AMERICAN BANKERS ASSOCIATION

1120 Connecticut Avenue, NW
Washington, DC 20036

1-800-BANKERS
www.aba.com

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Keith Leggett
Senior Economist
Tel: 202-663-5506
Fax: 202-828-4547
Email: kleggett@aba.com

September 29, 2008

Ms. Mary Rupp
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428

Re: National Credit Union Administration; Prompt Corrective Action; Amended Definition of Post-Merger Net Worth; 12 CFR Parts 702 and 704; 73 Federal Register 44197, July 30, 2008

Dear Ms. Rupp:

The American Bankers Association (ABA) appreciates the opportunity to comment on the National Credit Union Administration's (NCUA) proposed definition of Post-Merger Net Worth. The American Bankers Association brings together banks of all sizes and charters into one association. ABA works to enhance the competitiveness of the nation's banking industry and strengthen America's economy and communities. Its members – the majority of which are banks with less than $125 million in assets – represent over 95 percent of the industry's $13.3 trillion in assets and employ over 2 million men and women.

ABA does not object to the proposed rule allowing an acquiring natural person credit union to include the merging credit union's retained earnings with its own to determine the acquirer's post-merger net worth. However, ABA does object to allowing an acquiring corporate credit union to include with its capital the retained earnings of the merging corporate credit union to determine the acquirer's post-merger capital. Congress explicitly exempted corporate credit unions from net worth provisions in 1998 that applies to natural person credit unions. As such, corporate credit union combinations should be required to follow the acquisition method, the standard for any mutual combination as set by the Financial Accounting Standards Board (FASB).

Background

The Credit Union Membership Access Act[1] (CUMAA) mandated a system of regulatory capital standards for federally-insured natural person credit unions. For regulatory capital purposes, CUMAA explicitly limited a credit union's net worth to "the retained earnings balance of the credit union, as determined under generally accepted accounting principles."

[1] Public Law 105-219

At the time CUMAA was enacted, the predominant practice for financial reporting of credit union combinations was the "pooling method." This method required an acquiring or continuing credit union to combine with its own financial statement like components of the merging credit union. Thus, an acquiring credit union would combine its own retained earnings with those of the merging credit union for purposes of measuring the acquirer's post-merger net worth ratio.

However, FASB issued Statement of Financial Accounting Standards No. 141(R) (SFAS 141(R)), which replaced the pooling method of accounting for business combinations with the purchase method or acquisition method. SFAS 141(R) applies to any mutual business combination occurring after December 15, 2008.

Concerned that SFAS 141(R) in conjunction with the statutory limitation on net worth would stifle natural person credit union mergers, Congress in 2006 enacted Section 504 of the Financial Services Regulatory Relief Act (FSRRA).[2] According to the Senate Report, "[t]his section amends the Federal Credit Union Act's prompt corrective action requirements by redefining a credit union's net worth as the retained earnings balance of the credit union (as determined under generally accepted accounting principles, as under current law), together with any amounts that were previously retained earnings of any other credit union with which the credit union has merged."[3]

ABA's Position

ABA believes that the changes to the Net Worth Definition in Part 702 of the proposed rule are consistent with the statutory changes enacted by Congress in 2006. However, the proposed rule modifies the definitions of "capital" and "core capital" in part 704, ***which are changes that NCUA does not have the authority to make.*** Therefore, ABA believes NCUA should withdrawal its proposal to amend part 704.

Changes in Net Worth Definition in Part 702 Are Consistent with Statute

NCUA is seeking public comment on a proposed rule implementing a statutory amendment to the definition of a natural person credit union's net worth. The amendment expands the definition of net worth to allow the acquiring credit union, in a merger of natural person credit unions, to include the merging credit union's retained earnings with its own to determine the acquirer's post-merger net worth.

The net effect of the modifications to Part 702 is to apply SFAS 141(R) to **natural person credit union mergers** for financial reporting purposes, while for Prompt Corrective Action (PCA) purposes to replicate the post-merger net worth that would have resulted under the pooling method.

[2] Public Law 109-351
[3] Senate Report 109-256, p. 5.

ABA does not object to this portion of the proposal, as it is consistent with the statutory changes enacted by Congress in 2006. Section 216(o)(2)(a) of the Federal Credit Union Act defines the net worth requirement for a natural person credit union as "the retained earnings balance of the credit union, as determined under generally accepted accounting principles, ***together with any amounts that were previously retained earnings of any other credit union with which the credit union has combined***." [emphasis added]

NCUA Should Withdrawal Its Proposal Amending Part 704

CUMAA explicitly exempts federally-insured corporate credit unions from Section 216 dealing with PCA and the statutory definition of net worth. In 2006, Congress amended the definition of net worth for natural person credit unions to include the retained earnings of merging credit unions. ***But because corporate credit unions were explicitly exempted from the PCA requirements in 1998, the 2006 statutory change does not apply to corporate credit unions***. If Congress intended to allow corporate credit unions to count the retained earnings of a merging corporate credit union as part of the capital of a corporate credit union, Congress would have made this explicit. The only conclusion is that NCUA in its proposed rule is substituting its judgment for that of Congress and the FASB.

In a merger of ***corporate credit unions***, the proposed rule similarly redefines corporate credit union capital to allow an acquiring corporate credit union to include with its capital the retained earnings of the merging corporate credit union to determine the acquirer's post-merger capital. Moreover, the proposed rule would treat the combination of corporate credit unions differently from other mutual combinations.

Specifically, the proposed rule modifies the definitions of "capital" and "core capital" of a corporate credit union that acquires another credit union by merger to include "the retained earnings of the acquired credit union, or of an integrated set of activities and assets, at the point of acquisition." The same modification is made to the definition of a corporate credit union's "retained earnings ratio." Further, NCUA is proposing to exclude identifiable and unidentifiable intangibles from the definition of a corporate credit union's "moving daily average net assets." Moving daily average net assets is the denominator of the capital ratio for corporate credit unions.

By excluding identifiable and unidentifiable intangibles and allowing a corporate credit union to count as part of its capital the retained earnings of the acquired corporate credit union, NCUA contends that this would by regulation generate an outcome comparable to the pooling method.

However, NCUA through regulation is extending its sphere of influence beyond its authority. NCUA is not the arbitrer of accounting standards. Since 1973, the FASB has been the designated organization for establishing standards of financial accounting and reporting and these standards are officially recognized as authoritative by the Securities and Exchange Commission. The FASB has made the

determination that all business combinations should be subject to the acquisition method.

Thus, ABA believes that NCUA does not have the authority through regulation to preserve the pooling method for corporate credit union mergers. Therefore, ABA recommends that NCUA withdraw its proposed changes to Part 704 dealing with corporate credit union post-merger net worth.

If you have any questions, please feel free to contact the undersigned.

Sincerely,

Keith Leggett