Strategic Connections

Ted Goldwyn

In the right conditions, mergers and bank acquisitions can improve consumers' access to credit union services.

White Sulphur Springs, Mont., is a town of 908 people, with a median annual income of $28,229, and one ATM.

Soon, residents will have two ATMs thanks to Vocal Credit Union. The $28 million asset credit union in Helena, Mont., acquired a failing bank branch this fall in the remote community, where for years residents had just one other banking option.

Vocal's new branch is the only credit union facility within 112 miles. In early 2018, it will install the town's second ATM in its drive-through lane—surcharge free.

"It was important to us that our credit union serves the needs of the White Sulphur Springs community better," says Eddie Black, CEO of Vocal. "Our staff is looking forward to introducing new members to the credit union difference."

Vocal's efforts are working: On its first day of operation, the branch brought in $800,000 in deposits and other business.

It's the perfect example of how, when approached from a strategic mindset, mergers and acquisitions can help credit unions serve members better, particularly those in underserved communities.

Following the credit union movement's consolidation over the past two decades, fewer opportunities exist for credit unions to serve more members through mergers. As a result, some are pursuing less-common options such as bank acquisitions to expand into new markets and offer credit union services to underbanked populations.

Through September 2017, there were 89 credit union mergers, according to CUNA statistics, compared with 216 mergers in 2016. While the pace of consolidation has slowed this year, the number of credit unions has fallen from nearly 12,000 in 1996 to about 5,800 today.

Although fewer merger opportunities present themselves, it's still an attractive option for many credit unions pursuing growth and looking to expand services to new members. Those that have completed mergers in recent years cite the many benefits to credit unions and their members.

"There are two driving forces behind mergers," says Brian Bone, CEO of $13 million asset High Desert Community Credit Union in Aztec, N.M. "One, the need to survive and thrive, which can be translated as making certain we're serving our members with competitive products and services. And two, the age-old drive for credit unions to grow."

Bone understands firsthand the challenges experienced by remote, rural communities with underserved financial needs. High Desert Community recently completed a merger with a credit union that had $300,000 in assets and 170 members.

"The credit union wasn't able to meet its members' needs outside of offering one auto loan and one small signature loan per member," Bone says. "This merger has allowed the members of that credit union to access more services with no reduction in service [levels] or change in the team serving them. We're the only credit union in that county, and there's solid community sup-

Focus

- ▶ **The pace of mergers** has slowed of late, but whole acquisitions of community banks is gaining traction.
- ▶ **Make sure** the merger or acquisition partner is a good fit for your credit union.
- ▶ **Board focus:** Merging with another credit union or acquiring a small bank may be good options for pursing growth and expanding credit union services.

‘We’re very well-received… because people know credit unions bring value.’

Brian Bone

port for expanding our operations there.

“We’re in the process of meeting with the county, the city, and various nonprofits, and we’re very well-received in that community because people know credit unions bring value,” he continues. “They’re welcoming us with open arms.”

Such communities are in vital need of accessible credit union services. Bone notes that in recent years major banks such as Bank of America and Wells Fargo have completely vacated the two counties High Desert Community serves.

“We’re seeing an exodus of the larger institutions,” Bone says. “I think they’re having a harder time building the kind of numbers they want to see in a branch environment, and they’re not doing the bread-and-butter lending that credit unions do so well.”

Buying banks

A new type of transaction has gained popularity in recent years—the whole acquisition of community banks. Achieva Credit Union in Dunedin, Fla., was among the nation’s first credit unions to complete a “whole-bank” acquisition when it acquired Calusa Bank in 2015.

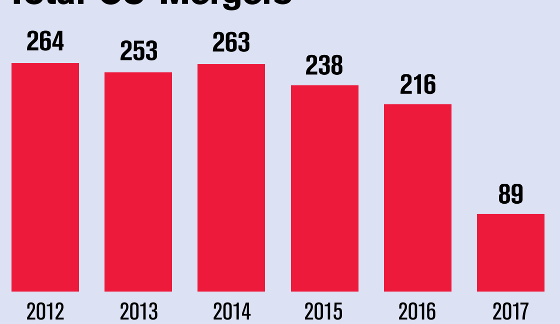
“We purchased the stock directly from the shareholders to merge the bank into Achieva,” says Dennis Holthaus, executive vice president at the $1.5 billion asset credit union. Florida is one of several states that allows credit unions to buy bank stock.

In June 2017, the credit union formed Achieva Merger Services, led by Holthaus, a banking and credit union industry veteran who’s participated in more than a dozen mergers during his career. The division is a specialized mergers and acquisitions consulting group that helps credit unions and community banks locate suitable merger partners, and guides them through every step of the transaction.

For community banks looking to sell, Holthaus sees a major advantage that makes credit unions attractive partners. Most community bank-to-bank acquisitions involve the exchange of stock shares, which for smaller community banks typically aren’t sold on an exchange and are considered “illiquid,” or difficult to trade on the open market. With a member-owned credit union as the buyer, this isn’t an issue.

