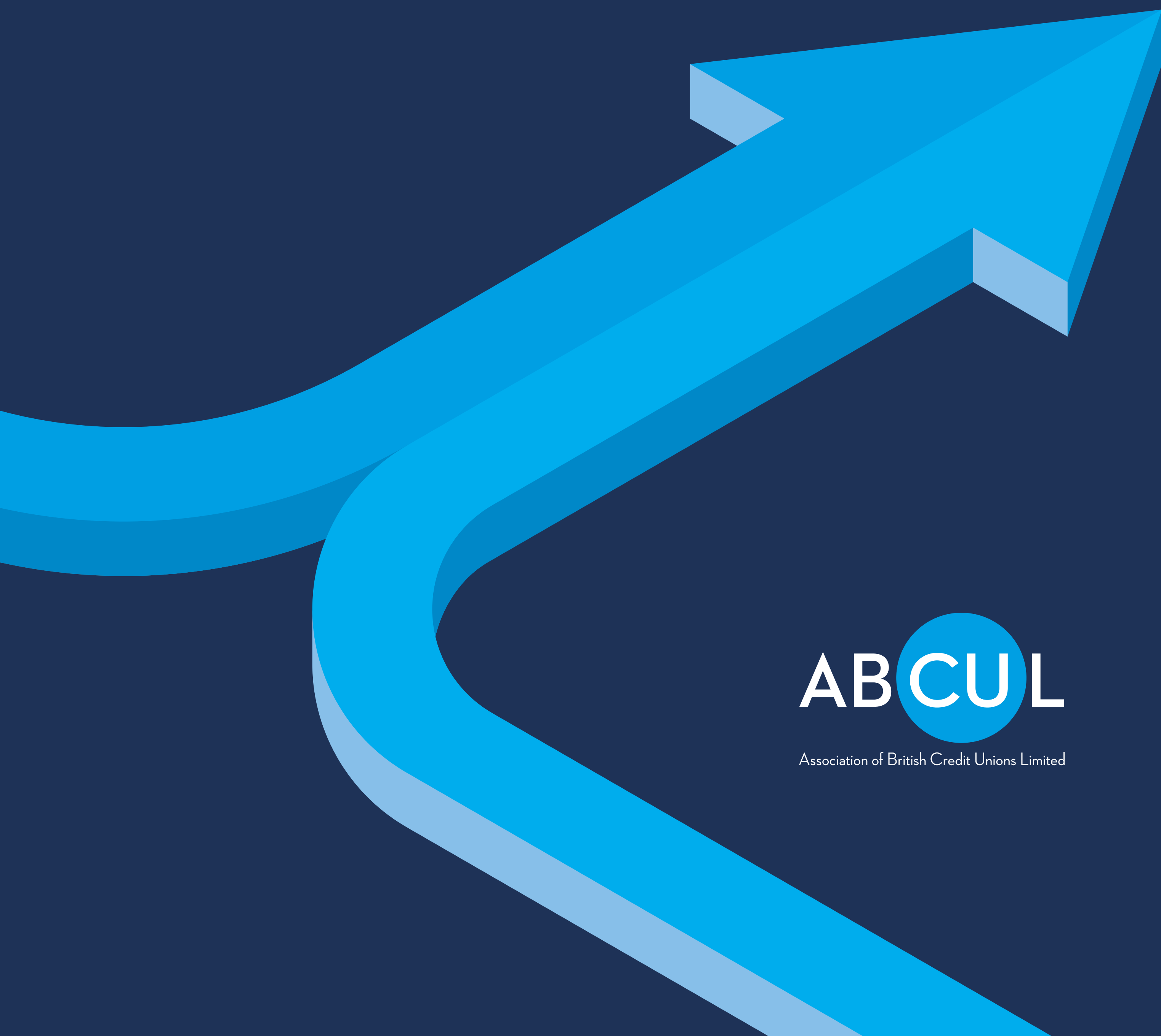
Towards a Strategic Approach

Mergers in the Credit Union Sector



INTRODUCTION

Consolidation has been a long established and common feature of the British credit union sector, with a continued pattern of credit union mergers evident in recent years. A merger, where a credit union transfers its full assets, liabilities, and operations into another, can provide a vital and valuable step in the development of many credit unions. In particular, mergers can work to improve credit unions' sustainability prospects and service offerings to members, via the breadth of opportunities accessed through combining two organisations. However, the merger process can also be complex and difficult. Mergers can involve a range of logistical and emotional challenges for credit unions' boards, staff, and volunteer networks, that present several barriers to merging within the British sector. These barriers work to prevent potentially valuable credit union mergers from happening or mean that mergers go ahead at the last-minute before failure, when the value of merging is compromised.

As a result, there is a need to raise awareness of, and contest, the barriers towards merging within the British credit union sector. It is proposed that the adoption of a strategic approach to mergers by credit unions, combined with the right stakeholder support, could overcome these barriers, and enable credit unions to pursue the strategic mergers that would deliver value for their members.

This paper will promote a strategic approach to credit union mergers and notify stakeholders of the barriers towards strategic merger activity. The content will be particularly useful to credit union leaders and board members, as well as policymakers, who want to learn about best practice for credit union mergers, why a strategically approached merger may present value to a credit union, and what can be done to facilitate strategic merger activity in the sector.

The Association of British Credit Unions Limited (ABCUL), the largest trade body within the British sector, has produced this paper to support the success of the national credit union movement. This work is based on consultation and research on strategic credit union mergers, carried out as a part of ABCUL's Vision 2025 development strategy for the sector. To action the commitments made in this strategy, ABCUL set up the Strategic Merger Taskforce (SMT), a group that has met throughout 2021 to explore the role and context of strategic mergers in the British credit union sector. This paper compiles the thoughts and work of the SMT.

