



# TRUTH IN MERGERS:

## A Guide for Merging Credit Unions

**NATIONAL CREDIT UNION ADMINISTRATION**

Trends in Credit Union  
Mergers

Benefits: When is a  
merger in the credit  
union's best interest?

Warning Signs: When is  
a merger necessary?

Best Practices for  
Merging Credit Unions

NCUA Resources

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# Preface

This brochure has been prepared by NCUA's Office of Small Credit Union Initiatives (OSCU) as a resource to help credit unions:

- Understand trends in credit union mergers.
- Determine when a merger is in their best interest or, in the worst case, necessary to continue operations.
- Negotiate a merger agreement that best serves the merging credit union's interests.

NCUA's *Credit Union Merger and Conversion Manual* provides detailed information about how to conduct a merger once that course of action has been decided upon. The manual is available at <http://go.usa.gov/k54A>.

# Overview

Mergers between credit unions are commonplace in the industry today. Like any business or financial institution, credit unions can merge as part of a business growth strategy and can consider mergers or merger partners as part of an ongoing strategic planning process. And like all businesses and institutions, mergers can be successful or unsuccessful.

## Voluntary Mergers

The vast majority of mergers are initiated and approved by a credit union's board and membership. Only 9 percent of mergers that occurred between January 1, 2012 and June 30, 2013 involved NCUA as a conservator or liquidator.

Typically, a merger between credit unions is structured as follows: Credit Union A assumes the assets (loans, investments, equipment, buildings, etc.) and liabilities (shares, payables, etc.) of Credit Union B. Credit Union A is the credit union that will continue after the merger (the "continuing" credit union); Credit Union B (the "merging" credit union) is merged into Credit Union A and will not exist after the merger. The charter of the continuing credit union is amended to include the groups formerly served by the merging credit union.

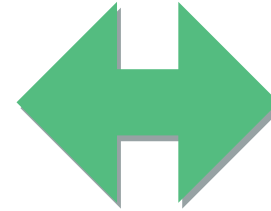
Credit unions in sound financial condition are in a better position to engage in a merger that has positive outcomes. NCUA does not endorse mergers, but agency studies have shown that mergers undertaken proactively by credit unions in sound financial condition have better outcomes for the credit unions involved and their members.

## A Merger Between Two Credit Unions

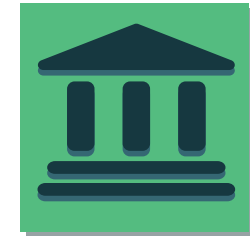
### 1 Finding a Partner

Using professional contacts and NCUA resources, credit unions identify potential merger partners

Credit Union A  
("surviving" credit union)



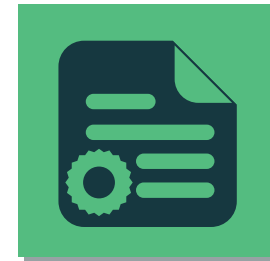
Credit Union B  
("merging" credit union)



### 2 Negotiating the Contract

Merging credit unions may want to negotiate such issues as:

- Maintaining branches, ATMs, and other services to members
- Retaining staff or providing bonuses or severance
- Obtaining board or committee seats for merging credit union's officials
- Issuing a bonus dividend or rebate



### 3 Finalizing the Transaction

NCUA will consider the merger proposal, focusing on the credit unions':\*

- Charter types (federal, state, uninsured)
- Fields of membership (single SEG, multiple SEG, community)
- Number of primary potential members
- Financial condition

If the proposal is approved, the merging credit union may need to hold a membership vote.

The "Surviving" Credit Union A



\* Situation-specific requirements and forms can be found in NCUA's [Credit Union Merger and Conversion Manual](#).

## Involuntary Mergers

*Part 702.203(b)(12) of NCUA's Rules and Regulations states that agency can require a "Significantly Undercapitalized" credit union—a credit union whose net worth ratio has fallen below 4% of total assets—to merge with another financial institution.*

Oftentimes, however, a credit union may wait until it is in a financially vulnerable position or, in a worst case scenario, it is directed by NCUA to explore merger options.

