ICBA
Independent Community
Bankers of America®

MERGERS AND ACQUISITIONS BETWEEN BANKS AND CREDIT UNIONS

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Executive Summary and Introduction

- Credit unions began as small, cooperative financial institutions created to expand access to financial services. Membership in a credit union was limited to those sharing a single common bond of association or occupation. Congress granted credit unions a tax exemption in order to further this limited mission.
- The National Credit Union Administration (NCUA), rather than ensuring credit unions adhere to their original mission, has acted as a cheerleader for the industry and allowed the creation of multiple common bond credit unions. Since the enactment of the Credit Union Membership Access Act (CUMAA) in 1998, which enshrines multiple common bond credit unions into law, the credit union industry has grown rapidly. The cost of the industry's taxpayer funded subsidy now amounts to almost $2 billion annually.
- Because of their tax advantage and relaxed field of membership regulations, credit unions have begun to acquire community banks in order to fuel their growth. This trend should concern taxpayers because with each acquisition a previously taxpaying financial institution becomes tax exempt and the tax base is further eroded. Additionally, the remaining banks in the community gain a new competitor that has the taxpayer subsidized advantage of being tax exempt.
- Banks also have the opportunity to acquire credit unions. However, the NCUA has erected regulatory barriers that make this process difficult and costly. For example, the NCUA must approve of the adequacy of process used to conduct the member vote required to approve a merger. No similar requirement exists for a credit union to acquire a bank. Additionally, NCUA regulations require credit unions that are considering acquisition to send their members speculative disclosures, designed to discourage support for any proposed deal.
- On their face, these hurdles appear to be an attempt by the NCUA to protect its regulatory turf rather than to diligently supervise the conduct of its industry.
- ICBA urges Congress to stop the NCUA from preventing bank acquisitions of credit unions by continuing to impose unequal and overly burdensome regulations.
- Additionally, ICBA urges Congress to consider legislation that would prohibit the NCUA from requiring credit unions considering acquisition or charter conversion from making disclosures to members that are speculative, inaccurate, or misleading about the effects of the acquisition or conversion.

It is no secret that there has been a trend towards consolidation in the banking industry. The increasing cost of regulatory compliance has pushed many small and mid-size banks to merge in order to benefit from economies of scale. Some of the same regulatory challenges that affect banks have also been felt by credit unions and that industry has moved towards consolidation as well. This 'bigger is better' mindset has pushed some credit unions to take the (until recently) unthinkable step of buying banks.

Since 2012, there has been a spate of bank acquisitions by credit unions. In the past, these transactions would not have been attempted; but the recent trend of more lenient field of membership requirements has turned previously impossible credit union growth into a reality.[1] According to a report by the St. Louis Fed, "restrictions on their field of membership have relaxed, giving credit unions more options for growth than ever before."[2]

These acquisitions are driven by a desire by credit unions to benefit from economies of scale, grow their branch footprint, bring on new talent, enter lines of business traditionally associated with banks, or to gain new customer and business relationships. For example, a credit union may seek to buy a community bank to increase its exposure to agricultural and business lending. While there are some regulatory and business model barriers to these transactions, there are cases where bank acquisitions make business sense for growth-minded credit unions.

These acquisitions represent a threat to the community banking industry because of the tax subsidy enjoyed by credit unions and because of the unequal regulatory playing field relating to credit union mergers and acquisitions (M&A). Each time that a credit union expands by acquiring a community bank, the tax base is eroded and other banks in that community must face a newly tax-exempt competitor.

Furthermore, even in cases where it makes business sense for an acquisitive community bank to turn the tables and acquire a credit union, the NCUA has imposed a byzantine approval process designed to make such acquisitions as time consuming and costly as possible. A credit union acquiring a bank faces fewer regulatory obstacles than a bank acquiring a credit union. The inequality of this process is evidence that the NCUA is a captive regulator. At a minimum, the regulatory burden should be equalized so that all community-minded financial institutions are set on a level regulatory playing field.

1 Richard Gallagher, "The Next Frontier for Credit Union Mergers," *Credit Union Journal* (Jan. 22, 2019) ("Twenty years ago, this question [a credit union buying a bank] would not have been approached – bank acquisitions were not on the radar").

2 Andrew P. Meyer, "Why Are More Credit Unions Buying Community Banks," Federal Reserve Bank of St. Louis *Regional Economist* (2019), available at: https://www.stlouisfed.org/publications/regional-economist/first-quarter-2019/credit-unions-buying-community-banks.

