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MERGER, HUH, WHAT IS IT GOOD FOR: THE IMPACTS OF CREDIT UNION MERGERS

I. INTRODUCTION

The American Dream is predicated on the aspiration of social mobility.¹ Under the economic system that has developed in the United States, the fulfillment of that aspiration is largely dependent on the dreamer's access to credit.² In response to a letter from then-President William Howard Taft urging states to authorize state-chartered credit unions, the first U.S. credit union was established in New Hampshire in 1909.³ Following the Great Depression, access to credit was extremely limited.⁴ In light of the fact that state chartered credit unions fared relatively well, the Federal Credit Union Act of 1934 ("FCUA") sought to address the broader market failure by authorizing federally chartered credit unions to serve members of "small means."⁵ As federal credit unions began to rise in prominence and the credit crisis of the Great Depression eased, the increase in size and consolidation among credit unions led to numerous prominent legal challenges to the rules and

1. See Lendol Calder, FINANCING THE AMERICAN DREAM: A CULTURAL HISTORY OF CONSUMER CREDIT, 12–13 (2009) (arguing that while material goods and access to credit are not the only elements to the American Dream concept, without those things, the ability to achieve that goal of social mobility would be severely limited).

2. See *id.* at 13 ("It takes more than a credit card to secure the American dream. . . . But since the 1920s the most crucial element in the pursuit of the good life has been access to consumer credit. Consumer credit finances American dreams; by means of it, money is loaned out to car buyers and home furnishers, travelers and vacationers, diners and shoppers, hospital patients and public utilities customers—nowadays to almost anyone for virtually any purpose. Today the idea behind giving credit to consumers seems natural enough, but not so long ago it was an open question whether households deserved the same access to credit as business enterprises.").

3. See LISSA L. BROOME & JERRY W. MARKHAM, REGULATION OF BANK FINANCIAL SERVICE ACTIVITIES: CASES AND MATERIALS 98 (5th ed. 2018) ("The first credit union in the United States was created in 1909 by St. Marie's Parish in New Hampshire. It was founded in response to a letter written to the governors of each state by President William Howard Taft in 1908.").

4. See *TI Fed. Credit Union v. DelBonis*, 72 F.3d 921, 931 (1st Cir. 1995) ("In response to devastating Depression era losses-failed banks; high interest rates; diminished credit opportunities-Congress created scores of federal organizations and corporations designed to stabilize the national economy and pursue other governmental ends.").

5. See *id.* (quoting FEDERAL CREDIT UNION NATIONAL ASSOCIATION, INC., *Legislative History of the Federal Credit Union Act: A Study of the Historical Development From 1934 to 1980 of the Statute Governing Federal Credit Unions*).

regulations governing credit unions.⁶ Despite these legal challenges and congressional amendments to the law governing mutual institutions, credit unions continue to grow in size.⁷ One of the primary ways in which credit unions have continued this growth trend is through further acquisition of other credit unions.⁸ Commentators have questioned whether this increased growth encourages credit unions to go beyond their mandate.⁹ Others argue that mutuality alone can no longer justify the tax exemption.¹⁰

This Note discusses credit union merger activity by analyzing merger trends, processes, and motivations. It also considers the potential effects of this activity on the role of credit unions in the financial services industry. Part I details aspects of credit unions that set them apart from other financial services providers, such as banks and other thrifts.¹¹ Part II provides a brief overview of the history and development of credit unions, and introduces credit union merger trends.¹² Part III focuses on the complex process of regulatory approval for a credit union merger by discussing the permissibility of various mergers based on the proposed merger type, outlining how a merger must be presented to the regulator (The National Credit Union Administration (“NCUA”)), and the process

6. See, e.g., *Nat'l Credit Union Admin. v. First Nat. Bank & Trust Co.*, 522 U.S. 479 (1998) (striking down a broad reading of the common bond requirement argued by the credit unions); *Am. Bankers Ass'n v. Nat'l Credit Union Admin.*, 306 F.Supp.3d 44 (D.D.C. 2018) (holding that the NCUA's rule violated in-part The Administrative Procedure Act in defining “local Community” and “rural district”).

