Bank Sales to Credit Unions

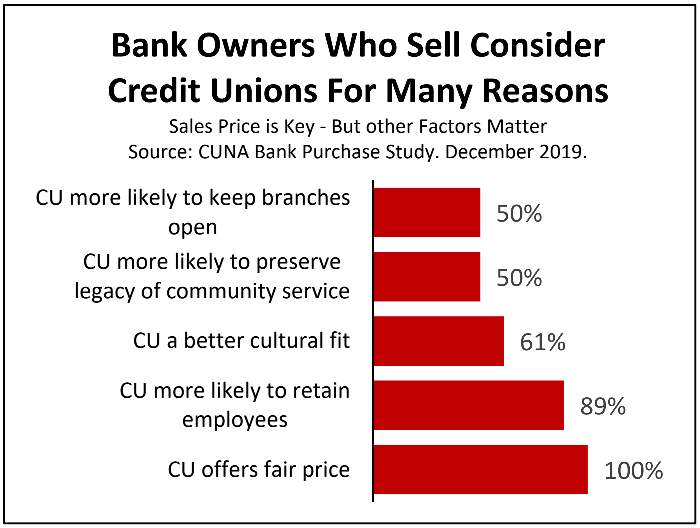
February 2020

A recent St. Louis Federal Reserve publication authored by Senior Economist Andrew Meyer explores bank sales to not-for-profit credit unions, concluding *"if they can retain enough of the employees and customers, these transactions have the potential to be a win for all the stakeholders involved."* [1]

Bank sales to credit unions provide significant benefits to bank owners because they provide cash proceeds rather than stock ownership in another institution as is very often the case when banks sell to other banks.

These types of sales are also embraced (as Meyer notes) because credit unions have no outside stockholders demanding high investment returns which means credit unions are more likely than stockholder-owned banks to focus on covering costs, providing superior member service and maintaining an adequate regulatory capital base.

That emphasis clearly resonates with community bankers who care deeply about community service, about the treatment of employees and, more generally, about their stature in the community and their legacy.



Indeed, Meyer notes credit unions can be seen as "*preferable suitors*" for many banks because *"small community banks tend to have deep ties to their customers and take pride in fostering their communities' growth and financial security. All things equal, the owners of these banks might prefer to sell to an organization that has similar customer-oriented values. That is, they might feel that they have more in common with the culture at a neighborhood credit union than with the culture of a distant large bank."*

This idea is very clearly reinforced by a recent CUNA survey which was sent to all CEOs of credit unions to whom banks had been sold since 2007.[2] Eighty-nine percent of respondents cite specific reasons other than price as factors that bank owners considered when deciding to sell to the credit union. As shown in the graphic above, nearly all mention employee retention as a key factor and nearly two-thirds say cultural fit played an important role in the bank owners' decision.

Communities also benefit from these transactions. Since they are not-for-profit and are not owned by outside stockholders, credit unions pass earnings through to average consumers in the form of lower loan interest rates, higher savings yields and fewer/lower fees.

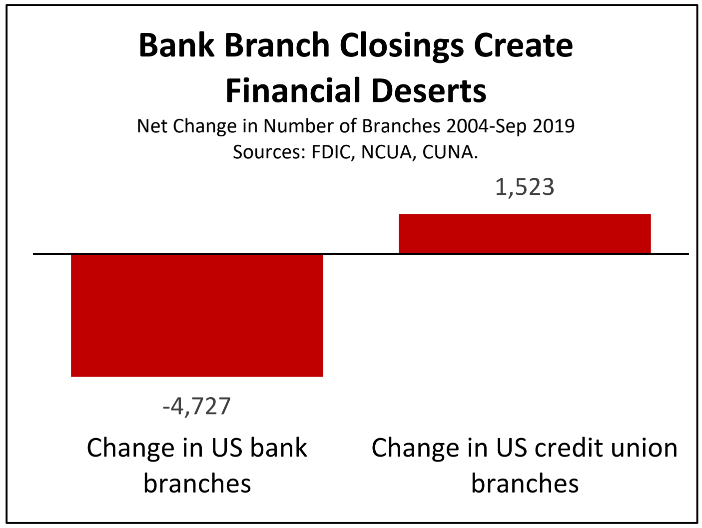
Using Datatrac pricing data CUNA estimates through Q3 2019, U.S. credit unions collectively delivered nearly $14 billion in direct financial benefits to their 115 million member-owners compared

