

CU Financial Services

Strategic Planning and Implementation Services for Progressive Financial Institutions

Alan D. Theriault, President

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West Coast Office:

San Francisco, CA

March 25, 2009

Dear Credit Union Executive:

The costs imposed by the collapse of the two largest corporate credit unions and the multi-billion dollar contingent liability looming at dozens of natural person credit unions will stunt the growth and relevance of the credit union charter for many years to come. Members and employees will pay the price and for some the hard earned consumer franchise is threatened. Fortunately, steps can be taken to mitigate the damage and make the future of your institution more secure.

The conversion from the credit union charter is a strategic tactic to preserve member capital and a hard earned franchise. Although the question of cost and contingent liability is currently elusive, conversion to a bank charter opens the door to expanded product and market opportunities as well as capital to restore and fund future growth opportunities which are sure to surface during these challenging times. Mutual banks, like credit unions, work to preserve a heritage of serving their members / depositors and the community.

Over 30 credit unions have made the charter switch and more are in the pipeline. Our firm has advised most of them – including *all* the billion dollar institutions and most of those which later raised regulatory capital. Although the switch is not for everybody, why not explore the positives and negatives with an experienced advisor? With first hand experience no one can replicate, we have a comprehensive and cost effective program to address the feasibility of the switch and document the due diligence. Since our work on the first conversions dating back to 1993, we have developed a suite of tools for credit union executives to utilize throughout the process. For example, we help with the feasibility plan, the regulatory business plan, the CRA plan, the public relations plan, and guide management and staff with solid briefings during the process.

In addition to charter options, our team can help your management and board evaluate the impact of CRA. We help converting credit unions and start-up banks prepare comprehensive CRA compliance programs. Our programs will help you be prepared for CRA and hence reduce the stress and uncertainty for your board and employees.

Why not take advantage of an opportunity to share with us your specific needs and goals? Call me today at 800-649-2741 to set up a *no-cost, no-obligation* and *confidential* meeting.

Sincerely,

Alan D. Theriault,
President

ADT:ap

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February 25, 2009

Credit unions are facing an uncertain future. Therefore, now more than ever, executives need to give fresh consideration to all their strategic options including conversion from the credit union charter. Those with earnings or capital problems may want to review how a merger with a bank could better serve members with a stronger institution.

Conversion to a bank charter opens the door to capital to fund future growth opportunities which are sure to surface during these challenging times. Likewise, a well structured merger or sale to a bank, among other benefits, can put money in the pockets of members and help restore employee defined benefit or retirement programs hit by plunging financial markets.

PCA, poor consumer awareness, product and market constraints, merger and acquisition prohibitions, mortgage and business lending limits, excessive capital requirements, yield-eroding investment limitations, a certain insurance premium, FASB threats, and regulator issues – they all generate a “hidden tax” that keeps U.S. credit unions from gaining the market share enjoyed by our Canadian neighbors and U.S. banks and thrifts. Credit union leaders making the switch agree that conversion benefits more than offset the tax bite. Banks manage taxes just like any other business expense.

Over two dozen credit unions have made the charter switch or accomplished a merger with a bank, and more are in the pipeline. We advised the majority -- including those which later raised regulatory capital. Although the switch is not for everybody, why not explore the positives and negatives with an experienced advisor? Mutual banks, like credit unions, work to preserve a heritage of serving their members / depositors and the community.

Since 1993, we've worked hard to develop a specialty helping credit unions evaluate and execute this strategic move and we bring a solid team of advisors to the table. Why not take advantage of an opportunity to share with us your specific needs and goals? Our team can help you evaluate which strategic move would work for your membership and thus make your future more certain. Call today to set up a *no-obligation* and *confidential* meeting.

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Sincerely,

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ADT:ap

Converting from a Credit Union

Update

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

News for those interested in mutual bank charter conversions by credit unions

Strategic Planning and Implementation Services for Progressive Credit Unions

CU Financial Services, Portland, ME & San Francisco, CA – Tel: 800-649-2741 – www.cufinancial.com – May 1, 2007

Florida and Minnesota Credit Unions

NCUA Clears Two to Convert to MSB Charter

NCUA has cleared the member vote for the \$1.3 billion Think Federal Credit Union (MN) and the \$137 million Sunshine State Credit Union (FL). Clearing the member vote is one of the final steps of the conversion process. Both are expected to start operating as federal savings institutions during the 3rd quarter of 2007.

Think serves employees of IBM and other select employee groups from branches in three states. The conversion will allow Think to build additional branches and establish a commercial lending program free of the actual and perceived constraints related to the credit union charter.

Located in Tallahassee, Sunshine State serves state government employees and select employee groups. The conversion will allow it to efficiently expand its branch network and raise capital to support the asset and loan growth anticipated.

New Conversion Rule Requirement

Three Credit Unions ask for Member Comments

In accordance with new NCUA rules, which became effective in January, members from three credit unions are being given 30 days to provide comments to the board of directors regarding conversion to the mutual saving institution charter.

At the end of the comment period the board of directors, after considering member input, may adopt a plan of mutual charter conversion and ask members to vote on the proposal.

In 2004, a \$1 billion Michigan state chartered credit union collected comments from its members because of a similar rule required by state law. As expected, many of those commenting wanted to maintain the status quo since they were very satisfied with the credit union services.

Some comments were sent by those who viewed conversion as a negative because of bad experiences with banks. A few feared the management might profit from the move at the expense of the members. The board considered and addressed the comments as part the conversion process. Less than ½ of 1% of the members sent comments.

The comment period, like other requirements of this fourth round of NCUA conversion rulemaking, lengthens the conversion process and increases the cost. Thus, legal experts, credit union executives, and members of Congress have viewed the rules as an illegal attempt by NCUA to stop conversions.

(NCUA's budget is hurt by conversions. It loses the annual assessments from federal credit unions which convert and interest income on the

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NCUSIF deposit from both state and federal credit unions.)

In 1998, when H.R. – 1151 was passed, it contained an amendment specifically authorizing the conversion of a credit union to a mutual savings bank and abolished NCUA's approval authority. Congress instructed NCUA to immediately promulgate rules which were to be no more or less restrictive than charter conversion rules in place at the OTS and OCC.

The following companies work with CU Financial Services to help educate credit union executives about charter options and growth opportunities.

Should you decide to implement a charter change, raise capital, implement a merger, and / or need help to craft a strategic plan, these firms are available to help.

Please contact Alan Theriault at 800-649-2741, or the individuals listed below.

Silver Freedman & Taff

3299 K Street, N.W., Suite 100
Washington, DC 20007
202-295-4502 * Fax: 202-337-5502

Robert Freedman, Esq.

SFT represents credit unions on a variety of matters, including advising them on charter options. It has served as advisor to the majority of credit unions converting to a thrift charter including all those over \$1 billion in assets.

Keefe, Bruyette & Woods, Inc

211 Bradenton Avenue
Columbus, OH 43017
614-766-8400 * FAX: 614-766-8406

Patricia McJoynt

KBW provides investment banking and financial advisory services to financial institutions including credit unions. It is advisor to almost all of the credit unions which converted to the thrift charter and implemented an IPO.

Prior to that NCUA's conversion rules required over 50% of members eligible to vote to return a ballot authorizing the conversion. Mandatory disclosure language was also compulsory. Both requirements were viewed by many as bureaucratic red tape.

Credit Union Performance is Weak
**2006 Statistics Validate
Credit Union Conversion
Trend**

NCUA reported that almost 4,600 credit unions lost members and over 4,400 reported declining assets. Over 900 credit unions lost money. Credit unions in total barely grew enough to cover credited interest. Meanwhile the top 116 largest credit unions captured 67% of the 2006 asset growth. As a group they grew at a rate of 8.1% and represented 37% of total credit union assets.

These statistics provide a window into the reasoning of those looking at a conversion to the mutual savings bank charter. For many the challenge of growth and relevance to the community outweigh the benefits of a tax subsidy. Despite the credit union income tax advantage, it is an indisputable mathematical fact that a depository institution can do more for its members and its community, can offer more financial products and services, and can open more branches if it has a bank charter. Access to the capital markets further expand the opportunity to serve.

"Mutual thrifts are federally insured depository institutions most similar in structure to credit unions, because like credit unions, mutual thrifts generally do not have corporate stock, are not for profit entities, and are owned by their depositors, or members, rather than shareholders".

January 2001, US Department of the Treasury study comparing credit unions with other depository institutions.

Advisor to credit unions considering conversion to a mutual savings institution charter.

CU Financial crafted the first state chartered credit union conversion, and is advisor to many subsequent applicants.

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Critical: Experienced Conversion Team

The Conversion Learning Curve Covers Disciplines from Public Relations to S.E.C. Rules

The idea of converting to the mutual bank charter often comes from hearing about it at a conference, from a colleague, or during a strategic planning meeting. Conversion is a strategic decision, and although it may not be appropriate for all credit unions, it is worthy of thorough study by many. The first step to embracing the idea involves education.

The following are among the areas to be examined as a credit union considers and moves through the conversion process:

- Charter powers and limitations
 - What are the limitations and benefits of the mutual charter?
 - How are we being constrained by the credit union charter? Is our future in jeopardy?
 - What is the future of credit union legislation? Will conversions be constrained?
 - Evaluate other non-conversion options (e.g. merger - liquidation - CU community charter)
- Feasibility for our credit union
 - What is in it for the members?
 - How will members react?
 - Can we get the vote?
 - Do we have the senior staff expertise to implement a conversion?
- Financial modeling
 - Are we in a growth market/mode?
 - Can we deploy capital from an IPO profitably?
 - What is the impact of income taxes versus the net revenue from seizing new opportunities?
 - What are the one-time costs of conversion and will our revenues cover them without sacrificing service quality and member benefits?
 - What are the "hidden" and/or opportunity

costs of remaining a credit union?

The cost of conversion for larger institutions amounts to a few weeks' earnings. Smaller credit unions, because of the fixed expenses involved, may take months to recover the costs.

The basic information which needs to be

Conversion Update						
<i>Credit unions converted, merged, and/or pending.</i>						
Credit Union	St.	Before	After	Growth	Date	
12 Non –Stock Institutions (Pure Mutual)						
1 @LANTEC Financial	VA	85	115	11%	1/12/04	
2 Beacon Federal	NY	155	606	19%	7/1/99	
3 Professional Teachers	TN	1	Merger		7/1/01	
4 Salt City Hospital	NY	8	Merger		3/1/03	
5 Caney Fork Coop	TN	.9	Merger		11/1/00	
6 Marcy	NY	24	Merger		12/29/06	
7 Carolina Federal	SC	16			8/1/99	
8 OmniAmerican CU	TX	1,200	1,063	-11%	1/2/06	
9 Roper Employees	SC	7	Merger		3/1/01	
10 Share Plus	TX	150	180	6%	10/1/04	
11 CU of the Pacific	WA	141	221	12%	5/19/03	
12 Washington's CU	WA	262	257	-1%	3/31/04	
10 Non-Stock Mutual Holding Companies (Hybrid)						
13 AAL	WI	37	Merger		6/30/01	
14 AAL Member	WI	177	Merger		6/30/01	
15 Atlantic Coast	GA	321	843	15%	11/1/00	
16 AGE FCU	GA	269	399	7%	7/1/01	
17 AWANE Bank	NH	10	54	17%	5/1/96	
18 Community CU	TX	1,300	1,577	21%	1/2/06	
19 Kaiser Federal	CA	190	777	19%	11/1/99	
20 Lusitania SB, FSB	NJ	55	172	21%	9/1/95	
21 Nationwide FCU	OH	600	Merger		1/2/07	
22 Ohio Central Federal	OH	29	64	9%	6/1/98	
9 Full Stock Institutions						
23 Affiliated Federal	TX	9	118	33%	6/1/98	
24 Allied Pilots	IL	82	159	12%	9/1/01	
25 BUCS Federal	MD	58	149	11%	3/1/98	
26 Citizens Community^^	WI	102	290	19%	12/10/01	
27 Community Schools^^	MI	41	41	7%	1/1/02	
28 I.G.A. Federal	PA	160	N/A	N/A	7/1/98	
29 Pacific Trust	CA	224	813	17%	1/1/00	
30 Rainier Pacific	WA	383	903	13%	1/1/01	
31 Synergy Financial	NJ	182	986	21%	5/1/98	
5 Conversions Pending Comments or Completion						
32 Sunshine State	FL	137	137		Cleared	
33 Pending ^	MA	150	150		Pending	
34 Think	MN	1,200	1,200		Cleared	
35 Pending ^	TX	150	150		Pending	
36 Pending ^	UT	150	150		Pending	

processed for a conversion includes:

- Feasibility Plan (including financial models)
- Public Relations Plan
 - Media training for management and the board
 - Member communications
 - Dealing with opposition
- Pre-filing package for regulatory agencies
- Process member comments
- Time and Responsibilities schedule
- Application forms and management biographical information
- Assessment of current and proposed activities
- Business Plan (with 3 years of financial projections in OTS/FDIC format)
- Community Reinvestment Plan (CRA)
- Eligibility exam briefings for staff
- Community Foundation Plan
- Board training in public company issues
- Policies and procedures transition plan

Under the direction of CU Financial Services as conversion advisor and coordinator, the following participants work as a team on the conversion process:

- Washington D.C. (regulatory) law firm
- Local legal counsel (state law issues and litigation)
- Federal and state lobbyists
- Financial trade associations (training, etc.)
- Financial printer
- Public relations consultants
- Vote solicitor
- Inspector of Elections
- Investment banker
- Accounting firm with S.E.C. experience

As an advisor to credit unions since 1984, CU Financial Services has been dedicated to gathering the tools and material to help credit union management and directors get up to speed quickly on important new ideas.

As the coordinator of the feasibility and conversion process, CU Financial has developed numerous tools to help reduce the stress and learning curve for management, employees and directors. The firm has advised the majority of credit unions which have embraced this pioneering change.

“Like other new ideas in the credit union industry, the mutual bank charter option has its critics as did share drafts, investing in government securities, mortgage lending, offering investment services, making commercial loans, and secondary capital”, said Alan D. Theriault, President, CU Financial Services.

“The critics have always claimed these new innovations will lead to taxation and the demise of the credit union philosophy, but where would credit unions be today without share drafts or mortgage loans”, he said. “Embracing change is critical to survival.”

2007 Conference Schedule

The Cooperative Banking Charter Conference:

A one day, economically priced (\$125) seminar designed to provide up to date information about the mutual bank charter, FDIC insurance, conversion pros and cons, the impact of NCUA rules, and director due diligence.

Attendance is limited to credit union executives and credit union board members.

Learn from those who have made the switch:

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

Call 800-649-2741 for details

10:00 a.m. to 2:30 p.m.

Chicago

Wed., May 16, 2007

Salt Lake City

Wed., June 6, 2007

Los Angeles

Thurs., June 7, 2007

Dallas

Wed., Sept. 19, 2007

New York

Wed., Sept. 26, 2007

Orlando

Wed., Nov. 14, 2007

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Strategic Planning and Implementation Services for Progressive Credit Unions; CU Financial Services, Portland, ME & San Francisco, CA **Tel: 800-649-2741** WEB Site: www.cufinancial.com; Vol. 26 No. 1 **January 3, 2006**

Convenient CUNA GAC Location

Conversion Network Members to Host Cocktail Reception for CU Executives During GAC

Members of the CU Financial Services Conversion Network are hosting an informal cocktail reception from 4:30 pm to 7 pm, Tuesday, February 28, 2006, before the scheduled evening GAC events.

The reception will give credit union executives an opportunity to visit with the directors and CEOs of several credit unions which have converted to the mutual savings institution charter. Also attending are several attorneys from Silver Freedman & Taff; a partner from the public relations firm; an executive from the financial printing company; and two investment bankers from Keefe Bruyette and Woods, the Wall Street firm handling the majority of capital-raising transactions by converted credit unions. Other invited guests will be announced later.

For details and an invitation, please call 800-649-2741.

