CREDIT UNIONS MERGERS & ACQUISITIONS

Saving Money and Increasing Member Satisfaction

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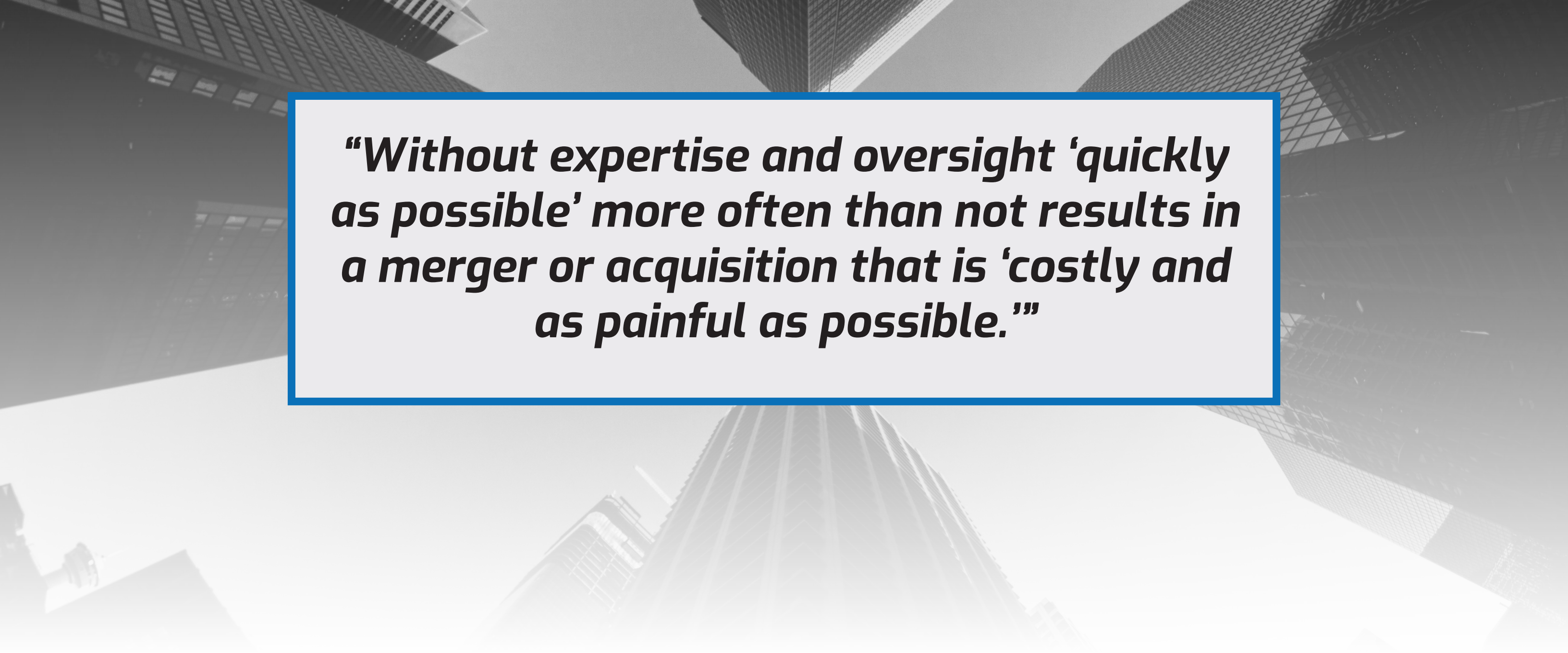
SAMAHA & ASSOCIATES®



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EXECUTIVE SUMMARY

From Hawaii to New York City to Alaska, and points between, Credit Unions are continuing the long-term trend of consolidation through mergers and acquisitions. This calculated growth strategy is changing the way in which both executives and members view and experience the Credit Union industry.

According to Filene Research Institutes's 2019 report, "Do Credit Union Mergers Create Value for Credit Union Members," Credit Union mergers account for much of the decline in the number of U.S. credit unions. From 1969 to 2017, for instance, the number of Credit Unions shrank from 23,866 to 5,571

The report also found that the number of new Credit Unions—not those acquired or merged—also dropped from over 9,000 in the 1960s to just 21 between 2010 and 2017.
"Merger targets have consistently been small, totaling under 10 percent of the credit union system's assets," the report noted. "Mergers will likely continue at their rate of three percent per year for the foreseeable future."