[1] Meyer, Andrew P. St. Louis Federal Reserve. "Why Are More Credit Unions Buying Community Banks?" Regional Economist. April 2019. To be clear, credit unions are not legally able to purchase banks in the strict sense of the word since they cannot own bank stock. Rather, the acquisitions described here are essentially "forward mergers for cash" in which a credit union pays cash to bank owners for the right to assume the deposits, loans, branches and bank customers (who become members of the credit union). The bank charter is retired.

[2] CUNA 2019 Bank Purchase Survey. December 2019.

to what those consumers would experience if they conducted their financial business at a for-profit bank. Since 2007, those financial benefits totaled over $115 billion.[3]

Additionally, credit unions are more likely to preserve access to financial services for bank customers who become credit union members, compared to bigger banks. Recent literature is replete with references to big banks purchasing smaller institutions, cherry-picking the branch networks and then closing those that don't meet stringent profit criteria.[4]



Concerns over the increasing prevalence of financial deserts — both in urban and rural communities across America — are also rising. In the wake of the financial crisis between 2008 and 2016, banks went on a branch-closing spree that resulted in 86 new banking deserts with no banks within a 10-mile radius of populated areas.[5] Research confirms that the decrease in access to branches harms local businesses, residents and consumers due to reduced access to credit, higher loan interest rates, and lower intergenerational mobility.[6]

Against the backdrop of bank branch closings, data from the NCUA reveals that credit unions are expanding branch networks and access to affordable financial services.[7] Credit union branches have increased by 1,523 since 2004 while bank branches have *decreased* by 4,727 over that period of time.[8] Bank sales to credit unions can play an important role in reducing these dislocations.

Consumers — both credit union members and bank customers — routinely say that credit unions are more consumer-friendly, more trustworthy and an overall better value than banks. For example:

- A recent national study found consumers are twice as likely to "agree strongly" that credit unions "act in consumers' best interests and are good corporate citizens" compared to the same answer about banks.[9]
- Gallup research finds that "credit unions have built strong member relationships by using a personal approach, thoughtful products and member-centric service models to help members manage their finances." Nearly half — 46% of members — "strongly agree" with this statement about their credit union, while less than one-third (only 31%) of bank customers feel similarly.[10]
- Consumer Reports states: "Credit unions are among the highest-rated services we've ever evaluated, with 96 percent of our members highly satisfied…that satisfaction is driven by

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[3] NCUA, Datatrac and CUNA.

[4] See for example: Ensign, Rexrode, Jones. "Banks Shutter 1,700 Branches in Fastest Decline on Record", Wall Street Journal. February 5th, 2018.

[5] NCRC, "Bank Branch Closures from 2008-2016: Unequal Impact in America's Heartland," Research memo, 2017.

[6] See for example: Mayer, E. (2018). Big Banks, Household Credit Access, and Economic Mobility. Working paper and Nguyen, H. L. Q. (2014). Do bank branches still matter? The effect of closings on local economic outcomes. Massachusetts Institute of Technology, Working Paper.

[7] CUNA in collaboration with the University of Wisconsin Applied Population Lab uses FDIC and NCUA branch location data to examine geographic access to financial institutions finding credit unions are more likely than banks to locate branches in middle-, moderate- and low-income areas – both in urban and in rural settings. Banks are more likely to locate branches in upper income areas.

[8] FDIC and NCUA.

[9] CUNA-commissioned Morning Consult National Tracking poll of 2,200 U.S. adults. January 2020.

