

# Mergers & Acquisitions: What you need to know

REGION 3 MEETING  
SEPTEMBER 23, 2024

PRESENTED BY

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Principal/Shareholder  
Financial Institutions Group



# Overview

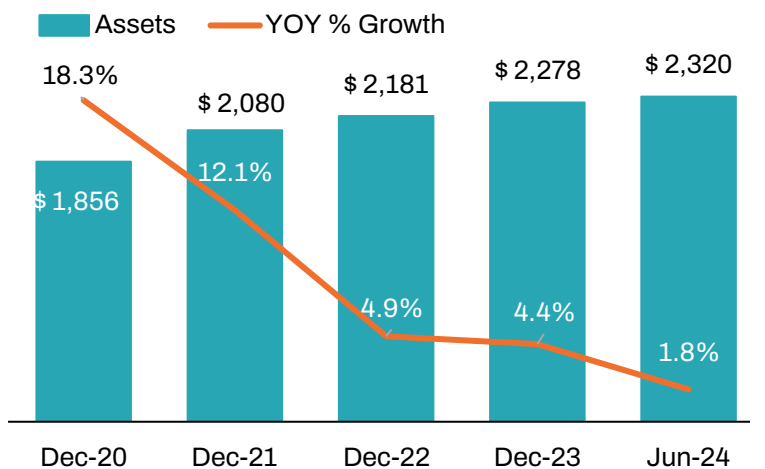
- Credit union industry trends
- Merger considerations
- Internal Audit's participation in mergers
- Questions



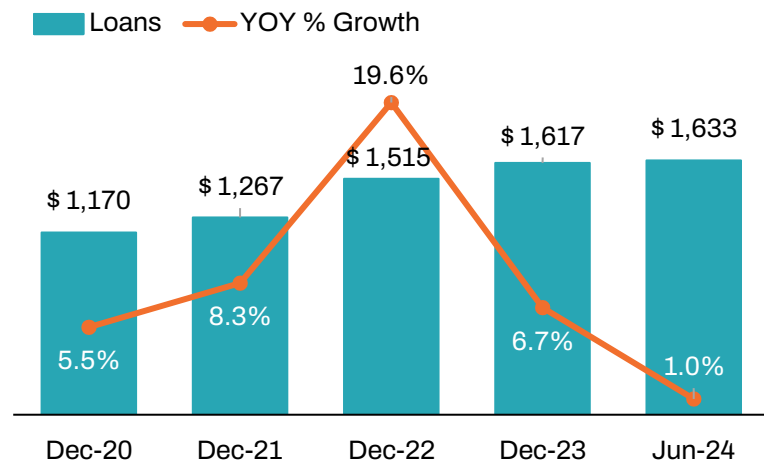
# Industry Trends

# Industry Trends & Observations

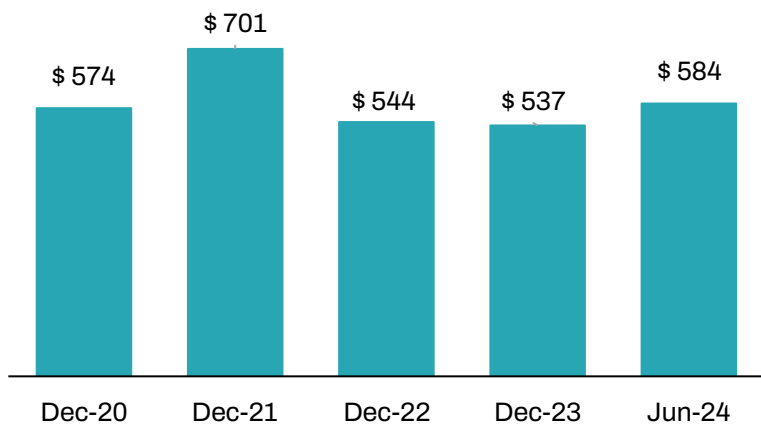
## Assets (\$B)



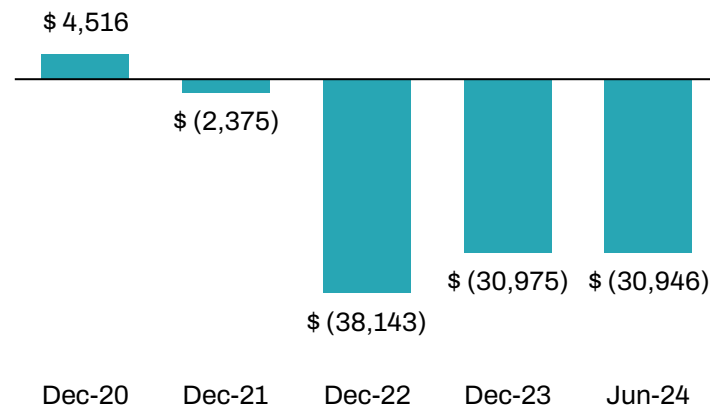
## Loans (\$B)