History

When the Federal Credit Union Act was enacted in 1934, credit unions were defined as groups tied together by a single common bond of occupation or association, or by residence within a certain geographic area. Due to their small size, cooperative structure, restricted membership, and mission to serve people of modest means, they were given a tax exemption not granted to banks. In 1982 the NCUA began to permit federal credit unions to be composed of multiple, unrelated employer groups, each having its own distinct common bond of occupation. [3] The creation of multiple common bond credit unions was a significant departure from the original purpose of credit unions and marked the beginning of their expansion into uncharted territory.

The legality of multiple common bond credit unions was challenged in NCUA v. First Nat. Bank & Trust Co. wherein the Supreme Court concluded that the NCUA's policy of allowing credit unions to be composed of multiple unrelated employer groups was "contrary to the unambiguously expressed intent of Congress."[4] However, this ruling was only a temporary halt to credit union expansion. In 1998, credit unions lobbied Congress and persuaded them to pass the Credit Union Membership Access Act (CUMAA). CUMAA enshrined the creation of multiple-common bond credit unions in statute and paved the way for the reality of today's expansionist credit unions.

If one is looking for an example of an expansionist credit union, they need not look further than Navy Federal. In December of 1999, the credit union had roughly $11 billion in assets – today it has over $100 billion.[5] A financial institution of this size goes beyond the original limited mission of a credit union and may even cross into the territory of creating systemic risk. Navy Federal, as its name indicates, was originally created to serve Navy sailors. However, its field of membership has since been expanded to include the Army, Air Force, Marines, Coast Guard, DoD, veterans, and their families.

Though Navy Federal is the most notable example, it is far from the only expansionist credit union operating today. And as the credit union industry grows, so does the size of its taxpayer-provided subsidy. With the increasing prevalence of bank acquisitions this subsidy is poised to grow even further because each transaction means that a bank, which previously paid taxes, becomes tax exempt.

3 47 Fed. Reg. 16775 (1982).

4 *NCUA v. First Nat. Bank & Trust Co.*, 522 U.S. 479, 503 (1998).

5 "First Credit Union to Hit $100b," Credit Union Today (Apr. 2019), available at: https://www.cutoday.info/THE-feature/First-Credit-Union-to-Hit-100-Billion.

Credit Union Acquisition of a Bank

Before delving into the process of a credit union acquiring a bank, it is important to understand the motivations for doing so. Some credit unions seek to acquire banks to expand geographically, beef up a branch network in an existing territory, grow their depositor base, create economies of scale, bring in new talent, or to benefit from the acquired bank's commercial relationships.[6]

These deals generally occur when the credit union is significantly larger than the bank it acquires. Some consultants advise that acquisitions make sense when the credit union has more than $500 million in assets and the bank has less than $300 million in assets.[7] In practice, it is more typical to see credit unions with $1billion or more in assets acquiring banks in the $100 million to $200 million in assets range.

Part of the reason that credit unions generally buy banks that are considerably smaller than themselves is because of their ownership structure. Credit unions are cooperatively owned and therefore cannot issue stock to finance a transaction. This means that they must fund their acquisitions with retained earnings or debt. In turn, this makes credit union offers appealing to some bank shareholders who prefer to receive a cash offer, as opposed to shares of the acquiring bank.[8]

Furthermore, the fact that credit unions are tax exempt means that their evaluation of potential acquisition targets differs from those made by a similarly sized bank. When a credit union acquires a bank, the newly acquired assets go from being taxed to tax exempt. Therefore, a credit union receives an automatic increase to the profitability of the acquisition target. Considering this advantage, credit unions may be able to pay a higher multiple for banks. This erodes the tax base and makes it difficult for acquisitive banks to compete.

Banks cannot merge into credit unions, so most acquisitions are structured as purchase and assumption (P&A) transactions. A P&A transaction involves the acquisition of bank branches, loans and other assets, the assumption of deposits and other liabilities, and the dissolution of the acquired bank's charter. The P&A structure is more paperwork-intensive than a standard merger, and additional complexity can arise if the bank is owned by a bank holding company (BHC).[9]

6 Sharon Simpson, "3 Stories of Bank Acquisition" (June 11, 2018), https://www.creditunions.com/articles/3-stories-of-bank-acquisition/.

7 Palash Ghosh and Jackie Stewart, "If you can't beat 'em, buy 'em: more CU-bank purchases on the horizon" (June 20, 2017), https://www.cujournal.com/news/if-you-cant-beat-em-buy-em-more-cu-bank-purchases-on-the-horizon.