When it comes to mergers and acquisitions, conventional wisdom says to complete the often unchartered process as quickly and painlessly as possible. This approach, however, is neither logical nor prudent. Without expertise and oversight "quickly as possible" more often than not results in a merger or acquisition that is "costly and as painful as possible."

Even knowledgeable Credit Union teams have limitations during a merger as they are essentially operating within a bubble that is the construct of their respective Credit Union experience. These well-intended C-Level executives appreciate and understand the complexities of their respective operations, but due to their linear scope, are not in the position to see the forest for the trees. This linear scope occurs after the merger and leaves so much on the table unknowingly.

It is seasoned and successful consultants who are equipped to take a step back and unabashedly see the proverbial forest. And by hiring an experienced consultant for a merger or acquisition, the Credit Union's investment is easily absorbed. Why? The savings realized include, among other all-important initiatives, adept vendor contract negotiation and sound project management strategies.

MERGING DUE DILIGENCE

When the merging of two Credit Unions is discussed in closed door meetings, operational procedures and related redundancies, as well as demographics and respective member base, all of which equate to large sums of capital, are determined. This all-important step is particularly important if the two Credit Unions are of equal size.

The National Credit Union Administration (NCUA) and its respective state level counterparts (e.g., Department of Financial Institutions, Department of Business Oversight, etc.) often have the collective responsibility of merger oversight and preliminary approval. To this end, these entities typically recommend that larger and more stable Credit Unions absorb smaller Credit Unions.
"A credit union first needs to understand the bigger picture of the optimal markets in which the credit union should compete and the best methods for gaining a presence in those markets," noted Glenn Christensen, president of the CEO Advisory Group. He conveyed these thoughts in a March 2019 Op-Ed, "The Anatomy of an Ideal Credit Union Merger Partner."

Christensen noted that a credit union can grow organically over time by adding branches, technology and marketing. Alternatively, a credit union can expedite its entry into new geographies, associational or employee based markets through mergers.
"This is the time to ask tough questions about future growth plans in terms of size and geography, preferred member demographic and characteristics and culture of ideal merger partners," he wrote.

Depending on the size of the merger, including technological, contractual factors and constraints, the NCUA and/or the counterpart state level agency will most likely want the merger to take place within four to nine months.

The due diligence discovery process includes studying the merging Credit Union's portfolio identifying critical and noncritical issues that need to be addressed. The typical checklist includes: operations, financial, contractual, technological, product and services, human resources and administration, marketing and public relations, risk management, regulatory and compliance.
If during this period critical issues and concerns are not quickly identified with a documented detailed strategy on how they will be addressed, the corresponding examiners may deny the merger application. Additionally, if the Credit Union is not able to forecast strong capital management and more efficient internal processes in-line with examiner recommendations, this too could cause a merger application to be declined.

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The aforementioned phase is essential, but the merger must first make sense for the Board of Directors. On average, only one or two board members of the merging credit union will remain if the merger is approved. As a result, board members on both sides carry the great responsibility of considering if the merger is beneficial to the respective Credit Unions.

To ensure a smooth process, a Credit Union that is in the process of reviewing merger candidates should have a seasoned consultant on their team. The consultant is an experienced advisor as well as a facilitator overseeing the entire process. This approach simultaneously saves the Credit Union money and ensures a high degree of predictability and transparency for all parties involved.

THE CONSULTANT PARTICIPATION VALUE-ADD

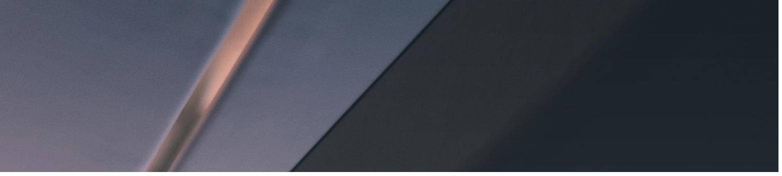
The prominent reason a larger Credit Union considers the merging of technology and product offerings with another Credit Union is to gain a new member base and book of business. But when two entities collapse into one there is a redundancy factor that is not only overwhelming but costly. For example, there are two of the following: core vendors and processors, ATM and card processors, online and bill payment processors, and the list goes on.

When Credit Unions merge, a decision has to be made as to which of the technology and operating platforms will be selected. In most cases, it is usually the larger Credit Union's platform; however, when two Credit Unions of equal size merge, this process becomes a more significant undertaking.