“A credit union can only provide consideration in one form, and that’s cash,” Holthaus says. “A community bank isn’t as interested in selling to another community bank and exchanging its illiquid stock for another cache of illiquid stock. The credit union all-cash deal helps the bank achieve its goal of a clean exit strategy.”

Total CU Mergers



Source: CUNA’s research and policy analysis department

A natural progression

Seventeen credit union whole acquisitions of community banks have taken place nationwide to date, according to Michael Bell, an attorney with Howard & Howard, which specializes in mergers and acquisitions.

The advantages of a whole-bank acquisition versus a credit union merger are primarily qualitative. “In this transaction, it’s 100% business and it involves no emotional issues,” Bell says. “There’s never a discussion about whose name is what, who gives up board seats, whether to hire all of the employees—the kinds of things we see in credit union mergers.”

Some see the recent trend of credit unions buying banks as simply a “natural progression” in the industry; a way for credit unions to take advantage of growth opportunities and the market’s ever-expanding need for better service.

“If credit unions of a certain size are struggling, then banks are, too, for the same reasons, except there’s a much higher expectation that they will return profits to stockholders,” says Bruce Jolly, a partner in the law firm Reed & Jolly PLLC.

CONDUCT DUE DILIGENCE ON POTENTIAL PARTNERS

When evaluating a potential merger or acquisition partner, analyze several key factors to ensure a tight fit with your credit union's strategic goals and attributes, such as:

▶ **Geography.** Where do you want to be? "The first thing to focus on is geography," says Michael Bell, an attorney with Howard & Howard. Where is the credit union or bank? Does it serve an area that doesn't have access to credit union services? "Geography matters strategically in our world."

▶ **Size and performance.** What's the prospective partner's asset size, branch footprint, operating performance, and credit quality?

▶ **Goals.** What do you want to achieve? "Is it about getting deposits or loans? Maybe both? Is it about obtaining expertise in a new line of business, or trying to enhance an existing line of business? All those factors should be considered in determining the right targets," Bell says.

▶ **Subjective factors.** "We won't sacrifice our purpose, core values, or culture when considering potential mergers or acquisitions," says Brandon Riechers, CEO at $2.1 billion asset Royal Credit Union in Eau Claire, Wis. "That's our primary focus during our early consideration of any opportunity."

Royal also considers other factors such as geographic diversification, potential gains in efficiencies, and access to new and emerging markets.

After the selection of a merger or acquisition partner, comprehensive due diligence becomes paramount. Riechers says this diligence should include items such as:

▶ **Engaging** and including all necessary regulators from the start.

▶ **Reviewing** all loan portfolios to ensure quality control and proper loan loss reserves.

▶ **Validating** that the credit union can legally hold all the investments it acquires.

▶ **Scouring** all third-party contracts and termination clauses.

▶ **Reviewing** current loan and share rates and fees.

▶ **Gauging** staff experience and skill levels to measure any gaps.

iStock

Along with some advantages, whole-bank acquisitions present unique challenges to credit unions pursuing such deals. These range from tackling the organizations' cultural differences, accounting nuances, and the uncertainty surrounding how regulators will treat the deal.

Staff is also a key factor to consider in an acquisition.

In the White Sulfur Springs, Mont., acquisition, Black says the bank CEO had one requirement for the deal: The four staff members had to be retained. Black knew replacing the bank staff with employees from the credit union would be detrimental in a small town, but he also had to make sure the bank staff would be able to operate under credit union philosophy.

"The staff were the most important piece of the puzzle," Black says. "If they didn't buy into the acquisition, if they didn't want to move to a credit union philosophy, it would make it tough to pull this off.

"The staff very quickly figured out the credit union model was going to help them serve their family and friends in the community," he continues. "And once they figured that out, the staff was all in."

Credit unions looking to acquire a bank should also expect to deal with multiple regulatory agencies, a factor that can slow the process.

"More eyes are involved," says Holthaus. "In the case of the bank we acquired, it was state-chartered and federally insured, and had a bank holding company. So that meant the Federal Reserve, the state of Florida, and the FDIC all had to approve the transaction.

"Achieva is state-chartered and federally insured, so the state and NCUA both had to approve the acquisition from our side," he continues. "Because NCUA was assuming insurance risk with the new deposits that were coming onboard from the bank, it actually went in and examined the bank."

Those who have gone through mergers or bank acquisitions emphasize the importance of focusing on "why."

"The primary concerns need to be first, an understanding of exactly why the merger is happening and what the benefits are for all," says Bone. "Second, determine if there are any issues that need to be uncovered or understood, such as the quality of the loan portfolio, operational soundness, and culture."

RESOURCES

▶ CUNA Environmental Scan resources: *cuna.org/escan*

▶ CUNA Operations & Member Experience Council: *cunacouncils.org*

▶ Howard & Howard: *howardandhoward.com*

▶ Reed & Jolly PLLC: *reedandjolly.com*