



November 16, 1999

§ 801.97, 802.2

BY FAX TO 202 / 326-2624
Thomas Hancock, Esquire
Premerger Notification Office
Federal Trade Commission
6th Street & Pennsylvania Avenue, N.W.
Washington, D.C. 20580

Dear Mr. Hancock:

The purpose of this letter is to confirm our understanding regarding certain credit union assets that the Federal Trade Commission (FTC) would view as exempt from the notification rules in the case of a merger of two corporate credit unions. Our understanding is based on conversations with FTC staff attorneys and our review of the Hart-Scott-Rodino Antitrust Improvement Act of 1976, 15 U.S.C. §18a (HSR Act or Clayton Act §7A) and FTC regulations and interpretations.

Background

Credit unions are nonprofit, membership cooperatives that provide financial services to their members. Credit unions, which may be chartered under federal or state law, may only provide services to their members. A credit union's charter establishes its field of membership and, generally, is based on an occupational or associational bond or residence or place of employment in a specific geographic community. Credit unions provide saving and credit services. Saving services includes share savings and draft accounts, share certificates, and credit services includes secured and unsecured consumer loans and real estate mortgage loans. They have limited authority to make commercial loans and investments. Credit unions are controlled by their members who, regardless of the amount of funds in their share account(s) with the credit union, have one vote in the election of a volunteer board of directors. The directors are charged with the general management and control of the credit union.

A special type of credit union is a corporate credit union whose membership is made up of so-called natural person credit unions. They function essentially like a banker's bank. Corporate credit unions, of which there are currently 38, provide a source of liquidity and investment for natural person credit unions as well as acting as clearing houses for financial transactions. Natural person credit unions are not limited to corporate credit unions as a source of liquidity or for clearing activities but may also turn to banks. Corporate credit union charters are generally geographic in that they are chartered to serve credit unions within a particular state or regional area. There are a number of corporate credit unions that have national fields of membership and can serve natural person credit unions located anywhere in the United States.

The Nature of a Credit Union Merger

Generally, when two credit unions merge, the financial statements of the two credit unions are simply "pooled." Because there is no voting stock, there is no payment for stock. The members of the acquired credit union vote to approve or disapprove a merger. If they approve the merger, the members of the acquired credit union simply become members of the acquiring credit union and their accounts are transferred. The merger of federally-insured credit unions requires the approval of the National Credit Union Administration. 12 U.S.C. §1785(b),(c). As a result of a merger, the charter of an acquired credit union is canceled by either the NCUA or, if a state-chartered credit union, by the appropriate state agency.

Exempt Assets

Assuming that a merger between two, federally-chartered corporate credit unions is subject to the provisions of the HSR Act, we have focused on what assets are exempt for purposes of calculating the size-of-the-transaction threshold of \$15 million, triggering the requirement of premerger notification. 15 U.S.C. §18a(a)(3); 16 C.F.R. §802.20.

16 C.F.R. §801.21

Under this regulatory provision, voting or nonvoting securities, other obligations referred to in section 7A(c)(2), and cash are exempt. Our view is that the following asset accounts are securities, cash, or the equivalent of cash and are exempt:

Investment accounts. Credit unions are limited by statute to particular types of investments. 12 U.S.C. §1757(7), (8), (15). Corporate credit unions have slightly expanded investment authority. 12 C.F.R. §704.5(c). Generally, corporate investments may include bonds, certificates of deposit, demand deposits, asset-backed securities, collateralized mortgage obligations (CMOs), money market purchases, third party repurchase agreements, deposits in the National Credit Union Share Insurance Fund (NCUSIF), capital accounts in the U.S. Central Credit Union, and limited mutual fund and stock ownership.¹ Accrued income on these investments is likewise exempt.

