WHITE PAPER

CEOAdvisoryGroup

Growth Planning | Mergers | Integration



From Discovery to Integration:

How to Manage the Four Phases of a Successful Credit Union Merger



The ideal path to growth for credit unions is often through a strategic merger. Having an experienced guide through the merger process, like having a Sherpa up the Himalayas, gives credit unions the easiest and fastest route to success—because they'll be executing best practices at every step. Experienced advisors will know what to look for in the discovery and evaluation stage, what to look out for in the due diligence phase, how best to engage during the communication and approvals stage, and how to execute a smooth integration between the two entities.

This white paper provides an overview of the four stages of a successful credit union merger:

1. **Discovery and Evaluation** — Looking for a good cultural and business goal fit between the two credit unions.

2. **Due Diligence** — Assessing the strategic opportunities, synergies and risks.

3. **Communication and Approvals** — Sharing news of the merger with members and employees, and managing the approval process.

4. **Integration** — Merging every component, including contracts, products, human resources and more into one entity.

Phase 1 — Discovery and Evaluation

This phase begins after an initial introduction between two credit unions that have decided they want to explore the possibility of a merger. At this stage, there is no commitment between the two entities other than to have conversations about the possibilities of a merger. They will conduct an exploration to see if a merger will benefit both credit unions.

The early-stage conversations in the discovery and evaluation stage include seeking answers to questions such as:

- Is their vision of the future compatible?
- Can they help each other accomplish their shared vision?
- Are the cultures of the two credit unions a good fit?
- Do they have the same values around members, employees, and their communities?
- How will they share and grow their membership bases?
- What community service projects are they committed to?





Once the two parties have discovered common ground on vision, mission, goals and culture, they will move into later-stage discovery questions that address more concrete deal points of the merger, such as:

- How can we make the new credit union stronger than we were before?
- Where can we capture economies of scale?
- How will we spend the extra income created by combining finances?
- Which credit union's products and services will we retain?
- Which branches will we retain, and will we create new branches together?
- Which CEO will become the CEO of the combined entity? What will the role of the other CEO become? What retention or severance agreements will be put in place?
- Which Board members will remain?
- Which headquarters will serve as the primary headquarters?
- Which name will be used? Or will a new credit union name be developed?

The answers to all of these questions and other key points will be compiled in a Shared Understanding Document. This is a living document that summarizes discussions between the two credit unions.

At the end of Phase 1, the two entities will either decide not to proceed or choose to continue the merger process. If they proceed, attorneys will draft a Letter of Intent. This is a non-binding agreement between the credit unions. The letter codifies that the two parties are interested in exploring a merger.

Credit unions gain many advantages by working with a merger advisor at this stage of the merger process. These include setting the expectations for meaningful discussions, making sure both entities' voices are heard and valued during the discussions, and acting as a neutral middleman to address frustrations that might otherwise alienate the two parties.

Phase 2 — Due Diligence

After the discovery and evaluation phase, the two credit unions enter the due diligence phase. This involves in-depth evaluations of the entities on several levels—including financial, legal, products, and human resources. This phase includes early-stage and later-stage steps, all of which explore each credit union's status individually and as a



combined entity. The goal is to understand how the entities would best be combined into one credit union.

The preliminary due diligence phase involves reviewing high-risk areas and creating assessments of all relevant areas of operation including:

- **Financial analysis** — such as balance sheets and income statements
- **Loan analysis** — assess risks and potential write-offs
- **Legal analysis** — including contracts
- **Human resource analysis** — such as benefits and pay scales
- **Member analysis** — including service and product policies and prices
- **IT systems analysis** — including what systems are involved and which are best to use going forward
- **Valuation** — credit unions are required to have an independent valuation of the target credit union

Human resources is a major concern, because the first question employees will ask is: Will there be a role for me in the new entity? Next, they'll want to know how the merger will impact their pay schedule and benefits, and to whom they will be reporting in the new entity. It's important to clarify these issues, because credit unions will need employees' support in educating members and securing their votes in favor of the merger.

Members are another top concern for the merging credit unions. Members will be concerned about:

- What will happen to employees they know and respect
- Whether the branches they visit will remain open
- Which product and service offerings will change
- And a host of tactical details: Will account numbers change? Will recurring bill payments be interrupted? Will new cards and checks be issued?

Financial due diligence includes determining what the consolidated balance sheets and income statements would look like post-merger, as well as determining the valuation of the target credit union. The valuation process can be lengthy and must be performed by an independent consultant or valuation professional. The consultants will perform a market valuation of the entity as well as of its assets and liabilities. This helps them





understand from an accounting perspective how the value of the acquiree will be incorporated into the acquirer's books. This is strictly for accounting purposes, since this is not a traditional business sale.

The end result of the due diligence phase is the creation of a report on the due diligence process. That is followed immediately by the creation of a definitive merger agreement, which indicates that both entities believe a merger is the best action to take for their members, employees, and community. The merger agreement is a binding legal agreement, signed by the two credit unions' CEOs and boards of director chairmen, stating their commitment to consummate the merger.

Along with subcommittees within the two credit unions, the credit unions may also hire several third parties to help execute the due diligence phase, including attorneys and CPAs. A merger advisor also brings added value to this stage of the process in several ways—including keeping the process moving forward, ensuring all of the critical steps are covered, and relieving the credit union staff from many of the time-consuming activities necessary for a successful merger.