## Cash and Investments (\$B)

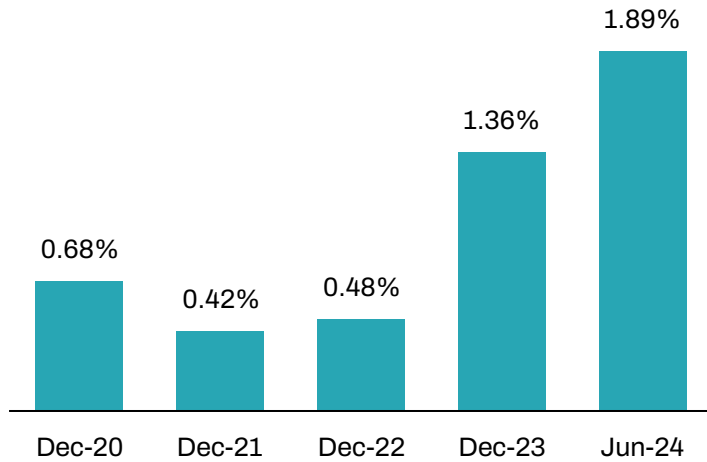


## Unrealized Gain on AFS Securities (\$MM)

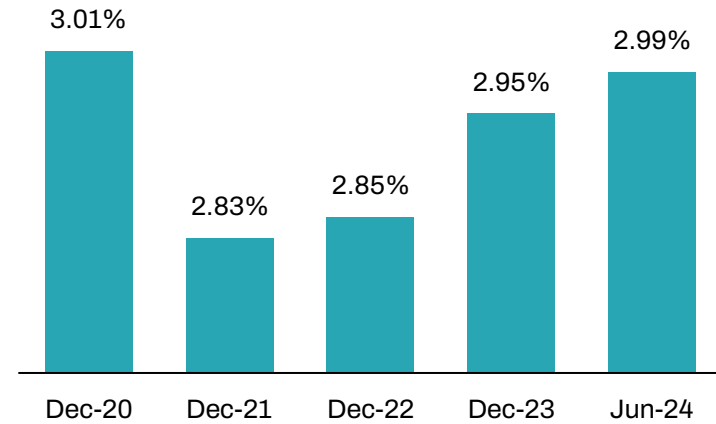


# Industry Trends & Observations

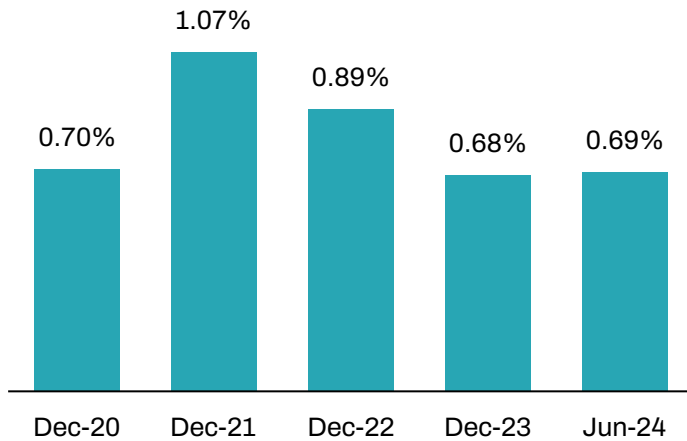
## Dividends & Interest



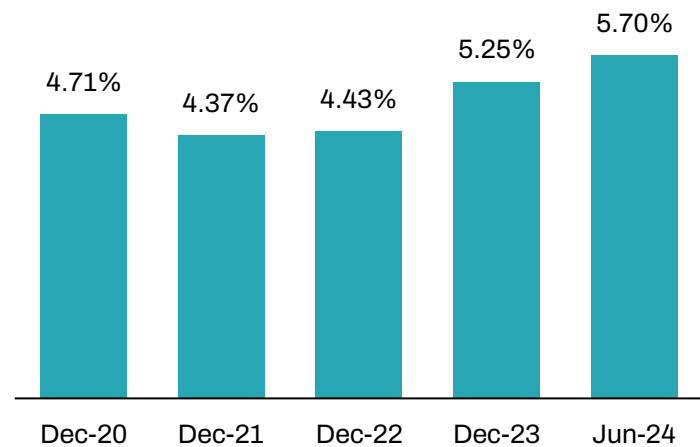
## Operating Expense Ratio



## ROA

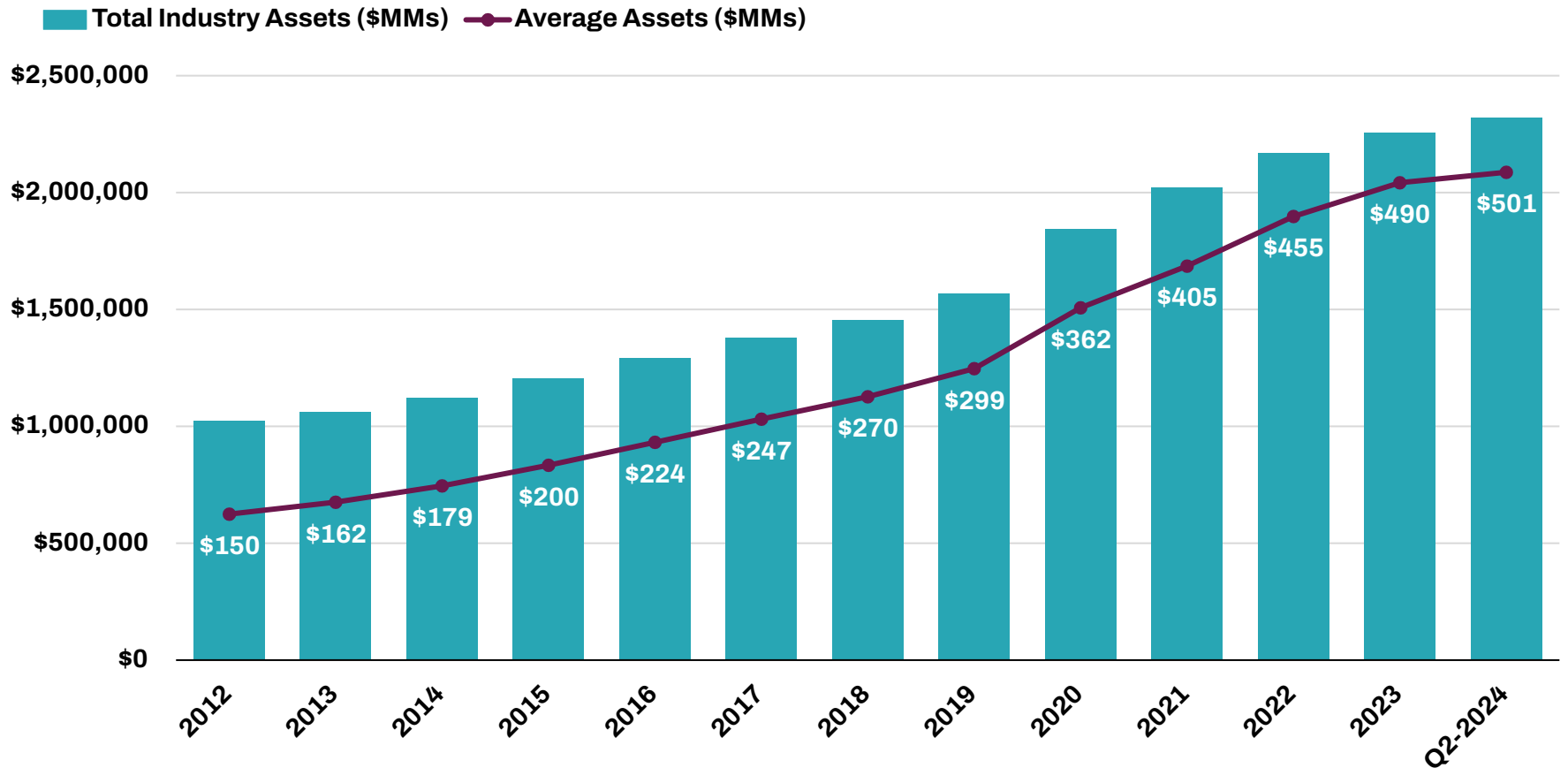


## Yield on Loans



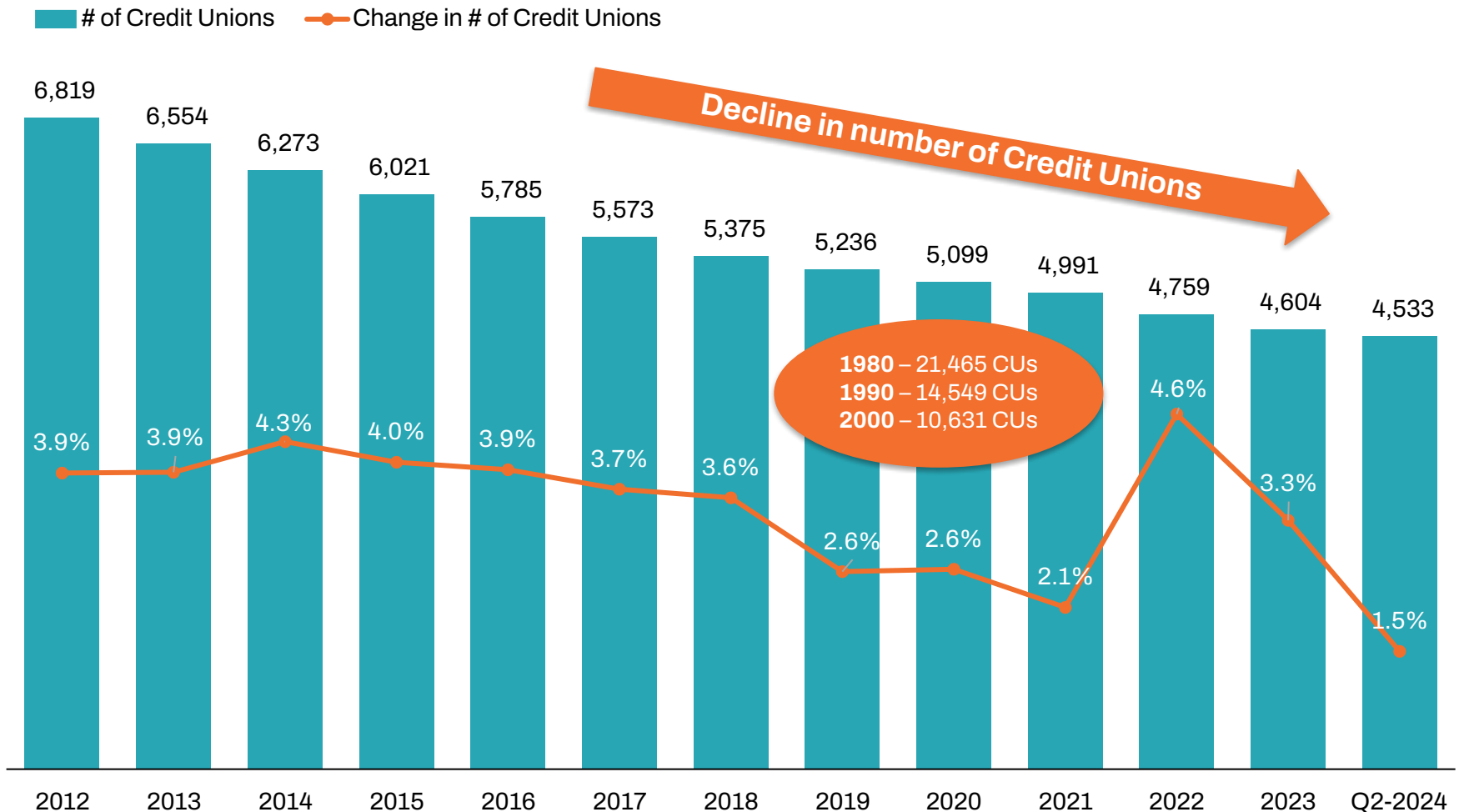
# Credit Union Asset Growth

## National Credit Union Assets (\$MM)



# Credit Union Consolidation

## National Declining Number of Credit Union

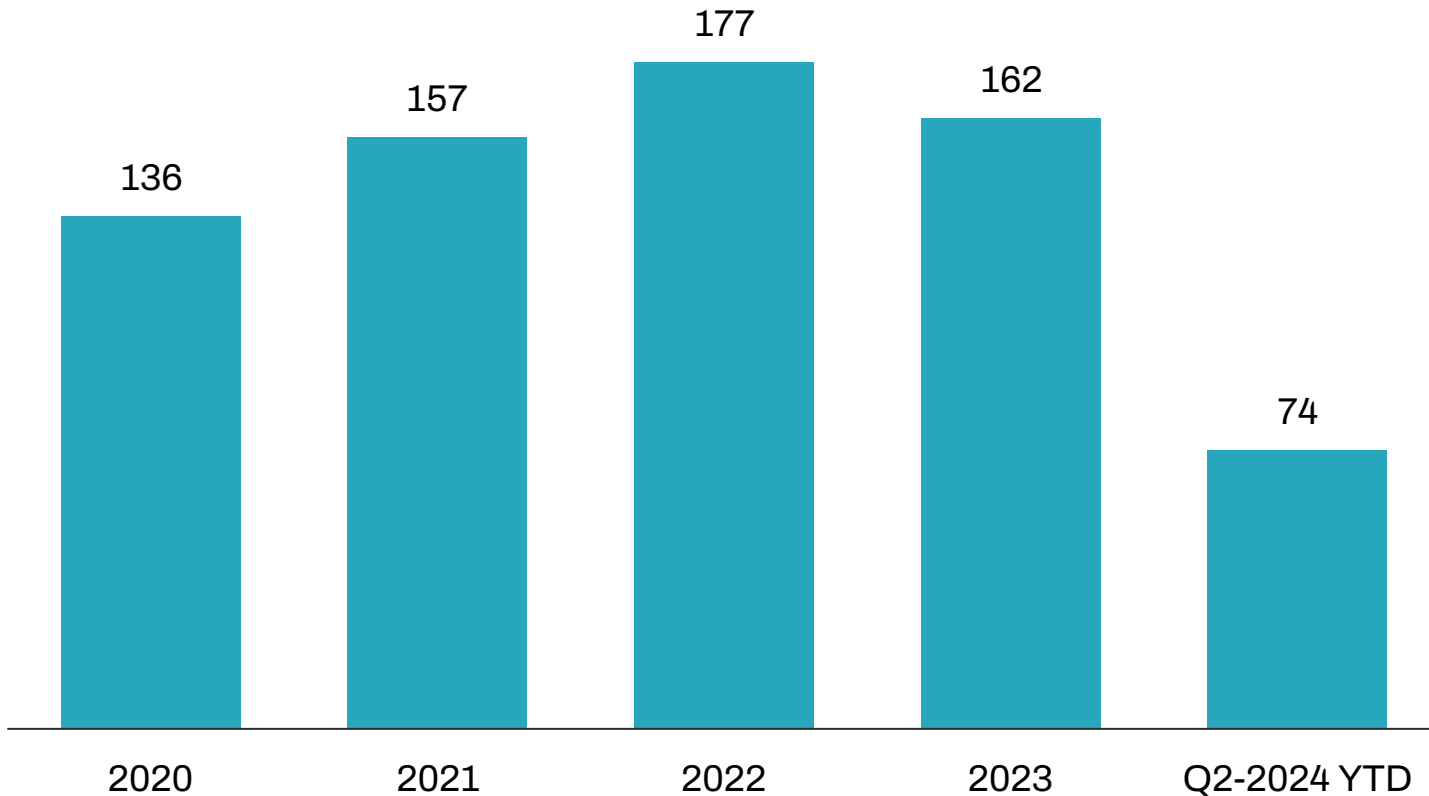