8 *Id.*

9 Jeffery Smith, "Acquisitions of Banks by Credit Unions," *The Bankers' Statement* (2018), https://www.vorys.com/publications-2215.html.

The state laws that govern the acquisition of a bank by a credit union vary. Some states, such as Alabama and Florida, have statutes that explicitly permit these transactions, while other states have not specifically addressed the issue.

At the federal level, 12 U.S.C. 1785 and 12 C.F.R. 741.8 govern credit union P&As.

- Insured credit unions seeking to purchase loans or assume an assignment of deposits, shares, or liabilities of a bank must receive prior approval from the NCUA.[10]
- Requests for approval must be submitted to the appropriate NCUA regional director and include copies of all relevant transaction documents. The time for approval will depend on the complexity of the transaction.[11]
- Prior approval by the NCUA is not required to purchase:
  - Student loans or real estate secured loans to facilitate the packaging of a pool of loans to be sold or pledged on the secondary market under §701.23(b)(1)(iii) or (iv).
  - Assumption of deposits, shares or liabilities as rollovers or transfers of member retirement accounts or in which a federally insured credit union perfects a security interest in connection with an extension of credit to any member.
  - Assets, including loans, or assumptions of deposits, shares, or liabilities by any credit union insured by the NCUSIF from another credit union insured by the NCUSIF.
  - Loan participations as defined in and meeting the requirements of 12 C.F.R. §701.22.[12]

Banks being acquired by a credit union in a P&A transaction must receive approval from each federal and state regulatory agency who is involved in insuring and chartering both the bank **and** the credit union.

According to 12 U.S.C. §1828(c)(1)(C), a bank wishing to transfer its assets to a non-FDIC insured institution (including a credit union) in exchange for the assumption of its liabilities (i.e. participate in a P&A transaction) must receive the prior approval of the FDIC.

10 12 C.F.R. 741.8(a)(2).

11 12 C.F.R. 741.8(c).

12 12 C.F.R. 741.8(b).

All acquisitions of banks by credit unions must receive approval by the bank's board of directors and shareholders. If the bank is held by a BHC, the BHC's board of directors and shareholders must approve the acquisition.

What Happens to Bank Customers Outside the Credit Union's Common Bond when a Bank is Acquired?

During any bank acquisition, the retention of depositors is a critical consideration for the acquirer. This is especially true in a credit union acquisition of a bank because it is most likely that not all bank depositors will be within the credit union's field of membership and eligible to become credit union members. In the past, this hurdle was sufficient to deter credit unions from acquiring banks, but more recently, the field of membership rules have become so relaxed that transactions that would have once been impossible now make economic sense.

The field of membership rules for credit unions are set forth in 12 C.F.R. Appendix B to Part 701. For credit unions seeking to expand, their new members must still fall into one of the recognized field of membership categories. There are several types of possible expansions described by the NCUA:

- Occupational common-bond expansion – an employer-based group or persons employed within a trade, industry or profession;
- Associational common bond expansion – a member-based group meeting the NCUA's threshold requirement and totality of circumstances test;
- Underserved area expansion – a geographic area meeting the NCUA's underserved area requirements (available only to multiple common bonds);
- Community – a geographic area meeting the NCUA's definition of a well-defined local community or rural district; and[13]
    - Since 2010, the Board has offered two ''presumptive community'' options that by definition meet the statutory criteria of a WDLC. Each is based on uniform, objective geographic units. One is a ''Single Political Jurisdiction . . . or any individual portion thereof'' (each an ''SPJ''), regardless of population. The other is a single Core Based Statistical Area (''CBSA'' or ''a statistical area,'' or a portion thereof) as designated by the U.S. Census Bureau (''Census''), or a

13 To qualify as a well-defined local community ("WDLC") or as a rural district, the NCUA requires a proposed area to have ''specific geographic boundaries,'' and for residents within those boundaries to interact or share common interests that signify a cohesive community.

Metropolitan Division within a CBSA, subject in either case to a 2.5 million population limit.

- Merged (or purchase and assumption) credit union's field of membership meeting the NCUA's requirements.[14]

If a bank is acquired by a credit union in a P&A transaction, in order for depositors to become credit union members, they must meet one of the above common bond tests.

The NCUA has, for years, pushed the limits of the common bond test, and has been liberal in allowing the expansion of multiple common bond and community or geographic based credit unions. For example, the NCUA has found that areas larger than several states put together can count as a single "rural district." See American Bankers Association v. NCUA, 306 F.Supp.3d 44 (D.D.C. 2018). This means that so-called "community" credit unions have been presumptively able to include people living in an area of thousands of square miles in their field of membership.