To begin, more detail on the background and motives behind this work will be provided. It is then clarified what exactly makes a merger 'strategic', followed by the case for a more strategic approach to be adopted towards mergers by British credit unions. The barriers to greater strategic merger activity in the credit union sector will then be identified. Subsequently, there will be a call to action, specifying how ABCUL, credit unions and their stakeholders can all work cohesively to overcome the barriers to strategic merger activity.

BACKGROUND

This paper concludes the work of the ABCUL Strategic Merger Taskforce (SMT). The SMT was set up to have open and honest discussion on the realities of credit union merger activity and how strategic mergers could be better facilitated in the sector. The SMT consisted of fifteen credit union leaders, both directors and Managers/CEOs, representing ABCUL member credit unions across Great Britain, and was chaired by the ABCUL CEO.

The SMT was set up as part of ABCUL's ongoing work on supporting the long-term development and sustainability of the British credit union sector. In 2019, ABCUL set out to consult all credit unions, regardless of trade body affiliation, across Britain on how the success of the credit union can be supported, via the Town Hall Consultations. In consultation, actions were identified to achieve the long-term development goals of ABCUL's credit union membership. These actions and goals were drawn together to produce ABCUL's Vision 2025 strategy, guiding its work in supporting the sustainability, relevance, collaboration and purpose of the British credit union sector. As part of ABCUL's Vision 2025 strategy, it had been promised by ABCUL to consult further on how it could respectfully support strategic merger activity in the sector.

As Part of ABCUL's exploration of the topic of strategic mergers throughout 2021, ABCUL invited its credit union membership to share their experience of and attitudes towards mergers via a consultation survey. Quotes from various credit unions' survey responses are featured throughout the paper.

The inclusion of the exploration of strategic merger activity in the Vision 2025 strategy was motivated by an observed potential for change in the approach towards mergers in the sector. A potential within the sector to utilise a more strategic approach to mergers was identified both by ABCUL and by its members via consultation. There had already been ongoing consolidation within the British sector, and the number of credit unions has been steadily decreasing in recent years. However, ABCUL observed a pattern within this consolidation of many credit unions merging as a last resort to prevent their failure, rather than to a proactive step to improve their performance and capabilities. ABCUL had seen a contrast in the approach to merging between Britain and the USA, where mergers are often driven by the desire to create better value and services for both sets of members.

> *"History tells us that few mergers take place before it is absolutely essential or the key players are ready to retire/step down."*

To work towards its Vision 2025 strategy, ABCUL proceeded to set up the Strategic Merger Taskforce to discuss the agenda of supporting strategic merger activity in the credit union sector with a group of credit union leaders experienced in navigating credit union mergers. Since early 2021, the group has discussed the following range of themes related to strategic mergers: the current context of merger activity in the credit union sector; the challenges SMT members personally faced with merging; the wider stigma and negative perception towards merging held in the sector; the barriers towards credit union mergers; the sensitivities of the subject of credit union mergers; what it means to merge strategically; when mergers are appropriate and the alternatives to merging; and how strategic mergers can be supported in the sector. The SMT has had guest presentations from two credit unions, one from the Republic of

Ireland and the other from the USA, to provide merger cases studies from the international credit union movement. These case study presentations provided useful insight into the how a merger can be used to strategically to develop credit unions and provide an honest discussion on the lessons learnt from going through a merger.

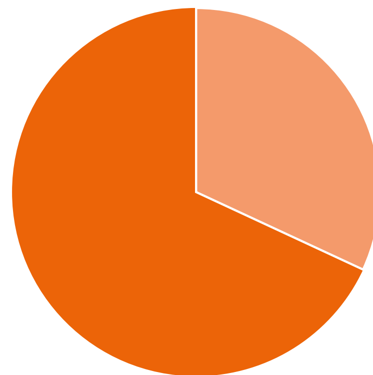
A consultation survey was also conducted to receive input from the wider ABCUL membership on their experience and attitudes towards mergers. The consultation survey received responses from 55 credit unions, a mixture of both those who had and had not been through a merger in the last 10 years. The survey asked a mixture of multiple choice and open qualitative questions to help inform the white paper and a new guide for ABCUL members on strategic mergers.

The SMT had open discussion on mergers in the sector and were honest on the challenges and sensitivities that come with a transfer of engagements. Due to the sensitive nature of this topic, there was not always agreement on the details of the discussion. However, there was a consensus on the reasons why strategic credit union mergers are needed in the sector, and the challenges faced in increasing strategic merger activity.

The members of the SMT agreed with ABCUL that mergers in the sector were mainly being instigated to save financially distressed credit unions, rather than as a proactive and strategically driven step. The results of the consultation survey further suggested that many credit union mergers were being driven by financial distress. Of the survey respondents who had been through a merger in the last 10 years, 82% identified concerns of one or both the credit unions' financial sustainability as a key reason for the merger, and 68% identified this concern of financial sustainability as the most significant reason.

A critical area of the SMT's discussions was around the attitudes many credit unions in the sector hold towards mergers. The SMT identified that many credit unions have a negative perception of mergers, where a transferring credit union is equated as a failed credit union. It was frequently raised how the stigma towards merging in the sector is preventing transfers of engagements where they would be beneficial, sensible and, in some cases, necessary for the credit union's longevity. Subsequently, it was recognised by the SMT that challenging the stigma towards mergers within the sector is equally important as eliminating the logistical barriers to mergers for supporting strategic merger activity.

68% of survey respondents identified the concern of either credit union's sustainability as the most significant reason for merging



It was recognised throughout discussion that an appropriate method of sharing the work of ABCUL and the SMT was through a white paper that informs on the case for strategic merger activity to the wider credit union sector and its stakeholders. As a result, this paper seeks to clarify and promote the idea of a strategic credit union merger, as well as addressing how these mergers can be facilitated.