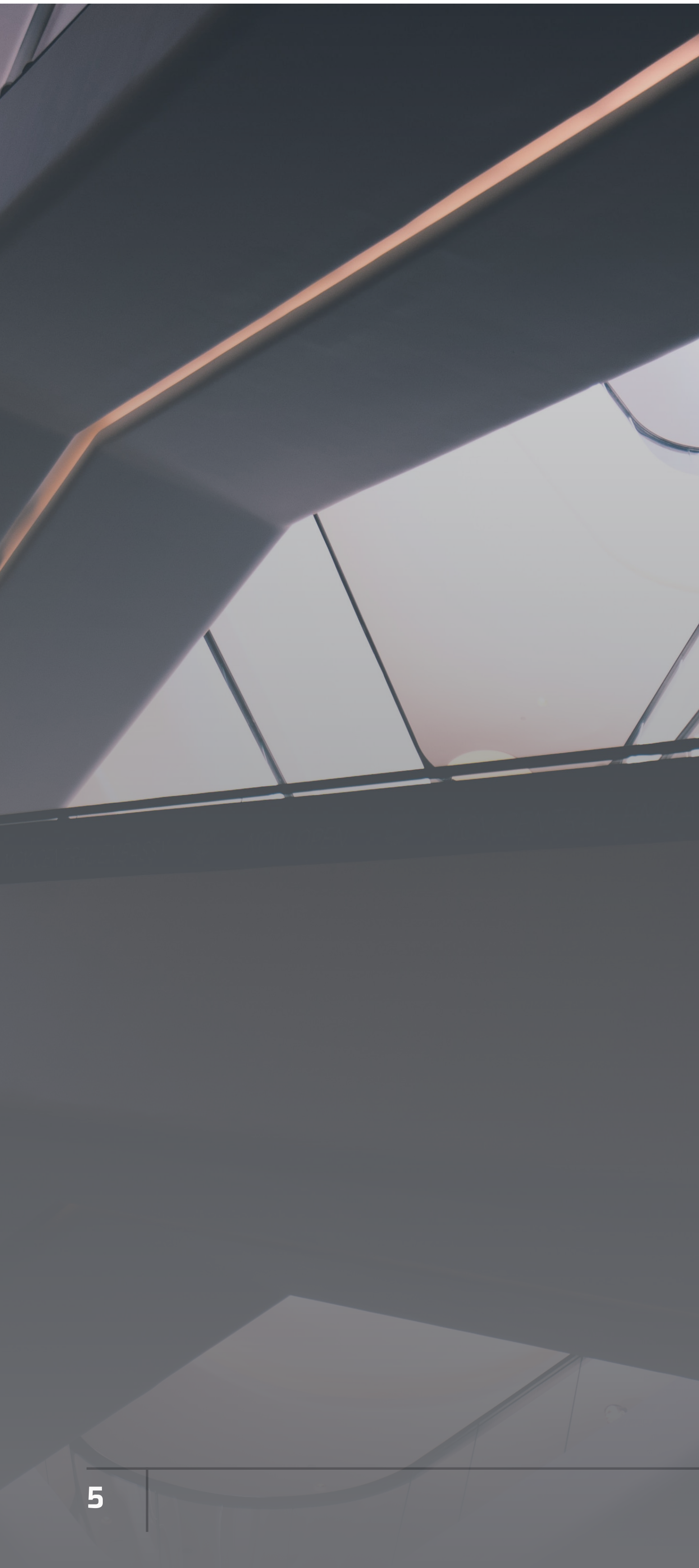
Once a decision is made, there will be termination costs associated with whichever vendor will be discontinued. A best-in-breed consultant can lower such costs and deliver de-conversions from the outgoing vendors in an optimal manner. Instead of the Credit Union dealing directly with vendors and terminating the relationship via the "Termination for Convenience Clause," the Credit Union should hire an experienced consultant who can significantly minimize financial and operational impacts.

It is reasonable to assume that in most cases a merger project that is handled by an inexperienced internal Credit Union team will result in a longer list of post-merger problems and issues than if the merger that was handled by an experienced consultant.

The goal is to have a good de-conversion and then produce a "clean" conversion across all related platforms, which is a highly complex process that requires expertise. A successful de-conversion and conversion can only be accomplished via a proven merger process that has been tested over time. The process is best performed by partnering with a seasoned consultant to negotiate the remaining vendor contracts and provide the additional necessary resources required to produce cleaner merger results.



