POWER FINANCIAL
CREDIT UNION

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Mary Rupp
Secretary of the Board
National Credit Union Administration
1775 Duke Street
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Subject: Comments on Notice of Proposed Rulemaking for Parts 702 and 704

The forthcoming effective date of Statement of Financial Accounting Standards ("SFAS") No. 141 (Revised) ("the statement") as it applies to combinations of mutual entities, including credit unions, has stirred a lot of interest by the industry and their independent accountants regarding it's eventual impact on the definition of Net Worth for purposes of compliance with the Net Worth regulations under Parts 702 and 704 of the National Credit Union Administration ("NCUA") Rules and Regulations ("the regulations").

While I believe that it's unnecessary to revisit the history leading up to the Financial Accounting Standard Board's ("the FASB's") issuance of the revised statement, the FASB's intent with the statement is clearly observable in the Summary section of the statement. It reads in part … *"the objective of this Statement is to improve the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial reports about a business combination and it effects."*

Under the revised purchase accounting principles set forth in the statement and now applicable to credit unions for fiscal years beginning on or after December 15, 2008; assets acquired and liabilities assumed from the acquiree are recorded on the financial statements of the combined entity at their fair market value as measured on the acquisition date. Except for circumstances involving credit unions in very serious financial condition and have already or are about to fail, the resulting measures of assets and liabilities recorded on the books of the acquiree will very likely give rise to a fair market value for assets which are greater than the fair market value of liabilities. In such merger circumstances, paragraph A67. of the statement provides that the acquirer … *"shall recognize the acquiree's net assets as a direct addition to capital or equity in its statement of financial position, not as an addition to retained earnings, which is consistent with the way in which other types of entities apply the acquisition method."* Therein lies the issue which the NCUA is attempting to resolve through its Proposed Rulemaking. The regulations under Part 702 and 704 presently define Net Worth to include only Retained Earnings as generally defined by Generally Accepted Accounting Principles ("GAAP"). Consequently, since the FASB statement provides that the net assets of the acquiree be credited as an addition to capital, but not to retained earnings, there is no provision under the present definition of Net Worth to embrace any components of capital other than retained earnings, thereby preventing the recognition of the fair market value of the net assets acquired in a credit union merger.

While the provision set forth in the Proposed Rulemaking to include the ending retained earnings balance of the acquiree in the retained earnings of the combined entity might seem a solution, this proposal falls significantly short of FASB's goal of achieving representational faithfulness and comparability in financial reporting. For purposes of this comment letter, I have omitted any discussion of the impact of purchase price as it relates to purchase accounting which may in some instances become a consideration in credit union combinations.

Representational Faithfulness

The Proposed Rulemaking falls materially short of achieving a definition of Net Worth in anyway resembling GAAP, which is mandated by the regulations for financial reporting purposes. And the Proposed Rulemaking creates a potentially enormous difference in the amount of equity reported in the financial statements under GAAP, and the amount of Net Worth as defined under the Proposed Rulemaking. Under the purchase accounting rules (as amended by the FASB) followed by combining entities since the initial adoption of Accounting Principles Bulletin Opinion No. 16 in 1970, an acquiree's assets and liabilities are recorded on the books of the acquirer at their fair market value. The current market place therefore has been the basis for determining the amount of net assets in excess of the fair market value of liabilities. Consequently, depending on the market conditions at the time of the merger, those net assets can vary significantly (both positively and negatively) to the retained earnings then recorded on the financial statement of the acquiree just prior to the merger.

An additional and also significant factor contributing to a difference between the GAAP equity and Net Worth under the Proposed Rulemaking is the amount of any identifiable intangible assets (including, but not limited to a core deposit intangible). Under GAAP in a merger transaction, the acquirer will recognize all identifiable assets, including intangible assets, acquired. Such assets were generally never recognized in the financial statement of the acquiree, and consequently never included in the acquiree's retained earnings, but nevertheless an important economic factor in the decision to merge. By failing to include the full amount of the addition to equity under GAAP as proposed in the rulemaking, a very significant component of the economic consideration driving merger decisions will not be captured in the definition of Net Worth and will likely prevent a significant number of merger transactions which otherwise would have been in the best interests of the credit unions.

