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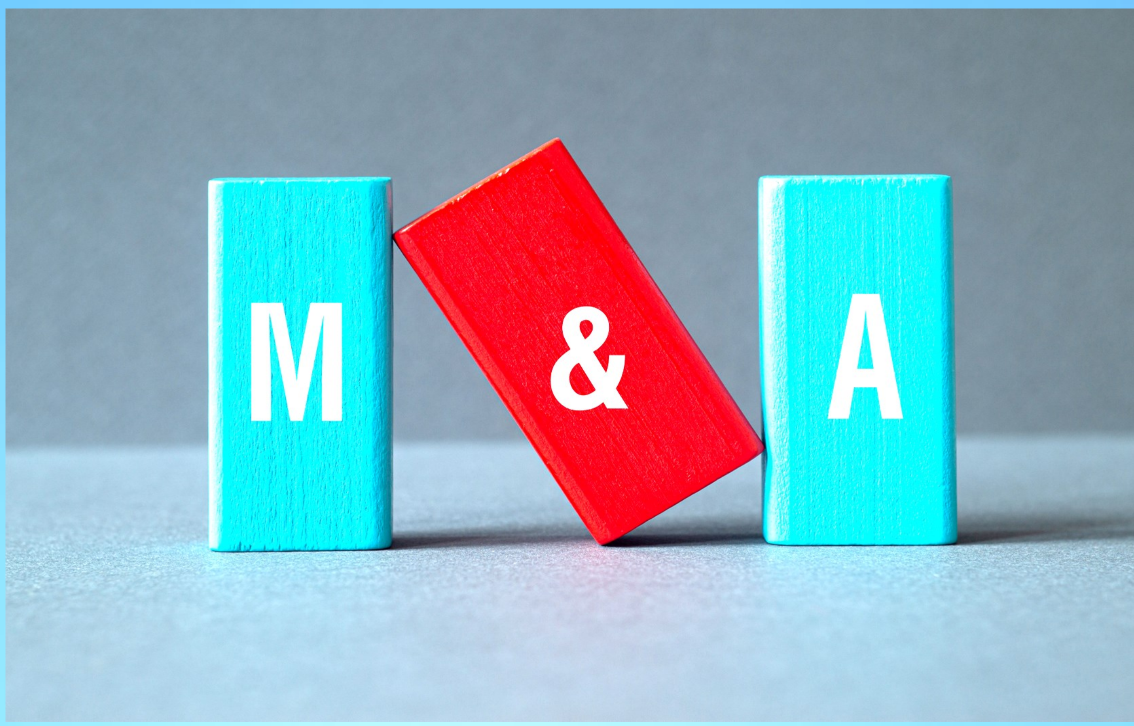

A Credit Union's Roadmap to Successful Mergers & Acquisitions—Technology Decisioning and Implementation Best Practices in 2024 and Beyond

A White Paper

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Executive Summary

The pandemic slowed business operations on just about every front, including Credit Union mergers and acquisitions. According to the National Credit Union Administration (NCUA), for example, 40 consolidations were approved in the Fourth Quarter of 2021. Over the last two years, however, the nation has embraced a new sense of normalcy—the pace at which mergers and acquisitions are occurring has vastly increased. By the Second Quarter of 2024, for instance, the NCUA reported the consideration of more than 75 consolidations.

The topic of mergers and acquisitions is not new. In fact, in 2019 Samaha & Associates published a white paper entitled, *Credit Union Mergers & Acquisitions—Saving Money and Increasing Member Satisfaction*. Among the data shared, from 1969 to 2017 the number of Credit Unions shrank from 23,866 to 5,571. Where does that figure stand today? As of March 31, 2024, the NCUA reported that there were 4,572 federally insured Credit Unions with 140.4 million members. Does this continual downturn in the number of Credit Unions represent an industry in decline? Not necessarily. Many industry insiders believe that consolidation makes the Credit Union's "people helping people" movement even stronger. Why? When smaller Credit Unions merge with larger Credit Unions, or when it is a merger of equals, the reach and ability to compete against "big banks" on behalf of membership increases exponentially.

