

Guidelines for an Application

1. Credit Union Regulatory Citations that Permit a P&A Transaction Allowing a Credit Union to Purchase a Bank

A Washington state chartered credit union may choose either of the following two methods to permit it to purchase a bank using a P&A transaction:

- A. Under the RCW and 12 CFR 741.8** – Under RCW 31.12.402(6), a credit union may acquire interests in personal property and real property, and under RCW 31.12.402(1) a credit union can issue shares and receive deposits. Also, under RCW 31.12.436(1)(a) a credit union can invest its funds in loans to nonmembers held by other lenders, with the approval of the director, and under RCW 31.12.438(1) a credit union can invest in real property or leasehold interests. A credit union also has *incidental* powers under RCW 31.12.402(24), and the Director of Credit Unions may therefore under RCW 31.12.516(8) interpret RCW 31.12.402(6), RCW 31.12.402(1), RCW 31.12.436(1), RCW 31.12.438(1) and RCW 31.12.402(24) so as to permit a P&A transaction wherein a bank is the seller and the credit union is the purchaser. Other than those citations previously mentioned, the Washington Credit Union Act provides no provisions for a P&A. The NCUA Rules and Regulations applicable to all federally insured credit unions, set no standards for P&As other than those set forth in 12 CFR 741.8, which is titled Purchase of Assets and Assumption of Liabilities.
- B. Invoking the Federal Power Parity Provision of the RCW** - A Washington state chartered CU who is purchasing the bank can invoke the federal power parity provision of the RCW 31.12.404(1). Specifically, Section 205(b) of the Federal Credit Union Act and 12 CFR 741.8(a) (2) govern a federally insured credit union's acquisition of a non-NCUSIF insured institution.

2. Regulatory Approval from all the Necessary Regulatory Agencies

It will be important to promptly determine which regulatory bodies must approve this P&A transaction and whether any of the regulatory agencies have any concerns that may prevent the transaction or whether any of these regulatory bodies have any unique or unusual requirements for the transaction.

Regulatory Agencies whose Approval Must be Received

- **State of WA Division of Credit Unions (DCU) Approval Authority** – A state chartered CU who is purchasing the bank must cite which method it is using to apply for regulatory approval (method A or B listed above) and it will need DCU's Director's approval.
- **NCUA Approval** – As stated above, Section 205(b) of the Federal Credit Union Act and 12 CFR 741.8(a) (2) govern a federally insured credit union's acquisition of a non-NCUSIF insured institution. Most P&A applications will need to go before the NCUA Board of Directors.
- **Required Bank Regulatory Approval** – Approval from the primary federal regulator (FDIC, FRB or OCC) will be required, along with the chartering authority (DOB, OCC) of the bank. FRB approval is necessary, if the bank is owned by a holding company or if it is a member of the Federal Reserve. FDIC approval is necessary, if the bank is state-chartered and a non-member of the Federal Reserve.
- *Note: Most bank regulatory agencies treat this type of transaction as a P&A. Approval letters will need to be received from each regulatory agency who is involved in insuring and chartering the bank and credit union.*

Work closely with DFI Director of Legal and Regulatory Affairs, and the Division of Banks (DOB) regarding the banking requirements for the P&A transaction.

3. Must Receive Approval from the Bank's Shareholders

- **Bank Shareholder Approval** – The bank's shareholders must approve the selling of the bank's assets and/or liabilities. If the bank is owned or held by a bank holding company, then the holding company must approve the merger. Note: Most banks are owned by a banking holding company who owns all the shares of stock in the bank.

The applicable DOB law for a bulk sale of assets and/or liabilities (P & A) by a bank to another bank is covered under RCW 30A.44.240. Although this statute does not cover the situation of a credit union acquiring a bank thru a P & A transaction, RCW 30A.44.240 gives a great deal of flexibility to the DOB Director to apply these standards to a credit union purchase (P & A) of a WA state chartered bank. See ISGC-2013-004-DOB. A two-thirds (2/3) majority of the outstanding voting shares of Seller must vote affirmatively for the proposed Transaction. Absent some

requirement contained within its bylaws, *Purchaser* does not need shareholder approval to consummate the Transaction as represented.

- 4. A Comprehensive Bank into Credit Union P&A Plan must be Submitted to DCU.** The Plan, must at a minimum, stipulate the important terms of P&A agreement and provide adequate support for the P&A transaction. At a minimum, the Plan must address all the items that are found in a standard merger of a credit union into another credit union, and stipulate the following additional items:

Additional Items that must be Addressed in a P&A Application which are Different from a Standard Merger Application