# Credit Union Consolidation

## National Number of Credit Union Mergers

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■ # Of Credit Union Mergers





# Credit Union Consolidation

## Mergers by Peer Group

	Number of Mergers by Peer Group					Total	
	2020	2021	2022	2023	Q2-24	#	%
Less than \$100M	122	140	159	152	60	633	89.53%
\$100M-\$249M	8	13	11	6	10	48	6.79%
\$250M-\$499M	3	3	4	1	2	13	1.84%
\$500M-\$1B	1	2	2	-	1	6	0.85%
\$1B-\$10B	2	-	1	3	1	7	0.99%
Greater than \$10B	-	-	-	-	-	-	0.00%
<b>Total</b>	<b>136</b>	<b>158</b>	<b>177</b>	<b>162</b>	<b>74</b>	<b>707</b>	<b>100%</b>

(\$ in thousands)	Assets Acquired from Merging Credit Union to Continuing					Total	
	2020	2021	2022	2023	Q2-24	\$	%
Less than \$100M	1,504,875	2,218,124	2,803,966	2,942,803	1,077,401	10,547,169	27.21%
\$100M-\$249M	1,213,567	1,826,917	1,960,859	949,890	1,522,868	7,474,101	19.28%
\$250M-\$499M	1,069,007	846,882	1,457,483	284,390	683,880	4,341,641	11.20%
\$500M-\$1B	867,839	1,616,211	1,149,289	-	693,789	4,327,128	11.16%
\$1B-\$10B	3,714,506	-	2,644,084	3,988,040	1,727,493	12,074,123	31.15%
Greater than \$10B	-	-	-	-	-	-	0.00%
<b>Total</b>	<b>8,369,795</b>	<b>6,508,134</b>	<b>10,015,681</b>	<b>8,165,123</b>	<b>5,705,430</b>	<b>38,764,162</b>	<b>100%</b>