7. See John Reosti, *Credit Unions are Bulking up via M&A—and Banks are Nervous*, AM. BANKER, May 16, 2018, <https://www.americanbanker.com/news/credit-unions-are-bulking-up-via-m-a-and-banks-are-nervous> (discussing the increase in merger activity among Credit Unions in the early part of 2018 and some motivations for these mergers); see generally, NCUAchannel, *BOD 3-2 Mergers: Trends and Warning Signs*, YOUTUBE (Apr. 28, 2016), https://www.youtube.com/watch?v=qi4ChqHzZUo&index=2&list=PL—na5_QagEiZ4SznTg2f1leff1cUbokC (describing the recent trend in mergers among credit unions including key statistics on the number and rate).

8. See *id.* (discussing the historical trend of merger activity in credit unions and the increase in merger activity among Credit Unions in the early part of 2018).

9. See, e.g., Reed White, Note, *If It Quacks Like A Duck: In Light of Today's Financial Environment, Should Credit Unions Continue to Enjoy Tax Exemptions?*, 28 GA. ST. U. L. REV. 1367, 1374–79 (2012) (arguing that modern credit unions have gone beyond their original justification and must demonstrate commitment to service of lower income communities to retain the tax exemptions).

10. Kathryn R. Edge, *Feud Is Alive and Raw for Banks and Credit Unions*, 46 TENN. B.J. 29, 30 (2010) (arguing that modern credit unions are not “true consumer organizations with real common bonds of membership” by displaying financial trends and detailing how the diverse membership of modern credit unions is far different than originally intended).

11. See *infra* Part I.

12. See *infra* Part II.

of membership approval.¹³ Part IV considers possible motivations for credit union mergers and analyzes those motivations in light of recent merger trends across other financial services.¹⁴ Part V highlights the impact of mergers on the continuing credit union's members and other stake holders by analyzing financial outcomes.¹⁵ Part VI offers suggestions for how regulators could ensure that credit union mergers represent the best interests of the members.¹⁶ This Note concludes by arguing that, with a comprehensive understanding of the complex merger regulations and a critical eye for the effects of these mergers, credit union members and the tax paying public are largely in the dark when it comes to the necessity and efficacy of credit union mergers.¹⁷ Improving transparency throughout the process and increasing member engagement would both improve the quality of the merger transaction and alleviate the self-serving critics.

II. BACKGROUND AND CREDIT UNION HISTORY

A. *Credit Union Beginnings and the Common Bond Requirement*

The first credit unions in the United States were organized under state charters.¹⁸ As a financial institution, credit unions grew in popularity as an alternative source of credit when commercial banks showed little interest in taking the type of risk that moderate to low income earners represented.¹⁹ “A credit union is a non-profit, member owned, and democratically controlled institution, chartered with the purpose of making loans available to people of small means.”²⁰ Federal credit unions were authorized under the FCUA.²¹ This act “establish[ed]

13. See *infra* Part III.

14. See *infra* Part IV.

15. See *infra* Part V.

16. See *infra* Part VI.

17. See *infra* Part VII.

18. See White, *supra* note 9, at 1374–79 (arguing that modern credit unions have gone beyond their original justification and must demonstrate commitment to service of lower income communities to retain the tax exemptions).

19. See NAT'L CREDIT UNION ADMIN., HISTORICAL TIMELINE, <https://www.ncua.gov/About/Pages/history.aspx> (last visited Jan. 7, 2019) (detailing the history of the NCUA, credit unions, and the regulation surrounding the institution).

20. Amanda Masset, Note, *The Evolution of the Common Bond in Occupational Credit Unions: How Close Must the Tie That Binds Be?*, 3 N.C. BANKING INST. 387, 389 (1999).

