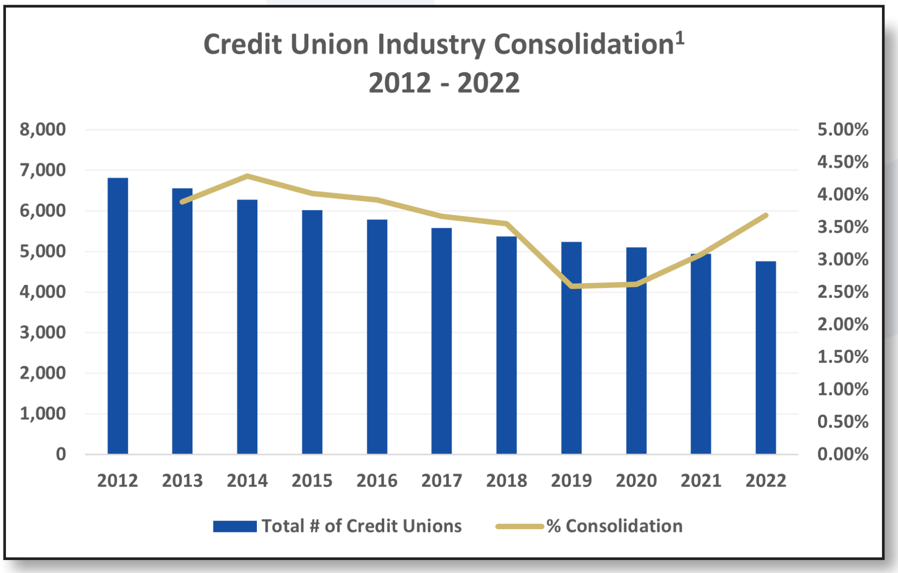
Strategic Mergers

An Underutilized but Emerging Strategy for Credit Unions

Consolidation of the credit union industry has proceeded steadily over time, with the total number of credit unions in the United States declining from 6,819 in 2012 to 4,760 at the end of last year. The steady stream of consolidation slowed, however, in the period immediately preceding the COVID-19 pandemic, as many credit unions resisted merging into larger partners and rarely combined with similar sized partners. Since 2020, the pace of mergers has as again accelerated, with the post-pandemic period challenging the digital capabilities of smaller credit unions and stoking competition from non-bank financial institutions. The chart below tracks the pace of consolidation over the ten-year through 2022.

Consolidation in the credit union industry naturally proceeded from the competitive dynamics and heightened regulatory environment that has characterized the banking sector since the Great Financial Crisis. Together, these trends have favored financial institutions with more scale. Notably absent from this period's dealmaking, however, are transactions we would characterize as "strategic." Instead, the period's merger activity tended to involve: (1) small deal sizes, where the merging credit union lacked any sort of scale to support full-service banking operation, or (2) evident pressures on the merging credit union in the form of poor financial condition, inability to execute leadership succession, or lack of support from a primary sponsor. In fact, a closer look at the deal related activity in the industry over the most recent period reveals a series of mostly "necessary" transactions rather than strategic dealmaking.

FIGURE 1



[1] Source: National Credit Union Administration. Industry at a Glance Reports. (December 2012 & December 2022), available at https://ncua.gov/analysis/credit-union-corporate-call-report-data/industry-glance.

In this paper, we contend that the credit union movement stands to benefit from more focused and widescale efforts to form strategic mergers. Such benefits span macro and micro considerations and include the following:

01 **Formation of a stronger industry** to capture more banking sector market share for the credit union movement

02 **More effective extension** of banking services to underserved markets

03 **Expansion of products** and services to improve member experience and attract young members

04 **Even more financial stability** and lower failure rates within the industry

The discussion that follows explores this thesis in detail.

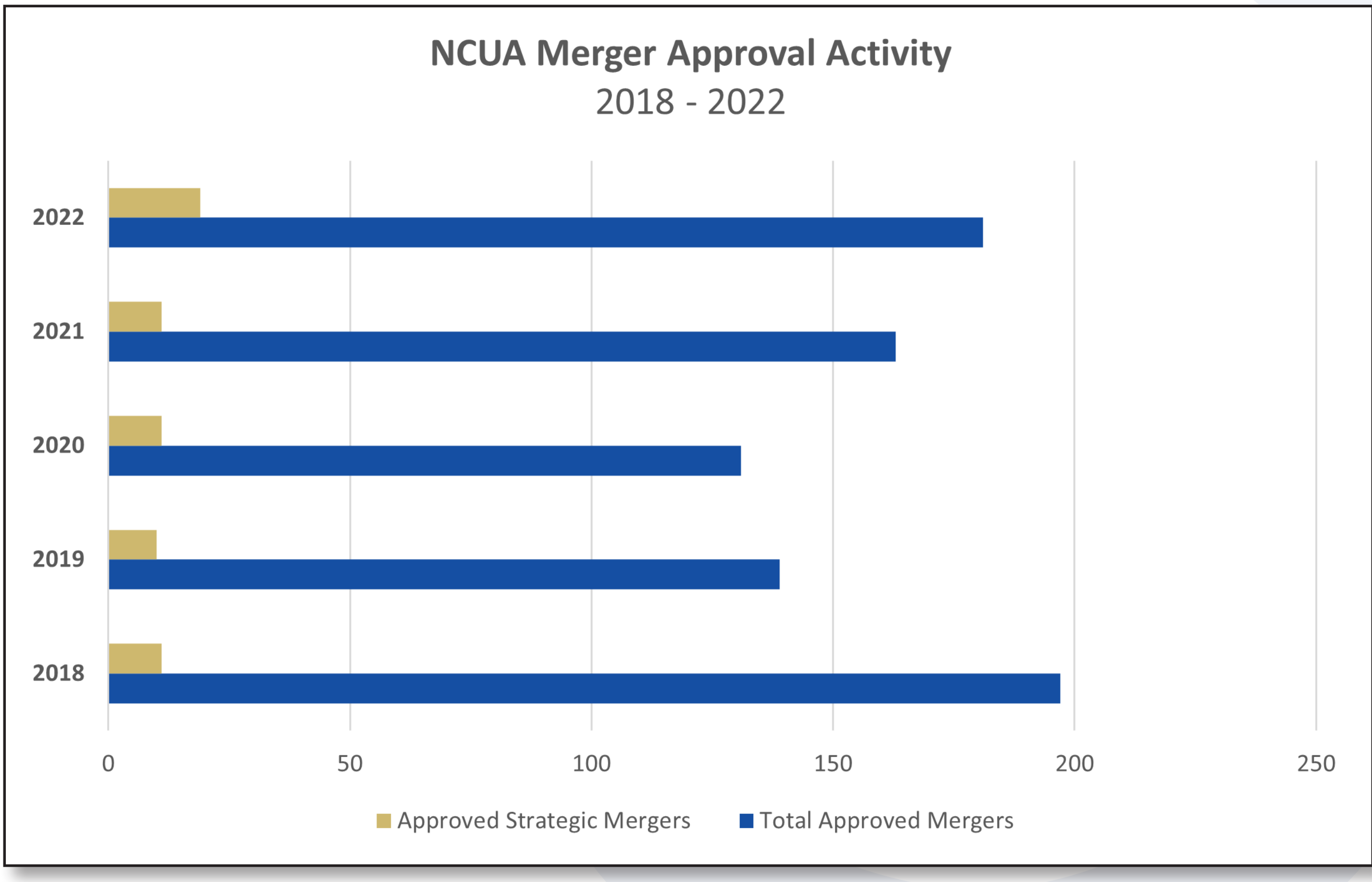
Historical Utilization of Strategic Mergers and Positive Recent Trends

