



# Merger Mania

Jim Craven

2016 Fall Leadership Development Conference



# McQueen Financial Advisors

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### Investment Advisor

- \$4 Billion + under management
- Municipal & Corporate Credit Reviews
- Comprehensive Reporting

## Valuations

- Credit Union + Bank Mergers
- Mortgage Servicing Rights
- Complex Investments
- Branch Sales

## Consulting

- Strategic Planning
- Branch Analysis
- Board Training
- Policy Development
- Exam Preparation

## Risk Analysis

- Asset Liability Management
- Liquidity Stress Testing
- Core Deposit Studies
- Assumption Sensitivity Analysis
- Prepay Speed Analysis
- ALM Validations
- Back Testing Analysis

# Today's Agenda

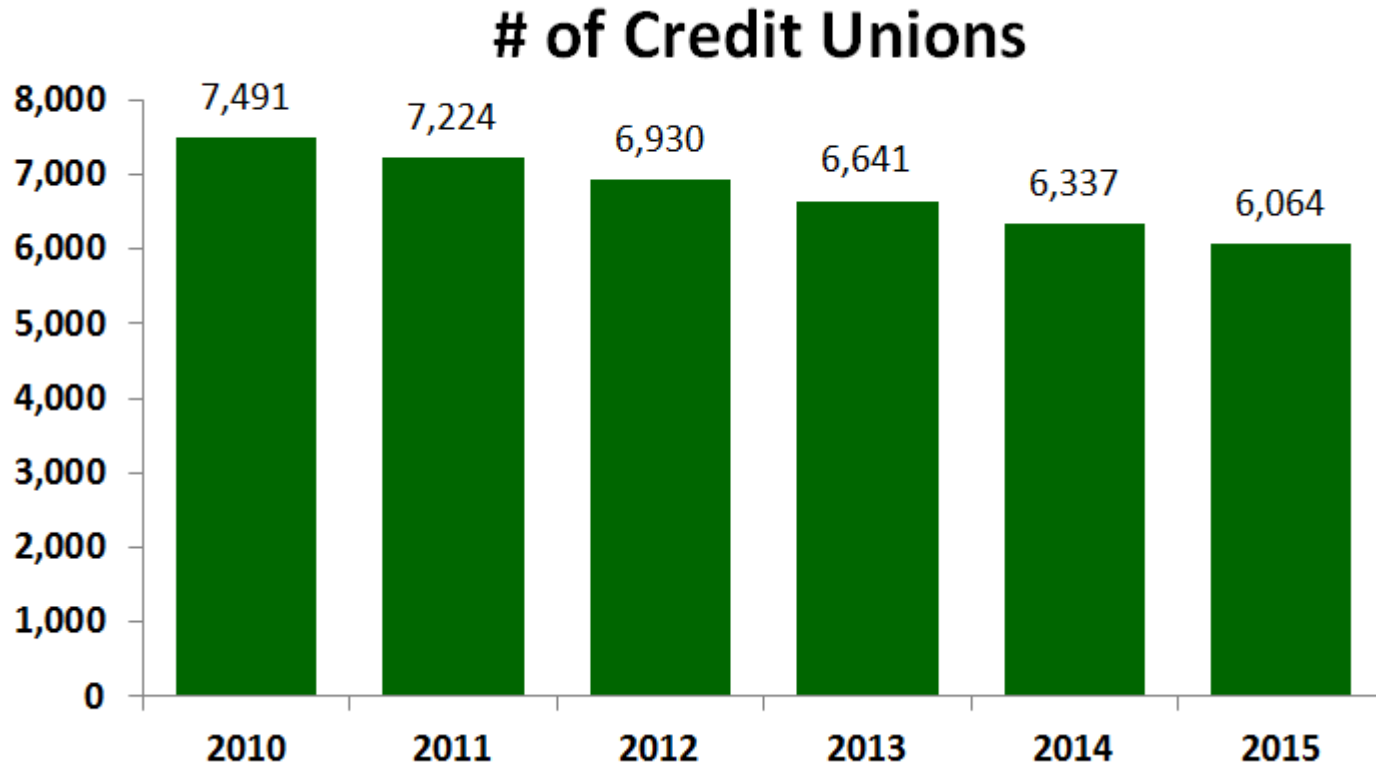