In the case of large multiple common bond credit unions, their field of membership may be broad enough to convert most of a bank's depositors into members. This is most likely in areas that have a handful of large employers or a regional economy focused on a certain industry. The bottom line is that the barrier to who falls within a credit union's field of membership used to be much higher than it is today. As credit unions continue to push the envelope and further erode this once-central aspect of their industry, the number of bank acquisitions by growth-hungry credit unions is only likely to increase.

In conclusion, when a bank is purchased by a credit union, there will probably be some depositors who do not qualify for membership at the credit union. These customers will have to bank somewhere else. However, because of the NCUA's relaxation of field of membership rules and willingness to allow multiple common bond credit unions, many more of a community bank's depositors are likely to be eligible for credit union membership today than at any time in the past. This permissive regulatory landscape may change the calculus of acquisitive credit unions considering bank acquisition.

14 NCUA, *Field of Membership Expansion,* available at: https://www.ncua.gov/support-services/credit-union-resources-expansion/field-membership-expansion.

Conversion of Insured Credit Unions to Mutual Savings Banks

In addition to acquiring banks, credit unions may wish to convert to a mutual savings bank because, banks are able to offer a wider range of products like business loans and real estate loans and some consumers are confused about what credit unions are and what services they can offer. Additionally, a credit union that converts to a mutual savings bank can later more easily convert to a stock bank, which can be an appealing option for institutions looking to raise capital, or management interested in the personal financial benefit of receiving stock in the transaction. Critics of conversion argue that conversion can be lucrative for a credit union's management and directors and dilute the control of its members.

Credit union conversions into banks – much like credit union acquisitions of banks – were once impossible. However, the Credit Union Membership Access Act of 1998 (CUMAA) created a new process by which insured credit unions could convert into mutual savings banks.[15] This change "replaced the NCUA's transaction approval authority with a narrower authority to administer the process by which member votes are held to consider a conversion proposal."[16] As mentioned above, this is frequently the first step of a two-step process for a credit union to convert into a stock-issuing bank.

Converting from a credit union to a bank requires a majority vote of both the credit union's members and directors. Once a conversion has been approved by a credit union's members and directors, the methods by which the member vote was taken and the procedures applicable to the member vote must also be approved by the Board of the NCUA.[17]

12 C.F.R. pt. 708a. Subpart A governs the conversion of credit unions into mutual savings banks. Subpart C governs the merger of credit unions into existing banks. Both processes require the approval of the NCUA with regard to the methods by which the member vote was taken and the procedures applicable to the member vote, but mergers into existing banks require the Board's prior approval. The NCUA has a history of aggressively scrutinizing the procedures of member votes in order to deter institutions from attempting to convert or merge.

Once a conversion into a mutual savings bank is proposed by the board of directors of a credit union, notice must be circulated to all the credit union's members. Boards must consider all comments submitted by members before voting on conversion. After the board votes to convert, it must submit a

15 12 U.S.C. 1785(b)(2).

16 Michael W. Briggs, *Credit Union Conversions: Charter Choices and Controversy,* 10 N.C. Banking Inst. 1 (2006).

17 12 U.S.C. 1785(b)(2)(G)(ii)

notice of its intention to the credit union's members and conduct a member vote. This notice must include "a clear and conspicuous disclosure that the conversion from a credit union to a mutual savings bank could lead to members losing their ownership interests in the credit union if the mutual savings bank subsequently converts to a stock institution and the members do not become stockholders."[18] It must also include a disclosure that directors and managers may receive additional economic compensation from the conversion.[19]

Certain disclosures (including disclosures about director compensation and loss of credit union membership) must be placed "in a box, must be the only text on the front side of a single piece of paper, and must be placed so that the member will see the text after reading the credit union's cover letter but before reading any other part of the member notice. The back side of the paper must be blank."[20] These requirements – ostensibly for the purpose of providing clear disclosure – also serve as a way to discourage credit unions that are considering conversion.

Prior to the member vote, the board of directors must submit a notice of its intent to convert to the NCUA Regional Director. There is a laundry list of things this notice must contain, including, "[a] statement that each director signing the certification supports the proposed conversion and believes the proposed conversion is in the best interests of the members of the credit union," a written description of all materials submitted to the Regional Director, and an acknowledgement that federal law prohibits misrepresentations, omissions of material facts, and fraudulent statements.[21]

After the member vote, "The Regional Director will review the methods by which the membership vote was taken and the procedures applicable to the membership vote. The Regional Director will determine: if the notices and other communications to members were accurate, not misleading, and timely; the membership vote was conducted in a fair and legal manner; and the credit union has otherwise complied with part 708a."[22]

18 12 C.F.R. 708a.104(c)(1)

19 12 C.F.R. 708a.104(c)(3).

