More For Members:

Credit Union Leaders Plan
Post-Pandemic Merger & Acquisition Strategies

Part One: Merger Considerations in the Post-Pandemic Age

While the pandemic caused many credit unions to hit the brakes on potential mergers, it has been an impetus for others to pursue them.

What Do Credit Union Leaders Need to Know?

DDJ Myers
Advancing Leadership Success

Part One | Series of Three
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Credit Unions

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Table of Contents

2 INTRODUCTION

6 POST-PANDEMIC PUSH TO MERGE

6 Uncertainties Slow Merger Conversations in 2020

8 Accelerated Shift to Technological Transformation

11 Persistent Regulatory, Financial, and Competitive Challenges

14 Finding Opportunity in Crisis

15 Getting Back to the New Normal

17 THE CASE FOR CONSOLIDATION

17 Aiming for a 'Win-Win-Win'

18 Achieving Sustainable Scale

20 Expanding into New Geographic Markets

21 Expanding Product and Services Offerings

22 Enhancing Talent Acquisition

24 Supporting Leadership Succession

25 Expanding Fields of Membership

26 Presenting a Clear Case to Potential Merger Partners

27 When to Proceed with Caution

29 CONCLUSION

30 ACKNOWLEDGEMENTS

31 REFERENCES

Introduction

Entering a new decade, credit unions had no reason to think that merger activity within their industry would slow down. The industry's rationale for continuing unabated on a pathway toward mergers was sound. Many smaller credit unions facing regulatory, financial, and competitive challenges were looking for merger partners to ensure their members would have the products, services, and full range of delivery channels they expected from their financial institution. Mid- to large-sized credit unions were receptive to mergers as a means of propelling growth and giving themselves the critical mass to invest in new technologies and delivery channels that would help them keep pace in a competitive marketplace.

As credit unions prepared for how their merger plans would play out in 2020, expectations abruptly changed with the emergence of COVID-19. On Jan. 1, 2020, very few outside of the health care community understood just how devastating this virus would be—not only as a worldwide health crisis but as a major disruption to the global economy. However, all of that had changed less than three months later. On March 11, the World Health Organization declared COVID-19 a worldwide pandemic, and every credit union executive in the U.S. was thrust into the situation of implementing parts of their business continuity plan they had never suspected would be needed: closing branches, setting up remote-work arrangements for the majority of their staff, ramping up digital delivery channels and drive-through services, canceling in-person meetings and travel plans, reassessing cybersecurity risks, and managing a list of myriad other crisis-management activities.

As credit union executives grappled with this major shift in priorities, it was not difficult to see how merger plans would have to be placed on the back burner—or moved off the stove entirely. While some mergers did move forward, overall M&A activity plummeted. Credit union leaders were not only preoccupied with adjustments to the way they did business but also reluctant to move forward with

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mergers until they could gain a clearer picture of how the economy would progress during a pandemic-driven recession.

In the spring of 2021, credit union leaders now have a clearer picture of what the future holds. By May 1, with more than 100 million Americans fully vaccinated, representing nearly 40% of the country's adult population, there is a sense that the U.S. is on the cusp of a return to normalcy.

Anticipating a need to assess the merger and acquisition environment for credit unions in the post-pandemic world, DDJ Myers has produced this white paper as a guide for decision-makers. Early in 2021, we turned to the people whose opinion and expertise would be valuable in determining the rationale for moving forward with a potential merger and outlining the steps to do so most effectively: credit union leaders themselves. In all, we spoke to nearly 25 credit union executives and board members, many of whom have extensive merger experience and understand what is needed to construct an effective strategic merger plan.

We came away with a treasure trove of information that forms the basis of this three-part white paper. Each part addresses a specific part of the process for making merger decisions as the industry emerges from the COVID-19 crisis.

PART ONE: MERGER CONSIDERATIONS IN THE POST-PANDEMIC AGE

Part One provides a description of the post-pandemic environment for mergers and acquisitions in the credit union industry. This part of the white paper is divided into two sections:

Post-Pandemic Push to Merge

The opening of the white paper provides context by describing the pre-pandemic trend toward industry mergers, largely driven by persistent regulatory, financial, and competitive challenges that have overwhelmed many smaller credit unions and are accelerated by the need for credit unions to achieve sufficient growth in undertaking a technological transformation. This first section of the white paper also addresses the uncertainties around the pandemic that led to a dramatic merger slowdown and how the industry is moving toward a post-pandemic world with an eye toward establishing a new normal.

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The Case for Consolidation

In this section, we identify the importance of aiming for a "win-win-win" scenario as the hallmark for a successful merger. Our white paper contributors also describe the various advantages that can be achieved via a merger—from economies of scale to enhancing your credit union's talent field to opening up a better route for leadership succession.

PART TWO: UNDERTAKING THE MERGER PROCESS

Part Two of the white paper focuses on the merger process itself, from identifying appropriate merger partners to the importance of conducting due diligence. It likewise is divided into two sections.

Refining Merger Strategies

The first section of Part Two addresses how to assess the synergies between two organizations in order to ensure that a merger makes sense. Credit union leaders discuss the role that size plays in determining the best merger partner. We also take a deeper dive into the advantages of economies of scale with the caveat that mergers are not always the most optimal path for achieving growth.

Moving from Merger Talks to Action

This portion of the white paper focuses on how the rubber meets the road, describing how to move forward with and overcome obstacles for a successful merger. Credit union leaders describe how important it is not to lose community ties in the wake of a merger and how to ensure upfront that the merger will result in a good cultural fit between the merging organizations.

PART THREE: THE NEWLY MERGED ORGANIZATION

The third and final part of the white paper encompasses transitional issues that typically arise in the newly merged organization. Like the first two parts of the white paper, Part Three contains two sections:

Bringing the "People Helping People" Together

One of the most important decisions for a newly merged organization concerns who will be CEO. This portion of the white paper addresses how that decision is made, discusses how to realign the board by integrating staff and creative solutions, and explains when it's appropriate to seek third-party guidance.

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Transitional Issues

This concluding section of the white paper addresses the myriad decisions related to the identity of the new credit union, such as rebranding in markets where a new name must be established and supporting the community in the post-merger period. Finally, the white paper concludes with guidance on how the continuing credit union can gauge the merger's success.

As you read the three parts of this white paper, we hope you find helpful the many insights from the credit union leaders who generously shared their insights and opinions. As we move ever closer to a post-pandemic age, the need for well-informed and thoughtful decision-making will be more important than ever.

POST-PANDEMIC PUSH TO MERGE

The COVID-19 outbreak and its unprecedented economic ramifications exacerbated many of the wide range of factors involved in the decision to seek out a merger, but those pressures have been building for years.

