



Association
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Certified Professional
Accountants®

Merger Strategies

Douglas Winn, President
Wilary Winn LLC

Today's Presenter

Douglas Winn – President

Mr. Winn co-founded Wilary Winn in the summer of 2003 and his primary responsibility is to set the firm's strategic direction.



Mr. Winn is a nationally recognized expert in financial institution accounting and regulatory reporting and has led seminars on the subject for many of the country's largest public accounting firms, the AICPA, the FDIC, the FFIEC and the NCUA. Mr. Winn began his career as a practicing CPA for Arthur Young & Company - now Ernst & Young.

Topics Covered Today

Overall marketplace

- Number of credit unions and merger activity

Reasons to merge

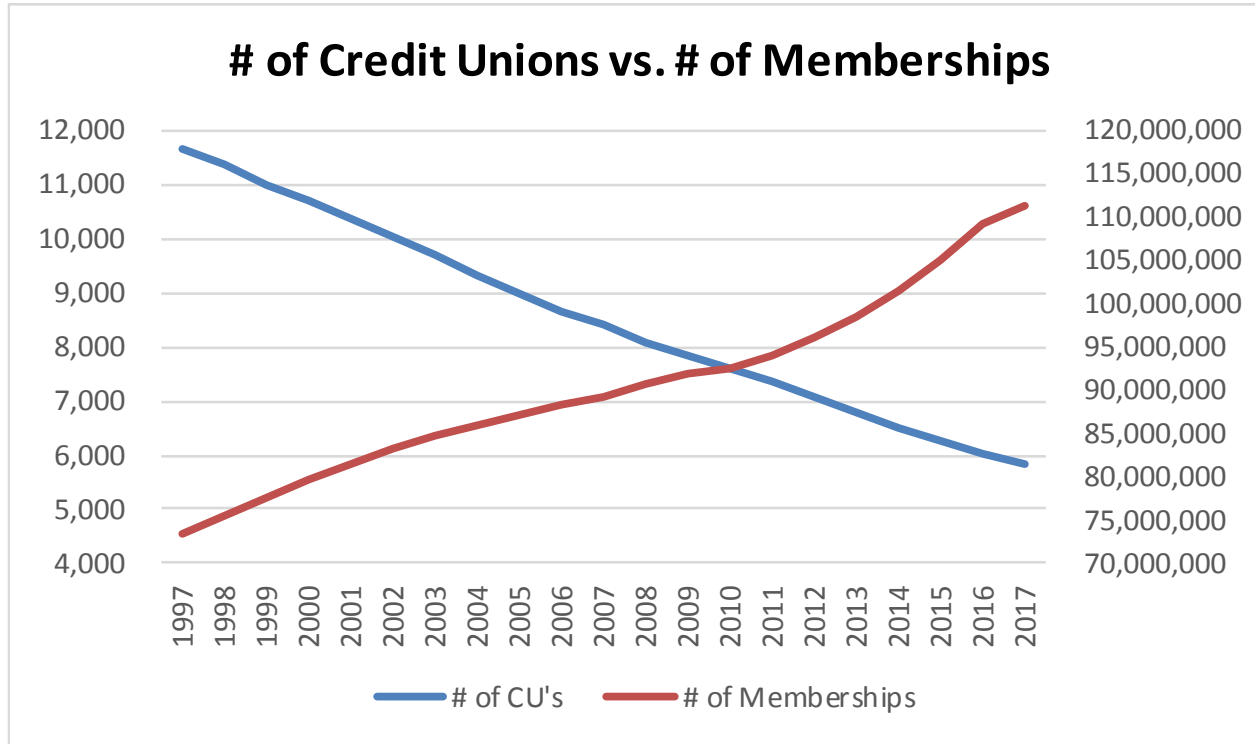
- NCUA
- WW client survey

Things to consider

- Members
- Culture
- Employees
- Technology
- Governance
- Financial and accounting