20 708a.104(d)(2).

21 12 C.F.R. pt. 708a.105.

22 12 C.F.R. pt. 708a.108(a).

Credit Union Acquisition by a Bank

A bank may wish to "turn the tables" and acquire a credit union for many of the same reasons that a credit union would want to acquire a bank. Acquiring a credit union may allow a bank to grow its depositor base, increase its branch footprint, develop economies of scale, and acquire appealing assets.

According to 12 C.F.R. 708a.302, "A credit union, with the approval of its members, may merge into a bank only with the prior approval of NCUA, the Federal Deposit Insurance Corporation, and the regulator of the bank. If the credit union is State chartered, it also needs the prior approval of its State regulator."

The merger of a credit union into a bank is a multi-step process that involves the vote of credit union's members and approval by multiple regulators.

- Step 1: Merger Valuation – Credit union must conduct a public auction, receive at least three bank bids (at least two must be stock); or retain a "Qualified Appraisal Entity" to render a merger value estimate.[23]
- Step 2: Advance Notice – Credit union must publish 30-day advance public notice of intent to vote on merger proposal published in a newspaper of general circulation, on the credit union's website, etc.[24]
- Step 3: Member Comments – Credit union must collect and review comments by credit union members submitted during the merger process.[25]
- Step 4: Approval of Board – Majority of the credit union board must vote to approve merger.[26]
- Step 5: Notice to NCUA – Notice to the NCUA must be provided within 30 days following board approval and include:

    1. The merger plan;
    2. Resolutions of the boards of directors of both institutions;
    3. Certification of the board of directors;
    4. Proposed Merger Agreement;
    5. Proposed Notice of Special Meeting of the Members and any other communications about the merger that the credit union intends to

23 12 C.F.R. 708a.303(a).
24 12 C.F.R. 708a.303(b).
25 12 C.F.R. 708a.303(c).
26 12 C.F.R. 708a.303(d).

send to its members, including electronic communications posted on a Web site or transmitted by electronic mail;

6. Proposed ballot to be sent to the members;
7. For State chartered credit unions, evidence that the proposed merger is authorized under State law;
8. A copy of the bank's last two examination reports;
9. A statement of the merger valuation of the credit union;
10. A statement of whether any merger payment will be made to the members and how such a payment will be distributed among the members;
11. Information about the due diligence of the directors in locating a merger partner and determining that the merger is in best interests of the members of the credit union;
12. Copies of all contracts reflecting any merger-related compensation or other benefit to be received by any director or senior management official of the credit union;
13. If the merging credit union's assets on its latest call report are equal to or greater than the threshold amount established annually by the Federal Trade Commission under 15 U.S.C. 18a(a)(2)(B)(i), currently $63.4 million, a statement about whether the two institutions intend to make a Hart-Scott-Rodino Act premerger notification filing with the Federal Trade Commission and, if not, an explanation why not;
14. Copies of any filings the credit union or bank intends to make with another Federal or State regulatory agency in which the credit union or bank seeks that agency's approval of the merger; and
15. Proof that the accounts of the credit union will be accepted for coverage by the Federal Deposit Insurance Corporation.[27]

- Step 6: Member Vote – Written notice of intent to merge must be provided to every eligible voting credit union member 90 and 30 days before the member vote to approve the merger.
    - The ballot must be included with the 30-day notice and may not be distributed before then.
    - In addition to other required disclosures, the 30- and 90-day notices both must include the following regulatory disclosure:

27 12 C.F.R. 708a.304(a).