To provide greater insights into this issue, a 2023 *CU Today* article, "An Interesting Data Point in New Merger Numbers," noted that in the Third Quarter of 2023 the NCUA reported that the median size of acquiring Credit Unions was $148 million. This included nine Credit Union acquirers with assets exceeding $1 billion, and 14 Credit Union acquirers with assets below $100 million. The mean and median assets of merged Credit Unions were respectively $24.3 million and $14.1 million.

Aside from being involved in more merger projects than ever before—a sign of the times, another aspect of the mergers and acquisitions game that has changed since Samaha & Associates published its last report is that Credit Unions are acquiring regional banks in greater numbers. In the same quarter noted above, for example, 34 bank acquisitions were announced and of that number, six were acquired by Credit Unions.

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While these noted facts help to provide an overview of the current mergers and acquisitions market, the purpose of this white paper is to provide Credit Union executives—whether from the surviving Credit Union or the Credit Union that is being acquired—with a "best practices" guide to mergers and acquisitions.

Realities and Considerations: Time to Buckle Up

The leading reasons a Credit Union is ripe for acquisition is normally due to the following: membership is in decline; a decreased net worth; reduced or negative earnings; lack of a senior leadership succession plan; lack of digital services; and strategic planning shortfalls.

There are a host of initial questions Credit Union executives often ask when considering acquiring another Credit Union or when their institution is the target acquisition. Chief among these thoughts is: How long does the process take, and how will our membership be impacted? In most cases, the answer is up to 18 months, and if managed by experts, membership should not realize any change in their banking transactions. These two factors are but the tip of the proverbial iceberg. For executives to deliver a seamless transition, they must be prepared to honestly answer detailed questions about all aspects of operation—like a request for proposal (RFP) on steroids. If vetting a new credit card system or implementing a new core platform is considered daunting, it is time to buckle up.

Top 10 Mergers and Acquisitions Technology Questions

1. Has each financial institution clearly shown their products and services and have they shared their disclosures for each?

2. What third-party agreements are in place with vendors and have any recently been renewed (and have you determined potential deconversion costs for all vendors that may be terminated for either institution)?

3. Are there any other projects from both institutions that can be placed on hold or are there required projects that need competing resources?

4. What resources from both financial institutions can serve on the various committees (to lead the multiple efforts)?

5. How will the new institution go about objectively deciding which major system will be the go-forward system (e.g., core, digital banking, loan origination, general ledger, etc.)?

6. Will existing vendor relationships have an opportunity to be interviewed or conduct hands-on evaluations before software decisions are made?

7. How will system selection scorecards be applied during system evaluations?

8. Due to policy or regulatory requirements, which products and services will no longer be offered?

9. When will the newly acquired membership or existing membership be able to take advantage of the new products and services resulting from the merger?

10. Where are the "keys" maintained for access and system interoperability (i.e., physical keys and key codes, such as for card plastic enablement)?

In a merger of equals, the best way forward is for all involved parties to understand that they share a common goal that will only be achieved when representatives from both Credit Unions work together on behalf of membership. For a smaller Credit Union being rolled into a larger Credit Union, the process is more straightforward from a technology and operations standpoint, but in both cases, it is important that the culture of each organization as well as the demographics and geographic locations are considered. To this end, a merger project needs to be the highest priority and both institutions must clear the deck of any other implementations as the process requires a significant amount of time from all departments and staff to successful merge products, processes, and procedures.

Typically, when Credit Unions merge or acquire other financial institutions, most, if not all, employees maintain their jobs (this may not be the case when a bank is acquired by a Credit Union). Regarding senior leadership positions, instead of one person holding the title of president and chief executive officer, for example, these roles are often reallocated to the most senior leaders of each organization. In the case where there are two chief financial officers or two chief technology officers, a similar position could be created within the department.