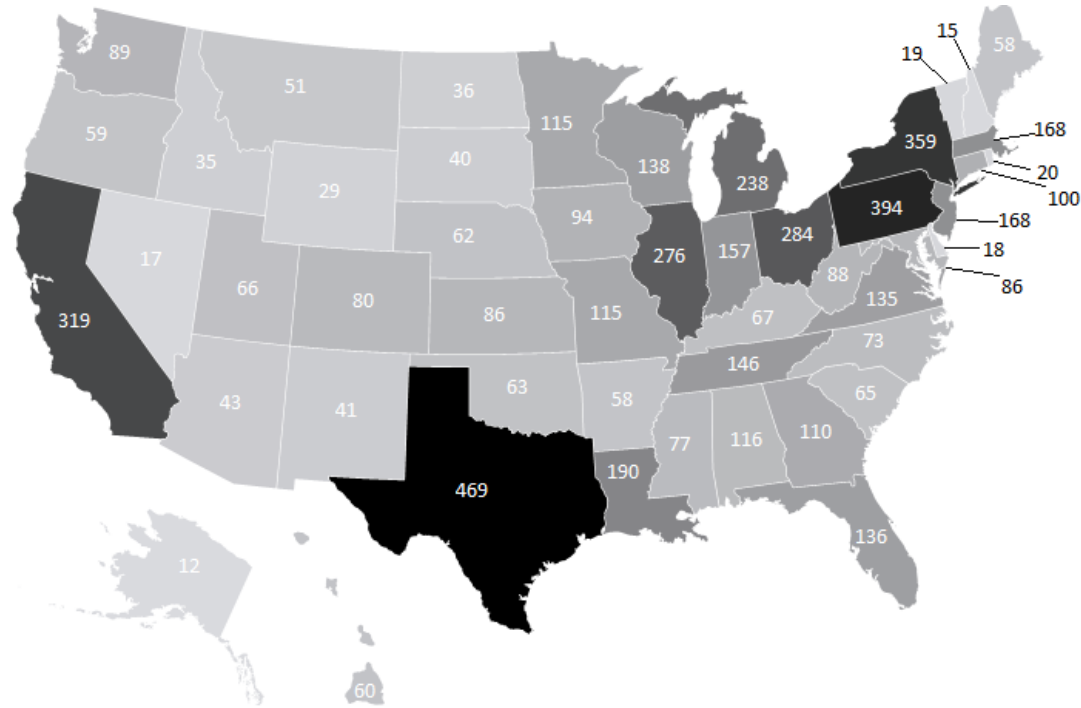
Dos and Don'ts

Credit Unions and Membership



Source: CUNA

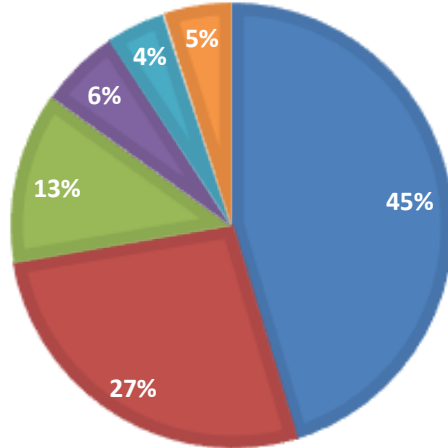
Distribution of Credit Unions Today



Existing Credit Unions by Asset Size

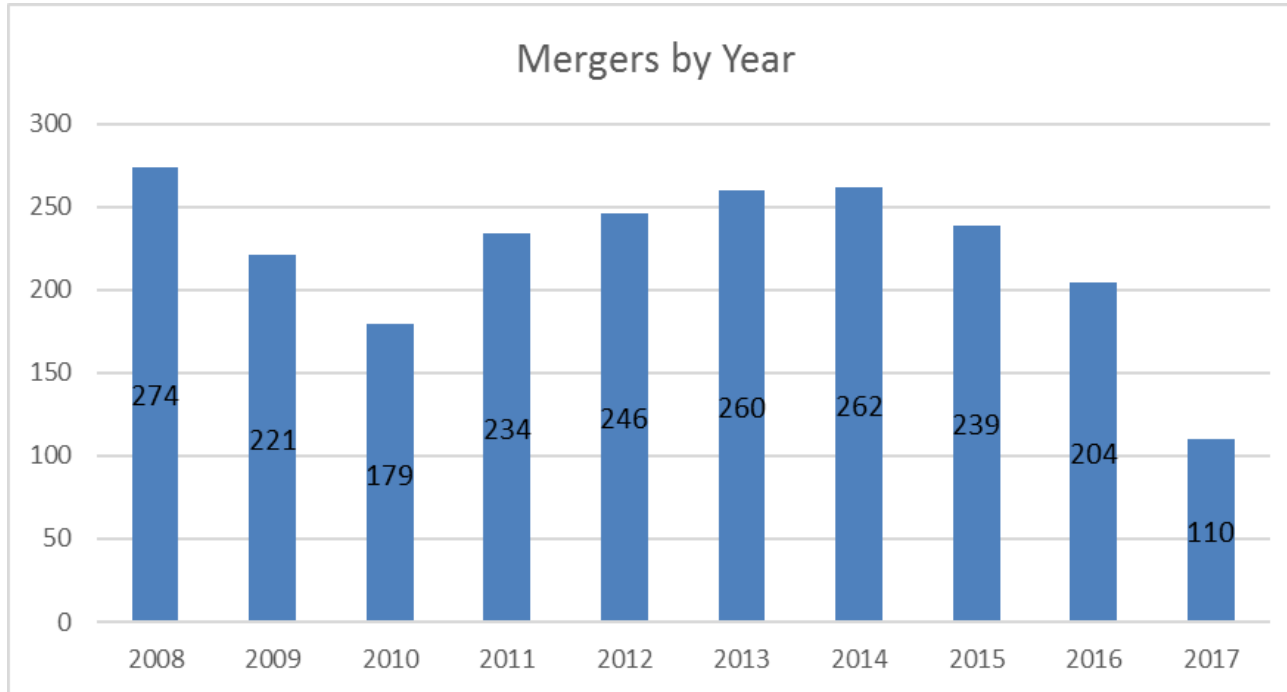
ASSET SIZE COMPOSITION

■ <\$25M ■ \$25-\$100M ■ \$100-\$250M ■ \$250-\$500M ■ \$500-\$1B ■ >\$1B



Asset Range	Count
<\$25M	2,629
\$25-\$100M	1,563
\$100-\$250M	723
\$250-\$500M	345
\$500-\$1B	247
>\$1B	291
Total	5,798

Number of Mergers per Year



*data is through June 2017

Top Credit Unions States by Count

State	Number of Credit Unions		% Decrease
	2011	2017	
TX	542	469	-13.47%
PA	525	394	-24.95%
NY	428	359	-16.12%
CA	422	319	-24.41%
OH	367	284	-22.62%
IL	375	276	-26.40%
MI	314	238	-24.20%
LA	218	190	-12.84%
NJ	207	168	-18.84%
MA	218	168	-22.94%

Credit Unions Mergers by State

State	2011	2012	2013	2014	2015	2016	2017	Total	% of Total*
PA	14	21	23	24	18	22	9	131	24.95%
CA	8	16	21	17	17	19	5	103	24.41%
IL	13	15	19	22	18	9	3	99	26.40%
OH	8	15	17	14	11	13	5	83	22.62%
WI	20	12	14	11	12	6	6	81	36.99%
MI	10	7	15	18	13	7	6	76	24.20%
NY	12	11	18	6	8	11	3	69	16.12%
TX	12	14	12	14	11	6	4	73	13.47%
VA	6	8	12	10	9	8	3	56	29.32%
MA	7	8	11	6	8	4	6	50	22.94%

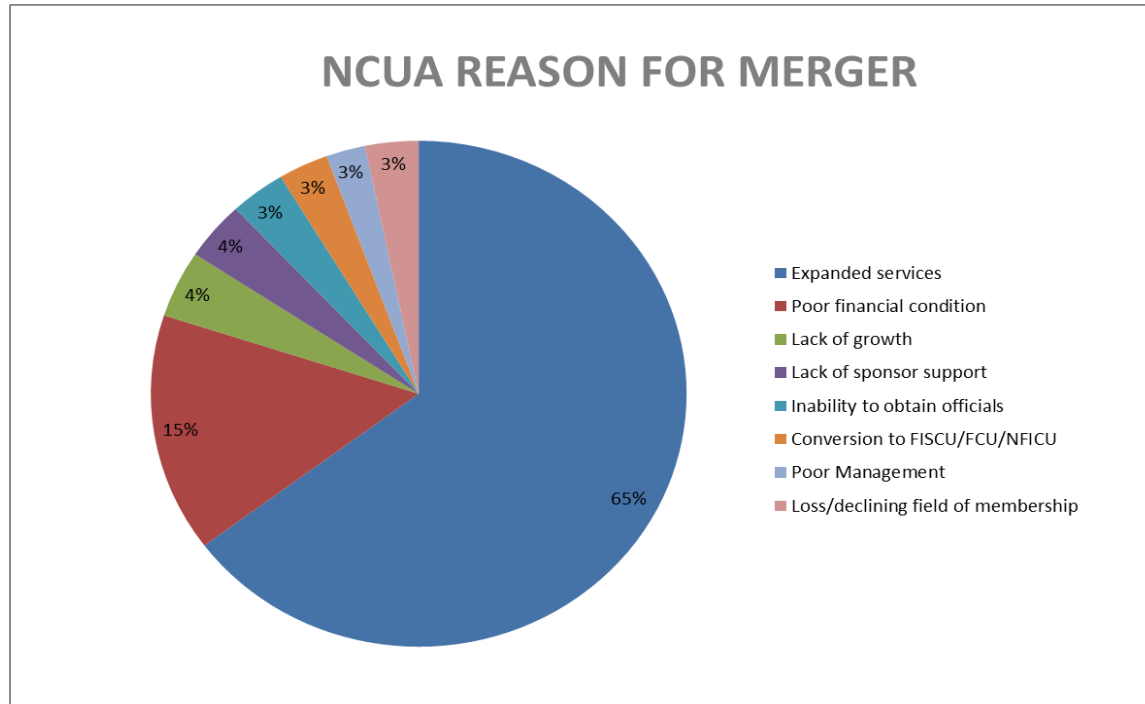
*as a percentage of those that existed as of the beginning of 2011

Most Active Acquirers

Credit Union	Total Mergers since 2011*
Community Choice CU	11
Pentagon FCU	11
Great Lakes CU	11
Landmark CU	10
USX FCU	9
Financial Plus CU	9
American Heritage FCU	8
Summit CU	8
Corporate America Family CU	8
Metro CU	7
Community First CU	7

*based on NCUA data from 2011 and forward

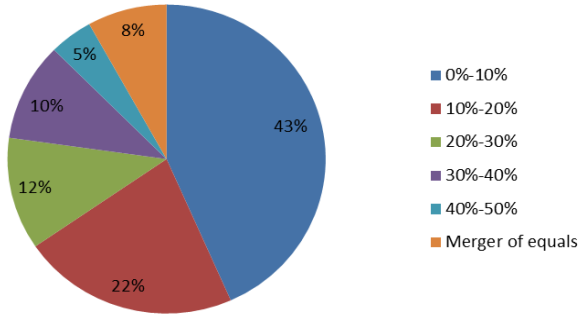
NCUA Reason for Merger



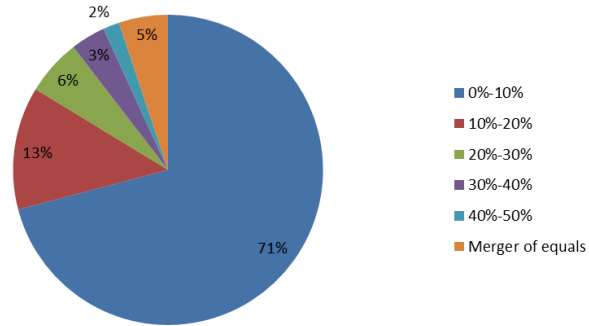
*based on NCUA data from 2011 and forward