IMPORTANT REGULATORY DISCLOSURE ABOUT YOUR VOTE
The National Credit Union Administration, the Federal government agency that supervises credit unions, requires [insert name of credit union] to provide the following disclosures:
1. LOSS OF CREDIT UNION MEMBERSHIP. A vote "FOR" the proposed merger means you want your credit union to merge with and become a bank. A vote "AGAINST" the proposed merger means you want your credit union to remain a credit union.
2. [For Mergers into Stock Banks Only]. LOSS OF OWNERSHIP INTERESTS. If your credit union merges into the bank, you will lose all the ownership interests you currently have in the credit union and you will become a customer of the bank. The bank's stockholders own the bank, and the directors of the bank have a fiduciary responsibility to run the bank in the best interests of the stockholders, not the customers.
2. [For Mergers into Mutual Banks Only]. POTENTIAL PROFITS BY OFFICERS AND DIRECTORS. Merger into a mutual savings bank is often the first step in a two-step process to convert to a stock-issuing bank or holding company structure. In such a scenario, the officers and directors of the bank often profit by obtaining stock in excess of that available to other members.
3. RATES ON LOANS AND SAVINGS. If your credit union merges into the bank, you may experience changes in your loan and savings rates. Available historic data indicates that, for most loan products, credit unions on average charge lower rates than banks. For most savings products, credit unions on average pay higher rates than banks.

- Approval is required by a majority of voting credit union members. At least 20% of eligible credit union members must participate in the vote. Incentives for participation may be provided but receiving the incentive must not be contingent on voting "Yes."[28]
- Step 7: Certification of Member Vote – "The board of directors of the merging credit union must certify the results of the membership vote to the Regional Director within 14 calendar days after the vote is taken."[29]
- Step 8: NCUA Approval of the Merger – The NCUA Regional Director will review "The methods by which the membership vote was taken and the procedures applicable to the membership vote. The Regional Director will determine if the notices and other communications to members were accurate, not misleading, and timely; if the membership

28 12 C.F.R. 708a.306(a).
29 *Id.*

vote was conducted in a fair and legal manner; and if the credit union has otherwise met the requirements of this subpart, including whether there is substantial evidence that the factors in section 205(c) of the [Federal Credit Union] Act are satisfied."[30]

- After this review, the Regional Director will approve or disapprove the merger. If he disapproves it, he may direct that a new vote be taken.
- Disapprovals may be appealed to the NCUA Board.[31]

• Compensation Limits – No director or manager of the acquired credit union may receive more than "reasonable compensation and other benefits paid in the ordinary course of business."[32]

Speculative Disclosures

The member vote is highly scrutinized and failure to comply with the requirements of any step may result in a disapproval of the merger for inadequate process. This means additional time and expenses to start the process anew, or the end of the proposed transaction.

One of the most problematic parts of this process are the disclosures that must be made to members prior to the member vote (Step 6 above, 12 C.F.R. 708a.305 in the NCUA regulations). In the first place, the mandatory disclosures are speculative and present a one-sided view of proposed transactions. For example, while members will lose their credit union membership, they may still be customers of the bank and receive similar or expanded services. Additionally, while they will lose their ownership interest if they are bought by a stock bank, they will receive compensation for that interest, and they are free to use that compensation to buy stock in the acquiring bank. Finally, the disclosure about loan rates and savings is speculative and the actual rates available to customers will depend on macroeconomic factors such as prevailing interest rates and microeconomic factors such as the financial characteristics of the individual acquiring bank.

The one-sided and speculative nature of these disclosures appears designed to persuade members to vote against proposed transactions without considering their merits. This is troubling given the fact that the disclosure specifies that the NCUA "requires [the acquired credit union] to provide the following disclosures." This could easily lead a member to think that the disclosures represent legal and financial advice being given to the NCUA or that the agency opposes the merger.

30 12 C.F.R. 708a.308(a).

31 12 C.F.R. 708a.308(d).

32 12 C.F.R. 708a.310.

NCUA as a Captive Regulator

Even if a credit union's members decide to vote in favor of a merger after reading through the prejudicial required disclosures, the NCUA may still refuse to accept the vote. In Community Credit Union (CCU) v. NCUA, the NCUA refused to accept an affirmative vote of 71% of a credit union's members to convert from a credit union to a mutual savings bank. This type of charter conversion requires a similar mandatory disclosure to the disclosure required for a credit union being acquired by a bank. However, in the CCU case, the NCUA concluded that the members received inaccurate and misleading information because the disclosures were folded in such a way that they appeared opposite CCU's rebuttal. The NCUA contested that the disclosure should have been folded so that it was the first thing members saw.[33]

In CCU v. NCUA, the Court concluded that the NCUA abused its discretion and that the disclosure provided by CCU was sufficiently accurate and conspicuous. Despite the happy ending in this case, CCU v. NCUA illustrates how aggressive the NCUA is willing to be to prevent credit unions from converting into or being acquired by banks. They were willing to hold up a conversion already approved by 71% of voting members for something as inconsequential as the way a paper was folded.