We are encouraged by the observation that merger activity in 2022 included a pronounced increase in strategic mergers. We are optimistic that this is a result of the industry's growing awareness of the advantages related to strategic mergers.

To relate our thesis to data in respect of historical merger activity, we first adopt an objective and quantifiable standard for recognizing strategic mergers in such data. To that end, we define a "strategic merger," solely for purposes of analyzing historical data, as a transaction between credit unions with at least $100 million in assets where the reason for the transaction as identified in official sources relates to expansion of services and not to poor financial condition, difficult succession, or a lack of sponsor support. We believe such cases tend to involve parties with sufficient means to carry on as independent of one another, but who determined that strategic benefits exist from a negotiated combination. With this definition in mind, we examine the dataset of NCUA merger approvals since 2018 to identify the level of strategic merger activity and its contribution to industry consolidation.

As the table below illustrates, the pace of overall merger activity dipped in the period immediately preceding the pandemic, before surging higher in the post-pandemic period. We observe a consistent level of strategic dealmaking in Years 2018 through 2021 at a pace of about ten to eleven transactions per year. Strategic mergers account for about 6.8% of the overall merger activity during these years, with the highest annual contribution at 8.4% in 2020. Social distancing measures in 2020 seems to have suppressed the overall level of merger activity in this year without negatively impacting the historical level of strategic dealmaking. In 2022, there was a marked pickup in the number of strategic mergers (19) with a corresponding increase in the contribution of such dealmaking to overall activity at over 10%.

FIGURE 2



Source: National Credit Union Administration. *Merger Activity and Insurance Reports.* 2018-2022

While the enduring nature of last year's trend remains to be seen, we observe positive developments in the first quarter of 2023. In a very busy quarter, the NCUA approved 34 mergers in Q1 2023, including three notable strategic mergers:

1 RTN Federal Credit Union

($1 billion in assets) approved to merge into **Merrimack Valley Credit Union** ($1.4 billion in assets). Both credit unions are headquartered in Massachusetts.

2 Powerco Federal Credit Union

($196 million) based in Atlanta, GA approved to merge into **APCO Employees Credit Union** ($3.5 billion) based in Birmingham, AL.

3 Northwest Community Credit Union

($1.8 billion) approved to merge into **TwinStar Credit Union** ($2.3 billion). Both credit unions are headquartered in Oregon.

In addition to NCUA approvals, industry participants announced intentions in respect of new strategic mergers in Q1, including:

1 121 Financial Credit Union

($684 million) announced its intention to merge with **VyStar Credit Union** ($13.8 billion). Both credit unions are headquartered in Jacksonville, FL.

2 Bellco Federal Credit Union

($169 million) announced its intention to merge with **First Commonwealth Federal Credit Union** ($1.1 billion). Both credit unions are headquartered in Pennsylvania.

3 St. Lawrence Federal Credit Union

($231 million) announced its intention to merge with **Seacomm Federal Credit Union** ($809 million). Both credit unions are headquartered in New York.

We anticipate that strategic merger activity will ramp up as consolidation pressure in the industry builds. We believe it should. Financial results across the industry in Q1 2023 indicate emerging earnings pressure and the impact of fierce deposit competition as credit union earnings fell to their lowest level since the start of the COVID-19 pandemic and average cost of funds climbed to its highest level since 2010. A successful path for the industry through today's challenges will certainly include the formation of a healthy number of strategic partnerships. Such combinations will enable more competitive and financially resilient institutions.

[2] National Credit Union Administration. Merger Activity and Insurance Report. (March 2023), available at: https://ncua.gov/analysis/chartering-mergers/merger-activity-insurance-report.

[3] Jim DuPlessis. Credit Union Earnings Fell Sharply in Q1: Callahan. CREDIT UNION TIMES. (May 17, 2023), available at: https://www.cutimes.com/2023/05/17/credit-union-earnings-fell-sharply-in-q1-callahan/.