Industry Trends

Merger Terminology

Small Credit Unions Can Survive

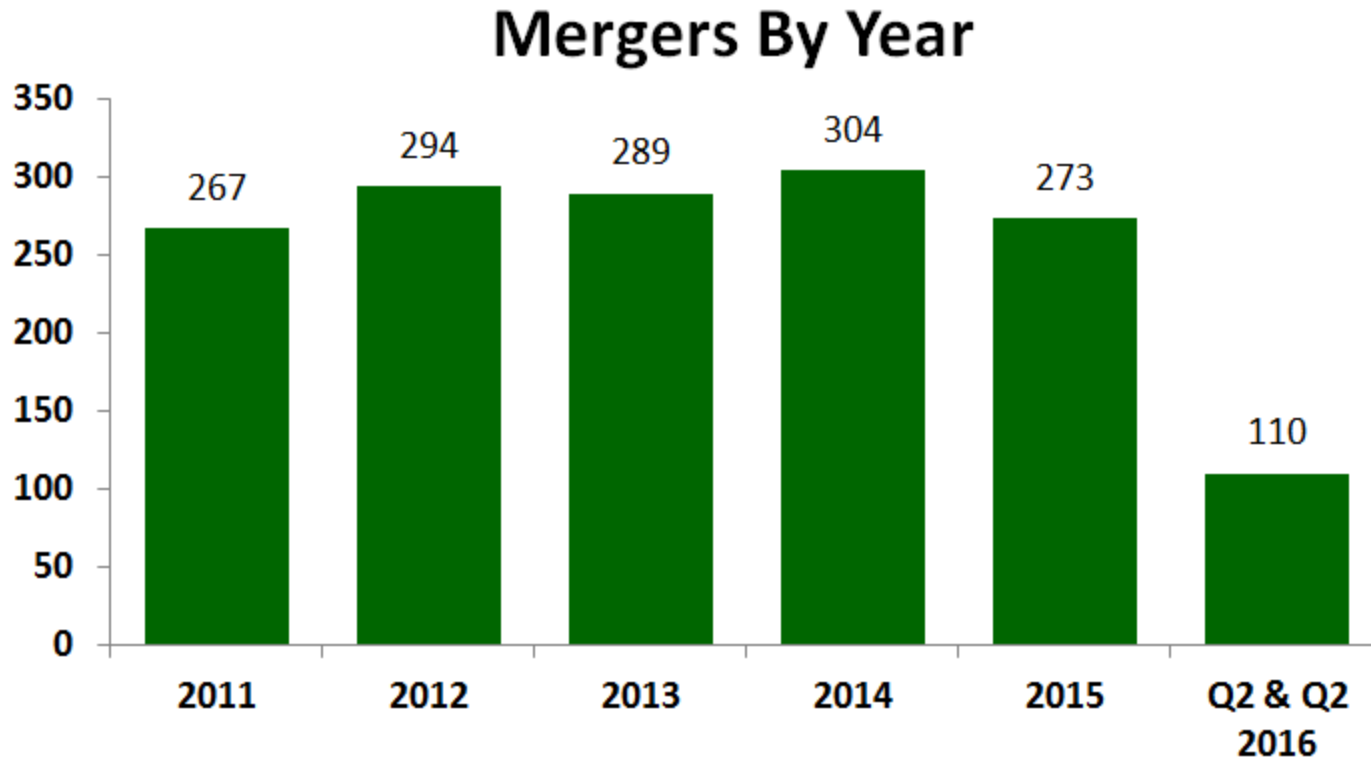
Merger Considerations

# Industry Trends



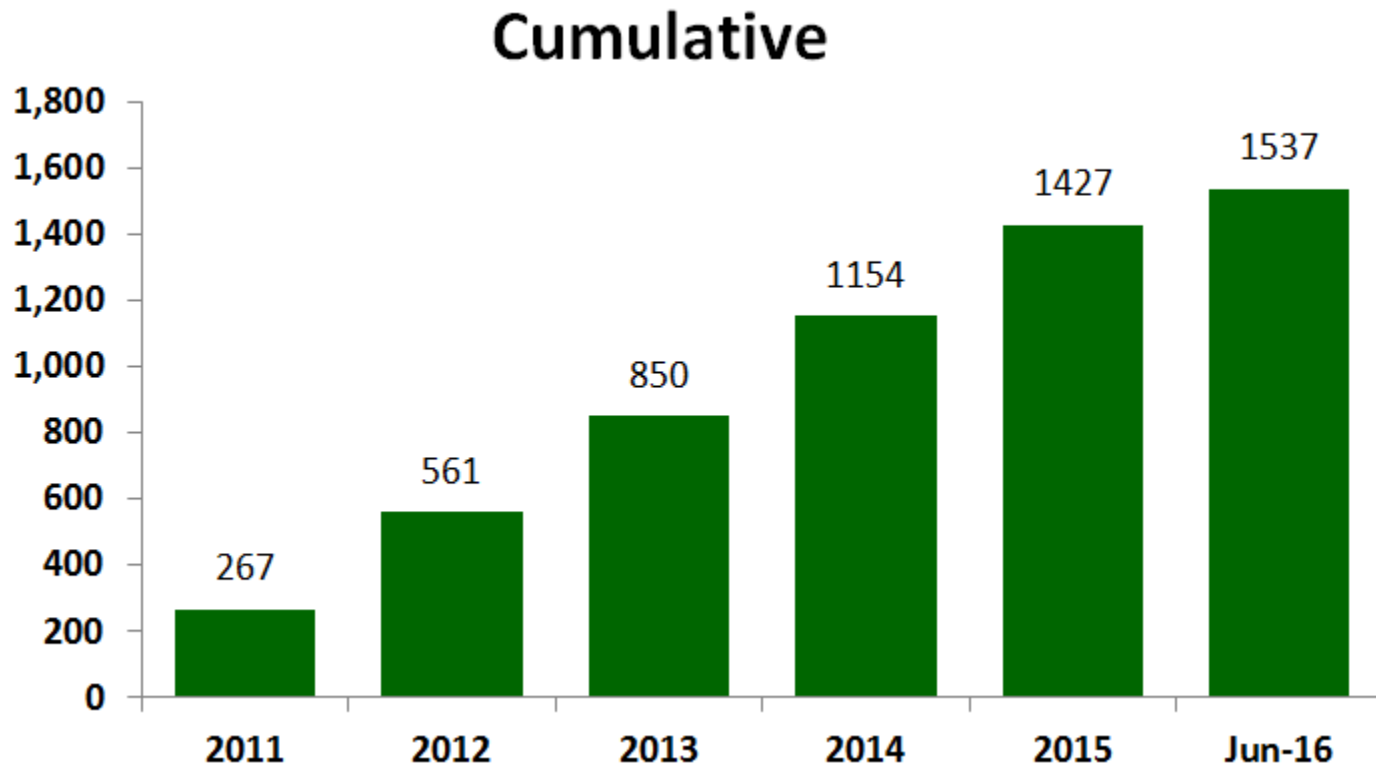
There are nearly 1,500 fewer credit unions now than at the end of 2010

# Industry Trends



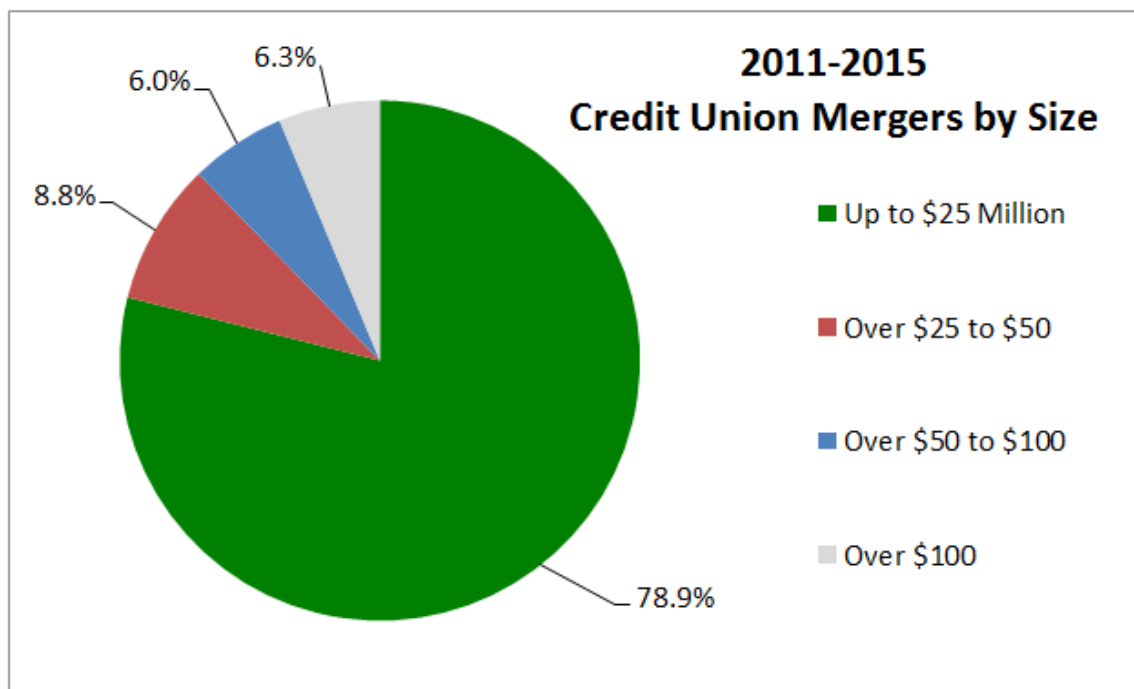
In 2015, Michigan and Illinois posted the highest number of mergers at 18 each.

# Industry Trends



# Industry Trends

Small Credit Unions Much More Likely Merger Targets



Within the past 5 years, nearly 80% of all mergers have been credit unions of \$25 million or less in assets

# Industry Trends

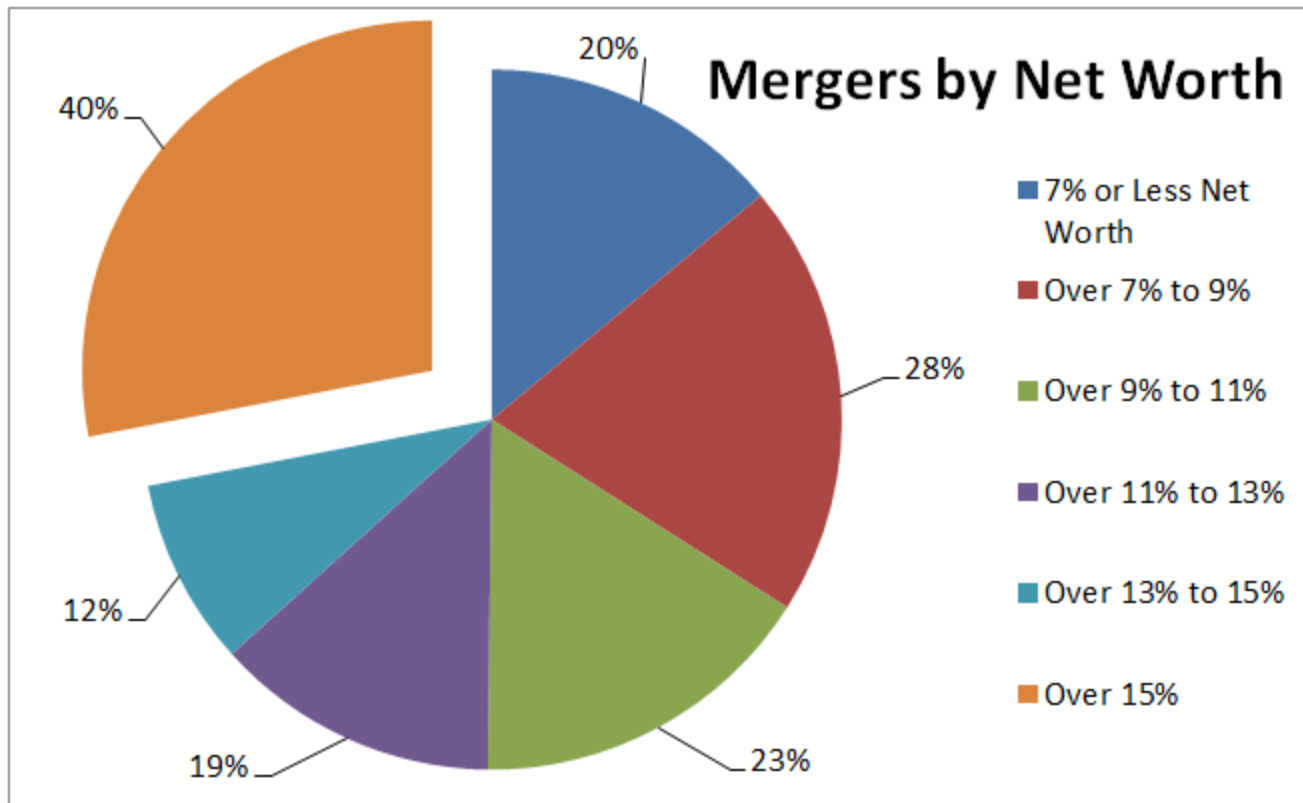
**Other than size, what factors may make a merger more likely?**

We will look at:

- Net Worth
- Delinquent Loans
- Loan to Deposit Ratio
- Location

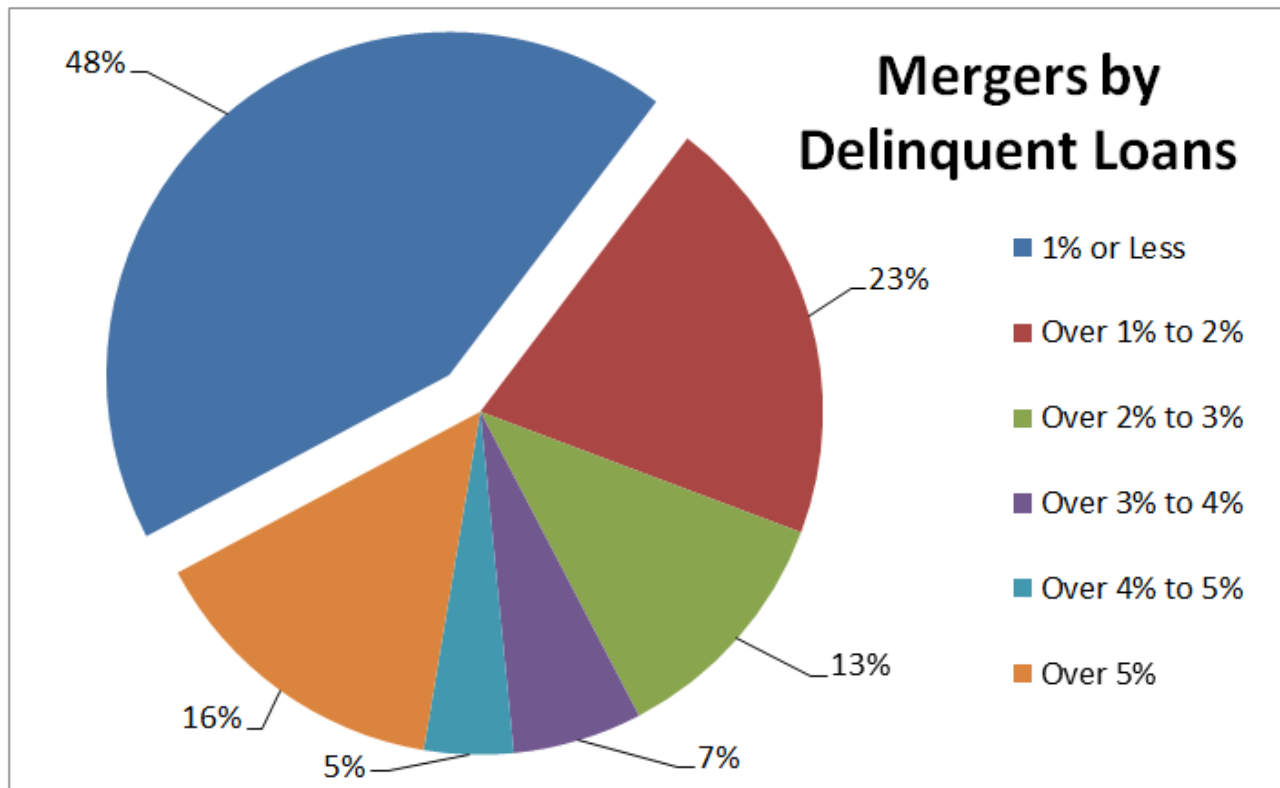


# Industry Trends



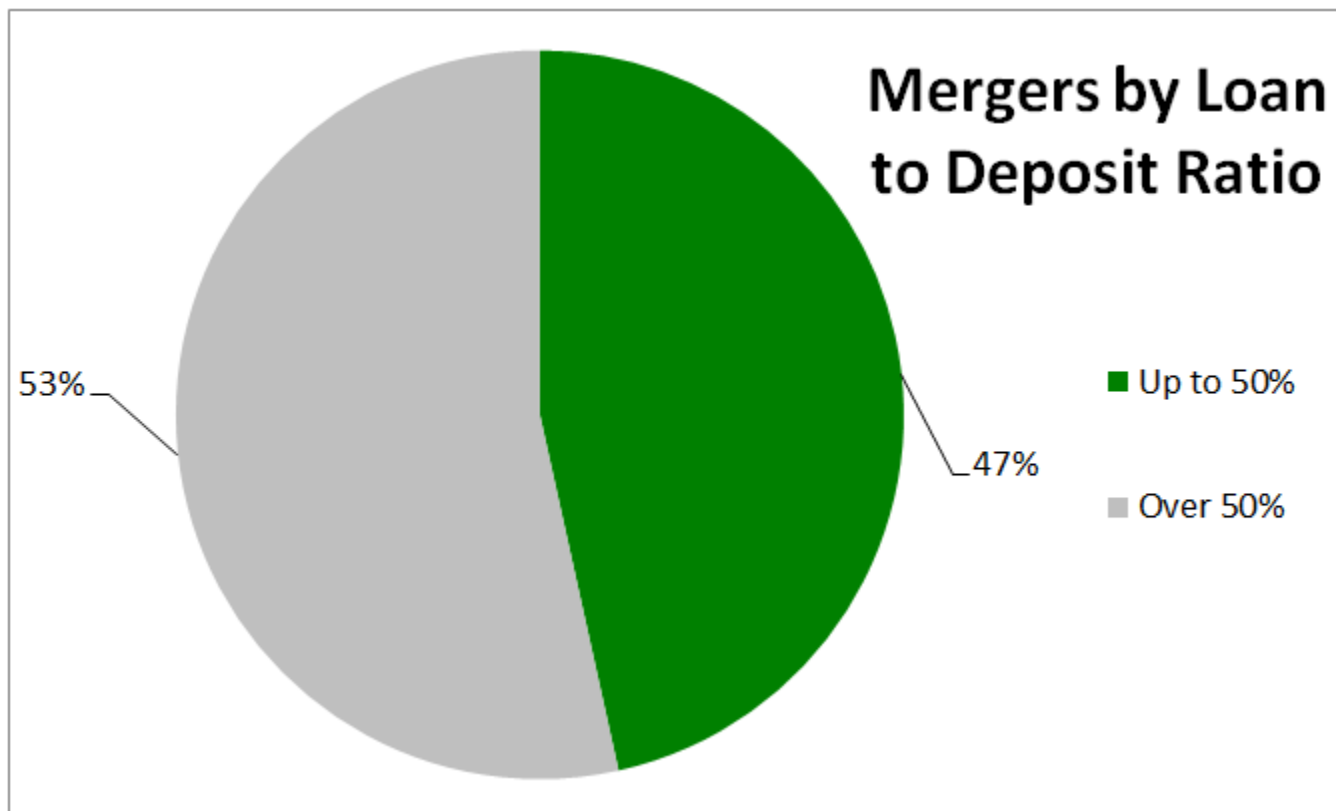
Within the past 5 years, 40% of merged credit unions had net worth of at least 15%

# Industry Trends



Within the past 5 years, 48% of merged credit unions had loan delinquency of 1% or less

# Industry Trends



Within the past 5 years, 53% of merged credit unions had a loan to deposit ratio of 50% or more

# Industry Trends

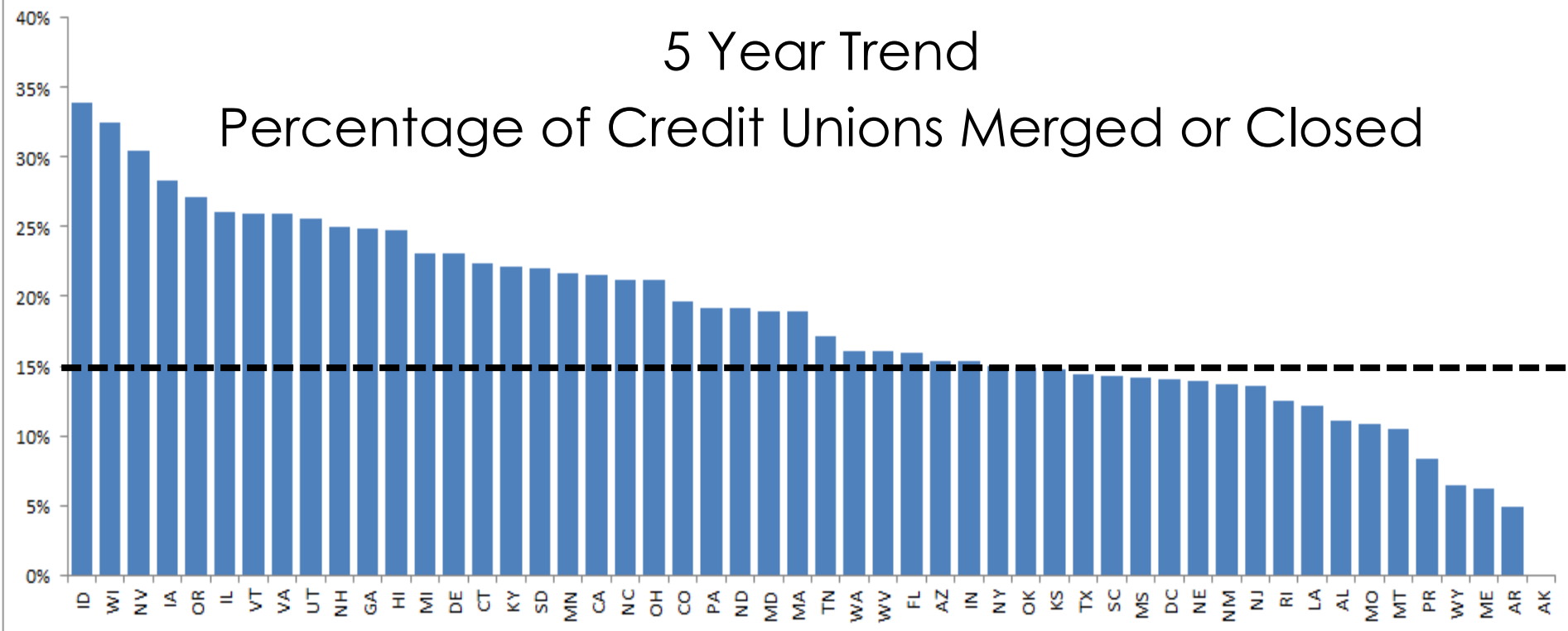
Year	# Closed	Average			
		Assets (Million)	Net Worth	Delinquency	Loans To Deposits
2011	267	38.1	14.3%	2.64%	62.1%
2012	294	21.4	12.5%	3.12%	55.1%
2013	289	54.1	13.3%	2.43%	52.4%
2014	304	42.4	14.1%	2.57%	49.2%
2015	273	57.3	13.5%	2.68%	50.9%