New Filing: Fourth Billion-Dollar CU on File \$1.8 Billion DFCU Financial Files for Mutual Savings Institution Charter

Michigan's largest credit union, and one of the top 30 credit unions in the U.S. by assets, the \$1.8 billion DFCU Financial, filed applications on December 14, 2005 with the Office of Thrift Supervision, the FDIC, and the NCUA to convert to a mutual savings institution. DFCU is the fourth billion-dollar credit union to file and it joins over 30 other credit unions which have made or are making the move. Combined, these institutions represent over \$10 billion in assets.

DFCU's 12-member board voted unanimously to approve the plan of conversion, according to Kim

Gabbert, spokeswoman for the credit union. "We are excited about the opportunity this will provide DFCU Financial and its members," she told reporters. The credit union has 11 branches and 48 ATMs located around Dearborn, Michigan and serves employees of Ford Motor Company and other nearby select employee groups. As a federal credit union, DFCU must obtain a simple majority (50.1%) of those members voting to approve the conversion.

In December of 2004, over 60% of the members of Lake Michigan Credit Union, a Michigan state chartered credit union, voted in favor of conversion. Nevertheless, voting mandated by a 2001 state law sponsored by the Michigan Credit Union League required a "super" majority vote (66 2/3%) of members voting. Lake Michigan fell short by just over 2,000 votes.

January 2, 2006 Conversion Dates

\$1.5 Billion Community CU & \$1.2 Billion OmniAmerican Are Now MSBs

Two large and dynamic Dallas-Fort Worth area credit unions started the New Year as mutual savings institutions, unleashing a new style of competition for area banks and credit unions. Putting the personal touch and a focus on the needs of members together with the powers and consumer awareness enjoyed by FDIC-insured banks helps position these two billion-dollar-plus institutions to become leaders in a booming marketplace which offers significant growth and expansion.

As part of its expansion plan, Community Credit Union of Plano launched a re-branding campaign and changed its name to ViewPoint Bank. Community applied to convert on December 30, 2004. Over 71% of the members who voted did so in favor of the conversion.

To learn more about the Mutual Charter Option, Mutual Holding Company Charter, and raising regulatory capital. Log on to:
www.cufinancial.com

OmniAmerican Credit Union of Fort Worth will continue to operate using the same trade name – OmniAmerican Bank. Omni applied to convert on February 18, 2005. Over 76% of its members who voted did so in favor of the conversion.

Both institutions faced temporary delays after NCUA attempted to block their conversions by claiming the credit unions did not provide proper disclosures to members. It said the credit unions needed to re-vote. This tactic successfully stopped the \$650 million Columbia Credit Union's (WA) 2003 conversion application after its BOD decided against taking NCUA to court. Columbia had applied to convert from a state chartered credit union to a state chartered savings bank.

However, rather than abandoning their growth plans or incurring a costly re-vote, these two Texas state chartered credit unions successfully sued NCUA. About 30 days after filing suit, a federal court demanded the defiant NCUA certify their conversion votes. Contrary to NCUA's claim, the OTS, FDIC, and Texas Credit Union Commissioner all had said earlier the conversion process was properly handled.

After reviewing NCUA's allegations, many observers, including dozens of members of Congress, claimed NCUA's assault was self-serving. A powerful banking committee member stated NCUA's position was "ridiculous." Almost two dozen Congressmen and two U.S. Senators sent written appeals to NCUA to reconsider. News reports, however, implied that NCUA met with members of Congress and dismissed their concerns. Later, NCUA said of the meetings that members of Congress were "clueless."

The Texas lawsuit was both speedy and cost-effective. It vindicated the institutions and their attorney from the false claims made by NCUA and other critics. The judge ruled the lawsuit was essentially won when the comprehensive applications were filed and that NCUA was wrong on multiple fronts. The judge also sprinkled his injunction with some colorful touches, declaring NCUA was "silly," "inept" and that it acted "arbitrarily and capriciously in failing to certify the member vote." The agency agreed to drop its objections – pursuing an appeal could have resulted in NCUA's entire punitive disclosure regulation being invalidated by the court.

CUNA Lobbying Team

Laying the Groundwork for a Taxation Compromise

While arguing *size does not matter* when judging whether credit unions should be taxed, a frustrated CUNA lobbyist admitted to the Credit Union Magazine that both Republican and Democratic members of Congress disagree with him regarding "big credit unions."

One Congressman said, "I've always supported credit unions, especially the smaller ones. Larger ones, well, we may need to take a look at how they're treated." Another Congressman was quoted questioning, "A credit union in my home town looks just like a bank. Why does it deserve differential treatment?"

The CUNA lobbyist continued by saying, "This exchange isn't an anomaly. Other members of Congress echo similar sentiments." In fact, during a Hike the Hill visit, the

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Steven M. Begley

Graphic Design * Financial Typesetting *
Annual Meeting Materials * Conversion
Disclosure Printing & Mailing

The Altman Group, Inc

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New York, NY 10165
Tel: 201-806-2206

Paul R. Schulman

Proxy Solicitation and Corporate
Governance Consulting

Consultant to credit unions considering conversion to a mutual savings institution charter.

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lobbyist was told by a House Financial Services Committee member “unequivocally” credit unions over \$250 million in assets don’t deserve their tax exemption.

3

secondary capital, will the financial markets support the conversion, and an IPO years down the road, as much as they do now?

Publishing these candid statements draws attention to the uphill battle CUNA faces in preserving the tax exemption. It makes one wonder whether CUNA is working to manage expectations about the inescapability of taxation. Perhaps this is an easy task considering that over 60% of credit union executives responding to a CU Times poll believe taxation will be a reality within five years, either for all credit unions or at least ‘large’ ones.

Reading between the lines leads many to believe that a *Compromise* taxation plan is inevitable. The plan may tax both larger credit unions and community chartered ones. It could also simultaneously *trap* these targeted credit unions in the credit union charter.

Why the *trap*? Because if taxation becomes inevitable, many credit union executives have said they would promptly convert to a mutual savings institution charter. CUNA’s only revenue salvation would be to have a key element added to the *Compromise* that would *trap* these credit unions in their restrictive credit union charter, presumably to “protect” the NCUSIF from massive withdrawals. Credit union lobbyists could boldly acknowledge that taxation was inevitable, and expected by all; and in the next breath they would proclaim *victory* for “saving” the “credit union movement,” *victory* for the consumer, and *victory* for the low-income people that “depend” on credit union service.

Credit union executives who challenged the anti-conversion *Compromise* would be blamed for creating the taxation problem. They would be branded as abandoning the credit union philosophy because of their greedy desire to become a “bank.” The bank trade associations, elated with finally getting some traction on taxation, may be quick to agree to the *trap*, since it would help satisfy the desire of some to “contain” competitive credit unions.

Should taxation become imminent, will your credit union be snared in a low-growth, restrictive charter, which many believe suffers from poor consumer awareness? If such a *trap* is not an element of the *Compromise*, will taxation be like someone yelling “FIRE” in a crowded theater? Will the waiting room of the FDIC be so jammed that it takes years to complete a conversion? Will bank regulators become more selective about who they let in once they have a plate full of applicants? Will your credit union qualify for tougher standards imposed to slow applications? Will the FDIC charge an entrance fee or NCUSIF an exit fee, thus increasing the cost of conversion? If your credit union could benefit from

Jack Welch is the former CEO of GE and one of the most well-known change agents in modern times. He said, “Change is an absolutely critical part of business. You need to change, preferably before you have to.” Welch’s experience about resisters of change is also timely because he advises, “Resisters only get more diehard and their followings more entrenched as time goes on. They are change killers; cut them off early.”

Spotlight on NCUA

Studies by GAO Designed to Help Re-Focus NCUA on Safety and Soundness

“Mutual thrifts are federally insured depository institutions most similar in structure to credit unions, because like credit unions, mutual thrifts generally do not have corporate stock, are not for profit entities, and are owned by their depositors, or members, rather than shareholders”.

January 2001, US Department of the Treasury study comparing credit unions with other depository institutions.

On the day before the largest credit union in Michigan announced that it had applied to become a mutual savings institution, a prominent member of Congress and author of the 2005 bank and credit union regulatory relief bill asked for a study by the Government Accountability Office (GAO), looking into how the NCUA regulates credit union-to-bank charter conversions.

In a letter dated December 13, 2005, Texas Rep. Jeb Hensarling (R) asked the GAO to investigate whether NCUA is obstructing the conversion of credit unions to mutual savings banks. In his

letter, Hensarling said recent news reports had “given the impression that a bias against credit union conversions may exist at the NCUA and could lead the administration to intentionally or unintentionally obstruct the ability of credit union members to decide freely and fairly the future of their credit union.” Two Texas credit unions recently converted to mutual savings banks but, in both cases, NCUA challenged the process before being turned back in the courts.

Hensarling was among 22 members of Congress this past summer who, after reviewing NCUA’s allegations against the Texas credit unions, sent a written appeal to the agency for reconsideration of its decision to block the conversions.

NCUA allowed a number of smaller credit unions to convert relatively painlessly following the streamlined conversion legislation in H.R. 1151 in 1998. By 2003, under pressure from credit union trade associations, NCUA launched an assault on charter change by announcing new conversion regulations. Its assault message was sent on the

day that \$650 million Columbia Credit Union (WA) mailed its first notice of conversion to members. Later, NCUA blocked Columbia's successful conversion vote by claiming a number of technical violations and ordering a re-vote.

In early 2005, NCUA again revised its regulations after the \$1.4 billion Community Credit Union filed to convert. These changes included mandatory boxed language similar in nature to the pre-H.R.1151 language mandated by NCUA. It was NCUA's conversion regulations and boxed disclosure requirements that prompted Congress to severely limit NCUA authority over conversions in 1998.

In November 2005, after suffering defeat in federal court from its effort to block the conversion of two Texas credit unions, for the third time in two years NCUA announced plans for stricter conversion rules in 2006. Hence, many believe NCUA is deliberately circumventing a 1998 federal law and Congressional directive by imposing illegal regulations in order to stop conversions. It's understandable – when a credit union converts to a mutual savings institution, NCUA loses the revenue from its interest free deposit in the NCUSIF and any other assessment.

The GAO study may also provide support to a bill introduced in August which would further limit NCUA oversight of credit unions converting to mutual savings banks, and stop NCUA from trying to use its power over the charter vote to regulate subsequent shifts to publicly owned banks.

Rep. Patrick McHenry (R-N.C.), the bill sponsor, said the federal agency should restrict its oversight to the switch in charters from credit union to mutual savings bank, and leave the subsequent change to a publicly owned bank to the thrift regulators. "The Office of Thrift Supervision governs conversions to stock," McHenry told attendees to NAFCU's annual Congressional Caucus. "They have regulations on their books that govern that part of the process." McHenry, who labeled NCUA's actions in the two Texas credit union conversions "re-freaking-diculous," said his bill would prevent NCUA from requiring converting credit unions to speculate on their future actions after switching to mutual savings banks. That would include future plans for raising capital in an initial public offering and for the remuneration of top managers and directors. McHenry said his bill would ensure that disclosures to members are clear and concise and not speculative.

Future conversion candidates can take comfort in knowing that the conversion process has been validated and that Congress is alert to NCUA's self-serving tactics to stop conversions. In addition, although it is widely reported that the courts are quick to defer to a regulator, the Texas case sent a loud message that NCUA should not be bullying or intimidating its clients.

A team of experienced professionals is required to lead a credit union through the conversion process safely. The two successful Texas conversions prove that, with the right team in place, the goal of better serving members can be reached.

2006 Conference Schedule

The "Cooperative" Banking Charter Conference: A one day, economically priced (\$125) seminar designed to provide up to date information about the mutual bank charter and FDIC insurance. Attendance is limited to credit union executives and credit union board members.

Learn from those who have made the switch

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

Call 800-649-2741 for registration and location details

Date	Day	Conference Title	City
27-Jan	Friday	The Cooperative Banking Charter Conference	Dallas
28-Feb	Tuesday	Open House & Cocktails: 4:30 pm to 7 pm - informal gathering of the conversion team members and leaders from converted credit unions, including directors - Call for details and an invitation	DC
10-May	Wednesday	The Cooperative Banking Charter Conference	Las Vegas
27-Sep	Friday	The Cooperative Banking Charter Conference	NYC
8-Nov	Wednesday	The Cooperative Banking Charter Conference	Chicago

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Update

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Strategic Planning and Implementation Services for Progressive Credit Unions; CU Financial Services, Portland, ME & San Francisco, CA **Tel: 800-649-2741** WEB Site: www.cufinancial.com; Vol. 25 No. 3 **November 18, 2005**

Be a Regulator, Not a Cheerleader

Congress Warns NCUA during Tax Hearing

With NCUA General Counsel Robert Fenner sharing the stage and the scrutiny, NCUA Chairwoman Joanne Johnson faced the wrath and humiliation of yet another committee of Congress. During an unusual question and answer session, the chairman of the Congressional Ways and Means Committee said NCUA had failed to demonstrate credit unions were holding to their legislative mandate to serve low income people, thus raising questions about whether credit unions deserved a tax subsidy.

Echoing the tone from this summer's regulatory relief hearing, when several congressmen ridiculed NCUA for attempting to invalidate the conversion voting at two Texas credit unions, the early November session continues to dampen the prospects for CURIA, the credit union regulatory relief bill. Despite gaining over 100 co-sponsors. "Credit unions are asking for CURIA but it looks like Congress is going to give them CRA," said one observer.

One lobbyist said NCUA's credibility is severely weakened after the twin Congressional hearings. In addition, it has been on the losing side of several high profile and costly lawsuits, including its landmark 1998 defeat in the Supreme Court for mis-applying field of membership legislation and again in federal court in Utah for yet another field of membership infraction. This past summer, a Texas federal court labeled NCUA arbitrary and capricious in its application of HR-1151's conversion legislation. The 1980s S&L regulator, like NCUA today, was charged with behaving like a cheerleader and being a tool of the trade associations. It led to supervision weaknesses and the dismantling of the S&L agency.

Consequently, some observers say NCUA is likely to react, or overreact, by putting a chill on credit union expansion and by ramping up enforcement of field of membership rules. It may also freeze community charter growth, and demand more branches be opened and loans be made in low income areas.

This knee-jerk reaction could also result in examiners imposing costly and subjective "phantom"

CRA requirements and a down-grading of management ratings for failure to fulfill the perceived mission of serving low income people. Some of the credit union industry's most recent successes, like business and mortgage loan increases, may be viewed by examiners as a failure to serve low income people.

Credit union trade association leaders fear that the possibility of taxation; continued restrictions on credit union capital, lending, and fields of membership; and the imposition of CRA, could trigger credit union sentiment to "tip in favor of a bank charter." One possible outcome is a loss of dues revenues from mass defections to the mutual savings bank charter, a possibility discussed at the hearing and in related news reports.

MHC Conversion Yields Multiple Benefits

Charitable Foundations Funded with IPO Stock Are Gaining Popularity at Converting CUs

As part of the re-organization of a credit union to mutual holding company, many converting credit unions are considering organizing and funding a community foundation. Cash proceeds from the minority stock offering, plus an allotment of newly issued shares, are generally combined in equal dollar amounts to fund the foundation. Following its organization, the foundation will issue annual grants for up to 5% of its net worth, far more in benefits for the community than would be possible as a credit union.

The grants can be significant since rules permit funding foundations with up to 8% of the offering proceeds. In the case of an institution raising \$100 million, almost \$8 million can be deposited in the foundation, half in stock and half in cash. If the value of the stock increases over time, the foundation can increase the size of its community grants.

To learn more about the Mutual Charter Option, Mutual Holding Company Charter, and raising regulatory capital. Log on to:
www.cufinancial.com

In addition to providing huge benefits to the community, the gift generates tax advantages for the bank and provides an avenue for the bank to handle future charitable funding requests.

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conversion by implying that conversions are being done for personal gain.

Copycat Policies

A Few CU Leagues Adopt Policies Designed to Stop Conversions

CUNA recently launched a coordinated effort to get state credit union leagues to adopt anti-conversion policies. A handful of states have acquiesced, despite opposition from many credit unions leaders who want to keep the conversion option open.