# Credit Union Consolidation

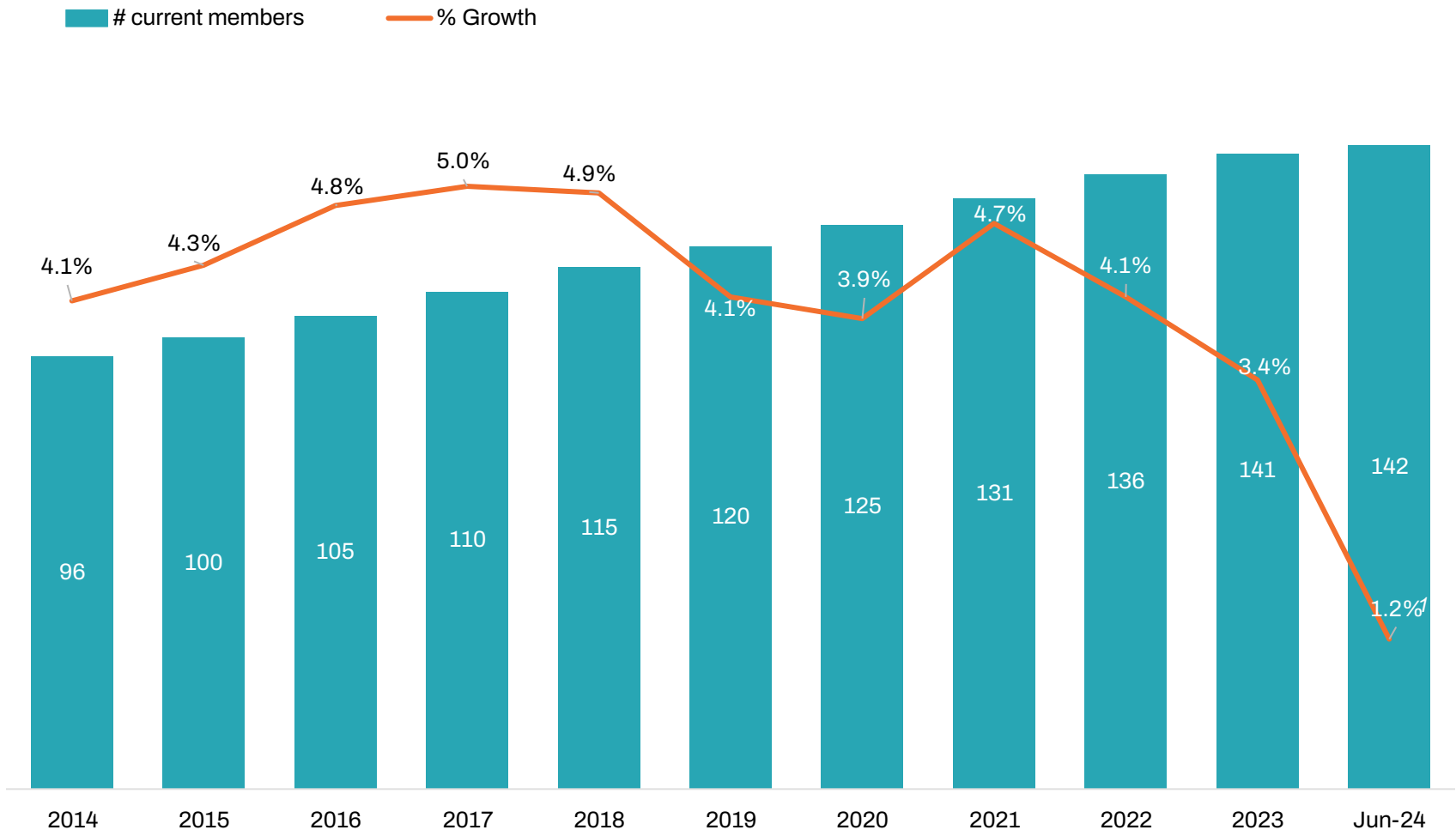
## National Credit Union Peer Group Mix

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Peer Group	# of Credit Unions	% of Credit Unions
Greater than \$1b	438	10%
\$500m – \$1b	275	6%
\$100m – \$500m	1,070	24%
\$50m – \$100m	624	14%
\$10m – \$50m	1,230	27%
Less than \$10m	895	20%
<b>Total</b>	<b>4,533</b>	<b>100%</b>

# Membership Growth

## National Membership and Annual Growth (\$MM)

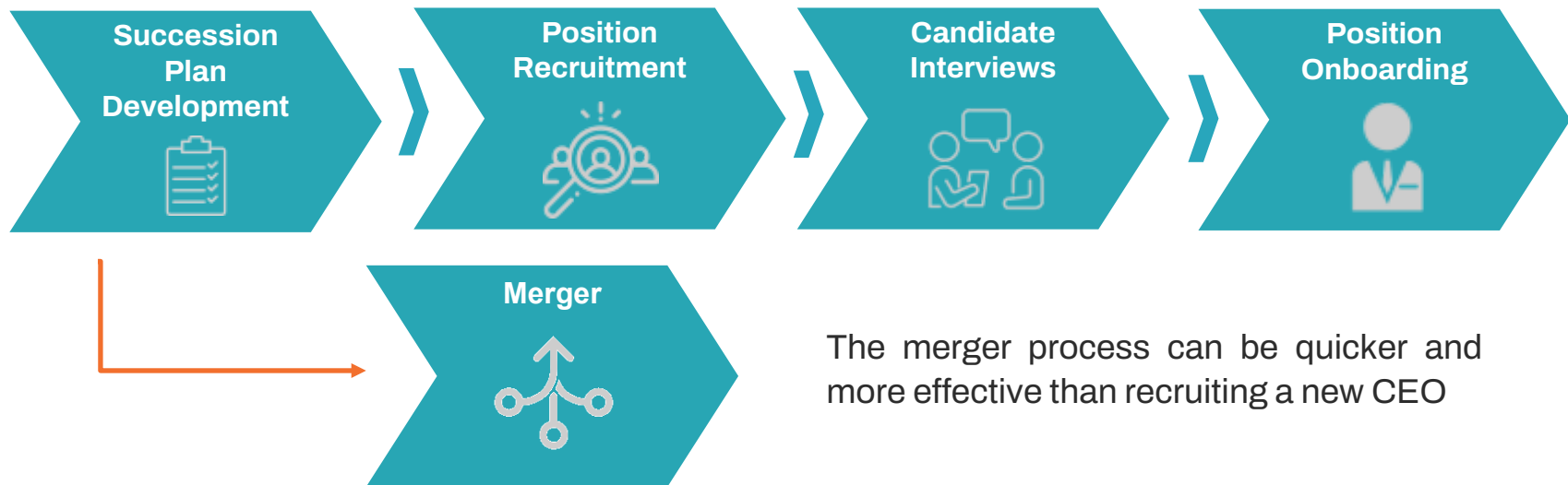




# Why Credit Unions Merge

# Succession Planning

- The average CEO is near retirement
- Challenging economic environment
- Lack of a deep bench - not enough talent in the industry
- Urgency can be created through a “retirement package”
- Mergers as an option



# Member Benefits

- **Convenience:** Provides ability to increase member access points and extend geographical coverage with increased face-to-face locations.
- **Expansion:** Provides ability to expand branch footprint while allowing for more general expansion of the operational structure
- **Products & Services:** Creates opportunity to research and implement products and services faster when member needs or market competition (innovation) changes.
- **Price:** Supports opportunity for competitive rates through combined financial resources (see loan yields and savings dividend rate graphical differentials).
- **Technology and Digital:** Younger generations demand modern technological delivery channels and obtaining their business is vital for credit unions to continue viability and marketplace relevance: Mobile banking, NFC-enabled cards (Contactless / Tap), Advanced ATMs, Real-time payments / Transactions / Zelle / Venmo / Applepay / Messenger
- **Familiarity:** Same friendly, recognizable employee base.