Merger activity is not generally related to low net worth, high delinquency or very low loan to deposit ratios

# Industry Trends

5 Year Trend

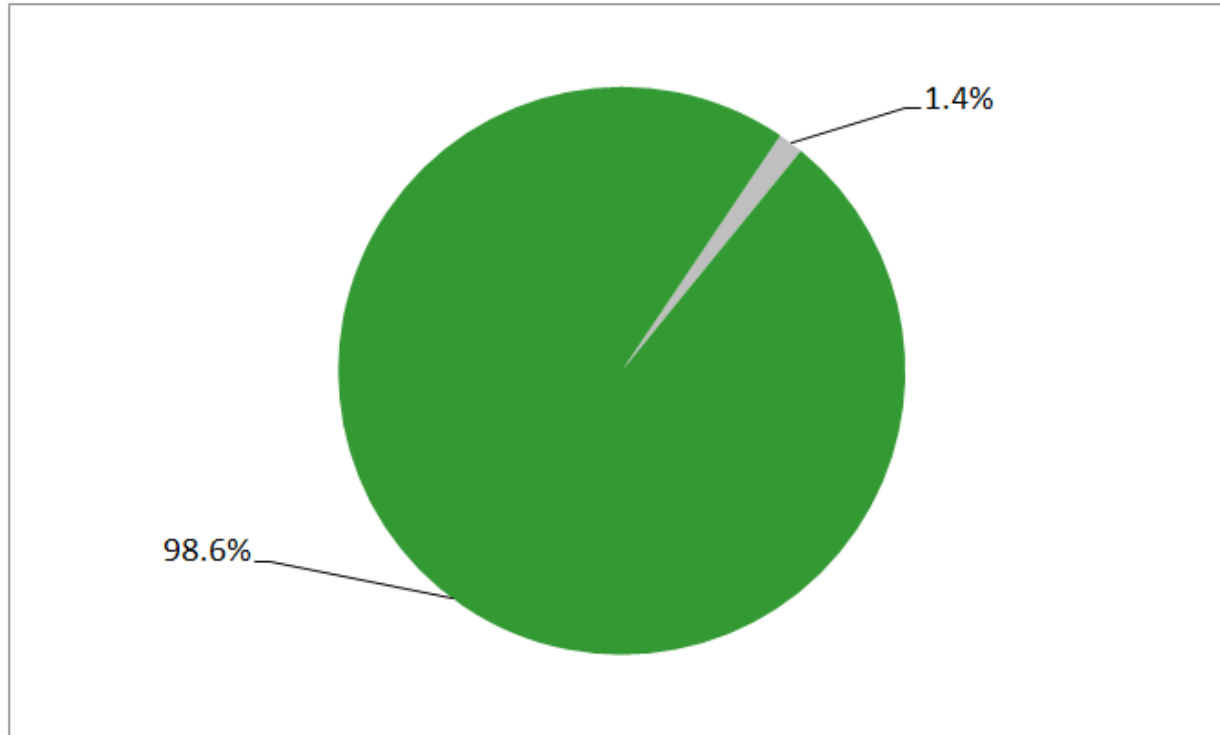
Percentage of Credit Unions Merged or Closed



In over half of US States,  
15% of credit unions have merged or closed

# Industry Trends

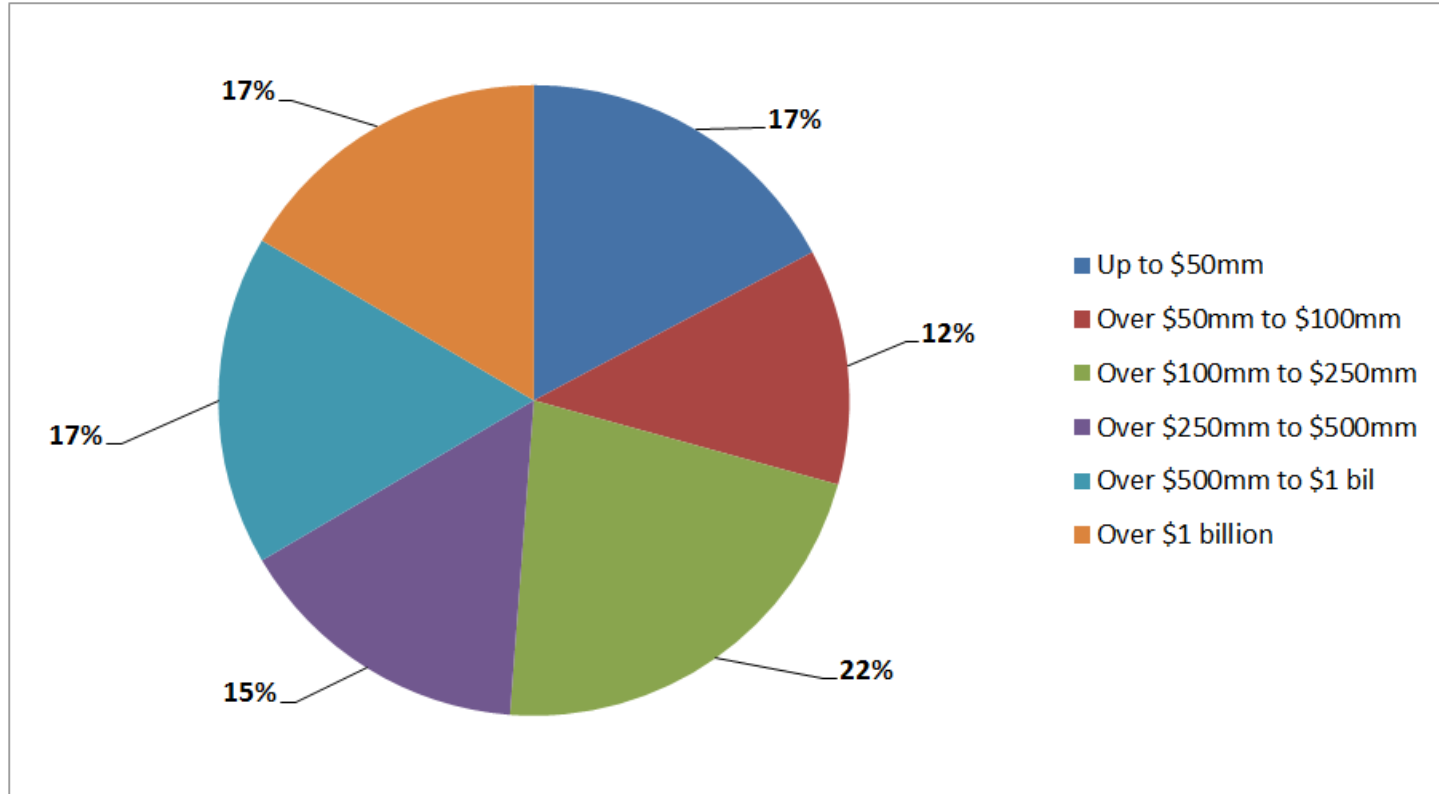
## Merger of Equals?



Within the past 3 years, less than 2% of mergers have been with credit unions of similar size

# Industry Trends

## Pre-Merger Assets of Acquiring Credit Union



Most target credit unions are small  
Many merger partners are also small

# Industry Trends

Common characteristics of merged credit unions

- Target credit unions are primarily small
- Limited growth opportunities
- Aging member base
- Lack of succession plan
- Compliance and other forced costs
- Inactive board
- Attracting and retaining talent



# Merger Terminology

Survivor

Target

Independent

Assisted  
Merger

**These terms are sometimes misunderstood**

# Merger Terminology

## Survivor

When credit unions merge, the one with the surviving charter number is called the survivor. This is not an indication that they have 'acquired' the merger partner (the target).