Considering Strategic Merger Case Studies from the Recent Period

The sixty-two strategic mergers between 2018 and 2022 noted in the previous section include several interesting case studies that demonstrate the potential of strategic mergers to create compelling partnerships and form stronger credit unions. Among this group, we highlight the following cases:

Nuvision Credit Union and Denali FCU (2018).
Nuvision CU, a California-based credit union with $1.6 billion of assets, merged with Denali FCU, the third largest credit union in Alaska at the time with $663 million in assets. Prior to the merger, Nuvision operated sixteen branch locations across California, Wyoming, and Arizona. The merger extended Nuvision's branch network into Alaska, where Denali operated fourteen locations, and Washington where it operated a single location. Today, Nuvision operates twenty-six branches across these five states and counts over $3 billion in assets. Nuvision does business in the Alaska market as "Nuvision Alaska" and an image of the Denali Mountain features prominently in Nuvision's local branding.

GESA Credit Union and Inspirus Credit Union (2019).
This combination merged two state-chartered credit unions serving members in different regions of Washington state. The Seattle headquartered Inspirus CU added $1.3 billion in assets, five branches in the western counties surrounding the Pugent Sound and one location in Spokane to Richland-based GESA CU's $2 billion in assets and 18 branches in the central and eastern portion of Washington. Today, GESA is the third largest credit union in Washington, with over $5 billion in assets and 32 branches providing services across the state.

SchoolsFirst FCU and Schools Financial CU (2020).
Schools Financial CU, a Sacramento-based credit union with over $2 billion in assets, merged with SchoolsFirst FCU, the largest credit union in California with over $15 billion in assets at the time. Both credit unions pursued a mission to serve educators in California prior to the merger. The merger formed the largest education-based credit union in the country. Today, SchoolsFirst is one of the largest credit unions in the country with over $28.5 billion in assets, more than 1.3 million members and 70 branches across California.

TruStone Financial Credit Union and Firefly Credit Union (2020).
Two similarly sized Minnesota credit unions combined when Firefly CU ($1.6 billion) merged into TruStone Financial CU ($1.8 billion) to form the North Star state's second largest credit union. The combination doubled the asset size and branch network of the individual credit unions.

Financial Plus Credit Union and Wanigas Credit Union (2022).
Two nearby Michigan credit unions with less than $1 billion in assets respectively combined into a credit union with over $1 billion in assets when Wanigas CU ($415 million) merged with Financial Plus CU ($813 million) in August 2022. Today, Financial Plus has assets of $1.3 billion and eleven branch locations within a 60-mile radius of its headquarters in Flint, Michigan. A recent rebrand has also brought increased loan growth and member growth.

State Employees FCU and Capital Communications FCU (2022).
Two multi-billion federal credit unions in New York combined to form the fourth largest credit union in the Empire state, with over $8 billion in assets when CapCom FCU ($2.7 billion) merged with SEFCU ($5.4 billion) in August 2022. The combined entity rebranded itself as "Broadview FCU" to reflect its wide multi-SEG field of membership. Broadview's total membership exceeds 469,000 members, the second largest membership among credit unions in New York.

Global Credit Union and Alaska USA FCU (2022).
Two credit unions with military affinities combined when Global Credit Union ($624 million) merged with Alaska USA FCU ($11.3 billion) in August 2022. The combination with Global added seven branches in Washington state to Alaska USA's existing network of 26 branches in Washington. The transaction also extended Alaska USA's branch network into Idaho for the first time with the addition of two Global branches. In addition, Alaska USA picked up two international branches on military bases in Italy. In April 2023, Alaska USA rebranded itself as Global Credit Union, adopting its merger partner's name to reflect the combined credit union's significant geographical and market span.

Pentagon FCU:
Pentagon FCU, the country's second largest credit union, has grown prolifically through mergers in recent years. Part of this growth has included leveraging its scale to insert itself as a willing merger partner for smaller credit unions. PenFed has also been strategic in its merger activity, staking a claim as the industry's best pro-active and strategic merger dealmaker. PenFed was party to eight NCUA approved mergers from 2018 through 2022, including three strategic combinations that increased the credit union's penetration into Texas and the New York metropolitan markets. PenFed's mergers include deals with (1) Texas Partners ($159 million) in 2018, (2) McGraw Hill FCU ($425 million) based in New Jersey in 2019 and (3) Sperry Associated FCU ($265 million) based in New York in 2022.

Formation of a Stronger Industry to Capture More Banking Sector Market Share for the Credit Union Movement

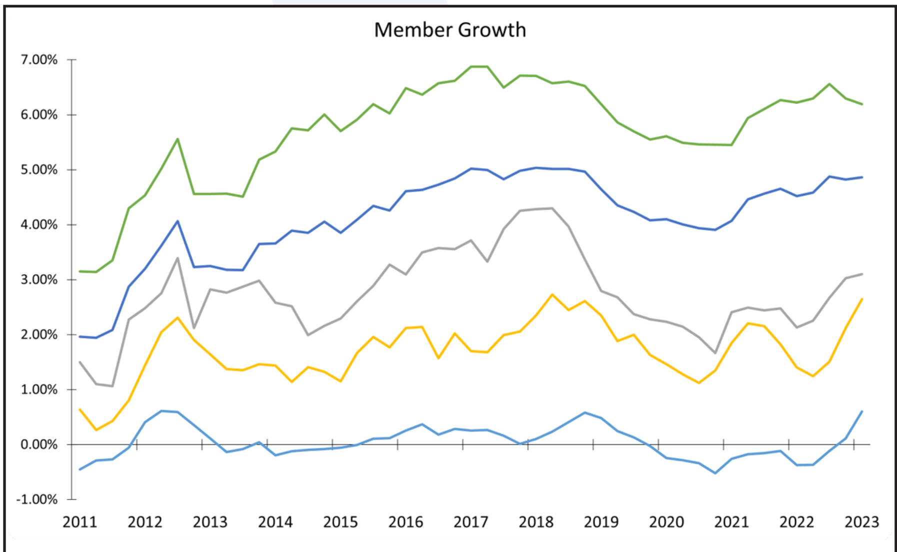
In early 2023, failures of the regional banks Silicon Valley Bank, Signature Bank and First Republic Bank focused attention on the importance of regional and small banking institutions to the United States economy.[4] These institutions play a pivotal role in banking the nation's underserved neighborhoods and its small business sector. For credit union advocates, the cooperative banking model offers a special quality of community financial services that empowers members with financial education, trustworthy service, and a stable financial partner invested in its members and the surrounding community.