Whereas historically the IT and accounting departments of both organizations would manage the merger, today employees from every department are required to participate. For both institutions, it is housecleaning—from top to bottom. In the case of a bank and a Credit Union merger, the process is more complicated. These two organizations do not function in the same manner—moving from one set of operating standards and requirements to another. To this end, for a merger to happen, the organizations need approval from the Federal Deposit Insurance Corporation (FDIC) and NCUA, which, in certain respects, are "night and day" governing bodies. Redisclosures of insured funds, delinquency fee notices and how loan products are processed are among the pressing concerns.

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To ensure both organizations buy-in to the merger or acquisition, the following 10 merger considerations should be addressed:

1. Determine which Credit Union is the surviving charter.
2. Determine what branches will be retained, where the new headquarters will be located and how branding efforts will be managed.
3. Determine the new name of the organization or if there will be "division of" designations.
4. Determine who will serve in volunteer capacities on the board of directors, supervisory committee, and/or special member committees.
5. Determine what staff is retained, what staff will need to be hired and what staff will be terminated.
6. Determine regulatory differences between the institutions (e.g., state or federal regulatory due to institution type and/or counties, cities and municipalities).
7. Determine the intent of the surviving institution regarding what will be changed by Legal Day One versus at time of full data merge (conversion).
8. Determine any fixed assets and property by obtaining valuation (be cognizant of the condition of these items).
9. Determine the merging institutions' delinquency and any potential write-offs.
10. Determine if there is a large gap between interest rates for income analysis and potential for high accrued dividends (pay attention to geographical differences) and whether there will be different rates for share and loan products.

If there are pain points, however, the process will be slowed, or the merger/acquisition could ultimately fail.

Gap Analysis: 'Avoid Poison Pills'

Whether a smaller Credit Union is absorbed or two Credit Unions of similar asset size join forces, a GAP analysis should be executed. This initiative-taking approach demonstrates due diligence to membership—after all, a merger cannot move forward without a member vote, and they don't always go as planned. To this end, NCUA's merger rule requires a merging Credit Union to permit members to vote by written mail ballot or in person at a special meeting held for the purpose of voting on the merger. As such, members should be aware of the added value to their banking life—from new credit and debit cards to branch locations to online and mobile banking upgrades.

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A 15-Point Gap Analysis Checklist

1. Product Differences
2. Services Differences
3. Fee Differences
4. Dividend Rate Differences
5. Interest Rate Differences
6. Third-Party Software Differences
7. Knowledge Differences
8. Department Name Differences
9. Branch Location Differences
10. Core System Differences
11. Digital Banking Systems Differences
12. Loan Origination System Differences
13. Visa/Mastercard Brand Differences
14. General Ledger Differences
15. Real Estate Origination/Servicing Differences

Like the trend of Credit Unions acquiring banks, recently many vendors and Credit Union associations have merged. While it seems logical that two organizations using the same vendor would make for an easier fit, this isn't always the case—parameters and configurations are almost always different. Reasons include each Credit Union using the technologies and services in a different manner; use of data and related regulatory issues (e.g., keeping seven years of transaction history), and/or the vendor's ability to accommodate the merger. And in many cases, there are waiting lists for vendors to comply. While a Credit Union might want to move quickly on an acquisition, they might have to adhere to the Hollywood adage of "hurry up and wait," which is why they should be proactive rather than reactive.

To ensure that the best contracts are in place moving forward, negotiation tactics are required on both the non-surviving institution and the acquiring institution. For the surviving Credit Union, the ability to negotiate becomes favorable due to increased assets. And whereas it might make sense that the acquiring institution would continue using its existing vendors, in certain cases the non-surviving institution's services are deemed more favorable.