Under NCUA Rules and Regulations, the agency has the authority to conserve, liquidate, or take other action against an undercapitalized credit union; that is, a credit union whose net worth has fallen below acceptable levels.

These authorities and actions are illustrated in the table on page 5.

## Status of Capital and Resulting NCUA Action

Credit Union Capital	Net Worth	Action Triggered	
		Mandatory	Discretionary
Well capitalized	7% or higher		
Adequately capitalized	6–6.99%	Earnings retention required (for example, increase dollar amount of net worth by 0.1% of total assets and transfer from undivided earnings to regular reserve account until the credit union is well capitalized)	
Undercapitalized	4–5.99%		
Significantly undercapitalized	2–3.99%	<ul style="list-style-type: none"> <li>– Conservatorship</li> <li>– Liquidation</li> <li>– Other corrective action</li> </ul>	<p style="text-align: center;">Net Worth Restoration Plan</p> <ul style="list-style-type: none"> <li>– Restrictions on approvals for acquisitions, branching, new lines of business; transactions/ ownership of CUSOs; dividends</li> <li>– Prohibit asset growth, nonmember deposits</li> <li>– Alter, reduce, or terminate an activity</li> <li>– Dismiss director or senior executive officer</li> <li>– Employ qualified senior executive officer</li> <li>– Restrict senior executive officers' compensation (under 5%)</li> <li>– Forced merger (under 4%)</li> </ul>
Critically undercapitalized	Less than 2%		

# Trends in Credit Union Mergers

Between 2003 and 2012, there were 2,462 credit union mergers. During this period, the total number of credit unions declined from 9,369 to 6,812, or 27 percent. In other words, over a nine-year period, a credit union merger occurred approximately every 1.5 days, which underscores how commonplace these transactions are.

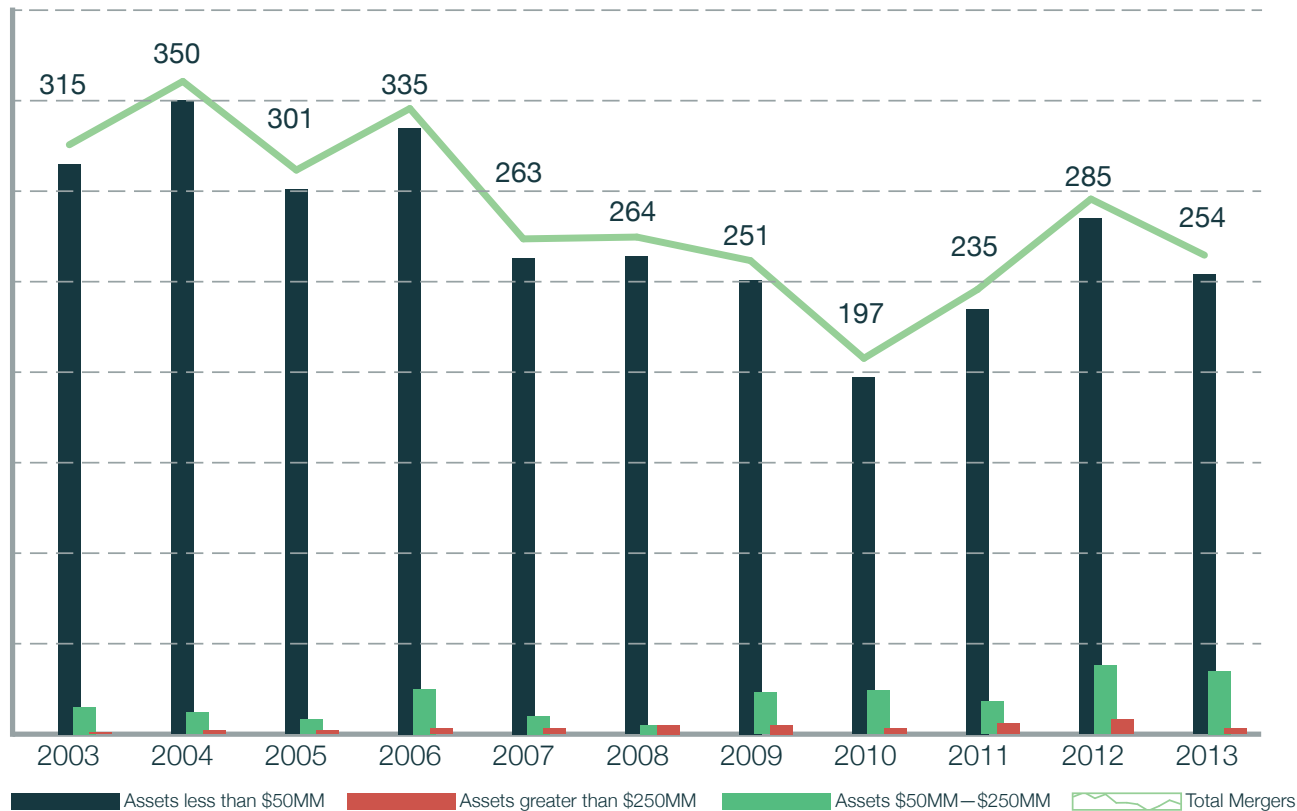
As part of our review of credit union mergers, OSCUI looked at existing research, as well as:

- Financial characteristics for the 476 credit unions that ceased to exist for any reason—merger, purchase and assumption, or liquidation—between January 1, 2012 and June 30, 2013. A vast majority of these credit unions (438) ceased to exist as the result of a merger with another credit union.
- A random sample of recent merger packages from each region. Ten packages were selected from each region for merging credit unions with assets below \$50 million.



## Hundreds of Credit Union Mergers Occur Every Year

Mergers between credit unions are fairly common, with around 200 of these transactions occurring each year since 2003. As demonstrated below, most mergers involve credit unions with assets less than \$50 million.



## Findings

Our analysis produced the following findings:

### Merging Credit Unions Exhibit Certain Negative Financial Characteristics

As stated previously, many credit unions wait until they are in a troubled financial position before exploring the option to merge. Not surprisingly, these merging credit unions exhibit the following negative characteristics:

1. **Declining Membership** — 47 percent of merging credit unions had negative member growth for three consecutive years prior to failure.
2. **Prompt Corrective Action (PCA)** — 26 percent of merging credit unions were in PCA sometime during the 3-4 years prior to failure. Existing OSCUI research shows that only 33 percent of small credit unions recover from PCA within four years.
3. **Negative Earnings** — 54 percent of merging credit unions had negative return on average assets (ROAA) for three consecutive years prior to failure.
4. **Declining Net Worth** — 53 percent of merging credit unions had declining net worth ratios for three consecutive years prior to failure.
5. **Weak CAMEL Ratings** — 47 percent of merging credit unions had a composite CAMEL rating of 4, or three consecutive years with a composite rating of 3, prior to failure. None were rated a CAMEL 5.

## Weak Financial Condition Drives Most Credit Union Mergers

Most of the merger packages included in our sample cited multiple reasons for the merger. Based on our review, we determined primary and secondary reasons for each merger and the frequency of occurrence of each reason.

### Primary and Secondary Reasons for Credit Union Mergers (percent)

Reason	Primary	Secondary	Either
Weak financial condition	56	28	74
Increase services	20	38	44
Poor management succession planning	18	22	32
Field of membership disruption	6	9	12
Recordkeeping problems	–	3	2

# Benefits: When is a Merger in the Credit Union's Best Interest?

There can be significant benefits to a merger between credit unions. From a management perspective, a merger can:

- Improve a credit union's financial condition
- Help a credit union expand or improve the services it offers to members
- Expand a credit union's field of membership
- Ensure a succession plan

A merger can also provide direct benefits to credit union members, including lower cost of services, lower loan rates, and higher dividends. These benefits are significant, immediate, and persistent.

OSCU's study of a random sample of merger packages found that 68 percent included negotiated items. Negotiating the terms of the merger contract is one way a merging credit union can realize the greatest benefits of the transaction.