Wilary Winn Data

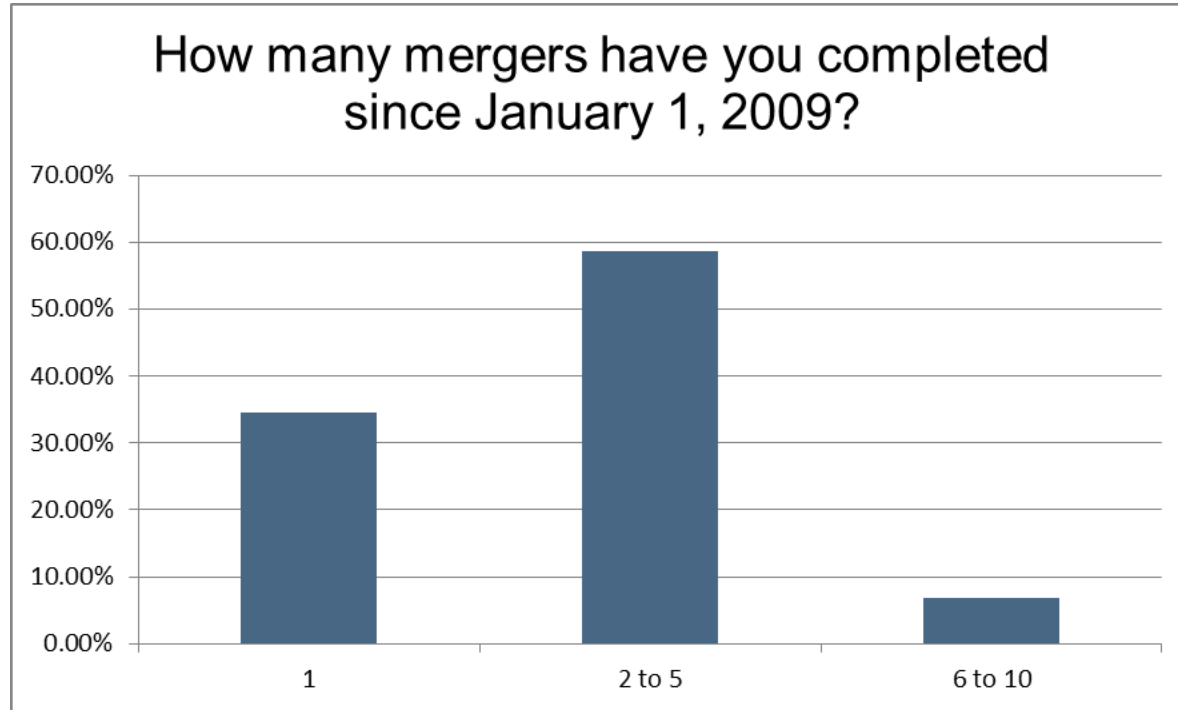
WW Mergers - Asset Size Relative to Acquirer



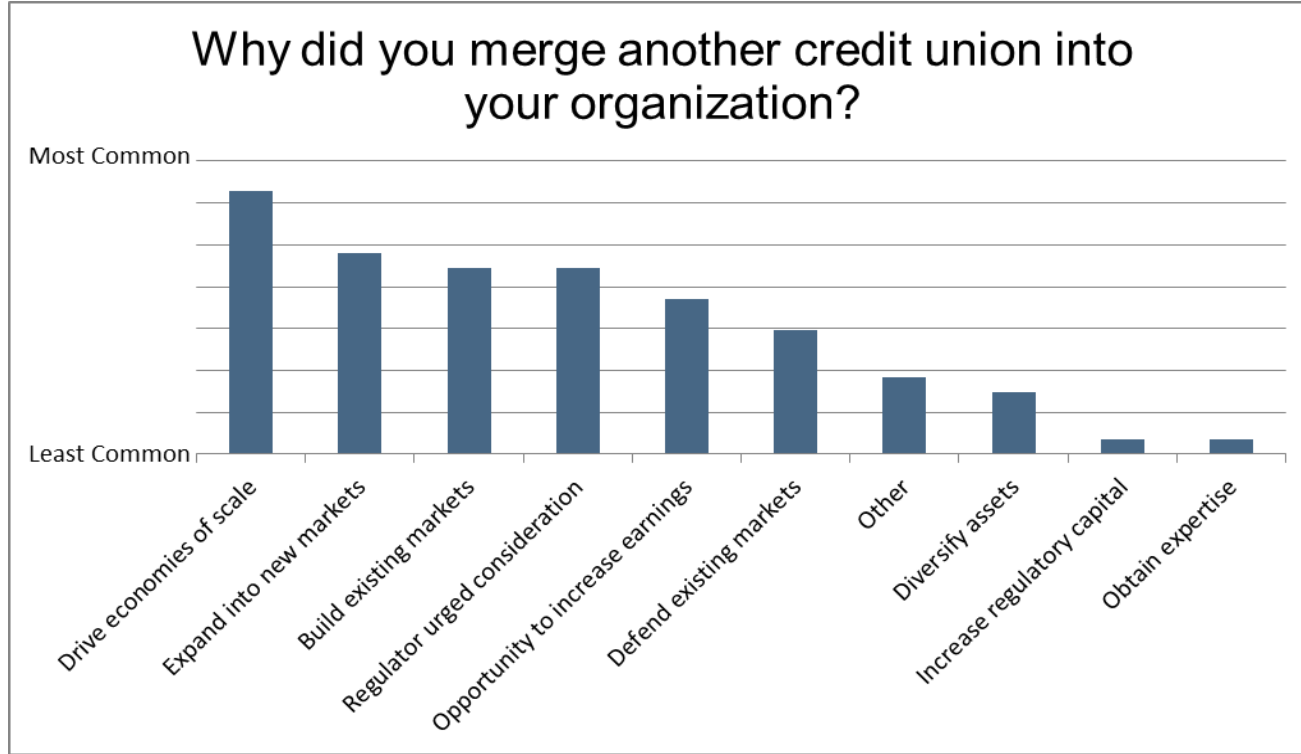
All Mergers - Asset Size Relative to Acquirer



Wilary Winn Data – Survey Results



Wilary Winn Data – Survey Results



Merger Considerations

Membership Considerations

- Acquirer can better serve the members than the acquired institution
 - Better Rates
 - More loans and deposit products (i.e. mortgage lending)
 - Mobile banking
 - More branch locations
- Differing member profile in some cases
 - i.e., different age or economic circumstances
 - Need deposits/liquidity – merge with older membership base
 - Need loans – merge with younger/lower income membership base
- Other considerations
 - SEG versus geographic membership – limited ability to grow within existing FOM

Merger Considerations

Cultural Considerations

- Does the acquired institution have similar goals and values?
- Does the to be acquired institution have similar business model and operating strategies?
- What is their definition of member service?
- Mergers affect the acquirer as well – what can you learn?

Merger Considerations

Employee Considerations

- Acquisition of specialize expertise
- Senior management from merging-in organization could have a better understanding of local market
- Other considerations
 - Define who is and who is not going to be retained as part of the merger agreement
 - Does the merger bring sufficient benefit to permit overstaffing in the short or medium term?

Merger Considerations

Technology Considerations

- Core system operating and conversion costs
- Mobile banking/deposit
 - Smaller organizations cannot afford to provide these types of services yet younger members demand it

Merger Considerations

Governance Considerations

- How do you ensure the acquired institution continues to be represented?
 - How many members will be added to your board?
 - Consider forming advisory committee

Merger Considerations

Other Considerations

- What is the minimum or maximum size that you as an organization would consider merging in?
- Name retention – how long or should the organization's existing name be maintained?
 - Organizations we interviewed said that they found the costs of maintaining the old name outweighed the benefits and contributed to an internal perception of them versus us

Intro to Fair Value Accounting

	Book Balance	Estimated Fair Value %	Estimated Fair Value \$	Difference
ASSETS				
Cash	23,000,000	100.0%	23,000,000	-
Cash Equivalents	-	-	-	-
Available for Sale Securities	11,000,000	99.5%	10,945,000	(55,000)
Held to Maturity Securities	-	-	-	-
Deposits in Commercial Banks, S&Ls, Savings Banks	3,000,000	100.3%	3,007,500	7,500
Loans to, Deposits in, and Invests in Natural Person CU	-	-	-	-
Total Membership and Paid In Capital	1,200,000	100.0%	1,200,000	-
All Other Investments in Corporate Credit Unions	-	-	-	-
All Other Investments	350,000	135.0%	472,500	122,500
Loans Held for Sale	-	-	-	-
Total Loans and Leases	183,000,000	99.8%	182,635,000	(365,000)
Total Loans and Leases - Loss Allowance	(1,000,000)	0.0%	-	1,000,000
Foreclosed and Repossessed Assets	-	-	-	-
Land and Building	7,000,000	90.0%	6,300,000	(700,000)
Other Fixed Assets	450,000	100.0%	450,000	-
NCUA Share Insurance Capitalization Deposit	1,900,000	100.0%	1,900,000	-
Accrued Interest on Loans	300,000	100.0%	300,000	-
Accrued Interest on Investments	30,000	100.0%	30,000	-
All Other Assets	7,000,000	100.0%	7,000,000	-
Total Assets	237,230,000	100.0%	237,240,000	10,000
LIABILITIES				
Notes Payable	-	-	-	-
Accrued Dividends & Interest Payable	1,000	100.0%	1,000	-
Accounts Payable and Other Liabilities	3,300,000	100.0%	3,300,000	-
Share Drafts	35,000,000	100.0%	35,000,000	-
Regular Shares	60,000,000	100.0%	60,000,000	-
Money Market Shares	65,000,000	100.0%	65,000,000	-
IRA/KEOGH Accounts without Defined Maturities	5,500,000	100.0%	5,500,000	-
All Other Shares	6,000,000	100.0%	6,000,000	-
Share Certificates	25,000,000	100.5%	25,125,000	125,000
IRA/KEOGH Certificates	11,500,000	100.5%	11,557,500	57,500
Total Liabilities	211,301,000	100.1%	211,483,500	182,500
EQUITY				
	25,929,000		25,756,500	(172,500)

