Mergers – Part 2: From MOU to Due Diligence

Stabilization Central
CREDIT UNION

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Introduction

This is the second in a series of four papers sharing lessons learned about the credit union merger process. While every merger has unique features, the series outlines the common steps in the process most mergers will (or should) follow and addresses some of the "I wish I had known" elements that past merger participants have highlighted.

The **first paper in this series** focused on some foundational decisions: deciding whether a merger could facilitate your credit union's strategy; determining the attributes your credit union needs in a merger partner; and seeking a partner opportunity. It concluded at the point in a merger process where the potential partners are entering into a Memorandum of Understanding (MOU) to explore the merger further.

This paper focuses on the next stage, which includes:

- engaging employees, members, and other key stakeholders
- a deep dive (due diligence) into all aspects of your merger partner(s)

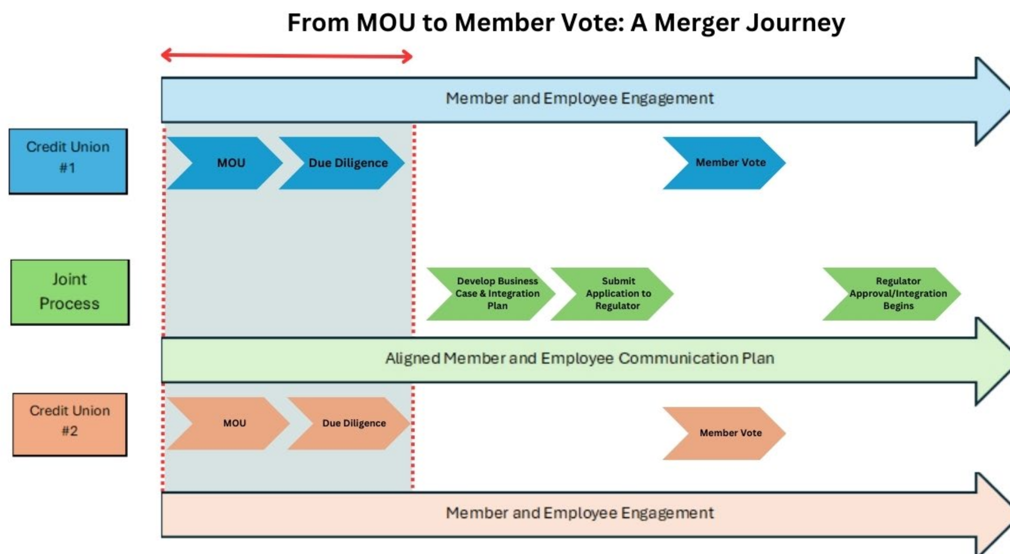
The third paper will cover the remaining steps through to the member vote, while the final paper will centre upon the Integration Planning aspects of a merger after members have voted in favour of it.

Lesson 1: Leveraging Your MOU

As this stage begins, it's important to clarify that the MOU is an agreement in principle, but not legally binding. If due diligence uncovers a problem or misalignment, the parties are free to disengage.

That said, the MOU can still contain a level of specificity that will make the next steps — particularly the business case — more straightforward. In fact, past merger participants recommend making and documenting as many decisions as possible in the MOU, such as the new credit union's Board composition (including chair and vice chair), the name, where the head office will be located (legal address), and even who the new CEO will be. Ideally, the executive leadership structure is also laid out, although specific incumbents may not yet be named to those roles. While these decisions can be made later (and are required before the regulator will consent to the merger), the more clarity you can achieve from the outset, the better.

This extra time at the MOU stage will save far more time and money down the road. Conversely, shortcuts in this stage often lead to challenges later on that are exponentially harder to address.



Lesson 2: Project Management Is Key – Realistic Budgets and Timeframes

There is a saying about home renovations: if you have an estimated budget and timeframe, double both, and you'll probably be close to the actual figures. A merger can be similar — it's easy for scope, timelines and costs to creep up if you don't have a thoroughly researched and detailed project plan and budget. And even then, experts suggest building in a generous contingency budget for both time and costs. This becomes even more important if there are more than two credit unions involved in the merger transaction.

While this paper dives into detail about one specific phase of the merger (MOU to Due Diligence), the project plan has to contemplate the whole process and must be developed early in that process. Every merger participant we spoke with said they wished they'd done more research to identify the detailed steps, timeframes, and costs from beginning to end. For example, as you conduct due diligence, the number of high-risk issues that are identified and need to be resolved will have corresponding delays that will also increase legal and operational costs. The governance review and approval process also has many layers, which add time to the process.