The new policies are characterized as being intended to benefit members and consumers, but in reality they do more to protect the status quo at the leagues. As one credit union director said, "They are designed to preserve full employment and financial performance at NCUA and CUNA... It is nothing less than 'cult-like' intimidation."

From California to Florida, and several states in between, these anti-conversion policies pay lip service to the notion that the option to convert to the mutual charter should be preserved. But then they go on to suggest the imposition of near-impossible terms under which a conversion should be allowed. The suggestions include requiring a 2/3 majority vote, a 50% members' quorum requirement, costly comment periods designed to lengthen the conversion process, and the funding and enabling of dissident groups, often comprised of fired employees, rejected loan applicants, left-wing social activists, and employees of the league and other credit unions.

By increasing the risk of failure, the policies' authors hope to intimidate those looking at conversion into becoming complacent and deciding to live with the impediments of the credit union charter. Furthermore, the policies also attempt to discredit and demonize directors who might undertake a

"Mutual thrifts are federally insured depository institutions most similar in structure to credit unions, because like credit unions, mutual thrifts generally do not have corporate stock, are not for profit entities, and are owned by their depositors, or members, rather than shareholders".

January 2001, US Department of the Treasury study comparing credit unions with other depository institutions.

The assault on conversions is being countered by The Coalition for Credit Union Charter Options (www.ccuco.org), an education and advocacy group formed to represent the interests of credit unions that want to preserve charter choice under reasonable rules and at a reasonable cost. The group is funded by credit unions and advised by credit union leaders and those who have converted to the mutual charter. CCUCO has confronted many false and misleading statements being made by conversion critics and their agents, including implying that converting to a mutual bank charter is tantamount to a conversion to a stockholder-controlled commercial bank. The reality is a mutual savings bank is still a member-owned cooperative, and even when stock is issued under a mutual holding company structure, the institution remains member owned and controlled.

The following companies work with CU Financial Services to help educate credit union executives about charter options and growth opportunities. Should you decide to implement a charter change, raise capital, implement a merger, and / or need help to craft a strategic plan, these firms are available to help. Please contact Alan Theriault at 800-649-2741, or the individuals listed below.

Silver Freedman & Taff

1700 Wisconsin Avenue, N.W
Washington, DC 20007
202-295-4502 * Fax: 202-337-5502

Robert Freedman, Esq.

The firm represents credit unions on a variety of matters, including advising them on charter options.

Keefe, Bruyette & Woods, Inc

211 Bradenton Avenue
Columbus, OH 43017
614-766-8400 * FAX: 614-766-8406

Patricia McJoynt

Provides investment banking and financial advisory services to financial institutions including credit unions.

Tri-State Financial L.L.C.

109 North 5th Street
Saddle Brook, NJ 07663
Tel: 201-226-9220

Steven M. Begley

Graphic Design * Financial Typesetting *
Annual Meeting Materials * Conversion
Disclosure Printing & Mailing

The Altman Group, Inc

60 East 42nd Street
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Paul R. Schulman

Proxy Solicitation and Corporate
Governance Consulting

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CCUCO produced a four-page color brochure entitled *"Myths and Truths about Charter Conversions - Twenty Questions - Cutting through the emotional rhetoric to get at the truth about charter conversions."* The brochure outlines the facts about how, after conversion, taxation is managed like any other business expense; how CURIA won't eliminate the need for charter conversions; and how current members benefit from expanded branches and loan offerings, and by new capital to fund growth rather than tapping existing retained earnings. It also explodes several common myths about conversions and the bold credit union leaders who achieve them. Hard copies of the brochure are available by contacting Lee Bettis, CCUCO's executive director, at 800-881-1698.

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An Experienced Conversion Team Is Critical

The Conversion Learning Curve Covers Disciplines from Public Relations to S.E.C. Rules

The idea of converting to the mutual bank charter often comes from hearing about it at a conference, from a colleague, or during a strategic planning meeting. Conversion is a strategic decision, and although it may not be appropriate for all credit unions, it is worthy of thorough study by most. The first step to embracing the idea involves education.

The following are among the areas to be examined as a credit union considers and moves through the conversion process:

- Charter powers and limitations
 - What are the limitations and benefits of the mutual charter?
 - How are we being constrained by the credit union charter? Is our future in jeopardy?
 - What is the future of credit union legislation? Will conversions be constrained?
 - Evaluate other non-conversion options (e.g. merger - liquidation - CU community charter)
- Feasibility for our credit union
 - Do we have the senior staff expertise to implement a conversion?
 - How will members react?
 - Can we get the vote?
- Financial modeling
 - Are we in a growth market/mode?
 - Can we deploy capital from an IPO profitably?
 - What is the impact of income taxes versus the net revenue from seizing new opportunities?
 - What are the one-time costs of conversion and will our revenues cover them without sacrificing service quality and member benefits?
 - What are the "hidden" and/or opportunity costs of remaining a credit union?

The costs of conversion for larger institutions amounts to a few weeks' earnings. Smaller credit unions, because of the fixed expenses involved, may take months to recover the costs.

NAFCU

Pay Credit Union Directors

NAFCU wants federal credit union directors to get paid like directors of state chartered credit unions in California, Texas, Pennsylvania and almost a dozen states in total. Director compensation is customary at banks and thrifts.

Current rules for federal credit unions permit only one director to be paid. To circumvent the rules, some credit unions will rotate the paid position so each director, over time, gets a paycheck. In addition, directors of some credit unions receive generous travel budgets so they can travel with a family member or significant other to luxury meeting locations around the country. The policy is an attractive benefit of serving on a credit union board for retired 'volunteers' and/or those who enjoy travel. However, some say it causes a significant increase in the average age of board members by discouraging younger people with less time for discretionary travel from considering a board position.

NAFCU's compensation push acknowledges the need for credit unions to go beyond "volunteers" to attract solid board of director candidates to handle the increasing work load and personal risk of governing a financial institution, and to identify those who can bring business to the institution because of community contacts and relationships. Their expertise, and the commitment of their valuable time, deserve legitimate compensation rather than the occasional 'freebie.'

For years, retaining unpaid directors was boldly proclaimed as another reason credit unions deserve their tax exemption. Although some credit union zealots still promote the concept, marketplace pressures and indefensible travel and expense policies are forcing some credit unions to abandon the volunteer director refrain or illusion. As boards face demands to become more accountable for their performance, corporate-style director compensation plans become more necessary.

The basic information which needs to be processed for a conversion include:

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where would credit unions be today without share drafts or mortgage loans.”

- Feasibility Plan (including financial models)
- Public Relations Plan
 - Media training for management and the board
 - Member communications
 - Dealing with opposition
- Pre-filing Plan for regulatory agencies
- Time and Responsibilities schedule
- Application forms and management biographical information
- Assessment of current and proposed activities
- Business Plan (with 3 years of financial projections in OTS/FDIC format)
- Community Reinvestment Plan (CRA)
- Eligibility exam briefings for staff
- Community Foundation Plan
- Board training in public company issues
- Policies and procedures transition plan

Under the direction of CU Financial Services as conversion consultant and coordinator, the following participants work as a team on the conversion process:

- Washington D.C. (regulatory) law firm
- Local legal counsel (state law issues and litigation)
- Federal and state lobbyists
- Financial trade associations (training, etc.)
- Financial printer
- Public relations consultants
- Vote solicitor
- Inspector of Elections
- Investment banker
- Accounting firm with S.E.C. experience

As a consultant to credit unions since 1984, CU Financial Services has been dedicated to gathering the tools and material to help credit union management and directors get up to speed quickly on important new ideas. As the coordinator of the feasibility and conversion process, CU Financial has developed numerous tools to help reduce the stress and learning curve for management, employees and directors.

“Like other new ideas in the credit union industry, the mutual bank charter option has its critics as did share drafts, investing in government securities, mortgage lending, offering investment services, and making commercial loans,” said Alan D. Theriault, President, CU Financial Services. “The critics have always claimed these new innovations will lead to taxation and the demise of the credit union philosophy, but

Marketing Conundrum

Do Credit Unions Exist to Serve Low Income People? Will Your Members Want to Be Identified with This Group?

Congress wants credit unions to do a better job serving low income people and documenting what is being done. But how will this focus impact the current and potential middle income and affluent members who bring profitable relationships to the credit union, and who represent the majority of its ownership stake? Will they want to be identified as a customer of an institution chartered primarily for the low income? What kind of marketing message does this send to the clients of credit union financial planners, trust officers, or mortgage loan officers?

Already, credit unions are having trouble convincing business owners, municipalities and non-profits that they are capable of serving their needs. Broadcasting a mission that your credit union is chartered for low income people may be inconsistent with the message that it is capable of serving business owners, or affluent and even middle income consumers. This dilemma in marketplace positioning could cost your credit union valuable relationships and add to the “hidden tax” of being a credit union.

Key Benefits of Conversion

- Capital Advantages - a bank is well capitalized at 5% and has access to the capital market tools for funding growth
- Improves Consumer Awareness relative to your capabilities - FDIC insurance
- Removes Political and Public Relations Risk
- Enhances Corporate Governance - holding company opportunities - director compensation allowed - mergers
- Product & Market Flexibility - real estate and business lending is encouraged; and regulators are experienced in these areas
- Unlimited Field of Membership

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Strategic Planning and Implementation Services for Progressive Credit Unions; CU Financial Services, Portland, ME & San Francisco, CA **Tel: 800-649-2741** WEB Site: www.cufinancial.com; Vol. 25 No. 2 **September 26, 2005**

Court Injunction Castigates NCUA

Two Texas Credit Unions are now free to Convert to MSBs

Rather than face a costly re-vote two Texas credit unions sued NCUA. Community Credit Union of Plano and OmniAmerican Credit Union of Fort Worth asked a federal court to force the defiant NCUA to certify their conversion votes. The OTS, FDIC, and Texas Credit Union Commissioner all had earlier said the conversion process was properly handled and approved the conversion of the two billion-dollar-plus institutions.

The short-lived drama started when NCUA claimed a one-page, two-sided notice to members was folded the wrong way and ordered Community and OmniAmerican to re-vote. After reviewing the facts, many observers including dozens of members of Congress dismissed NCUA's assault as being self-serving.

A powerful banking committee member stated NCUA's position was "ridiculous." Nevertheless, a few, including an uninformed conversion attorney who has not been involved in the last dozen or so filings, incorrectly reasoned that the only way the Texas credit unions would get free was by obeying NCUA's order to re-vote.

However, it was clear from NCUA's actions during the Columbia Credit Union and the Lake Michigan Credit Union conversions and the stepped-up level of anti-conversion rhetoric from the lips of NCUA's chairwoman, regional directors, and its general counsel that NCUA would likely work overtime to find yet another reason to overturn a new vote.

The lawsuit was both speedy and cost effective. It vindicated the institutions and their attorney from the false claims made by NCUA and a few critics. The judge

ruled the lawsuit was essentially won when the comprehensive applications were filed and that NCUA was wrong on multiple fronts. The judge also sprinkled the injunction with some colorful touches claiming NCUA was "silly," "inept" and that it acted "arbitrarily and capriciously in failing to certify the member vote."

With the OmniAmerican court hearing scheduled just 15 days after Community's hearing, NCUA was pressured to settle the matter or face a more heated and colorful reception by the judge. Pursuing an appeal could have resulted in NCUA's entire disclosure regulation being invalidated by the court.

Despite the credit union income tax advantage, it is an indisputable mathematical fact that a depository institution can do more for its members and its community, can offer more financial products and services, and can open more branches if it has a bank charter with access to the capital markets.

NCUA's post-settlement press release trivialized the impact of the settlement. However, Washington lobbyists and other observers said the credit union legislative agenda suffered greatly because of the incident.

Future conversion candidates can take comfort in knowing that the conversion process has been validated and that Congress is alert to NCUA's self-serving tactics to stop conversions. In addition, although its widely reported that the courts are quick to defer to a regulator, the Texas case sent a loud message that NCUA should not be bullying or intimidating its clients. Now, how can that message be delivered to the credit union leagues?

Desperate to Maintain the Status Quo

AACUL Report Struggles to Discredit Conversions

While stating that the possibility of taxation, continued restrictions on credit union capital, lending, and/or fields of membership restrictions could "tip in favor of a bank charter," this group of credit union

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league executives set out to make conversion so risky and costly that it removes it from serious consideration as a strategic alternative for credit unions.

AACUL's effort is a loud statement that regulatory and statutory relief has run its course and credit union powers and capital access are stalled. The report, although weighty and filled with legalese, when digested in context of how credit unions operate today, actually does more to highlight the huge benefits of the mutual savings institution charter and how it might be more suitable for many institutions. It is also likely to fuel a spate of conversions as credit union boards move up their timetables fearing termination of the conversion option.

For example, the report talks about how mutuals are allowed to use running proxies for certain matters proposed at annual meetings. Despite the fact that many state chartered credit unions also use proxies, the AACUL implies members are somehow harmed. But, they fail to address the resulting chaos when membership factions motivated by socialist groups, disgruntled former employees, or credit union leagues organize to take over a credit union by controlling a meeting venue for in-person balloting. Proxies give representation to the silent majority, help tip the scales in favor of common sense and protect the continuity and stability of the organization.

And, the AACUL report opens a Pandora's box by pushing the concept of credit union liquidation as an alternative to a mutual conversion. The AACUL authors are so out of touch with credit union corporate governance and member reality that they fail to recognize that armed with AACUL's proposed tools, an opportunistic member group would move for liquidation in a heartbeat. For a ten dollar bill, the majority of the membership would vote to liquidate, leading to the rapid demise of all

credit unions - not just the ones seeking growth and expansion opportunities.

AACUL proposes states should adopt more stringent conversion rules than NCUA thus putting the state charter at a competitive disadvantage to the federal credit union charter. Its plan calls for a voting quorum of 50% of the members and a super majority vote of two-thirds in favor. This would effectively give dissident groups the edge since each "no" vote would require two "yes" votes to neutralize. Hence, a minority (likely social activists, fired employees, or credit union league shells) would control the conversion decision. Furthermore, in recent conversions, opposition groups have resorted to speculation, innuendo, and outright lies to promote their anti-conversion agenda; and because of NCUA's odd mix of disclosure requirements along with unconscionable administration makes it difficult for responsible people to play defense.

The following companies work with CU Financial Services to help educate credit union executives about charter options and growth opportunities. Should you decide to implement a charter change, raise capital, implement a merger, and / or need help to craft a strategic plan, these firms are available to help. Please contact Alan Theriault at 800-649-2741, or the individuals listed below.

<p>Silver Freedman & Taff 1700 Wisconsin Avenue, N.W Washington, DC 20007 202-295-4502 * Fax: 202-337-5502</p> <p>Robert Freedman, Esq.</p> <p>The firm represents credit unions on a variety of matters, including advising them on charter options.</p>	<p>Keefe, Bruyette & Woods, Inc 211 Bradenton Avenue Columbus, OH 43017 614-766-8400 * FAX: 614-766-8406</p> <p>Patricia McJoynt</p> <p>Provides investment banking and financial advisory services to financial institutions including credit unions.</p>
<p>Tri-State Financial L.L.C. 109 North 5th Street Saddle Brook, NJ 07663 Tel: 201-226-9220</p> <p>Steven M. Begley</p> <p>Graphic Design * Financial Typesetting * Annual Meeting Materials * Conversion Disclosure Printing & Mailing</p>	<p>The Altman Group, Inc 60 East 42nd Street New York, NY 10165 Tel: 201-806-2206</p> <p>Paul R. Schulman</p> <p>Proxy Solicitation and Corporate Governance Consulting</p>

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The AACUL justifies its self-serving agenda by proclaiming it is working to "protect the rights and interests of credit union members." Apparently, it believes it owns your credit union member relationships. Clearly, this is an unusual position for a trade association to assume -- namely, opposing the strategic efforts of dues-paying members. In reality, according to one director of a converted credit union, AACUL is in the business of "promoting full employment at the credit union trade associations and NCUA."

