

THE BUSINESS BENEFITS OF FEDERAL TO STATE CHARTER CONVERSIONS

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Lately we have heard a lot of talk about mergers. Articles about mergers have appeared in virtually every industry publication this past year, and their numbers are not diminishing. Almost all of these articles note the obvious fact that the consolidation trend which began in the early nineties is continuing. Most also point out the not-so-ironic fact that while the number of charters is diminishing, credit union membership and overall assets continue to grow – notwithstanding slowing growth in loan portfolios. Indeed, while assets and membership numbers are up, more than 4,000 credit union charters have disappeared over the last 15 years, a drop of approximately thirty five percent.



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Some commentators make the additional observation that the number of mergers between healthy institutions is significantly on the rise, representing a new trend within the greater consolidation trend. The parties to these transactions make the convincing point that operating costs (including dramatically increased compliance costs), economic conditions, and relaxed membership rules, have caused an increasing number of financially healthy credit unions to begin viewing merger as a legitimate strategic alternative.

It is true that hundreds of charters continue to disappear each year, as more and more credit unions turn towards merging as a survival strategy. But the consolidation trend is not responsible for the industry wide growth in membership and assets. Consolidation consolidates; it combines existing fields of membership. It does not, in and of itself, expand those populations. In fact, the industry wide increase in membership and assets over the past 15 years has more to do with federal-to-state charter conversions (and, of course, marketing practices) than it does with the effects of consolidation. A merger increases the number of members of only the surviving credit union, not of the industry; a charter conversion typically originates new populations of eligible members, thereby increasing industry wide membership.

Mergers and charter conversions are merely two responses to the mandate of growth. While the effects of, and rationale for, mergers are widely known and discussed, the important, but less visible, impact of charter conversions over the past several years is not as well understood.

As the historically protectionist policies of NCUA gradually evaporated during the eighties and nineties, and the Credit Union Membership Access Act provided new opportunities for growth, credit unions began competing with each other. But cumbersome expansion approval rules promulgated by NCUA (in part to appease the banking lobbies and stave off additional legal challenges) created time consuming and expensive bureaucratic obstacles. As a result, a number of large federal charters in states like Florida which provide greater expansion flexibility with less bureaucracy converted from federal to state charters. In Florida, as in a number of other states, this conversion trend has been significant, with the conversions of large credit unions such as Eastern Financial Florida Credit Union, Tropical Financial Credit Union and Power One Credit Union, among others. The growth resulting from these federal-to-state conversions has been

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substantial. Importantly, they reflect the growing significance of the regulatory “red tape” factor in a credit union’s decision to change charters, and the determination of a number of longstanding federally chartered credit unions not to permit federal rules and procedures to impede their business plans.

From the perspective of these credit unions, the analysis goes like this: Unlike the Federal Credit Union Act, the Florida Credit Union Act does not require a “common bond” among its members. Instead, Florida’s law requires only a “limited field of membership”, defined as follows:

[T]he group of persons designated as eligible for membership in the credit union who:

(a) have a similar profession, occupation or formal association with an identifiable purpose; or

(b) reside within an identifiable neighborhood, community, rural district or county; or

(c) are employed by a common employer; or

(d) are employed by the credit union; and

(e) members of the immediate family of persons within such group.

Under Florida’s law, “immediate family” means “*parents, children, spouse, or surviving spouse of the member, or any other relative by blood, marriage, or adoption.*”

By way of comparison, the Federal Credit Union Act provides three types of federal credit union charters, all of which require a “common bond”. These are single common bond (occupational or associational), multiple common bond (multiple groups), and community charters. The state statute compares favorably with the federal statute because the special rules and definitions promulgated for adding large new groups of members under any type of federal charter can be difficult, time consuming and expensive. Additionally, federal regulators continue to be exposed to national political pressures which have prevented meaningful streamlining of the rules and, in the future, may well result in additional obstacles. State law, on the other hand, permits membership based, among other things, on broad geographic boundaries.

Although Florida does not grant “community charters” per se, the flexibility it provides in permitting a large credit union to define its field geographically, in effect, creates a community-like charter. Additionally, upon converting, Florida law permits more rapid field of membership expansion. Typically, the state will allow a credit union, at the inception of its state charter, to define a geographic area which, after netting out existing eligible groups in that area, will permit a 30% increase, more or less, in its current membership base. The credit union can continue to grow from that point forward, assuming, of course, that the credit union has the capitalization, administrative ability, and infrastructure to support the increased base.

Other perceived advantages to membership expansion opportunities under Florida law are:

1. The laws and regulations governing state chartered credit unions are far fewer than those governing federally chartered credit unions. Furthermore, state examinations, generally, are less frequent than federal examinations.

2. The state bureaucracy is thin compared to the bureaucracy of NCUA, and state credit union regulators have traditionally been reasonable and facilitating in their relationships with well run, state chartered credit unions.

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3. Problems or regulatory questions which arise in the course of the credit union's affairs and cannot be directly resolved with an examiner can be discussed – and often resolved – in direct conversations with the state's chief credit union administrator, Ms. Sharon Whiddon.

4. State chartered credit unions in Florida are not as subject to unfavorable legislative change as are federally chartered credit unions. The banking movement to curb the ability of credit unions to expand is primarily national in character. Credit unions in Florida have enjoyed a substantial degree of protection from this type of pressure.

5. Although the tax exempt status of Florida credit unions may rise and fall with national legislative change, the bankers' lobby has, to date, not been able to mount any effective challenge to the broad statutory authority granted to state charters.

It is true that under a state charter, the credit union is subject to dual regulation, since it must still obtain its insurance from NCUA. Although this is not an insignificant consideration, this circumstance does not present an obstacle which weighs heavily against the substantial advantages of conversion, especially since the examinations conducted by NCUA, as your insurer, are intended to be limited to those "safety and soundness" matters which would pose a risk to the share insurance fund.

Although mergers will continue to be an effective means of strengthening the financial health of surviving credit unions, the impact of conversions from federal charters to more flexible state charters will apparently continue to play an important role in the growth of overall industry membership and assets.

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