Consider, too, the timeframes that are outside the credit unions' control. The regulator's consent is required at several checkpoints, not only for the overall merger application but for the key messages, member voting package, and so on. There's also an application to the Competition Bureau, which is costly and can take months to process (more on this below). Regulators try to provide feedback as quickly as possible, but they also have finite resources and many priorities, which means the timeframe (and associated costs) can expand unexpectedly.

Bottom line: Do this homework early and set out a detailed, realistic project plan that anticipates the potential delays. Once the partners commit to a timeline, it's crucial to hold to it, as even small delays early on can have a cascading effect that may delay merger completion by months past the original plan — with the accompanying escalation of costs to both credit unions. Mergers can be very complex, with evolving expectations from regulators, vendors, or the credit unions themselves. Project plans have to reflect enough contingency to accommodate these realities.

How Stabilization Central can help?

If credit unions engage us early, we can leverage our experience with mergers to support your project planning process.

Lesson 3: Identifying Your Team(s)

A merger is a complex, high-stakes project that needs a focused team from each credit union. Three key decisions must be made from the outset:

- Who will be the dedicated leader of the project and who will provide the necessary administrative support?
- What in-house subject-matter experts will be part of the team? You'll need support from legal, finance, marketing, communications, member relations, risk, operations, and project management, to name a few.
- What external vendors are needed to support it? What costs are associated with that?

For some team members, it will be impossible to both support the merger and carry out their regular full-time jobs (in some cases, for short, defined periods; in others, for the duration of the project). A focused human resources plan (and accompanying budget) will help ensure the credit union's day-to-day operations remain smooth and employee burnout is avoided. Remember, a merger is a marathon; prepare accordingly.

On the governance side, the Board must also establish a Steering Committee (SteerCo)

made up of representatives from each credit union's Board and management, to help guide the merger process. A regular cadence of meetings is necessary to ensure the SteerCo remains updated as the project progresses and evolves. They will typically meet bi-weekly or sometimes weekly if required. It is important to set clear agendas for the meetings and ensure the SteerCo is prepared with the right information to make decisions in the meetings. The project plan must consider how the SteerCo will be selected and the process for keeping the rest of each Board updated.

Lesson 4: Stakeholder Engagement and Communication: Early and Often

> **How Stabilization Central can help?**
>
> We can support your teams directly or help credit unions access and select vendors with the specific expertise for this work.

Once the team is in place, identifying and engaging with your stakeholders should be the first job on your list — and one that continues throughout the entire project.

While your credit union may have a variety of stakeholders, we'll focus on key influencers in your merger process: the regulator, Board members and ex-members, employees, ex-employees, community leaders, and of course, members.

> **"Remember to look through the eyes of the people you are talking to and tailor your message to ensure their concerns are addressed and they have the information they need."**
>
> *~ Floyd Yamamoto, Former Credit Union Board Chair (with direct experience overseeing several mergers under G&F Financial)*

Regulator: Anticipating and Meeting Expectations

All of the work described in this paper will ultimately be part of the merger application to the provincial regulator, so it's wise to consider them a key stakeholder throughout your process.

Engaging them early and communicating throughout each stage will ensure a number of things. First, you'll have a clear sense of their expectations, as well as any emerging or evolving requirements. Second, if they've been part of the conversation all along, the regulator will have a better understanding of your objectives for the merger and the work you're doing to determine whether it's in the best interest of your members. Finally, you'll be providing the regulator with foundational knowledge, ahead of the application, about the proposal and the parties involved, which can facilitate and in some instances speed up the regulator's review process.

Simply put: early and consistent regulator engagement is a great way to avoid surprises (for both sides).

> **How Stabilization Central can help?**
>
> Stabilization Central has regular touchpoints with the BCFSA regulatory approvals team, and we can leverage these to facilitate conversations for our BC credit union partners. For credit unions in other provinces, we can advise on things to consider regarding engaging with the regulator in a merger process.

Board Members: Keeping Everyone Engaged

For a merger to succeed, the entire Board of Directors from each credit union must be engaged and aligned. This is often not the case at the outset. For example, some may have reservations about the proposed change and its impact on the members. Also, some Directors will not have a role in the new, merged credit union, and it can be challenging for Directors who have been passionate about

their credit union and feel "passed over" to stay engaged in the work.

