUA disclosure provision does not run afoul of the spirit of the OTS confidentiality provision. If an MSB violates 563b.120, the first element of the cure is for the MSB to make full public disclosure. 12 CFR 563b.120(c)(1). The confidentiality provision is designed to protect against limited disclosure to the benefit of select individuals, such as professional depositors, and to the detriment of the MSB membership as a whole. NCUA's disclosure provision is consistent with this intent because it ensures that all interested parties, including the credit union's membership, are aware of the credit union's intent to go to convert to stock and professional depositors and others with access to inside information will not have an advantage over the credit union's members.

NCUA is aware that professional investors can purchase private research predicting which credit unions are likely to convert to MSBs and then to stock banks. Professional depositors already have an information edge over the member-owners of a credit union and it is only proper that the board of a credit union keep its membership informed of its intentions when those intentions could have a fundamental effect on that ownership interest.

The Board also notes that the OTS has never informed NCUA that it objects to the NCUA requirement that a converting credit union disclose its intent with regard to a future stock conversion. In 2005, two Texas credit unions converted to MSBs. Their notices to members about the upcoming vote stated their intention, after the MSB conversion, to convert to stock institutions. Following the member vote, these credit unions requested OTS certify the member vote, and OTS issued formal certification orders. OTS Order No. 2005-24 (July 20, 2005) and Order No. 2005-23 (June 29, 2005). These orders state that OTS reviewed the text of the member notices. While the orders criticize some of NCUA's disclosure requirements, neither order mentions the disclosure of intent to convert to stock.

The ballot.

Most commenters strongly support the proposal that the ballot be sent only with the 30-day notice. These commenters believe members must have time to consider both the advantages and disadvantages of the conversion and to hear what other members have to say about the conversion before deciding how to vote. Several of these commenters also suggested NCUA require that a converting credit union allow a member to change his or her vote anytime up to the close of the special meeting. These commenters cited the balloting rules in Roberts Rules of Order and also those applicable to for-profit companies.

Several commenters objected to the requirement that the ballot go only with the 30-day notice, stating this would shorten the time frame for voting and discourage voters from voting. One commenter stated NCUA should not presume that voters need more time to vote absent evidence to the contrary.

One commenter suggested a credit union "mail the ballot separately from the 30-day disclosure."

NCUA has carefully considered both sides of this issue. NCUA has heard from members of converting credit unions that they need time, once the membership voting process has been launched, to communicate with one another and to consider their votes. The decision made by most converting credit unions not to allow members to change their votes once cast makes it imperative that the members receive and consider all relevant information before they cast an irrevocable ballot. NCUA wishes to balance the need for an informed vote with the burden on the converting institution. For example, it could be burdensome to allow voters to change their votes up to the close of the special meeting. It would also be a burden on a converting credit union to require all voting be done in person at the special meeting, and that no ballots be sent, or any votes cast, by mail.[18] NCUA believes that the proposed rule strikes the appropriate balance between voter's rights and the burden on the credit union. Accordingly, the final rule retains the requirement that the ballot be sent with the 30-day notice and not earlier.

One commenter noted that the statement on the ballot about loss of credit union membership required by proposed §708a.4(b)(4)(iii) did not track the corresponding boxed disclosure exactly, because it simply said "bank" and not "mutual savings bank." The text of the final §708a.4(b)(4)(iii) tracks the final version of the boxed disclosure.

One commenter objected to the proposed rule's limiting information on the ballot to a statement of the conversion proposal under consideration, the board's recommendation, and voting instructions. This commenter believes this constitutes censorship. NCUA disagrees. A converting credit union is free to make its case for conversion in the notice materials and other communications to members. The ballot itself should focus on the mechanics of voting and not include other information that may confuse members and keep them from exercising their voting rights.

The FCUA states that "[t]he member vote concerning charter conversion . . . shall be administered by the [NCUA]." 12 U.S.C. 1785(b)(2)(G)(ii). The courts have given a very broad meaning to the word "administer."[19] NCUA's authority to administer the vote certainly includes the authority to dictate the form of the ballot and its delivery.

[18] The FCUA is silent on ballot delivery. The FCUA language stating that the credit union "shall submit notice to each of its members . . . 90 days before the date of the member vote" could be interpreted to mean that the member vote must be conducted in person on the date of the vote, with no ballots sent, or votes received, by mail. 12 U.S.C. 1785(b)(2)(C)(i).

[19] As one court stated, "[t]he word 'administer' is one susceptible of a very broad interpretation . . . [t]o 'manage' is to control and direct, to 'administer,' to take charge of . . . ." *Costonis v. Medford Housing Authority*, 343 Mass. 108, 114 (Mass. 1961). Another court analyzing the use of the word "administer" stated that "[t]o administer a decree is to execute it, to enforce its provisions, to resolve conflicts as to its meaning, to construe and to interpret its language." *United States v. Hennen*, 300 F. Supp. 256, 263 (D.C. Nev. 1968).

Procedure for members to communicate with each other at the member's expense.

Most commenters supported the proposal's provisions for facilitating member-to-member contact, including the timing, advance payment amounts, and NCUA review of disputed materials. These commenters generally felt the proposal protected the rights of members to make their views known to other members without delaying the conversion or unduly burdening the credit union.

Several comments touched on the proposed amount of the required advance payment (50 cents per member) for hardcopy mailings. A few commenters though 50 cents was too low. One commenter said the cost of a member mailing was currently closer to one dollar per member. This commenter also suggested the regulation should accommodate changes in costs over time and recommended NCUA specify the advance payment rate in terms of a multiple of the first class postage rate or, alternatively, permit the converting credit union to establish some reasonable rate. Another commenter was also concerned about the "hard coding" of these costs, and suggested credit unions should determine the cost, within reason. Another commenter suggested NCUA set a maximum amount a credit union could seek for cost reimbursement. A few commenters were concerned about the collectability of the remainder of the reimbursement, and one suggested NCUA authorize a credit union to take additional monies, not to exceed the maximum amount, from a member's share accounts. One commenter stated the cost to a member should be based on actual amounts, and not specified in the regulations. One commenter asked if the reimbursable expense included any credit union overhead.

First, NCUA would like to clarify that the proposed rule did not require a member to pay the full cost of delivery in advance. Reimbursement is not required in advance, but the member must make an advance on the full reimbursement to ensure the communication is delivered. The credit union and member will subsequently work out the actual cost of delivery. The credit union may not take the remaining monies due out of the member's account unless the member concurs.

Second, the Board clarifies that the reimbursable cost only includes direct costs to the credit union. It does not include indirect costs or overhead. For example, if the credit union plans to use internal staff to prepare some or all of the mailing a credit union may not charge the member for staff salary or benefits. The final rule provides for this.

Third, NCUA agrees with those commenters suggesting that some advance payment formula adjusting with changes in future prices would be better than a fixed amount, at least for the advance payment on hardcopy mailings. Accordingly, the final rule replaces 50 cents, the proposed fixed amount, with an advance payment calculation using 150% of the first class postage rate on a letter of less than an ounce. The current first class postage rate is 39 cents, and

150% of that, or 58.5 cents, lies between the proposed 50 cents and the one dollar cost that the one credit union commenter suggested would be its total per-member cost of a hardcopy mailing.