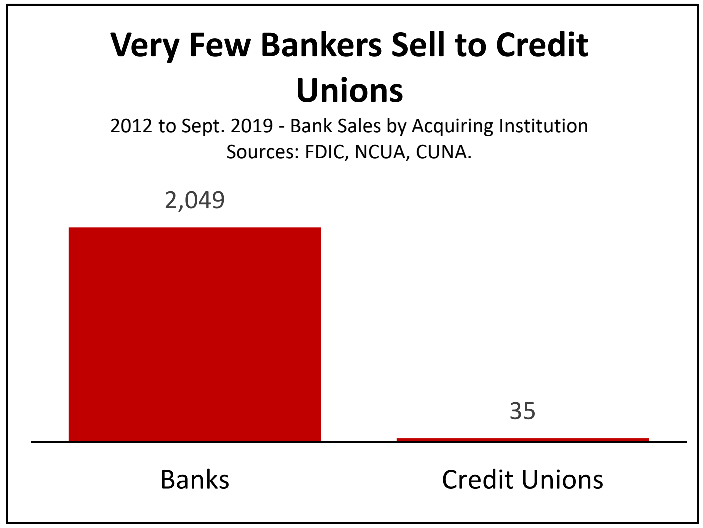
[10] Gallup. https://www.gallup.com/workplace/268220/credit-unions-banks-financial-wellbeing-proposition.aspx

good customer service, not surprising when you consider that credit unions are owned and managed by their members."[11]

- CFI Group reported their Credit Union Satisfaction Index stood at 86 in 2018 — well above the Bank Satisfaction Index which finished the year at 80.[12]

Of course, the St. Louis Fed author notes **these transactions also benefit credit unions** since they help credit unions grow, expand service offerings and leverage synergies like cultural alignment (including knowing customers on a more personal level than big banks do)**.**

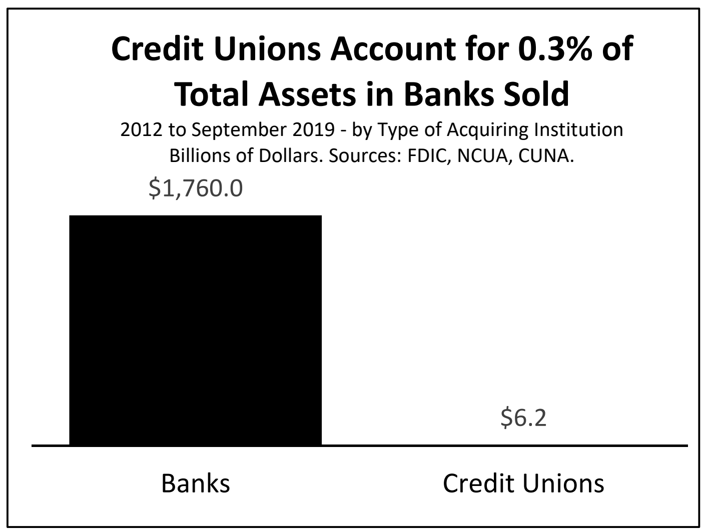
But the paper also identifies significant regulatory challenges and credit union field-of-membership constraints as important barriers that are likely to limit these transactions in the future. It correctly points out that very few of these transactions have occurred historically and that the transactions that have taken place have been sales of comparatively small banks. For example, Meyer identifies seven such bank sales to credit unions in 2018 (with an average bank asset size of $138 million). For context, note that the FDIC reports a total of 275 bank-to-bank sales occurred in that year (with an average asset size of $700 million, about five times larger than banks that sell to credit unions).



Historical Trends & Updates

The St. Louis Fed research paper provides a list of bank sales to credit unions between 2012 and 2018. However, additional transactions have occurred in 2019.

Accordingly, we've updated the list to compare recent credit union merger activity to similar bank activity over the December 2012 to September 2019 period, providing additional context and insight (See Appendix).



The overwhelming majority of bank sales involve bank purchasers — a total of 2,049 transactions between December 2012 and September 2019. In contrast, over the same period, only 35 bank sales involved transactions with credit union. Overall, banks accounted for 98.3% of all transactions and credit unions accounted for 1.7% of the total.