AACUL's report, like several conversion studies produced and those pending which are paid for by leagues losing dues-paying members, can all be utilized during the feasibility phase of conversion. However, rather than balance the presentation and add to the informative content available for consideration, the league studies tend to bring emotional rhetoric into the debate and a feeling of intimidation or being bullied.

Their conclusions also call into question whether these critics really understand cooperatives since they are so quick to attack the cooperative mutual savings bank charter and the mutual holding company charter. As one director said, "these are bridge burning reports." Rather than working to identify ways to earn their dues in the future these "arrogant and self-righteous characters are forever turning us away - whether we convert or stay a credit union."

Australian Credit Union Leader

Taxation Is No Big Deal

Although he would fight to keep a tax exemption if he had one, the CEO of Australia's second largest credit union told the CU Times recently that "taxes are just another expense, like payroll. You can still be a credit union if you're taxed," said Rob Nicholls, CEO of \$1.5 billion Australian National Credit Union. "Fees can still be competitive," he said.

He pointed out that Australian Building Societies (like mutual savings banks in the US) are cooperative societies similar to credit

unions. They have always paid tax and still serve the interests of their members and the cooperative spirit.

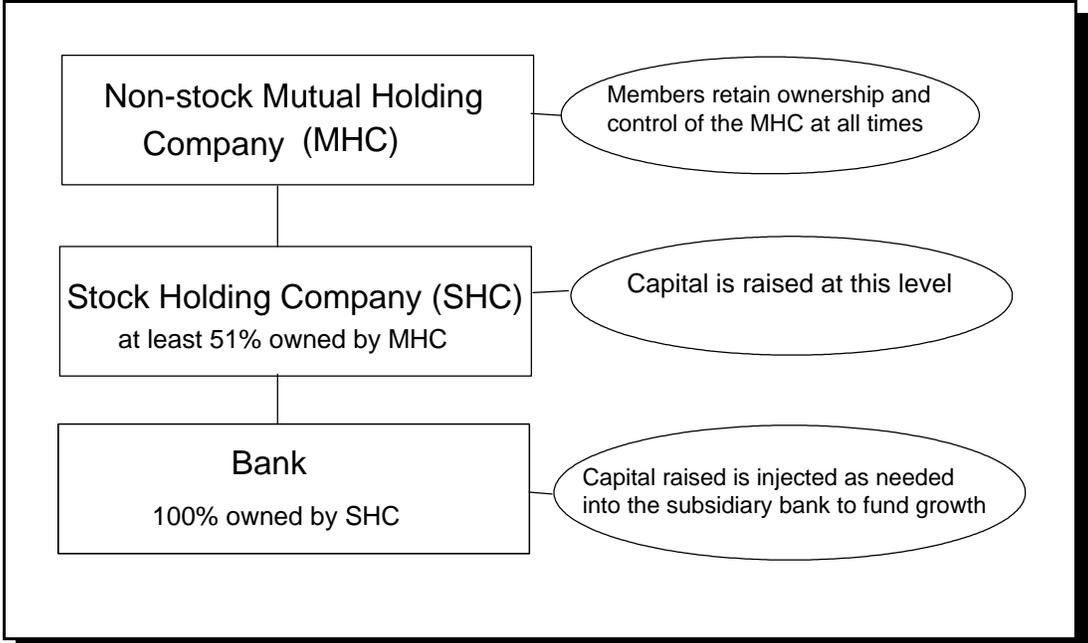
Nicholls sees no contradiction between the social goals of credit unions and the "social

The Mutual Holding Company The Best of Both Worlds

The mutual holding company is depositor-owned and non-stock, allowing the members to keep control. Two levels down, management can raise all the capital it needs to pursue its business strategy and opportunities, without the same burden faced by managers of public companies in answering to stockholders. Stock-based compensation programs transition this hybrid into a member and employee-owned cooperative, thus capitalizing on superior consumer attitudes toward both of these cooperative business structures.

Moving to a mutual holding company -- a hybrid structure that combines cooperative ownership with capital-raising powers -- is a neat balancing act. You can serve your members *and* build the strength to serve the community at large. Mergers and acquisitions are also facilitated.

(See Chart Below)



For More information, or to receive a free subscription to "Converting from a Credit Union", please contact: Alan D. Theriault, at 800-649-2741; E-Mail: atheriault@cufinancial.com; Web site: www.cufinancial.com. Copyright 2004: CU Financial Services * P.O. Box 1053 * Portland, Maine 04104 * Telephone: 800-649-2741 * Fax: 202-478-0935

4 responsibility of paying taxes" which is all part of civic responsibility, the CU Times reported in its August 31, 2005 edition.

NASCUS Report

CUs Should Have Access to Alternative Capital

A Summer 2005 white paper prepared by NASCUS makes a case for credit unions having access to alternative capital instruments. Since HR-1151, the paper states, "... credit union leaders have loudly decried the "PCA Trap." These leaders argue that successful member service inevitably leads to asset growth; rapid asset growth results in diminished capital ratios; the PCA minimums (which are higher than those for banks and thrifts) mean that growth and member service have to be curtailed."

The paper validates the efforts by a number of credit unions to convert to the mutual holding company (MHC) charter and raise capital. In fact, such conversions were contemplated by HR-1151 when the US Senate Banking Committee added an amendment to streamline the conversion process and sent a message to NCUA to facilitate conversions, not obstruct them as it had in prior years. Therefore, in the minds of members of Congress, credit unions already have access to alternative capital, thus making additional legislation unnecessary.

MHCs have a well tested process of accessing capital without dilution of member control or net worth. A MHC is a cooperative. When coupled with a minority stock offering and employee benefit plan, like an E.S.O.P., it transitions the former credit union into a powerful and stronger consumer-owned and employee-owned cooperative.

The NASCUS paper describes several investment vehicles that with enabling legislation could be used to increase capital from third parties. Some are quite similar to the tools regularly used by banks and thrifts to attract Wall Street investors. However, given the corporate governance structure of credit unions it is

likely, at least in the early years, that investors would demand a higher yield on instruments like preferred shares than demanded from banks and thrifts, thus impacting the credit union's competitiveness.

Two models discussed in the paper are truly wishful thinking and are clear non-starters with Congress and the Federal Reserve. First is the proposal that members be allowed to invest in the paid-in-capital of credit unions in the same way credit unions can invest in the paid-in-capital of corporate credit unions. Years ago, Mutual Savings Banks could sell such investments to any depositor. However, the FDIC and Congress halted the practice when one institution failed and "little old ladies" who purchased the investments claimed they were told the investment was FDIC insured.

The second non-starter is selling paid-in-capital to other credit unions, or the so-called "daisy chaining" of capital. That too has been tried by other depositories and stopped by Congress because the leverage weakens the national deposit insurance structure.

In conclusion, powerful historical forces both political and economic make alternative capital within a credit union charter unlikely. With a clear path to capital that was made part of HR-1151, credit union executives should not expect action any time soon on the wish list contained in the NASCUS paper.

"Mutual thrifts are federally insured depository institutions most similar in structure to credit unions, because like credit unions, mutual thrifts generally do not have corporate stock, are not for profit entities, and are owned by their depositors, or members, rather than shareholders".

January 2001, US Department of the Treasury study comparing credit unions with other depository institutions.

Friday September 30, 2005 - NYC

Wednesday November 9, 2005 - Chicago

9:30 am to 1 p.m.

The Cooperative Banking Charter

We are pleased to announce a one-day meeting bringing together credit union CEOs, CFOs, and credit union directors interested in the mutual thrift charter. The meeting will provide up to date information about the mutual charter, mutual holding companies, raising capital, FDIC insurance, and developing economic conditions which may make the change imperative for some credit unions.

It will also outline cooperative strategy for keeping the mutual thrift charter an option in the face of NCUA and CU Trade Association conversion road blocks.

Call: 800-649-2741 for more details and to register

Consultant to credit unions considering conversion to a mutual savings institution charter.

CU Financial crafted the first state chartered credit union conversion, and is advisor to many subsequent applicants.

Alan D. Theriault, 800-649-2741; E-Mail: atheriault@cufinancial.com; Web site: www.cufinancial.com Copyright 2004:

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Converting from a Credit Union

Update

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

News for those interested in mutual bank charter conversions by credit unions;

Strategic Planning and Implementation Services for Progressive Credit Unions; CU Financial Services, Portland, ME & San Francisco, CA **Tel: 800-649-2741** WEB Site: www.cufinancial.com; Vol. 25 No. 1 **March 15, 2005**

US Congress & GAO Conclusions Agree: **Conversion to the Mutual Charter Is the Legal Solution to Capital Constraints Imposed by HR-1151 - Not New Legislation**

According to a 2004 GAO Report: "Credit union officials, including NCUA, have stated that some credit unions have had to reduce their services to members in an effort to satisfy PCA requirements." This finding validates the trend by credit unions to convert to the mutual charter and then to the mutual holding company (MHC) to raise capital. For many credit union leaders, cutting services to members is not an acceptable solution to credit union regulatory impediments.

The mutual savings bank charter can actually better position a credit union to serve its membership and community, given the access to capital, increased product and market flexibility, and better consumer awareness. Under bank rules, a \$50 million capital injection resulting from issuing a minority ownership position in a holding company supports a \$1 billion increase in assets. Given increasing costs for services demanded by members and thinning banking margins, credit unions are mathematically unable to match this type of growth and service opportunity.

To avoid losing deposit or loan market share and thus jeopardizing a hard-earned franchise, some credit unions are selling their credit card portfolios and mortgage portfolios to generate short-term capital gains to support growth. Some are forced to participate loans and lose the income otherwise generated. Others merge to survive.

Conversion to a mutual bank charter solves numerous problems and is the logical option for funding growth for those credit unions wanting to maximize

Each over \$1.2 Billion in Assets

Two Billion Dollar Texas Credit Unions Slated to Convert to Mutual Thrift Charter

Plano & Fort Worth, TX - Community Credit Union of Plano and OmniAmerican Credit Union of Forth Worth have filed applications with the OTS, FDIC, and the Texas Credit Union Department to convert to federal thrift institutions.

Members are expected to vote on the moves sometime during the second quarter. Silver, Feedman, and Taff, CU Financial Services, and Tri-State Financial, LLC are advisors to the firms on this strategic change and have advised the majority of credit unions making the move, including all applications filed under NCUA's 2004 and 2005 conversion rules.

their efficiencies, effectiveness, and to significantly broaden their impact within their communities. (Continued on Page 2)

"Mutual thrifts are federally insured depository institutions most similar in structure to credit unions, because like credit unions, mutual thrifts generally do not have corporate stock, are not for profit entities, and are owned by their depositors, or members, rather than shareholders".

January 2001, US Department of the Treasury study comparing credit unions with other depository institutions.

Despite the credit union income tax advantage, it is an indisputable mathematical fact that a depository institution can do more for its members and its community, can offer more financial products and services, and can open more branches if it has a bank charter with access to the capital markets.

Less than 1 Month's Earnings **Conversion Costs Are Worth It Despite Increases Mandated by NCUA**

During the last 12 months three credit unions with over \$1 Billion in assets have filed applications to convert to the thrift charter. Despite NCUA's efforts to make conversion more costly than Congress intended, in each case, the total cost of the conversion effort is less than a few weeks of earnings.

Conversion rules require three member mailings, a special meeting, a firm to tally the ballots, plus the legal and consulting services typical of such strategic initiatives. Internal costs include signage, stationery, and investments in marketing and training.

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The benefits of making the strategic move are huge, including better consumer awareness which provides savings in marketing expenses and more revenues from business owners, non-profits, and municipalities. While maintaining member control, access to \$100 million in capital can be leveraged into \$2 billion in loans, investments, and a broader branch network, thus providing more member convenience and a huge benefit to the community infrastructure.

In summary, for institutions within a growing market and employing a team capable of taking advantage of these economic dynamics, the decision to convert is a simple one. Once decided, the CU Financial Services "Conversion Team" brings together the talent with the experience of having been involved in over 20 conversion applications, thus easing the burden and minimizing the learning curve for execution of this one-time strategic transition.

(Conversion - the legal solution; from page 1)

When it imposed capital and business lending limits Congress acknowledged that HR-1151 would put progressive credit unions in a quagmire. Thus, it made it perfectly clear that conversion from a credit union to a mutual bank was a legal right. Congress also sent a clear message to NCUA to stop its pre-HR-1151 efforts to thwart conversions. For a few years NCUA listened. However, now that larger credit unions are heading down the conversion road, NCUA is working overtime to impose conversion road blocks to protect its turf and preserve credit union trade association livelihoods.

A few critics have made inflammatory and slanderous remarks about those that start down the conversion path implying that conversion is criminal. These pawns of NCUA and the credit union trades, whether they are individuals, credit union executives or credit union reporters, are unable to argue against merits of the move and the obvious benefits to members and the community from conversion and so they attack the individuals involved by implying that conversions are motivated by greed. A couple of the most vocal critics appear to be outright socialists who promote an anti-business and anti-free enterprise agenda. Regrettably, they are finding fertile minds among credit union supporters for their caustic and faulty reasoning.

Conversion to a bank charter is not for every credit union. Many will remain relevant by maintaining the status quo. However, as others expand their community reach, establish an infrastructure that needs to be supported by more volume, or identify community needs to expand lending and investment opportunities, conversion to a bank becomes compelling.

Of the 9,200 credit unions in the country, just 30 have ventured down the conversion road. Yet, the daily and weekly news stories in the credit union press about conversions testify to the growing need for some to make this move and illustrates the overwhelming fear it strikes in the minds of those that depend on the status quo. These unprecedented efforts to stop conversions are clear acknowledgment that regulatory and legislative relief being pursued for credit unions are likely to fail; new relief is, quite frankly, wishful thinking. Congress has already provided the relief with the escape route to the economically desirable and socially responsible mutual bank charter.

The following companies work with CU Financial Services to help educate credit union executives about charter options and growth opportunities. Should you decide to implement a charter change, raise capital, implement a merger, and / or need help to craft a strategic plan, these firms are available to help. Please contact Alan Theriault at 800-649-2741, or the individuals listed below.

<p>Silver Freedman & Taff 1700 Wisconsin Avenue, N.W Washington, DC 20007 202-295-4502 * Fax: 202-337-5502</p> <p style="text-align: center;">Robert Freedman, Esq.</p> <p>The firm represents credit unions on a variety of matters, including advising them on charter options.</p>	<p>Keefe, Bruyette & Woods, Inc 211 Bradenton Avenue Columbus, OH 43017 614-766-8400 * FAX: 614-766-8406</p> <p style="text-align: center;">Patricia McJoynt</p> <p>Provides investment banking and financial advisory services to financial institutions including credit unions.</p>
<p>Tri-State Financial L.L.C. 109 North 5th Street Saddle Brook, NJ 07663 Tel: 201-226-9220</p> <p style="text-align: center;">Steven M. Begley</p> <p>Graphic Design * Financial Typesetting * Annual Meeting Materials * Conversion Disclosure Printing & Mailing</p>	<p>The Altman Group, Inc 60 East 42nd Street New York, NY 10165 Tel: 201-806-2206</p> <p style="text-align: center;">Paul R. Schulman</p> <p>Proxy Solicitation and Corporate Governance Consulting</p>

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The Credit Union Difference? **Growth Comes by Looking Like a Bank**

California and Michigan Credit Union League executives, among others, are promoting and executing plans for expensive marketing campaigns to make credit unions look different than banks. The campaigns are supposed to help credit unions grow but could have the opposite result.

The campaigns will make credit unions look different. But, does the typical consumer and business owner want "different?" Surveys on both sides of the continent say consumers lack an understanding of what credit unions are about and they could care less about the cooperative structure, voting policies, volunteer boards of directors, and service to low income communities. Consumers, however, universally understand (and trust) banks.

Study the fastest growing credit unions. Many of these credit unions change their names to look like bank names and put the words "credit union" in the fine print. They build branches that look like bank branches and offer the complete menu of services found at a bank. Their employees also call checking accounts "checking accounts." Members talk about "going to the bank." St. Mary's Bank, a credit union in New Hampshire and the first in the US, is doing fine even with "Bank" in its name.