The credit union industry often distinguishes itself as a "movement" bent on aligning participating financial institutions and their communities around a shared purpose where all value generated by the community's banking activity may be returned, in the form of attractive lending terms, better access to credit, more generous savings rates, or more personal service. As the banking sector braces for a potential wave of hyper consolidation, proponents of the "credit union movement" should consider candidly the appropriate responsive actions that will allow the movement to grow and thrive into the next era.

The credit union industry faces a period of steep competition due to the recent emergence of non-bank financial intermediaries from the technology sector and a widespread shift in consumer appetite for expansive remote banking capabilities following the pandemic. The recent surge in interest rates and government policies aimed at withdrawing liquidity from markets exacerbate these competitive dynamics by disadvantaging depository institutions, for the time being, in the competition for deposits. The inverted yield curve also presents challenges to a model which borrows short and lends long. Successful navigation of these conditions often benefits from an element of scale.

As we observe over time, those credit unions with larger scale have grown much faster than those with less. This dynamic is evident in the relative member growth rates across the industry. Those credit unions with more than $1 billion in assets tend to attract new members to the industry far more effectively than their smaller counterparts. In fact, on average, those credit unions with less than $250 million in assets have struggled to produce any meaningful member growth whatsoever.

FIGURE 3



Source: National Credit Union Administration. *5300 Call Reports.*

[4] Mark Vandevelde. Turmoil Shines Light on Lifeline Provided by Small U.S. Banks. FINANCIAL TIMES, (March 20, 2023), available at https://www.ft.com/content/7bfc94c6-798e-4d9c-ac27-2a4eddd5c07f.

To be fair, we do note that smaller credit unions recently experienced a pronounced uptick in member growth compared to historical rates. We suspect this may evidence the special appreciation and trust that such institutions often foster in small markets. Such qualities may be in greater demand as consumer sentiment and economic confidence waned in the most recent period. We will discuss the importance of preserving such qualities in a consolidating marketplace later in this paper. Regardless, the data illustrate the important role of consolidation for the industry's ability to sustain and thrive through the headwinds it seems likely to confront in the immediate future. Credit unions with scale are the primary vehicle for projecting the credit union movement into the national market and banking sector. Among other things, their size simply provides a natural advantage in (1) the ability to hire and retain top talent in a competitive labor market, (2) the leverage to negotiate with service providers, and (3) the resources and economies of scale to offer more competitive rates and services. For the movement to expand most effectively, it must consolidate in an orderly, opportunistic, and strategic manner to create the most competitive combined credit unions feasible. We contend that the credit union industry's future success will increase directly with the strategic execution of its consolidation in future years.

More Effective Extension of Banking Services to Underserved Markets

While we often dance around them, the conditions described in the previous section are matters of general awareness across the industry. We are hardly the first to notice them or to point them out. Merger professionals have highlighted these dynamics to the industry with a steady drum beat over the years, albeit with a louder banging in most recent times. In March 2023, American Banker published an article titled "Why don't midsize credit union want to grow through mergers?" reporting on the most recent expression of such lamentations.[5]

While such observations do reflect important and irresistible realities, they also tend to give short shrift to important aspects of the credit union movement.

First, smaller credit unions often serve niche markets and underserved neighborhoods overlooked by other institutions. They serve these areas with passion for the unique qualities of their members, steadfast commitment to a community-oriented mission, scrappy determination to serve members to their best ability, and often creative measures to deliver effective banking to underserved markets. We surmise that all who get an opportunity to become well-acquainted with such institutions come away inspired. This is our experience. Over the years, countless NCUA Board members have expressed similar inspiration in their public comments. We regard such sentiments as sincere and a typical inclination of most anyone personally acquainted with this element of a movement which embodies the "people helping people" mantra.

Second, the credit union movement understands practical considerations inherent in the consolidation pressures described above, but it does not behold itself to them. This quality is a feature of cooperative banking, where raw economic considerations supply guiding parameters, but more caring considerations contend to motivate behavior within the parameters of acceptable profitability. As such, it is natural for the industry to instinctively defy market pressure where it senses mission compromise.

Finally, credit union professionals also tend to guard their members and look skeptically upon those drawn to them by a sense of opportunity. This can engender dubious feelings when set on by a merger-minded peer, especially one of much larger size.

[5] Ken McCarthy. Why Don't Midsize Credit Unions Want to Grow Through Mergers? AMERICAN BANKER. (March 15, 2023), available at https://www.americanbanker.com/creditunions/news/why-dont-midsize-credit-unions-want-to-grow-through-mergers .

In short, we do not take issue with the sentiments resisting merger consolidation in the credit union industry. Such attitudes are motivated fundamentally by some of the best qualities of the credit union movement, including (1) fidelity to the credit union's unique mission to provide essential services to those too often overlooked and underbanked by the larger banking segment, (2) wariness that certain cultural and tactical idiosyncrasies fundamental to accomplishing the credit union's mission may not translate or find appropriate adoption in a more expansive institution, and (3) skepticism that an underserved market would be sincerely valued by the combined institution. However, we do contend that reflexive resistance to consolidation pressure, absent appropriate consideration, is also a mistake. Market forces and societal changes that are steadily compressing the number of credit unions cannot practically be resisted over time. Further consolidation is inevitable.

