



Credit Union National Association

cuna.org

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September 29, 2008

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

Filed via: [Regcomments@ncua.gov](mailto:Regcomments@ncua.gov)

RE: PCA - Amended Definition of Post-Merger Net Worth

Dear Ms. Rupp:

On behalf of the Credit Union National Association, I am providing comments to the National Credit Union Administration on the Board's proposed rule to amend the definition of post-merger net worth. By way of background, CUNA is the largest credit union advocacy organization in this country, representing approximately 90% of our nation's 8,200 federal and state-chartered credit unions, which serve 91 million members. CUNA's letter was developed under the auspices of our Accounting Task Force.

### **Brief Background and Summary of the Issue**

The Credit Union Membership Access Act includes Prompt Corrective Action provisions that limit net worth for regulatory purposes to retained earnings. When the Act was adopted in 1998, the pooling method of accounting was the acceptable approach used to report net worth in a merger situation. Under this method, the net worth, i.e., retained earnings, of the institutions could be combined or "pooled." This approach not only simplified accounting but actually facilitated mergers because it permitted the full amount of retained earnings of both institutions to be included in the net worth of the acquiring credit union.

However, in 2001, the Financial Accounting Standards Board adopted Accounting Statement 141, Business Combinations, which requires covered entities, such as credit unions and others, to forego the use of



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the pooling method in mergers and instead follow the acquisition method (it did defer the application of this method to credit unions until after 2008).

Under the acquisition method, the value of assets acquired in a merger have to be reflected as an addition to equity, not as an addition to retained earnings, as they are under the pooling method. This means that in a merger of two credit unions, not only would the acquiring credit union not be able to include the retained earnings of the merging credit union in its net worth, but the net worth ratio of the acquiring credit union would likely decline. That is because the net worth would be diluted by the addition of assets reflected in the denominator of the net worth ratio.

To address this anomaly, in 2006 Congress passed a provision in the Financial Services Regulatory Relief Act that would allow credit unions to follow the FASB acquisition method but nonetheless include the net worth of the merging credit union in the net worth of the acquiring credit union for purposes of net worth ratio calculations under NCUA's regulations.

In July of this year, NCUA proposed changes to its PCA rule that would implement the statutory provisions to allow the net worth ratio of an acquiring credit union, following a merger, to reflect the acquired retained earnings of the merging credit unions. The proposal would also make parallel changes for corporate credit unions.

### **CUNA's Position**

After considerable deliberation by CUNA's Accounting Task Force chaired by Scott Waite, CUNA supports NCUA's efforts to implement the statutory provisions, which will facilitate mergers when put into effect. However, we have three concerns about the proposal as drafted.

### **Changes Are Needed in the Definition of "Net Worth"**

The proposed definition of net worth may not achieve the objective of properly implementing the statutory provisions because it appears to be inconsistent with the valuation of retained earnings under the FASB rule. In light of this, CUNA recommends amendments to the definition that will address this concern. These changes will make it clearer that the entirety of the merging credit union's retained earnings may be included in the net worth of the continuing credit union. (Suggested additions are shown in italics and suggested deletions are shown as strikethroughs.)

- Section 702.2(f) Net Worth means –
  - (3) For a credit union that acquires another credit union in a mutual combination, the *resulting* net worth includes the acquired *equity, including* the retained earnings *after valuation* of the acquired credit union or of an integrated set of activities and assets ~~at the point of acquisition.~~

### **Changes Are Needed in the Chart**

The chart NCUA has provided is useful. It illustrates how the proposed rule would be implemented taking Generally Accepted Accounting Principals (GAAP) into consideration compared to the application of GAAP without the proposal. We appreciate it being provided as a tool to facilitate understanding of how the proposal will impact mergers.

However, we are concerned that the depiction of retained earnings in the last column, which shows the acquiring credit union's retained earnings under GAAP plus the merging credit union's retained earnings, does not properly reflect that this is the acquired retained earnings, as of the acquisition date, and not the GAAP defined acquired equity at the time of reporting. NCUA should revisit this and either change the chart or provide an explanation of how it arrived at the valuation for the merging credit union's retained earnings.

### **Guidance Needs to Be Provided With the Final Rule Regarding the Accounting Treatment of Combined Net Worth**

While NCUA does not make accounting pronouncements, we do think it is important that NCUA provide guidance on how it anticipates the merging credit union's retained earnings will be reported for accounting purposes as part of the net worth of the acquiring credit union. We believe such guidance should be addressed in the Supplementary Information accompanying the final rule.

CUNA appreciates the time and effort NCUA has committed to addressing the issue of post-merger net worth for credit unions. While, as noted, we do have some concerns, we feel that this proposal is an overall step in the right direction.

Sincerely,



Mary Mitchell Dunn

CUNA Senior Vice President and General Counsel