Some of the risks of unengaged / unsupportive Directors include:

- Potential breach of Board confidentiality / unanimity following the decision to pursue the merger. This can lead to leaks and perceived dissent within the Board. In extreme cases, a Director who disagrees with the credit union's direction may publicly express that opinion. This impacts the overall credibility of the Board and credit union itself, both when engaging with the regulator and with the members who look to their elected Board representatives for guidance.

- Employees or members who speak with unengaged Directors may perceive their lack of enthusiasm or engagement as disapproval. This is particularly problematic for credit unions in smaller communities, where members are more likely to personally know and engage with Directors of their credit union.

- Unengaged Directors may choose to resign before the merger is concluded and in an extreme scenario, quorum may be lost. This could leave the Board unable to ratify decisions on behalf of the credit union — not only regarding the merger, but also fundamental decisions related to governing the credit union's regular operations.

To mitigate these risks, the Board Chair must show strong leadership to maintain Director engagement, emphasizing that: a) the merger's completion is not a given; and b) while it's under consideration, members are still depending on the Directors they elected to fulfill their obligation to operate their credit union. This obligation continues until the completion of the merger, which occurs several weeks beyond the point where the membership votes.

Employees: Change Management is Key

Employees from the frontline to the CEO and executive team are the brains, heart, and face of your credit union. In addition to being members themselves (and a crucial segment of your member vote), they know the credit union best. They will have unique information needs and valuable input that must be considered. Employees are also key, trusted ambassadors to the membership; many members will take their cue from the front line.

Remember that this is a pocketbook issue for employees — the primary concerns for most will be job security and understanding their place in the new organization. But their commitment to and emotional investment in the credit union are also crucial factors. The merger is fundamentally changing the credit union in which they've invested themselves.

One might think change management is solely focused on post-merger integration, but we suggest there are multiple stages of change. The merger exploration period, when the potential change is not yet fully understood or confirmed, can be a particularly challenging one for employees. From the time you begin merger discussions, it's ideal to engage a change management specialist to ensure the communication and engagement plans are embedded in a broader change management strategy that encompasses the entire merger process. Each of the merger partners has to share a consistent approach to communication and change management with employees.

Most importantly, leaders have to approach this work with empathy, authenticity, and transparency. It is imperative for the entire executive team to demonstrate its dedication to

> **"Lead in such a way that you make it easier for your people to want to follow you. Trust is key with employees."**
>
> *~ Ted Pahl, Former CEO, North Peace Savings and Credit Union (with direct experience overseeing several mergers)*

the credit union and its people at every stage of the merger process.

Members: The Ultimate Decision Makers

Throughout the evaluation process, the credit union's member-owners deserve transparency about what is happening and why the merger is being explored, and the opportunity to ask questions and provide feedback.

This is not only the right thing to do, it's essential to the success of your member vote. Your credit union leaders will not be alone in communicating about the merger. There will inevitably be an anti-merger movement, led by members who are particularly passionate about the credit union's history, such as former Directors or employees. Don't leave a vacuum of silence for these opponents to fill; be prepared to share information candidly, early, and frequently. Not doing this increases the risk of reputational damage and a failed member vote. (More on "no" campaigns will be covered in the Member Vote section, in the next paper of this series.)

3 Cs of Stakeholder Communication: Candid, Clear, and Consistent

Develop your stakeholder communication plans early and jointly with the partner credit union(s). This includes establishing the protocol for communicating emerging information throughout the process. This is not something to develop "on the fly."

Mixed messages from the merging credit unions can be deadly. So decide what you'll say, who will say it, how, and when. In some past mergers, key messages have even been developed and embedded in the MOU. Creating extensive FAQ documents — one for staff questions, one for members — can be a helpful way to approach this. These FAQs then become the foundation for all communication, including scripting to assist employees with managing or escalating member enquiries.

Finally, remember that all employee and member communication about the merger must be reviewed by the regulator. Sharing the FAQ documents can be an expedient way to convey this information and demonstrate to the regulator that you're presenting complete and truthful information.

The more clarity stakeholders have about the process, timelines, and rationale for considering the merger, the better. Continual engagement is essential, with updates that share as much information as possible (even if it's just "we are still preparing the business case").

While employee and member communication should happen throughout the process, it ramps up and becomes even more crucial as you approach the Member Vote stage, covered in our next paper.

Lesson 5: Dive Deep with Due Diligence

Due diligence is the step where the merger partner(s) really get to know one another's business in order to confirm whether the organizations are the right fit and can be stronger together as a single credit union. The due diligence reports are meant to be entirely independent, and the credit unions do not share them with one another. Each credit union Board needs to formally approve the report before proceeding to the next phase.