Some have said these campaigns are more about preserving a role and income stream for trade associations during a time when some large credit unions are revisiting disaffiliation. Contributions to advocacy advertising become another hidden "credit union tax."

Myth or Reality

Rate Advantage - Is It real? How Important Is Rate? Does Taxation Affect Rate?

Compare the top 50 credit unions to the top 50 banks and the claim is made that credit unions pay higher yields. But, is this a fair comparison? Does this make credit unions a better choice? Not necessarily. The mega-banks and mega-credit unions represented by these studies generally serve different niches than a typical community-focused credit union. And so, the comparison is not valid universally.

The credit union list includes credit unions (like Navy Federal) which have a government or corporate operating subsidy and / or marketing advantage. The mega-banks include trillion dollar diversified institutions serving many corporate customers. They approach yield as just one component of the customer value proposition. Thus banks can

pay lower rates while maintaining market share and satisfied customers.

For the typical community-focused credit union, the lack of a government or corporate operating subsidy, narrowing margins, and cost pressures are making it more difficult to compete on rate alone. The bank / credit union rate and fee differential is getting smaller. The most successful community-focused institutions don't depend on just rate to maintain their franchise.

Wednesday May 11, 2005

9:00 am to 1 p.m.

The Cooperative Banking Charter The Venetian - Las Vegas

We are pleased to announce a one-day meeting bringing together credit union CEOs, CFOs, and directors of larger credit unions interested in the mutual thrift charter. The meeting will provide up to date information about the mutual charter, mutual holding companies, raising capital, FDIC insurance, and developing economic conditions which may make the change imperative for some credit unions.

It will also outline cooperative strategy for keeping the mutual thrift charter an option in the face of NCUA and CU Trade Association conversion road blocks.

Guest Speakers

- *Two CEOs who have made the switch and one with a conversion pending*
- *The principal of a North American public relations company experienced with conversions*
- *The vice president of the financial printing company who prints and mails member disclosures (the highest budgeted conversion cost item)*
- *The executive director of a national proxy solicitation firm with experience doing member solicitations*
- *The CFO of a billion dollar thrift who is also an expert on FASB's mutual combination rules and experienced at crafting successful mergers*
- *A managing director of the Wall Street firm helping credit unions access the capital markets*
- *The senior attorney from the law firm responsible for filing all the conversion applications since HR-1151, and the majority of conversions historically*
- *The executive director of the Coalition for Credit Union Charter Options*

Optional Golf and Tennis are scheduled following the meeting.

Call: 800-649-2741 for more details and to register

For More information, or to receive a free subscription to "Converting from a Credit Union", please contact: Alan D. Theriault, at 800-649-2741; E-Mail: atheriault@cufinancial.com; Web site: www.cufinancial.com. Copyright 2004: **CU Financial Services * P.O. Box 1053 * Portland, Maine 04104 * Telephone: 800-649-2741 * Fax: 202-478-0935**

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Generating economies of scale and maximizing infrastructure efficiency is critical to meeting member demands and posting a respectable bottom line. That is why many progressive credit unions are looking at the mutual charter. The capital raising ability, lower regulatory capital requirements, and improved consumer awareness facilitate growth and efficiency and are too attractive to ignore.

The facts show that credit unions are faced with numerous "hidden taxes," thus, converted credit unions are finding that income taxes are affordable without compromising member service or benefits. Banks prove by their huge market share that taxation is manageable, just like any other business expense. Credit unions in other countries have also managed the impact of taxation and retain and increase market share.

In conclusion, yield comparisons support the status quo and are manipulated by conversion critics to discourage members from voting in favor of a charter switch. However, these comparisons are misleading when applied to the specific economic dynamics of a single conversion. Rate offerings are balanced by other dynamics and any so called rate "advantage" is not dependent on a tax subsidy.

Earnings Crises

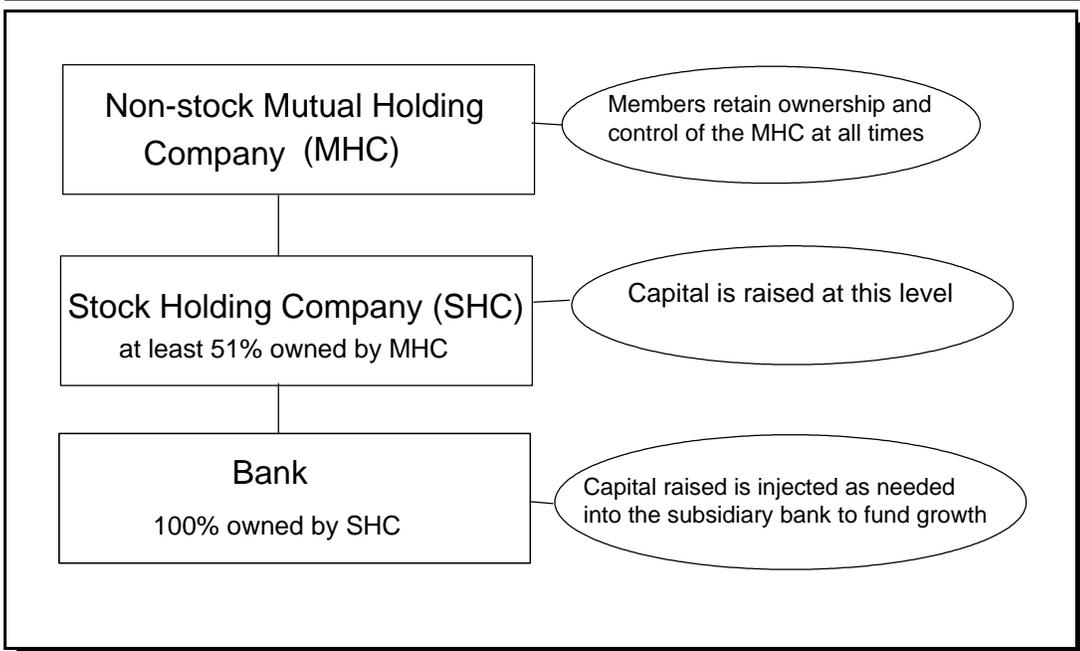
Credit Union ROA Declines Will Lead to a Huge Jump in Mergers

In 2004 credit union ROA declined to a new modern day low. Furthermore, almost 50% of credit unions are now earning less than 50 basis points. And in some states, like Michigan for example, 55 credit unions out of 413 lost money. NCUSIF insurance fund statistics show a rise in number and size of troubled credit unions.

The best of both worlds

The mutual holding company is depositor-owned and non-stock, allowing the members to keep control. Two levels down, management can raise all the capital it needs to pursue its business strategy and opportunities, without the same burden faced by managers of public companies in answering to stockholders. Stock-based compensation programs transition this hybrid into a member and employee-owned cooperative, thus capitalizing on superior consumer attitudes toward both of these cooperative business structures.

Moving to a mutual holding company – a hybrid structure that combines cooperative ownership with capital-raising powers -- is a neat balancing act. You can serve your members *and* build the strength to serve the community at large. Mergers and acquisitions are also facilitated.



Economic conditions, recent performance, and CEO retirements are signaling the rapid extinction of as many as 1,000 credit unions during 2005. Mergers, which have been growing in numbers in recent years, may soon sky rocket.

Historically, credit unions, like privately insured or uninsured depositories, have had to pay higher rates compared to FDIC insured banks in order to attract and retain deposits. Consumers expect it, especially at credit unions which offer few other conveniences. It is this kind of pressure to pay higher rates, and the concomitant pressure on margins, that ultimately will lead to merger discussions.

Poor earnings also spell trouble for CEOs nearing retirement age and facing an unfunded retirement plan. Regulators will frown on funding retirement programs at a poor performing institution. The only logical solution is to seek a friendly merger to facilitate the retirement funding.

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Strategic Planning and Implementation Services for Progressive Credit Unions; CU Financial Services, Portland, ME & San Francisco, CA **Tel: 800-649-2741** WEB Site: www.cufinancial.com; Vol. 24 No. 6 **October 12, 2004**

Capital Conundrum Unsolved

GAO Opposes Secondary Capital and PCA Tinkering

The outcome of the GAO report means the credit union capital conundrum will remain unsolved for a very long time thus making the mutual savings bank option that much more critical.

Credit unions are caught in a political and philosophical quagmire because of the GAO report. The report indicated many of the biggest credit unions (those with significant influence over NCUA policies) want to maintain the status quo which, along with the GAO findings, means all credit unions are likely to go without secondary capital for a long time. Furthermore, PCA changes are unlikely until the impact of the current legislation is further tested through several economic cycles.

GAO said: "Credit union officials, including NCUA, have stated that some credit unions have had to reduce their services to members in an effort to satisfy PCA requirements." For many credit union executives, cutting services to members is not an acceptable solution to credit union regulatory impediments.

This finding validates the trend by credit unions to convert to the mutual savings bank and then to the mutual holding company (MHC) to raise capital.

By this assertion, NCUA also contradicts one of the disclosure elements in its proposed regulation targeting conversions. (See *Second NCUA Conversion Rule in 12 Months.*) NCUA wants converting CUs to state that services will be reduced by conversion as a result of taxation, when in fact the mutual savings bank charter can actually better position a credit union to serve its membership and community, given the access to capital markets, increased product and market flexibility, and better consumer awareness.

Despite the credit union income tax advantage, it is an indisputable mathematical fact that a depository institution can do more for its members and its community, can

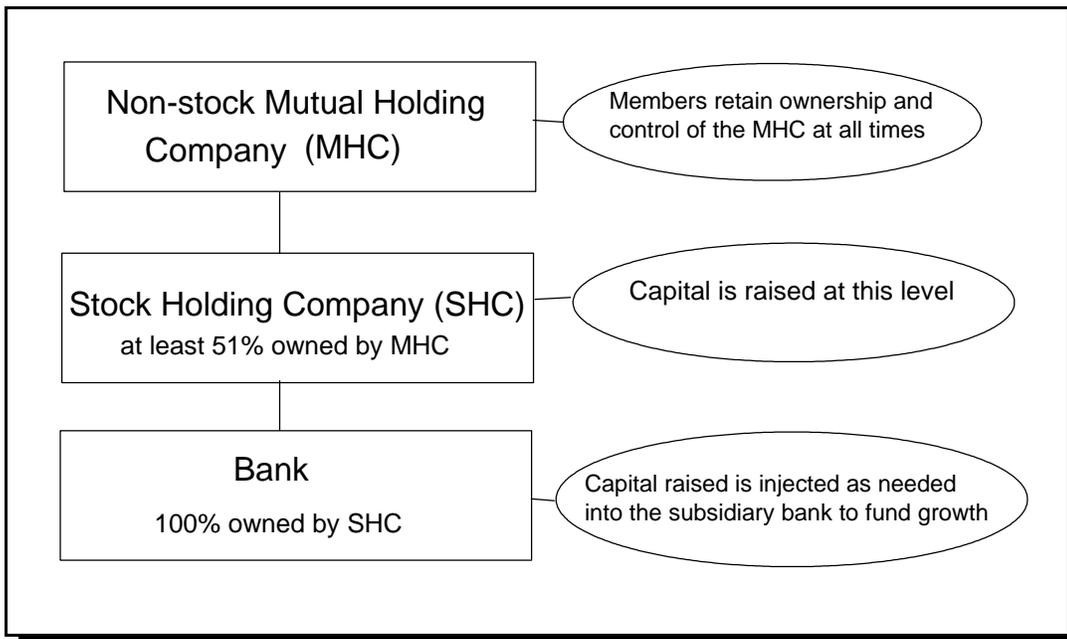
offer more financial products and services, and can open more branches if it has a bank charter with access to the capital markets. **(Continued on Page 4)**

A Capital Idea

The Trend to Mutual Holding Companies

One of the biggest problems facing successful credit unions is a chronic shortage of capital. A 2002 survey of NAFCU members concluded that an astounding 42% expect to need capital soon in order to maintain growth, to meet Prompt Corrective Action (PCA) requirements, or for other reasons. Exacerbating the problem is the 7% core capital ratio CUs must maintain, compared to 5% for banks. Complex CUs also take a 'capital haircut' because of concentrations in real estate loans, business loans, and certain investments. And they have no access to the capital markets without converting to a bank charter. In addition, the NCUSIF is likely to have problems keeping up with the growth rates of large credit unions, thus leading to the need to charge premiums, an unpopular subject especially with smaller credit unions already faced with earnings problems.

Not every CU that has converted to the mutual savings bank charter has gone public though. Far from the inevitable stock conversions being decried by the likes of the



NCUA, the facts are these: Of the 30 conversions done (or in the pipeline), only seven have raised capital by moving – sooner or later -- to full stock through an IPO. Six merged with other 'like-minded' mutuals. Another nine have formed, or are in the process of forming, a mutual holding company.

Mutual banks can raise capital in a number of ways. One obvious method is a public offering of shares, to which the former credit union's members have first right of refusal up to a certain limit. But because not all members will choose to participate, or participate to the same degree, the ownership composition of the institution will be immutably changed.

What may make more sense for some credit unions contemplating a charter change is the *mutual holding company* (MHC). Under this option, the members' ownership rights in the credit union are converted to ownership rights in a non-stock holding company.

The MHC, in turn, will own the shares of a bank holding company, which can sell stock to members of the institution and the community up to 49% of the capitalization. It is this stock-based holding company that would own the stock-based operating thrift, plus any number of subsidiaries for mortgage lending, insurance, securities or other businesses permitted and fitting the institution's objectives. In the same way a credit union owns a CUSO, which is stock-based, the cooperative operating philosophy is filtered downward. Control is maintained.

Without selling any stock, the MHC can raise capital in other ways. It can arrange a commercial loan at the stock holding company level or organize a nonvoting trust to offer shares to institutional investors. The proceeds are pushed downstream to create core capital in the subsidiary bank and for the support of its operating companies.

Keeping the voting rights at the top level -- still in the hands of the original members -- allows the institution to retain its cooperative philosophy, community focus, management team, directors and culture.

"Mutual thrifts are federally insured depository institutions most similar in structure to credit unions, because like credit unions, mutual thrifts generally do not have corporate stock, are not for profit entities, and are owned by their depositors, or members, rather than shareholders".

January 2001, US Department of the Treasury study comparing credit unions with other depository institutions.

"It's really the best of both worlds," claims Alan Theriault, president of CU Financial Services, a credit union consulting firm specializing in charter conversions. "The mutual holding company is depositor-owned and non-stock, allowing the members to keep control. Two levels down, management can raise all the capital it needs to pursue its business strategy and opportunities, without the same burden faced by managers of public companies in answering to stockholders. Stock-based compensation programs

transition this hybrid into a member and employee-owned cooperative, thus capitalizing on superior consumer attitudes toward both of these cooperative business structures."

In conclusion, expansion-minded credit unions exploring a charter conversion have four primary options: community credit union; mutual savings bank; stock-based bank; and mutual holding company. The community charter addresses the field of membership problem. But it still leaves the CU stuck with severe limits on its powers and forced to build capital at a snail's pace. The mutual savings bank option lifts the limits on activities such as real estate and commercial lending. But building core capital is mostly limited to increasing retained earnings and other capital strategies efficient for large institutions only. Converting to a publicly traded, stock-based institution offers broad powers for product diversification and opens the doors wide to capital. But it strays from cooperative roots, and some critics feel that demutualization amounts to disenfranchisement of some members.

On the other hand, moving to a mutual holding company – a hybrid structure that combines cooperative ownership with capital-raising powers -- is a neat balancing act. You can serve your members *and* build the strength to serve the community at large. Mergers and acquisitions are also facilitated.

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Robert Freedman, Esq.

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Provides investment banking and financial advisory services to financial institutions including credit unions.

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Steven M. Begley

Graphic Design * Financial Typesetting
* Annual Meeting Materials *
Conversion Disclosure Printing & Mailing

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False and Misleading Disclosure Proposed **Second NCUA Conversion Rule in 12 Months**

NCUA is at it again with another proposal (the second in 12 months) requiring a converting institution to include a NCUA-crafted, false and misleading statement in its notice. Space does not permit a full discussion of all the flaws with this onerous proposal, but more commentary is available on the CU Financial Services web site. Obviously, NCUA hopes to slow conversions with this new rule, but it may in fact accelerate the process as credit union leaders studying this path start to wonder what NCUA might think of next.