A few commenters stated that, because of the impact of the bank conversion decision on members and their rights, a credit union should bear the entire cost of the member-to-member communication. These commenters questioned whether the cost of sending the communication might discourage some members from attempting to communicate with other members. Several of these commenters noted that converting credit unions spend large sums of money promoting the conversion and individual members opposed to the conversion cannot raise this kind of money. Some commenters suggested member comments be included with the 90-, 60-, and 30- day notices if received by the credit union before those mailings, citing SEC proxy solicitation requirements. One commenter suggested the credit union could put all member communications in one separate mailing to be sent before the 30-day notice. Another commenter suggested the credit union fund "a reasonable number" of these communications. Another commenter suggested that, if a member could obtain a certain minimum number of member signatures on a petition supporting a communication, the credit union should send it for free.

NCUA has carefully considered these comments. Members who only want their comments posted only on the credit union's website may do so for free. Other forms of distribution, however, may involve significant credit union resources. Members who feel strongly about delivery of their message to other members should be willing to pay to have it delivered. NCUA did not want all the communications to be sent together in one mailing because that might raise the issue of which communications (e.g., for or against the conversion) would be placed first. The petition idea is interesting, but there are only sixty days between the first notice and the mailing of the ballot, and NCUA is not sure that a petition would work given the time needed to gather and validate signatures. In addition, the idea of having the credit union fund a reasonable number of communications, but not all communications, raises issues such as the definition of "reasonable" and who will select those communications that will be sent for free and which must be paid for.

One commenter objected to the proposed communication procedures because of the resources a credit union would have to devote to determining which members have agreed to receive e-mail communications and which communications were not proper. This commenter felt the proposed provisions providing for the posting of comments in the credit union's branches and on its websites were sufficient communication methods. NCUA disagrees because such postings are not guaranteed to reach every member. If the member wants a communication delivered directly to other members and is willing to pay for it, the credit union should do it.

Credit unions should follow their customary mailing practices for member-to-member communications. For example, if a credit union regularly delivers

information or statements with respect to two or more members sharing the same address by delivering a single mailing to those members, referred to as "householding," then the credit union should follow this same practice for member-to-member communications. The householding method of delivery will reduce the amount of duplicative information that members receive and also lower printing and mailing costs for the credit union and, ultimately, the requestor.

One commenter stated that, as between e-mailing and regular mail, the regulation should clarify whether the requestor must select one method or the other, and, if a combination is permitted, how the advance payment is to be calculated. NCUA believes the rule is clear. The member may request that the communication be sent by mail, by e-mail, or both. In the latter case, the member must make both advance payments. Those members that have agreed to accept communications by e-mail will then get the communication by both mail and e-mail.

A few commenters were concerned that, if a credit union could not meet the timeline for review and delivery of a communication, postponement of the special meeting unduly burdens the credit union. Another credit union commenter stated that the proposal allowing only seven days to deliver the communication was unrealistic in that it would take at least 14 days to print, stuff, and mail the 90,000 pieces of mail required to reach that credit union's members.

The proposed paragraph 708a.4(f)(1) provided that:

> A converting credit union must mail or e-mail a requesting member's proper conversion-related materials to other members eligible to vote within seven days of receiving such a request if . . . . .

The Board has considered this and agrees a seven-day delivery standard may be overly burdensome. The final rule deletes the words "within seven days of receiving such a request" from paragraph (f)(1). The final rule retains the requirement, however, that the credit union must deliver the member communication on or before the date members receive the 30-day notice and ballot. There are at least 60 days between the date the 90-day notice is mailed and the date the members receive the 30-day notice. The rule provides that members have 35 days from the date of the 90-day notice to submit any communication requests to a converting credit union. That leaves at least 25 days (60 minus 35) for a credit union to process and deliver a communication. In the event of a disputed communication, NCUA has seven of those 25 days to review the communication, but that still leaves 18 days for a credit union to process and deliver the communication. The Board recognizes this timeline may be demanding, but it is certainly achievable. A large converting credit union should anticipate it may have to deliver several member communications on short notice and plan accordingly in advance of sending the 90-day notice.

A few commenters addressed the proposed standard for determining if a particular communication is proper and were supportive of the proposal.

A few commenters suggested the required member notices include a statement informing members they may provide materials for distribution to other members. Paragraph 708a.4(f)(9) of the proposed rule requires this, and the final rule retains this provision.

One commenter objected to the proposal and analogized such member-to-member communications as junk mail or spam. NCUA disagrees. Communications among members are part of the democratic character of credit unions.

One commenter stated that, after a credit union delivers a communication to its members, it should inform the requesting member that the communication has been delivered. NCUA agrees, and the final rule has been modified accordingly.

One commenter suggested a group of members might get together to request delivery of a single communication and the rule should specifically permit that. NCUA agrees, and has added a new subparagraph (f)(10) to address that situation. The converting credit union will refer to the group in the manner requested by the group, for example, with a single group name or by listing each member's name individually.

One commenter objected to NCUA resolving disputes over the propriety of the communication, stating this would constitute NCUA censorship of the conversion debate. The commenter claims OTS resolves disputes over the communications of MSB members only when requested. NCUA will perform a similar role to OTS. NCUA will only become involved when requested. If there is a dispute, the parties will request NCUA to resolve it, which is the same role OTS plays in MSB communications.

NCUA solicited comment on possible alternative methods of communication, including, for example, having the member prepare the communication for mailing, including sealing the envelopes and applying postage, with the credit union itself being responsible only for putting mailing labels on the envelopes and mailing them. NCUA received a few comments on this proposal. Some commenters thought this would put too much burden on a member. A few commenters supported the proposal but only if NCUA reviewed the communication before mailing for proper content. Another commenter thought this approach would reduce the burden on the credit union and the credit union should have the option of requiring the sender to prepare the mailing. After fully considering these options and comments, NCUA concludes that the form of communication as proposed is best, and not the alternatives.

One commenter stated NCUA should regulate the content of communications made by those opposed to the conversion in the same manner it regulates the content of communications made by the credit union itself. In fact, the rule

provides for NCUA review of comments made by the credit union and comments made through the credit union, regardless of whether those comments are for conversion or against conversion.

Accordingly, and except as discussed above, the final rule retains §708a.4 as proposed.

708a.5 Notice to NCUA.

The current §708a.5 requires that converting credit unions notify NCUA of the intent to convert within 90 days of the member vote. The credit union must provide NCUA with copies of the notice and material it has or will send to the members. A state-chartered credit union must provide NCUA with certain information about the laws and regulations it intends to follow with regard to the conversion. The current §708a.5 also permits a credit union, if it chooses, to provide notice to NCUA more than 90 days before the member vote, and to request a preliminary determination as to the proposed methods and procedures of the conversion.

Requirement for board certification.

The proposed rule provided for directors to submit to NCUA a certification of their support for the conversion proposal and plan. Each director who votes in favor of the conversion proposal would have to sign the certification.

The certification must include a statement that each director signing the certification supports the proposed conversion and believes that the proposed conversion is in the best interests of the members of the credit union. It must include a description of all materials submitted to the Regional Director with the certification and a statement that these materials are true, correct, current, and complete as of the date of submission. Finally, it must include an acknowledgement that federal law prohibits any misrepresentations or omissions of material facts in connection with the conversion. 18 U.S.C. 1001.

Most commenters strongly supported the proposed director certification requirement as written. These commenters think it is important that credit union directors understand their fiduciary obligations. Several commenters noted that, with the financial incentives to convert, the certification helps directors to focus on their fiduciary obligation.