Banks acquired $1.76 trillion in merged bank assets, while credit unions transactions accounted for only $6.2 billion in assets. In other words, banks accounted for 99.7% of acquired bank assets since 2012 whereas credit unions accounted for only 0.3% over the period.[13]

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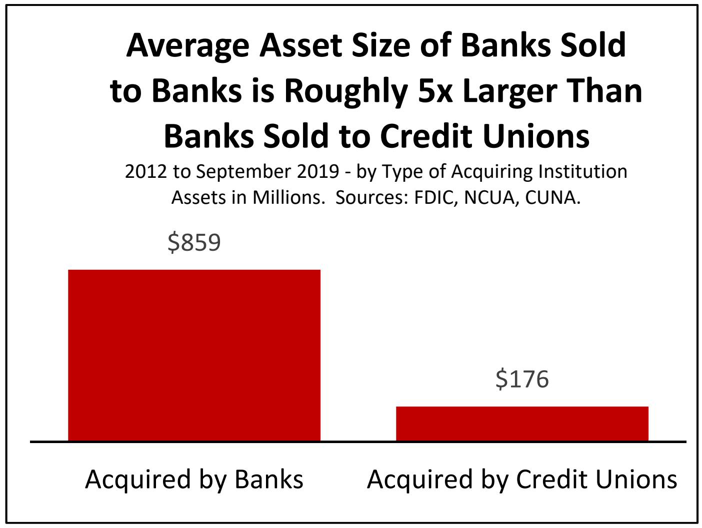
[11] Consumer Reports. March 23, 2018. https://www.consumerreports.org/banks/best-and-worst-banks-and-credit-unions/

[12] CFI Group. 2018. www.cfigroup.com.

[13] For a more detailed discussion see Robert Klingler, ''The So-Called Rise of Credit Union Buyers'' (Sept. 24, 2019), https://bankbclp.com/2019/09/the-so-called-rise-of-credit-union-buyers/

An average of 264 bank sales/mergers with other banks have taken place annually since 2012, while bank/credit union transactions averaged only five annually.



Bank sales to credit unions have been concentrated in small community banking institutions: The average asset size of banks sold to credit unions since 2012 is $176 million. In contrast, the average asset size of banks sold to other banks is $859 million. In other words, on average, bank/bank transactions over this broader time period are about five times larger than similar bank sales to credit unions.

In addition, consistent with the observations in the St. Louis Fed research, we find that banks sold to credit unions reflect low asset growth and comparatively low earnings. The typical bank sold to credit unions reflects asset growth of just 1.5% annually over the three calendar years prior to the merger and 46% of the banks acquired by credit unions reflect total asset declines over the three years prior to the merger.

Over the same three-year period leading to the merger, the median annual earnings rate (return on average assets, or ROA) at these banks is only about 0.3%. That's well below banking industry norms and about half the level of ROA among banks that sold to other banks since 2012.

Credit unions transactions involve smaller, lower-profit banks that most *other* banks (especially big banks) likely don't want to be bothered with. In general, that's good because credit union transactions are more likely to provide continuity, keeping communities serviced by local institutions rather than by Wall Street banks with few ties to or interests in the localities.

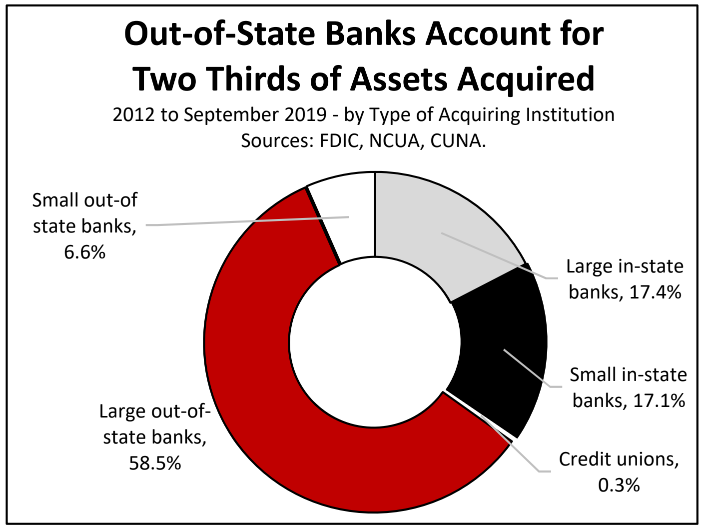
In a similar vein, a recent report by the Filene Research Institute finds that, since 2012, credit unions involved in bank sales transactions have reflected greater financial stability and thus higher safety and soundness than other institutions. The report finds no apparent basis to discourage credit unions from involvement in these transactions, and that bank sales to credit unions are not unusually risky for the National Credit Union Administration's Share Insurance Fund or the credit union environment.[14]

Because of this, local consumers benefit financially. Using national average benefit data, CUNA estimates that the 155,000 new members added to credit unions through bank sale transactions since 2012 accrued financial benefits of roughly $25 million in the past calendar year alone. On average, these new credit union members can reasonably expect to enjoy similar advantages (of similar magnitude) in the future.

