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Via electronic submission

June 15, 2020

Mr. Gerard Poliquin
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, Virginia 22314

RE: ICBA Comments on NCUA Proposed Rule, "Combination Transactions with Non-Credit Unions; Credit Union Asset Acquisitions" [RIN 3313-AF10]

Dear Mr. Poliquin:

The Independent Community Bankers of America ("ICBA")[1] is writing in response to the National Credit Union Administration's ("NCUA") proposal to adopt new Subpart D of Part 708a and to revise Section 741.8 of NCUA regulations. Among other changes, NCUA's proposal would create new and explicit regulatory requirements governing credit union acquisitions of non-credit unions, such as tax-paying community banks. While ICBA welcomes NCUA's efforts to address concerns and bring much needed attention to this matter, more needs to be done to increase the transparency of these deals.

Background

Currently, NCUA regulations stipulate the process for a credit union conversion to a mutual savings bank (Section 708a Subpart A) and the merger of a credit union into a bank (Section

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[1] The Independent Community Bankers of America® creates and promotes an environment where community banks flourish. With more than 50,000 locations nationwide, community banks constitute 99 percent of all banks, employ nearly 750,000 Americans and are the only physical banking presence in one in three U.S. counties. Holding more than $5 trillion in assets, more than $4 trillion in deposits, and more than $3.4 trillion in loans to consumers, small businesses and the agricultural community, community banks channel local deposits into the Main Streets and neighborhoods they serve, spurring job creation, fostering innovation and fueling their customers' dreams in communities throughout America. ICBA is dedicated exclusively to representing the interests of the community banking industry and its membership through effective advocacy, best-in-class education, and high-quality products and services.

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708a Subpart C), but there are no explicit requirements or restrictions on credit union acquisitions of banks. NCUA is proposing new Subpart D to Section 708a to account for this omission.

NCUA is also proposing to expand the list of acquired assets that are subject to additional disclosure and limitations. Current Section 741.8 of NCUA regulations sets requirements and limitations only on loans acquired from banks. This proposal would expand those requirements to extend to all assets acquired from a non-credit union, not just loans.

ICBA Comments

NCUA should consider wider public policy considerations associated with this rulemaking

Given the surge in credit union acquisitions of banks, it is wholly appropriate for NCUA to more explicitly govern these transactions and remedy the absence of any codified regulation permitting such deals. This is especially true given the confusion and uncertainty surrounding several recent credit union bank deals.[2] ICBA urges the Agency to consider several broader policy implications beyond the immediate proposal at hand, discussed further below. Such consideration would better inform this and subsequent rulemakings.

Membership – not growth – is the mission of credit unions and the purpose of the tax-exemption

The trend of credit union tax-subsidies being used to acquire tax-paying community banks skews the underlying intent behind credit unions' tax-exemption. As ICBA has reiterated countless times, the tax-exemption is conferred to credit unions to serve people of modest means. While reasonable minds may differ about which populations constitute people of "modest means," it should be widely agreed that Congressional intent behind the tax-exemption is to subsidize lower loan rates and higher savings rates for credit union members. Providing these benefits to people of modest means is the credit union mission.

But over the past several years, a growing number of credit unions have made decisions and engaged in activities that have eroded this mission to a point of being meaningless. These credit unions have begun to prioritize growth over members by using their tax subsidy toward a myriad of projects and endeavors that detract from benefiting members.

Perhaps the most compelling statistic to evidence this assertion is that for every dollar of the tax subsidy afforded to credit unions, the credit union industry withholds 21 to 33 cents. In

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[2] *See* Passman, Aaron, "State regulator in Colorado blocks credit union's bank purchase," American Banker, Jan. 16, 2020, *available at* https://www.americanbanker.com/news/state-regulator-in-colorado-blocks-credit-union-planned-bank-purchase, and McCarthy, Ken, "Settlement in Iowa resolves dispute over bank-credit union branch deal," American Banker, Mar. 9, 2020, *available at* https://www.americanbanker.com/news/settlement-clears-way-for-iowa-bank-to-sell-branches-to-credit-union.