So, under the provisions of the Proposed Rulemaking, the carryover of the closing retained earnings balance of the acquired credit union could, and will likely differ sharply

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from the amount of net assets acquired in a merger/business combination of credit unions. This is clearly not what the FASB had in mind as a result of their new statement. The Proposed Rulemaking will produce a Net Worth result materially different from the financial statement recognition of equity.

Comparability

Banks and other financial service providers will have a significant advantage over credit unions because their definitions of Capital and Net Worth will embrace the concepts promulgated by the FASB, while credit unions will not. Banks, for instance, have a multi-dimensional basis for determination of compliance with capital regulations, while credit unions are stuck with the single dimensional view via the definition including only retained earnings. Bank capital standards include several definitions of Capital including "Tangible" and "Core" Capital, both of which embrace the GAAP definition of equity under the FASB's purchase accounting standards. Therefore, banks and savings institutions will have a significant advantage over credit unions of including the entire amount of net assets in their regulatory Capital and Net Worth calculations.

The impact of the differences in those definitions of Capital and Net Worth can be enormous! Let's say, for example, that the core deposit base of a financial institution is approximately 50% of total assets, and the identifiable intangible value assigned to the core deposit base is somewhere between 3% and 7%, which is not unreasonable. Then the amount of net assets acquired attributable to the core deposit base would be somewhere between 1.5% and 3.5% of total assets recognized as an addition to equity for GAAP, but not included in the Proposed Rulemaking's definition of Net Worth. And this of course excludes any adjustments to net assets resulting from the recording of the acquiree's assets and liabilities at fair market value. Banks, savings, and other financial institutions would be allowed to include that additional amount in their Capital and Net Worth calculations, but not credit unions.

Summary

If there ever was a Proposed Rulemaking to the disadvantage of credit unions, this is it! Banks and savings institutions would be significantly advantaged in acquiring credit unions, than credit unions acquiring other credit unions. In this period of economic weakness, this Proposed Rulemaking will become a barrier to healthy credit unions acquiring their weaker brothers. Clearly, one incentive for a stronger credit union to acquire a weaker one is the franchise value the acquiring credit union receives in the business combination. Without the ability to include a core deposit intangible together with the other net assets of the acquiree, the combined Net Worth under the Proposed Rulemaking will likely prevent a significant number of mergers from occurring.

And while this comment letter has omitted any discussion of purchase price in a business combination, it should be noted that there very well may be instances where credit unions might bid against other credit unions for the opportunity to acquire a failing franchise from the NCUSIF. The Proposed Rulemaking again ignores the affect on Net Worth of

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such circumstances and actually may contribute to gaming the regulatory system in such circumstances in order to succeed to a regulatory Net Worth which might be considerably higher than the resulting GAAP equity.

GAAP has continued to evolve and change since the regulations were first adopted. There are now several newer components of equity which have been added in recent years affecting the recognition of equity for credit unions. Statement of Financial Accounting Standards ("SFAS") No. 115 added the "Unrealized Gain or Loss on Available for Sale Securities". SFAS No. 158 added the Comprehensive Income adjustment for Changes in the Funded Status of Defined Benefit Pension Plans. And there are and will continue to be other Comprehensive Income and equity adjustments under recent and future projects of the FASB.

A noble goal is to promulgate a definition of Net Worth for credit unions which is consistent with the underlying economic considerations in merger transactions and perhaps the FASB goals of relevance, representational faithfulness, and comparability.

SFAS No. 141 (R) has been a project in progress by the FASB for several years. It wasn't just thrust upon the industry suddenly and by surprise. It's clear that the industry and the accountant's were expecting that the results generally produced by the revised GAAP would become the definition of Net Worth under the regulations. It's my view that the limited definition of Net Worth under the regulations to include only retained earnings is a holdback to periods when the only GAAP component of equity attributable to credit unions was retained earnings. Times have changed, and GAAP has changed with it. Consequently, the definition of Net Worth under the Proposed Rulemaking is totally inconsistent with fairness, business economics, and best practice. I refuse to believe that the definition of Net Worth was intended to be exclusive, and not inclusive.

Sincerely,

Clifford A. Hope
Executive Vice President & CFO