Intro to Fair Value Accounting

	Base Value	Weighting	Weighted Value
Overall Value of Xyz Credit Union - Income Projected	19,000,000	75%	14,250,000
Overall Value of Xyz Credit Union - Guideline Transaction	18,250,000	15%	2,737,500
Overall Value of Xyz Credit Union - Market Valuation	17,000,000	10%	1,700,000
Overall Value of Xyz Credit Union - Total Wtd Avg	-	100%	18,687,500
Excess Capital Value Dollar-for-Dollar			10,000,000
Estimated Value of the Franchise			28,687,500
Value of Assets and Liabilities			25,756,500
Value of Core Deposits			2,572,500
Total Liquidation Value of the Entity			28,329,000
Total Estimated Value of the Entity (Max of Income and Market Valuations or Liquidation Value)			28,687,500
Value of Financial Assets and Liabilities			19,006,500
Value of Non-Financial Assets and Liabilities			6,750,000
Value of Core Deposits			2,572,500
Goodwill (Bargain Purchase)			358,500

Intro to Fair Value Accounting

Acquirer's Equity before OCI Adjustment (Abc CU Pre-Merger Equity)	60,000,000	
Plus: Acquirer's OCI Adjustment	<u>(200,000)</u>	
Total GAAP Equity	59,800,000	
Plus: Equity Acquired in Merger	28,687,500	12.09%
Plus: Bargain Purchase Gain	<u>-</u>	
Acquirer's Post-Merger GAAP Equity	88,487,500	

PCA Net Worth Merger Entries (Regulatory Only, Non-GAAP)

Acquirer's Regulatory Net Worth After Merger	88,487,500	
Less: OCI Adjustment	(200,000)	
Less: Equity Acquired in Merger	28,687,500	
Plus: Adjustments to Retained Earnings through Business Combinations	<u>25,929,000</u>	10.93%
Equity for PCA Net Worth Calculation	85,929,000	

Intro to Fair Value Accounting

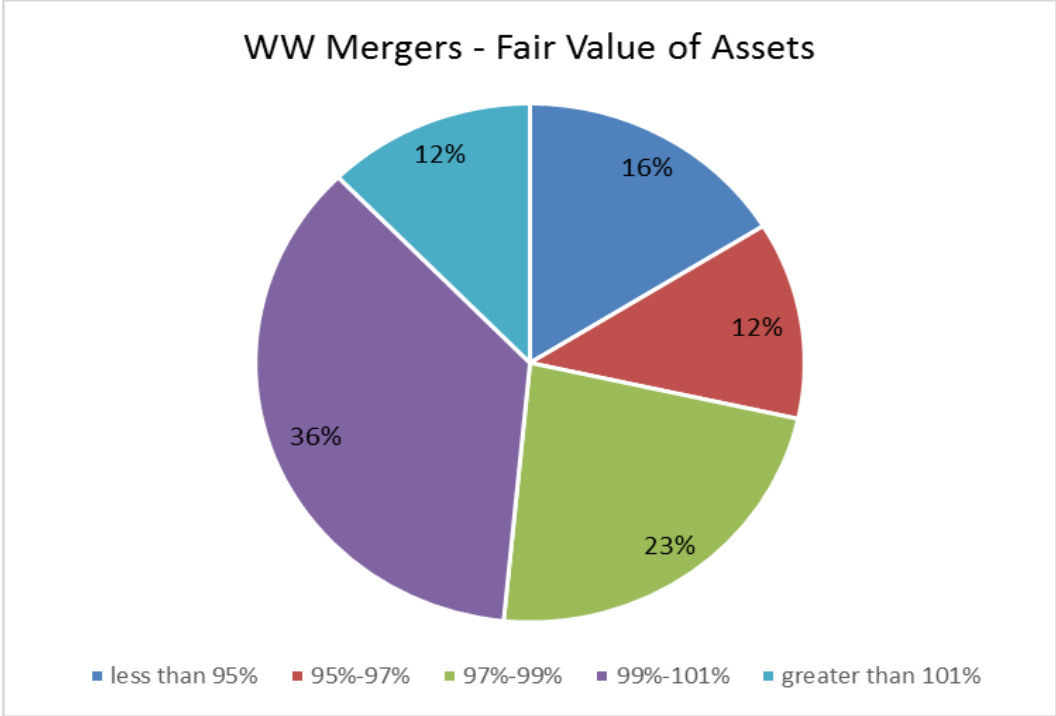
	Debit	Credit	Future Lifetime Impact on Income
Investments			
Available for Sale Securities	-	55,000	55,000
Deposits in Commercial Banks, S&Ls, Savings Banks	7,500	-	(7,500)
All Other Investments	122,500	-	
Loans			
Credit Adjustment	-	1,125,000	
Discount Rate Adjustment	970,000	210,000	(760,000)
Total Loans and Leases - Loss Allowance	1,000,000	-	
Fixed Assets			
Land and Building	-	700,000	
Other Assets			
Core Deposit Intangible	2,572,500	-	(2,572,500)
Shares/Deposits			
Share Certificates	-	125,000	
IRA/KEOGH Certificates	-	57,500	182,500
Equity			
Equity (removal of existing equity accounts)	25,929,000		
Equity (record equity acquired in merger)		28,687,500	
Goodwill	358,500	-	
Bargain Purchase	-	-	
	30,960,000	30,960,000	(3,737,500)

Merger Considerations

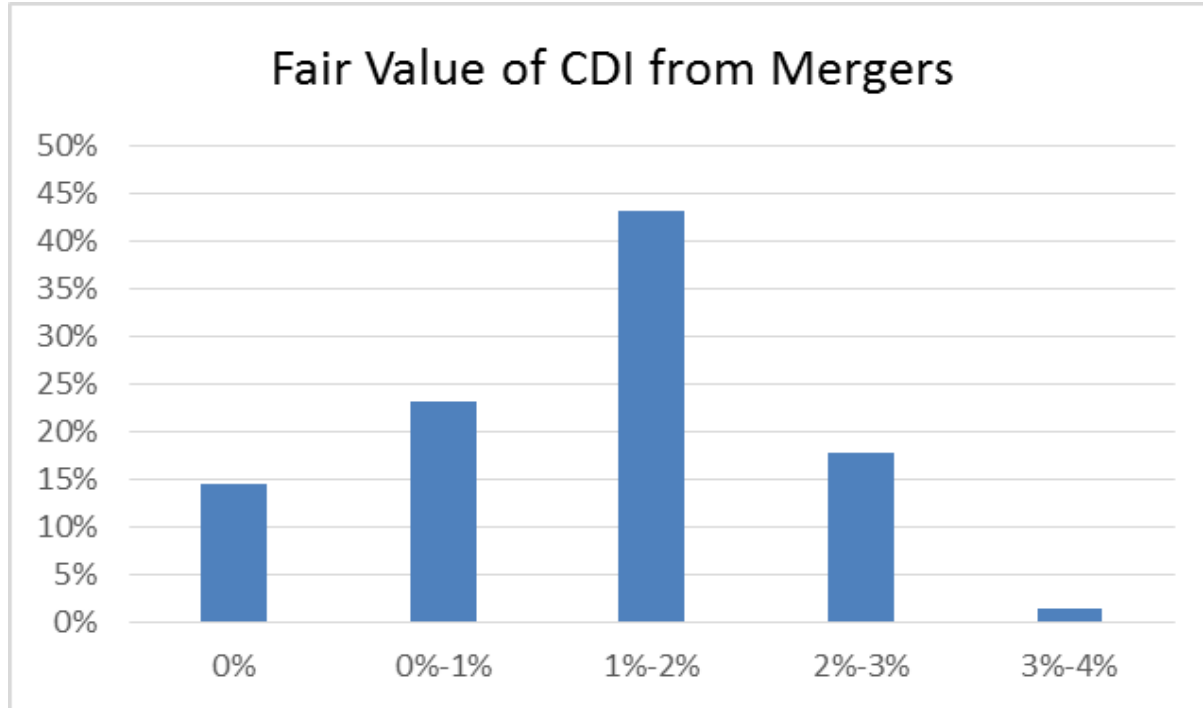
Financial Considerations

- Economies of scale
- Complementary balance sheets
 - Diversification
 - ALM profile
- Accretive or dilutive to earnings
- Regulatory capital considerations – Risk-Based Capital
- Cost/Benefit of member acquisition