- The P&A application must state how much monetary consideration will be paid to the bank shareholders and how this monetary transaction will be done (including but not limited to liquidity or borrowing decisions). For example, if the price of the P&A transaction is \$1 million dollars and there are 250,000 shares of outstanding stock, then the P&A Plan must designate that a cash payment of \$4 would be received for each share of common stock and then there would be an immediate cancellation of the common stock.
- The P&A application must state what the credit union will do with the bank. For example, the credit union may stipulate that it will purchase all the assets and assume all the liabilities of the bank, but it does not intend to retain any bank stock or run certain banking businesses granted under the bank charter (such as trusts, etc.).
- The application should state how the bank will surrender its charter and legally merge or become part of the continuing credit union.
- The application must state how the credit union will amend its FOM bylaws to include the bank's depositor/borrower base in its field of membership (FOM), if needed.
- The application may provide for an opt-in/opt-out option for the bank's depositors/borrowers to become members of the credit union, whether they will accept NCUSIF deposit insurance or withdraw their deposit without a penalty, and stipulate how these options will work. Note: The bank account holders may choose not to continue with the credit union and will not be part of the credit union. Examples of customers not continuing with the credit union are: (1) Those who opt-out and withdraw their deposits (if an opt-out notice is given); (2) Those who close their bank account and withdraw their deposits; (3) Those who choose not to sign a

credit union membership agreement and close their account(s); and (4) Those bank customers who do not qualify for credit union membership and the credit union is not eligible to accept non-member deposits. A reasonable time period (such as six months from the completion of the P&A transaction) will be needed to sort out the membership of the credit union after the P&A transaction is consummated.

- The application must contain a projected net worth ratio (i.e. dilution analysis), which projects what the credit union's net worth ratio will be after the P&A transaction. For example, if the credit union currently has \$100 million in total assets and has a net worth ratio of 10%, and the community bank has \$10 million in total assets, \$1.5 million of fair value equity and the purchase price is \$2 million (consideration). The projected net worth ratio after the P&A transaction would be 8.64% (\$9.5 million net worth and \$110 million of total assets).
- The application should contain at least two years of projected financial statements for the combined entity and a two-year strategic plan for how the bank will be successfully integrated into the credit union's operations. In particular, the plan must describe how the credit union will continue banking products or services that are different from current credit union products and services (such as agricultural lending, if the credit union has no experience in agricultural lending). For example, the plan might explain which bank lending specialists it will need to retain in order to successfully perform the type of lending the credit union personnel are not familiar with or skilled in.
- The application must include a timeline that details how the sequence of P&A transaction events will occur.
- The application must stipulate what type of accounting treatment for the P&A transaction will occur, almost always it will be the fair value accounting method. Additionally, the application must state who will perform the fair value accounting analysis and when the preliminary and the final fair value accounting valuations must be provided.

Items that are Submitted with a Standard CU into CU Merger Application, Which Must be Submitted with a Standard Bank into CU P&A Application

- What are the credit union's plans for the main office and branches of the bank? Will these offices remain open and for how long?
- Will there be any changes to the credit union's board of directors or supervisory committee as a result of the P&A transaction?

- Will there be any additional retirement, compensation, or severance benefits paid-out or given as a result of the P&A transaction? Will any financial incentives be offered to any employee or official of the bank?
- What is the plan for the bank's employees? Will some bank staff lose their jobs, what is the plan for back operations employees (Human Resources, Information Technology, or Fiscal)? Will the bank employees whose employment is continued by the credit union have salary and benefits (including retirement) that remain the same as was given by the bank or will their salary and benefits be converted to match what the credit union is offerings? Are there any current bank employment contracts, and if so, how will these contracts be treated going forward?
- Are the Hart Scott Rodino Act reporting thresholds met?
- Is the detailed merger/acquisition plan signed by the board chair and the CEO of each entity (credit union and the bank)?
- Has the credit union satisfactory performed due diligence on the bank's operations, including a due diligence review on the bank's financials, loans, liabilities, contracts, etc. and has the credit union provided DCU with a summary report of the due diligence that was performed?
- Has the credit union performed an analysis of depositors/shareholders in common to ascertain whether there will be account holders in common that would approach or exceed the \$250,000 NCUSIF depository insurance limit? Typically, DCU requires the credit union to complete an analysis as to whether any bank depositor, who had deposits in the bank and at the credit union, would exceed the maximum NCUSIF deposit insurance coverage. The credit union should offer these depositors an "opt-out" period to restructure their deposits within the NCUSIF deposit insurance coverage or withdraw their deposits that are over the insured amount without penalty.
- Does the P&A application state the reasons for the proposed P&A transaction? Do these reasons make sense and are they well supported?
- Has the credit union and bank notified its bonding companies of the proposed or impending P&A transaction?
- Ask for and review the previous two exam reports for the bank.
- If the bank has a significant amount of commercial loans. The DCU analyst/reviewer should evaluate whether the credit union has the commercial lending infrastructure and personnel experience to handle the influx of commercial lending. Will the credit

union count on existing bank staff and management to adequately control the risk in this area? Will the addition of the bank's commercial loans push the credit union beyond its safety and soundness or its regulatory limit on aggregate member business loans? Will the commercial loan concentrations be within a safe and sound limit or will the credit union need to sell participations in existing loans to reduce its concentrations?

- Does the P&A application discuss when and how the conversion of the bank's core data processing system and other important systems into the credit union's system will occur? Has a date been set, and is there an implementation plan? Will the credit union's current data processing system support that bank's products, services, and accounts?

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