



NATIONAL CREDIT UNION ADMINISTRATION

WASHINGTON, D.C. 20456

December 17, 1991

Mr. Peter J. Liska
McKenna, Liska & Leone
P.O. Box 610
Red Bank, NJ 07701

Re: Compensation of Employees (Your October 3,
1991, and December 3, 1991, Letters)

Dear Mr. Liska:

Your client, the Merck Employees Federal Credit Union (the FCU), is considering offering stock options in its sponsor, Merck & Company (the Company), to its manager as part of his compensation package with the FCU. The FCU is also considering a onetime grant of options to purchase stock in the Company to each FCU employee. You have asked several questions about these proposals. Your questions and our answers follow.

1. Question: Is the Credit Union authorized to offer a stock plan similar to the Agreement which I have enclosed as a compensation agreement with its employee?

Answer: The Agreement provides that the manager shall receive from the FCU options to purchase stock in the Company. It emphasizes that the FCU and the Company are separate legal entities and that options granted under the Agreement are distinct from the Incentive Stock Option Program offered by the Company. The Agreement states that each year on December 1, the FCU shall award to the manager an option to purchase a certain number of shares of the Company's common stock at the price in effect on the date the option is awarded. The manager has the option of purchasing the number of awarded shares, at the option price, for 10 years.

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Section 113(12) of the FCU Act, 12 U.S.C. §1761b(12), authorizes the board of directors of an FCU, subject to the limitations of Title I of the FCU Act and the FCU's bylaws, to provide for the hiring and compensation of officers and employees. Under this authority, an FCU may offer only a limited stock plan to its employees. See discussion below.

2. Question: Is the Credit Union authorized to purchase common stock for transfer to the employee in the event the employee exercises the option? In this situation, the Credit Union would be purchasing the common stock pursuant to a compensation agreement with its employee and would not be holding the stock for investment purposes.

Answer: We assume that you are asking here whether the FCU can provide a stock option to an employee and then, some time later, when the employee exercises the option (presumably when the price has risen), purchase the stock and immediately transfer it to the employee. As you suggest in your next question, this plan subjects the FCU to substantial financial exposure in the event the price of the stock rises dramatically. On safety and soundness grounds, such a plan is not permissible for FCUs.

3. Question: Is the Credit Union authorized to hold common stock as part of a Compensation Agreement with its employees? Since the Credit Union will not be issuing stock in itself but instead will have to purchase stock, on the open market, in Merck & Company, Inc., can the Credit Union reduce its financial exposure by actually buying an equal number of shares of stock in Merck & Company, Inc., contemporaneously with the issuance of stock options to its senior management? In this respect I am concerned that the Federal Credit Union Act does not authorized the Credit Union to hold common stock as an investment.

In the event the Credit Union is authorized to hold stock during the term of the stock option, the stock would be held in a Credit Union account identified as: "Employee Compensation Account Payable." In the event the employee subsequently exercised the option to purchase the stock, the stock would be transferred to the employee and there would be no loss or gain to the Credit Union. In the event the employee did not choose to exercise the option, presumably

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because the value of the stock had declined, the Credit Union would sell the stock at a loss.

Answer: While an FCU investing on its own behalf is restricted by the investment provisions of the Act and the Regulations, see 12 U.S.C. §§1757(7), (8), and (15) and 12 C.F.R. Part 703, those provisions do not apply when the FCU as the employer is acting pursuant to its authority to compensate its employees. Thus, the investment provisions do not prohibit an FCU from purchasing and holding common stock as part of a compensation agreement with an employee. However, such activity is prohibited on other grounds. As you point out, the FCU might have to sell the stock at a loss if the price has declined. In addition, even if the price of the stock rises and the employee exercises the option to purchase, the FCU loses the appreciated value of the stock and the opportunity cost of nonproductive funds. In light of the safety and soundness concerns raised by these issues, an FCU may not purchase and hold common stock as part of a compensation agreement.

In addition, we question the logic of an FCU providing stock options to its employees. Generally a corporation offers stock options to its employees to provide incentives to improve performance. If performance improves and the fortunes of the corporation rise, so do those of the employees. We do not see the point of tying the fortunes of the FCU's employees to something over which they have no control, i.e., the performance of the Company's employees.

4. Question: In the event the Credit Union is authorized to purchase common stock for the limited purposes of funding a Compensation Agreement with its employees, can the Credit Union hold this common stock for a period not to exceed ten years? Ten years is the usual time period for a stock option to be in effect. The option decreases in value if the option period is shortened. In the event the ten year period is unacceptable to the National Credit Union Administration, is a lesser period of seven years or five years acceptable?

Answer: An FCU may not purchase and hold stock for safety and soundness reasons. See answer to Question 2.

5. Question: Assuming that the Credit Union offers an

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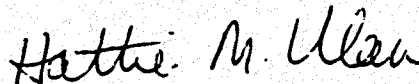
overall stock option plan to all or most employees with an agreement with each employee similar to the Stock Option Agreement for senior management, would there be any prohibition in granting a stock option to each employee of the Credit Union?

Answer: Pursuant to the authority to compensate employees, an FCU may only offer a stock plan in which it purchases and makes an outright grant of stock to an employee. It may offer such a plan to any employee.

6. In the event the Credit Union were to decide, as part of its compensation package with its employees, to give outright stock in Merck & Company, Inc., in the form of stock grants, would the Credit Union be authorized to purchase the stock for transfer to the employee?

Answer: Yes, see answer to Question 5, above.

Sincerely,



Hattie M. Ulan
Associate General Counsel

GC/LH:sg
SSIC 3601
91-1015

cc: Tim Hornbrook, Office of Examination & Insurance