This is the behavior of a captive regulator. The NCUA receives its funding from the fees it charges to credit unions to conduct examinations. If credit unions convert to banks, or are acquired by banks, the revenue of the NCUA decreases. Conversely, if the asset base of the credit union industry grows, so too does the agency's revenue. Therefore, the NCUA has a clear incentive to prevent banks from acquiring credit unions. Likewise, it benefits from allowing credit unions to expand their field of membership beyond the scope of their original mission and to acquire banks. With the incentives of the regulator and the regulated this closely aligned, it is not surprising that the NCUA has moved from supervising the industry to promoting it.

Role of Bank Regulators

According to 12 U.S.C. 1828(c), a federally insured bank may not merge or participate in a P&A transaction with any bank or institution not insured by the FDIC (i.e. a credit union) without the prior approval of the FDIC and the bank's prudential regulator.

In considering whether or not to grant approval for a merger transaction, the responsible agency will consider competitive factors and will not approve

33 *Community Credit Union v. National Credit Union Administration,* No. 4:05 CV 285 (E.D. Tex., Aug. 24, 2005).

any combination that would result in a monopoly in any part of the United States or otherwise substantially lessen competition.[34]

The FDIC Statement of Policy on Bank Merger Transactions says, “In every proposed merger transaction, the FDIC must also consider the financial and managerial resources and future prospects of the existing and proposed institutions, the convenience and needs of the community to be served, and the effectiveness of each insured depository institution involved in the proposed merger transaction in combating money-laundering activities, including in overseas branches.”

34 12 U.S.C. 1828(c)(5).

Possible Solutions

Credit Union Charter Choice Act

The NCUA has a financial incentive to make sure that federally chartered credit unions stay federally chartered credit unions. The more large, federally chartered credit unions there are, the greater the NCUA's budget. Because of this, they have created a complicated, time-consuming, and expensive regulatory approval process designed to deter credit unions from converting to or being acquired by banks. They police this process aggressively, and even if their decisions are eventually thrown out in court, the expense of litigation has a chilling effect on conversions and M&A in the industry.

Congress could combat this chilling effect by enacting the Credit Union Charter Choice Act. The Act, first introduced in 2005 would limit the NCUA's power to prevent credit unions from converting to mutual savings banks. The Act achieves this purpose by:

1. Prohibiting the NCUA from requiring a converting credit union to make disclosures to its members that are speculative or that distort the impact of the conversion on members. This would require the NCUA to eliminate or modify its current required disclosures.
2. Removing the NCUA's authority "to require a new vote on the basis of the contents of…any…communication from the converting insured credit union to the members of the credit union, unless the notice or communication contains a knowingly false statement that affects the outcome of a conversion vote."[35]
3. "Absent fraud or reckless disregard for fairness during the voting process that affects the outcome of the vote,"[36] the NCUA would have no authority over the conversion process after the member vote has been certified to the NCUA by the board of the converting credit union.

These changes would remove obstacles for credit unions wishing to convert to banks which would empower credit union members. As mentioned previously, there are several compelling reasons why converting to a bank charter may be in the best interest of credit union members. From entering new lines of business to raising additional capital, members of a credit union should be allowed to vote on the charter type that best suits them, without the regulatory overreach of the NCUA mandating prejudicial disclosures.

35 Credit Union Charter Choice Act, H.R. 3206(a)(3), 119th Cong. (2005).

36 *Id.*

Bank Acquisition Tax / Deposit Insurance Fund Exit Fee

The NCUA directly benefits when the credit union industry grows. Therefore, it has relaxed its field of membership restrictions and paved the way for the acquisition of banks by credit unions. These changes have allowed credit unions to grow to previously unimaginable size. They have also harmed taxpayers by increasing the size of the subsidy that the industry receives as long as it remains tax exempt.

Despite the complex regulatory approval process, credit unions have a natural advantage when they are seeking to buy banks: they are exempt from federal and state income taxes. This means that whenever a bank is purchased by a credit union, tax revenue is decreased. The taxpayer, in effect, subsidizes the transaction. A one-time acquisition tax assessed to credit unions when they acquire a bank would partially offset the loss to taxpayers associated with bank acquisitions.

Another possibility is charging banks that are acquired by a credit union an exit fee when they leave the Deposit Insurance Fund. This fee would only apply to banks acquired by credit unions, not to banks acquired by other banks which would remain insured by the FDIC.

There is precedent for exit fees of this kind. In the 90s, after the insolvency of the Federal Savings and Loan Insurance Corporation, the FDIC managed a separate Bank Insurance Fund (BIF) and Savings Association Insurance Fund (SAIF). Because S&Ls were considered less stable than banks, the cost of being insured by SAIF was higher than being insured by the BIF.