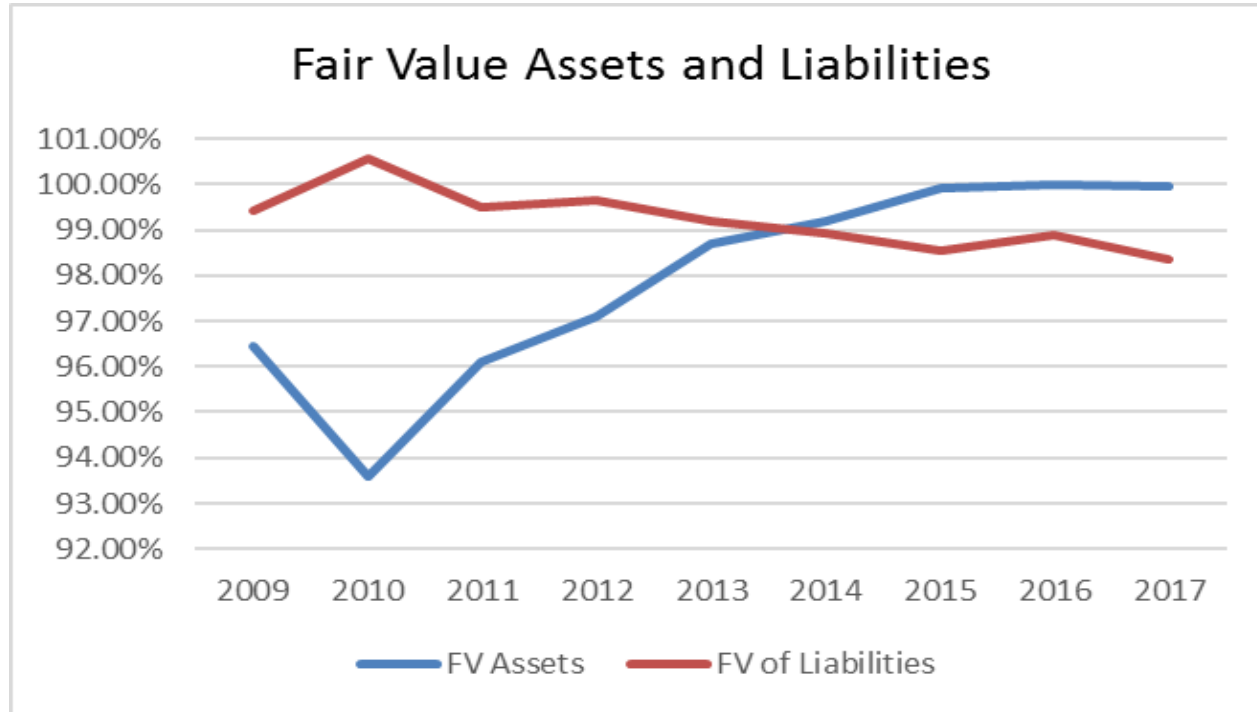
Wilary Winn Data – Fair Value of Assets



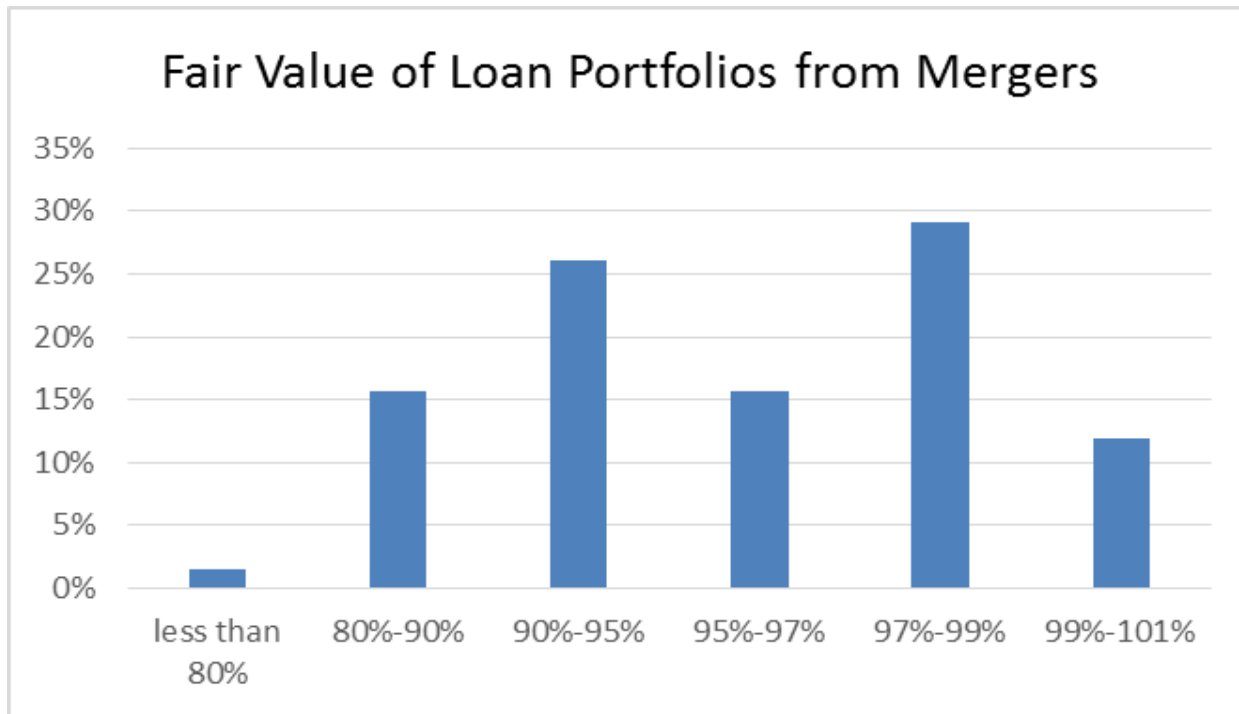
Wilary Winn Data – Core Deposit Intangible



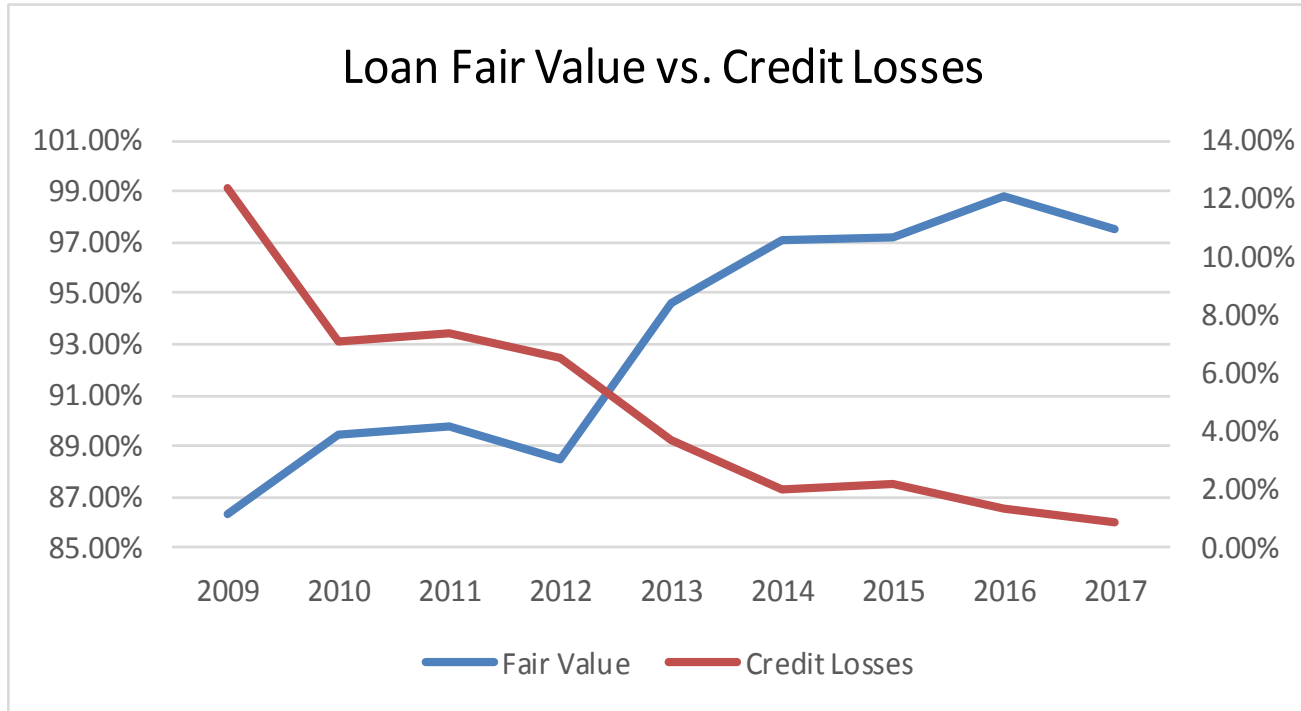
Wilary Winn Data – Financial Implications