## Target

The credit union who's charter number will be dissolved post-merger. This is not an indication that they have been 'acquired' by the merger partner (the survivor).

## Independent

A credit union that is neither a survivor or a target. Management and the board wish to remain independent and retain the current business plan.

## Assisted Merger

A failing credit union is merged into a healthy credit union with financial assistance from the NCUA.

**Not part of this presentation**

# Merger Terminology



# Small Credit Unions Can Survive

	Under \$10 million	\$10 million to \$100 million	\$100 million to \$500 million	\$500 million or more
# of Credit Unions	1,755	2,689	1,047	493
Average Assets	\$4.1 million	\$37.5 million	\$220 million	\$1.8 billion
Net Worth %	14.91%	11.74%	10.82%	10.64%
Return on Average Assets	0.05%	0.32%	0.51%	0.87%
Net Interest Margin	3.29%	3.03%	3.03%	2.81%
Fee & Other Income to Average Assets	0.63%	1.09%	1.35%	1.25%
Operating Expenses to Average Assets	3.71%	3.59%	3.62%	2.87%
Loan to Share %	55.5%	58.8%	70.8%	79.6%

Source: NCUA (March 2016)

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Small credit union net worth ratios are generally healthy

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Small credit union returns are generally low

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Small credit union margins are somewhat higher

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Source: NCUA (March 2016)

Small credit union fee income is lower



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Source: NCUA (March 2016)

Small credit union operating income is not significantly higher

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Source: NCUA (March 2016)

Small credit union loan to share ratios are lower

# Small Credit Unions Can Survive

Key elements for growth and independence

- Mortgage Lending
- Auto Loans (Indirect Lending)
- Investment Portfolio
- Fee Income
- Partnerships
- Core Deposits = Fee Income
- Succession Planning
- Branch Strategy

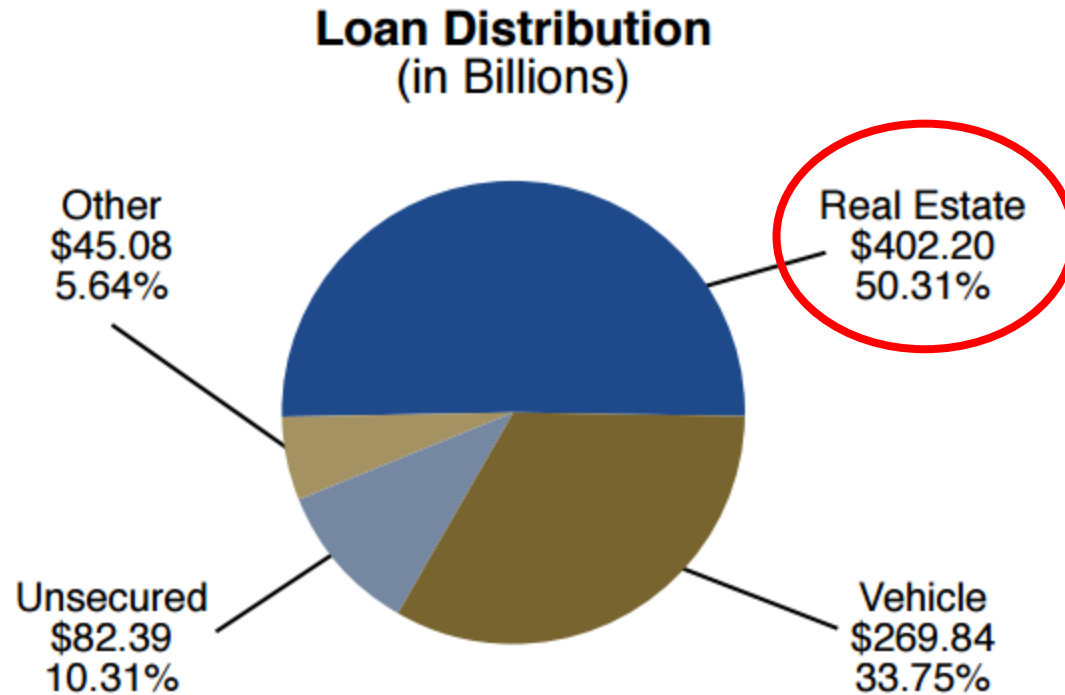
# Small Credit Unions Can Survive



Strategies discussed today are  
**NOT** one-size-fits all

# Small Credit Unions Can Survive

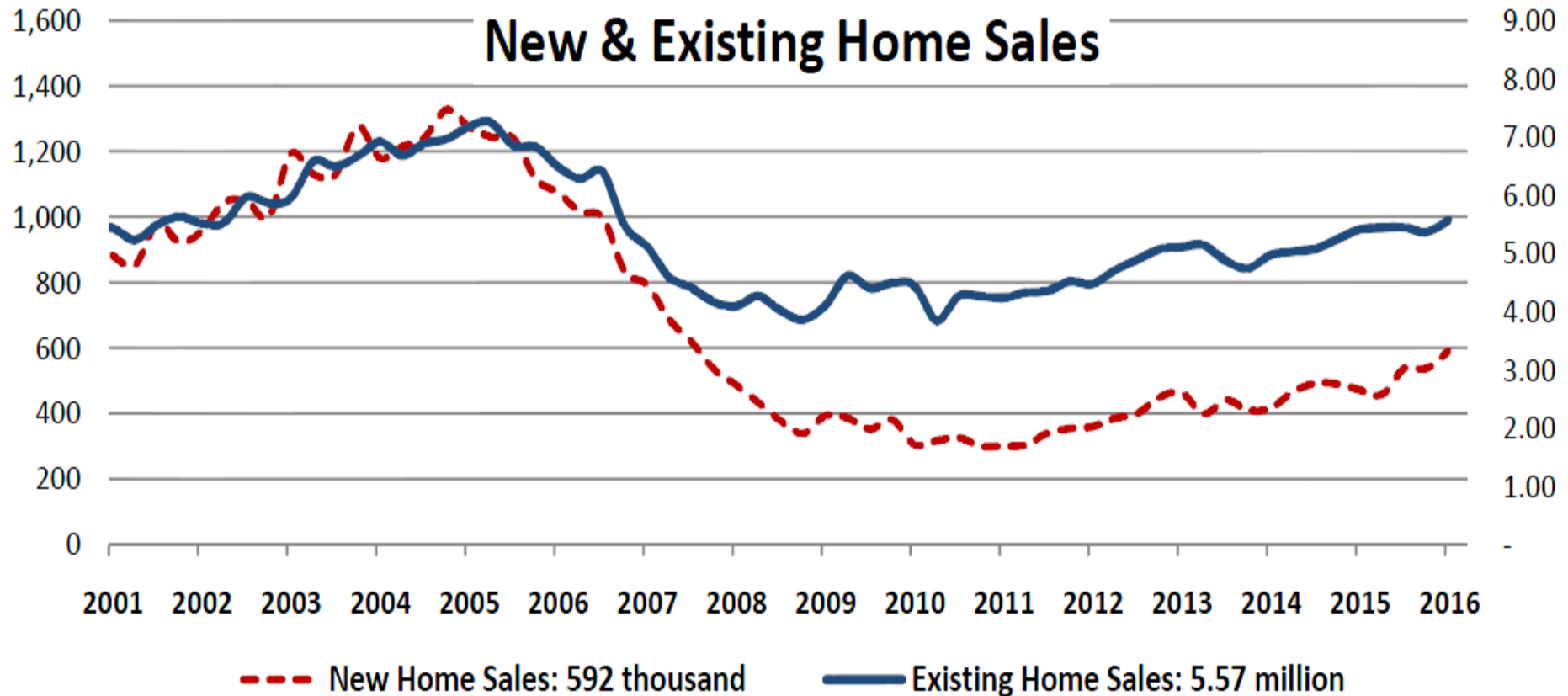
## Mortgage Lending



Real estate loans are 50% of total industry wide lending yet many small credit unions avoid this sector

