

Credit Union Conversion Plan Draws Opposition from Members

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The nine-member board of directors of the Lafayette Federal Credit Union has been working for months on a plan to convert the 76-year-old not-for-profit institution into a for-profit bank, a process that could give the directors and other top executives a multimillion-dollar windfall.

But they have not formally informed the Kensington-based credit union's 16,000 stakeholders, who include workers in several federal agencies and residents in the District and Maryland.

Opponents of the conversion express concern that these credit union members will not be prepared to watch out for their own interests when the proposal comes to a vote by the end of the year. The federal regulator overseeing the proposal warned the board of directors last month that the information packet it then planned to send out was "misleading," but approved an amended version yesterday.

The problem, the opponents say, is that turning Lafayette into a bank could mean rising fees and declining services because the board's priority would shift to earning a profit for shareholders. Under law, a credit union's board must instead serve the best interest of the people who own it -- the depositors.

They also point out that in most credit-union-to-bank conversions, members of the new bank's management team have ended up owning more shares and making more profit than rank-and-file members.

"I have rarely seen a situation with such a lack of transparency, even in the developing world," said Tom Carter, a member of the credit union, who promotes the creation of cooperative businesses around the world in his job at the U.S. Agency for International Development. "And I'm outraged because it's a betrayal of trust by individuals elected to represent and protect the interest of the 16,000 member-owners."

Five of Lafayette's directors did not return telephone calls seeking comment. Four others referred questions to Lafayette chief executive Michael Hearne, who did not return telephone calls. In a statement released last night, Hearne said he thought the proposal was in the members' best interests and was "intended to allow us to continue to provide the type of affordably priced financial services that we have provided for many years."

Carter and other members who heard about the plan by word of mouth and plan to fight the proposal say they are angry that rank-and-file members have not been informed about the plan along the way -- especially because the directors have used members' money to pay a lawyer, Richard S. Garabedian, dubbed by the banking trade press as the "Credit Union Conversion Guru," to guide them through the process. Garabedian declined to comment for this story.

And they are concerned that directors, who are unpaid volunteers, and top executives have a conflict of interest in recommending the conversion because of the financial benefits they could reap through higher salaries, stock awards and other compensation.

In the statement released last night, Hearne said, "We may institute a stock ownership plan for all our employees." He said all members "will have the opportunity to invest on the same basis."

Credit unions evolved about a century ago to provide reasonably priced loans to consumers who could not get them from banks. As not-for-profit institutions owned and controlled by the people who use them, they are exempt from federal taxes and face limits on what products they can sell. And they can accept as depositors only people who come from defined groups who share something in common, such as where they work or live.

But in the past several decades, reduced profit margins at banks and credit unions alike has intensified competition as both institutions vie for many of the same customers. Because of their

tax-exempt status, credit unions have offered on average lower fees and better interest rates than banks.

In 1998, Congress passed a law making it easier for credit union directors to convert their institutions to banks, in part by removing the requirement that a majority of members had to approve the conversion. Instead, they need only a majority of those members who vote.

In the past decade, 29 of the approximately 9,500 credit unions in the country have converted to for-profit, shareholder-owned banks. In each case, industry officials say, the board of directors and top executives have cited the need to attract a wider customer base and sell a broader array of financial services for the institution to remain viable long-term.

And in most cases the directors and top managers, but few other members, have profited from the conversion, mostly from stock sales, according to government and industry officials. In a study of five conversions, the Credit Union National Association, the industry's trade group, says that stock and other awards averaged \$742,000 for each director and more than \$1.2 million each for the chief executive and other top executives.

The Lafayette board's lawyer, Garabedian, was a lead lawyer on many of the conversions.

Last month, the National Credit Union Administration, the federal agency that regulates the institutions, rejected Lafayette's request to send out ballots on the conversion plan. The regulator said the proposed information packet accompanying the ballots was, in several specific ways, "inaccurate," "misleading" and "insufficient" to enable members to make a fully informed decision.

The NCUA's letter cites Lafayette's May board minutes as saying "the decision to proceed with a charter conversion was based on the board's opinion that the conversion is in the best interests of the members and not because the board of management has any desire of self-enrichment." But, the NCUA said, the information the board was planning to give members included no discussion of whether the change would benefit members, and instead focused on the difference in projected financial performance between a bank and a credit union.

The regulator also said the board's argument that the institution needed to become a bank to win more customers did not make sense, because Lafayette's own estimates say the credit union has 900,000 potential new customers within its current market.

Garabedian resubmitted the request with changes to address the regulators' concerns. Yesterday evening, Lafayette announced it had won NCUA approval to send out a revised information packet and the ballots. Garabedian declined to release a copy of the revised application.

Every member of a credit union that converts must be given a chance to buy stock in the resulting banking company before it is sold to the public, up to an amount set by the board and bank regulators. In theory, that means they have the same chance to profit once the initial stock sale ends, when share values typically jump. In practice, however, industry and government officials say few members understand how to participate or have the money to do so.

"It ends up that the people with money take advantage of the opportunity and the poorer guy won't be able to," said Russell Kashian, an associate professor of economics at the University of Wisconsin's Whitewater campus who studies credit unions.

Scott Stiens, another Lafayette member who also works for the Agency for International Development, said he planned to fight the proposal because he thinks members will not benefit.

"A conversion leads to losing tax-exempt status, and that translates into a business cost that has to be passed along to customers in the form of higher fees and charges or lower service," he said.

Lafayette has assets of \$331 million, with \$30 million in reserves that now belong to its members. Under the terms of the deal, the \$30 million will transfer to the new bank.

Lafayette members will have 90 days after receiving the ballot to vote.