The industry will continue to consolidate regardless of credit union trepidation because consolidation is not a choice.

The better question before the industry is how best to consolidate – by (1) a consistent series of small capitulations in necessary fashion or (2) through tactical combinations formed in deliberate manner to strengthen the industry and preserves its values and special qualities. We urge the latter.

The merging credit union is a sought-after commodity within the industry. A merging credit union with reasonable financials, strong member relationships and a unique foothold in small target markets can retain negotiation leverage in a consolidating market. These institutions have much to offer to any number of motivated potential partners. They may engage such partners on terms that form stronger combined institutions which adopt the merging credit union's mission into its core purpose and install assurances to sustain such a commitment. For example, such assurances may include substantial executive management participation, regional membership committees, and meaningful Board representation.

Done deliberately, strategic consolidation of the credit union industry entails combining into stronger and better equipped institutions, while preserving the industry's fundamental values and qualities, especially those that relate to the traditional work of credit unions in serving low- and moderate-income Americans and other underserved markets. This task is best accomplished through strategic dealmaking whereby more credit unions of all sizes form detailed and specific merger strategies and seek to execute the strategies by instigating constructive and detailed discussions with potential merger partners seeking terms that mutually advance the values and objectives of both parties.

Skeptics of credit union merger consolidation occasionally suggest that the formation of larger credit unions through such means threatens to water down the value proposition of credit unions over time and could undermine the distinctions that has set the industry apart from banks.[6] We reject such notions.

The smaller size and scale of the credit union industry is not its distinguishing attribute relative to banks. Rather, the organization of credit unions as cooperatives creates the fundamental distinction. As credit unions operate without profit maximization for the benefit of shareholders as a sole motivating principle, they will always react differently than banks. The ethics of the credit union movement derive from the fundamental corporate structure of the credit union movement, not from any per se commitment to small scale banking.

[6] See Tiffany Taylor, Three Major Trends in Credit Union Mergers and Acquisitions. THE FINANCIAL BRAND. (July 1, 2022), available at https://thefinancialbrand.com/news/banking-trends-strategies/three-major-trends-in-credit-union-mergers-and-acquisitions-148154/.

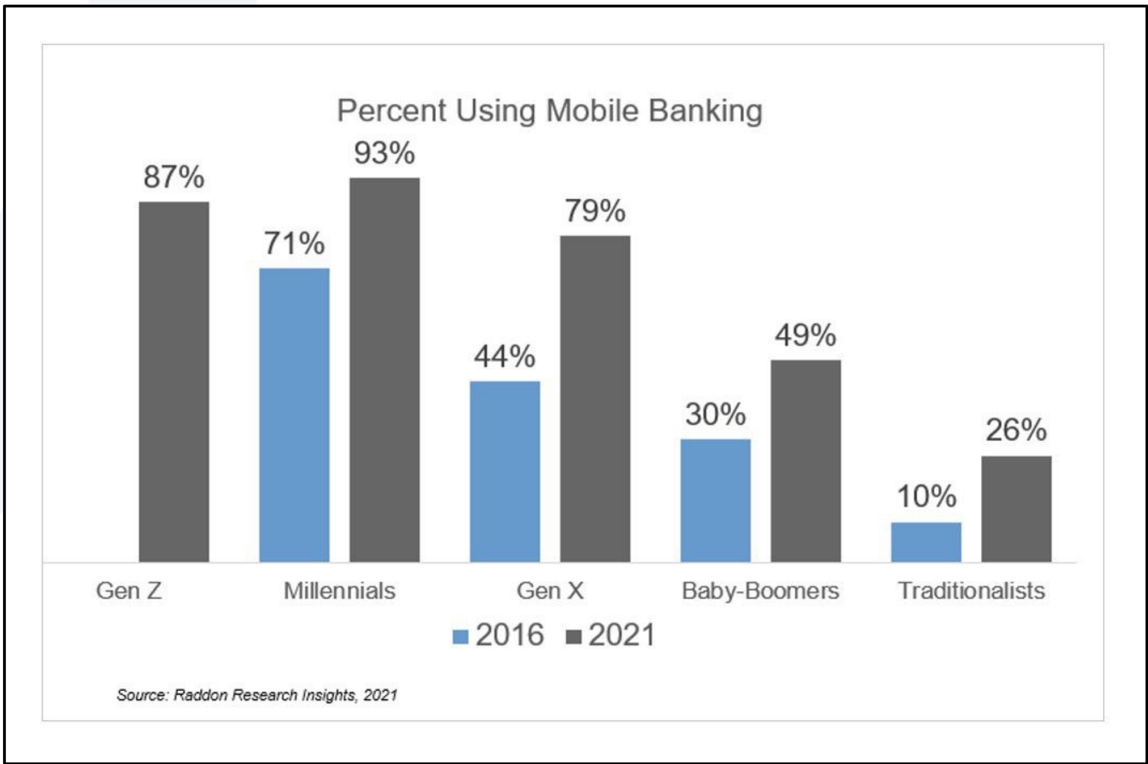
We find just as much commitment to community banking, corporate responsibility, and service to low-and-moderate income members in some of our largest clients as we do in our most dedicated small-scale clients. There are numerous examples among the nation's largest credit unions of such commitment where the ethics of the credit union movement are complimented by the resources of a larger scale banking operations capable of investing larger amounts in community projects and reaching out more broadly to underserved markets with greater technological capabilities and a wider span of products and services. In fact, nine of the top twenty credit unions by size currently maintain the NCUA's low-income designation by serving members that primarily meet certain low-income thresholds based on data available from the U.S. Census Bureau.

We conclude that underserved markets that rely upon credit unions would be better served should the industry consolidate more often by means of strategic mergers of like-minded credit unions rather than by necessary ones. Strategic mergers are generally (1) better suited to ensure that such markets are valued by the combined institutions and (2) organized to serve such markets more effectively in the future.