Kirk Kordeleski, executive benefit consultant with OM Financial Group (om-financial.com), sees some parallels in credit union merger trends over the past decade with those in the community-banking sector in the 1990s and early 2000s. With the removal of regulatory barriers in the late 1980s, bigger banks began acquiring smaller community banks until they achieved regional, then super regional, and finally national reach. Bank of America is the product of hundreds of mergers over two decades.

The march to consolidate tapered off as the mega-banks achieved market dominance. In fact, one reason credit unions are now undertaking community bank acquisitions is that demand within the bank sector has cooled, Kordeleski suggests.

Credit unions are following the same cycle to build the scale necessary to deliver a compelling and sustainable value proposition to keep members in the fold. All indicators point to a near-term acceleration in the pace of consolidation as continuing credit unions seek to improve their standing in a hypercompetitive marketplace by delivering on members' evolving definitions of superior financial service.

Uncertainties Slow Merger Conversations in 2020

COVID-19 was the pervasive consideration dominating virtually all short-term and many long-term business decisions in 2020, and it continues to steer operational and strategic discussions in 2021. Exacerbating the pandemic's effects are uncertainties about its ultimate duration and overall effect. The net effect during the Year of COVID-19 was to slow merger activity, but in the near future, the pandemic will likely increase the pace of consolidation as credit unions already struggling to maintain adequate capital and revenue production may be less likely to see a viable path forward.

According to an industry analysis in *Forbes* (McIntyre, 2021), "Recovery from the pandemic will be a marathon, not a sprint." Thus, recovery could lead to continued consolidation of smaller financial institutions over time: "As the big get bigger, 'too big to fail' will be replaced by 'too small to succeed,' but banks' viability will vary by market" (McIntyre, 2021). That dynamic will apply to credit unions as well.

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The uncertainty surrounding the COVID-19 pandemic is widely regarded as a reason for slowing mergers and acquisitions throughout a broad spectrum of industries. Writing for *Credit Union Management*, Stephen Morrissette (2020) reports that M&A activity across business sectors was down 53 percent for the first half of 2020, in comparison to the previous year, and several banks put off mergers that had been announced in late 2019.

While the pandemic caused many credit unions to hit the brakes on potential mergers, it has been an impetus for others to pursue them. Morrisette notes, "Experience and research have shown that turbulent inflection points are often the most important strategic moments in a company's journey—some would say that times like this separate the 'winners' from the 'losers.' Winners will find the opportunity in turbulence and use this time to leapfrog competitors."

Credit unions' responses to the COVID-19 outbreak have consumed a great deal of management bandwidth and forced leaders to rethink strategic priorities, which may have dropped mergers down on the to-do list, suggests Barry Shaner, President/CEO of Directions Credit Union (Directions), Toledo, Ohio (www.directionscu.org; $1.1 billion; 110,000 members).

Uncertainties about the potential effects of the pandemic on credit unions' financial performance are another likely reason for the short-term slowdown in merger activity. According to the NCUA (2014), the industry consolidation rate also declined significantly in 2010 as credit unions dealt with fallout from the Great Recession and then rose steeply over the next two years.

The pandemic-driven economic slowdown has put great pressure on smaller financial institutions, which will likely drive up the supply side of the merger equation extending beyond 2021 and beyond. "It's a tough time to be a smaller credit union," Shaner observes. "If you throw in the potential for elevated loan losses, I think that heightens the financial factors that drive their decision making."

> The stimulus influx was more problematic for credit unions with lower net worth and/or loan-to-share ratios, says Brandon Riechers.

The big influx of deposits, driven by pandemic stimulus checks, and the shift toward a higher demand for digital services has had an uneven influence across the financial services sector, says Brandon Riechers, CEO of Royal Credit Union (Royal), Eau Claire, Wisconsin (www.rcu.org; $3.5 billion; 226,000 members).

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Many high-performing credit unions have made it through the pandemic well. For institutions that have average net worth, the surge of deposits may have provided a temporary boost and delayed the need to consider mergers. However, the stimulus influx was more problematic for credit unions with lower net worth and/or loan-to-share ratios.

Val Mindak, President/CEO of Park City Credit Union (Park City), Merrill, Wisconsin (www.parkcitycu.org; $290 million; 22,000 members), concurs that certain aspects of federal support mechanisms have masked potential financial problems that could crop up in the post-pandemic era. "A lot of smaller credit unions currently have a false sense of security," Mindak says. "Their assets are growing like never before, and they're able to perhaps do loan deferrals to minimize the delinquencies at this time. But the reality is they don't have the ability to sustain that."

Merger volume may also have slowed because the pandemic prevented credit union leaders from congregating to discuss the challenges facing their organizations. "People not being able to communicate as effectively with one another hampered the ability of getting things through," notes Matt McCombs, President/CEO of Vibrant Credit Union (Vibrant), Moline, Illinois (www.vibrantcreditunion.org; $970 million; over 50,000 members).

Accelerated Shift to Technological Transformation

The pandemic has ratcheted up the need to embrace what Kordeleski refers to as "the latest stage of the industrial revolution"—the deployment of data and digital technologies as the foundation for artificial intelligence and machine learning in member service, lending, marketing, and other aspects of financial services.

While the transition to digital channels was already well underway throughout much of the previous decade, driven by demographic shifts and the innovations made commonplace by firms such as Amazon and Netflix, shutdown of face-to-face commerce due to the pandemic accelerated that shift. "Once the convenience switch is flipped, you just don't go back. There's no reason to go to a branch just to make a deposit," Kordeleski notes.

Although data-driven commerce is still in the early stages, according to a recent analysis by The Financial Brand (Streeter, 2021), the future success of financial institutions "hangs on their ability to put data to use, especially for marketing and improving the customer experience." With data-powered business applications projected to grow more than fivefold by 2025, credit unions are increasingly working to put to use the mountain of data within their existing systems.

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"The digital and data transition requires significant investments of capital and talent, which will continue to drive mergers," Kordeleski says.

Brandon Michaels, former President/CEO of JSC Federal Credit Union, Houston, Texas (www.jscfcu.org; $2.6 billion; 135,000 members), says COVID-19 was a "wake-up call" to credit unions regarding the need to speed up their transformational journey. As a result, the transition to digital capabilities has accelerated, but the hefty price tag is putting a strain on smaller credit unions—and in many cases, causing them to look toward mergers as a solution.

"The costs of digital, as a percentage of revenue and capital, are just too high for smaller credit unions to withstand," Michaels says. "Credit unions can't go down the path of just dabbling in this technology. They have to go all in because that's the only way to compete in the world."