Unlike the "Surgeon General's" cigarette package warning which can be supported with factual research, the proposed NCUA warning contains only unsupported speculation and sensational claims.

For example, it requires the following language to be bold and capitalized: "**ADDITIONAL EXPENSES MAY CONTRIBUTE TO LOWER SAVINGS RATES, HIGH LOAN RATES, OR ADDITIONAL FEES FOR SERVICES.**" This treatment is crafted to imply that this is an automatic outcome of conversion as a result of assuming a federal tax liability. In fact, for many converting credit unions, NCUA's imagined outcome is more likely if the conversion is not undertaken.

Despite the credit union income tax advantage, it is an indisputable mathematical fact that a depository institution can do more for its members and its community, can offer more financial products and services, and can open more branches if it has a bank charter. Contrary to NCUA's view that converting to a taxable institution would mean injury for members and the community, financial modeling shows that, as a future thrift, not only is increased loan activity a real benefit to members and the community, the earnings from that business – coupled with investment yields far superior than those historically possible for credit unions – would produce net profits for members greater than what is now possible as a tax-exempt credit union.

Credit union executives and others surely understand the benefits banks enjoy from lower capital requirements and access to the capital markets. Several credit union CEOs recently told the GAO that because of PCA, higher capital requirements and lack of access to secondary capital, credit unions are faced with: (1) Refusing deposits; (2) Reducing services to members in order to retard the growth of assets; (3) Converting to a savings and loan or community bank; or (4) Merging with another credit union.

The GAO confirmed this view when it said: "Credit union industry officials, including NCUA, have stated that some credit unions have had to reduce their services to members in an effort to satisfy PCA requirements."

A May 2004 report produced by the Washington Credit Union League entitled "*Defining the Credit Union Difference*" stated: "PCA rules induce credit unions to maintain capital levels higher than necessary to protect the share insurance fund. Credit union response to these pressures is to limit growth, which requires limiting service to members. This,

KBW's Second Annual CU Conference for Financial Competitiveness - NYC

Dinner - Wednesday, October 27, 2004
Conference - Thursday, October 28, 2004

- US Economy - Consumer Behavior
- The Future of Community Banking
- The Role of Secondary Capital
- Benefits of building a Sales Culture
- Trends in Financial M&A
- CU Investment Strategy
- CU to Thrift Conversions

Contact: Thomas H. Huthwaite at (212) 887-8990

in turn, reduces the amount of funds that credit unions can devote to member loans that support the economy."

A senior vice president of CUNA Mutual's Credit Union Financial Solutions Group complained in a recent news story that "current law mandates that credit unions, unlike other financial institutions, must rely on retained earnings alone to build capital to satisfy regulatory Prompt Corrective Action (PCA) requirements." He continued, "This puts most credit unions and ultimately their members at a competitive disadvantage because it dampens the credit union's growth potential." Speaking about conversions, the CEO of the Washington Credit Union League stated: "These conversions may represent a fundamental weakness in the overall national credit union charter that needlessly restricts capital accumulation and business lending."

NASCUS Chairman and Michigan Credit Union Regulator Roger Little told the *Credit Union Times*, as reported in its September 22, 2004 edition: "Credit unions continue to be punished for their success because they are restricted in their access to capital." Little added, "Alternative capital for many state chartered credit unions is imperative if they are to continue to meet the financial needs of their members such as financing home ownership, financial education, and credit counseling. The combination of PCA requirements established by Congress for credit unions in 1998 and significant deposit growth has created a financial

\$175 Million in Assets

Share Plus Federal Credit Union Starts Operation as a Federal Mutual Savings Bank

Plano, TX - Share Plus commenced operation as a mutual savings bank on October 1, 2004 making it the third credit union to make the move during 2004 and the first to complete a conversion using NCUA's February 2004 disclosure rules. Members overwhelmingly approved the conversion in July. Share Plus filed its application to convert in December of 2004. Silver, Feedman, and Taff, CU Financial Services, and Tri-State Financial, LLC advised the firm on this strategic change.

For More information, or to receive a free subscription to "Converting from a Credit Union", please contact:
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and regulatory dilemma for many state-chartered credit unions."

In an August 27, 2004 editorial to *American Banker*, CUNA's Chief Economist Bill Hampel said, "To suggest that credit unions are less regulated than banks is ridiculous. Granted, credit unions are not subject to the Community Reinvestment Act, a law passed to address bank redlining. But in virtually every other regard they are more regulatorily constrained than banks: Credit unions still face binding -- although somewhat reduced -- field-of-membership restrictions; have no access to net worth other than retained earnings; are subject to higher capital requirements than banks; are much more limited in business lending; and face more restrictive investment regulations." As the Treasury Department said in 2001, federal credit unions "have more limited powers than national banks."

As evidenced by these comments from credit union leaders, plus common sense and basic math, credit unions converting to banks and maximizing the chartering opportunity are not taking on a tax expense that will negatively affect member savings rates, loan rates, or fees. The facts show that pricing is primarily set by market forces and not by a dependence on a tax subsidy.

With NCUA requiring such false and misleading statements in charter conversion disclosure statements, one is tempted to ask: Does the insurer of deposit-taking institutions with over \$600 billion in assets somehow fail to comprehend the mathematical relationship and contribution to revenues that result from lower capital ratios and third party capital? If so, that comprehension gap in itself is enough reason to exit the charter.

(GAO Report - continued from Page 1)

Although CUNA's Dan Mica agrees with the GAO that, for now, the majority of credit unions are not affected by PCA net worth requirements, he states that upward of 15% percent of well-managed, well-capitalized credit unions are now sufficiently close to the PCA net worth cutoffs to be concerned that they could run into PCA issues in the mid- to near term.

According to NCUA data, just 12% of credit unions control 75% of deposits. Many of the credit unions identified by Mica as affected by these mid- to near term issues are part of this group and could thus control up to \$200 billion in credit union assets, according to CU Financial Services estimates.

In a press release regarding NCUA's proposed rule, CU Financial Services said NCUA's recent efforts to stall conversions to the mutual bank charter and impose costly and punitive conversion rules is clear acknowledgment that capital and meaningful PCA relief is only a distant possibility. The ability to select a charter that best supports the mission of a financial institution is a critical right that should be preserved. It is what Congress intended when it added streamlined conversion language to HR-1151.

Clearly recent events, and NCUA's compulsive rulemaking targeting conversions, indicate that the regulator is unable to remain independent and objective on the topic of conversion to the mutual savings bank charter. Credit union executives, especially the 15% that could be affected by

Laws Permit Banks to Do More For Their Community

Despite the credit union income tax advantage, it is an **indisputable** fact that a depository institution can do more for its members and its community, can offer more financial products and services, and can open more branches if it has a bank charter.

Contrary to the view that converting to a taxable institution would mean injury for members and the community, financial modeling shows that, as a future thrift, a hypothetical credit union with \$50 million in net worth would be able to offer members and future members more than \$1.3 billion in new loans and still remain in cooperative form.

Common sense and basic math illustrate the combination of lower capital ratios and access to capital prove that credit unions converting to a banks and maximizing the chartering opportunity are not assuming expenses, including taxes, which will negatively affect member savings rates, loan rates, or fees.

Not only is increased loan activity a real benefit to the community, the earnings from that business – coupled with investment yields far superior than historically possible for credit unions – would produce net profits for members greater than what is now possible as a tax-exempt credit union.

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capital and PCA issues, should act now to help remove NCUA from the conversion process. Credit unions should be free to adopt the mutual savings bank charter if it is right for their institution.

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Number 3 & 4 Bank Conversions for 2004

Two More Credit Unions Cleared for Mutual Conversion

Each with assets approaching \$200 million, a Florida state chartered credit union and a Texas federally chartered credit union just received member approval and NCUA clearance to convert to mutual savings banks. They are the first credit unions to win NCUA clearance after the agency imposed new and widely criticized conversion requirements in February 2004.

The two credit unions won member approval by a wide margin and will represent the third and fourth credit unions to convert during 2004, increasing the number of converted credit unions to 28.

The Florida credit union, Sunshine State Credit Union, also gave members notice that after becoming a bank it will reorganize into a mutual holding company structure and conduct a member minority stock offering of no more than 49% of the shares of a subsidiary holding company.

Dallas based Share Plus Federal Credit Union plans to continue to serve its nationwide membership from branches in four states while executing community based expansion plans in the fast growing Dallas suburbs.

PR Concerns Help Justify Conversions

Earnings Troubles at 5,000 Credit Unions Mobilize CUNA & AACUL

CUNA and AACUL announced a program to help boost earnings at poor performing credit unions. An early August news story said 3,274 credit unions had a ROA of less than 40 basis points, and 1,211 credit unions had a negative ROA. Some believe the CU trade associations fear a public relations catastrophe for the entire movement if the situation fails to improve or gets worse.

Poor performance is blamed on margin contraction caused in part by increased competition from large credit unions adding broad fields of membership. Small CUs are facing eroding membership and wallet share, in part because of generous community charters granted to large, prosperous

credit unions. Regulatory costs and management complacency are other reasons cited.

Should the earnings situation deteriorate further, NCUA might be forced into taking punitive action which could throw cold water on political initiatives and direct political attention in the wrong places. In addition, better performing (larger) credit unions continue to rapidly grow, putting pressure on the NCUSIF and leading to the need to charge an insurance premium. This increases earnings pressure on the poor performers and also widens the gulf between smaller and larger credit unions. The FDIC insurance fund is better capitalized, does not require a deposit, and enjoys better consumer awareness, highlighting several significant advantages of a mutual savings bank charter.

Poor consumer awareness of a credit union's capabilities also has a material impact on credit union performance and forces many to pay higher rates and charge below market loan rates in order to attract business. This impacts retained earnings accumulation, member service levels and growth. Negative national press attention to inferior credit union performance, business lending troubles, risks of privately insured credit unions, and an increase in problem credit unions add to the "hidden tax" of operating under the credit union charter and make the mutual savings bank charter that much more attractive.

A dramatic short term jump in mergers is one predicted outcome of the recent CUNA and AACUL initiative. Some say the trades are out to pressure poor performing credit unions to merge in order to capture economies of scale and fall off the NCUA radar. Closing a deal fast will be important because a proposed FASB rule change would negatively impact credit union mergers as early as the end of 2005.

Early Warning

NCUA Alarm! Business Lending

After months of touting the benefits of business lending and encouraging credit unions to make loans to self-employed borrowers, NCUA in early August issued a stern warning to credit unions making business loans.

Business lending presents a unique underwriting risk because, in general, new small businesses have a high failure rate, the borrower's income typically fluctuates from year to year, and the borrower may be personally liable for the debts of his business, NCUA Chairman JoAnn Johnson said.

The warning comes just one month after NCUA clamped down on state credit union regulators in Washington,

Missouri, and Texas who were broadly interpreting their authority under state business lending regulations previously approved by NCUA under the Dollar administration.

The warning also followed July reports that even as the number of credit unions dropped by over 1,000 from June 2000 to June 2004 the number of problem credit unions jumped from 202 to 251. They now represent the highest percentage of insured shares in over 10 years.

Mutual savings banks are not faced with anywhere near the "business lending" limits faced by credit unions. For example, federal thrifts can make unlimited residential real estate loans, including second homes, rental vacation homes and multifamily loans. Residential loans are not counted in the business and commercial loan buckets. Thrifts may make loans secured by nonresidential commercial property in aggregate amounts up to four times the capital of the institution. Loans secured by non-real estate business assets are allowed, with some distinctions, up to 20% of the assets of the thrift. Loans to one borrower are limited to 15% of capital.

Bank regulators are very experienced in the review of commercial loans and business loans and understand unique and complex structures, some of which might include the use of interest rate swaps to accommodate the special needs of the borrower.

Sets \$1 Billion Threshold

OTS Streamlines CRA

WASHINGTON – The Office of Thrift Supervision (OTS) announced that effective October 1, 2004, it will modify the existing "small institution" test for thrifts under the Community Reinvestment Act (CRA). The rule increases the "small institution" threshold for savings associations from \$250 million to \$1 billion. The "small institution" test focuses on lending activities in order to comply with CRA.

The final rule will permit thrift institutions qualifying as small savings associations to benefit from streamlined CRA examinations as well as reduced data collection and reporting

burdens under the CRA. The FDIC, which examines many state chartered thrifts, is expected to adopt a similar rule.

Banks over \$1 billion in assets will continue to have CRA exams focused on lending, investment, and service.

Is it outdated? Still relevant?

One Member - One Vote

A credit union is not a labor union, a country club, or a city. It's not a political organization or a social welfare organization like a charity, commune, or kibbutz. Credit unions were organized by small groups of people with similar backgrounds and financial circumstances in order to facilitate their individual monetary gain. During the organizing days of credit unions, postal workers, telephone workers, teachers, military personnel, and community members each brought roughly the same level of financial resources to the table. Hence, the one member - one vote was easy and made perfect sense. It was fair. At the time, economic reality was the prevailing consideration, not social activism.

Today, things are dramatically different. A credit union has evolved into an economic entity which attracts member deposits and loans based on convenience, service and rates. Members mainly vote with their money and quickly will move their account to get a better deal - even to a bank. Unlike the early days, multiple banking options are easily accessible and competitive options abound.

Consumers do not define their credit union relationship based on ownership or one member - one vote. Hence, credit unions today only get modest levels of voter participation in director elections or thrift conversion votes. Defining credit unions as democratic organizations is just rhetoric since, in practice, member apathy means they are not. Thus, modifying the voting structure to one based on participation actually improves the governance and member participation. This is closer to the standard practice for all other financial organizations.

Credit unions today, especially the larger, are economic organizations with individual members making disparate financial commitments. Members now come from widely different backgrounds and economic circumstances. For

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example, many are retired and have banked large pension plan payouts; and early organizers of immigrant credit unions are now seeing very different savings and work behaviors from newly immigrated members.

Furthermore, studies at larger credit unions indicate that just 20% of the membership own almost 80% of the net worth. Many ask, rightly so, why should a member participating with a \$5 deposit have the same influence as one participating with a \$100,000 deposit? Maybe it is time to rethink the wisdom of one member - one vote. Most members today quickly see the wisdom of voting by participation when these economic realities are debated.

Mutual savings banks offer voting structures that recognize each depositor with a minimum of one vote, much like a credit union. However, it rewards another vote for each additional \$100 on deposit up to 1,000 votes or \$100,000 on deposit. The more a member participates with his deposits the more votes he has, up to a cap. Yet, no single member can exercise excessive control because of his millions on deposit. The influence is capped at 1,000 votes. This voting structure acknowledges the level of commitment and risk of the larger depositors which are the long time members. It is fair. Nevertheless, credit unions converting to federal mutual banks can still retain their one member - one vote structure and a few converting credit unions have done so.

Pro-rata by Deposits or Split Up Equally

Who Owns the Credit Union Net Worth?

The one member - one vote structure of credit unions has led some people to believe that the net worth of a credit union is equally owned by each member. In error, a CU marketing consultant and vocal critic of credit union conversions has made this false claim as well as the CEO (and social activist) of a multi-billion credit union. NCUA employees from time to time publish generalizations that promote the error.

By law, the only member claim to credit union net worth is during a liquidation when the net worth would be distributed on a pro-rata basis based on deposits. Therefore, members really don't own the net worth, but a claim to the net worth in a liquidation ("liquidation rights"). And, moreover, they do not own equal shares of the net worth unless they hold equal deposits. A member cannot borrow against his "ownership" in the credit union, sell it, or pass it on to his children, except after a liquidation. Studies at larger credit unions calculate that just 20% of the membership "own" almost 80% of the net worth.