THE CONSULTANT PARTICIPATION VALUE-ADD CONTINUED



And while conventional wisdom surmises that it will be an easier merger process if both Credit Unions are on the same core operating system, it is actually a more difficult process because the systems are configured differently. The client will assume that the project will be easier thus creating an over dependence on the vendor. Additionally, since the vendor is not gaining new sales and revenue stream, they are not as incentivized. This job is also hard on the vendor because the two merging Credit Unions are using the same system but in different ways, which makes it problematic to determine which parameters to use for the new (or merged) operating system. This lethal mix of misconceptions will produce a difficult project outcome that catches those inexperienced by surprise.

The benefit of hiring a consultant is not just for oversight and cost-savings — Credit Union executives receive a "merger" education. In most cases, after a Credit Union that works with an experienced consulting firm on two mergers, that Credit Union is often well-equipped to handle many of the merger tasks internally (less contractual negotiations).

Due to the current compressed time periods facing today's merger climate, it is imperative that Credit Unions have assurance out of the gate. This approach is achieved by adopting best practices from experienced consultants who handle mergers and acquisitions on a regular basis.

THE CONSULTANT **FINANCIAL** VALUE-ADD

Senior executives are understandably caught up in the massive amount of details associated with the merger. As a result they are not aware of all the aforementioned subtle issues. This is where **a top tier consultant can not only facilitate a clean and less painful merger, but provide a streamlined, structured and less costly solution with a high degree of member transparency: a winning business proposition.**

It is surprising that given the high stakes of a merger or acquisition, some C-Level executives are sometimes wary of increasing the budget by hiring a consultant to oversee this intertwined, varied, and complicated process. This is typically attributed to the misconception that consultants costs are higher that their return on investment. To this end, many inexperienced internal Credit Union teams may feel that bringing in an outside consultant will muddy the process. The experienced consultant who conducts mergers on a more frequent basis, however, is able to deliver merger best practices approaches and compare overlapping vendors on an apples-to-apples basis.

While an unadvised Credit Union can accomplish a merger in a similar time frame without a consultant, it can lead to greater unnecessary expenses and negative internal impact and perhaps most importantly, unnecessary member attrition. To this end, you wouldn't hire a plumber to fix a broken hand and you wouldn't hire an orthopedist to fix your plumbing.

Savings, of course, will depend on the size of the Credit Unions. The consultant's price and approach, conversely, is usually a fixed fee. **On average, a small investment by the Credit Union will net hundreds of thousands, if not millions in additional savings. In total, the process normally takes three to six months. And not only are saving secured but more importantly, a high degree of member transparency is achieved.** This is critical during the merger process—member satisfaction through communication, education and setting proper expectations.

An additional financial benefit of hiring a consultant is that the consumption of internal resources is rendered efficient. This removes the possibility of high internal impact, spinning wheels and wasting capital while members potentially vacillate on taking their hard earned money to another financial institution.

In order to understand the needs of a member base, a financial institution must have in place a system that tracks members/customers' activity in relation to products and services. Many members/customers today, for example, demand online and real-time access across all electronic delivery channels. Financial institutions hindered in their efforts to expand these types of services—by systems that do not interface well with ancillary products—must consider rebuilding from the foundation up. While the latter might be expensive, the knowledge of specific member needs will provide a firm negotiation stance.

CONCLUSION

When operations stall or fail due to a merger or acquisition, it is not due to Murphy's Law. Rather, it is a consequence of juggling too many unfamiliar balls. If one juggler can effortlessly keep five balls in the air, how is that same performer expected to have three more balls thrown into the mix without expecting to drop a few? Therefore, it is important to keep in mind the member experience. If the balls drop, so do their perceptions and loyalty to their Credit Union.

Why send letters of apology to members because the core or other delivery channels are not functioning and meeting their expectations? Rather, a Credit Union could, and should, proudly disseminate letters to members celebrating a successful streamlined, transparent merger.

Without proper oversight, including renegotiating vendor contracts, costs will mount during a merger. Credit Unions have but one chance during the merger to use an otherwise headache-inducing set of circumstances to restructure an efficient environment that will best serve senior level executives, employees and most importantly, members. Why take the chance on an all-important merger transition without the guidance of an unbiased, progressive and experienced consultant?

Sabeh F. Samaha is president and CEO of Samaha & Associates Inc., a consulting group that works collaboratively with financial Institutions to help improve business processes by optimizing efficiency and increasing revenue opportunities. Whether it is vendor contract negotiations, system conversions, or mergers, Samaha & Associates understands what gets the job done from beginning to end. Sabeh can be reached toll-free at (855) 772-6242 x2020, sabeh.samaha@ssamaha.com or www.ssamaha.com.

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