The pandemic has brought about what David Ritter (2020), writing for *Credit Union Times,* calls a "new normal" in the credit union industry, which has required credit unions to shift their focus to assessing ways to achieve operational effectiveness in serving their members more efficiently via remote delivery channels, drive-through services, and "appointment-only" branch visits. "Now that many internal operational procedures have been put in place in this 'new normal,' many more credit unions are looking at strategic mergers as a viable option for long-term sustainability and relevance," Ritter writes.

Riechers concurs that the COVID-19 outbreak has ratcheted up many members' demand for remote access, but that does not mean credit unions in certain markets can shift away from maintaining their brick-and-mortar infrastructure. Royal's branches throughout 2020 handled about 80 percent of the traffic they did during the previous year, though members seeking routine transactions relied primarily on drive-through access.

Jeff Disterhoft, President/CEO of GreenState Credit Union (GreenState), North Liberty, Iowa (www.greenstate.org; $7.1 billion; 250,000 members), agrees that the pandemic-driven shift toward mobile channels was notable, but likely would not be permanent among members in some markets. Soon after GreenState began reopening its branch lobbies as the shutdown eased, some of its members returned for in-person banking.

"It's been surprising to us how quickly certain consumers have gone back to their traditional means of transactions—even after they did those transactions electronically while our branches were closed," Disterhoft reports. "Some of those people who were doing things the 'old-fashioned way' before probably were doing that for reasons other than convenience: They enjoy the interactions

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with other people. They want to get out and about, especially during these interesting times we live in."

The permanence of the embrace of digital channels will reflect geographic differences, but in rural states such as Iowa, Disterhoft expects the branch network to continue to be a popular component of service delivery.

> "The branch continues to be an extension of our brand and our commitment to the community."
>
> **Jeff Disterhoft**

"There will continue to be people who want to visit their money. Here's a perfect example: When farmers sell their crops in the fall, I don't see them depositing those checks electronically," he notes. "The branch continues to be an extension of our brand and our commitment to the community."

When GreenState acquired several First American Bank branches in the Des Moines area last year, the credit union did close some offices in close proximity to other locations. "But if there's no overlap, you have to think long and hard about decisions to close branches," Disterhoft says.

> "... many credit unions do not have the financial resources to maintain high levels of service across both traditional and digital channels."
>
> **Kathy Courtney**

Even in markets where branch traffic is picking up, investing in digital transformation is imperative to keep pace with the service expectations of the broader membership, but many credit unions do not have the financial resources to maintain high levels of service across both traditional and digital channels, notes Kathy Courtney, GreenState's Executive Vice President/Chief Operating Officer.

To grow their membership and wallet share, credit unions cannot shift their resources from brick-and-mortar infrastructure to invest in digital, at least in the short term. Many members value choice in channels: Even as they migrate increasingly to mobile and online banking, they want to know a conveniently located branch exists where they can consult knowledgeable financial professionals.

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"This is where scale and the blending of talent and capabilities through mergers can really help to benefit the cooperative and the collective membership," Courtney says. "Consolidation was already occurring across our industry, and the impact of COVID-19 will only accelerate this trend."

Persistent Regulatory, Financial, and Competitive Challenges

For credit unions that were already struggling to remain viable, the impact of the pandemic on vital performance ratios has exerted even more pressure on their ability to survive. In its assessment of industry trends, CUNA Mutual Group reports that credit unions should anticipate significant downward pressure on earnings in 2021 and 2022, with record-low net interest margins being a major concern. According to its February 2021 Economic & Credit Union Update report: "Credit union ROA fell from 0.93% in 2019 to 0.65% in 2020, but the latter figure was propped up by fees from significant sales on mortgages and PPP loans. Overall, the very low interest rates and falling loan-to-share ratio means that credit unions will be forced to place funds in low-yielding investments, and newly disbursed loans will receive tiny interest margins. CUNA economists forecast ROA of 0.50% in 2021 and 2022. The combination of fast asset growth and tepid earnings will further reduce the industry's net worth ratio, from 10.3% in 2020 to 9.2% by year-end 2021 and 8.9% in 2022" (p. 45).

Credit unions that were considering consolidation as a solution to deal with rising operational costs even before the pandemic have likely seen that challenge magnified post-2020, says Teresa Freeborn, President of Kinecta Federal Credit Union (Kinecta), Manhattan Beach, California (www.kinecta.org; $6 billion; 300,000 members).

> "... larger credit unions have a much lower expense burden than smaller credit unions."
>
> Keith Sultemeier

"I'm convinced that what credit unions have done to be there for our members and provide them with the relief and support they've needed throughout the pandemic is absolutely the right thing to do, and that the measures we've taken to protect our employees' health have been absolutely necessary," Freeborn says. "I wouldn't change any of that, because it's one of the things that distinguishes us from the big banks, who are all about making profits. But the fact is all of these things come at a cost, and many credit unions simply don't have the scale to absorb those costs."

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The issue of scale is crucial for the survival of credit unions, says Kinecta CEO Keith Sultemeier, citing industry data that larger credit unions have a much lower expense burden than smaller credit unions.

Consolidation allows the continuing credit union to leverage Kinecta's fixed costs across a larger base of assets, which provides additional "dry powder" to increase investments and enhance member benefits, he notes.

"That's a very clear indicator of the advantage that larger credit unions have in achieving strong earnings levels that ensure their ability to serve member-owners in the long run," Sultemeier adds. "Technology costs and regulatory burdens continue to grow, and I don't see that changing any time soon. For most credit unions, merging isn't so much a matter of pros and cons, but of surviving or not surviving."

The pandemic has fueled boardroom discussions in some institutions about the viability of their business strategy and marketability, in light of the current economic reality around margin compression and other economic factors, says Shawn Gilfedder.

The pandemic has fueled boardroom discussions in some institutions about the viability of their business strategy and marketability, in light of the current economic reality around margin compression and other economic factors, Shawn Gilfedder, President/CEO of Kitsap Credit Union, Bremerton, Washington (www.kitsapcu.org; $1.7 billion; 115,000 members), contends.

"In times of crisis, you expose gaps in your current business plan and business strategy," Gilfedder says. "Given that the Fed has publicly stated they will keep interest rates at current levels for the next two years, it's imperative that institutions take a look forward and plan for the future with an eye toward what challenges may look like."

Michael Lussier, President/CEO of Webster First Federal Credit Union (Webster First), Worcester, Massachusetts (www.websterfirst.com; $1.2 billion; more than 100,000 members), reports that the pandemic has led to a period of more generous loan forgiveness on the part of financial institution regulators. The NCUA (2020) suggests several strategies credit unions could use to assist borrowers who were falling behind on loans because of the pandemic, including providing payment forbearance options, waiving late payment fees, and postponing classification of some of these loan modifications as troubled debt restructurings (TDRs).

