-----Original Message-----
From: Rick Heldebrant [mailto:rickh@starone.org]
Sent: Thursday, March 06, 2008 5:31 PM
To: _Regulatory Comments
Subject: NCUA Seeks Comments On Whether It Should Issue Rules On Charter Changes And Share Insurance Terminations

March 6, 2008

NCUA National Credit Union Administration

Dear NCUA National Credit Union Administration:

My comments are specifically on their question whether a "merger dividend" is needed when equity ratios are different.

I wanted to comment on the question put forth in the Advance Notice of Proposed Rulemaking - Mergers and Conversions as to :

Member Right to Equity.

NCUA is broadly considering the issue of how to deal with unequal net worth ratios among merging credit unions. This imbalance may result in unfair treatment of members of a credit union with a higher net worth. One method NCUA is considering to address this issue is to require a merger dividend. Another option could be to simply require the board of directors of a merging credit union to consider this issue as part of its due diligence, come to its own conclusion, and then justify that decision to its members. Generally, federal credit unions may only return net worth to members in the form of dividends or a return of interest. 12 U.S.C. 1761b, 1763. Dividends must be based on an account balance as of a specific date or calculated over a period of time, whether a month, a quarter, or several years. 12 CFR 707.7(a), Appendix B (b). Often, credit unions undertake a calculation of a dividend going back for a period of years to permit a credit union to reward longtime members. As noted, a merging credit union often has a higher net worth ratio than the continuing credit union. Also, a merging credit union may have other valuable characteristics for which the continuing credit union is willing to pay a premium, such as a complementary field of membership, thus increasing the net worth of the merging credit union in the context of the merger. In recent merger transactions, issues about merger dividends, also sometimes called a ''share adjustment'' and ''capital equalization,'' have arisen because of the nature of dividends in credit unions. NCUA's Office of General Counsel has addressed this issue and concluded that so-called ''per capita'' dividends (a flat amount paid to all members) are legally impermissible. OGC Op. 07-0410 (April 13, 2007), OGC Op. 97-0813 (September 29, 1997). NCUA recognizes that requiring a merger dividend or other return of interest in certain circumstances could include the following advantages: (1) Rewarding the merging credit union's members; (2) equalizing an imbalance in net worth between the credit unions, although this could lessen the merging credit union's value to the continuing credit union; and (3) establishing a consistent approach (e.g., setting a record date or dividend period, identifying the kinds of accounts to receive the merger dividend, and so forth). On the other hand, NCUA recognizes that not imposing a merger dividend requirement in this area allows credit unions the flexibility to decide for themselves whether to include a merger

dividend as part of their due diligence and negotiations and leaves calculation of any dividend to the merging credit unions, essentially allowing market forces and the wishes of the members to determine if a dividend is appropriate. The Board notes that, in a recent FICU to stock bank merger, the merging FICU returned to its members their equity interest in the credit union plus a premium, and the Board believes a return of equity can be a fair way to compensate members for the loss of the credit union they own. In other transactions, such as FICU to MSB conversions, NCUA has noticed that The Act authorizes federal agencies to provide federal credit unions space in federal buildings on a rent-free and utility-free basis if certain conditions are met. 12 U.S.C.
1770. The key condition is that ''at least 95 percent of the membership of the credit union to be served by the allotment of space is composed of persons who either are presently federal employees or were federal employees at the time of their admission into the credit union, and members of their families * * *'' See also 41 CFR 102-79.40. MSBs do not have any similar authority, although it appears that, under General Service Administration regulations, commercial entities, including banks, can lease space on a rental basis in publicly-accessible areas of federal buildings. 3 Outside of the credit union context, where there is a tender offer for stock of a public company (the mechanism by which a hostile bidder solicits the stockholders of the target), it triggers the provisions of the Securities Exchange Act of 1934 and Securities and Exchange Commission (SEC) rules. These provisions address communications by third parties to stockholders and, as noted in OGC Op 07-0342 (April 6, 2007), those SEC provisions provide detailed requirements regarding disclosures, tender offers, and other matters. SEC oversight in this regard helps protect stockholders by ensuring they are informed with accurate information about the transaction. many of the converting credit unions seek to convert at a time when their net worth is high. In some instances, the conversion appears timed to occur after a period where the credit union has purposefully acted to increase its net worth. NCUA believes that, in those instances where excess equity has been built up, fairness to members may dictate payment of some equity to members of a merging or converting credit union instead of transferring it to a new institution where the credit union members will have less control and have diluted or no ownership interests. NCUA seeks comment on all possible options for dealing with this issue either as an amendment to current regulations or by issuing a new regulation.

NCUA should not make any requirements for "equalization" of equity ratios.

Making a simple rule would ignore the complexities that exist in different credit unions. An equity ratio is simply the mathematically calculated proportion of equity dollars to asset dollars. The difference in ratios of two credit unions may be due to 1) higher equity dollars built and retained or 2) lower assets accumulated.

A rule to consider equity ratio would also ignore the differences that may exist in equity dollars per member. See the hypothetical example in the table below: (ommitted)

If one looks at equity ratio: in the first example the Joe CU members went from a CU with a 15.92% equity ratio to a merged CU with a 9.65% equity ratio. One could think that their equity was diluted. In the second example the Joe CU members kept the same equity ratio because they received a payout.

If one looks at the equity dollars per member: in the first example the Joe CU members go from a CU with $878 equity dollars per member to a merged CU with $1,553 equity dollars per member. This is a 76% increase in their equity dollars per member. In the second example the Joe CU members go from $423 equity dollars per member to $1,325 equity dollars per member. This is a 213% increase in their equity dollars per member.

From the standpoint of the Big C CU members - the first example increases the merged CU equity ratio for them but it also lowers their equity dollars per member by 30%. In the second example, the equity ratios stay the same, but the equity dollars per member are lowered by 40%.

If the proposed rule stated that CUs must equalize equity ratios, then the second example

would be the actual results. This seems very unfair. In both cases, the equity dollars per member of Big C CU were diluted. I think that not adjusting the equity is fairer than a payout.

There are many reasons why equity ratios differ:

If one CU maintains a higher equity ratio because their interest rate risk is higher, than a payout will cause the merged CU to have higher rate risk that is not offset by a higher equity ratio. If a CU has better rates and attracts more savings dollars, the equity ratio would be lower than for a CU that did not attract savings dollars. Consider a merger of a CU with a high equity ratio but a low savings dollars per member - what if they merge and their members save more dollars because of better rates with the merged partner - their "former" high equity ratio will be diluted as their savings increases. Should the merger consider current equity ratio or projected future equity. If a CU built more branches to improve convenience and attracted more savings dollars, the equity ratio would be lower. If a CU bought their branch locations the assets would show the value at historic cost and not market value (probably higher) this would make the equity ratio look lower compared to a CU that leased their locations. If a CU invested in training their staff and developing a wide range of products and services, they may have a lower equity ratio but a better reputation brand for the future.

I could give many other examples where the equity ratio equalization would make sense or not make sense. The issue is an important one to consider, but it must be made in context with everything else about the merger. This is an issue for both of the Boards of Directors to consider as they review the merger. It may or may not make sense to make a payout of equity dollars to the members of one of the merging CUs.

I urge the NCUA to not require a merger dividend. Do not codify overly simplistic thinking into merger analysis.

Sincerely,

Rick Heldebrant