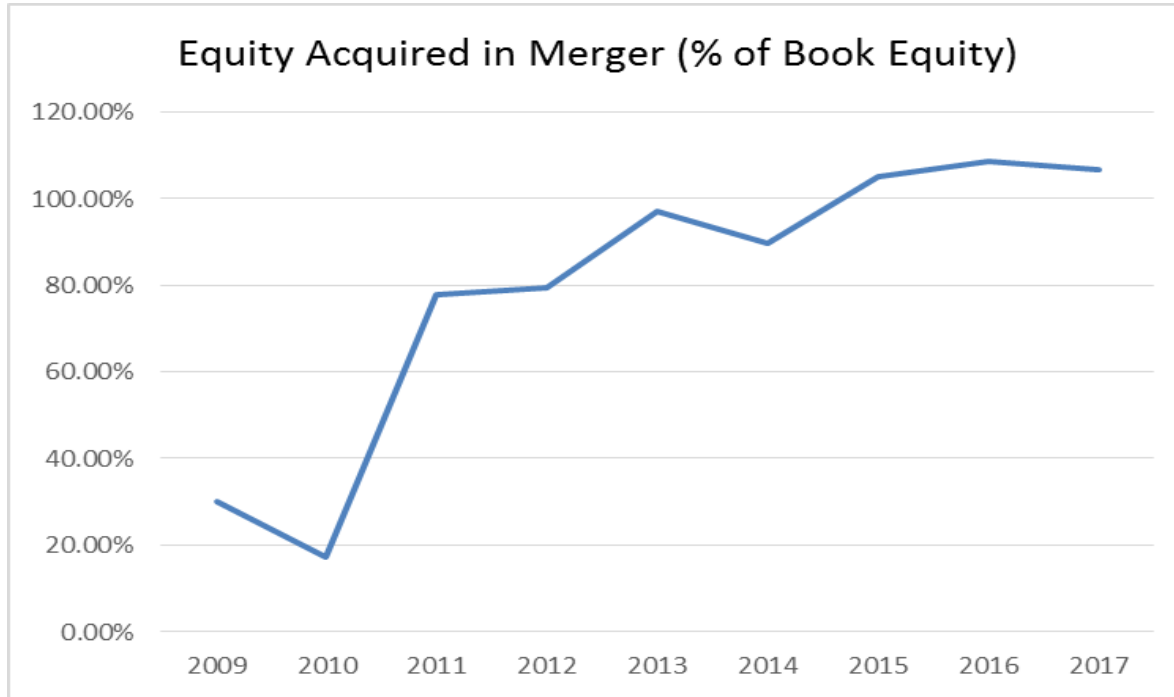
Wilary Winn Data – Financial Implications



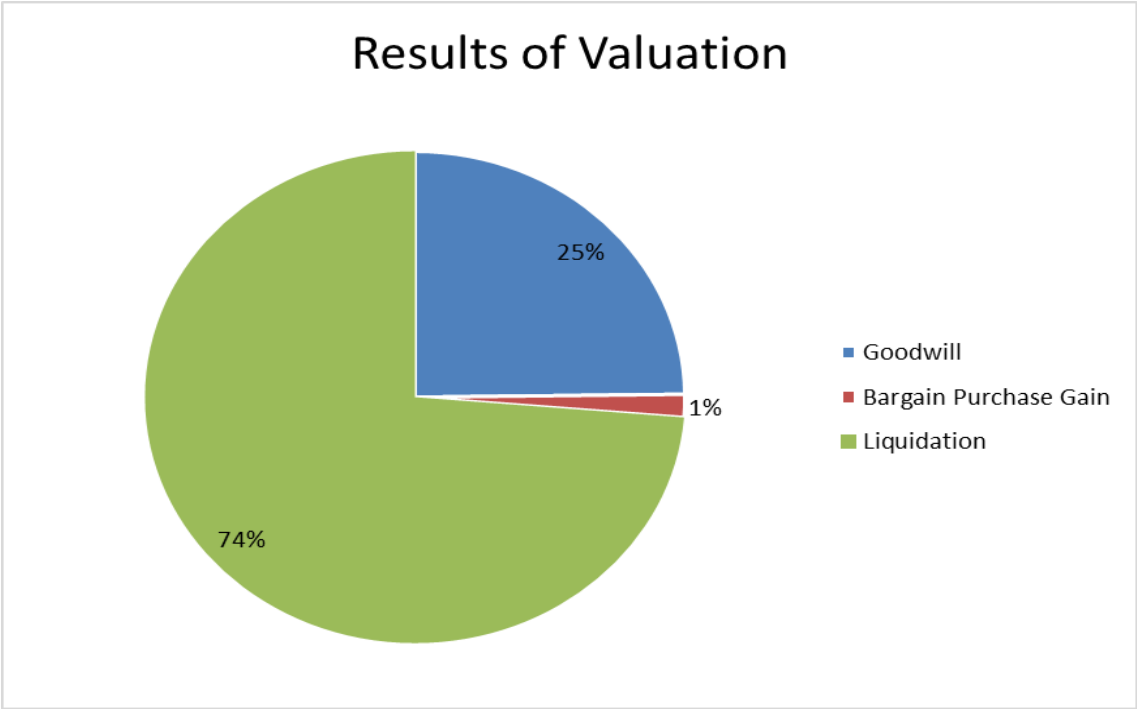
Wilary Winn Data – Financial Implications



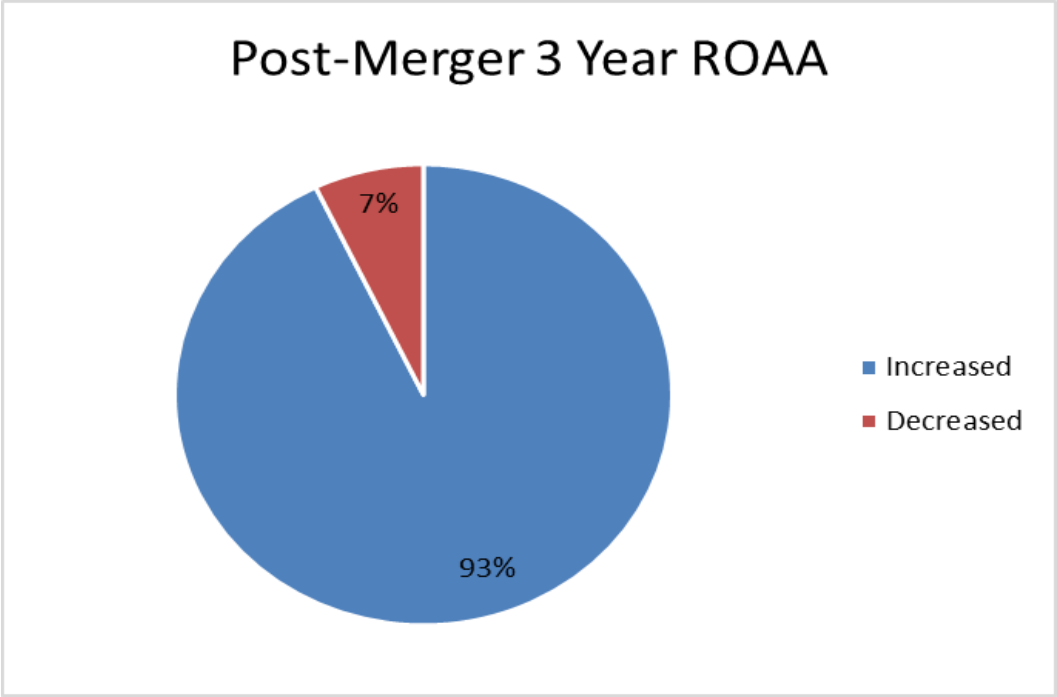
Wilary Winn Data – Financial Implications