Several commenters objected to the certification requirement. Some of these commenters believe it exceeds NCUA's statutory authority to impose such a requirement. Some of them felt the requirement will have the effect of deterring credit union board members from voting in favor of a plan of conversion by increasing the potential for litigation against directors. One of these commenters believed the vast majority of written comments received as part of the advance notice requirement would oppose the conversion process and that this, combined

with the certification requirement, would discourage board members from doing what they believe to be in the best interests of the credit union, its members, and the communities it serves. One of these commenters asked why only a conversion vote merits this certification when "other, equally fundamental changes do not," without identifying what changes are equally fundamental. One commenter stated that NCUA had not offered any evidence that in the past a board has skirted its fiduciary responsibility on this topic. One of these commenters suggests NCUA adopt certification requirements identical to the OTS certification requirements. One commenter objected to the certification but suggested that, if adopted, the reference to 18 U.S.C. 1001 should be expanded to indicate that the title 18 provision only applies to willful and knowing false certifications.

The Board has carefully considered these comments. Given the financial incentives to credit union officials in connection with conversion and the need to link the board's conversion due diligence to the interests of the members, the Board believes the certification requirement is both appropriate and necessary. This imposition of this certification requirement is within NCUA's authority, as discussed in the previous section on NCUA's rulemaking authority.

The Board has also considered the suggestion that the reference to 18 U.S.C. 1001 be expanded to indicate that the provision only applies to willful and knowing false certifications. The Board has examined similar citations to 18 U.S.C. 1001 used in director certifications submitted to OTS in connection with other charter conversions, and found no use of the words "willful and knowing."

Accordingly, the final rule retains the certification requirement as proposed.

Materials subject to NCUA review.

Proposed §708a.5(b) retained a credit union's right to request NCUA make a preliminary determination regarding the intended methods and procedures applicable to the membership vote. The proposal expands that right to allow a credit union also to request review of all of its proposed notices, including the public notice it intends to publish before the board of directors votes on a conversion proposal. Under the proposal, the NCUA Regional Director will make a determination on the request within 30 calendar days unless more time is required to review the submission or obtain additional information.

Virtually all the comments on the proposed expansion of reviewable materials supported the expansion. Accordingly, the final rule retains this provision as proposed.

Consultation with State Supervisory Authorities (SSA).

One commenter requested that, for converting state-chartered credit unions, NCUA specifically add a provision to the rule stating it will coordinate with the state supervisory authority on the conversion and conversion process. The

Board has added a provision that requires the Regional Director, upon notification from a state-chartered credit union that it has adopted a plan of conversion, to contact and consult with the credit union's SSA.

Accordingly, and except as described as above, this final rule adopts §708a.5 as proposed.

708a.6 Membership approval of a proposal to convert.

The current §708a.6 provides that the board of the converting credit union must certify the results of the member vote to NCUA within ten days of the member vote. The board must also certify that the materials actually provided to the members were the same as those previously submitted to NCUA or provide an explanation for any differences.

As noted previously, the proposed §708a.6 included the requirements found in the current §708a.4 that members must approve the proposal by affirmative vote of the majority of members who vote and the vote must be by secret ballot conducted by an independent entity.

Proposed §708a.6(b) required the board of directors to set a date determining member eligibility to vote. The proposal required the voting date of record be at least one hundred twenty days before the board of director's publishes the §708a.3 notice of intent to consider conversion.

Most commenters agree with the 120-day voting eligibility requirement. No commenters opposed the requirement, although one thought that 30 to 60 days was more appropriate, so as to disenfranchise as few legitimate members as possible. Another commenter thought the eligibility date should be as close to the advance notice date as possible.

NCUA agrees with the last commenter. The final rule modifies the voting eligibility requirement to no later than one day before publication of the advance notice. This will still minimize the impact of professional depositors while disenfranchising as few legitimate members as possible.

NCUA also solicited comment on whether it should permit electronic voting. Only a few comments addressed this issue. One supporter stated the opportunity to vote electronically must be consistent with the timetable prescribed in the proposed regulations and that integrity of the process must be verified and maintained. Dissenters were generally concerned about the possibility of fraud. Given the general lack of response to this suggestion, the final rule does not authorize electronic voting.

Several commenters recommended the rule be amended to prohibit the independent teller from providing interim updates to the credit union on the member vote. These commenters believe the credit union may abuse this information or that the information creates an unfair advantage because the

credit union management knows the vote tally while members opposed to the conversion do not. In the alternative, some of these commenters suggest that, if the teller is permitted to make interim voting reports available to credit union officials, then those reports should also be made available to all interested parties.

The interim reporting of voting results is not addressed in the proposed rule and so is beyond the scope of this rulemaking. The Board notes that, by requiring the ballot to be sent with the 30-day notice, the final rule mitigates any advantage that may be gained through interim reporting.

Accordingly, the final §708a.6 is adopted as proposed.

708a.7 Certification of vote on conversion proposal.

Proposed §708a.7 retained the requirement, currently located in §708a.6, that the board of directors certify the results of the membership vote to NCUA. No comments were received on this section, and the final rule retains §708a.7 as proposed.

708a.8 NCUA oversight of methods and procedures of membership vote.

The current §708a.7 provides that the Regional Director will issue a determination to approve or disapprove a credit union's methods and procedures for the membership vote within 10 calendar days of the receipt of the credit union's certification of the member vote.

The proposal lengthened this time period to 30 calendar days and relocated this provision from §708a.7 to §708a.8. Based on past NCUA experience, 10 days does not provide adequate time for the Regional Director to review all of the written materials provided to members, particularly if the credit union amended them in the process, and verify all of the information necessary to make the required determination.

Section 708a.8(d) of the proposal also contained a new provision permitting a credit union dissatisfied with a Regional Director's determination to appeal to the NCUA Board. Any appeal must be filed by the credit union within 30 calendar days after receipt of the Regional Director's determination.

Most commenters supported the proposed changes, including allowing the Regional Director 30 days to approve or disapprove of the methods and procedures of the vote and the proposed appellate process.

One commenter objected to the proposed appeal process as illegal. This commenter characterized the appeal as "mandatory," and stated a mandatory appeal was impermissible under the Administrative Procedures Act (APA), 5 U.S.C. 702 and 704; and *Darby v. Cisneros*, 509 U.S. 137 (1993). The Board intends the appeal to be permissive, not mandatory. Both the proposed and final

rules state that “[a] converting credit union **may** appeal the Regional Director’s determination . . . . “ (emphasis added). Accordingly, there is no APA issue.

708a.9 Other regulatory oversight of methods and procedures of membership vote.

Proposed §708a.9 retains the requirement, currently located in §708a.8, that the entity that will regulate the credit union following conversion must verify the vote and may direct that a new vote be taken. NCUA received no comments on this section, and the final rule retains the language as proposed.

708a.10 Completion of conversion.

This section retains the provisions in the current §708a.9 stating that, once the credit union has received the approvals required in the current §§708a.7 and §708a.8, it may complete the conversion. NCUA will then cancel its account insurance and, if it is a federal credit union, its charter.

The proposal amends the current rule to require a credit union to complete the conversion transaction within one year of the date of receipt of its approval from NCUA under proposed §708a.8.

Many commenters agreed with this one year completion window. One commenter suggested that NCUA grant the Regional Director authority to extend this window, upon request of the converting institution, for an additional six months. A few commenters objected to this provision. One of them thought two years was more reasonable.

The final rule permits the Regional Director, upon timely request and for good cause, to extend the one year completion period for an additional six months. This provides additional flexibility to converting credit unions, while still ensuring that the process moves along, that the membership vote will not become stale, and, as discussed in the preamble to the proposed rule, that NCUA can plan for efficient use of its examination resources.

Except as discussed above, the final rule retains §708a.10 as proposed.

708a.11 Limit on compensation of officials.