# Credit Union Benefits

- Enhanced / additional products and services
- Efficiencies through combined systems and support networks
- Geographic and demographic diversity
- Additionally cross-sell and transactional revenue opportunities
- Diversification of demand, product and service usage
- Sustainability – stay and remain relevant in industry and to members
- Larger asset and capital base to increase value to members
- Larger employee base
- Increased source of new members and undermarketed members
- Obtain and retain board talent representative of the field of membership, communities, and geographic diversity served
- Retain relevancy and a foundation in the communities served – give back

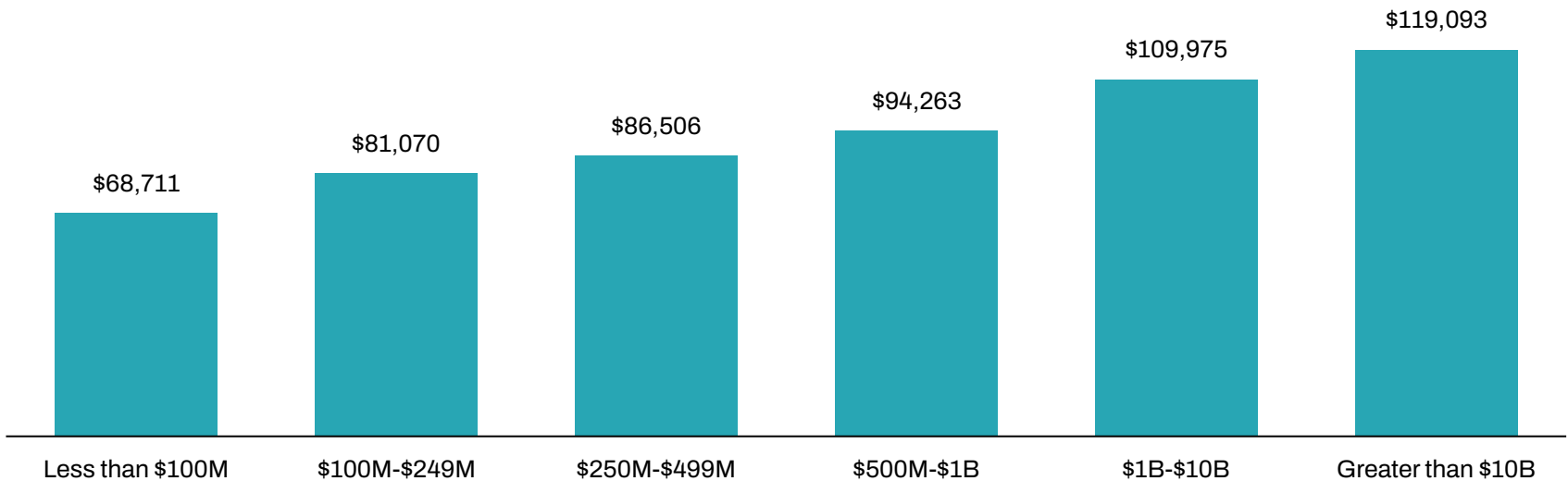
# Employee Benefits

- Employee **career growth** opportunities based on larger organization.
- Larger organization = **higher tier** peer group compensation is benchmarked to
- Ability to provide better **training/cross training** due to increased number of employees.
- Combined ability to support remote work force and migrate work physical locations.

## Total Compensation & Benefits Per Full-Time Employee

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(by peer group)

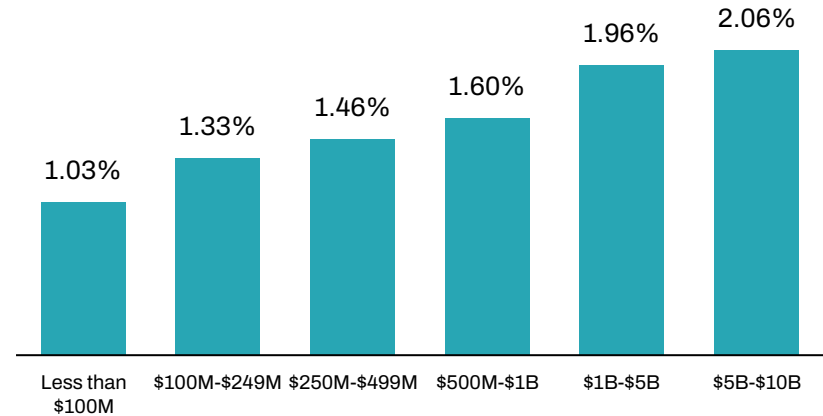




# Summary Quantitative Rationale

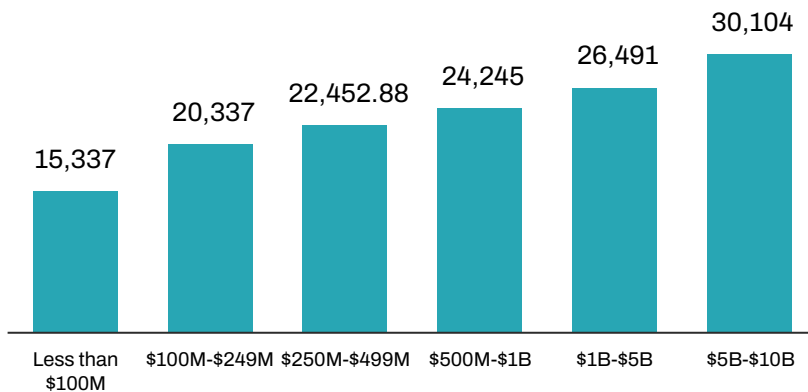
Members Benefit Significantly From Increasing Scale Among Peer Groups