DEFINING A STRATEGIC MERGER

A central theme of the discussions of the Strategic Merger Taskforce was around the definition of a strategic merger itself. It was established that a merger is strategic when it utilises the opportunities made available by the transfer of engagements to reach the credit union's long-term business objectives. For a merger to be strategic, it must be driven by a strategic imperative – a clearly defined rationale behind the merger, where that rationale will deliver the credit union's business goals.

Essential to such a merger is the element of strategic planning. It was stressed and clarified amongst the SMT that for a merger to be approached strategically, the long-term business goals for the credit union should always be defined prior to taking the decision to merge, with the assessment of a merger carried out according to the merger's ability to reach these overarching goals for the credit union. Further, a strategic merger should be supported by a detailed logistical plan to carry out the transfer of engagements successfully, with defined actions and deliverables to reach the desired outcomes of merging.

> *"Clear reasons for the merger must be identified, agreed by the board and red line issues addressed as early as possible."*

In the spirit of the credit union movement, the needs and wants of a credit union's membership should determine the credit union's strategic goals, and therefore be the central consideration of any decision to merge. The motivation to merge in the interest of the membership could be for improving service provision and offering to members, or simply improving the financial sustainability of the credit union so that it can continue to serve its members. Throughout the discussions of the SMT, it was stressed that any decision to merge, or not merge, should be made with the credit union's membership at heart. If a merger is the way to achieve the best results for members, it should be strongly considered.

> *"A merger should only be considered if it can be shown to produce sustainable member benefits and a good case presented to the voting members at the required general meetings."*

A strong caveat to the strategic merger is that a credit union should not merge for the sake of merging. Mergers can be resource intensive and should not be entered into lightly, so a central consideration as to whether a credit union merger should be pursued is whether it is necessary in achieving the credit union's objectives. As part of considering whether a merger is necessary, it should be considered whether the same benefits could be reached through organic growth opportunities, as well as whether outcomes could be achieved via forms of collaboration with other credit unions. There should always be a strong case for proceeding with a strategic merger as opposed to other actions for developing the credit union.

There was some dispute as to whether a merger to help a financially distressed credit union is strategic. However, a level of agreement was reached on the idea that a merger involving a financially distressed credit union could be strategic, provided the merger was clearly assessed as beneficial, sensible, and matching the long-term business goals of the credit union.

For strategic mergers to occur according to this definition across the credit union sector, it was identified by the SMT that a broad change in approach to merging would be needed. A merger proactively led by strategic planning contrasts with the last-resort approach too-often taken towards credit union mergers. As a strategic merger requires a credit union to identify if a merger could be utilised to reach its long-term objectives, it requires credit unions in practice to be setting long term strategic objectives, building business plans to achieve these objectives and monitoring progress towards their goals, all with the consideration of a strategic merger as a potential option for the credit union to grow and develop.

THE VALUE OF STRATEGIC MERGERS

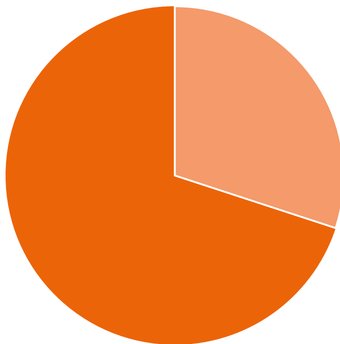
An aspect of the SMT's discussion was clarifying the potential value that strategic mergers hold for credit unions. In this section, it is set out why ABCUL are carrying out this project to promote and support a more strategic approach to mergers in the sector. It will be set out why strategically driven mergers can present significant value to individual credit unions, followed by the potential role strategic mergers can play in the development of the wider British credit union movement.

Mergers as a Strategic Tool for Credit Unions

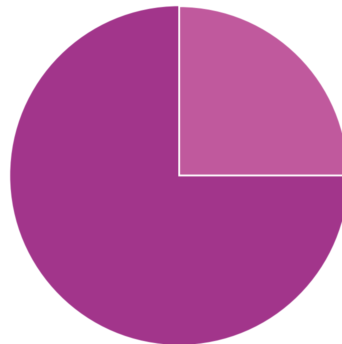
ABCUL's exploration of strategic mergers has been motivated by the belief that many credit unions have a lot to gain from taking a more strategic approach to transfer of engagements. Strategic mergers present untapped potential for some credit unions to improve not only their sustainability, but also their service offering, enabling them to further expand their social impact.

The consultation survey on strategic mergers established that the credit unions already merging in the sector have seen clear benefit. The consultation survey asked respondents who had received a transfer of engagements in the last 10 years what benefits were seen from merging, and found that:

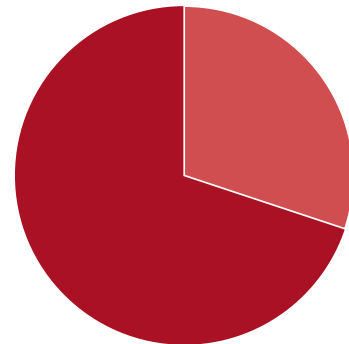
70% of credit unions saw improved financial sustainability



75% of credit unions saw improved operational efficiency and costs



70% of credit unions saw improved board and succession prospects



However, not all of these mergers would have been pursued strategically, and some may have been last-minute efforts to 'rescue' another credit union. It is also worth noting that mergers would not have been motivated by all of these reasons, e.g. an already financially strong credit union would not necessarily see any improved financial sustainability from merging.