The ownership structure of a mutual thrift and a mutual holding company are virtually identical to that of a credit union. Even during a full stock conversion, and / or subsequent sale of the institution, a liquidation account is established at the new institution to recognize the inchoate ownership position of the original credit union members. Members participating with higher deposit levels get additional votes if the mutual

CU Name	Assets as CU	Assets 3/31/04	Date of 1st Conversion	
Full Stock Conversions				
1	Affiliated Federal (TX)	9	92	06/01/98
2	Allied Pilots (IL)	82	130	09/01/01
3	BUCS Federal (MD)	58	119	03/01/98
4	I.G.A. Federal (PA)	160	467	07/01/98
5	Pacific Trust (CA)	215	623	01/01/00
6	Rainier Pacific (WA)	383	684	01/01/01
7	Synergy Federal (NJ)	180	631	05/01/98
Mutual Holding Company Conversions				
1	AGE FCU (GA)	266	331	07/01/01
2	Atlantic Coast (GA)	321	499	01/11/00
3	Beacon Federal (NY)	145	328	07/01/99
4	Citizens Community (WI)	102	134	12/31/01
5	Community Schools (MI)	35	46	02/01/02
6	Kaiser Federal (CA)	190	874	11/01/99
7	Lusitania SB, FSB (NJ)	55	159	09/01/95
8	Monadnock FSB (NH)	10	44	05/01/96
9	Ohio Central Federal (OH)	29	54	06/01/98
Source: CU Financial Services www.cufinancial.com				

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- SBA & USDA
- Compensation flexibility
- Holding company powers - merger growth
- Full range of products
- RE & Business Loans: trained examiners
- Increased marketplace credibility
- Use of 1% deposit
- Unlimited branching authority
- State law preemption
- Maintain control of future direction

authorizes voting based on participation. (See related article above.)

For More information, or to receive a free subscription to "Converting from a Credit Union", please contact:

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Mica Appeals to Bankers for Relief, but What is the Real Message?

CUNA President Dan Mica recently appealed to bankers to bury the hatchet. Strategically what does such an appeal accomplish? What is the real message? *Compromise*.

Will CUNA meet with bankers and policy makers to discuss credit union taxation? Many are arguing that this would be the right thing to do and ultimately it will happen. It's been said that the "C" in Capitol Hill stands for "*Compromise*".

Bankers are willing to *compromise* and leave some 6,000 smaller credit unions untaxed, thus costing larger credit unions the support of the smaller on the tax issue. Smaller credit unions, many which are facing earning problems, would not generate significant tax revenues anyway since they have only a modest share of total CU assets.

A tax on large credit unions will also come at the cost of freedom to convert to a bank charter. For years many credit union executives have been threatening to convert to a bank unless NCUA accommodated their expansion plans. NCUA got the message and produced broad fields of membership and expanded powers, but the accommodation may be coming to an end now that NCUA is trying to make conversion more costly and difficult.

A tax *compromise* could cause large credit unions to face the need to live with the lack of charter options and capital options, poor consumer awareness, restricted lending and investment powers, and taxation. Congress may not be convinced that credit unions are ready for a full slate of powers, and if they received expanded powers whether NCUA is capable of supervision or administering such things as commercial lending and secondary capital. Some believe a serious commercial lending misstep or participation default will ultimately cost the NCUSIF big dollars and attract Congressional scrutiny.

Thus, any *compromise* would prohibit conversion to a bank charter to protect the NCUSIF from a flood of deposit withdrawals. The credit union trade associations would claim victory because they saved the credit union movement by stopping conversions and keeping NCUSIF intact. They would claim taxation was inevitable. The trades would further argue that they primarily exist to protect the member / consumer and that they had no choice but to negotiate large credit

unions into a charter trap. Executives of large credit unions lobbying for the flexibility to convert would be falsely accused of being greedy.

In conclusion, Dan Mica is setting the stage for *compromise* and a credit union charter trap. A conversion prohibition secures revenues for both CUNA and NCUA, and it will be promoted as a victory for consumers. But, what about the members / owners? What about the lost benefits to the community and lost efficiencies and lost productivity otherwise generated by expanded powers and capital access?

Although recent changes to conversion rules increase conversion costs - the two credit unions recently cleared prove conversion is still possible. How long will that be true?

Fearing a Wave of Conversions NCUA Proposes yet Another Conversion Rule

It's clear that if they had their way, NCUA and the credit union trade associations would outlaw conversions. Members and credit union executives have no interest in making conversion more difficult or more costly. Yet, NCUA is at it again with another proposal (the second in 12 months) requiring a converting institution to include a NCUA crafted, false and misleading statement in its notice.

Comments received during NCUA's February 2004 rulemaking attacking conversions prove credit unions did not want NCUA tampering with the HR-1151's streamlined conversion law. Just over 40 comments were received. Of

9,000 - plus credit unions, only 16 cared enough to comment. Of the 16 credit unions commenting, 4 opposed the rule and 3 had concerns it went too far. Of the remaining 9 in favor, 4 submitted forms provided by the trade association with Yes / No boxes to check; 5 are in direct competition with credit unions that converted or are about to convert; 3 had less than \$35 million in assets.

Sixteen comments favoring the rule were from CU trade associations or credit union regulators. Of the 16, all the associations / regulators but two have lost revenues (or are about to) as a result of conversion.

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The Community Benefit Model **Members and the Community are the Ones to Gain from a Conversion to a Bank**

Economic Conditions Require a Progressive Response

The mandate of a community chartered credit union is to serve the entire community. Some market areas served are facing increasingly sober news including weak employment numbers, layoffs, factory closings, and slow economic growth. In order to maximize their contribution to turn these communities around, a few credit unions are proposing a conversion to a mutual savings bank, or thrift charter, and even the additional step, which requires another vote of depositors, to raise equity capital by providing the opportunity for members to invest in a minority stock offering.

The credit union charter has supported the growth of many institutions. But many credit unions can do a lot more. These communities need everybody to do their part – to be their best. The additional investments that can be made, in new loans, is a way for progressive conversion candidates to serve communities to the very best of their abilities – something that they can't do under current credit union regulations. The reorganization as a mutual savings bank unlocks substantial additional lending ability because bank regulations and bank convention permits higher loan volumes per dollar of net worth. Credit unions are handcuffed by punitive net worth requirements that affect their competitiveness in this area. Also, credit unions are prohibited from accessing the capital markets in order to increase net worth (capital), while banks do this on a regular basis.

Switching to a thrift charter would mean giving up the state and federal income tax exemption enjoyed by credit unions. Critics point to taxable status as a disadvantage, without considering the growth in revenue and profit that can come from an expanded market opportunity, product line, and capital access.

The vast majority of financial institutions in this country pay taxes and achieve a return on equity far in excess of most credit unions, while delivering value that results in market share domination. Income taxes, like any other cost of doing business, are manageable. Credit Unions in other countries pay

taxes. Some non-profits (like \$300 billion TIAA-CREF) have relinquished their tax exemption in exchange for modern powers.

Taxation is Managed Like Every Other Business Expense

Contrary to the view that converting to a taxable institution would mean injury for members and the community, financial modeling shows that, as a future thrift, a hypothetical credit union with \$50 million in net worth would be able to offer members and future members more than \$1.3 billion in new loans. Not only is increased loan activity a real benefit to the community, the earnings from that business – coupled with investment yields far superior than historically possible for credit unions – would produce net profits for members greater than what is now possible as a tax-exempt credit union. Credit unions historically earn much lower yields on the investment component of their balance sheet compared to banks. Recent NCUA and FDIC data indicates the yield disadvantage is greater than 2%. A better performing investment portfolio along with higher levels of loans outstanding, at a minimum, neutralizes the impact of taxation. (*Continued on Page 3, "Benefit Model"*)

Correcting Distortions

Facts Shine Positive Light on Mutual Bank Conversions

By: Alan D. Theriault, President, CU Financial Services

Based on the press coverage in the past several months, you'd think mutual bank conversions were happening in the hundreds. Yet, of the more than 9,300 credit unions, just 26 have converted to the bank charter or merged with like-minded institutions.

The topic is attracting volumes of publicity, some of it critical of this evolutionary process. Distortion and misrepresentation, whether intentional or because of carelessness, appears to be fair play for some critics.

Generally, a trade association and those directly impacted by the distortion or misrepresentation would step up and set the record straight. Currently, however, no trade organization exists to promote and defend a credit union's right to convert. In contrast, CUNA and others are working overtime to make conversions off-limits and intimidate those who would defend the move. Furthermore, leaders who have converted are occupied with the more important matter of running a newly

empowered institution. For them, the incentives for weighing in on the debate are few.

Thus, in order to balance the rhetoric, CU Financial Services, a consulting firm focused on strategic planning, is thrust into the debate. Its web site, www.cufinancial.com, has become a popular source for information designed to support the view that conversion, for some credit unions, is a positive move for members and the community. In fact, 4 credit union conversions are in the pipeline, others are in the feasibility/pre-filing stage, and we are being contacted on a regular basis for information about conversion. So, in the paragraphs that follow, I find it imperative to correct a few recent distortions.

Distortion: After conversion, demutualization is inevitable.

CUNA is fond of implying that all conversions to the mutual charter will lead to full stock conversions, or demutualization. Recently, CUNA's CEO, Dan Mica issued a quote which said, "I also note that thus far it appears the majority of those credit unions converting to mutual thrifts have not preserved their members' ownership of the institutions, but rather have quickly flipped to stock ownership within a few years after the initial conversion." Further, a February 2004, *Credit Union Magazine* article reported: "12 of the 18 since 1998 already have done so."

Far from representing a majority, in fact, only 7 out of 26 have completed full stock conversions. Mica also ignores the fact that many members of these seven purchased stock during the conversion process and continue to be member/owners today.

Of the seven full conversions, three were institutions with less than \$5 million in net worth operating in giant metropolitan areas. At the time, the full conversion resulted in a more efficient capital raising process and better preserved the right of members to share in the ongoing ownership by making more stock available. The remaining four institutions were much larger, but also were located in huge, well-banked, metropolitan areas. The capital raised allows their progressive management teams to execute competitive branching and acquisition

strategies with much less risk than they would have faced with the credit union charter, which is limited by punitive capital standards and a prohibition on access to the capital markets.

Another 8 of the 26 moved to the mutual holding company charter (MHC), which preserves member ownership, member control, and the cooperative structure while allowing depositors to inject fresh capital into the organization. This dynamic innovation offers a solution for credit unions seeking to maintain their cooperative structure while accessing capital. It also brings together the public benefits of consumer ownership and employee ownership since employees can have an ownership stake too by virtue of access to an Employee Stock Ownership Plan (ESOP). In the years ahead, as banking margins continue to shrink and competition makes improving economies of scale imperative, we believe the MHC is likely to become the cooperative banking charter of choice. The balance of the converted credit unions remains in mutual form today or has merged with other cooperatively owned institutions.

Distortion: Conversion is all about greed

Despite the credit union income tax advantage, it is an indisputable fact that a depository institution can do more for its members and its community, can offer more financial products and services, and can open more branches if it has a bank charter. Thus, unable to attack the process, critics attack the decision-makers.

Greed becomes the rallying charge. At a CUNA-sponsored discussion group during the 2004 Government Affairs Conference, CUNA paraded its anti-conversion evangelist from 1993, now a retired credit union CEO, to again recite the purity of his motives in resisting a conversion and equating conversion to a crime against God, with a price to pay at the Judgment Seat.

CUNA's board also passed a resolution which in part implies that credit union directors – ironically, the same people who authorize the payment of dues to CUNA and in the past participated in CUNA training programs and governance activities -- would, by conversion, put their personal interests ahead of the interests of members.

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In fact, the conversion process, and the mutual capital-raising process, has survived decades of review and scrutiny by hundreds of board members and depositors, government officials, legal experts, the court system, and the United States Congress. Credit union conversions to a bank charter were again confirmed legal in 1998 as part of HR-1151, and are viewed by many members of Congress as the solution to credit union capital and product restrictions imposed as part of HR-1151.

It is insulting and simply incorrect to suggest that credit union boards are not working in the best interest of their members in these conversions. All the boards that have worked with CU Financial Services have only taken the conversion step after reviewing the powerful business case, member benefits, and community benefits for the charter change and explored all reasonable options as a credit union. Board and management compensation issues, although a tangential part of the process, were of little importance and in most cases not even considered relevant.

Moreover, each step of the way during the conversion process from credit union to mutual and from mutual to MHC, or even to full stock, members, and shareholders must vote. Management compensation plan details are public information and also must be approved by shareholders. There's nothing secretive about the process, as some critics would have you believe by clamoring for expanded disclosure.

Unfortunately, space does not permit me to address other published distortions, such as: "Each conversion to a bank weakens our ability to serve a nation with affordable financial services;" "The credit union is equally owned by its members;" and NCUA is doing an "outstanding job" in the area of supervising conversions.

(Benefit Model; Continued from Page 1)

Member service levels and returns are thus preserved.

Therefore, converting to a bank charter allows a former credit union to be in a better position to serve its members and its communities while retaining high levels of service, a member oriented philosophy, and independence. The benefits of being able to make more loans, provide more employment opportunities, build more branches, and serve all types of depositors and borrowers generate economies of scale that causes a former credit union to be more productive. The move is clearly a win for the community and the membership.

Converting Allows Growth and Member Benefits to Continue

As a credit union, many are currently faced with slowing growth to stay in compliance with the higher credit union capital requirements. The slow down would not be necessary as a bank. Slowing growth involves reducing rates on deposit accounts and has the undesirable effect of encouraging

CU Name	Assets Before	Assets 3/31/04	Date of 1st Conversion
Full Stock Conversions			
1 Affiliated Federal (TX)	9	92	06/01/98
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3 Beacon Federal (NY)	145	328	07/01/99
4 Citizens Community (WI)	102	134	12/31/01
5 Community Schools (MI)	35	46	02/01/02
6 Kaiser Federal (CA)	190	874	11/01/99
7 Lusitania SB, FSB (NJ)	55	159	09/01/95
8 Ohio Central Federal (OH)	29	54	06/01/98
Source: CU Financial Services www.cufinancial.com			

Conversion to a Federal Mutual Savings Bank

- Member ownership continues
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- Positive reception at OTS & FDIC
- Lower capital requirements
- Unlimited field of membership
- SBA & USDA
- Compensation flexibility
- Holding company powers - merger growth
- Full range of products
- RE & Business Loans: trained examiners
- Increased marketplace credibility
- Use of 1% deposit
- Unlimited branching authority
- State law preemption
- Maintain control of future direction

members to move banking relationships elsewhere. Although increasing loan rates and fees helps mitigate the need to slow growth, a credit union's competitiveness and new account acquisition strategies would suffer. These strategies underwrite adding member conveniences, like new branches, as well as support ongoing high levels of member responsiveness. Branch development requires account and deposit acquisition to cover operational costs and helps make services more cost effective for all members. But, branch expansion must be supported by capital. Lack of capital slows growth and delays branch development, thus reducing convenience for existing members,

For More information, or to receive a free subscription to "Converting from a Credit Union", please contact:

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and delays the hiring of new employees and infrastructure development which supports economic recovery.

Remaining a credit union and living with capital constraints will mean putting a stop to growth, turning away new members, lowering the rates offered on deposits and raising the rates charged on loans. Moreover, the facts challenge the assertion that credit unions have an inalienable pricing advantage over banks, as some observers would have you believe. Many banks and other financial institutions charge no fees whatsoever on basic products like checking accounts, or offer savings yields well in excess of the average credit union.

The credit union capital disadvantage is widely acknowledged by credit union industry leaders. For example, Dan Mica, President of Credit Union National Association, recently wrote, "Credit unions are indeed burdened by an inappropriate system of prompt corrective action, which requires them to hold even more capital than a bank despite their typically lower risk profile." John Annaloro, president of the Washington Credit Union League, said in a press release that recent (bank) conversions are representative of the "fundamental weaknesses in the overall national credit union charter that needlessly restrict capital accumulation and business lending." Mica remarked that he was "heartened" by legislation proposed to reform PCA.