Notwithstanding the significant advantages associated with bank sales to credit unions, big banks that are not locally owned or controlled have acquired the great majority of assets in bank mergers since 2012. In total, out-of-state chartered banks accounted for 66% of total assets obtained through all sales transactions. And large out-of-state banks (those with $5 billion or more in assets) accounted for 59% of assets acquired since 2012. Large banks — whether located in-state or out-of-state — accounted for over 75% of assets acquired since 2012 as shown in the graphic on the following page.

[14] Walker, David A. and Largay, John A. Credit Unions' Acquisitions of Banks and Thrifts. Filene Research Institute. June 2018. Also see: https://podcasts.apple.com/us/podcast/filene-research-institute/id1124551986?i=1000413067117

This activity reduces consumer choice, increasing overall banking concentration in a small number of very large institutions. In 1992, the largest 100 banking institutions controlled 41% of total depository assets — whereas the largest 100 institutions control 75% of depository assets today. Small bank and credit union market share has declined from 59% in 1992 to just 25% at mid-year 2019.



As might be expected, banking trade associations, such as the American Bankers Association (ABA) and the Independent Community Bankers Association (ICBA), have attacked the small number of community banks that have sold operations to credit unions. They've gone so far as to call for Congressional investigations into these transactions. To "sell" their story, the bank trades engage in well-worn, deceptive narratives that lack context and gloss over facts.

Nowhere in their communications with policymakers is there context provided like that included in the graphic above. In addition, their communications lack discussion of the many benefits of bank sales to credit unions, such as those outlined in the St. Louis Fed research. This includes benefits that communities experience and those that bank sellers clearly desire. Banks want the ability to engage in these transactions even if their trade associations object.[15]

Instead of cultivating consumer financial wellbeing and strong neighborhoods, the bank trades have once again shown their true colors — fighting turf wars that will only benefit bank trade groups and a small number of very large banks if successful.

Complaining about tax revenue implications of bank sales transactions rings hollow while the banking industry embraces and celebrates the $30 billion annual tax cut windfall recently conveyed on banks. Claiming to care deeply about communities seems trite in the context of helping to create the biggest financial catastrophe in modern history. And after adopting policy positions that create more — not fewer — too-big-to-fail institutions that have incurred more than a quarter-trillion dollars in fines over the past 10 years.

False Narratives on Credit Union Bidding Power and Taxes

Bank trade associations allege that credit unions hold a disproportionate and unfair advantage over banks in banking entity sales transactions. Bank trade groups say that disparities in accounting conventions, capital treatment and structural characteristics (i.e., lack of stockholders) give credit unions the ability to tender significantly higher cash offers to banks sellers, essentially locking other banks out of the bidding process.

However, as noted above, banks completely dominate bank sales activity, accounting for 98.3% of all sales transactions over the past eight years.

Moreover, existing sales transaction data makes it clear that banks *can* and *do* compete for these transactions. A 2019 blog post by the Bryan Cave law firm titled "The So-Called Rise of Credit Union Buyers" finds that bank purchase multiples are higher — not lower — on average than are the multiples in credit union transactions:

[15] It's interesting to note that about a decade ago, when a small number of credit unions converted to bank charters - subsequently merging into larger banks in several cases – there was no outcry from the ABA or the ICBA. No emergency actions requested. No investigations needed. In fact, both groups applauded and encouraged the trend.

*"…**underlying data available doesn't support the notion that banks can't compete. In the four credit union transactions to date in 2019 that have publicly provided pricing, the acquisition price was 1.40 times tangible book value. In the 20 non-credit union, all-cash, transactions to date in 2019 that have publicly provided pricing, the acquisition price was 1.52 times tangible book value**."*[16]

Additionally, even though she repeatedly calls on Congressional policymakers to hold hearings on the topic, Rebeca Rainey, president and CEO of the ICBA, acknowledges that banks have a fiduciary responsibility to their shareholders and are actually doing right by their shareholders by selling to credit unions.[17] According to S&P Global Market Intelligence reports, though, Rainey doesn't like that credit unions are taxed differently.

