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EXPERT OPINION

Strong Foundation Built for More Credit Union-Bank Deals in 2021

Favorable industry conditions, a well-traveled regulatory path, and proven member focus will give CUs an advantage in the space.

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The first acquisition of a bank by a credit union occurred back in 2012. Since then, the market has seen a wide range of acquisitions made by credit unions – from FDIC-insured banks to OCC-regulated banks to converted mutuals. The trend of both state- and federally-chartered credit unions buying banks has grown in number and scale.

In looking at the last eight years of activity, trends have formed answering the all-important questions of why credit unions look to buy banks:

1. Which financial considerations should credit unions acknowledge before entering the market?
2. Why is member conversion so critical to the transaction?
3. How has the regulatory approval process evolved since that first transaction in 2012?

While the past cannot predict the future, we can use the lessons learned in answering these questions to anticipate what the future of credit unions buying banks may look like moving forward.

Merger and acquisition activity present a nonorganic growth opportunity for credit unions. Whether a credit union is looking to acquire a whole bank or a portion of a bank branch network, the transaction presents an opportunity to strengthen services the credit union can offer to its members, extend the geographic reach of the credit union, and bolster its balance sheet.

Nonorganic growth can have an immediate impact and open new avenues of opportunity compared to the more traditional growth model. Nonorganic growth will continue to be a part of the "buy or build" decisions that credit unions will make over the coming years.

Key Financial Considerations in CU-Bank Transactions

As a result of the unique nature of how a credit union must acquire bank assets, pricing and tax matters have been – and will continue to be – key when evaluating and determining if an acquisition is economically feasible. Without going too deep into tax mechanics, credit unions generally pay a higher price compared to a bank buyer to provide a competitive bid. Often, the credit union must defray some portion of the tax expense that is generated as a result of the selling bank engaging in a transaction to sell to a credit union buyer.

This is especially relevant when the target bank is organized as a C-corporation. The transaction generates a layer of tax that is not triggered in a stock sale to another bank. While the pricing for bank assets may compress as a result of the economic climate, the tax challenges will remain. In certain situations, this will continue to force credit union buyers to pay a higher premium in order to generate the capability of a bank to recognize the same financial return its shareholders would receive if the bank was sold to another bank.

While the pandemic has slowed the acquisition market compared to 2019, transactions are still being announced and completed. Interestingly, through the end of October, announced bank branch acquisitions have outpaced announced whole bank acquisitions. Branch acquisitions present similar benefits of a whole bank acquisition, while not requiring the same amount of financial commitment. With an immediate focus on capital preservation in the wake of the pandemic, the short-term trend may tip toward an increased number of branch purchases. This allows a credit union buyer to scale into the acquisition market and be more strategic about the use of its capital, while still obtaining nonorganic growth.

Strong Community Engagement, Marketing Are Proven Advantages for CUs in Effective Customer Retention

Another key element to success of any acquisition is the conversion of bank customers to credit union members. Historically, credit union acquisitions of banks, whether it be a whole bank acquisition or a branch purchase, have seen a high rate of retention of bank customers ultimately becoming credit union members.

Anecdotally, credit unions see less than a 5% runoff in connection with an acquisition of a bank. This level of retention may come as a surprise to some, as it is a better than expected runoff in connection with a bank-to-bank deal.

The success here is largely due to the developed communication plans and messaging promoting the values of membership to the acquired bank customers. As a credit union looks to expand its concentration in a geographic area, it often looks to buy smaller banks with community ties. This allows the credit union to easily demonstrate that it can serve the banking needs while providing at least the same level of community-focused service. This will continue to be a driving factor in the success of customer-to-member conversion for credit unions moving forward.

Successfully Navigating the Regulatory Landscape

Due to the structuring requirements of a whole bank acquisition and the regulatory approval process, acquiring a whole bank is more complicated than acquiring another credit union. However, the regulatory process at this point is well traveled, especially in Florida, Michigan, Illinois and Wisconsin to name a few.

While a well-traveled path does not necessarily cut down on the complexity, legal representatives and state and federal regulators are gaining familiarity with the process. This familiarity in turn is providing more efficiency. There will be more regulatory complexity to buying a bank as opposed to merging with a credit union; however, that should not on its own be a deterring factor.

While the future is impossible to predict, history can serve as a guide. As an industry, we have eight more years of experience than we had in 2012. Nonorganic growth opportunities will continue to present themselves as consolidation continues across the industry. This consolidation may tip the scales toward more branch purchases than in recent years as credit union buyers look to retain more capital.

The regulatory process, while not completely free of bumps in the road, will continue to evolve, develop and refine, leading toward a smoother, more efficient process for the approval of transactions.

Despite changing conditions in the financial services sector, the future of acquisitions remains bright. Credit unions will continue to be a part of the bank acquisition market, and well-positioned credit unions will be poised to capture nonorganic growth by utilizing the acquisition market to their strategic advantage.

Have questions about credit union transactions or want to know more about financial considerations? Justin Gingerich can be reached at jgingerich@howardandhoward.com.