Proposed §708a.11 retains the limit on compensation for officials currently found in §708a.10. NCUA received no comments on this section, and the final rule retains §708a.11 as proposed.

708.12. Voting incentives (Proposed: Member access to books and records).

The proposed rule included a new provision on member access to the books and records of the converting credit union. The proposal stated that members may

request access to the books and records of a converting credit union for purposes such as facilitating contact with other members about the conversion or obtaining copies of documents related to the due diligence performed by the credit union's board of directors. The proposal also stated that FCUs will grant access under the same terms and conditions that a state-chartered for-profit corporation in the state in which the FCU is located must grant access to its shareholders.

Some commenters suggested that, in lieu of relying on the state law where the FCU is located, NCUA establish a particular standard for access to member books and records. These commenters noted that state law on records access varies widely from state to state. They also noted that, because of the way state corporation statutes are written, it is possible that a state court may decline to apply state corporate law to an FCU. Some commenters expressed concern about access to certain records, including member names and other sensitive personal information and safety and soundness information. One commenter suggested NCUA specify the kinds of documents members could review, such as the conversion proposal, the board minutes addressing conversion, and related documents. One commenter stated NCUA should require disclosure of all communications between the credit union and "outside promoters of the conversion." One commenter that supported the provision stated NCUA needed to provide a definition of where an FCU that does business in more than one state is located. One commenter believed access to FCU books and records should be governed by the same law that applies to records access for members of state-chartered mutual savings banks or members of state-chartered nonprofit organizations. One commenter thought it should be made clear that access to books and records does not give members permission to disrupt the normal course of business.

The Board has decided not to adopt a regulatory provision on member access to books and records at this time. FCUs should continue to follow existing legal opinions on member access to books and records, including NCUA OGC Legal Opinion 06-0127B (February 6, 2006), located on NCUA's website at www.ncua.gov.

Accordingly, the final rule does not adopt §708a.12 as proposed. Instead, the final §708a.12 addresses voting incentives. The text of the final §708a.12 is discussed below.

708a.13 Voting guidelines.

Section 708a.11 of the current conversion rule contains some guidelines to assist converting credit unions in conducting their member vote. The current guidelines discuss the interplay between state and federal law affecting the vote, the determination of who is eligible to vote, and the time and place of the special meeting at which the members will cast their ballots.

The proposal moved the voting guidelines to §708a.13. It retained the existing guidance and added additional guidance on the use of voting incentives.

Many commenters supported these proposed changes, although many also thought the rule should be amended to specifically prohibit the use of raffles or other voting incentives. Some of these commenters desire a blanket prohibition, while others want to prohibit only those incentives constructed to affect the outcome of a conversion vote or designed to encourage rapid voting (e.g., raffles that are only open to the first 500 voters). Some of the commenters supporting a blanket prohibition feel that voting incentives increase the participation of "casual" or "indifferent" members, while they do not increase the participation of those who "properly regard conversion as a matter of the highest importance." One commenter stated these incentives are intended to encourage members to vote quickly, before fully discussing the issue with other members. Some of these commenters distinguish the use of raffles in other contexts, stating that, while raffles may be permissible in other contexts, the importance of the charter conversion decision should keep out any mechanism that could skew the fairness of the vote. One commenter also suggested that, in addition to a discussion of voting incentives in the guidelines attached to the rule, NCUA should specifically prohibit any incentives offered to affect the outcome of the vote rather than to encourage participation in the voting process. One commenter thought a credit union should be allowed to conduct raffles as it desired without NCUA oversight.

The Board believes voting incentives are not necessarily bad. Still, when incentives are employed, they must be used in a way that does not skew the results of the vote or encourage members to vote before they have time to consider the ramifications of the conversion. After careful consideration, the Board has determined the final rule should include a disclosure requirement in connection with voting incentives. Accordingly, the final §708a.12 requires that, if a converting credit union offers an incentive to encourage members to participate in the vote, including a prize raffle, every reference to such incentive made by the credit union in a written communication to its members must also state that members are eligible for the incentive regardless of whether they vote for or against the proposed conversion.

Members should take the time that they need to consider their vote, and so incentives should not encourage rapid voting. Incentives should be available equally to all who vote, whether by mail or in person at the special meeting. The final guidelines address this.

A few commenters believe the statement in the proposed guidelines that "incentive(s) should not be unreasonable in size" is ambiguous and requested clarification.

An incentive could be unreasonably large in two different ways. First, the cost of the incentive could be unreasonable in relation to the credit union's net worth. In other words, the cost of the incentive should have a negligible impact on the

credit union's net worth ratio. Second, the incentive could be unreasonable if it is so large that it distracts the member from the purpose of the vote. The Board has added additional language to the guidelines to reflect this guidance.

Except as discussed above, the final §708a.13 is adopted as proposed. Also, as discussed above, the final §708a.12 is retitled and restructured.

D. Other comments and issues.

NCUA received other comments not related to any particular section of the rule. Some of these comments were beyond the scope of this rulemaking, including:

- A few commenters asked that NCUA review its position that it generally does not become involved in bylaws disputes. These commenters believe NCUA should actively enforce bylaw provisions, particularly as they relate to the conversion process. Some of these commenters stated NCUA often focuses on bylaw issues as part of its examination process. One of these commenters stated the bylaws should be a regulation.

- One commenter stated NCUA should create a private right of action for members against directors who violate their fiduciary duties.

- Some commenters urged NCUA to require converting credit unions to release their due diligence to the members before they vote. Some of the commenters thought converting credit unions should address how conversion to a mutual is more beneficial than converting directly to a stock based organization and giving member a *pro rata* share of stock based on their investment in the credit union.

- A few commenters suggested NCUA promulgate a rule requiring a converting credit union distribute its capital and surplus in a pro rata distribution to credit union members before converting.

As these comments are beyond the scope of this rulemaking, NCUA declines to address them in this final rule.

A few commenters suggested NCUA permit credit unions to convert directly to stock banks. A few commenters suggested that, in addition to a conversion rule, NCUA also promulgate a rule on credit union mergers into banks. The FCUA permits credit unions to merge into banks, but a rulemaking specific to those conversions is also beyond the scope of this rulemaking. 12 U.S.C. 1785(b)(1).

Several commenters noted the current regulation has no minimum quorum requirement for the member vote and the decision to convert could be made by only a small fraction of the members. These commenters suggested NCUA should require a quorum of a substantial percentage of the membership. The FCUA, however, does not permit the NCUA to establish a quorum requirement for MSB conversions. The FCUA states that membership approval "shall be by

affirmative vote of a majority of the members of the insured credit union who vote on the proposal." 12 U.S.C. 1785(b)(2)(B).

Several commenters who objected to the proposed rule felt the proposed rule undermined the corporate business judgment rule. The Board does not agree that anything in the proposed or final rule, which focuses on process and procedures not the substantive decision, undermines the corporate business judgment rule.

Many credit unions that convert to MSBs subsequently convert to stock banks in a mutual holding company format. One commenter stated that NCUA "vilifies" the MHC form unjustly. This commenter states that the MHC form allows mutual savings associations to raise additional capital, add branches, and acquire whole businesses, all the while "retaining their mutual ownership structure." This commenter states "it is hard to find where the NCUA has any experience on this matter to give their views credibility."