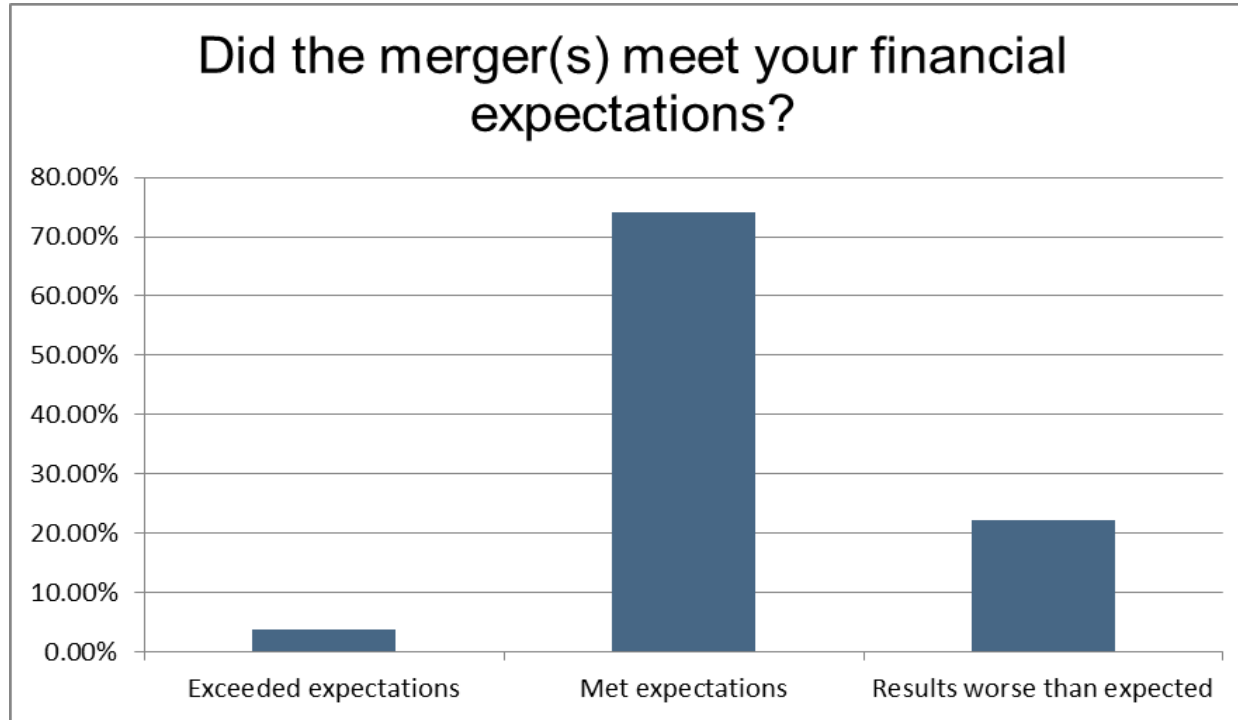
Wilary Winn Data – Results of Valuation



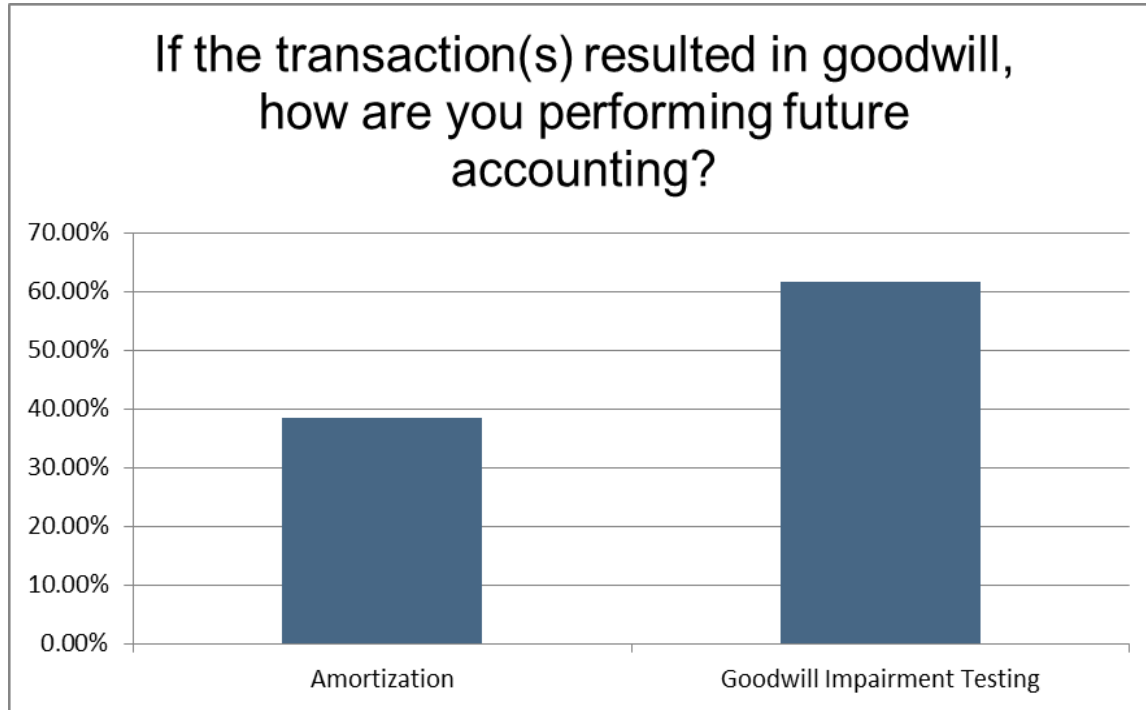
Wilary Winn Data – Financial Implications