Expansion of Products and Services to Improve Member Experience and Attract Young Members

Perhaps the most significant consolidation pressure influencing the industry today is the shift in consumer preference toward fuller service institutions with feature laden digital banking capabilities. The pandemic accelerated societal trends across the Board, including such preferences. Previously, younger generations expressed such preferences most patently, but the experience of social distancing during the COVID-19 pandemic acquainted all generations with remote banking and its conveniences. A 2021 Raddon Research Insights study measured substantial increases in the utilization of mobile banking among all generations in the 5-year period beginning 2016, with Gen Z and Millennials logging nearly universal utilization.[7]

FIGURE 4



[7] Jaime Armistead. It's Time to Disrupt the Traditional Deposit Strategy. RADDONREPORT. (Sept. 29, 2022), available at https://www.raddon.com/en/insights/raddon_report/disrupt-traditional-deposit-strategy.html.

We see no slowing of these trends post-pandemic. Indeed, the continuous development of technologies that augment banking services rolls on at breakneck pace. The advent of Artificial Intelligence technologies suggests that digital banking may rapidly evolve to deliver ever more personal digital banking experiences to consumers. Moreover, the rising generations of banking consumers possess a ferocious appetite for the conveniences and capabilities that such technologies offer in the management of their personal finances.

To attract new members in such conditions, credit unions must invest in and deploy strategic capabilities to satisfy member expectations around customer service and product offerings. Credit unions must also be strategic about their outreach across various channels to capture the attention of their fields of membership in a digital age when algorithms increasingly filter messaging for relevance to each individual. Such conditions create ever more challenges for the small and medium-scale credit unions. A recent American Banker piece entitled *"'Mom and pop' credit unions are losing the tech race — and members"* highlighted the challenge for smaller credit unions when it began.

> **"[t]echnology is giving large credit unions an advantage in attracting new members, so much so that the growth the industry experienced over the past 12 months is concentrated almost entirely among those with $1 billion of assets and up."[8]**

The future of any financial institution relies on its ability to translate its value proposition to rising generations. On that score, the credit union movement has reasonable cause for concern. For example, a 2022 survey by GoBankingRates.com found that only 14% of people between the ages of 25 and 34 are likely to be members of a credit union and attributed such low penetration to a generalized failure of credit unions to make themselves known to younger generations and the need to improve digital presence and capabilities.[9]

The Credit Union Times recently published an expert opinion piece titled "What Do Credit Unions Need to Attract Millennials & Gen Z?" that described the challenge and opportunity for credit unions with the younger set. The article charactered such generations as budget conscious, receptive to assistance with financial literacy, and motivated by a strong sense of social responsibility. Such characteristics should tend to attract these younger generations to the credit union movement. To succeed in reaching younger members, the article prescribed a combination of focused efforts, including attractive savings products offering low-to-no minimum deposits and fees, automatic savings features, assistance with financial organization, round the clock customer support, and digital innovation to promote a seamless remote banking experience.[10]

[8] Ken McCarthy. Mom and pop' credit unions are losing the tech race — and members. AMERICAN BANKER. (January 9, 2023), available at https://www.americanbanker.com/creditunions/news/mom-and-pop-credit-unions-are-losing-the-tech-race-and-members.

[9] Nicole Spector. Gen Z and Millennials Favor National and Online Banks, Survey Shows — What Does That Mean for the Future of Credit Unions? GOBANKINGRATES.COM.(Feb. 6, 2022), available at https://www.gobankingrates.com/banking/credit-unions/gen-z-millennials-favor-national-online-banks-survey-shows-what-does-mean-for-future-credit-unions/.

[10] Kate Marienthal. What Do Credit Unions Need to Attract Millennials & Gen Z? ALM-CREDIT UNION TIMES. (May 30, 2023), available at https://www.cutimes.com/2023/05/30/what-do-credit-unions-need-to-attract-millennials-gen-z/.

From our conversations with clients and a survey of recent industry literature, we surmise that several key technological capabilities and product offerings will differentiate the "haves" from the "have nots" in the coming era. These include:

01 ***Mobile banking apps*** with supportive features for financial management, including BillPay functionality and organizing tools;

02 ***Seamless and efficient*** digital account opening and lending experiences;

03 ***Mobile payment features*** in the form of digital wallets, P2P payment applications and real-time payment capabilities;

04 ***Emerging technologies*** such as robotic process automation, machine learning, and conversational artificial intelligence in the form of chat bots and digital assistants;

05 ***Relevant savings products*** complemented by financial management tools;

06 ***Modern and varied investment services*** including a digital wealth management platform with robo-advisory technology, member directed investment options, varying degrees of optional advisory support, and cryptocurrency investing;

07 ***Active social media marketing*** in the form of unique and relevant content; and

08 ***Best-in-class*** financial education and budgeting tools.

To expand their relationship with members and translate value to younger generations, credit unions ought to seek scale and offer fuller service operations through strategic combinations. Expansion of services has long been the most popular stated reason for credit union mergers in official sources. However, too often such mergers tend to involve small-scale merging credit unions gaining substantially in this regard from a combination with a larger peer. In the emerging era, we expect that credit unions of all sizes may benefit from strategic mergers that position the combined institution with (1) larger scale to invest in the latest technologies and strategic communication initiatives, (2) broader market opportunity to penetrate with such technologies and communications and (3) a wider array of product offerings for members.