The Board believes the conversion to an MHC form presents the directors with conflicts of interest, and the directors' waiver of dividends in favor of minority stockholders and to the detriment of the members of the MHC exemplifies this conflict. Another banking regulator, the FDIC, agrees. The FDIC has expressed its concern over this waiver practice as follows:

> The Competitive Equality Banking Act of 1987 and the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 authorized conversion of mutual savings institutions into federal mutual holding companies, which in turn transfer virtually all their assets and liabilities to new, stock savings institutions, part of whose stock is acquired by subscribers in the conversion, with the majority retained by the mutual parent. This structure has the benefit of permitting converting institutions to raise only the amount of new capital they actually need. It has, however, in our view, potential for even a higher level of insider abuse than in standard conversions. We note that many newly formed mutual holding companies propose to refuse dividends declared by their operating subsidiary -- with no corresponding change in their percentage ownership of the subsidiary as dividends flowed to its minority stockholders. It seems to us that this could constitute a breach of fiduciary duty on the part of the trustees-which would be particularly acute were the trustees significant stockholders of the subsidiary . . . . As our suggested form of standard conversion would eliminate the need to raise excessive amounts of capital, we believe use of the mutual holding company structure should be discouraged in future conversions.[20]

[20] Review of Mutual-to-Stock Conversions of State Nonmember Savings Banks, 59 FR 30357, 30362-63 (June 14, 1994). *See supra* note 11 and accompanying discussion.

The Board understands the FDIC, as a matter of past and present policy, does not approve MHC conversions of state nonmember banks unless the converting institution agrees not to waive dividends in favor of minority stockholders. In this regard, the FDIC policy differs from the policy OTS applies to federal MHC conversions.

Conversions in process at the time this final rule becomes effective.

A few commenters asked about how conversions in process, if any, will be affected by this rulemaking. The Board intends that credit unions in the process of conversion, to the extent it is reasonable for them to do so, comply with the provisions of this final rule. If compliance with a particular provision of the rule, however, would impose a significant burden on the credit union by requiring it to repeat something it has already done, it need not comply with that provision of the rule. For example, if, on the date this rule is published in the *Federal Register*, the board of directors of a converting credit union has already adopted a conversion proposal, it need not give advance notice nor adopt the conversion proposal again. It must, however, provide public notice as soon as possible that it has adopted a conversion proposal. Similarly, if, on the date that this rule is published in the *Federal Register*, a credit union has already adopted a conversion proposal and mailed the 90-day notice, it need not redo that notice nor comply with the member-to-member communication procedures in the final rule. The Board anticipates that a credit union in the process of converting when this rule becomes effective will consult with its Regional Director for further guidance.

E. *Regulatory Procedures*

Regulatory Flexibility Act.

The Regulatory Flexibility Act requires NCUA to prepare an analysis to describe any significant economic impact a proposed rule may have on a substantial number of small credit unions (those under ten million dollars in assets). The Regulatory Flexibility Act requires NCUA to prepare an analysis to describe any significant economic impact a rule may have on a substantial number of small credit unions, defined as those under ten million dollars in assets. This proposed rule amends the procedures an insured credit union must follow to convert to an MSB. Based on past experience with MSB conversions, NCUA believes that, in any given year, it is unlikely there will be any conversions by credit unions with less than ten million dollars in assets. Accordingly, the Board certifies that this final rule will not have a significant economic impact on a substantial number of small credit unions, and, therefore, a regulatory flexibility analysis is not required.

Paperwork Reduction Act.

Part 708a contains information collection requirements currently approved under Office of Management and Budget (OMB) Control Number 3133-0153. As

required by the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)), NCUA has submitted a copy of this proposed regulation as part of an information collection package to the OMB for its review and approval of a revision to Control Number 3133-0153. At the time of this rulemaking, OMB approval is still pending.

Executive Order 13132.

Executive Order 13132 encourages independent regulatory agencies to consider the impact of their actions on state and local interests. In adherence to fundamental federalism principles, NCUA, an independent regulatory agency as defined in 44 U.S.C. 3502(5), voluntarily complies with the executive order. The proposed rule would not have substantial direct effects on the states, on the connection between the national government and the states, or on the distribution of power and responsibilities among the various levels of government. NCUA has determined that this proposed rule does not constitute a policy that has federalism implications for purposes of the executive order.

The Treasury and General Government Appropriations Act, 1999--Assessment of Federal Regulations and Policies on Families.

The NCUA has determined that this rule will not affect family well-being within the meaning of section 654 of the Treasury and General Government Appropriations Act, 1999, Pub. L. 105-277, 112 Stat. 2681 (1998).

Small Business Regulatory Enforcement Fairness Act.

The Small Business Regulatory Enforcement Act of 1996 (Pub. L. 104-121) provides generally for congressional review of agency rules. A reporting requirement is triggered in instances where NCUA issues a final rule as defined by section 551 of the Administrative Procedure Act. 5 U.S.C. 551. The Office of Management and Budget has determined that this rule is not a major rule for purposes of the Small Business Regulatory Enforcement Fairness Act of 1996.

List of Subjects

12 CFR part 708a

Charter conversions, Credit unions.

By the National Credit Union Administration Board on December 14, 2006.

____
Mary F. Rupp
Secretary of the Board

For the reasons stated above, the NCUA Board revises 12 CFR part 708a as follows:

PART 708a – CONVERSION OF INSURED CREDIT UNIONS TO MUTUAL SAVINGS BANKS

Sec.
708a.1 Definitions.
708a.2 Authority to convert.
708a.3 Board of directors' approval and members' opportunity to comment.
708a.4 Disclosures and communications to members.
708a.5 Notice to NCUA.
708a.6 Membership approval of a proposal to convert.
708a.7 Certification of vote on conversion proposal.
708a.8 NCUA oversight of methods and procedures of membership vote.
708a.9 Other regulatory oversight of methods and procedures of membership vote.
708a.10 Completion of conversion.
708a.11 Limit on compensation of officials.
708a.12 Voting incentives.
708a.13 Voting guidelines.

Authority: 12 U.S.C. 1766, 12 U.S.C. 1785(b).

§708a.1 Definitions.

As used in this part:

Clear and conspicuous means text in bold type in a font size at least one size larger than any other text used in the document (exclusive of headings), but in no event smaller than 12 point.

Credit union has the same meaning as insured credit union in section 101 of the Federal Credit Union Act.

Federal banking agencies have the same meaning as in section 3 of the Federal Deposit Insurance Act.

Mutual savings bank and *savings association* have the same meaning as in section 3 of the Federal Deposit Insurance Act.

Regional director means the director of the NCUA regional office for the region where a natural person credit union's main office is located. For corporate credit unions, *regional director* means the director of NCUA's Office of Corporate Credit Unions.

Senior management official means a chief executive officer, an assistant chief executive officer, a chief financial officer, and any other senior

executive officer as defined by the appropriate federal banking agencies pursuant to section 32(f) of the Federal Deposit Insurance Act.

§708a.2 Authority to convert.

A credit union, with the approval of its members, may convert to a mutual savings bank or a savings association that is in mutual form without the prior approval of the NCUA, subject to applicable law governing mutual savings banks and savings associations and the other requirements of this part.

§708a.3 Board of directors' approval and members' opportunity to comment.

(a) A credit union's board of directors must comply with the following notice requirements before voting on a proposal to convert.

(1) No later than 30 days before a board of directors votes on a proposal to convert, it must publish a notice in a general circulation newspaper, or in multiple newspapers if necessary, serving all areas where the credit union has an office, branch, or service center. It must also post the notice in a clear and conspicuous fashion in the lobby of the credit union's home office and branch offices and on the credit union's website, if it has one. If the notice is not on the home page of the website, the home page must have a clear and conspicuous link, visible on a standard monitor without scrolling, to the notice.