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2018, this amounted to between $500 and $900 million annually of taxpayer dollars which was not directed toward activities directly benefitting credit union members. Instead, several credit unions used their tax subsidies to buy stadium naming rights, construct and develop multi-million dollar office buildings, provide million-dollar salaries to senior management, and of course, relevant to this proposal – use tax subsidies to buy tax-paying banks. These activities are not typically correlated with the activities of tax-exempt entities.

None of these activities directly benefit the credit union member. While credit unions should be permitted to pursue marketing campaigns, advertise, and provide competitive salaries to senior management, the degree to which some of these credit unions pursue these activities are not indicative of tax-exempt organizations.

Looming mission erosion

Earlier this year, banks outperformed credit unions for the first time in the history of the American Customer Satisfaction Index.[3] Banks scored 80 on the index, topping credit unions' score of 79. Community and regional institutions led the way with a score of 83, while national and super regional banks scored 78. Separately, banks are paying higher rates for deposits than credit unions for the first time since 2007. Total interest expense in 2019 is 90 basis points for banks and 83 for credit unions, a 7.8 percent difference.[4] Meanwhile, an independent report found that free checking has dropped 59.2 percent at credit unions compared with a 37.2 percent decline at banks.[5]

And finally, since the Great Recession, credit unions are generating more in fee income than banks, where "banks are at only 84% of their overall 2008 service charge totals, while credit union have soared to 132%."[6] These trends, coupled with the activities discussed earlier, indicate a de-prioritization of the member, resulting in erosion of the credit union mission. NCUA should halt and reverse this erosion, lest there is not even a vestige of difference among credit unions and other financial institutions justifying a continued tax-exemption for credit unions.

Credit unions are acquiring healthy community banks

In response to recent credit union acquisitions of community banks, some have argued that the town or community would lose a financial institution but for the acquisition by a credit union. ICBA has several issues with this common defense of credit union acquisition of community banks.

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[3] https://www.theacsi.org/news-and-resources/press-releases/press-2019/press-release-finance-insurance-and-health-care-2018-2019

[4] https://www.cutoday.info/THE-feature/The-Risk-From-Paying-Lower-Deposit-Rates-Than-Banks

[5] http://www.moebs.com/Portals/0/pdf/Articles/Final%20Nail%20in%20the%20Free%20Checking%20Coffin.pdf

[6] https://www.cutoday.info/THE-feature/9B-In-Annual-Service-Charge-Revenue-For-CUs

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First, the argument is a false dilemma, establishing a narrow "either-or" scenario that simply does not exist. There are a wide range of scenarios that could unfold that do not result in a town being left with the "either-or" choice being proffered by some.

Second, this fallacy is, itself, based on the false premise that the acquired banks were unhealthy and on the verge of failing, thus needing to be acquired by a credit union. In fact, of the 36 transactions in 2018 and 2019, only one bank could arguably be considered on the verge of failing, and thus, providing the town with one less financial institution. The other 35 banks bought by credit unions were very healthy. The average leverage ratio of acquired community banks was 11.12% in their final quarter of reporting; the average tier-1 risk based capital ratio of acquired community banks was 18.70% in their final quarter of reporting; and the average total risk based capital ratio of acquired community banks was 19.79% in their final quarter of reporting. None of this indicates imminent failure nor even an impaired financial condition, and refutes the false narrative that some have proffered.

In fact, ICBA is aware of circumstances where banks were not actively seeking buyers, and even declined several unsolicited offers, until a growth-prioritized credit union used its tax subsidy to make inflated, market-distorted offers. These transactions were not based on the free market; these were based on desires for growth at any cost.

NCUA should increase the transparency of acquisition of non-credit unions

Not long ago, NCUA recognized that there were a certain number of credit unions focused on consuming smaller credit unions to drastically grow their size. The Board responded to this mission erosion by promulgating a rule intended to increase the transparency of credit union acquisitions of other credit unions. At the time, many credit union industry stalwarts weighed in and applauded the rulemaking.[7] They recognized then, what NCUA should recognize now: these transactions are not about helping credit union members. They are fundamentally about growing the assets of credit unions that have growth-based goals and compensation schemes.