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While these strategies were helpful to members, they put added pressure on some credit unions that may have already been having difficulty staying competitive.

"The experience for many smaller credit unions during the pandemic was they were surviving, but they were experiencing a period of lower interest rate margins, and it became increasingly difficult for some to make a profit," Lussier says. "The question now becomes: What happens if, after COVID goes away, interest rates remain low, the economy doesn't pick up, and loan demand doesn't come back?"

More credit unions will likely end up under watch by the NCUA, he predicts. The only path forward for these troubled credit unions whose gaps in efficiency the pandemic exacerbated will be to move into a merger with a larger, more efficient partner.

Smaller credit unions must follow the same regulatory mandates as larger credit unions—with no reprieve from compliance, says Bob Burrow.

Smaller credit unions must follow the same regulatory mandates as larger credit unions—with no reprieve from compliance. Bob Burrow, President/CEO of Bayer Heritage Federal Credit Union (Bayer Heritage), Proctor, West Virginia (www.bayerhfcu.com; $572 million; 36,500 members), observes that regulatory issues have proven to be a tougher challenge for smaller credit unions during the pandemic.

"There's no one saying to the smaller credit unions, 'We realize you guys don't have a lot of money, so we're going to cut you some slack,'" Burrow says. "They have to comply and spend the money, same as everyone else. Proportionately, it's going to be harder on small credit unions. Some of them have been regulated to the point where they'll be unable to survive on their own."

In sum, there were still uncertainties in early 2021 about the potential lingering impact of the pandemic, the course of economic recovery, and the possibility of additional regulations with a new administration in the White House, notes Bob Jacobson, Board Chair of Pen Air Federal Credit Union (Pen Air), Pensacola, Florida (www.penair.org; $2.1 billion; 115,000 members). Those factors, especially in combination, may push smaller credit unions to consider merger opportunities, which should benefit both organizations: Merging credit unions gain access to digital services and platform resiliency on behalf of their members, whereas continuing credit unions gain members, expand their loan portfolios and asset bases, and move into new markets.

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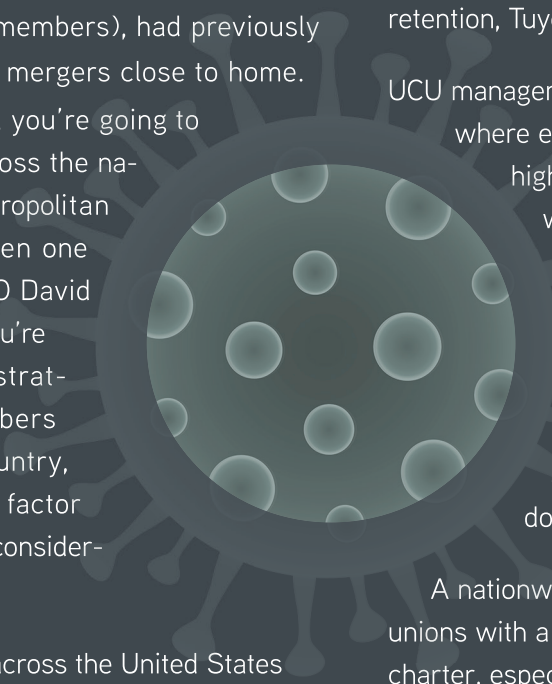
Finding Opportunity in Crisis

Although the COVID-19 pandemic is associated with shutdowns, it could also create openings for credit unions aiming to expand through mergers. Like many of its peer institutions, University Credit Union (UCU), Los Angeles, California (www.ucu.org; approaching $1 billion; 45,000 members), had previously looked for prospective mergers close to home.

"But in the new world, you're going to see more mergers across the nation, not just in one metropolitan area, one state, or even one region," President/CEO David L. Tuyo II suggests. "You're going to see business strategies where, as members fan out across the country, distance and time will factor into member service considerations differently."



UCU serves members across the United States and around the world, with the vast majority on the West Coast. However, as people have become more nomadic, the credit union is serving significant pockets of members in New York, Miami, and other regions. UCU's member distribution may continue to widen if the "Zoom town" phenomenon—the increasing ranks of remote workers realizing that they can resettle far from corporate headquarters—takes hold.

Increased member mobility could untether merger conversations from geographic restrictions and favor discussions among prospective partners with contact centers on both coasts to serve the early risers in the East and the late risers as far west as Alaska and Hawaii. The combination of regional operation centers and work-from-anywhere options, as discussed by Choudbury (2020), could give the continuing credit union an edge in recruitment and retention, Tuyo suggests.

UCU management was exploring work-from-anywhere even before the pandemic, given the high costs of housing in the LA market, with some staff members talking about moving to Las Vegas, where the cost of living is 58 percent that of their employer's home base. "If we can give our team members a 42 percent lift in their quality of life, financially speaking, why wouldn't we help them do that?" he asks.

A nationwide merger strategy well suits credit unions with a SEG-based, industry, or association charter, especially if regulations defining fields of membership and common bonds are updated to reflect the realities of member service in the digital age, he says.

"I think the regulatory agencies are supporting the new world and readdressing legacy issues that plague our industry. Looking at membership based on ZIP codes or counties is just a yesterday way of defining fields of membership," Tuyo adds. "What we're trying to identify in a field of membership is a common bond, and that could span ZIP codes, state lines, and even the entire globe."

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"Economies of scale are important, especially when you get into developing and maintaining digital platforms. The larger financial institutions have much greater resources to apply," Jacobson adds. "Hopefully, the merger should provide some additional security capabilities and the capacity for systems to be more resilient in the event of natural disasters—in our case, hurricanes."

Those factors sum up Pen Air's strategic pursuit of mergers: "Our aim is to grow the credit union and make sure it can continue to serve the community we all live in and continue to improve the digital environment by leveraging economies of scale."

Getting Back to the New Normal

The credit union movement was experiencing steady consolidation before the pandemic, and the 2020 slowdown will not reverse that trend, says Steve Ewers, President/CEO of Members Cooperative Credit Union (MCCU), Duluth, Minnesota (www.membersccu.org; $950 million; 55,000 members). If anything, the events of the past year present an opportunity for credit unions to reflect upon their viability.

"Our world is changing faster than ever. If the pandemic has crippled their abilities and capabilities, and if they are unable to close any service gaps, merging with another organization is one possibility they should consider to enhance member value," Ewers says.

From his view as a member of the NAFCU Board of Directors, including a stint as chair, Lussier was particularly attuned to the pace of mergers. Lussier estimates credit union mergers occurred at a pace of one a day, five days a week, for 52 weeks a year when he joined the board in 2005. By the end of his tenure in 2014, the pace had accelerated to one a day, six days a week—and Webster First has been active in that arena. During his 33 years with the credit union, Lussier has led the organization through 15 successful mergers. Based on his extensive expertise, NAFCU tapped him to author its *Credit Union Merger & Acquisition Handbook* (2017).