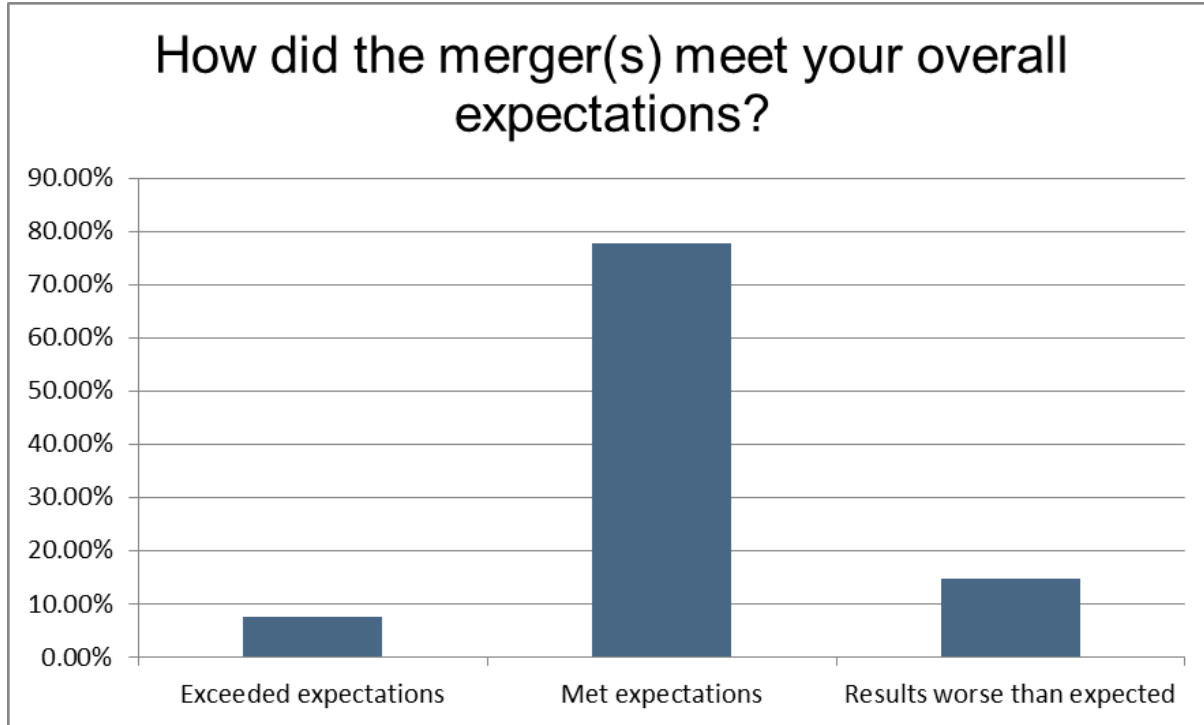
Wilary Winn Data – Survey Results



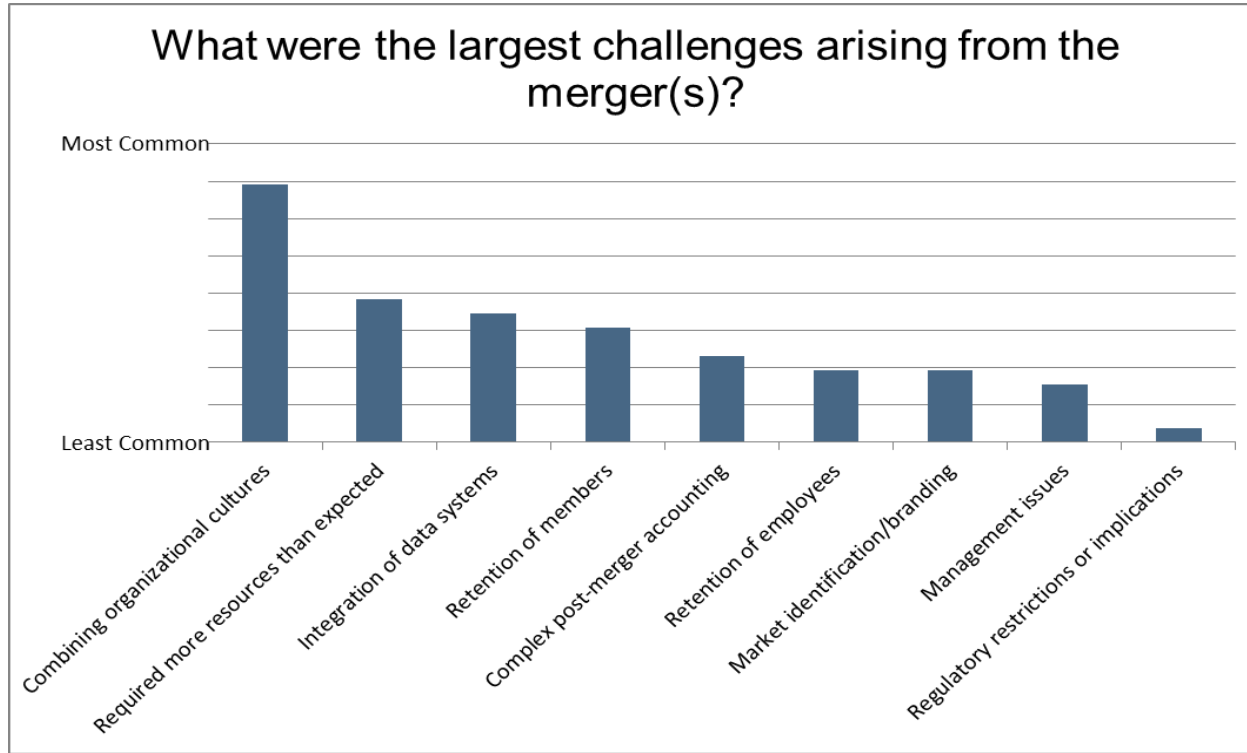
Wilary Winn Data – Survey Results



Wilary Winn Data – Survey Results



Wilary Winn Data - Survey Results



Merger Dos

Memberships Dos

- Make transition easy and incent members to stay
- Be sensitive to cultural fit and member perception (community presence, perception of being taken over by a much larger organization in some cases)

Merger Dos

Balance Sheet Risks

- A thorough review of the loan and investment portfolios to identify any material or significant risks
 - Fraud/poor approval process
 - Legal loan documentation
 - Large commercial loans
 - Underwater real estate properties
 - Collateral age
 - Credit quality of loans
- Determine if there are any large assets or liabilities that are not recorded on the financial statements
 - Underfunded retirement or pension benefits
 - Golden parachutes
 - Other financial obligations (i.e. large lines of credit that cannot be cut off)

Merger Dos

Other Financial Dos

- Review the general ledger for any items that must be written off, including assets that will not be used post-merger
 - Core system software
 - Other fixed assets
- Get an idea of the market value of the branch locations
 - Consider branches that you may want to sell or leases you want to terminate

Merger Dos

Earnings and ALM

- Perform a high-level valuation to determine the future income impact of the mergers
 - Is the transaction accretive or non-accretive from a fair value accounting standpoint?
 - What is the effect on regulatory capital?
- Consider the impact on ALM profile
 - Run the NEV and NII analysis for a combined organization pre-merger to determine how the merger will affect the profiles of each
- Determine any concentration risk that will result from a merger
 - Would you be out of policy with regards to any current concentration limit policies?

Merger Dos

Accounting Dos

- Contact your CPAs and/or regulators for any large judgement calls or questions
- Consider Day Two Accounting
 - Accretion/Amortization of purchase premiums and discounts
 - Consider the accounting method you would use in the instance of Goodwill
 - Consider if any loans will be Purchased Credit Deteriorated
 - This involves very complex accounting – do you have the resources internally or will you have to pay an external vendor for valuations and accounting advice?

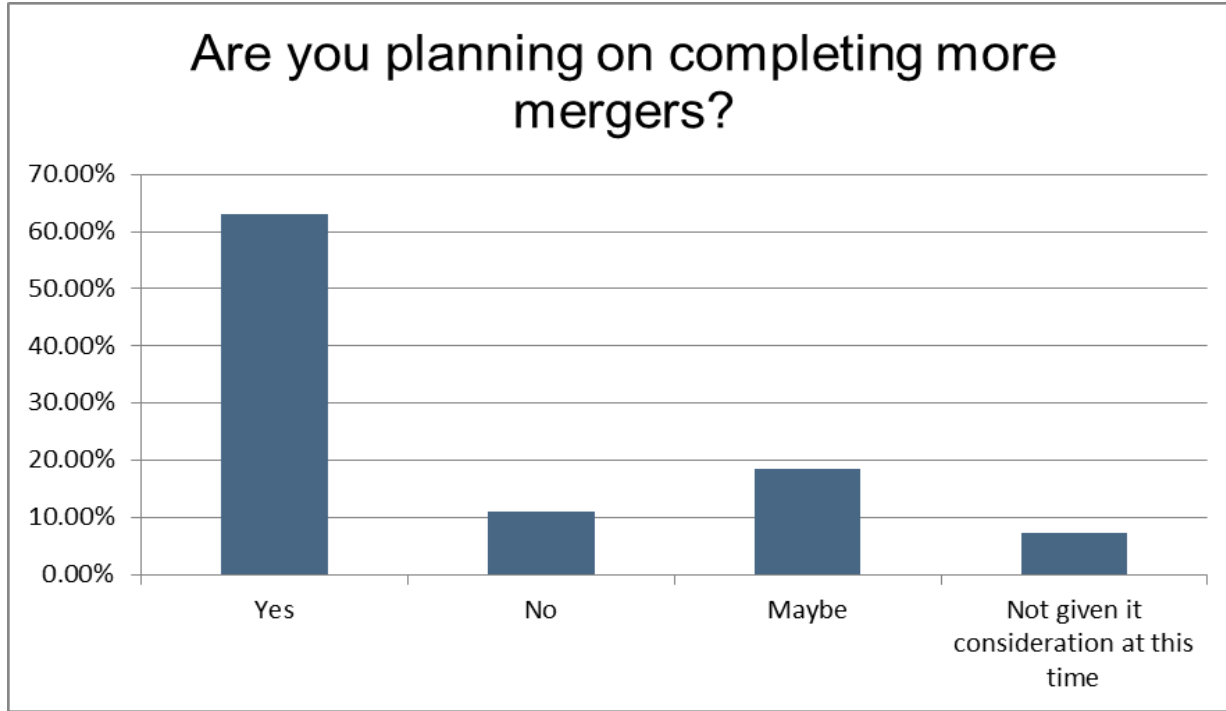
Merger Accounting Don'ts

- Over fund the allowance
 - The fair value accounting entries write the existing allowance to zero
 - Pre-merger overfunding of the allowance decreases the equity counted for regulatory capital purposes post-merger
- Book merger-related expenses on the merging-in institution's financials
 - Anything triggered by the merger needs to be accounted for at the combined institution level
- Use an exact quarter-end effective date
 - Give yourself one quarter to make the entries, understand the accounting, and assemble your first call report!
- Assume that the organization is deemed immaterial without speaking with your auditors and regulators first

Merger Don'ts

- Underestimate the cost, time, and complications that can result for data/core conversion
- Underestimate the length of time for regulatory approval
- Take due diligence lightly
 - Watch for “messy accounting”
 - Fraud
 - Poor collection procedures

Wilary Winn Survey Results





Insights & Resources

FEATURED EVENT

**WILARY WINN TO PRESENT AT THE
2017 AICPA CONFERENCE ON
CREDIT UNIONS**

📅 October 23, 2017

 [View Event Info](#) »

FEATURED PUBLICATION

CECL IS COMING: ARE YOU READY?

 [Download](#) »

FEATURED PERSPECTIVE

**REVENUE RECOGNITION -
MORTGAGE BANKING**

📅 July 19, 2017

 [Read Full Post](#) »

Merger Accounting Resources

Estimation of Fair Value

 [CREDIT UNION PURCHASE ACCOUNTING WHITE PAPER](#)

 [CREDIT UNION MERGER FAQs](#)

 [FAS ASC 310-30 LOAN ACCOUNTING WHITE PAPER](#)

 [CECL AND ASC 310-30 MEMO](#)

 [ACCOUNTING FOR GOODWILL IMPAIRMENT FOR CREDIT UNIONS](#)

 [CUNA COUNCIL - CFO FINANCIAL FLASHES: PURCHASE ACCOUNTING FOR CREDIT UNION MERGERS](#)

 [TROUBLED DEBT RESTRUCTURINGS - WHITE PAPER FROM THE CENTER FOR AUDIT QUALITY](#)

 [FAIR VALUE: WHERE FINANCE MEETS ACCOUNTING](#)

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