(2) The public notice must include the following:

(i) The name and address of the credit union;
(ii) The type of institution to which the credit union's board is considering a proposal to convert;
(iii) A brief statement of why the board is considering the conversion and the major positive and negative effects of the proposed conversion;
(iv) A statement that directs members to submit any comments on the proposal to the credit union's board of directors by regular mail, electronic mail, or facsimile;
(v) The date on which the board plans to vote on the proposal and the date by which members must submit their comments for consideration, which may not be more than 5 days before the board vote;
(vi) The street address, electronic mail address, and facsimile number of the credit union where members may submit comments; and
(vii) A statement that, in the event the board approves the proposal to convert, the proposal will be submitted to the membership of the credit union for a vote following a notice period that is no shorter than 90 days.

(3) The board of directors must approve publication of the notice.

(b) The credit union must collect member comments and retain copies at the credit union's main office until the conversion process is completed.

(c) The board of directors may vote on the conversion proposal only after reviewing and considering all member comments. The conversion proposal may only be approved by an affirmative vote of a majority of board members who have determined the conversion is in the best interests of the members. If approved, the board of directors must set a date for a vote on the proposal by the members of the credit union.

§708a.4 Disclosures and communications to members.

(a) After the board of directors has complied with §708a.3 and approves a conversion proposal, the credit union must provide written notice of its intent to convert to each member who is eligible to vote on the conversion. The notice to members must be submitted 90 calendar days, 60 calendar days, and 30 calendar days before the date of the membership vote on the conversion. A ballot must be included in the same envelope as the 30-day notice and only in the 30-day notice. A converting credit union may not distribute ballots with either the 90-day or 60-day notice, in any other written communications, or in person before the 30-day notice is sent.

(b)(1) The notice to members must adequately describe the purpose and subject matter of the vote to be taken at the special meeting or by submission of the written ballot. The notice must clearly inform members that they may vote at the special meeting or by submitting the written ballot. The notice must state the date, time, and place of the meeting.

(2) The notices that are submitted 90 and 60 days before the membership vote on the conversion must state in a clear and conspicuous fashion that a written ballot will be mailed together with another notice 30 days before the date of the membership vote on conversion. The notice submitted 30 days before the membership vote on the conversion must state in a clear and conspicuous fashion that a written ballot is included in the same envelope as the 30-day notice materials.

(3) For purposes of facilitating the member-to-member contact described in paragraph (f) of this section, the 90-day notice must indicate the number of credit union members eligible to vote on the conversion proposal and state how many members have agreed to accept communications from the credit union in electronic form. The 90-day notice must also include the information listed in paragraph (f)(9) of this section.

(4) The member ballot must include:

(i) A brief description of the proposal (e.g., “Proposal: Approval of the Plan Charter Conversion by which (insert name of credit union) will convert its charter to that of a federal mutual savings bank.”);

(ii) Two blocks marked respectively as “FOR” and “AGAINST;” and

(ii) The following language: “A vote FOR the proposal means that you want your credit union to become a mutual savings bank. A vote AGAINST the proposal means that you want your credit union to remain a credit union.” This language must be displayed in a clear and conspicuous fashion immediately beneath the FOR and AGAINST blocks.

(5) The ballot may also include voting instructions and the recommendation of the board of directors (i.e., “Your Board of Directors recommends a vote FOR the Plan of Conversion”) but may not include any further information without the prior written approval of the Regional Director.

(c) An adequate description of the purpose and subject matter of the member vote on conversion, as required by paragraph (b) of this section, must include:

(1) A clear and conspicuous disclosure that the conversion from a credit union to a mutual savings bank could lead to members losing their ownership interests in the credit union if the mutual savings bank subsequently converts to a stock institution and the members do not become stockholders;

(2) A clear and conspicuous disclosure of how a conversion from a credit union to a mutual savings bank will affect members’ voting rights and if the mutual savings bank intends to base voting rights on account balances;

(3) A clear and conspicuous disclosure of any conversion-related economic benefit a director or senior management official will or may receive including receipt of or an increase in compensation and an explanation of any foreseeable stock-related benefits associated with a subsequent conversion to a stock institution or mutual holding company structure. The explanation of stock-related benefits must include a comparison of the opportunities to acquire stock available to officials and employees with those opportunities available to the general membership;

(4) A clear and conspicuous disclosure of how the conversion from a credit union to a mutual savings bank will affect the institution’s ability to make non-housing-related consumer loans because of a mutual savings bank’s obligations to satisfy certain lending requirements as a mutual savings bank. This disclosure should specify possible reductions in some kinds of loans to members; and

(5) An affirmative statement that, at the time of conversion to a mutual savings bank, the credit union does or does not intend to convert to a stock institution or a mutual holding company structure.

(d)(1) A converting credit union must provide the following disclosures in a clear and conspicuous fashion with the 90-, 60-, and 30-day notices it sends to its members regarding the conversion:

IMPORTANT REGULATORY DISCLOSURE ABOUT YOUR VOTE

The National Credit Union Administration, the federal government agency that supervises credit unions, requires [insert name of credit union] to provide the following disclosures:

1. LOSS OF CREDIT UNION MEMBERSHIP. A vote "FOR" the proposed conversion means you want your credit union to become a mutual savings bank. A vote "AGAINST" the proposed conversion means you want your credit union to remain a credit union.

2. RATES ON LOANS AND SAVINGS. If your credit union converts to a bank, you may experience changes in your loan and savings rates. Available historic data indicates that, for most loan products, credit unions on average charge lower rates than banks. For most savings products, credit unions on average pay higher rates than banks.

3. POTENTIAL PROFITS BY OFFICERS AND DIRECTORS. Conversion to a mutual savings bank is often the first step in a two-step process to convert to a stock-issuing bank or holding company structure. In such a scenario, the officers and directors of the institution often profit by obtaining stock in excess of that available to other members.

(2) This text must be placed in a box, must be the only text on the front side of a single piece of paper, and must be placed so that the member will see the text after reading the credit union's cover letter but before reading any other part of the member notice. The back side of the paper must be blank. A converting credit union may modify this text only with the prior written consent of the Regional Director and, in the case of a state-chartered credit union, the appropriate state regulatory agency.

(e) All written communications from a converting credit union to its members regarding the conversion must be written in a manner that is simple and easy to understand. Simple and easy to understand means the communications are written in plain language designed to be understood by ordinary consumers and use clear and concise sentences, paragraphs, and sections. For purposes of this part, examples of factors to be considered in determining whether a communication is in plain language and uses clear and concise sentences, paragraphs and sections include the use of short explanatory sentences; use of definite, concrete, everyday words; use of active voice; avoidance of multiple negatives; avoidance of legal and technical business terminology; avoidance of explanations that are imprecise and reasonably

subject to different interpretations; and use of language that is not misleading.

(f)(1) A converting credit union must mail or e-mail a requesting member's proper conversion-related materials to other members eligible to vote if:

(i) A credit union's board of directors has adopted a proposal to convert;

(ii) A member makes a written request that the credit union mail or e-mail materials for the member;

(iii) The request is received by the credit union no later than 35 days after it sends out the 90-day member notice; and

(iv) The requesting member agrees to reimburse the credit union for the reasonable expenses, excluding overhead, of mailing or e-mailing the materials and also provides the credit union with an appropriate advance payment.

(2) A member's request must indicate if the member wants the materials mailed or e-mailed. If a member requests that the materials be mailed, the credit union will mail the materials to all eligible voters. If a member requests the materials be e-mailed, the credit union will e-mail the materials to all members who have agreed to accept communications electronically from the credit union. The subject line of the credit union's e-mail will be "Proposed Credit Union Conversion – Views of Member (insert member name)."