Lussier forecasts that the cumulative impact of the pandemic may increase merger activity to "probably be one a day for seven days a week for a while" before settling back into the same brisk pre-2020 pace.

Driving the potential for increased merger activity is the expansion of charter and field of membership options, which offers "more flexibility to serve a bigger space" and frees up credit unions to look beyond their closest markets and SEGs to a wider field of potential partners, Kordeleski suggests. In combination, those trends signal the likelihood of two tiers of merger discussions among larger and smaller credit unions.

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"For the largest acquirers of credit unions, as they continue to gain scale, the logic of pursuing mergers of smaller institutions with two branches and less than $50 million in assets becomes less and less viable," he notes. "Smaller credit unions and banks need to keep that in mind. If they're going to need to partner, doing so soon would be ideal, and they should be talking to credit unions in the next asset class up."

The pattern over the last decade is that larger credit unions have been able to take advantage of their greater resources to continue to grow in membership, wallet share with existing members, and income production, whereas many smaller financial cooperatives have steadily lost ground. Credit unions with more than $500 million in assets offer products such as mortgages and commercial lending that scale well and facilitate growth, which many small institutions cannot match.

"Banking is a commoditized retail marketplace, where credit unions' main advantage is their ability to price aggressively, but to maintain that advantage, scale matters," Kordeleski adds.

Gilfedder advises credit unions to monitor their financial performance constantly to gauge their viability before a merger becomes the only pathway to survival. "Mergers are a reality, and you need to have those discussions," he says. "Having those discussions, from a pragmatic perspective, allows you to think with clarity and not get clouded in the moment when you may be experiencing transition of key executives or mounting pressures of the business."

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THE CASE FOR CONSOLIDATION

As credit unions resume a more active pursuit of mergers, their leaders will be looking to inform those conversations with compelling arguments about the advantages of consolidation. Moreover, they must position their organizations as strong partners in optimizing outcomes for the combined membership, employee base, and communities served by the continuing credit union.

Aiming for a 'Win–Win–Win'

Lussier advises credit unions that the best reason to proceed with a merger is achieving a mutual benefit for all parties involved. "I always say it has to be a win–win–win," he says. "It has to be a win for the other institution, it has to be a win for the acquiring institution, and most importantly, it has to be a win for the membership."

Ewers agrees mergers should always begin with an analysis of the proposed value for members of both organizations. "Member benefits can be broad and range from access to new locations to enhanced access with technology and availability to new products and services," Ewers says. "It obviously depends on what each organization brings to the table."

In identifying the best candidates for merger opportunities, Gilfedder advises looking for credit unions that are "complementary to your culture, complementary to your business environment, and complementary to your emerging needs from a talent and technology perspective."

"The most important reason for proceeding with a merger is to benefit the members by creating a stronger, more viable, more relevant, and more sustainable organization for the future," he adds.

At GreenState Credit Union, openness to mergers and acquisitions has come into sharper focus in recent years through firsthand experience of the benefits for its chief stakeholders: members, the organization and its employees, and the communities it serves. "If we take really good care of those groups, good things will happen," Disterhoft says.

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Achieving Sustainable Scale

Scale is an inescapable aspect of sustainability in financial services. A great deal of discussion and debate has arisen within the movement in recent years concerning the optimal size needed for credit unions to improve operational efficiencies continually, keep pace with an ever-growing competitive field, and invest in product, service, and delivery channel innovations. Current estimates range from $250 million to $1 billion in assets or more, but all the credit union leaders and industry observers interviewed for this white paper agree that threshold continues to rise, and some caution that it will likely exceed $5 billion within the five-year strategic planning horizon to which many institutions adhere.

Mary Yasui-Yamabe recommends "a hard-nosed assessment of the financial services landscape by all leaders—whether they're with a prospective acquiring credit union or a prospective merging credit union—to look at scale as one of the fundamentals that has to be in place for their organization to serve their mission on behalf of their member-owners."

Noting that the number of U.S. credit unions has been halved to the current 5,000 in just two decades through consolidations and closures, Courtney cites the reality that many remaining financial cooperatives are "too small to scale" and the predictions that by 2030, the average credit union will hold $1 billion in assets.

Kinecta Board Chair Mary Yasui-Yamabe recommends "a hard-nosed assessment of the financial services landscape by all leaders—whether they're with a prospective acquiring credit union or a prospective merging credit union—to look at scale as one of the fundamentals that has to be in place for their organization to serve their mission on behalf of their member-owners."

Scale is not the only factor, she notes, but it is increasingly at the center of evaluating whether a credit union can continue to make a positive difference in members' lives, and "go toe-to-toe with the big banks and a multitude of new competitors."

Other leaders concur. "What we're seeing now is that our main competitors are not other credit unions or community banks. The biggest money centers, like Chase,

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Wells Fargo, and B of A, are grabbing market share by increasing their investments in technology," Shaner says. "The disruption from the pandemic has accelerated that trend. It's expensive for credit unions to try to keep pace, especially when a branch network needs to be supported at the same time. The more resources available, the more likely members are going to be taken care of and be successful."

Directions' history exemplifies the mergers' role in building the scale necessary to support infrastructure improvements and fuel continued organic growth. The organization is the product of two major consolidations in the mid-2000s, including a merger of near-equals between a $200 million and $150 million credit union.

Optimal size and scope likely vary by region. From their view headquartered in Los Angeles, the second-largest metropolitan area in the United States, the leaders of University Credit Union (UCU; www.ucu.org; approaching $1 billion; 45,000 members) agree that the current sustainable asset size is $2 billion, a target that will more than double by the middle of this decade, says President/CEO David L. Tuyo II. He acknowledges that based on that premise, UCU will need to grow aggressively over the next five years to continue being competitive and delivering value.

The strategic blueprint for mergers at UCU consists of two tiers, with a primary emphasis on potential partners that serve one or more universities or higher education in general, Tuyo says. The second tier includes SEG-based credit unions not confined geographically by a community charter, "unless there's an extraordinary circumstance that fits our approach." The aim of using those criteria to refine its merger strategy is to streamline integration, ensure a strong cultural fit, and realize economies of scale and scope more effectively.

UCU's most recent merger, through the NCUA's 2019 liquidation of CBS Employees Federal Credit Union ($21 million; 2,800 members), was a good fit for the members of both institutions, Tuyo says. "We serve the number one, number two, and number six film schools in the country, and many of our graduating members end up working with an entertainment company like CBS. That line of business has grown 10 percent a year for each year since the merger, so we continue to make sure that the economies of scale and value are given to that stakeholder base."

