



VIA E-MAIL: [regcomments@ncua.gov](mailto:regcomments@ncua.gov)

September 23, 2008

Mary Rupp  
Secretary of the Board  
National Credit Union Administration  
Alexandria, VA 22314-3428

Dear Ms. Rupp:

Re: Prompt Corrective Action; Amended Definition of Net Worth

On behalf of the California and Nevada Credit Union Leagues, I appreciate the opportunity to comment on NCUA's proposed change to Part 702, which implements a statutory amendment to the definition of a natural credit union's "net worth" that applies to the agency's "prompt corrective action" (PCA) regulatory standards. By way of background, the California and Nevada Credit Union Leagues are the largest state trade associations for credit unions in the United States, representing the interests of more than 400 credit unions and their 9 million members.

***Background***

In 2001, Financial Accounting Statement (FAS) No. 141 replaced the "pooling method" of financial reporting of business combinations with the "purchase method" (later renamed the "acquisition method"). Whereas the "pooling method" allowed an acquiring credit union to combine the merging credit union's retained earnings with its own (thus enhancing acquirer's post-merger net worth), the acquisition method requires the fair value of the net assets acquired in a merger to be classified as a direct addition to the acquirer's equity, not as an addition to its retained earnings. As a result, the pooling method, when applied in conjunction with the statutory definition of credit union net worth, provided an incentive to merge, while the acquisition method would have exactly the opposite effect. The Financial Accounting Standards Board deferred the 2001 effective date of FAS 141 for mergers between mutual enterprises (such as credit unions), but that deferment will expire at the end of 2008.

***The Proposed Rule***

To address this issue, Congress enacted the Financial Services Regulatory Relief Act (Act) in 2006. Section 504 of the Act expanded the PCA definition of a natural person credit union's "net worth" to include "any amounts that were previously retained earnings of any other credit union with which [it] has combined." To implement Section 504, NCUA's proposed rule amends the definition of post-merger net worth under Part 702 by adding the following to the current definition:

*(3) For a credit union that acquires another credit union in a mutual combination, net worth also includes the retained earnings of the acquired credit union, or of an integrated set of activities and assets, at the point of acquisition. A mutual combination is a transaction in which a credit union acquires either another credit union, or an integrated set of activities and assets that is capable of being conducted and managed as a credit union for the purpose of providing a return in the form of economic benefits directly to owner members.*

The first sentence of proposed section (3) adds to an acquiring credit union's net worth an amount equal to the merging credit union's retained earnings balance, yielding a capital measure that approximates the net worth previously obtained from the "pooling method." Additionally, according to the definition of "mutual combination," subsection (3) can apply to transactions that convey substantially all of the components of a credit union, even though the components together no longer legally constitute a credit union.

#### ***The Leagues' Position***

The Leagues support the proposal's amended definition of net worth for PCA purposes as described above. As noted in the proposal, without such a change an acquiring credit union's net worth ratio not only would not increase as a result of a merger, it would probably decline. The risk of being demoted to a lower PCA net worth category, and in turn being exposed to the mandatory and discretionary supervisory actions of PCA, would naturally discourage interest in mergers, thus limiting their availability to rescue troubled credit unions.

However, we are puzzled and concerned about the following language in the amended definition of net worth:

*A mutual combination is a transaction in which a credit union acquires either another credit union, or an integrated set of activities and assets that is capable of being conducted and managed as a credit union for the purpose of providing a return in the form of economic benefits directly to owner members.*

The underlined clause introduces a new standard not found in any other NCUA regulation or guidance that addresses mergers. Indeed, NCUA's *Merger Manual* states only that credit unions considering a merger should take into consideration whether a merger would be in the members' "best interests." Not only is the clause irrelevant to the topic of determining net worth (which, fundamentally, is an accounting issue), but it could lead to confusion and highly unreasonable compliance burdens, as affected parties would need to attempt to define terms such as "economic benefits" and

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“directly.” Further, such a clause could hinder needed mergers in the situation of a troubled credit union. Therefore, the Leagues’ respectfully urge the NCUA to remove this clause.

In closing, I would like to thank the NCUA for the opportunity to comment on this necessary and beneficial rule change. We appreciate your consideration of our views.

Sincerely,

A handwritten signature in black ink, appearing to read 'Bill Cheney', with a long horizontal flourish extending to the right.

Bill Cheney  
President/CEO  
California and Nevada Credit Union Leagues