Seasoned mergers and acquisitions consultants can greatly assist in these all-important contract negotiations and identify existing contract "poison pills." This process includes developing a third-party vendor list for each institution, identifying any similarities, and determining, which are the best surviving vendors. This also ensures that all notifications and termination requirements are satisfied under the existing contract, so that the new contracts can be executed without issue.

While a merger can take anywhere from six to 18 months, there are two important dates to consider. The first is "Legal Day One" and the second is "Data Merger." The former is when the institution that is absorbing the merged Credit Union becomes responsible for all operations—in many instances, this first involves assuming responsibility for "share insurance." The time frame for this aspect of the process can take as little as three months and should be focused on the 10 noted merger considerations. Generally, the first month is spent determining these considerations and during the following two months the agreed business plans are carried out. The Data Merger process, conversely, usually takes up to one year to fully complete.

To ensure a streamlined transition, mock mergers are suggested. During this process, which usually takes place roughly 30 days before the go live date, data is evaluated to make sure it is clean and successfully transferred from the acquired institution to the surviving Credit Union. In some cases, certain data may have to be manually transferred. To successfully administer this database evaluation, a considerable amount of time and effort is required from both organizations. When this methodology is satisfied, it provides assurance that when the live date arrives, the process, which usually takes two to three days from Friday midnight to Monday morning, is rendered predictable, like flipping on a light switch.

Five Mergers and Acquisitions Tips from Proven Technology Consultants

1. Provide an accurate and detailed business plan as to why the merger makes sense to the credit union, its members, and the share insurance fund.

2. Maintain open communication and foster inclusion (this includes ensuring the call center is operational before, during and after conversion).

3. Determine the following differences: product, service, fee, dividend rate, interest rate, third party software, core system, digital banking platform, loan origination system, Visa/Mastercard brands, real estate origination, and general ledger.

4. Execute a gap analysis.

5. Clearly separate the merger from systems integration.

Parting Thoughts: Credit Unions Need to Be Proactive

As a consulting firm with 26 years-plus experience, Samaha & Associates has been party to over 30 mergers and acquisitions. In fact, as this paper is being written we are engaging in more than five mergers of varying asset classes. What is more surprising is that we are now being contacted by more returning clients asking the firm to seek Credit Unions that want to merge. We are often asked: When is the best time to contact a consultant? In our experience, it is approximately three months before “Legal Day One.” Understandably, many Credit Unions prefer to wait until they receive merger approval from the powers to be before taking this step, but in most cases, the approval will be received. Credit Union executives, therefore, must be brave and proactive as it will better serve the membership in the long run.

“Clearly separate the merger from systems integration.”

When it comes to studying mergers and acquisitions, seasoned consultants understand where the risks, threats and gaps are during each step in the process—whether high-level or from a granular, tactical perspective. There are no surprises because consultants have an expert line of sight that brings forth awareness, avoiding unnecessary hurdles that negatively impact service levels to membership as well as operational impacts on staff.

Due to the current volume of mergers and acquisitions, the number of Credit Unions continues to decrease, so it may only be a matter of time before your Credit Union engages in a mergers and acquisitions conversation. For Credit Unions that have undertaken a merger or acquisition before, they may have developed a routine based on lessons learned. In most cases, however, this process is unfamiliar territory for Credit Union executives and requires thorough planning, so nothing is lost in the mix.

As experienced consultants, Samaha & Associates has built a detailed road map providing Credit Union executives with clear, efficient directions to the arduous mergers and acquisitions journey on which they will embark.

Celebrating its 26th anniversary, the Miami, Fla.–based Samaha & Associates, Inc. is a nationally recognized consulting group that works collaboratively with financial institutions to assist in the improvement of business processes by optimizing efficiency and increasing revenue opportunities. Specializing in vendor contract negotiations, core system conversions, third party vendor searches and implementations, payments program assessments, regulatory compliance, and mergers, Samaha & Associates expertly executes each respective project by exceeding client expectations.