Since 2015, MCCU has completed two successful mergers with two credit unions outside the greater Duluth area, the largest of which was with the $196 million Lake State Credit Union.

"Having scale is critical, as it positions credit unions not only to compete, but to quickly pivot during disruptive events such as what we've experienced with COVID-19," Ewers contends.

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McCombs concurs there is some confusion about the benefits of scale, citing the common misconception that "if I'm bigger, it automatically means I'm better."

"Size doesn't naturally make you more efficient. It doesn't always make you nimbler, but it does give you the resources to be able to leverage that mindset of nimbleness in the things that you do," McCombs says. "Size and scale give you the ability to navigate changes that occur or to force changes that should be occurring in your business."

Expanding into New Geographic Markets

In many instances, mergers can be the quickest route for credit unions to expand into new markets. When McCombs joined Vibrant as CEO 10 years ago, the organization had about $400 million in assets. The credit union's growth to nearly $1 billion in assets was aided in part by six mergers over the last 3.5 years. While these six mergers combined represented a total of $100 million in assets, they contributed to the institution's expansion into new geographical markets and helped in achieving greater economies of scale.

"We went from being in a single market in the Quad Cities to having locations expanding from Des Moines, Iowa, to Covington, Indiana, about forty minutes west of Indianapolis," McCombs says.

Other credit unions similarly have been able to enter new markets via mergers. Bayer Heritage achieved the lion's share of its asset size via organic growth, although the organization has expanded its geographic scope with several small mergers. Burrow reports that the credit union expanded geographically with mergers of Zane Trace Federal Credit Union in Zanesville, Ohio, and South Berkeley Federal Credit Union in Martinsburg, West Virginia. Another merger, Reynolds Memorial Hospital Federal Credit Union in Moundsville, West Virginia, strengthened Bayer Heritage's presence in Marshall County. The largest of these merger partners, Zane Trace, had $17 million in assets.

> "Even younger members and more technologically adept members place a high value on a conveniently located branch they can visit when they need to."
>
> **Barry Shaner**

Especially for credit unions with community charters, mergers can increase their market position and visibility. For example, a 2018 merger with Education Plus

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Credit Union, a $116 million organization based in southeast Michigan, allowed the then-$715 million Directions to expand its presence across the state line and grow to become the No. 3 financial institution in that market area.

"It makes a big difference when you are that visible; it improves your chances of being successful in that market. That's what we look for—that kind of a relationship in a particular market. There's a lot to be gained in terms of scale," Shaner notes. "Branches are still the most effective tool we have for building awareness in a market. They're a big billboard, as long as they're located in a visible place. Even younger members and more technologically adept members place a high value on a conveniently located branch they can visit when they need to."

Expanding Product and Services Offerings

A strong argument for mergers is the ability to offer a wider range of products and services to members of the merging financial cooperative, which in turn should accelerate membership and share of wallet growth for the continuing organization.

Nine years ago, Kris VanBeek came on board as President/CEO of USALLIANCE Financial Federal Credit Union (USALLIANCE), Rye, New York (www.usalliance.org; $2 billion; 120,000 members). During that time, the credit union has completed nine mergers, which contributed to the organization nearly tripling its asset size. Most of USALLIANCE's merger partners were in the range of $15 million to $40 million in assets, although one was as large as $100 million.

A primary impetus for several of those mergers was to provide a more robust product offering and better delivery channels to members that the smaller credit unions could not afford on their own, which also expands growth opportunities for the continuing organization. One such merger in 2015 with the $40 million PepsiCo Employees Federal Credit Union resulted in a significant surge in new members within that field of membership. PepsiCo employees who were not previously members joined USALLIANCE to take advantage of a full range of card programs, mobile banking services, a state-of-the-art call center, and other products that the merged financial cooperative did not offer.

"I would estimate that our membership from among these employees has tripled because of this merger," VanBeek says. "We've been able to duplicate this success with other mergers of similar size."

In fact, in its assessment of prospective mergers, the USALLIANCE management team aims to evaluate "untapped upside potential" by projecting the likelihood of the continuing credit union being able to triple membership within that new field of

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membership through providing expanded products, services, and delivery channels, he adds.

Bayer Heritage's most recent merger, which occurred in late 2020, involved ultra-small (less than $5 million in assets) Whetelco Federal Credit Union in Wheeling, West Virginia, encompassing a member base of approximately 600. Operating out of a small office, Whetelco had limited resources and could not offer a mortgage program or plastic card program.

"Before the merger, they didn't even have share draft accounts," Burrow says. "Now these members can have plastic cards with us, they can have checking accounts, they can have mortgages, and everything else we offer our other members."

Continuing credit unions can also expand their product and service lines through mergers and acquisitions. Several leaders cited the potential to expand their commercial lending portfolios and expertise through mergers. Furthermore, GreenState introduced treasury management to its business members and trust services to all members as the result of a bank branch acquisition in early 2020.

Enhancing Talent Acquisition

Beyond adding expertise to support new product offerings, Disterhoft sees infusions of talent as a merger's primary benefit since new employees "find themselves rejuvenated and looking for new challenges within the consolidated organization. Despite a recent downturn in the economy, finding top talent remains a relatively difficult endeavor, and mergers can really help in that regard."

Incoming professionals can apply new approaches within existing operations. For example, a financial professional who joined GreenState through the bank acquisition now heads up the credit union's governance and internal audit efforts, Disterhoft says. "She is doing a fantastic job. In a short amount of time, she has really moved us to a higher plane of performance in that area. Every organization is going to have a few people like that."

Assuming that the acquiring institution does everything its way is a mistake, he adds. "If you come into this with a more open mind, ready to figure out which approach makes the most sense for the continuing institution, then you've found that 'special sauce.'"

Likewise, other credit unions see the potential of mergers adding to their talent pools. "I consider a merger as an opportunity to grow my team and my knowledge resources," says Adele Sandberg, President/CEO of AEA Federal Credit Union, Yuma, Arizona (www.aeafcu.org; $300 million; over 32,000 members). "Assessing

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the team talent between the two institutions is important. You might be able to fill some gaps between the two institutions. I would hope that when people are looking to merge, they see it as an opportunity to grow a team that can make you stronger."

> "You've got to have enough capital and wherewithal to afford the talent that is going to take you to the next level."
>
> **Val Mindak**

Similarly, Mindak sees talent acquisition as one of the greatest benefits that a newly merged organization can leverage. "You've got to have enough capital and wherewithal to afford the talent that is going to take you to the next level," she says. "Sometimes smaller credit unions don't have that ability."