Congress was concerned that "SAIF could be jeopardized if healthy savings associations, in order to take advantage of BIF's lower premiums, converted to banks or transferred their deposits to banks."[37] To prevent this from happening, entry and exit fees were imposed on conversion transactions (i.e. a savings association becoming a bank, or visa versa).

These exit fees, described in the old 12 U.S.C. 1815(d)(2)(E), were to be assessed in the appropriate amount to prevent the dilution of the fund (either the BIF or the SAIF) from which the institution was exiting. The current 1815(d) makes no reference to exit fees or conversion transactions. It merely says that any institution that becomes insured by the FDIC shall pay any fee that the FDIC may by regulation prescribe.

For the purpose of recouping lost tax revenue when a community bank is acquired by a credit union, it is possible to impose an exit fee on any bank that terminates its charter and has its deposits assumed by a credit union. The FDIC has an incentive to charge an exit fee because community banks tend to be better capitalized than their too-big-to-fail bank peers because

37 *Wells Fargo Bank v. FDIC,* 310 F3d 202 (D.C. Cir., 2002).

community bankers know they are less likely to receive a bailout in the event of a crisis.

Additionally, because credit unions are likely to target the banks with the best assets and most stable deposits for acquisition, they will inevitably select the community banks that are least likely to fail. If a sufficient number of the most stable banks terminate their FDIC insurance because they are acquired by credit unions, it would destabilize the Deposit Insurance Fund.

The current version of 12 U.S.C. 1815, which governs deposit insurance, does not specifically mention exit fees. However, they are also not specifically excluded. This means that the FDIC could issue a rule requiring that any banks leaving the DIF and becoming insured by NCUSIF pay an exit fee in order to preserve the stability of the fund.

Taxing the Largest and Most Aggressive Credit Unions

The largest credit unions today have deviated from the original mission of credit unions. Navy Federal, which has over $100 billion in assets, looks more like a large commercial bank than a cooperative community institution. It – along with several other large credit unions – have grown too large and complex to receive a taxpayer subsidy.

Another option, as opposed to taxing credit unions based on asset size, is to tax credit unions that acquire banks. This step would make sense because it is not in keeping with the original limited mission of credit unions to make large acquisitions that stretch all reasonable interpretations of their field of membership limitations. If credit unions want to offer the same services as banks, raise capital like banks, and engage in mergers and acquisitions with banks, they must also be taxed and regulated like banks.

Conclusion

Credit unions have strayed from their original, limited mission and should no longer be favored with tax-exempt status. The trend of credit unions buying banks is just another step in the long process of blurring the lines between credit unions and full-service commercial banks. These acquisitions are particularly troublesome because they allow credit unions to grow the size of their taxpayer subsidy and to merge taxpaying banks into tax-exempt credit unions. This shrinks the size of the tax base and, due to the lax supervision of the NCUA regarding implementing risk-based capital requirements, potentially increases the amount of instability in the financial system.

Until credit unions are required to pay taxes on their earnings and are made subject to the same Community Reinvestment Act requirements as banks, they should not be permitted to acquire banks. Furthermore, the NCUA should stop erecting regulatory hurdles to prevent banks from acquiring credit unions. Banks are more heavily regulated, pay taxes, and do not have the same limitations on who can be a depositor. There is no reason for the NCUA to allow credit unions to acquire banks while simultaneously making it more difficult for banks to acquire credit unions other than to protect their own regulatory turf.

ICBA urges Congress to stop the NCUA from preventing bank acquisitions of credit unions by continuing to impose unequal and overly burdensome regulations. Additionally, ICBA urges Congress to consider legislation that would prohibit the NCUA from requiring credit unions considering acquisition or charter conversion from making disclosures to members that are speculative, inaccurate, or misleading about the effects of the acquisition or conversion. Finally, due to the aggressive behavior of the credit union industry and their deviation from their original limited mission, ICBA urges Congress to end the credit union subsidy and subject them to the same tax regime as commercial banks.

About

ICBA

The Independent Community Bankers of America® creates and promotes an environment where community banks flourish. With more than 52,000 locations nationwide, community banks constitute 99 percent of all banks, employ more than 760,000 Americans and are the only physical banking presence in one in five U.S. counties. Holding more than $4.9 trillion in assets, $3.9 trillion in deposits, and $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. For more information, visit ICBA's website at www.icba.org.

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