

May 23, 2011

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

**Subject: Proposal to Change the Definition of Credit Union “Net Worth”**

Dear Ms. Rupp:

Redwood Credit Union (RCU) appreciates the opportunity to comment on NCUA’s proposed rule to implement changes to the Federal Credit Union Act (FCUA) made by Public Law Number 111-382 regarding the definition of credit union “net worth.”

Current NCUA rules on net worth in mergers simply combine the net worth of both institutions without adjustment, pursuant to a statutory provision Congress added to the FCUA in 2006. The proposed rule would change the regulatory definition of “net worth” in a way which would generally decrease the amount of a combined credit union’s “net worth” in a merger. NCUA has proposed a “technical correction” to 12 C.F.F. § 702.2(f)(3) so that any “bargain purchase gain” – such as a discount from the target credit union’s book value or other situations where “the fair value of the net assets acquired exceeds the fair value of the equity of member interest in the acquirer” – in a credit union merger would be deducted from the target credit union’s net worth prior to the merger so that it is not included in the continuing credit union’s net worth. NCUA says that this “technical correction” will prevent “double counting of net worth for purposes of PCA.”

In addition to not being required by Public Law Number 111-382, however, this “technical correction” does not seem consistent with Congress’ intent in adopting the Financial Services Relief Act of 2006, which added to the definition of FICU “net worth” the phrase “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.” But for the 2006 amendments, Financial Accounting Standards Board changes to GAAP merger accounting would not have allowed a combined credit union to include the net worth of the target credit union in the combined credit union’s “retained earnings.” Under GAAP merger accounting “equity acquired from merger,” in lieu of the retained earnings balance of the target credit union, would be in the combined credit union’s “retained earnings.”

We believe that Congress' intent in the 2006 amendments was to increase post-merger credit union net worth compared to GAAP. However, even if we imagine the real intent of Congress was to base a combined credit union's "retained earnings" solely on GAAP accounting, the proposed "technical correction" still does not accomplish this objective. Based on RCU's experience, we would see our net worth ratio as calculated under the proposed "technical correction" scenario fall below what it would have been under a GAAP scenario (as well as the current regulation). This seems neither desirable nor fair.

A related concern is that many credit unions have already consummated mergers based on a clear understanding of the net worth impact. It is not unreasonable to speculate that at least some of these mergers would not have happened, or would have happened under different terms, had the surviving credit union understood there would be a negative impact on net worth, based on the proposed "technical change."

Finally, we believe the proposed "technical corrections" will have a chilling effect on potential future mergers. In the very least, there will likely be fewer healthy credit unions willing to take on a problem credit union. As a consequence, additional losses may be incurred by the share insurance fund.

We implore NCUA to drop the current proposal since it changes the intent of Congress and it will have a negative impact on the net worth of many credit unions that have either completed a merger or will be going through one in the future. However, if NCUA is determined to change the definition of regulatory net worth, we strongly encourage it to (1) substitute "equity acquired in merger" for "adjusted retained earnings acquired in merger," and (2) make the "technical correction" apply solely to mergers consummated after a future date certain. These changes would eliminate the difference between regulatory accounting and GAAP, and they would achieve a level of fairness and predictability not inherent with the current proposed rule change.

Sincerely,

Wade Painter, EVP/CFO  
Redwood Credit Union  
Santa Rosa, CA