Bill Birnie, President/CEO of Frontwave Credit Union (Frontwave), Oceanside, California (www.frontwavecu.com; $1.09 billion; 111,000 members), notes that a strong benefit of scale is being able to attract and retain highly talented people across all levels of the organization. Seeking out merger partners with talented staff within their ranks is a great way to add value to the continuing credit union and bolster its succession plan. High-performing executives in a merging credit union will have the opportunity to demonstrate their value and position themselves for consideration as the continuing credit union's future senior executive or CEO.

Frontwave's most recent merger was in 2016. However, Birnie is working to position the credit union as an appealing merger partner in the market. "Our desire is to attract merger partners to accelerate our growth, attain scale, and establish ourselves as a 'player' in the competitive landscape," he says. Birnie keeps his eyes open for credit unions that would be a strong cultural fit and align well with Frontwave's brand—which he believes is critical to a successful merger.

Being able to gain talent through mergers applies to board composition as well. At USALLIANCE, the current board chair and vice-chair came from the boards of two of its merger partners. As chair, Simon Walton stepped into an organization that was fiftyfold bigger than the credit union for which he previously served as board chair.

"It's really a great story. A chair of a $40 million credit union is now chair of a $2 billion credit union. The value that Simon has brought to his role as chair has been immeasurable," VanBeek says. Walton brings his experience as a corporate HR executive to the board table. In fact, all USALLIANCE board members have experience in executive roles, including mayor, chief of police, a trade union officer, and corporate leaders.

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Supporting Leadership Succession

A compelling impetus for prospective merging credit unions is a CEO's impending retirement with no clear line of internal succession in place. "What I saw in the Great Recession, and what I believe we're seeing during this pandemic, is a slow-down in CEO retirements," Birnie says. "My perception is that leaders typically don't want to announce their retirement during an external crisis such as a pandemic or recession. They want to stick it out and help their organization get through it."

However, post-pandemic, Birnie says he believes merger activity will heat up as CEOs who postponed retirement—and quite possibly those who are simply exhausted from the rigors of leading an organization through these fraught times—head for the door.

Among respondents to the 2019 CUES Executive Compensation Survey, 34 percent of CEOs anticipated retirement in the next five years and another 31 percent within the decade (Bankston, 2019), which indicates having a merger as an alternative to internal succession planning may be on the minds of many credit union leadership teams.

Even CEOs who had not been planning to retire in their pre-pandemic days may now be considering it because of the strains of the past year. "There's certainly a 'wear factor' that's starting to hit business leaders," McCombs says. "I'm hearing this from business leaders from not only our industry, but other industries as well. A lot of folks who have been leading organizations are asking themselves, 'How much longer do I want to do this?' I think there's going to be a large number of CEOs over the course of the next year who are going to be ready to exit the workforce."

When a long-time CEO is ready to step down, the void of leadership at the top may be too great of an obstacle for a small credit union to overcome, Shaner notes. "There's a whole generation of credit union leaders who grew up with their institutions. They may have started as tellers or loan officers and moved up to lead their institutions successfully as CEOs. They have a vast, wide knowledge of their credit unions. It's really hard to find that breadth of experience and expertise in the market."

The price tag of hiring a new CEO can add to the challenge of leadership succession, he says. The compensation of a leader who has spent his or her entire career at one organization often lags behind the market, thus a talented candidate's salary and benefits expectations based on current compensation practices may pose some sticker shock for the board and move the needle toward a merger as a viable option.

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Expanding Fields of Membership

Strategic merger opportunities can also open limited fields of membership, as in several mergers Webster First implemented.

"As a community credit union, we were restricted to membership in central Massachusetts and could not go outside of that area," Lussier reports. However, the NCUA (2010) specifies two types of transactions that allow healthy credit unions to acquire another credit union's field of membership: one is the assisted merger of a troubled credit union, and the second is the purchase and assumption (P&A) of a liquidated credit union. Webster First put in successful bids for several assisted mergers, the first being $70 million Saugus Credit Union, just outside Boston.

With this and other mergers, Webster First has expanded its market to Boston and now has locations in Middlesex, Essex, Suffolk, and Worcester counties. "With our expanded field of membership, we were able to grow from $400 million in assets to $1.2 billion today," Lussier says.

Consolidation is also an option for merging credit unions when their fields of membership experience an economic setback, or when a core sponsor ceases to exist. As an example, Lussier points to Webster First's acquisition of the credit union that served the Filene's department store chain. The $20 million credit union was active and doing well with its storefront location until Macy's acquired Filene's in 2007. "Macy's came in and said, 'That storefront is more valuable selling shoes than it is as a credit union,'" he recalls. The credit union moved to another location, still serving the former employees of Filene's, but eventually merged into and became a Webster First branch.

"That was a case where a merger occurred for a reason that was totally out of the credit union's control—not because it had bad numbers, but because the corporate sponsor no longer existed," Lussier says.

Gilfedder observes that regulatory-assisted transactions are sometimes the only choice for credit unions with no other avenue for survival. "Being an institution that can step in and help an organization realize its future is sometimes the best option," he notes.

There are a number of reasons that credit unions have fallen into a situation in which a regulatory-assisted merger is required. "They may have lost a core sponsor, or they may have financial conditions that are weighing heavily on the future viability of the organization," Gilfedder says. "Any number of factors can weigh into the equation, and while such organizations cannot continue on their own, they present opportunities for other institutions to scale or to provide services for those members."

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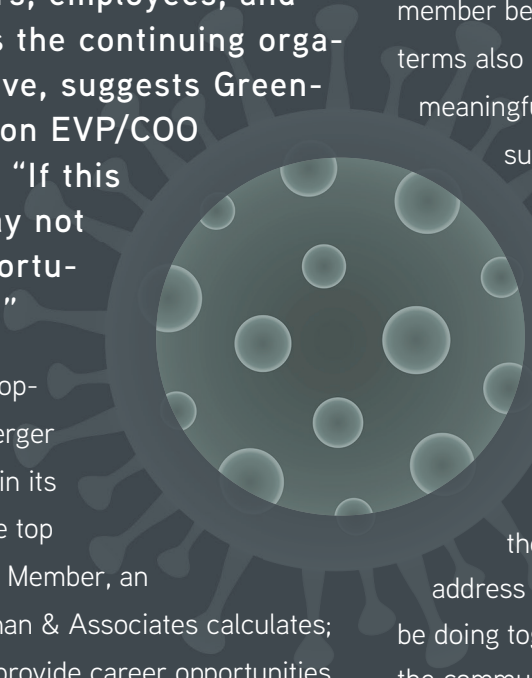
Presenting a Clear Case to Potential Merger Partners

Both parties in merger conversations must be able to see how "the whole can be greater than the sum of its parts" through delivering greater value to members, employees, and the communities the continuing organization will serve, suggests GreenState Credit Union EVP/COO Kathy Courtney. "If this isn't clear, it may not be the right opportunity to consider."