Proposed Legislation: A Risky Accounting Gimmick - Secondary Capital Unlikely

Despite Mica's optimism, the proposed legislation regarding PCA is viewed by some as an accounting gimmick that fails to provide a safe and solid solution for fast growing credit unions. The tinkering supported by this proposed legislation is not a long term solution. It does not add a single dollar of actual (tangible) capital - it merely leverages the credit union's existing capital across more assets. The legislation has mixed support among credit union leaders and generates serious concerns for the 8,000 smaller credit unions experiencing slow growth. The bill, designed to fuel the rapid growth of large credit unions, increases systemic risks and the liability of directors who might utilize its provisions. The growth would force NCUSIF to charge insurance premiums, thus hurting the

earnings of the smaller credit unions already pressured by plunging investment yields and rapid member defections to larger credit unions. The Bill's passage is unlikely. Efforts, dating back to 1999, to enact laws to allow secondary capital, opposed by many credit unions large and small, are also likely to fail.

(For more information, including tables which illustrate the concepts discussed in this article check the CU Financial Services web site at: www.cufinancial.com)

**Under the Microscope
CUs Face Close Scrutiny**

IRS, FASB, NCUA, Congress, consumer activists, investors, investment product competitors, and political groups are closely watching credit union activities as the industry expands its profile and pocketbook. It's not just the bankers.

For example, reports indicate that IRS is looking at the tax status of community credit unions, UBIT, and nonprofit executive compensation. Given the public's interest in corporate governance, a demand for disclosure of credit union board and management compensation/benefits is likely to surface, especially since some credit union insiders are pointing the finger at others.

FASB proposals would make credit union mergers and loan participation difficult, if not impossible. Concern about expensing the 1% share insurance deposit surfaces now and then, in part because of efforts by some to make the deposit nonrefundable and by increasing bank conversion hurdles.

NCUA directors are using their pulpit to furiously promote a social agenda designed to deliver services to low income areas. Using the argument that credit unions need to serve all segments of their charter, some may find their CAMEL rating drop because they fall short of NCUA examiner ideals.

Also, given the low interest rate environment, some are suggesting that older credit union depositors or special interest groups might pressure credit union managers to pay higher dividends, drop capital ratios, or even liquidate. Serving low income areas may not be a priority for most credit union members.

For these and other reasons, credit union charters will decline at an unprecedented rate and conversions to the mutual charter will increase.

The Cooperative Banking Charter

A one day seminar designed to provide up to date information about the mutual bank charter, mutual holding companies, raising capital and FDIC insurance.

- Learn from CEOs who have made the switch, conversion advisors, and those raising capital
- Tips on crafting a public relations strategy
- Review NCUA's new disclosure regulation and its affect on the conversion process
- Learn how state laws and regulations impact charter selection, the conversion process and FDIC approval

• Bonus: Tips for closing merger deals

July 1, 2004 - Tallahassee, Florida

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Strategic Planning and Implementation Services for Progressive Credit Unions; CU Financial Services, Portland, Maine & San Francisco, CA Tel: **800-649-2741** WEB Site: www.cufinancial.com; Vol. 24 No. 1 **April 2, 2004**

VA and WA Credit Unions

Two More Convert to Bank Charter during First Quarter 04

A \$90 million Virginia Beach federal credit union and a \$290 million Seattle area state chartered credit union completed their conversions to the mutual bank charter during the first quarter of 2004, the 25th and 26th credit unions to make the move. Four more are in the pipeline ranging in size from \$150 million in assets to over \$1 billion.

@LANTEC Financial FCU of Virginia served the Navy Atlantic Fleet Command headquarters personnel until making room for \$20 billion Navy Federal to take over the military base operation. Now, operating as Bank@LANTEC the depositor owned institution is executing its expansion strategy focused on mortgage lending.

First Security Bank of Washington is the new name for the former Washington's Credit Union, the third credit union to exit what many believe is the most permissive credit union state charter in the country. Improved consumer awareness and product and market flexibility are among the benefits this multi-branch former credit union will enjoy under a bank charter.

Member Control Continues

Two Former CUs Access over \$60 million in Capital using Mutual Holding Company

Former \$190 million California based Kaiser Permanente FCU and \$86 million Wisconsin based Citizens Community FCU raised a combined \$60 million in separate member approved and subscribed public equity offerings. Rather than fund growth by tapping member retained earnings, the new capital supports strategies designed to deliver superior member service and value while growing to take advantage of critical economies of scale. The members of each institution remain in control since both offerings involved less than a 49% equity interest.

In 1999 with a little more than \$190 million in assets the progressive Kaiser Permanente FCU made the bold move to a federal mutual bank charter. After years of serving employees of a cooperative hospital system, management recognized it needed new avenues for growth. In a few short years, assets expanded to almost \$500 million. The additional capital results in total capital approaching \$90 million, thus allowing growth to continue to the \$2 billion range.

Citizens Community FCU has always found that opportunities for growth exceeded the ability of retained earnings to support the growth. Since converting to a bank in December of 2001, Citizens has acquired new branches and its business plan indicated that fresh capital would facilitate expansion while maintaining a superior commitment to member service.

The credit union charter has supported the growth of many institutions. But many credit unions can do a lot more. The communities served need everybody to do their part. By having access to capital to support growth, additional investments can be made in new loans, as a way for progressive conversion candidates to serve communities to the very best of their abilities – something that they can't do under current credit union regulations.

The reorganization as a mutual savings bank unlocks substantial additional lending ability because bank regulations and bank convention permit higher loan volumes per dollar of net worth. Credit unions are handcuffed by punitive net worth requirements that affect their competitiveness in this area. Also, credit unions are prohibited from accessing the capital markets in order to increase net worth (capital), while banks do this on a regular basis.

A Capital Idea

The Mutual Holding Company

By: Lee H. Bettis, Senior Strategic Advisor, CU Financial Services & Former CEO / Director of Heritage Financial Group

No one would argue that failure to achieve a business plan brings with it all sorts of problems. But *success* – in the form of faster growth – carries its share of problems, too. One of the biggest problems facing successful credit unions is a

chronic shortage of capital.

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A 2002 survey of NAFCU members concluded that an astounding 42% expect to need capital soon in order to maintain growth, to meet Prompt Corrective Action (PCA) requirements, or other reasons. Exacerbating the problem is the 7% core capital ratio CUs must maintain, compared to 5% for banks. CUs also take a 'capital haircut' because of concentrations in real estate loans, business loans, and certain investments. And they have no access to the capital markets without converting to a bank charter. In addition, the NCUSIF is likely to have problems keeping up with the growth rates of large credit unions, thus leading to the need to charge premiums, an unpopular subject especially with smaller credit unions already faced with earnings problems.

The Trend to Mutual Holding Companies

Far from the inevitable stock conversions being decried by the likes of the NCUA, the facts are these: Of the 30 conversions done (or in the pipeline), only seven have raised capital by moving – sooner or later -- to full stock through an IPO. Six merged with other 'like-minded' mutuals. Another nine have formed, or are in the process of forming, a MHC.

Mutual banks can raise capital in a number of ways. One obvious way is a "full conversion" public offering of shares, to which the former credit union's members have first right of refusal up to a certain limit. But because not all members will choose to participate, or participate to the same degree, the ownership composition of the institution will be immutably changed.

What may make more sense for some credit unions contemplating a charter change is the *mutual holding company* (MHC). Under this option, the members' ownership rights in the credit union are converted to ownership rights in a non-stock holding company.

The MHC, in turn, will own the shares of a bank holding company, which can sell stock to members of the institution and the community up to 49% of the capitalization. It is this stock-based holding company that would own the stock-based operating thrift, plus any number of subsidiaries for mortgage lending, insurance, securities or other businesses permitted and fitting the institution's objectives. In the same way a credit union owns a CUSO, which is stock-based, the cooperative operating philosophy is filtered downward. Control is maintained.

Without selling any stock, the MHC can raise capital in other ways. It can arrange a commercial loan at the stock holding company level or organize a nonvoting trust to offer shares to institutional investors. The proceeds are pushed downstream to create core capital in the subsidiary bank and for the support of its operating companies.

Keeping the voting rights at the top level -- still in the hands of the original members -- allows the institution to retain its cooperative philosophy, community focus, management team, directors and culture.

"It's really the best of both worlds," claims Alan Theriault, president of CU Financial Services, a credit union

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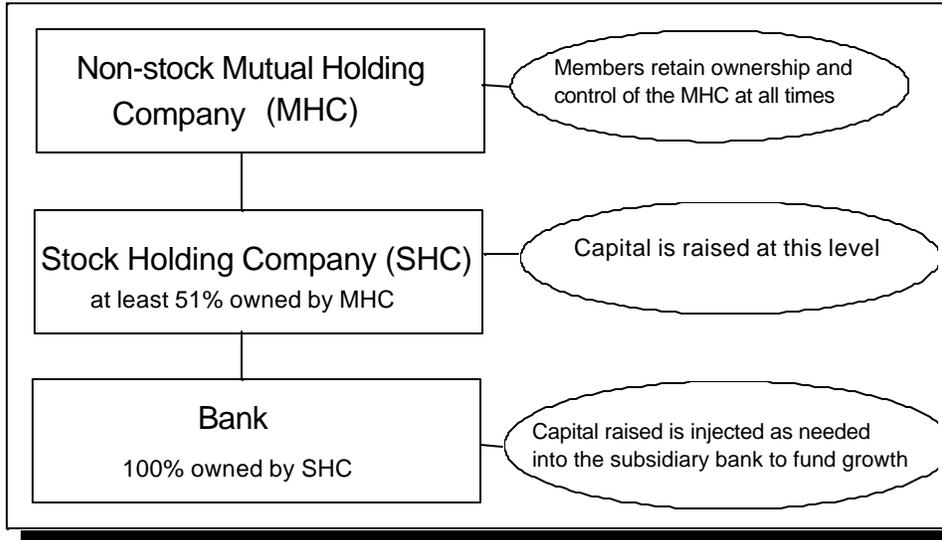
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consulting firm specializing in charter conversions. "The mutual holding company is depositor-owned and non-stock, allowing the members to keep control. Two levels down, management can raise all the capital it needs to pursue its business strategy and

Albany, GA. After a successful conversion in 2001, the new bank's growth blossomed, particularly in mortgage lending and commercial banking. In 2002, it reorganized under the mutual holding company structure. Len Dorminey is president and CEO of Heritage Financial Group, a stock holding company (owned

by a non-stock MHC) that owns 100% of the stock of the bank. A strategy of measured, well-grounded growth has given Heritage a strong foundation for future expansion in people, systems and infrastructure. Len explains: "We've built tried and true best practices and we know they work. We have a lot of expertise we can replicate and share, if others want to join us."

With 9% capital, and access to more, Heritage Financial is well-equipped to explore mergers with credit unions attracted by the possibilities of a mutual bank charter. And this course of action is a bold new alternative to the typical CU-to-CU merger. On top of their operating efficiencies and deep talent pool, progressive mutuals like Heritage allow the merging entity to retain its board of directors, corporate identity and cooperative philosophy.



opportunities, without the same burden faced by managers of public companies in answering to stockholders. Stock-based compensation programs transition this hybrid into a member and employee-owned cooperative, thus capitalizing on superior consumer attitudes toward both of these cooperative business structures."

In conclusion, expansion-minded credit unions exploring a charter conversion have four primary options: community credit union; mutual savings bank; stock-based bank; and mutual holding company. The community charter addresses the field of membership problem. But it still leaves the CU stuck with severe limits on its powers and forced to build capital at a snail's pace. The mutual savings bank option lifts the limits on activities such as real estate and commercial lending. But building core capital is mostly limited to increasing retained earnings and other capital strategies efficient for large institutions only.

Converting to a publicly traded, stock-based institution offers broad powers for product diversification and opens the doors wide to capital. But it strays from cooperative roots, and some critics feel that demutualization amounts to disenfranchisement of some members.

On the other hand, moving to a mutual holding company -- a hybrid structure that combines cooperative ownership with capital-raising powers -- is a neat balancing act. You can serve your members *and* build the strength to serve the community at large. Mergers and acquisitions are also facilitated.

This scenario held true for HeritageBank of the South, a \$340 million-asset bank that started life as AGE Credit Union of

Across the credit union system today, there is an abundance of news and comment about conversions past, present and future. Unfortunately, there is much misinformation, some of it politically motivated. For any credit union contemplating a conversion to mutual savings bank status, which I believe is one of the most revolutionary and exciting opportunities ever made available to CUs for achieving successful growth, it pays to deal with experienced professional advisors. If you think you'll need regulatory capital in the next few years, call CU Financial Services at 800-649-2741 today.

Conversion to a Bank **Growth and Member Benefits Continue with access to Capital**

As a credit union, many are currently faced with slowing growth to stay in compliance with the higher credit union capital requirements. The slowdown would not be necessary as a bank. Slowing growth involves reducing rates on deposit accounts and increasing loan rates which have the undesirable effect of encouraging members to move banking relationships elsewhere, and a credit union's competitiveness and new account acquisition strategies suffer.

The credit union capital disadvantage is widely acknowledged by credit union industry leaders. For example, Dan Mica, President of Credit Union National Association,

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Community / Member Benefit Illustration				
		A	B	C
	Financial Data (Dollars in thousands)	CU	Mutual Savings Bank	Mutual Holding Company
1	Capital / Assets ratio to manage to	7%	5%	5%
2	Assets	\$714,285	\$1,000,000	\$2,500,000
3	Capital	\$ 50,000	\$ 50,000	\$ 125,000
4	Investments	\$171,428	\$ 240,000	\$ 600,000
5	Loans	\$507,142	\$ 710,000	\$1,775,000
6	Additional community loan capacity	NA	\$ 202,858	\$1,267,858
7	Increased loan revenue NIM (3% estimate)	NA	\$ 6,086	\$ 38,036
8	Increased Investment Yield (2% estimate)	NA	\$ 4,057	\$ 12,000
9	Additional earnings available for taxes, member benefits, incidental costs, and stock dividends	NA	\$ 10,143	\$ 50,036
10	After Tax ROA @ 1.0%	\$ 7,143	\$ 10,000	\$ 25,000
11	Additional earnings (line 9) available for taxes, member benefits, incidental costs, and stock dividends plus regular ROA (Line 10)	\$ 7,143	\$ 20,143	\$ 75,036
12	Performance difference between a mutual and a credit union (Column "B") and between a MHC and a credit union (Column "C"). These earnings are available above and beyond current activity to increase retained earnings and to expand member benefits; like branches - technology - yields		\$13,000	\$ 67,893

- The table illustrates the huge differences possible by converting to a mutual savings bank. Column "A" illustrates a hypothetical credit union with \$50 million in regulatory capital. Column "B" indicates that with the same level of capital a non-stock mutual savings bank can outgrow credit union assets by almost \$300 million because bank regulations support higher levels of growth per dollar of capital; Column "C" illustrates \$1.5 billion more growth possible by utilizing the mutual holding company structure (MHC) and a \$75 million minority member stock offering. Members continue to control the non-stock mutual holding company. The MHC structure preserves the ownership and control of the institution. A MHC cannot be sold or taken over. It can, however, merge with another mutual or MHC and it may acquire banks or merge credit unions. This opportunity is not available to a credit union.
- Row 6 illustrates the much higher bank lending capacity in the amount of \$203 million and \$1.3 billion respectively. Invested in the community infrastructure, these loans would have a powerful impact on job creation and related community benefits, like home ownership and small business development.
- Row 7 & 8 illustrates the additional revenues from higher loan volumes per dollar of net worth (capital); and the impact of a bank's historical investment portfolio yield advantage. Added together (line 9) they illustrate that substantial revenues become available for paying taxes, adding member benefits, managing incidental costs and contingencies (like conversion cost), and to pay stock dividends. Row 7 does not consider the more profitable loan mix possible as a bank, which would result in higher revenues.
- Row 10 illustrates managing an institution to a 1.0% after-tax ROA.
- Row 11 illustrates the \$20.1 million annual additional member benefit as a mutual and an additional \$75 million annual benefit as a MHC. These additional benefits are available to pay taxes, incidental costs, stock dividends, increase retained earnings, and expand and improve branches, technology, and delivery systems or for member distribution in the form of higher yields or lower loan rates. Row 12 illustrates the net financial benefit from a conversion to a mutual or a MHC.

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