2017 NACUSAC Conference

RECENT TRENDS IN CREDIT UNION MERGERS

Thursday; June 15, 2017
Concurrent Sessions:
10:30am & 1:20pm

Presenter:
Mike Richards, CPA
Richards & Associates, CPAs

Brief History of Credit Union Mergers

- Since the peak in 1969, approximately 18,000 have been merged or closed
- Equates to roughly one credit union a day for 47 years
- Mostly smaller credit unions with less than $50 million in assets

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What Drives Credit Union Mergers

- Weak financial condition of merged credit union
- Lacking products and services, not keeping pace with technology
- Increased compliance
- Poor management succession planning
- Field of membership disruptions
- Record keeping problems

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In the Credit Union Industry – Size Matters

- Expand the field of members
- Gain branch locations
- Reduce costs of Cybersecurity
- Offer new technologies
- Offer new and more compelling products
- Attain economies of scale

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Prior to Deciding to Merge Consider

- Alternatives to merging, such as working with a mentor credit union or expanding your credit union's field of membership.
- The potential impact on your credit union's financial condition and operational capacity to serve the combined membership.
- Whether the merger is in your members' best interest

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Best Practices for Merging Credit Unions

- Identify potential merger partners
- Shop around for the best fit
- Include merger option in strategic planning process
- Negotiate important issues
- Complete due diligence audit
- Include measures to enforce the merger agreement

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Maximizing the Benefits: Negotiating Terms

- Maintain merging credit union's branches
- Maintaining credit union's staff
- Bonus dividend or interest rebate
- Obtain board seats for merging credit union officials
- Employee bonuses and severance
- Obtain Supervisory Committee seats for merging credit union officials
- Employee contract buyout

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Why Mergers Fail

- Primary focus on getting bigger
- Partner not a good strategic fit
- Different cultural values
- Different vision of member service/value
- Poor communication re: retaining officials
- Uncertainty about the retention of staff
- Significant differences in compensation and employee benefits

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Warning Signs that Merger is Eminent

- Declining membership due to lack of services and limited financial resources
- Not serving a unique niche, while competing credit unions provide better services
- Financial condition is deteriorating
- Poor CAMEL Rating
- Consistently negative earnings
- Consistently declining net worth

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Warning Signs that Merger is Eminent – (*continued)*

- Prompt Corrective Action
- Administrative action
- Repeat Document of Resolution items
- No realistic plan to address problems listed above
- Key credit union officials or employees are nearing retirement, with no succession plan

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Disadvantages of Waiting Too Long

- Fewer potential partners
- Less negotiating leverage
- Time pressure leads to poor decisions and limited options

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Recent Scrutiny of Voluntary Credit Union Mergers

- Accusations of healthy credit unions sold for pennies on the dollar
- Golden parachute exit plans for senior executives.
- Not always in the best interest of the membership
- Offering monetary incentives to senior executives and board members
- NCUA considering requirements for disclosure to members prior to merger

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What Should be Disclosed to Members

- Impact of the merger upon the types of products and services offered to members
- Impact of the merger upon the cost of products and services offered to members
- Impact of the merger upon the branches and electronic access available to members
- What happens to the credit union's capital as a result of the merger

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What Should be Disclosed to Members – (*continued*)

- Reasons that the board of directors is recommending the merger
- Describe compensation or other monetary benefit, if any, being offered to directors by the continuing credit union and the conditions of receipt
- Other than the retention of comparable jobs and salary, describe any compensation or other monetary benefit being paid to senior executives by the continuing credit union and the conditions of receipt

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Accounting Process

- Prior to 2008, Pooling of Interest Method used for credit union mergers
- In 2009 and beyond, Acquisition Method required for mergers
- ASC 805 [formerly FAS 141(R)] is the authoritative guidance on accounting for mergers

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According to ASC 805

- Assets acquired and liabilities assumed from the merged credit union must be recorded at fair value, including loans, investments, property and equipment, member deposits, etc.
- Goodwill and the core deposit intangible (CDI) must be recorded at fair value

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Core Deposit Intangible

- Core deposit intangible is subject to amortization over its useful life, typically seven to ten years
- The core deposit intangible relates to the future earnings potential of the acquired membership and the value of receiving core deposits that are less expensive than the credit union's marginal cost of funds

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Credit Valuation Account

- Loans acquired with deteriorated credit quality are recorded at fair value via a credit valuation account
- In most cases, the credit valuation account is significantly higher than the previously recorded allowance for loan losses (ALL) account balance
- Losses on the acquired loan portfolio are recorded to the credit valuation account with any excess balance accreted to interest income on loans

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The Network Credit Union Concept, an Alternative to Traditional Mergers

- Partners maintain their own identities
- Advisory Committee comprised of directors from the merged credit union
- One seat on Nominating Committee reserved for representative from merged credit union

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Benefits of the Network Credit Union Concept

- Creates more real value for members via scale and reducing footprint of back office and related distractions from better service
- Builds a platform for further scale
- Maintains local identities and local decision-making
- Operates as a partnership, and opens the door for shared services; better alignment of the member experience, and collaboration

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Challenges of the Network Credit Union Concept

- Difficulty gaining widespread agreement on decision making because of the number of CEOs and boards involved
- How will balance sheets be aggregated?
- Are long-term cost savings enough to generate a positive ROI?
- Member experience supremely dependent on alignment of all the credit unions' products, underwriting standards, services, and delivery channels
- Would each participating credit union operate under its own data processing system?

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About the Presenter
Michael E. Richards, CPA

Mike Richards has held the position of CEO of Richards & Associates, CPAs for nearly forty years. He joined the firm in 1973 after earning a bachelors degree in business administration from the California State University at Los Angeles and becoming a Certified Public Accountant. In addition to introducing many new services, he is responsible for quality control of all professional services offered by the firm.

RICHARDS & ASSOCIATES, CPAs
21520 Yorba Linda Blvd, #G-516
Yorba Linda, CA 92887
mrichards@richardscpas.com

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