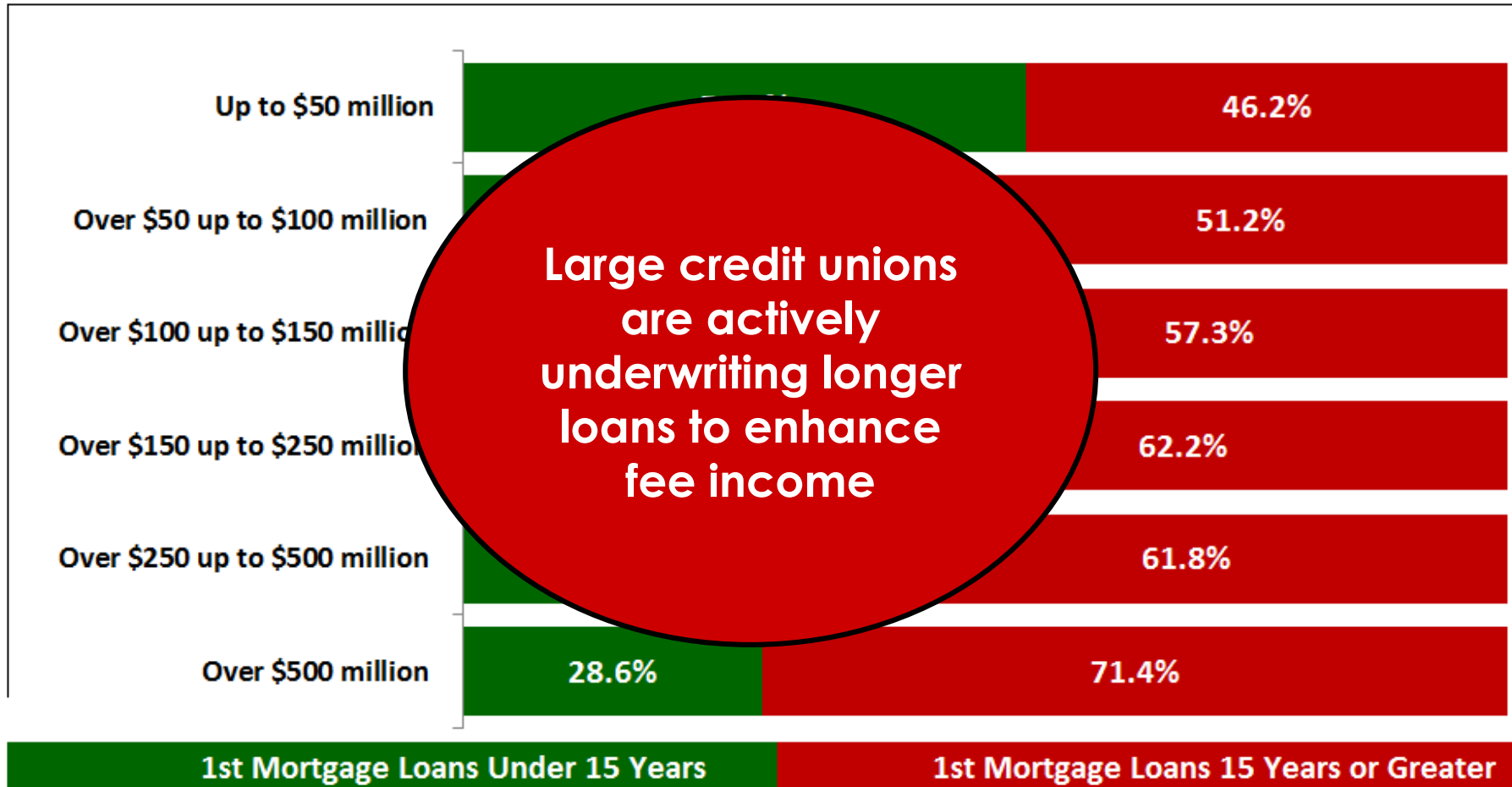
# Small Credit Unions Can Survive

## Mortgage Lending



# Small Credit Unions Can Survive

## Loan Originations by Credit Union Size & Mortgage Term



# Small Credit Unions Can Survive

## Mortgage Lending

**Consider:** Underwrite both long and short real estate loans, then choose which loans to retain (sell long loans)

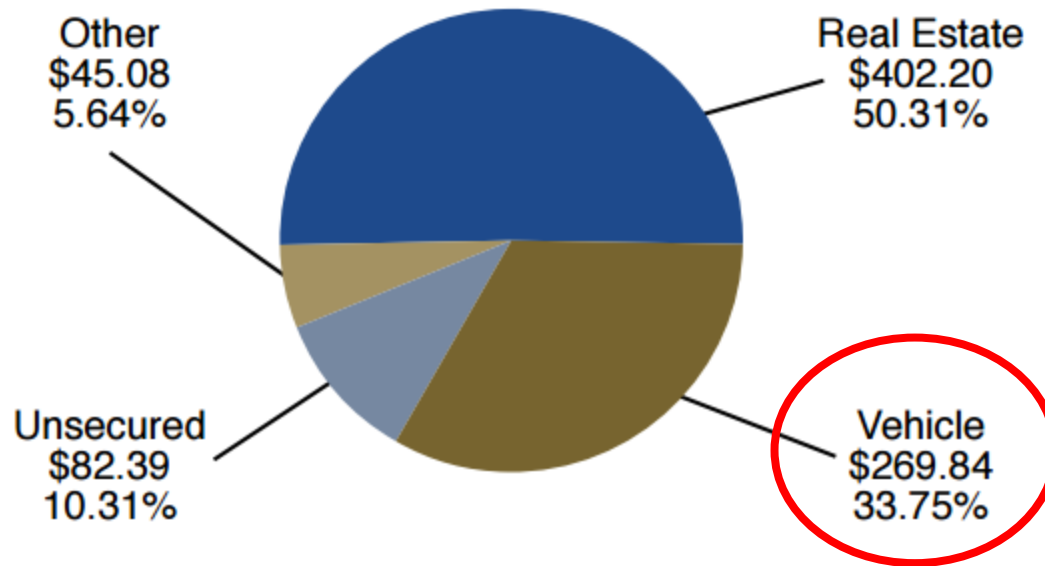
- Additional Fee Income
- Member retention
- Full Service



# Small Credit Unions Can Survive

## Auto Lending

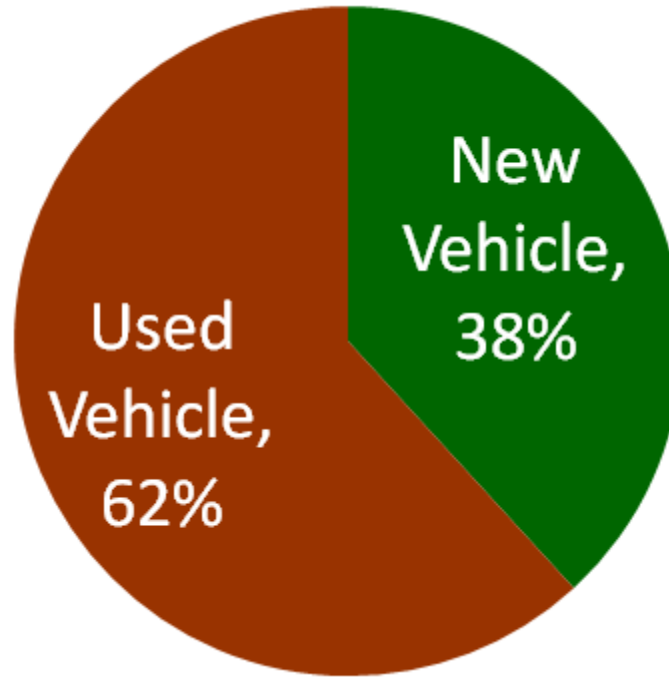
### Loan Distribution (in Billions)



Auto loans are 1/3 of industry wide lending.