"If credit unions want to operate as a bank, they should be taxed as a bank would be," she stated. This completely misses the point that credit unions most certainly do not want to "operate as a bank"; they want bank customers to enjoy the differences that credit unions provide. The substantial financial and non-financial benefits of credit union service and depositor-ownership stand in stark contrast to the for-profit, big-bank model characterized by outside ownership and control, excessive risk-taking and a long list of anti-consumer behaviors that have resulted in hundreds of billions of dollars in fines over the past decade.[18]

In addition to that significant distinction, a review of financials at banks sold reveals that the bank trades routinely exaggerate the negative income tax effects associated with bank sales to credit unions.

As a point of fact, a large percentage of the deals closed and pending since 2012 involve banks that appeared to pay no taxes in the year prior to their sale to a credit union. This is true in seven of the 14 completed or pending deals in 2019. Overall, half of banks that chose to sell to credit unions in 2019 appeared to pay no income taxes at all, according to regulatory call report filings. The median effective tax rate (including federal and state) on 2018 bank earnings is roughly 11% among all bank sales to credit unions that were announced in 2019.

For the 35 bank sales to credit unions going back to 2012, a total of 16 banks sold reported no applicable income taxes in the calendar year previous to the deal. That's 46% of the total banks that reported no applicable income taxes. Among all banks in the group going back to 2012, the median effective tax rate (federal and state) in the year prior to sale is 0%.

It should be noted that even in cases where a decline in income tax payments arises from the shift of taxable bank earnings to not-for-profit, or untaxed, entities, those reductions are dwarfed by other taxes that are routinely paid as a result of the purchase transactions. That's due to the fact that credit union purchases are cash deals that generate capital gains (whereas bank sales to other banks typically occur with stock payments rather than cash payments).[19]

CUNA estimates that bank sales to credit unions in 2019 occurred among banks that reported $4.2 million in applicable income taxes in the year prior to sale. Assuming stable earnings and tax rates, that would suggest lower annual tax receipts of a like amount in subsequent years, but the $4.2 million annual reduction in income taxes would be more than offset by roughly $65 million in taxes on gains, assuming a combined 26% rate (federal and state). One attorney who has been involved in

[16] Klingler. https://bankbclp.com/2019/09/the-so-called-rise-of-credit-union-buyers/

[17] Dholakia, Duren and Sullivan. "Number of credit unions acquiring banks approaching 2018 levels". S&P Global Market Intelligence. June 21, 2019.

[18] Coincidently, this desire for average consumers to have access to credit union services was reflected in Congress with passage of HR1151 - The Credit Union Membership Access Act.

[19] For example, if a bank has $10 million in equity, and it sells to a credit union for $18 million, there is tax due on the $8 million gain. The tax is comprised of federal and state taxes – typically at rates of 21% at the Federal level and 5% at the state level (for a total of 26%).

numerous transactions over the past several years indicated that the 35 sales of banks to credit union acquirers has generated a total of more than $100 million in taxes. The total taxes on gains would essentially offset federal income tax payments for roughly 20 years (all else equal).

Conclusion

Bank sales to credit unions have increased in the past year, but such activity is rare against the broad landscape of bank sales.

Even so, bank sales to credit unions benefit banks, bank customers (who become credit union members), communities and not-for-profit, depositor-owned credit unions.

Bank trade groups grossly exaggerate the tax implications of these transactions, ignoring the fact that many of the banks involved pay no income taxes. Likewise, they conveniently dismiss the substantial tax payments associated with gains on the sales, which tend to completely offset any reduction in income taxes.

In short, contrary to bank trade association rhetoric, bank sales to credit unions are truly a “win for all stakeholders.” The ability for banks to sell to credit unions should be preserved, not restricted.

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Appendix

Bank Sales to Credit Unions

Completed and Pending. Sources: FDIC, NCUA, CUNA.