Transparency for the members of the acquiring credit union becomes even more imperative when acquiring a bank. Acquisitions of banks drain credit union capital, which is the retained earnings of credit union members. This capital rightfully belongs to them, yet they have no say in the transaction. This can be remedied in the same manner that the Agency elected to use when addressing acquisitions of other credit unions: transparency. Indeed, the preamble to the rule explains that the Board believes a proposed transaction with an institution other than a

[7] *See* Chip Filson, "Why A New Merger Rule Is Vital," CreditUnions.com, Jun. 30, 2017, *available at* https://www.creditunions.com/blogs/commentary/why-a-new-merger-rule-is-vital/; Michael Lord, SECU Response to Notice of Proposed Rulemaking on Bylaws, Bank Conversions, and Mergers and Voluntary Mergers of Federally Insured Credit Unions; RIN 3133-AE73, *available at* https://www.ncua.gov/files/comment-letters/2017/comment-bylaws-20170807MLord.pdf.

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federally-insured credit union ("FICU") should receive at least the same level of review from a credit union's board of directors as a proposed merger with a FICU.

Proposed Section 708a.403 would explicitly require credit unions to submit certain information to increase transparency. Before seeking approval from the appropriate regulator(s), the proposed rule would require a FICU to conduct a vote of its board of directors. Upon affirmative vote of the board, the FICU would then be required to seek and obtain approval from NCUA (and state regulators, if a state-chartered FICU) by demonstrating compliance with a series of six statutory factors.[8]

Aside from the statutory requirements mentioned above, the acquiring credit union must submit financial disclosures, such as:

- a combined financial statement showing the transaction's potential impact on the credit union's net worth;
- a summary of the credit union's due diligence assessment process for the proposed transaction (including analysis to support the proposed transaction price);
- a delinquent loan summary for any assets involved in the transaction;
- an analysis of the adequacy of the credit union's allowance for loan lease losses; and
- a list of the bank's assets that would be impermissible for a credit union to hold and an explanation of the plan to dispose of those assets.

In addition to the disclosures required above, ICBA suggests that NCUA also incorporate other disclosures that are similar to those required in credit union mergers with other credit unions. For example, Sections 708b.103(3) and (4) of NCUA regulations require credit unions that merge with each other to each disclose, among other information, analyses of share values and an explanation of share adjustments. Also, Section 708b.104(8) requires a statement about whether the two credit unions intend to make a Hart-Scott-Rodino Act premerger notification filing with the Federal Trade Commission and, if not, an explanation why. Adding similar requirements to this regulation would increase consistency among the various rules that govern mergers and combinations, thereby reducing confusion of required elements.

Proposed Section 708a.403 would also require credit union management to explain how the transaction would benefit the current members of the FICU. However, while this is a good first step, more should be required to increase transparency and communication to the members of the acquiring credit union.

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[8] (1) The history, financial condition, and management policies of the credit union; (2) The adequacy of the credit union's reserves; (3) The economic advisability of the transaction; (4) The general character and fitness of the credit union's management; (5) The convenience and needs of the members to be served by the credit union; and (6) How the transaction fits into the credit union's purpose as a cooperative association organized for the purpose of promoting thrift among its members and creating a source of credit for provident or productive purposes.

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ICBA recommends credit unions be required to increase communication to their members and disclose the following:

- How much of their retained earnings are being used to fund the transaction?
- Whether senior management of the acquiring credit union has a pecuniary gain as a result of this transaction?
  - For example, does senior management have a compensation scheme based on the growth of the credit union that would be achieved via the acquisition?
- What the credit union paid for the bank, and what each member would have received if that money was instead paid out to them in the form of a dividend?
- How many customers of the acquiring bank are expected to become members?
- How significantly would the addition of thousands of members (former bank customers) dilute existing member ownership percentage, and what would that do to dividend checks?

Assessing the convenience and needs of the community of the acquired bank

In addition to providing transparency to members of the acquiring credit union, NCUA should evaluate the convenience and needs of the communities to be served by the credit union upon completion of the acquisition. Similar to the Federal Deposit Insurance Act and Bank Merger Act, this assessment should include the following:

- Information provided by the credit union to identify the types of services offered and whether any differences in services among its branches in different geographies may indicate how its services are tailored to the convenience and needs of its service area.
- Data regarding the costs and features of loan and deposit products, account usage and retention, geographic location of accountholders, and any other relevant information demonstrating that its services are tailored to meet the needs of its members and prospective members in the various geographies in its service area.