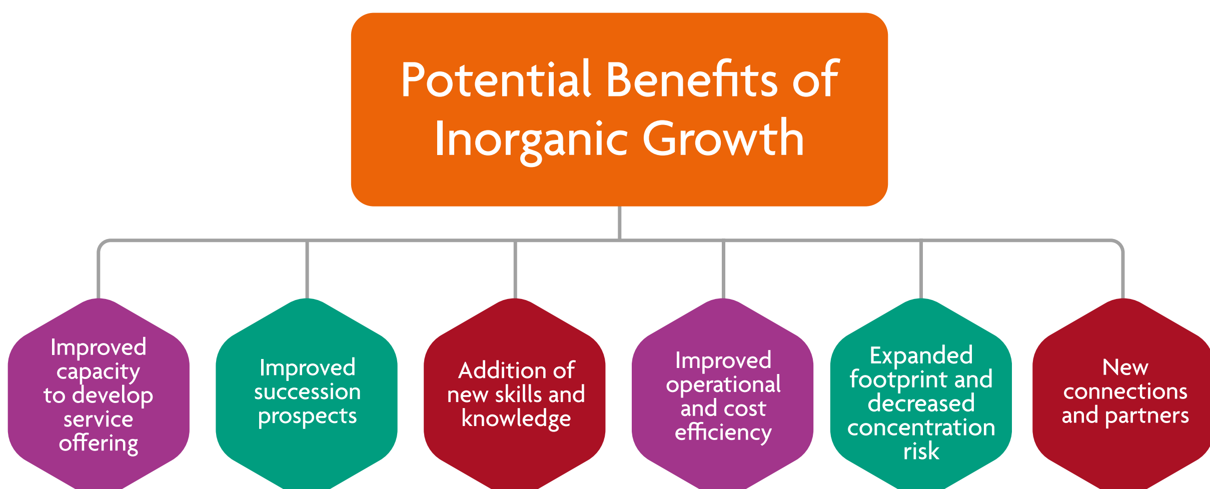
In the cases where a merger is a last-resort rescue effort for a failing credit union, there is a lot to gain by considering the option much earlier and from adopting a more strategic approach to merging. This is because the value of a merger can be lessened by a lack of strategic planning and a weakened balance sheet. Depleted capital, or a poor-quality loan book, will compromise the benefit of a merger to a potential partner and to the members of both credit unions. Further, a merger that is not properly planned and assessed holds the risk of jeopardising the financial and operational benefits of merging. As a result, credit unions can maximise the value of mergers by considering the potential of merging whilst in a stronger financial position and carrying out full strategic planning for a merger.

Further, strategic mergers can present value for many credit unions that are not struggling financially, but that would gain the benefits that would arise out of a merger opportunity. As an inorganic growth opportunity, a merger can allow growth that a credit union would not be able to achieve naturally or where it can be achieved in a shorter timeframe. When appropriate, a strategic merger can provide greater capabilities and opportunity for both credit unions involved. Inorganic growth opportunities may be particularly useful to credit unions that have reached their capacity and potential for growth within their common bond, as well as credit unions that could benefit from an increase in scale.

A key driver for a strategic merger is improved financial resilience and sustainability for both credit unions. Mergers can provide the opportunity for credit unions to achieve economies of scale in much quicker manner than with organic growth. Improving a credit union's operational and cost efficiency can help maintain the profitability required for the credit union to be sustainable and have reduced reliance on grant funding. Increased operational and cost efficiency can help credit unions to cover essential operational costs, such as the cost of regulatory compliance functions, with greater ease.

There are many other opportunities presented by a strategic merger, aside from an improvement in cost-efficiency, that can help the credit unions improve their financial sustainability. The addition of a profitable loan book can help expand and improve the opportunity for a credit union to generate revenue. A merger can also work to increase capital reserves, provided the transferring credit union is in good capital position. Further, the diversification into different common bonds can reduce the financial risk of being concentrated on one market. The expansion of the credit union's footprint means that membership and the loan book may have accelerated growth following the merger, due to increased presence and awareness of the credit union. The increased scale, and potential increase in profitability can help improve financial resilience of credit unions and improve capacity to manage challenging financial periods.

However, there are benefits that can be accessed via a strategic merger that go beyond financial resilience. A merger can be used strategically to widely improve service provision and the offering for a credit union's membership. The potential for greater capital reserves and improved cost efficiency from a merger can allow greater funds for investment in the offerings of the credit union, such as digital service offerings. Alternatively, greater profitability can enable a credit union to offer even lower interest rates or offer a greater dividend to members. The increased scale can enable the credit union to provide a wider range of products and services that offer value to members. Some credit unions even reported increased professionalism of the service to members as the credit union expanded and improved its operations.



An inorganic growth opportunity brings new connections and possibilities that go further than the increase in scale. The two merging credit unions can exchange knowledge and skills, both through acquiring a new staff skillset and knowledge of different services. A merger can strategically fill skill gaps, if it is assessed early on what the two credit unions can offer. Established relationships, such as payroll deduction partners or referral partnerships, can also be accessed via a merger.

In addition, the sustainability of the credit union can also be improved via the increased staff and board succession prospects that come with merging. Many credit unions struggle with poor succession prospects that compromise their sustainability. Recruiting directors can be challenging for credit unions as most board members are unremunerated. A small credit union staff team also presents succession challenges, as there can often be a reliance on key individuals in maintaining the credit union. However, the increased scale, reputation and influence that can come with a merger can improve how easy it is to attract and recruit qualified board and staff members for a credit union.

A merger can be used as a strategic tool to form a strengthened and different credit union for the future in several aspects. Mergers in the sector would strengthen the credit unions that may not be viable in the long run, but also the stable credit unions that have potential to strengthen through inorganic growth. To achieve these benefits, however, the merger must be assessed and planned strategically.