## Dividends & Interest on Total Shares

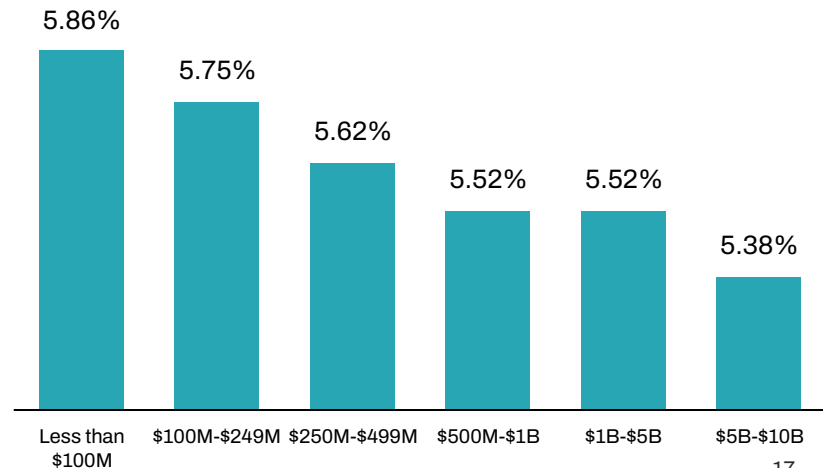


## Average Member Relationship

(Total shares + Total Loans/ Total # Members)