### Negotiated Merger Items

Negotiated item	Percent of merger packages
Maintain merging credit union's branch(es)*	46
Maintain merging credit union's staff	36
Bonus dividend or interest rebate	24
Obtain board seat(s) for merging credit union officials	14
Employee bonuses or severance	8
Obtain Supervisory Committee seat(s) for merging credit union officials	6
Employee contract buyout	4
Other	2

*\* This item is the most commonly negotiated item, but is frequently negotiated for the benefit of the surviving credit union. If this item is excluded as a negotiated item, the overall percentage of mergers with negotiated items falls to 44 percent.*

## Maximizing the Benefits: Negotiating Terms

OSCUI's study of merger packages also demonstrated a clear link between a merging credit union's financial strength and its ability to negotiate advantageously with the continuing credit union.

### Characteristics of Credit Unions with Negotiated Items\*

Financial indicators	Credit union mergers	
	with negotiated items	without negotiated items
Average CAMEL rating	2.71	3.38
Average Net Worth Ratio	14.74%	10.74%
In PCA	9%	29%
Average ROAA	-0.62%	-2.88%
With negative ROAA	77%	71%
Under administrative action	23%	54%

\* Excludes "maintaining the merging credit union's branch(es)" as a negotiated item.

# Warning Signs: When is a Merger Necessary?

Credit unions in good financial standing may pursue mergers as a business strategy. **However, under less ideal circumstances, a credit union may find that a merger is the only alternative that will ensure continued service for its members.**

Financially troubled credit unions have several disadvantages at this point:

- There are fewer potential partners willing to merge with a troubled credit union.
- The financially troubled credit union that does find a merger partner has less standing to negotiate terms of the merger agreement that could benefit the credit union's members, staff, and officials.
- Time pressure. Management may make poor decisions or their options may be limited if they wait until a merger deadline is imposed by NCUA.

Certain scenarios or conditions signal that a credit union's viability may be at risk. If any of the scenarios below sound familiar, it may be in the best interest of the credit union, its members, and its staff to explore merger options and to do so quickly.

Visit NCUA's website at <http://go.usa.gov/k5Zx> to access the Credit Union Merger Manual and other resources to assist in conducting a merger.

1. The credit union's membership is shrinking because it cannot provide desired services, or services on competitive terms, and the credit union's financial condition will not permit improvement.
2. The credit union is not serving a unique niche via services, convenience, price, among others. Competing credit unions provide needed services better.
3. The credit union's financial condition is deteriorating, as evidenced by:
  - CAMEL 4 or lower, or long-term CAMEL 3
  - Consistently negative earnings
  - Consistently declining net worth
  - PCA
  - Administrative action
  - Repeat Document of Resolution (DOR) items
4. The credit union does not have a realistic plan to address any of the problems listed above.
5. Key credit union officials or employees are nearing the end of their careers and no viable options for replacement exist.

In the course of an examination, contact, or consultation, NCUA may recommend that a credit union consider a strategic merger if any of the circumstances noted above apply.



# Best Practices for Merging Credit Unions

Based on the results of our study into credit union mergers, OSCUI has developed the following set of best practices to serve as a guide for the merging credit union.

**Identify potential merger partners.** Through existing professional networks. Credit unions are also encouraged to use NCUA's Merger Partner Registry to identify potential merger partners.

**Shop around for the best fit.** A merger is attractive for the continuing credit union because it can grow assets, net worth, and market share simultaneously. There is no other practical way for the continuing credit union to do this. To capitalize on this need, merging credit unions should seek out and evaluate multiple potential partners and critically evaluate major issues, such as:

- Organizational cultures
- Mission statements
- Respective memberships (Do they complement each other in terms of their saving and borrowing habits and other demographic issues?)

Visit CU Online at [www.ncua.gov](http://www.ncua.gov) to access the Merger Partner Registry.