The Wider Potential of Strategic Mergers

Strategic mergers can work to develop sustainable credit unions that provide their members with relevant services and strong business models. An increased rate of such strategic mergers would have the potential to accumulate and strengthen the sector overall. It is hoped that increased strategic merger activity could play a part in developing the sustainability, relevance and offering of the wider credit union movement.

Strategic mergers can be used as a tool to build the credit unions that have the capacity and offering to help the sector remain relevant to the public. Maintaining relevance is a key challenge for the long-term success of the British credit union sector. Growing membership levels for the future is key to the long-term success of the movement, and credit unions particularly need to maintain relevance to younger generations. The digital transformation of recent decades is outpacing the sector, as many credit unions do not have the capital to invest in as comprehensive digital services other financial services firms can offer.

Strategic mergers can offer the opportunity for credit unions to develop and invest in their offerings, allowing them greater flexibility to adapt to their members' needs. The benefits of operational and cost efficiency achieved through economies of scale can be passed on to larger membership via merging. Mergers that enable credit unions to offer a wider range of products and services, as well as invest in technological improvements, will help towards building credit unions that remain relevant and can maintain membership across a wider market demographic.

An increase in the number of larger credit unions with wider service offerings could allow the sector access to a wider market for building credit union membership. Strategic mergers could actively improve the wider reputation of the sector if there are larger, and thus more visible, credit unions.

Credit unions that are independent, sustainable, and serving their members with wider services and increased professionalism can help deliver the reputation the sector needs for building the profile and relevance for a sustainable future. As result of offering a wider range of financial products and services, and being better positioned to develop digital offerings, credit unions may be able to better compete with other financial institutions and increase their share of the wider financial services market.

A further way that a strategic approach to mergers could support the sustainability of the British credit union sector is mitigating the risk of reputational damage from credit union failure. Though most British credit unions are strong and thriving, the failure of some credit unions threaten the entire national credit union movement through building a reputation of credit unions as precarious and unsustainable. The reputation of credit unions as strong and sustainable is important to the long-term success of the sector, particularly with maintaining high membership levels and proportionate regulation. As a result, any step that can be taken collaboratively across the sector to prevent failure and strengthen other credit unions can support the entire national credit union movement. If used to improve credit unions' sustainability, strategic mergers can be used as a tool for mitigating credit union failure and the associated reputational damage to the sector.

> *“We believe that this is an important area for development and could protect our ongoing reputation as a sector.”*

BARRIERS TO STRATEGIC MERGERS

Though strategically planned and pursued mergers present great value to credit unions, both individually and collectively, there remains many barriers to strategic merger activity in the British credit union sector. This section will break down the key challenges British credit unions face in pursuing a strategically motivated merger. Four broad challenges for strategic credit unions were identified in ABCUL's consultation work:

1. Cultural barriers to strategic mergers
2. A lack of strategic planning
3. Difficulty in finding a merger partner
4. Resource limitations

Cultural Barriers

Perhaps the most significant barrier to strategic merger activity identified by the SMT was a cultural environment that discourages strategic mergers. Cultural factors foster reluctance within many credit unions in the sector to consider a transfer of engagements and prevent potential strategic merger activity. This section covers two features of the British credit union sector that act as a barrier to strategic mergers. The first feature is a stigma towards merging, where a transfer of engagements is equated with the failure of the transferring credit union. The second feature is a perception of mergers as entailing the loss of the transferring credit union's culture and identity.

A widespread stigma, or taboo exists towards mergers in the credit union sector. As there is a perception that a merger is a rescue from credit union failure, there is a stigma and conflation that the transferring merger partner has itself failed as a credit union. This perception and taboo of mergers prevents some credit unions from engaging with the idea of merging up until they see themselves at high risk of failure.

However, this attitude towards mergers is distinctly a feature of the British credit union sector. The general approach towards mergers varies greatly across the international credit union movement. A notable example of a credit union sector with a distinct attitude to merging to the sector in Great Britain is the US credit union movement. The US sector is also of larger scale and influence, with much higher penetration rate than evident in the Great Britain. In the USA, mergers are seen as a method of building capacity and finding new opportunities to deliver an improved service for members. In discussion with the US credit union merger case study presentation subject, the credit union's spokesperson remarked that they would always be open to either transferring or receiving the credit union's engagements, if that was the best way forward. The drive of this approach is to provide the best outcome for the membership.

Nevertheless, many British credit unions do not engage with the idea of merging until they are left with no other option, risking oversight of the best way forward for the credit union's membership. Adopting the perception that a merger can be a tool used for improvement, rather than as a rescue for failure, is key for instigating more strategically motivated mergers and realising the potential benefits of inorganic growth in the British sector.

A further barrier to strategic mergers, relating to the culture of the credit union sector, is the emotional ties to the credit union that come with operating a small, community business. A reluctance to merge in the sector is often driven by the fear of losing a credit union's identity and culture. Many staff and board members will have worked for the credit union for several years and have shared its successes. This can understandably create the concern that the credit union's presence and identity would be lost via merging. There is also the common fear amongst staff and board members that a merger will directly lead to the loss of their role with the credit union.

However, it was raised throughout the SMT's discussions that these risks and concerns of the transferring credit union can be mitigated through strategic planning and up-front agreement on the merger proposed. An assumption is often made that a merger necessarily entails the loss of the transferring credit union's culture, community presence and identity, whereas a carefully planned strategic merger can work to negate the loss of all of these factors.

It became clear that the way to ensure that a credit union merger does not present these risks is through open discussion about both party's non-negotiables for merging and upfront agreement on how the culture of both credit unions can be maintained. In many merger examples, all pre-existing credit union staff were kept on after the merger following an initial commitment to retaining all staff. The loss of community culture has been raised often as a risk of merging. However, consultation with different credit unions has opened the idea that there are steps to be taken to maintain a community feel post-merger, such as by: keeping local branches; maintaining separate brand identities; offering a service tailored to members; and sustained engagement within the community.