Year	Bank Sold	City	State	Asset Size ($M)	Year	Credit Union Sold To	City	State	Asset Size ($M)
2019	West End Bank	Richmond	IN	$299	2019	Three Rivers FCU	Fort Wayne	IN	$1,206
2019	New Buffalo Savings Bank	New Buffalo	MI	$122	2019	Teachers CU	South Bend	IN	$1,206
2019	Apollo Bank	Miami	FL	$747	2019	Suncoast CU	Tampa	FL	$10,414
2019	Ben Franklin Bank	Arlington Heights	IL	$100	2019	Corporate America Family CU	Elgin	IL	$600
2019	Hantz Bank	Southfield	MI	$228	2019	Credit Union One	Ferndale	MI	$1,455
2019	Pinnacle Bank	Scottsdale	AZ	$236	2019	Arizona FCU	Phoenix	AZ	$1,689
2019	Fidelity Bank of Florida	Merritt Island	FL	$168	2019	Central Florida Educators FCU	Lake Mary	FL	$1,800
2019	American Founders Bank	Louisville	KY	$88	2019	Evansville Teachers	Evansville	IN	$1,645
2019	Friends Bank	New Smirna Beach	FL	$98	2019	Fairwinds	Orlando	FL	$2,300
2019	Community Bank & Trust of FL	Ocala	FL	$733	2019	Mid Florida CU	Lakeland	FL	$3,487
2019	Transcapital Bank	Sunrise	FL	$205	2019	Power Financial	Pembroke Pines	FL	$654
2019	Bank of Washington	Lynwood	WA	$206	2019	Sound Credit Union	Tacoma	WA	$1,532
2019	South Central Bank	Chicago	IL	$296	2019	Verve CU	Oshkosh	WI	$961
2019	Citizens State Bank	Perry	FL	$279	2019	Vystar	Jacksonville	FL	$8,284
2018	Preferred Community	Fort Myers	FL	$116	2018	Achieva	Dunedin	FL	$1,552
2018	Golden Eagle Community	Woodstock	IL	$170	2018	Advia	Parchment	MI	$1,749
2018	State Bank of Georgia	Fayetteville	GA	$96	2018	Georgia's Own	Atlanta	GA	$2,343
2018	Encore Bank	Naples	FL	$392	2018	Lake Michigan	Grand Rapids	MI	$5,461
2018	Georgia	Dallas	GA	$94	2018	LGE	Marietta	GA	$1,310
2018	High Desert Bank	Bend	OR	$20	2018	Mid Oregon FCU	Bend	OR	$311
2018	Dairyland State Bank	Bruce	WI	$80	2018	Superior Choice	Superior	WI	$418
2017	Peoples Bank	Elkhorn	WI	$227	2017	Advia	Parchment	MI	$1,438
2017	Bank of Pine Hill	Pine Hill	AL	$20	2017	Family Security	Decatur	AL	$588
2017	Mackinac Savings	Boynton Beach	FL	$112	2017	IBM Southeast	Delray Beach	FL	$1,438
2016	Mid America Bank	Janesville	WI	$81	2016	Advia	Parchment	MI	$1,218
2016	American Bank	Huntsville	AL	$107	2016	Avadian	Birmingham	AL	$645
2016	Capital Bank	St Paul	MN	$35	2016	Royal	Eau Clare	WI	$1,856
2015	Calusa Bank	Punta	FL	$167	2015	Achieva	Dunedin	FL	$1,195
2015	Farmers State Bank	Lumpkin	GA	$45	2015	Five Star	Dothan	AL	$324
2014	Flint River National	Camilla	GA	$19	2014	Five Star	Dothan	AL	$275
2014	Hartford Savings	Hartford	WI	$175	2014	Landmark	New Berlin	WI	$2,309
2013	Advance Mutual Savings	Baltimore	MD	$54	2013	Municipal	Baltimore	MD	$1,198
2013	Second Federal S&L	Chicago	IL	$191	2013	Self-Help Federal	Durham	NC	$576
2012	Monadnock Community Bank	Peterborough	NH	$73	2012	GFA Federal	Gardner	MA	$353
2012	Griffith Savings	Griffith	IN	$85	2012	United Federal	St. Joseph	MI	$1,344
Median				$116	Median				$1,344
Group Total				$6,165	Group Total				$65,135