# Small Credit Unions Can Survive

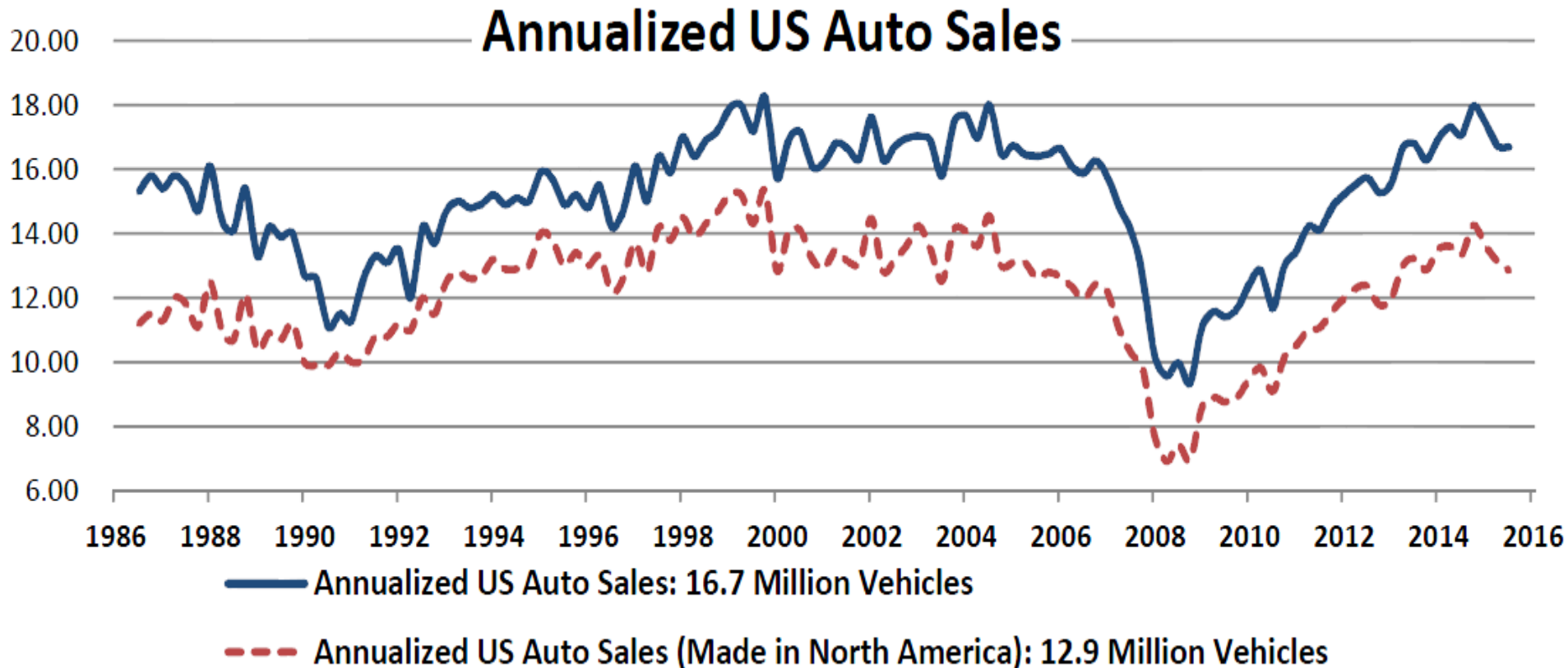
## Auto Lending



Surprising high percentage of industry wide auto loans are new cars

# Small Credit Unions Can Survive

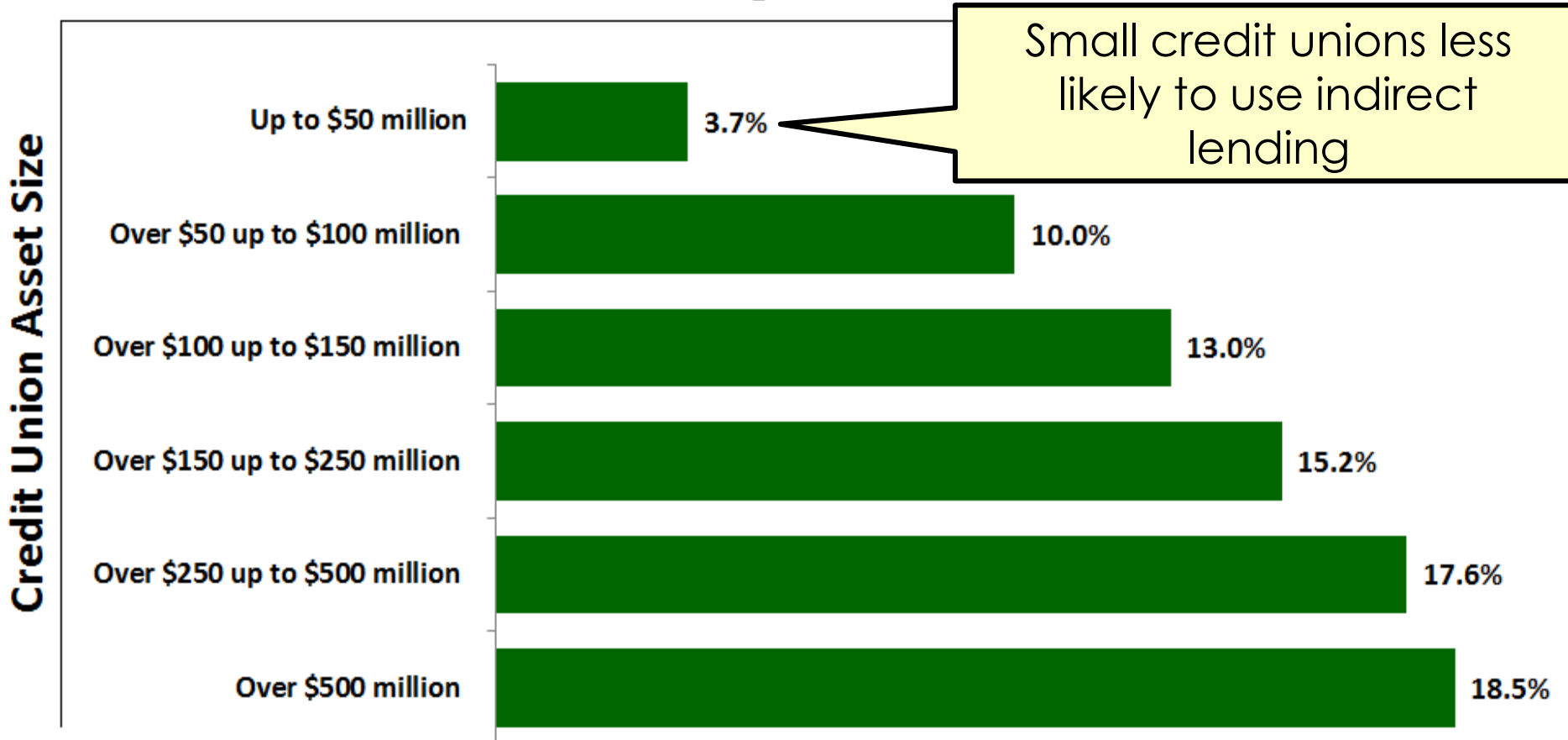
## Auto Lending



# Small Credit Unions Can Survive

## Auto Lending

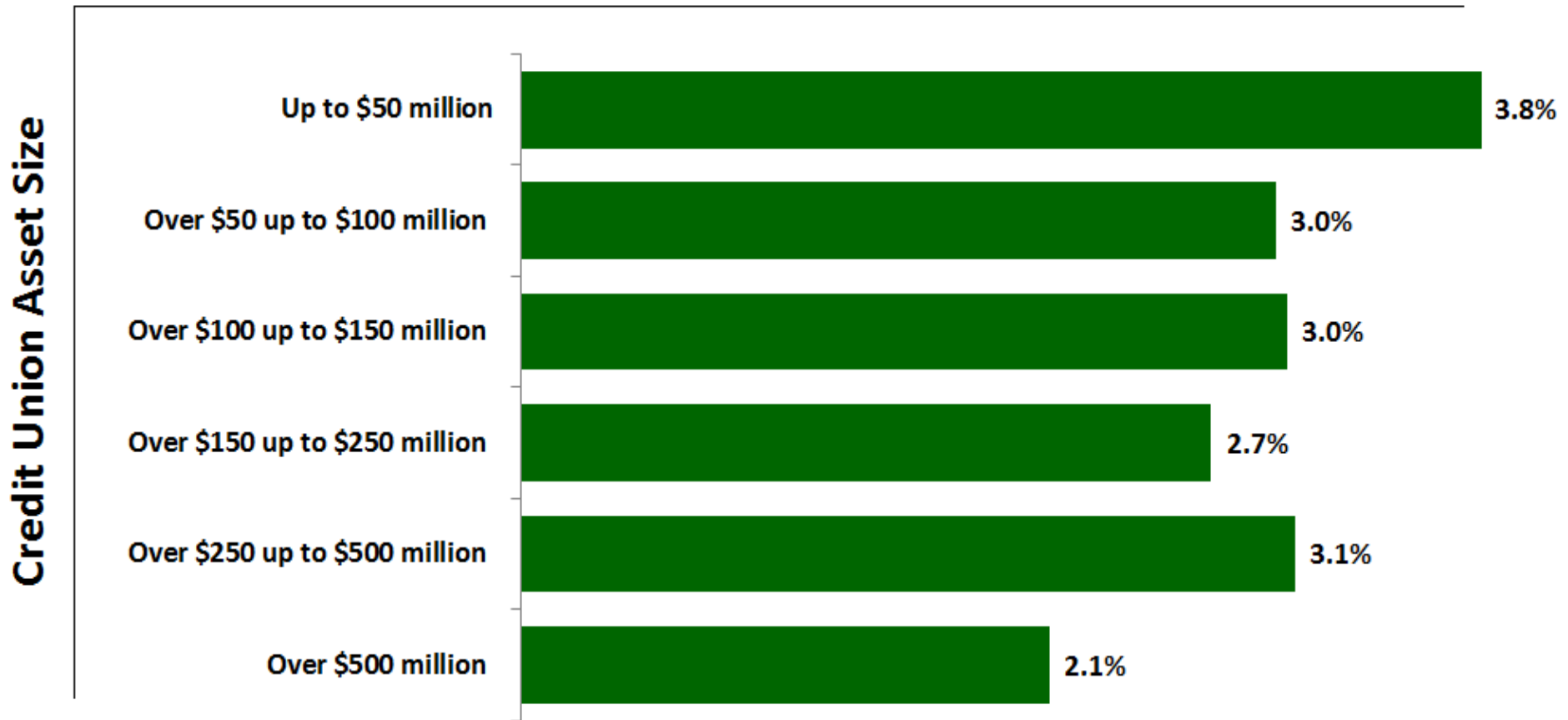
### Indirect Lending as a % of Total Loans