The concern raised by these cultural barriers is that mergers are being prevented in cases where they would be the best way forward for members, whether due to the potential for improved service provision or to improve the sustainability of the credit union. It is observed that there is room in the sector for some credit unions to have more an open mind towards mergers, to consider mergers as a key development opportunity and engage with the ways that strategic mergers can improve both credit unions involved.

Lack of Strategic Planning

An additional feature of the British credit union sector that acts as a barrier to strategic merger activity is the lack of a strategic drive and knowledge Credit unions' unique strengths come out of their volunteer base and community ethos. However, a consequence of the credit union structure is that there can be less strategic purpose and drive for some credit unions than you would find in commercial finance firms.

> *“Credit Union boards, because of their voluntary capacity, can lack the appropriate knowledge & skills required to grow the credit union, which can lead to conflicts within boards themselves. Consequently, credit union's operations stagnate, and they cease to become relevant to today's consumers.”*

It was identified by the SMT that some credit unions are not taking a strategic approach to mergers due to a lack of wider strategic business planning, with many credit unions not necessarily planning for 5-10 years down the line. The short-term approach for these credit unions is not due to a lack of care - there are many credit unions that simply do not have the resources and knowledge base to facilitate sophisticated, strategic, and long-term business planning.

The lack of strategic planning for some credit unions across the sector results in two issues. First, the lack of planning results in a low level of engagement with the idea of using a strategic merger to strengthen the credit union and improve their service for members. Second, inadequate strategic planning also results in some credit unions not recognising the risk in their business model until they are at risk of insolvency.

Insufficient strategic planning is a substantial threat to any credit union's sustainability and presents the risk of their business model being weak in the long term, leading to failure or mergers at the point when they are in financial distress with depleted capital. The issue of a lack of strategic planning is interlinked with a non-strategic attitude towards mergers within the sector, with a lack of long-term planning resulting in credit unions not realising where a merger would help them resolve fundamental issues in their business model.

Finding A Merger Partner

In cases where credit unions are actively pursuing a strategic merger, they face the key challenge of finding a suitable merger partner. This was the most frequently identified barrier to merging in the consultation of the wider ABCUL membership - 66% of consultation survey respondents identified difficulty in finding a merger partner as a barrier that would prevent them from going through a transfer of engagement. There are three key reasons why it is difficult for credit unions to find a merger partner:

1. A limited pool of potential merger partners in the sector
2. The unwillingness of potentially suitable partners to discuss a merger
3. The legal limit on common bond size excluding potential partners

> *"The most obvious merger candidate partners are reluctant to even talk, let alone discuss merger, at this point."*

The most overt reason why there is difficulty for credit unions in finding a merger partner is the limited pool of potential merger partners available. As of the first quarter of 2021, there were 264 Credit unions across Great Britain according to the Bank of England's quarterly statistical release for the credit union sector. Past consolidation, and occasional failure, in the sector has meant that the overall number of credit unions has steadily decreased. As a result, there may be a very small number of credit unions in enough proximity to be considered as potential merger partners.

Further, some suitable merger partners may be unwilling to merge due to the cultural barriers identified previously. Many credit unions may not want to even discuss the potential idea of merging due to understandable emotional ties, and the stigma around mergers. However, the reluctance of credit unions to discuss merging is particularly preventative of strategic merger activity where there are few suitable merger partners available. A reluctance to discuss merging is understandable where credit unions are independently sustainable and thriving, but there is perhaps room for credit unions to be more open to discussing a potential merger.

In addition, some credit unions may be discounted as suitable merger partners on the basis that the size of the two combined credit union common bonds would exceed the legal limit. The current legal limit on potential size of a credit unions common bond at 3 million persons, which applies to credit unions with a geographic aspect of their common bond, directly prevents mergers between credit union partners that would be otherwise be suitable.

Though 3 million is a significant number, credit unions in many cases only have memberships of a minute fraction of their common bond size. For comparison, the entire membership of British credit unions in Great Britain, according to the Bank of England quarterly credit union statistical release, was 1.4 million people in the first quarter of 2021 across 264 credit unions. Accordingly, the average credit union had 5,336 members at the beginning of 2021 – an insignificant number compared to the 3 million limit on potential membership through the common bond. This limit poses a challenge for credit unions looking to merge in highly populated areas.

Resource Limitations

A significant barrier to credit union mergers is the demand a transfers of engagements places on a credit union's limited capital reserves and staff resources.

Credit unions often operate on fine margins, do not have extensive workforces, and do not have the means to raise significant capital. Credit unions' co-operative business model and offering of affordable products result in the difficulty to raise funds for investment, costs and staff outside of basic operational requirements. Transfers of engagements, however, are resource intensive, requiring extensive planning, preparation, administration and regulatory compliance.

> *"Our staff team is too small to take the lead in planning either a transfer of engagements or business recovery."*

As a credit union must maintain the minimum regulatory capital-to-assets ratio throughout the merger, whilst also footing the cost of the significant extra work required, it can often be difficult for a credit union to have the extra capital required to merge. As a result, credit unions may be prevented from pursuing a merger by the cost, effort and complexity of the work involved, despite the potential to improve their offering to members and increase their social impact.

Throughout ABCUL's consultation of members on their merger activity, members reported that the transfers of engagements had taken significant time and staff resources to carry out, often distracting from the day-to-day operations of the credit union. It was further raised by the SMT that many credit unions do not have the staff capacity or internal knowledge to support the complicated transfer of engagements process.

