

Banks and credit unions: Partners in the M&A dance?

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Banks and credit unions frequently find themselves at odds. But when push comes to shove, would a bank and a credit union ever find themselves at the bargaining table?

There's nothing that says a bank can't merge with a credit union. And on the face of it, such transactions make sense. A rough-and-tumble interest rate climate has made life miserable. Competition for deposits seems to be at an all-time high, while opportunities to broaden revenue are few.

A number of area community banks have responded by merging. But given their line of business and overall structure, credit unions, which are nonprofit entities that look and smell like banks but pay no taxes, would seem to be a natural next target.

Such mergers aren't without precedent -- Columbus, Ohio-based Nationwide Financial Services merged its bank and credit union subsidiaries last year. Closer to home, industry observers say several such deals have been attempted, only to fall through.

What's the holdup?

Territorialism seems to be a major dealbreaker. Local bankers say transactions between banks and credit unions are often rejected outright to ensure that credit union members remain protected under their original charters. In fact, the National Credit Union Administration, the industry's chief regulator and lobbying arm, is a commonly cited roadblock. Calls to the NCUA were not returned.

"So what difference does it make, in terms of the charter they're under?" said Gerry Mulligan, the CEO of RiverBank in Lawrence and the former commissioner of banks in Massachusetts. He said critics have created a perception that banks and credit unions are fundamentally different, adding that similar arguments bogged down deal making among banks in the 1980s.

By combining with a bank, credit unions are released from certain regulatory caps on how they do business. By law, they can only do business with qualified members, usually defined by an industry affiliation or geographic location. They must also follow specific guidelines on

the amounts and types of loans they can make, although many bank proponents say credit unions are increasingly finding ways around those boundaries.

"There appear to be some regulatory hurdles that have to be overcome, but navigating over, under or around those hurdles could yield significant benefits," said Stefan Jouret, a litigator and banking expert at Donovan Hatem in Boston. He said bank/credit union mergers are all the more appealing, at least from a public policy standpoint, as the deals bring an un-taxed entity (credit unions) "into the tax fold."

Nonetheless, Kevin Handy, a banking attorney with Gallagher, Callahan & Gartrell in Boston, notes that such mergers, though legal in Massachusetts, would be complicated.

For one, credit unions have no shareholders and are technically "owned" by their members. That structure requires members to endorse any potential deal while also agreeing to divide or roll over the generations of untapped equity built up in their credit union.

While mutually owned banks have a similar ownership structure, things get dicey when it comes to blending such organizations together, as equity ownership in the combined entity can be tough to define.

The issue gets even stickier when it comes to merging a stock-based bank and a credit union, although M&A advisers have begun to use special payouts and financial engineering to make both credit union members and bank shareholders whole. Still, such arrangements often take some selling.

But Handy said he is increasingly hearing of M&A advisers nudging their banking clients toward credit unions as the number of acquisition targets dry up in the community banking sector.

"They recognize it's a great way to replenish that supply," he said.

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