Aside from bank customers, many consumers in a community might not be depositors of the bank, and therefore might not be alerted to a potential acquisition. Before finalizing this rule, NCUA should collaborate with the Federal Deposit Insurance Corporation ("FDIC") to establish public notice requirements of the proposed merger. The public notices should include whether the credit union has field of membership ("FOM") limitations that might inhibit continued service to the community that was otherwise provided by the acquired bank. For example, individuals that are not "customers," per se, may still have come to rely upon bank services, such as check cashing, remittances, or money orders.

Without public notice that informs the entire community, there is a greater risk that members of the community will not become aware of pending acquisitions. And without that awareness, the general public will not have the opportunity to weigh-in and ensure that the acquiring credit union will continue to meet their needs.

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Procedures for determining eligibility and consent requirements
The NCUA's long held position has generally required that for bank customers to become members of the acquiring federal credit union ("FCU"), the bank customers must affirmatively act through an authoritative vote or individual consent. However, it does not appear that the Office of the Comptroller of the Currency ("OCC") or any state-chartering authority (collectively, "Banking Agencies") has explicit guidelines establishing how a vote to demonstrate consent would proceed. Accordingly, ICBA recommends that NCUA collaborate with OCC and state-chartering entities to develop consistent and explicit voting procedures, which should mirror the requirements set out in Subparts A and C of Section 708a. Namely, to-be-acquired banks should:

- provide their customers with 90-day notices, 60-day and 30-day, explaining that the credit union is limited in its FOM and will no longer continue to serve the consumer if he/she is outside the parameters of the credit union's FOM; and
- provide the opportunity for bank customers to communicate with other bank customers.

Further, it should not be merely assumed that customers of the acquired bank are eligible to become members of the acquiring FCU. As such, NCUA should work with the Banking Agencies to establish verification procedures that document whether customers of the acquired bank are indeed eligible to become members of the acquiring FCU. In instances where certain customers are not eligible, or where eligibility cannot be verified and documented, NCUA and the Banking Agencies should develop standardized language that informs the bank customers of their potential ineligibility and methods to cure. Compliance with these procedures should be a condition precedent to final approval of combination by NCUA, the Banking Agencies and the FDIC. Failure to verify eligibility could result in a customer losing federal insurance on his or her savings.

Divestiture of non-compliant assets
NCUA is also proposing to revise Section 741.8 to update its scope and improve its clarity. The Board is proposing to apply Section 741.8 to all asset purchases from entities other than FICUs, not only loan purchases, as is currently the case. When impermissible assets are identified, the FICU proposing the transaction must explain how the parties to the transaction plan to exclude the assets from the purchase transaction.

ICBA supports this proposed provision as a good first step, as it would address certain statutory limitations placed on credit unions. However, ICBA recommends that the proposed rule more explicitly establish an identification protocol and procedure for credit unions to identify such assets and how to divest. For example, credit unions have member-business lending caps, fixed asset limitations and maturity limits that differ from the banks they acquire. NCUA should

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provide a non-exhaustive, illustrative list of assets and liabilities that are prohibited and require divestment, either delineated in Subpart D or by cross-reference to the relevant sections of NCUA regulations.

Finally, for transactions above a certain threshold, such as $100 million, ICBA recommends that the Office of the General Counsel also review and approve the transaction. This would ensure compliance with statutory and regulatory limitations on deals that pose increased risks and potential ramifications.

As stated above, ICBA appreciates NCUA's willingness to address this growing concern. This proposed regulation is a good first step toward addressing uncertainties and disparities that are currently present, but more should be done to stem further mission erosion of credit unions. If you have any questions or would like additional information, please do not hesitate to contact me at (202) 659- 8111 or michael.emancipator@icba.org.

Sincerely,

/s/

Michael Emancipator
Vice President & Regulatory Counsel