¹ Includes Federal Home Loan Bank stock and nonvoting stock in the National Credit Union Central Liquidity Facility (CLF). The CLF is a liquidity source within the NCUA; credit unions establish membership in the CLF by subscribing to "capital stock" in an amount not less than 1% of the credit union's paid-in and unimpaired capital and surplus. 12 U.S.C. §1795, 1795c.

Prepaid expense and prepaid tax accounts.

Settlement accounts including check clearing, automated clearing house, and Federal Reserve Bank transaction accounts established in connection with providing settlement services to member credit unions. To illustrate, each day member credit unions may deposit thousands of checks into their accounts with the corporate credit union for clearing. The corporate credit union aggregates these deposits and enters the dollar value of these checks in an asset account with a corresponding entry in a liability account. As checks clear, the corporate credit union releases funds to its members. If a check clears, the corporate credit union makes an asset adjustment: the amount moves from the settlement asset account to a cash account. At the same time, the corporate makes a liability adjustment: moving the dollar amount from the settlement liability account to the member's share account from which the member can withdraw the cash. If a check does not clear, the corporate credit union returns the check to the member with a notice that it has been dishonored, and then simply deletes the offsetting asset and liability settlement account entries. Settlement accounts are precipitated by an order for cash payment, generally a check or a wire transfer, and represent a temporary accounting for what is, essentially, a transfer of cash from a third party into the member's share account. We believe that these temporary settlement accounts are essentially an accounting mechanism and are exempt as the equivalent of cash under 16 C.F.R. §801.21.

16 C.F.R. §802.2(d)(2)

The provision exempts office property that is real property and includes office buildings, including common areas such as parking and recreational facilities, and "assets incidental to the ownership of such property, including cash, prepaid taxes or insurance, rental receivables and the like." We understand that the furniture and equipment of the acquired credit union, however, would not be exempt.

15 U.S.C. §18a(c)(2) or Clayton Act §7A(c)(2)

This provision of the HSR Act exempts acquisitions of "bonds, mortgages, deeds of trust, or other obligations which are not voting securities" from the premerger notification requirements.

We would appreciate your consideration of two particular types of loans or lines of credit that we believe should be exempt under 16 C.F.R. §801.21 as cash equivalents.

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Loans secured by cash assets in the possession of the credit union. Credit unions often make loans that are secured by cash deposits (member shares) of the debtor at the credit union. If the debtor defaults, the credit union has the right, without court intervention, to immediate possession and use of the cash collateral. We believe these loans should be viewed as cash equivalents exempt under 16 C.F.R. §801.21(a).

Settlement lines of credit. These loans are generally "overnight" loans, often retired the same day, made by a corporate credit union to member credit unions to cover temporary shortages in their settlement accounts at the corporate credit union. We believe these "overnight" settlement lines of credit should be treated as cash equivalents exempt under 16 C.F.R. §801.21(a).

Date of Valuation

We have also considered the date upon which the assets of the acquired credit union are to be valued for purposes of measuring those assets against the \$15 million size-of-transaction threshold. The corporate credit union merger at issue is scheduled to be consummated on December 31, 1999, and so we are now within 60 days of the merger date. Due to the fluid nature of corporate assets, the aggregate amount of assets and the classification of those assets can and will change significantly from day to day. We interpret 16 C.F.R. §801.10(c)(3) as authorizing the board of directors of the acquiring corporate to examine the assets of the acquired institution on any particular day between now and the merger, and if the aggregate nonexempt assets of the acquired corporate are below \$15 million on that one day, the acquiring corporate will not have to submit an HSR filing. We understand that this interpretation would have to be qualified if the acquiring corporate has acquired other assets of the acquired corporate in the preceding 180 days. 16 C.F.R. §801.13(b)(ii).

We would appreciate your review and informal opinion of our analysis regarding exempt assets and the date of asset valuation.

Sincerely,

[Redacted signature block]

11/16/99

I informed the writer that the approach reflected in this letter seems to be reasonable and the conclusions reached seem not unreasonable.
T.H.H.

[Redacted text]