Many credit unions reported that employing temporary staff, particularly professionals experienced in merging, made the transfers of engagements significantly easier to carry out. However, hiring a further staff member with merger expertise can be difficult, with credit unions often limited by the availability of suitably qualified individuals, as well by the lack of funds to employ further staff.

CALL TO ACTION

The benefits to credit unions and the wider sector of taking a more strategic approach to mergers are apparent, but so are the barriers. As a result, ABCUL are keen to encourage a cohesive and holistic approach to breaking down the barriers to strategic merger activity, in collaboration with both our member credit unions and all relevant stakeholders.

Actions for ABCUL

This section will lay out the actions that ABCUL is committing to in tackling the barriers that prevent strategic merger activity in the credit union sector. Alongside this paper, ABCUL has taken considerable action in providing the materials to assist its members with strategically approaching and carrying out mergers for the future.

An in-depth, practical guide to strategic mergers has been produced for ABCUL members. This guide not only provides information on how to navigate the merger process, but also information on considering when a strategic merger is the right step forward for a credit union. This guide has been informed by experiences of credit unions from the SMT's discussions and the wider consultation survey, so best practice and sector knowledge can be shared amongst ABCUL's membership. The guide also has a detailed section to help our members navigate the regulatory process for a transfer of engagements. We hope that the guide will provide an excellent resource to our membership, providing the knowledge and tools to enact a well-thought-out merger.

Further, ABCUL want to offer our advice to credit unions that are considering or already proceeding with a transfer of engagements and encourage our members to come to us whenever we may be of assistance. Following the launch of this paper, ABCUL will continue to promote mergers as a strategic tool and inorganic growth opportunity available to credit unions and will look to initiate further discussions and sharing of best practice across our membership. We will also work to promote collaboration as a strategic option available for credit unions as part of our holistic effort to strengthen the sector.

To overcome the difficulty in finding merger partners that credit unions have expressed, ABCUL will look at playing a more active role in assisting credit unions 'match' with one another to help in finding merger partners. Though ABCUL already offer informal assistance in this area, it will be explored how members can be best supported in approaching other credit unions and in fostering collaborative relationships.

To support a strong and resilient credit union sector, ABCUL is keen to provide the tools to support the credit unions who are limited in strategic planning by their resources. ABCUL are currently working to provide a financial toolkit service to help our members identify when they have financial weaknesses, to help prevent failure further along the line. As a side-effect, helping credit unions to identify risks to their financial sustainability earlier on may result in more credit unions seeking mergers from a position of strength. ABCUL will also look at providing some training resources on strategic business planning and work with relevant stakeholders to help support our members in this vitally important area.

Considerations for Credit Unions

At the heart of this undertaking is the intention to support ABCUL's credit union members and the valuable work they do to serve their members. To help realise the benefits of a strategic approach to merging, and collaboratively work to provide the best outcomes for the sector, the following four points are posed for credit unions to consider and, where appropriate, take action.

1. **Adopt an open-minded approach and confront any stigmas held towards merging**
2. **Engage with the idea of merging proactively, from a position of strength**
3. **Carry out long-term strategic business planning**
4. **Explore different merger strategies where deemed appropriate**

The key outcome of this paper ABCUL would like to achieve is for credit unions to engage with the idea that mergers can happen from positions of strength to improve credit unions capabilities, rather than as a solution to failure. The intention is for a greater number of credit unions to identify when and where a merger may provide the best outcome for existing members and overcome understandable emotional ties when transferring into another credit union.

To achieve these outcomes, credit unions must adopt a proactive approach for merging, with an awareness that mergers can be used as a tool for improving the future of the credit union. There is also a need for those who enter a merger discussion to do so with an open mind and willingness to compromise.

ABCUL want credit unions to be thinking about strategic mergers long before they reach the point of financial difficulty. Credit unions should identify when it would be beneficial to proceed with a merger as part of its strategic plan. ABCUL's new guidance document for mergers provides detailed information on considerations for when evaluating the option of merging. It is recommended to ABCUL members to consult this section of the guidance, regardless of whether the credit union is pursuing a merger, to think about when a strategic merger might be the right way forward for their membership.

> *"What is good for members will be good for the credit union."*

ABCUL would also like to stress the importance of business planning for 5-10 years ahead to all credit unions, regardless of whether a merger, collaboration or continuing to operate independently is appropriate for their situation. As part of strategic planning, credit unions need to be identifying and monitoring areas of financial risk. From ABCUL's experience, there are some credit unions that understandably struggle to adequately manage and monitor their long-term financial viability. ABCUL will be working with members to help identify financial risks, but credit unions should be paying attention particularly to their profitability, capital reserves, bad debt levels and provisioning. Out of responsibility to their members, it is essential that credit unions recognise earlier on where they have weak balance sheets, work to strengthen their financial position and consider merging strategically where appropriate.

Further, it is hoped that the discussions of this paper and the detail provided in the guide to a strategic merger can instigate credit unions to explore different merger strategies. If credit unions are to merge proactively, rather than out of necessity due to financial distress, they need to engage with and explore different approaches to merging. Credit unions should also explore the potential of collaborative relationships with other credit unions for building capabilities and resolving any weaknesses in their business models.

An area where it is relevant to explore different merger strategies is in mitigating any loss of a credit union's identity and community-feel by merging. Credit unions can look at ways of maintaining the community connection post-merger through proactive engagement with their membership. The transferring credit union's identity can continue after the merger such as by maintaining separate brands or local branches. Credit unions can look at tailored service provision and methods for maintaining community presence as part of their long-term planning for a merger. An example, taken from US credit unions, is to set up a local representative committee with a budget dedicated to supporting community initiatives and keeping close ties in the local area.