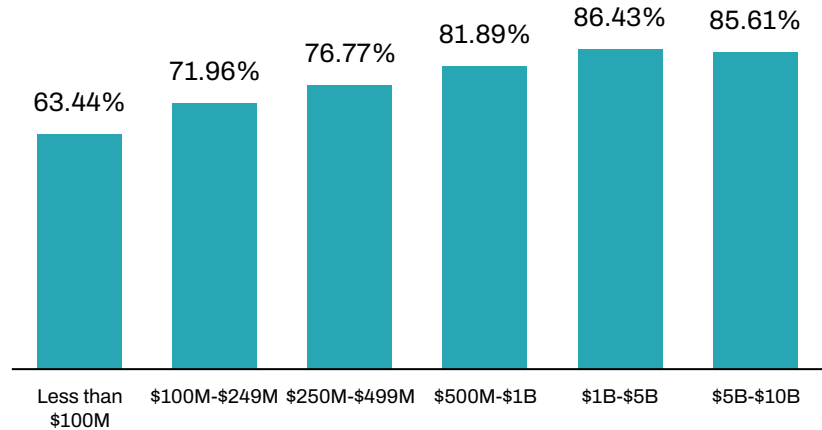
## Yield on Loans <sup>1</sup>



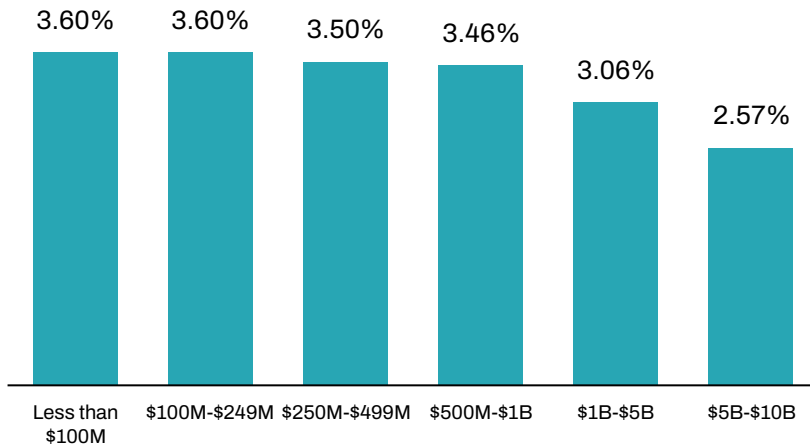
# Summary Quantitative Rationale

Credit Unions Benefit Significantly From Increasing Scale Among Peer Groups

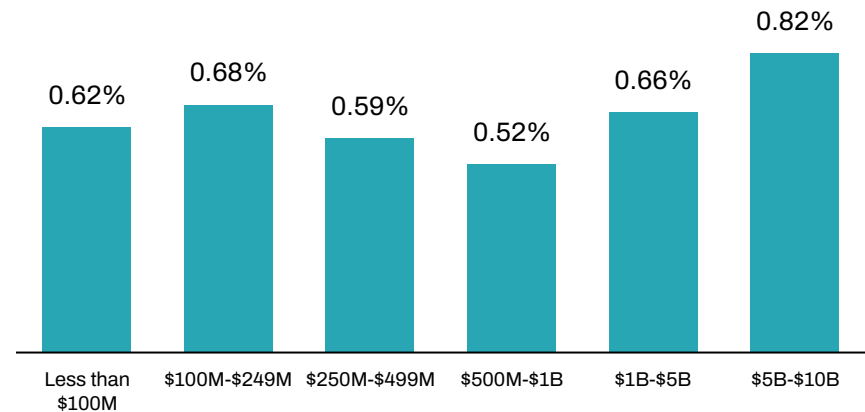
## Loans to Shares



## Operating Expense Ratio



## ROA





# Key Consideration Items

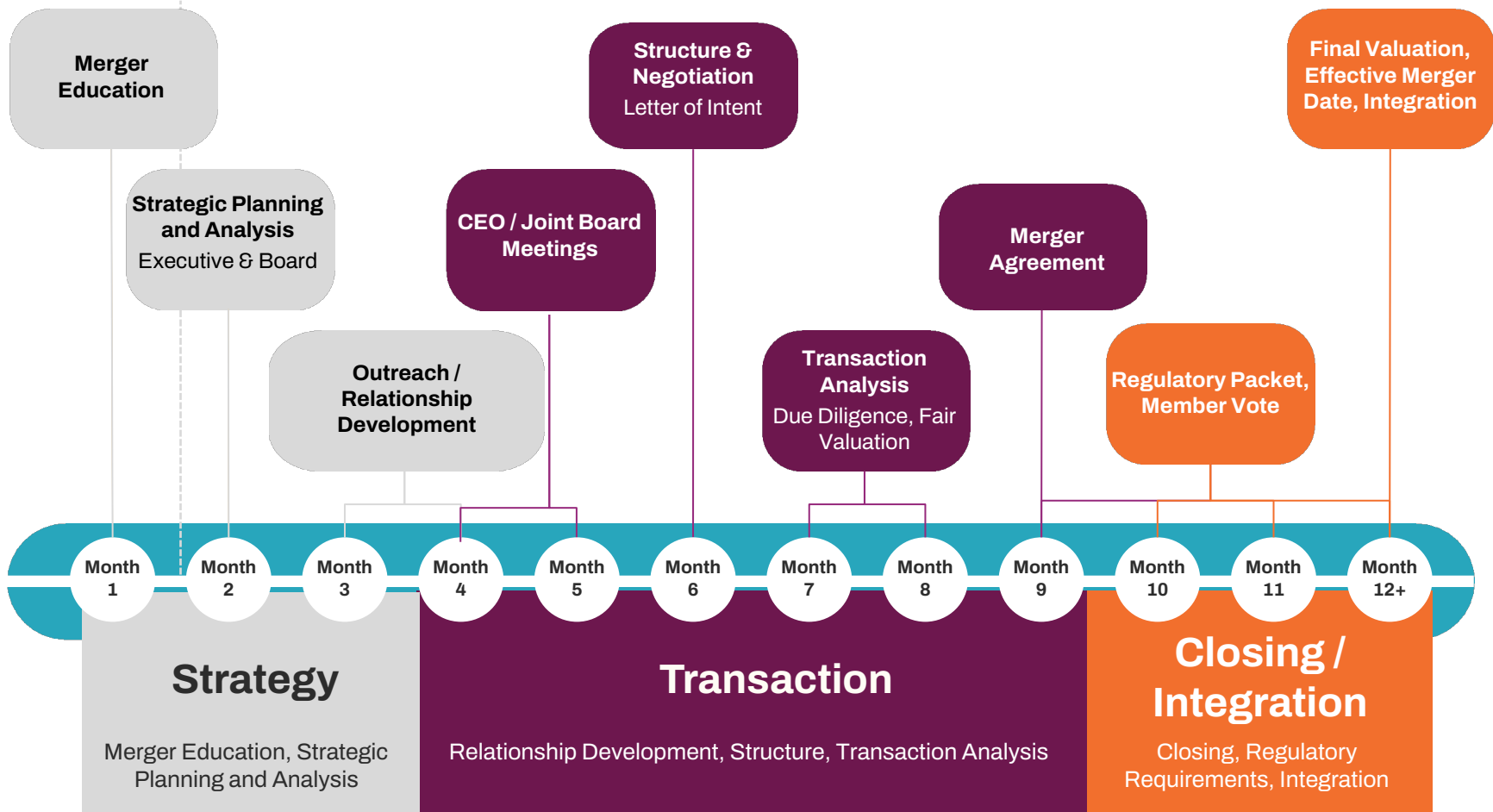
# Key Merger Concepts

- Name / Brand
- Board of Directors (seats, positions, structure and terms)
- Executive Team (CEO and C-Suite)
- Employees / Organization Chart
- Employment Agreements
- Headquarters
- Branches
- Charter
- Field of Membership
- Technology / Core System
- Member Vote
- Communication Plan
- Member Value
- Culture / Philosophy / Values
- Integration
- Pitfalls
- Other



# Credit Union Merger Process

# Typical Merger Process and Timeframe



"Ideal Path" As Actual Timing & Progression May Vary



# Internal Audit's participation in mergers

# Internal Audit's participation

- Ranking of actual participation in mergers:
  1. Post-merger audit of combined entity
  2. Post-merger integration
  3. Due diligence
  4. Merger approval and close (very minimal)
  5. Merger strategy (very minimal)



# Perceptions of IA related to mergers

- Considerations to initiate thought process
  - Commitment to IA and resources allocated will vary from organization to organization

# Perceptions of IA related to mergers

- IA participation in strategy will impair independence
- IA is control focused, not strategically focused
  - Demonstration of business acumen
- Involvement in merger activity is time consuming and time sensitive
  - Small IA departments have limited resources
- IA doesn't have the expertise and it's expensive for IA to obtain the skills

# Perceptions of IA related to mergers

- Management prefers third-party consultants due to outside business perspective
- IA's role is to validate systems and controls after merger
  - Traditional role: audit and control testing
- IA doesn't make efforts to change management's perceptions

# How can IA's role be expanded?

- Stated intention of IA to participate in mergers/other projects
  - Does management know you want to participate?
- Active participation with the audit/supervisory committee
  - If strong committee, IA's value in merger process can be communicated to management
- Share cases of IA positive effect on the merger process
  - Impact on financial implications, losses avoided
- Change cultural perception
  - Is the IA function perceived as value added?
  - Does it encourage IA input as advisor and consultant?

# How can IA's role be expanded?

- Professional proficiency and experience
  - Is management convinced that IA has necessary skills?
- Annual audit plan
  - Does the audit/supervisory committee support plan flexibility?
  - Allocation of resources for special projects
  - Ability to timely address requests for assistance and input
- Research and gain good understanding of target credit union
  - Know financial performance and risks
- Always maintaining objectivity
  - Be sensitive to making management decisions

# Merger strategy

- IA's role is normally very limited
- Stay appropriately informed about merger strategy and current activity
- Evaluate the process used in assessing and managing risk
- Advise on systems and processes that could reduce acquisition risk

# Due diligence

- Ensure due diligence is comprehensive and covers financial, operational, and **compliance** issues
- Conduct due diligence with other team members (e.g., finance, accounting, lending, HR, legal, outside consultants)
- Develop plans to integrate internal audit functions
- Ensure weaknesses identified in due diligence are considered in finalizing the deal
- Suggest opportunities for additional synergies for cost savings

# Due diligence

- Other considerations
  - Internal control environment “tone at the top”
  - Expectations and evaluation process for employees
  - Compliance issues and violations
  - Security issues
  - Fraud issues in the past and how dealt with
  - IT vulnerabilities



# Merger approval and close

- IA participation in this phase may be limited
  - Focus on legal documents and regulatory approval
- Keep apprised of progress
- During this phase, IA can continue to monitor the merging credit union's performance
  - Any deterioration or activity increasing risk

# Post-merger integration

- IA should be part of the integration team
- Play advisory role to functions carrying out the integration
  - Identify gaps in the integration plan
- Monitor progress and project plan documentation – timelines are being met
- Monitor activities necessary to achieve expected synergies
- Highlight potential gaps in the internal control structure
- Data conversion process
  - Quality control and validation

# Post-merger audit

- Audit integration process to identify control weaknesses
- Report audit findings and other observations to business owners regarding implementation execution
- Investigate whether the specific goals of the acquisition have been achieved
- Prepare lessons learned observations about the integration process



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Thank you ▶▶