Acquisitions of Banks by Credit Unions

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While once virtually "unthinkable," banks are now targeted for acquisition by credit unions with more and more frequency. Large credit unions have been active bidders in recent transactions, with a number of acquisitions pending or approved. The stretching of the "common bond" concept has enabled credit unions to take a more bold posture in pursuing bank acquisitions, and the general expansion of the credit union concept has emboldened credit unions to enter the bank M&A market.

In addition to the expansion of the "common bond" concept, this acquisition activity, featuring credit unions as buyers, is also a result of the tax advantage enjoyed by credit unions, which places them at an automatic advantage for cash bidding.

Because banks cannot merge into credit unions, the most common whole-bank P&A transactions involve acquisitions of bank branches and other related bank assets, assumption of deposit and other identified bank liabilities, and the dissolution of the underlying bank charter. The presence of a holding company and affiliates can add to the complexity of the transaction and additional transfer and/or dissolution issues. Statutory merger transactions transfer all seller liabilities to the buyer by action of law, which is not the case with P&A transactions. Therefore, comprehensive assumption of liabilities by the buyer is critical to a selling bank. As a result of the P&A structure, credit union acquisitions can be more paperwork-intensive than standard mergers.

Acquisitions of bank business units are another way in which credit unions have entered the banking sphere. Those transactions are more similar to transactions that bankers are familiar with and typically a simpler transaction than a whole-bank or branch P&A transaction.

Shareholder approval is much like that of standard mergers, requiring approval by the shareholders of the selling bank (or holding company as the case may be) for the sale of virtually all of the assets of the bank.

Shareholder approval may or may not be required for individual or group branch P&A transactions or sales of business units.

There are, however, a number of nuances to such transactions that make them unique and can provide atypical execution risks for bank sellers.

Regulatory Risk

The approving state and federal agencies for such transactions are the state and federal credit union licensing and insuring agencies. Part of the approval process entails finding that the new proposed banking customers meet the appropriate commonality tests applicable to credit union membership. Given the extent to which that concept has been expanded by credit unions and their regulators in recent years, it seems that the approval risk may not be as high as it once was. As a result, assuming the appropriate credit union agencies approve the proposal, the banking agencies are not part of the formal approval process. However, the approval process is not immune from potential litigation over whether the authority exists to grant such approvals, including recognition of the "common bond" issues, and legislators have taken note. FDIC and NCUA issues and the change in the nature of insurance can raise additional issues for certain products, however credit union P&A acquisitions are exempt from certain types of regulatory scrutiny present in bank transactions such as CRA considerations. Thus there is an element of potential additional concern regarding a potentially more lengthy and risky regulatory approval process.Customer Retention Risk

Whether bank customers (including commercial borrowers) wish to become credit union "members" may depend on the nature of the customer/member base. Transactions which have a "material adverse change" clause may be challenged in the event that significant customer runoff occurs during the pendency of the transaction. If the transaction fails to close, that runoff can leave the bank in a significantly weakened position.

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Execution Risk

The unique nature of a credit union acquisition of a bank may result in a heightened risk of litigation as well as the potential that approving credit union regulatory agencies may find themselves embroiled in political issues relating to the "common bond" issues as well as issues related to the bidding advantage enjoyed as a result of their built-in tax advantage.

Bank Shareholder Tax Issues

The P&A structure results in certain double-taxation risks relating to taxation of the sale of assets at the bank level and again for the shareholder/cash recipient.

Conclusions

Whether this acquisition trend will continue remains to be seen. While some elements of the referenced risks are common to any bank acquisition, they can be exacerbated in the context of an acquisition by a credit union as noted.

Certainly the pricing advantage enjoyed by credit unions highlights the tax advantages enjoyed by the credit union industry for policymakers. Likewise, stretching the "common bond" concept may bring attention to the process and create pressure on regulators and credit unions to explain the rationale for proposed transactions from that perspective as well.

The competitive cash pricing advantage may trigger further scrutiny of how and whether credit unions deserve continued special advantages enjoyed over their bank competitors, or whether the time has passed for that special consideration.