GreenState's value proposition to potential merger partners is grounded in its consistent place in the top 1 percent in Return to Member, an industry metric Callahan & Associates calculates; in its commitment to provide career opportunities and competitive compensation to its employees; and in its community support.

In their discussions on potential credit union mergers, GreenState leaders aim to present the benefits in a clear and logical way—"a thoughtful approach to planning," in Courtney's words—by presenting a draft term sheet that outlines a side-by-side comparison of the potential continuing and merging credit unions' loan rates, deposit rates, fee income, and other quantifiable comparisons along with a map of products, services, and delivery channels. In combination, this information should convey clear member benefits and broader access. The draft terms also cover employee benefits and put some meaningful numbers to its ongoing community support and volunteerism.

"A thoughtful, successful merger results in benefits to the membership in terms of improved loan and deposit rates, access to a broader product offering, and more robust channel capabilities. As our assets in a given community grow, so does the giveback," she says. "We want to address concerns by showing what we could be doing together for members, employees, and the community."

Although it can be an emotional endeavor, at the end of the day, the overall aim is to do more for the collective membership, employees, and community. As a $7 billion financial cooperative, GreenState has the scale to make a meaningful and lasting positive trajectory in its communities, which is consistent with the movement's "people helping people" mantra, Courtney notes.

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When to Proceed with Caution

Mergers are not the only path for greater efficiency and economies of scale. In some cases, Mindak suggests collaborating with credit unions might be the better strategy, especially if the leaders of a financial cooperative are not ready to merge. Park City has partnered with other credit unions in its market in a number of areas that have provided mutual benefit, including real estate loans, commercial lending, ALM strategies, and more.

"We're building relationships with these credit unions, and if they decide to do a merger in the future, we know we're going to be a natural partner," Mindak reports.

Some credit unions wait too long to pursue a merger, Burrow contends. It would be better if these institutions consider a merger when they are healthy rather than waiting until the NCUA designates them as troubled. Bayer Heritage has turned down several mergers because the credit unions have no equity and "there's nothing left to save," he notes.

"That's not the kind of merger we're looking for," Burrow says. "We're looking for somebody that's still a viable credit union where the problem is 'we don't have the wherewithal to grow any bigger and to compete in this ever-changing environment.'"

> "If the board or culture or any other aspect of the organization doesn't align with us, it's okay to say 'No, it's not a good fit.'"
>
> **Kris VanBeek**

Bayer Heritage's guiding consideration is to ensure that a merger is a positive for its existing members. "They've built this credit union," he says. "It would be very irresponsible of me and the board to merge with another entity that is going to be a draw on the capital of the surviving credit union with very little, if any, promise of reward for the members who are taking it on. For me, it's a no-brainer. If it's not a good deal, we would walk away."

While USALLIANCE has consummated nine mergers in the past decade, VanBeek estimates the organization has turned down 50 additional opportunities. The credit union receives such intense interest from potential merger partners because of its reputation for doing mergers correctly. However, with so many potential offers coming its way, VanBeek reports that it is important to be selective.

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"If the board or culture or any other aspect of the organization doesn't align with us, it's okay to say 'No, it's not a good fit,'" he says. In some cases, it might be one aspect of the business that quashes the deal. As an example, VanBeek describes a potential merger partner that was a great fit in every way except one—the credit union was doing business in taxi medallions.

"We really wanted to do the merger. It was a tough choice, but in the end, we decided the optics of having taxi medallions might not be worth the upside of the merger," he says.

One Midwestern credit union is pursuing mergers with the primary strategic aims to (1) achieve the necessary scale to finance digital transformation and keep pace with regulatory requirements, and (2) expand into nearby markets and "protect our territory." On the latter front, as the credit union was eyeing expansion in a community of about 100,000, several other financial institutions opened branches there. Thus, as the credit union assesses merger possibilities, the number and location of branches potential partners hold in key markets will be an important factor.

It may be difficult to measure, but a board official with a Midwestern credit union cautions that a merger could result in less optimal effects than anticipated if the merging organization's members are disillusioned by the loss of a brand with which they identify. While increased scale is designed to benefit members, some may be alienated over concerns that their financial cooperative is becoming "too big" to provide the level of personal service they appreciate.

That concern is especially likely to arise among members who are unhappy about the loss of local leadership and familiar faces at their hometown branches, the director cautions. "Loss of identity can be a big deal, especially in rural communities. 'Common bond' is not just a technical term associated with the field of membership—it has meaning for the people who belong to a credit union."

The question of how big is big enough can be a quandary for credit unions positioning themselves as the continuing organization in merger conversations. "I don't necessarily believe a credit union provides better member service just because it's bigger. In fact, I would argue there's a good chance service might suffer, if you ask members," the board official adds. "Growth means more complex operations, so you have to ask, 'Is your CEO up to the task? Can the person who was hired to run a $300 million credit union run a $2 billion credit union ten or fifteen years later?'"

"For me, the growth is an issue of concern. Everyone says you have to be bigger, and I understand the investments needed for a credit union to thrive. But I don't believe it's always better for members," he adds. "If all you do is offer more products and the level of personal service deteriorates, I don't see how that's better for members."

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Conclusion

Part One of this white paper provides context for what is to come in Part Two.

Strategic mergers have played an important role in the growth of many credit unions and have been a necessity for many smaller credit unions that otherwise would have been hard-pressed to survive.

As the pandemic has put the brakes on the pace of merger activity in the industry for the better part of a year, credit unions are poised to make up for lost time with an accelerated movement toward consolidation as the economy recovers and American life resumes with some semblance of normalcy.

In Part Two of this white paper, we address how credit unions can best refine their merger strategies and look for merger partners that are the best size and fit to achieve their objectives. Our white paper contributors will share their ideas for how to get the merger conversation started and describe the importance of scale, scope, and sustainability in determining whether to move forward with a merger. They will also describe various obstacles to mergers—such as pride, ego, cultural disagreements, and fear of the unknown—and provide their best strategies for overcoming these roadblocks so as to move the parties toward a successful outcome.

Every credit union merger is accompanied by a sense of loss. Members who have a close bond with an existing credit union may mourn the loss of its name, logo, and identity as they become part of a newly merged organization. However, credit union leaders note that this feeling can be overcome by focusing on the advantages of a bigger and better financial institution: new products and services, expanded delivery channels, greater staffing capabilities, and the ability to support the community in a more impactful way.

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More For Members:

Credit Union Leaders Plan
Post-Pandemic Merger & Acquisition Strategies

Part One: Merger Considerations in the Post-Pandemic Age

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