- Products (Is the surviving credit union's product line superior?)
- How will the merger impact the merging credit union's "free" products, such as life savings or loan protection insurance, etc.?
- How will the merger impact the merging credit union's:
  - Branch locations
  - Hours
  - Staffing
  - Products and services
  - ATM network
  - Electronic access
- Financial health of the continuing credit union. Regulators may not approve a merger where the continuing credit union is in financial distress—low net worth, low CAMEL ratings, etc. Therefore, it may be a waste of time to consider partners in weak financial condition.
- Are the surviving and merging credit unions' information technology systems compatible?
- What is the partner willing to negotiate?
- Does the partner have prior experience with mergers?

**Consider regulatory waivers.** General waivers for a merging credit union do not transfer over to the continuing credit union.

For merging credit unions that have a waiver on a particular loan or member (such as personal guarantee), NCUA would not require the continuing credit union to apply for a waiver on that individual loan or member. Also, NCUA would not require the continuing or acquiring credit union to obtain a waiver on individual loans granted under a blanket waiver by the merging credit union.

Therefore, the continuing credit union should have the ability to handle any increased assets and other issues resulting from regulatory waivers approved for the merging credit union.

**Include a merger in the strategic planning process.** Mergers are commonplace within the credit union industry; therefore, credit unions are encouraged to consider the impact of a merger as part of the strategic planning process. Proactive measures include the following:

- Develop a succession plan for executives and board members. Decide what happens when your CEO retires. Avoid letting the board and the CEO grow old together.
- Don't wait too long to initiate a merger. The better the credit union's financial condition, the more negotiating leverage it has.
- Realistically evaluate the potential of your membership base.
- Discuss how the prospect of a merger or acquisition fits into your growth objectives.
- If merger is a possibility, avoid vendor contracts with excessive termination fees.
- Identify deal-breakers, or issues that would "make or break" continuing independently versus merging, such as services, staffing, and locations.
- Discuss these issues without the pressure of an impending decision.

**Negotiate important issues.** Merger contracts can be negotiated to ensure that the merging credit union's members, staff, and community continue to be served. Take advantage of the opportunity and consider the following items when negotiating a merger contract:

- Continuing community commitments, such as donations, sponsorships, and financial literacy programs
- Continuing socioeconomic commitment to local neighborhoods
- Maintenance of any unique services to members, such as life savings and loan protection insurance
- Retaining the name of the merging credit union as a brand (for example, "ABC Credit Union," a branch of "XYZ Credit Union")\*
- Agreement to keep branch(es) and ATM(s) in service
- Agreement to retain similar or improved suite of services

*\* Requires special disclosures to ensure that members are not confused on NCUSIF Insurance coverage limits. See NCUA Letter to Credit Unions 99-CU-17*

- Employees of the merging credit union:
  - Who will be retained
  - What positions will they hold
  - Salaries or pay rates
  - Benefits
  - Seniority with the continuing credit union
  - Employee bonuses
  - Severance pay for employees not retained
  - Contract buyouts for contract employees
- Bonus dividends or interest rebates
- Board seat(s) or other volunteer positions for officials of the merging credit union (until next elections where applicable)

**NOTE:** A merging credit union can specify a period of time for the above items in the merger agreement. For example, the agreement may state: “Keep the merging credit union branch office located at 123 Elm St. open and fully staffed for a minimum of two years following the effective date of this merger.”

**Take measures to enforce the merger agreement.** How can merger agreement provisions be enforced when one party to the agreement no longer exists?

NCUA's Office of General Counsel suggests that a merging credit union name in the contract the third-party beneficiaries with standing to enforce the contract. For example, if the continuing credit union agrees to keep a branch open for at least one year, the agreement would note that the members of the discontinuing credit union are beneficiaries with standing. Likewise, if staff is promised a comparable position in the continuing credit union, the merger agreement should note their interest in the position, not to be terminated without cause for one year. Because these matters would fall under state contract law, the wording should be state specific.

# NCUA Resources

NCUA provides the following resources to help merging credit unions. Click on any of the bulleted items to be taken to that resource.

[Credit Union Merger Manual](#)

[Chartering and Field of Membership Manual](#)

[NCUA Regulations Part 708b–Mergers of Federally Insured Credit Unions; Voluntary Termination or Conversion of Insured Status](#)

[Webinar: Credit Union Mergers \(December 14, 2012\)](#)





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