(3) (i) A converting credit union may, at its option, include the following statement with a member's material:

On (date), the board of directors of (name of converting credit union) adopted a proposal to convert from a credit union to a mutual savings bank. Credit union members who wish to express their opinions about the proposed conversion to other members may provide those opinions to (name of credit union). By law, the credit union, at the requesting members' expense, must then send those opinions to the other members. The attached document represents the opinion of a member of this credit union. This opinion is a personal opinion and does not necessarily reflect the views of the management or directors of the credit union.

(ii) A converting credit union may not add anything other than this statement to a member's material without the prior approval of the Regional Director.

(4) The term "proper conversion-related materials" does not include materials that:

(i) Due to size or similar reasons are impracticable to mail or e-mail;

(ii) Are false or misleading with respect to any material fact;

(iii) Omit a material fact necessary to make the statements in the material not false or misleading;

(iv) Relate to a personal claim or a personal grievance, or solicit personal gain or business advantage by or on behalf of any party;

(v) Relate to any matter, including a general economic, political, racial, religious, social, or similar cause, that is not significantly related to the proposed conversion;

(vi) Directly or indirectly and without expressed factual foundation impugn a person's character, integrity, or reputation;

(vii) Directly or indirectly and without expressed factual foundation make charges concerning improper, illegal, or immoral conduct; or

(viii) Directly or indirectly and without expressed factual foundation make statements impugning the stability and soundness of the credit union.

(5) If a converting credit union believes some or all of a member's request is not proper it must submit the member materials to the Regional Director within seven days of receipt. The credit union must include with its transmittal letter a specific statement of why the materials are not proper and a specific recommendation for how the materials should be modified, if possible, to make them proper. The Regional Director will review the communication, communicate with the requesting member, and respond to the credit union within seven days with a determination on the propriety of the materials. The credit union must then immediately mail or e-mail the material to the members if so directed by NCUA.

(6) A credit union must ensure that its members receive all materials that meet the requirements of §708a.4(f) on or before the date the members receive the 30-day notice and associated ballot. If a credit union cannot meet this delivery requirement, it must postpone mailing the 30-day notice until it can deliver the member materials. If a credit union postpones the mailing of the 30-day notice, it must also postpone the special meeting by the same number of days. When the credit union has completed the delivery, it must inform the requesting member that the delivery was completed and provide the number of recipients.

(7) The term "appropriate advance payment" means:

(i) For requests to mail materials to all eligible voters, a payment in the amount of 150% of the first class postage rate times the number of mailings, and

(ii) For requests to e-mail materials only to members that have agreed to accept electronic communications, a payment in the amount of 200 dollars.

(8) If a credit union posts conversion-related information or material on its website, then it must simultaneously make a portion of its website available free of charge to its members to post and share their opinions on the conversion. A link to the portion of the website available to members to post their views on the conversion must be marked "Members: Share your views on the proposed conversion and see other members views" and the link must also be visible on all pages on which the credit union posts its own conversion-related information or material, as well as on the credit union's homepage. If a credit union believes a particular member submission is not proper for posting, it will provide that submission to the Regional Director for review as described in paragraph (f)(5) of this section. The credit union may also post a content-neutral disclaimer using language similar to the language in paragraph (f)(3)(i) of this section.

(9) A converting credit union must inform members with the 90-day notice that if they wish to provide their opinions about the proposed conversion to other members they can submit their opinions in writing to the credit union no later than 35 days from the date of the notice and the credit union will forward those opinions to other members. The 90-day notice will provide a contact at the credit union for delivery of communications, will explain that members must agree to reimburse the credit union's costs of transmitting the communication including providing an advance payment, and will refer members to this section of NCUA's rules for further information about the communication process. The credit union, at its option, may include additional factual information about the communication process with its 90-day notice.

(10) A group of members may make a joint request that the credit union send its materials to other members. For purposes of paragraphs (f)(2) and (f)(3) of this section, the credit union will use the group name provided by the group.

§708a.5 Notice to NCUA.

(a) If a converting credit union's board of directors approves a proposal to convert, it must provide the Regional Director with notice of its intent to convert during the 90 calendar day period preceding the date of the membership vote on the conversion.

(1) A credit union must give notice to the Regional Director of its intent to convert by providing a letter describing the material features of the conversion or a copy of the filing the credit union has made or intends to make with another federal or state regulatory agency in which the credit union seeks that agency's approval of the conversion. A credit union must include with the notice to the Regional Director copies of the notices the credit union has provided or intends to provide to members under §§708a.3 and 708a.4. The credit union must also include a copy of the ballot form and all written materials the credit union has distributed or

intends to distribute to members. The term "written materials" includes written documentation or information of any sort, including electronic communications posted on a website or transmitted by electronic mail.

(2) As part of its notice to NCUA of intent to convert, the credit union's board of directors must provide the Regional Director with a certification of its support for the conversion proposal and plan. Each director who voted in favor of the conversion proposal must sign the certification. The certification must contain the following:

> (i) A statement that each director signing the certification supports the proposed conversion and believes the proposed conversion is in the best interests of the members of the credit union;
>
> (ii) A description of all materials submitted to the Regional Director with the notice and certification;
>
> (iii) A statement that each board member signing the certification has examined all these materials carefully and these materials are true, correct, current, and complete as of the date of submission; and
>
> (iv) An acknowledgement that federal law (18 U.S.C. 1001) prohibits any misrepresentations or omissions of material facts, or false, fictitious or fraudulent statements or representations made with respect to the certification or the materials provided to the Regional Director or any other documents or information provided to the members of the credit union or NCUA in connection with the conversion.

(3) A state-chartered credit union must state as part of the notice required by §708a.5(a) if its state chartering law permits it to convert to a mutual savings bank and provide the specific legal citation. A state-chartered credit union will remain subject to any state law requirements for conversion that are more stringent than those this part imposes, including any internal governance requirements, such as the requisite membership vote for conversion and the determination of a member's eligibility to vote. If a state-chartered credit union relies for its authority to convert to a mutual savings bank on a state law parity provision, meaning a provision in state law permitting a state-chartered credit union to operate with the same or similar authority as a federal credit union, it must:

> (i) Include in its notice a statement that its state regulatory authority agrees that it may rely on the state law parity provision as authority to convert; and
>
> (ii) Indicate its state regulatory authority's position as to whether federal law and regulations or state law will control internal governance issues in the conversion such as the requisite membership vote for conversion and the determination of a member's eligibility to vote.

(b) If it chooses, a credit union may seek a preliminary determination from the Regional Director regarding any of the notices required under this part and its proposed methods and procedures applicable to the membership conversion vote. The Regional Director will make a preliminary determination regarding the notices and methods and procedures applicable to the membership vote within 30 calendar days of receipt of a credit union's request for review unless the Regional Director extends the period as necessary to request additional information or review a credit union's submission. A credit union's prior submission of any notice or proposed voting procedures does not relieve the credit union of its obligation to certify the results of the membership vote required by §708a.6 or eliminate the right of the Regional Director to disapprove the actual methods and procedures applicable to the membership vote if the credit union fails to conduct the membership vote in a fair and legal manner consistent with the Federal Credit Union Act and these rules.

(c) After receiving the notice described in paragraph (a)(3) of this section, the Regional Director will contact and consult with the appropriate State Supervisory Authority.

§708a.6 Membership approval of a proposal to convert.

(a) A proposal for conversion approved by a board of directors requires approval by a majority of the members who vote on the proposal.

(b) The board of directors must set a voting record date to determine member voting eligibility that is at least one day before the publication of notice required in §708a.3.