# Small Credit Unions Can Survive

## Auto Lending

### Indirect Loan Total Delinquency



Indirect loan delinquency higher than other loan types and higher at small credit unions

# Small Credit Unions Can Survive

## Investment Portfolio

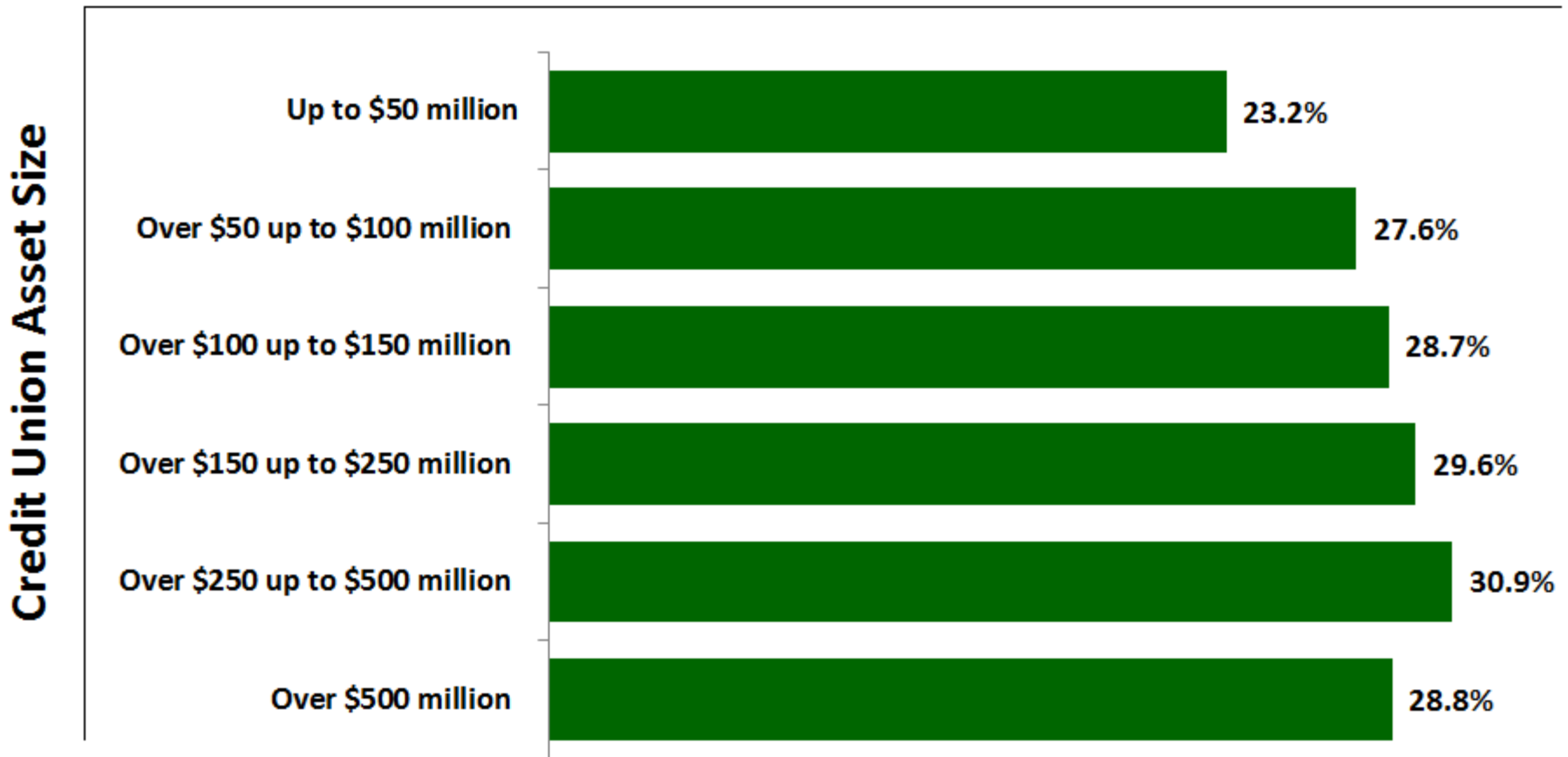
Products (Beyond CDs): To get higher returns, consider:

- US Agency Bonds
- US Agency Mortgage Backed Securities
- Taxable Municipal Bonds
  
- Alternative Portfolios
  - Employee Benefit Plans

# Small Credit Unions Can Survive

## Fee Income

### Fee Income as a % of Total Income



Small credit unions derive a smaller % of total income from fees

# Small Credit Unions Can Survive

## Partnerships

### Examples:

- Mortgage CUSO for real estate underwriting and loan sales
- Business Lending CUSO
- Investment Advisory Services
- Indirect Lending: it has been our experience that in-house lenders are more effective than outsourced

Investigate partnerships to expand lending and boost investment yields



# Small Credit Unions Can Survive

## Attract & Retain Core Deposits

- Shares, Drafts, Savings (Not Money Market)
- Inexpensive source of stable funds for lending, investment and fee income
- Members generally do not withdraw funds based on interest rates
- Opportunity for cross-selling and relationship building
- Will be more important when rates rise

# Small Credit Unions Can Survive

## Core Deposits



**GET UP TO \$300**

when you open and use a new



start with a...  
**\$200 bonus**

when you open a Fifth Third Essential Checking®

Large banks are aggressively seeking new accounts and fee income that follows



**Get up to \$25**

with a new Chase checking and savings account

Huntington



**Get \$200**

Open a qualifying checking account

# Small Credit Unions Can Survive

## Succession Planning: Field Experience

- Small credit union image as a potential employer
- Employees groomed to take over may leave early
- Train the best, keep the rest
- Steep learning curve – don't underestimate the time required to train key employees
- Understand that it may be expensive
- Be a mentor
- Choose wisely- 61 year old CFO training a 58 year old replacement

# Small Credit Unions Can Survive

## Branch Strategy

- Measure Branch Profitability
- Consider Local Retail Patterns
- Drive-Up ATMs vs Full Service Drive Through
- Loan Production Office
- Consider Branch Size
- Dedicated Loan Specialists – no office!
- Remodel for a fresh look
- Logo wear for everyone!

# Small Credit Unions Can Survive

## Characteristics of Independent Credit Unions

- Seek growth opportunities
- Progressive management & board
- Fee Income
- Not the highest rates in town
- Lending focus
- Technology driven
- Well structured succession plans
- Long term strategic focus
- Cohesive branch strategy
- Engages advisors and product specialists

# Merger Considerations

If a merger becomes reality...

**CONSOLIDATION TECHNOLOGY**  
**MEMBER OVERLAP COMMON GOALS**  
**AGING MEMBERSHIP SUCCESSION PLAN**  
**EMPLOYMENT TRENDS MEMBERSHIP VOTE**  
**LEGAL BOARD LOAN GROWTH TRENDS ACCOUNTING**  
**MEMBER CREDIT QUALITY ECONOMIES OF SCALE TRUST**  
**NET WORTH TREND** **STRATEGIC PLAN**  
**CONFIDENTIALITY AGREEMENT**  
**COMMUNITY PARTNERSHIPS INDIVIDUAL EMPLOYEES**  
**MEMBERSHIP OVERLAP KEY MANAGEMENT ROLES**  
**BUDGET FIELD OF MEMBERSHIP BRANCH PROXIMITY**  
**PHILOSOPHY MERGER AGREEMENTS WEBSITE**  
**EMPLOYEE RETENTION HOUSING ACTIVITY BYLAWS**  
**COST SAVINGS MISSION STATEMENT**  
**RETAINED IDENTITY MEMBER INCOME**  
**LOCAL ECONOMY CHARTER UPDATE**  
**GOVERNANCE DEPOSIT COSTS**  
**BRANCH AGE**

# Merger Considerations

If a merger becomes reality

- Establish a Clear Purpose & Goals
- Consider Risk Profile of Combined Balance Sheet
- Seek a Good Fit
  - Culture
  - Operations
  - People
- Identify Key Employees
- Over-Communicate
- Engage Members As Soon As Possible
- Seek Outside Consultants / Expertise

# Alternative Merger Concept

## Network Merger Model

- Merges several small credit unions under one large 'network' credit union: alternative to all-or-nothing
- Identity is retained
- Common back office systems are shared
- Small credit unions get the advantage of greater scale
- Operating costs spread over network of partners
- Local brand identities are retained
- Board of Directors becomes an advisory committee



# Summary

## Merger Mania

- The industry continues to face large consolidation
- Small credit unions can survive
- Key drivers of independence:
  - ✓ Loan growth
  - ✓ Investment portfolio strategy
  - ✓ Fee income
  - ✓ Succession planning
  - ✓ Strategic decision making
- If a merger becomes reality:
  - ✓ Consider carefully
  - ✓ Communicate
  - ✓ Engage outside expertise

# Questions



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