The goal is to develop a deep understanding of one another's culture, strengths, weaknesses, and alignment, and also to determine whether any deal-breaker issues exist. Ultimately, the question is: "Are we happy with what we see here, or should we stop this process now?"

Typically, there are independent due diligence teams made up of each credit union's subject-matter experts. These teams (often with support from external consultants) evaluate the operations, finances and culture of the partner credit union(s). A key lesson here is to ensure you have access to the right expertise — this is not the time to try saving a few dollars by "making do" instead of hiring the right expert with the specific skills and experience you need.

Financial due diligence is typically the core of a due diligence report. At the end of the day, you are deciding whether joining with this partner will make your credit union stronger, so the importance of truly understanding the financial position of the other credit union cannot be overstated. That said, a credit union with financial challenges is not automatically an undesirable partner — it may have other strengths that are strategically important to your credit union. But a deep understanding of their finances allows a realistic evaluation of those other strengths relative to the financial risk the partner brings to the table.

Due diligence also evaluates things like credit, risk management, governance, information technology, values, human resources, and community engagement. Another crucial item is analysis from your legal team regarding whether the merger would be categorized as a "complex" or "non-complex" transaction under Competition Law. This will have a significant impact on your application to the Competition Bureau (discussed in more detail in the next paper in this series).

A sample table of contents for a Due Diligence report is available in **Appendix A**.

Shares and Rules

It is recommended that due diligence include having legal counsel reviewing the credit union share structure and rules, to prevent unanticipated obstacles or delays. For example, if the credit union has investment shares with voting rights, an additional shareholder vote is required. This adds significant risk, as well as costing time and money (and may also be mitigated by early redemption or another strategy.)

One credit union had a scenario where its rules required holding an in-person Special AGM, where members had to physically vote at a specific location on whether to approve the merger. In an era where most credit union members are accustomed to mail, online, or in-branch voting, and where the credit union's geographic footprint is large, an outdated rule like this can derail an entire merger project.

How Stabilization Central can help?

Throughout the due diligence process, Stabilization Central can work with the regulatory approvals team to help flag emerging issues or findings and to support the credit unions and/or their vendors in clarifying expectations.

Conclusion

If the due diligence findings reaffirm the benefits of a merger, the next steps are to develop a business case for the new credit union, prepare the regulatory applications, and conduct the member vote. All of this work is discussed in Lessons 6–8 in our next paper on credit union mergers, which can be found here.

APPENDIX A: Due Diligence – Sample Table of Contents

** While due diligence reports vary depending on the credit union, the following provides a sample of the topics considered. Not all of these topics will be relevant to all credit unions.*

EXECUTIVE SUMMARY

RATIONALE FOR CONSIDERING A MERGER

- Economic Outlook
- Consumer Behaviours and Expectations
- Credit Union Landscape
- Digital Environment
- Workforce of the Future
- Regulatory Drivers

WHY CREDIT UNION A AND CREDIT UNION B?

ALTERNATIVES CONSIDERED

- Status Quo
- Collaboration, Partnerships, and Joint Ventures
- Federal Continuance
- Other Merger Partners

OVERVIEW OF THE APPROACH TO DUE DILIGENCE

- Principles of Due Diligence
- Approach to Due Diligence

MAJOR RISKS CONSIDERED IN THE DUE DILIGENCE PROCESS

- Impact on Staff
- Adequate Scope
  - Expertise to Support the Work
  - Adequate Independence

DEFINITION OF RATINGS

SUMMARY OF RATINGS

INDIVIDUAL DUE DILIGENCE SUMMARIES

- Section 1 – Board and Senior Management Governance
- Section 2 – Human Resources and Culture
- Section 3 – Key Contracts
- Section 4 – Information Technology and Security
- Section 5.1 – Enterprise Risk and Compliance

Section 5.2 – Data Governance

Section 6 – Legal Liabilities

Section 7 – Credit - Retail and Commercial

Section 8 – Accounting and Financial Reporting

Section 9 – Treasury, Capital, and Liquidity Management

Section 10 – Tax

Section 11 – Marketing, Brand, and Communications

Section 12 – Products and Services (Personal and Business)

Section 13 – Premises and Facilities Management

Section 14.1 – Wealth Management and Insurance Subsidiaries

Section 14.2 – General Insurance Subsidiary (Holdco)

Section 15 – Member Experience and Commercial

Section 16 – Centralized Operations

Section 17 – Merger and Integration Activity

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