(c) A member may vote on a proposal to convert in person at a special meeting held on the date set for the vote or by written ballot filed by the member. The vote on the conversion proposal must be by secret ballot and conducted by an independent entity. The independent entity must be a company with experience in conducting corporate elections. No official or senior management official of the credit union or the immediate family members of any official or senior management official may have any ownership interest in or be employed by the independent entity.

§708a.7 Certification of vote on conversion proposal.

(a) The board of directors of the converting credit union must certify the results of the membership vote to the Regional Director within 10 calendar days after the vote is taken.

(b) The certification must also include a statement that the notice, ballot and other written materials provided to members were identical to those submitted to NCUA pursuant to §708a.5. If the board cannot certify this, the board must

provide copies of any new or revised materials and an explanation of the reasons for any changes.

§708a.8 NCUA oversight of methods and procedures of membership vote.

(a) The Regional Director will review the methods by which the membership vote was taken and the procedures applicable to the membership vote. The Regional Director will determine: if the notices and other communications to members were accurate, not misleading, and timely; the membership vote was conducted in a fair and legal manner; and the credit union has otherwise complied with part 708a.

(b) After completion of this review, the Regional Director will issue a determination that the methods and procedures applicable to the membership vote are approved or disapproved. The Regional Director will issue this determination within 30 calendar days of receipt from the credit union of the certification of the result of the membership vote required under §708a.7 unless the Regional Director extends the period as necessary to request additional information or review the credit union's submission. Approval of the methods and procedures under this paragraph remains subject to a credit union fulfilling the requirements in §708a.10 for timely completion of the conversion.

(c) If the Regional Director disapproves the methods by which the membership vote was taken or the procedures applicable to the membership vote, the Regional Director may direct that a new vote be taken.

(d) A converting credit union may appeal the Regional Director's determination to the NCUA Board. The credit union must file the appeal within 30 days after receipt of the Regional Director's determination. The NCUA Board will act on the appeal within 90 days of receipt.

§708a.9 Other regulatory oversight of methods and procedures of membership vote.

The federal or state regulatory agency that will have jurisdiction over the financial institution after conversion must verify the membership vote and may direct that a new vote be taken, if it disapproves of the methods by which the membership vote was taken or the procedures applicable to the membership vote.

§708a.10 Completion of conversion.

(a) After receipt of the approvals under §708a.8 and §708a.9 the credit union may complete the conversion.

(b) The credit union must complete the conversion within one year of the date of receipt of NCUA approval under §708a.8. If a credit union fails to complete the conversion within one year the Regional Director will disapprove of the methods

and procedures. The credit union's board of directors must then adopt a new conversion proposal and solicit another member vote if it still desires to convert.

(c) The Regional Director may, upon timely request and for good cause, extend the one year completion period for an additional six months.

(d) After notification by the board of directors of the mutual savings bank or mutual savings association that the conversion has been completed, the NCUA will cancel the insurance certificate of the credit union and, if applicable, the charter of a federal credit union.

§708a.11 Limit on compensation of officials.

No director or senior management official of an insured credit union may receive any economic benefit in connection with the conversion of a credit union other than compensation and other benefits paid to directors or senior management officials of the converted institution in the ordinary course of business.

§708a.12 Voting incentives.

If a converting credit union offers an incentive to encourage members to participate in the vote, including a prize raffle, every reference to such incentive made by the credit union in a written communication to its members must also state that members are eligible for the incentive regardless of whether they vote for or against the proposed conversion.

§708a.13 Voting guidelines.

A converting credit union must conduct its member vote on conversion in a fair and legal manner. NCUA provides the following guidelines as suggestions to help a credit union obtain a fair and legal vote and otherwise fulfill its regulatory obligations. These guidelines are not an exhaustive checklist and do not by themselves guarantee a fair and legal vote.

(a) *Applicability of state law*. While NCUA's conversion rule applies to all conversions of federally insured credit unions, federally insured state-chartered credit unions (FISCUs) are also subject to state law on conversions. NCUA's position is that a state legislature or state supervisory authority may impose conversion requirements more stringent or restrictive than NCUA's. States that permit this kind of conversion may have substantive and procedural requirements that vary from federal law. For example, there may be different voting standards for approving a vote. While the Federal Credit Union Act requires a simple majority of those who vote to approve a conversion, some states have higher voting standards requiring two-thirds or more of those who vote. A FISCU should be careful to understand both federal and state law to navigate the conversion process and conduct a proper vote.

(b) *Eligibility to vote*.

(1) Determining who is eligible to cast a ballot is fundamental to any vote. No conversion vote can be fair and legal if some members are improperly excluded. A converting credit union should be cautious to identify all eligible members and make certain they are included on its voting list. NCUA recommends that a converting credit union establish internal procedures to manage this task.

(2) A converting credit union should be careful to make certain its member list is accurate and complete. For example, when a credit union converts from paper record keeping to computer record keeping, some member names may not transfer unless the credit union is careful in this regard. This same problem can arise when a credit union converts from one computer system to another where the software is not completely compatible.

(3) Problems with keeping track of who is eligible to vote can also arise when a credit union converts from a federal charter to a state charter or vice versa. NCUA is aware of an instance where a federal credit union used membership materials allowing two or more individuals to open a joint account and also allowed each to become a member. The federal credit union later converted to a state-chartered credit union that, like most other state-chartered credit unions in its state, used membership materials allowing two or more individuals to open a joint account but only allowed the first person listed on the account to become a member. The other individuals did not become members as a result of their joint account, but were required to open another account where they were the first or only person listed on the account. Over time, some individuals who became members of the federal credit union as the second person listed on a joint account were treated like those individuals who were listed as the second person on a joint account opened directly with the state-chartered credit union. Specifically, both of those groups were treated as non-members not entitled to vote. This example makes the point that a credit union must be diligent in maintaining a reliable membership list.

(c) *Scheduling the special meeting*. NCUA's conversion rule requires a converting credit union to permit members to vote by written mail ballot or in person at a special meeting held for the purpose of voting on the conversion. Although most members may choose to vote by mail, a significant number may choose to vote in person. As a result, a converting credit union should be careful to conduct its special meeting in a manner conducive to accommodating all members wishing to attend, including selecting a meeting location that can accommodate the anticipated number of attendees and is conveniently located. The meeting should also be held on a day and time suitable to most members' schedules. A credit union should conduct its meeting in accordance with applicable federal and state law, its bylaws, Robert's Rules of Order or other appropriate parliamentary procedures, and determine before the meeting the nature and scope of any discussion to be permitted.

(d) *Voting incentives*. Some credit unions may wish to offer incentives to members, such as entry to a prize raffle, to encourage participation in the

conversion vote. The credit union must exercise care in the design and execution of such incentives.

(1) The credit union should ensure that the incentive complies with all applicable state, federal, and local laws.

(2) The incentive should not be unreasonable in size. The cost of the incentive should have a negligible impact on the credit union's net worth ratio and the incentive should not be so large that it distracts the member from the purpose of the vote. If the board desires to use such incentives, the cost of the incentive should be included in the directors' deliberation and determination that the conversion is in the best interests of the credit union's members.

(3) The credit union should ensure that the incentive is available to every member that votes regardless of how or when he or she votes   All of the credit union's written materials promoting the incentive to the membership must disclose to the members, as required by §708a.12 of this part, that they have an equal opportunity to participate in the incentive program regardless of whether they vote for or against the conversion. The credit union should also design its incentives so that they are available equally to all members who vote, regardless of whether they vote by mail or in person at the special meeting.