Greater Financial Stability and Continued Low Failure Rates Within the Industry

The recent turmoil in the banking sector places a premium on financial stability. Jittery depositors took quick flight from regional banks identified by the market as vulnerable due to unrealized losses in the investment portfolio, high percentages of depositor concentration and uninsured deposits, and elevated levels of interest rate risk. For the most part, the credit union industry has been spared from the recent banking crisis due to differentiating factors that serve credit unions well in the current environment. Among these factors are:

- Smaller average account sizes relative to banks and lower concentration of commercial deposits, typically less than 5% of total deposits.
- Higher concentration of insured deposits, more than 90% on average.
- Smaller holdings of held-to-maturity securities relative to banks.
- Absence of publicly traded equity, eliminating negative stock price activity as a catalyzing event for depositor flight.[11]

Credit unions also tend to enjoy the trust and loyalty of their members, largely by eschewing certain tactics that maximize profitability in favor of benevolent service to members. As a result, the credit union industry increased its total deposits in Q1 2023 by $38 billion, a quarterly increase of 2.0%. By contrast, during that same period, bank deposits declined by a total of $421 billion, a quarterly decline of 2.4%.[12]

This trust in credit unions during the recent period is well-founded. Indeed, a recent research report prepared by Kroll Bond Rating Agency examined the historical rate of failures among credit unions relative to banks over the half century from 1972 through 2022. The report concluded that credit unions outperformed the banks through this period, with the former having an average failure rate of 0.27% versus the latter's 0.65%.[13]

According to the report, credit unions with over $1 billion in assets outperformed banks even more starkly.

"Notably, of the 2,312 credit union failures reported between 1972 and 2022, only eight failures (0.3% of failures) occurred in credit unions greater than $1 billion in total assets, of which seven were related to the Great Financial Crisis. By comparison, of the 3,594 bank failures over the same period, 260 banks greater than $1 billion in total assets failed, representing 7.2% of total bank failures."[14]

[11] See generally Michael C. Macchiarola, Credit Unions Should be Trumpeting Their Structural Advantages to Attract and Retain Deposits, (Mar. 27, 2023), available at https://www.linkedin.com/pulse/credit-unions-should-trumpeting-structural-advantages-macchiarola/?trackingId=axLTfQBnQtG-Ma934xtWiXA%3D%3D.

[12] National Credit Union Administration & Federal Deposit Insurance Corporation. *Call Reports.* (March 2023).

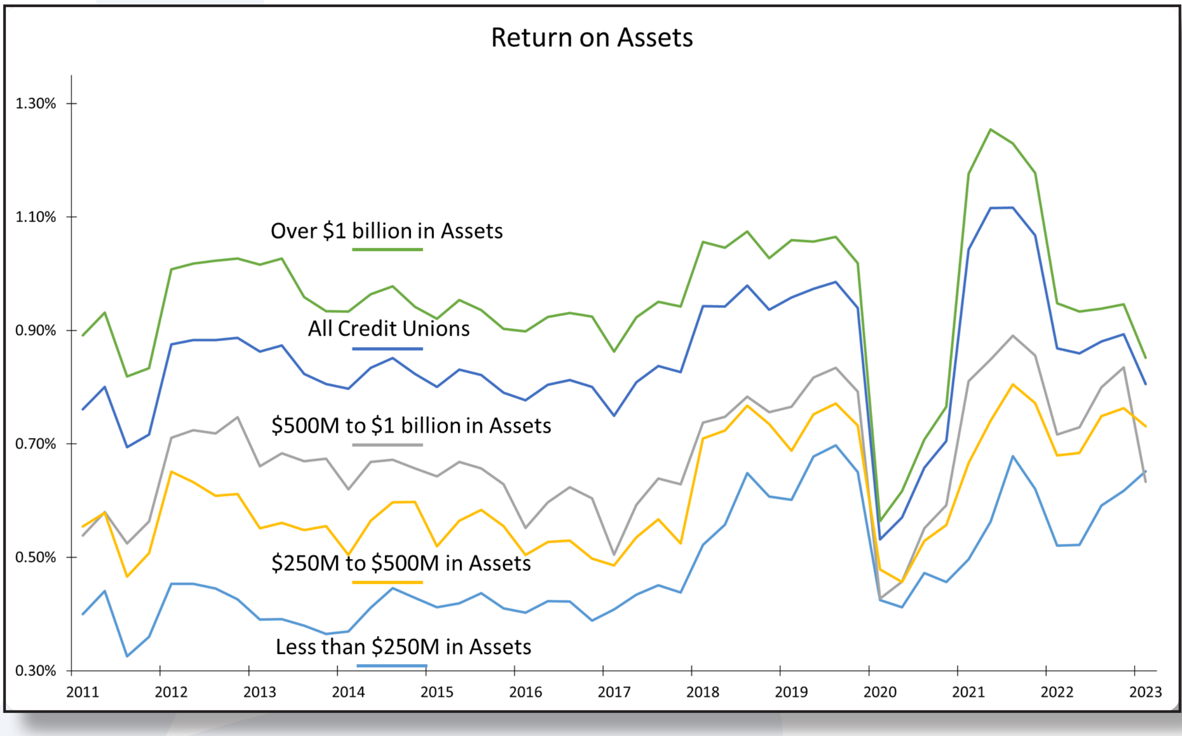
[13] Kroll Bond Rating Agency. *Financial Institution Research: Credit Unions Sector Overview.* (Feb. 23, 2023).

[14] *Id.*

In addition to the stable deposit base and liquidity profile described above, credit unions tend to benefit from granular loan portfolios of retail-oriented consumer and real estate loans, without concentrated exposures to large corporate credits. Moreover, the cooperative model tends to subdue urges for profit maximization that can motivate imprudent risk taking. As a result, credit unions tend to avoid the pitfalls that trigger financial institution failure. These qualities shine in credit unions that benefit from scale where they may be complemented by geographic diversification and better risk management technology and resources. Unsurprisingly, historical failure rates are negligible for credit unions with total assets greater than $1 billion.