Phase 3 — Communications and Approvals

After the discovery and due diligence phases, and the signing of the merger agreement, credit union mergers move into the third phase—communications and approval. How the entities communicate their merger plans to employees, members, and the community is critical—both for a positive vote on the merger and to retain the members and valued employees from both entities.

Even the most positive merger process can be stopped in its tracks if the members do not vote "yes." The key to a positive outcome is communications—with employees, members, regulators, and the media. To be effective, the communication process needs to be well planned, address the different concerns of each stakeholder group, and be carried out from phase three until well after the merger is completed.

Understanding the thought patterns of their various communities is critical to communicating the messages in the right way. For example, the notice of a big change like a merger will elicit shock and fear at first. The very word "merger" often invokes images of big, unfriendly Wall-Street type mergers that result in slashed jobs, major undesirable changes, and even business closures.

Employees will be worried about their jobs and members will be worried about losing the banking services they've come to expect. Also, members will be afraid of losing



the “small, friendly” local branch office they love and the relationships with the employees they’ve forged over years. They will resent the changes, including everything from their bank account numbers to learning new technologies.

The best way to address the natural fears and concerns of the credit unions’ two communities is to be upfront and to educate them with an abundance of information about the facts of the merger. Show them their fears are unwarranted. Tell them what they stand to gain. The best central message to drive home is that the two combined credit unions will be better for the members together than they were separately. The more they understand the upside, the more certain credit unions will be of getting a positive vote.

Communication should be carried in multiple ways simultaneously, including email campaigns, online, in the physical branches, in “town hall” meetings, and in the media. Some credit unions have even gone out into the community to meet members and potential members at events like farmer’s markets to spread the news. When the questions start pouring in, the credit union can craft new messages that answer the most common questions. Also, member-facing employees need to be trained to answer questions, as well, because well-educated employees will become the biggest spokespeople for the new entity.

Communication steps also include informing regulatory agencies. After the credit unions have met all of the requirements of each agency, they’ll need regulatory approval. This validates that the merger does not raise any safety and soundness issues, which could have an adverse impact on the NCUA Insurance Fund. Additionally, the regulators want to be sure that the information is adequately reported to the membership of the acquiree.

The guidelines for this process are fairly stringent. The merging entities will need to file detailed applications and support documentation with state and federal regulators including:

- **Their State Departments of Financial Institutions (DFI)** — if either credit union is state chartered
- **The National Credit Union Association** — if they are NCUA insured
- **The Federal Trade Commission** — if they meet the size criteria

The communication and approvals stage can be significantly streamlined and successfully executed with the help of a third-party advisor who’s been through the



whole process before. A seasoned advisor will ensure that the merging credit unions' communication campaigns are significant enough and on point enough to support a successful member vote and transition in the community.

Phase 4 — Integration

The final stage of the merger can best be described as the "nuts and bolts" stage. After all the stakeholders have approved the merger, it's time for the two credit unions to merge all of their systems, applications, and processes—this includes everything from the core banking systems to the employee payment applications. There are executive contracts to consider, change of control directives to execute, migration issues to address, product training programs to plan, and much more.

Each aspect of the integration has an uncountable number of details to address, for example, deciding if the new entity will use the ABC checking system or the XYZ checking system. Every department, from marketing to human resources, will have to thoroughly plan the transition. What's more, everything has to be ready on Day One of the new entity opening its doors for business. The new credit union needs the integration process to go smoothly so that members are satisfied with the process and feel good about the new merged credit union.

The integration phase can be significantly streamlined with an advisory partner who understands the process—both from a big picture perspective and down to the details. Having this experience on the team reduces the risks of oversight problem, gives senior executives time to deal with other issues, and ensures every detail of the integration process runs smoothly.

To make things painless, a merger integration consultant uses project plan templates—playbooks—to guide the process in a structured way that has been proven successful for multiple credit unions. This improves the likelihood of a successful merger for both parties.

In addition, integration consultants like CEO Advisory Group may provide a technology platform to help manage the merger planning process all the way through post-integration. In addition to facilitating use of the playbooks, the platform enables close collaboration between both parties with capabilities such as document management and oversight.

CEO Advisory Group has managed dozens of credit union mergers, and has the experience to offer a unique blend of merger experience, cultural sensitivity, and

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financial industry operations experience to every advisory assignment. Vast experience with boards and CEOs has provided the consultancy with the insight and compassion to understand the many factors that drive issues around credit union mergers, as well as the obstacles that may hinder the process.

Today, more than ever before, it's crucial that credit unions rise above the status quo and look for new ways to grow, including strategic mergers. Partnering with CEO Advisory Group provides an opportunity for credit unions to take advantage of today's leading credit union growth path so they remain viable in an increasingly competitive financial marketplace.

For a confidential discussion about your credit union's situation, contact CEO Advisory Group.

www.ceoadvisory.com | 206.219.5395

CEO Advisory Group serves as a trust-based advisor to credit unions providing mergers and acquisitions and growth planning. CEO Advisory was the first M&A consultancy with an exclusive focus on the credit union industry. Our goal is to successfully ensure members, communities, board and staff all win in mutually beneficial mergers.