CREDIT UNION JOURNAL

Members Of One Schools CU May Get A Hard Lesson

Credit Union Journal | Monday, March 14, 2011

By Frank J. Diekmann

I spoke too soon.

In this space on Jan. 31, I noted that 2010 was remarkable for the headline you didn't see: that of a credit union seeking to convert to a bank. Naturally, almost on the heels of this observation came an announcement from Har-Co Credit Union in Maryland that it has no choice but to dump its credit union charter in favor of converting.

In its announcement to members, the $188-million CU followed the always carefully parsed script of other would-be converts, saying a conversion to mutual savings bank would allow it to "increase membership and economies of scale to better meet the current and future needs of our members." The statement adds that as a bank it would be "open to any citizen, eliminating the restrictions on banking," and that it would be "allowed to offer loan and deposit services to anyone, something it cannot currently do as a credit union."

Surprisingly absent from this woe-is-us lament was any mention to members that there is such a thing as a community charter in credit unions. I am also guessing your socks will remain on when you learn that in its statement to members it said it currently "cannot raise capital to support or expand its operation other than by retaining net earnings."

Candy In the Piñata

Har-Co reported a $300,538 net gain in 2010. The CU's December 2010 5300 Call Report showed it had $15.8 million in capital, giving it a ratio of 8.51%, which NCUA defines as "well capitalized." It's that 15-million-bucks that's the candy inside the piÃ±ata for those who profit from CU charter conversions parties. And while it didn't say it on the party announcement, Har-Co members should start adjusting now to the idea that they won't be enjoying any of that candy should it ever hit the ground.

Here's another piece of spin so good it almost merits a tweet from Charlie Sheen. After complaining that it needs to convert in order to raise capital, its statement goes on to say, "As a federal mutual savings bank, however, Har-Co could raise additional capital by changing from the mutual to the stock form and selling stock to members and the public, although a change to stock form is not part of the current Conversion Proposal."

In short, yes, you read that correctly: we're making this move because we need to raise capital, but our plan is not to. One wonders if members will notice the disconnect. Har-Co's Clintonesque word selection is intentional; by saying it only intends to become a mutual savings bank it can make the claim that the new charter is just cosmetic; it will still be a mutual organization owned by its 26,000 members.

In fact, in its statement it borrows another sleight of hand from other CUs that have gone before it in attempting to convert by reassuring members that they will retain their voting rights. Going unsaid: it will no longer be one member, one vote, it will be one dollar, one vote. Imagine showing up at your polling place on voting day and finding out you have a vote, but it will now be weighted according to your home's value. But, hey, its still a democracy, right?

It's that little change in democracy that's critical to technically telling the truth when disclosing, "...although a change to stock form is not part of the current Conversion Proposal." Indeed, it's not in the current proposal, but you can bet a big stack of vacation home brochures that it's in the longer-term plan residing on some consultant's hard drive. Because going to stock form is where the riches lie.

My beef with these charter conversions has long been the smoke-and-fears tactics. Har-Co may indeed be correct; it will be better off as a bank. But before members make this important decision, the board has a responsibility to be upfront with members and uphold its fiduciary duties. It needs to answer how Har-Co Bank will offset the tax liabilities it will lose. In its letter to members, Har-Co does state, "The board has considered that a conversion to a federal mutual savings bank will end Har-Co's tax exemption. As a credit union, Har-Co is not subject to any federal, state or local taxes, other than real estate property taxes and payroll taxes. Based upon our analysis and meetings with consultants, the board of directors believes that the tax impact should be more than offset by the enhanced earnings capacity."

Data, Bought & Paid For

Hmm, those wouldn't be the same consultants whom you are already paying and who stand to profit from the conversion, would they? And the board needs to explain what "enhanced earnings capacity" actually means. That couldn't possibly be higher fees, now could it?

The board and management also need to be honest about how moving to an industry where there have been five times as many failures as there have been in credit unions in recent years holds promise. It needs to disclose how much of the members' funds is being spent on those conversion consultants, and what the terms of their deal is if it does convert. It needs to explain why it doesn't simply liquidate the credit union at the point of conversion and return as much of the capital as possible to members. It needs to explain why it doesn't just move to a community charter.

Har-Co was founded in 1955 to serve school employees in Harford County, Maryland. Here's hoping that for them the lesson won't come after the test.

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