Another area where there is potential to explore different approaches to merging is in the search for a suitable merger partner. Expansion of a credit union's criteria could help mitigate some of the difficulty in finding a suitable merger partner. For example, there is potential for more mergers to take place beyond neighbouring community credit unions. Discussions with different parties has raised the idea that perhaps credit unions can put less of a distinction between community and employee common bonds when merging, which could open doors for more merger opportunities. The merger between Commsave Credit Union and Harvest Money (explored as a case study in the strategic merger guide) is an example of a successful merger between an employee-based and community credit union in the UK. Mergers can be successful between credit unions that have dissimilar common bonds but are otherwise compatible in their operations, cultures and values. It is also not known by many credit unions that the geographic areas of a common bond do not need to be adjacent, meaning that there is potential for credit unions to widen their geographic criteria when looking for merger partners. Further, there is room for more credit unions to merge with similar sized credit unions, to combine offerings and strengthen both credit unions..

> *"We have opened a dialogue with a neighbouring credit union with a view to exploring how we can work together, and this may ultimately lead to a transfer of engagements."*

Recommendations for ABCUL Stakeholders

This call to action ends with the setting of recommendations for ABCUL stakeholders to reduce barriers to strategic merger activity in the British credit union sector. The majority of this section focuses on two kinds of direct material support provision to assist credit unions carry out strategic mergers: financial support and in-kind support. ABCUL would also like to instigate discussion on the legal limit on a credit union's common bond size to enable more strategic merger activity.

ABCUL believe that there should be financial support for credit union mergers in the cases where it is necessary. As previously noted, mergers add a temporary but significant extra workload for a credit union, which is hard to cover with a small capital reserve. One-off investment in a strategic merger

can enable and support a credit union through the merger process, helping it reach the critical scale and growth opportunities to support itself more sustainably for the long-term. Funding for strategic mergers would enable credit unions to carry out valuable transfers of engagements where they would otherwise be limited in doing by the cost of merging and the difficultly in maintaining regulatory capital ratios. To both support and ensure that these mergers are strategic, it would be appropriate to make the criteria for receiving funding related to the value the merger will deliver to the credit unions and their combined membership.

> *"We are currently in very early discussions with a local credit union of similar size, but whilst we are both willing to carry out the due diligence involved, it will potentially put a strain on the operational side of one or both credit unions. Obviously if we were being taken over by a larger credit union this would not be a problem, but it is very unfortunate that there is no longer funding available to facilitate mergers between smaller and medium-sized CUs."*

In addition to financial support for strategic credit union mergers, we recommend in-kind support from professionals experienced in mergers to support strategic transfers of engagements in the credit union sector. We recognise that there is difficulty in getting individuals with certain expertise levels to work with credit unions on a volunteer basis. As a result, we think that there is potential for a formal avenue of in-kind support to be explored for supporting credit unions carry out strategic mergers. In-kind support would not only help credit unions overcome the limited staff capacity to carry out the merger alongside day-to-day operations but would assist in the tackling the barrier of limited internal expertise on mergers held in many credit unions.

Finally, we pose that there should be reform of the common bond limit. As noted previously, a portion of ABCUL members reports that the limit on the common bond is actively preventing them from pursuing mergers. As difficulty in finding a merger partner is a commonly identified barrier to merging, changing the common bond limit is a direct way to increase the potential pool of merger partners and increase opportunity for strategic mergers in the British credit union sector. As a result, ABCUL recommend that there is greater legal flexibility given to the potential common bond size of credit unions, to relax restrictions on credit unions' scope for delivering ethical financial services.

> *Without changes to the common bond regulations the most sensible mergers are not available in London.*

There are two options to expand the common bond size limit for credit unions with a geographic aspect of their common bond. The first option is that HM Treasury can use its legal authority to raise the common bond limit from its current level of 3 million persons. The second is that the legal limit on common bond size is completely reformed to a limit on the number of active members of a credit union. The most appropriate method for increasing the common bond limit is up for discussion, as the two options present different level of change and complexity. However, ABCUL are clear that the common bond limit should be alleviated as a barrier to strategic mergers, given that credit unions' memberships remain at an insignificant proportion of their common bond.

ABCUL would like to initiate an open discussion on how these three recommendations and ideas could be put into practice by our stakeholders and offer support in developing a cohesive approach for supporting strategic merger activity in the credit union sector.

CONCLUSION

It is hoped that this paper can work towards fostering a positive reputation for mergers within the sector, create recognition of mergers as a strategic tool available to credit unions and instigate more mergers from a position of strength, to form stronger and more sustainable credit unions. Though not necessary or appropriate in every case, strategic mergers form an essential part of a suite of tools that can be used to help strengthen the British credit union sector for the future.

The work ABCUL has done to consult its membership throughout 2021 has raised the idea that a different approach to merging that can be adopted across the British credit union sector, based on the idea that mergers can be used strategically to deliver benefits for members from a position of strength. This notion is not a push for mergers where they are not necessary or appropriate – an essential dimension to a strategic merger is that a merger should not be carried out where there are more appropriate means of achieving the desired outcomes, such as via collaboration/peer to peer partnership or development activity.

Engagement with the idea of the strategic merger, and the challenge of the stigma around merging, can help support the possibilities of greater strategic merger activity across the British credit union sector. This is with the intention that strategic merger activity will contribute to building strong credit unions that offer their valuable services to a wider membership base, as well as prevent credit union failure wherever possible.

To continue this project, ABCUL will help to support and facilitate strategic merger activity. It is asked that credit unions work to question any stigma held around transfers of engagement and think about mergers as a strategic tool that should be pursued proactively where appropriate. It is also asked that stakeholders support strategic merger activity where possible, via material support or flexible regulation.

We wish to thank all members of the SMT, the ABCUL team and our international credit union partners for their insights, candour, hard work, dedication, and commitment to the task in hand.

ABCUL

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