In addition to the very low propensity for failure, on average, the larger credit unions consistently achieve considerably stronger financial performance and profitability than smaller peers. The comparisons of weighted average Return on Assets ("ROA") across peer groups based on asset levels are highlighted in the chart below.

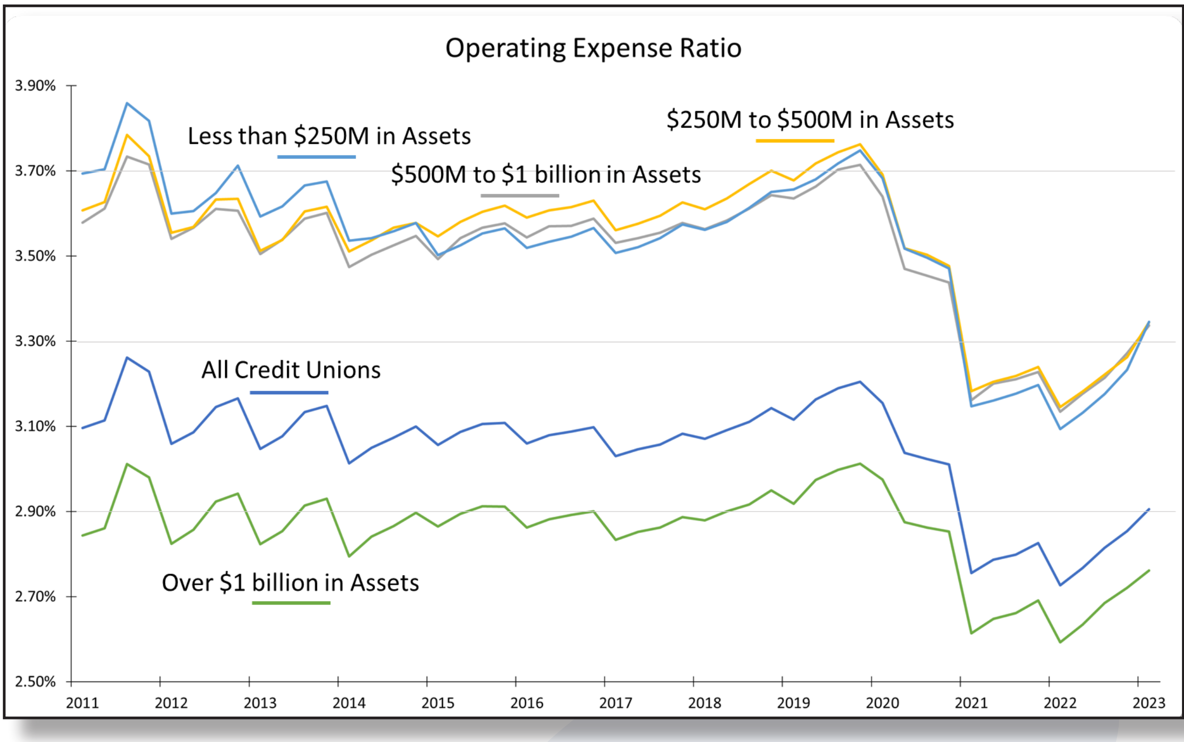
FIGURE 5



Source: National Credit Union Administration. *5300 Call Reports.*

Such outperformance appears to relate primarily to economies of scale, as it can be largely attributed to evident operating efficiencies of a larger-scale operation. It is unsurprising that the same outperformance is evident in the comparisons of weighted average Operating Expense Ratios across the same peer groups.

FIGURE 6



Source: National Credit Union Administration. *5300 Call Reports.*

However, we note that the average outperformance of larger credit unions in respect of ROA tends to lag their outperformance in terms of operating efficiency, since larger credit unions also tend to exceed their small peers in growth metrics and lending productivity. We suspect that larger credit unions are giving back some of their advantages as value to members in the form of lower loan rates, higher savings rates, additional points of service or community investments.

Currently, only about 9% of credit unions reach the $1 billion asset level. Yet, this cohort of credit unions accounts for about 75% of the industry's total assets.[15] We suggest that more credit unions should seek this level of scale through strategic mergers. Consolidation in such manner to strategically form stronger credit unions with assets greater than $1 billion should further solidify the credit union movement as a reliable financial partner and deliver greater value to members.

Conclusion: The Strategic Merger Challenge

Strategic merger activity in the credit union industry appears to be on the rise. This dynamic does not surprise us as the benefits of strategic mergers for all constituencies of the credit union movement are evident and becoming more acute in today's environment. However, strategic mergers have been elusive historically. Strategic mergers require complex dealmaking where parties propose, negotiate, and consummate a mutually beneficial combination. In other industries, the mutual benefit of a merger transaction is embodied in its price. The deal price supplies a singular variable to capture mutual benefit for the parties and catalyze the transaction. As cooperatives, credit union mergers do not hinge on price. Rather, such transactions are multi-faceted arrangements that must address the needs and objectives of multiple constituencies across both organizations. Simply put, successful dealmaking in such an environment requires a higher degree of social intelligence and a greater span of creativity. Herein lies the challenge for the credit union movement.

[15] National Credit Union Administration. *5300 Call Reports.* (March 2023).

1
Identify
interesting targets for merger partnership across all asset sizes – smaller, equivalent, and larger

2
Define terms
and parameters under which the credit union might consider combination with such targets

3
Form a vision
for a combination with the most attractive targets that achieves mutual benefit for members, employees, and leaderships of the collective parties

4
Craft proposals
to express such vision to relevant targets

5
Stimulate
discussion with targets to explore such proposals

Over time, this type of purposeful activity, generated at scale, will inject the industry with a healthy dose of dealmaking activity. From this constructive work, we expect that the industry will blossom more strategic mergers, offering their benefits for the credit union movement and its 137 million members.

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"We contend that the credit union movement stands to benefit from more focused and widescale efforts to form strategic mergers.

The discussion within this paper explore this thesis in detail."

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