21. See *TI Fed. Credit Union*, *supra* note 4 (quoting FEDERAL CREDIT UNION NATIONAL ASSOCIATION, INC., *Legislative History of the Federal Credit Union Act: A Study of the Historical Development From 1934 to 1980 of the Statute Governing Federal Credit Unions*).

a system of credit unions to facilitate the stabilization of the nation's credit structure and to achieve an increased availability of loans. Courts have construed and applied the FCUA to ensure that the credit union system is fair to the banking public."²²

Specifically, the FCUA contains a designation that federal credit unions are charged to provide "credit for persons of small means."²³ The FCUA further defines limitations that distinguish credit unions from other lending institutions. First, federal credit unions, as well as all state-chartered credit unions, require a board of directors who serve as volunteers.²⁴ Next, membership within credit unions is limited to persons sharing some quality or characteristic, known as the "common bond requirement."²⁵

The "common bond requirement" has been the source of great debate among legislators and commentators alike.²⁶ Originally, the common bond requirement was strictly construed to mean "groups having a common bond of occupation, or association, or to groups within a well-defined neighborhood, community, or rural district."²⁷ Thus, the original intention was understood to limit credit union membership to three types: occupational, associational, and residential.²⁸ Occupational credit unions serve members who share corporate bonds. Examples

22. Elizabeth D. Lauzon, *Construction and Application of Federal Credit Union Act of 1934 (FCUA) (12 U.S.C.A. §§ 1751 to 1795k)*, 89 A.L.R Fed. 2d 357, (I)(§1) (2014) (detailing several cases that have interpreted and applied the FCUA to provide clarity in the statute's purpose and scope).

23. Federal Credit Union Act (Credit Union Act) (FCUA) §1 (1934) (stating the purpose of the Act was to provide credit for persons of "small means").

24. 12 U.S.C. § 1761(c) (2012) ("No member of the board or of any other committee shall, as such, be compensated, except that reasonable health, accident, similar insurance protection, and the reimbursement of reasonable expenses incurred in the execution of the duties of the position shall not be considered compensation.").

25. 12 U.S.C. § 1759 (a)-(d) (2012).

26. See e.g., White, *supra* note 9, at 1374-79 (arguing that modern credit unions have gone beyond their original justification and must demonstrate commitment to service of lower income communities to retain the tax exemptions); *Senator Questions CU Tax Exemption as Bankers Blast 'Credit Union Power Grab'*, CUTODAY.INFO (Sept. 3, 2018), <https://www.cutoday.info/Fresh-Today/Senator-Questions-CU-Tax-Exemption-as-Bankers-Blast-Credit-Union-Power-Grab> (outlining a recent letter from Sen. Orrin Hatch directed to NCUA chairman wherein Sen. Hatch expressed concern over a the common bond requirement saying they had been "significantly watered down" by "cit[ing] credit unions that now offer insurance, real estate brokerage and wealth management, and suggested those CUs 'appear to operate in the same manner as taxable banks'").

27. Federal Credit Union Act of 1934, Pub. L. No. 73-467 § 9, 48 Stat. 1216, 1219 (1934).

28. KATY JACOB ET AL., WOODSTOCK INST., RHETORIC AND REALITY: AN ANALYSIS OF MAINSTREAM CREDIT UNIONS' RECORD OF SERVING LOW-INCOME PEOPLE 21 (2005).

include IBM Southeast Employee's Credit Union, which boasts \$1.09 billion in assets with more than 75,000 members,²⁹ or The North Carolina State Employee's Credit Union which has over \$35 billion in assets with 2.25 million members.³⁰ Associational credit unions can include groups such as: alumni associations; religious organizations, including churches or groups of related churches; electric cooperatives; homeowner associations; and parent teacher associations organized at the local level to serve a single school district.³¹ A residential credit union, now referred to as a community credit union, "consists of persons or organizations within a well-defined local community, neighborhood, or rural district."³² Examples of the community credit union can include credit unions founded on single political designations, such as a school board, or an urban community that is designated by a locally understood neighborhood.³³

The tax exemptions that credit unions enjoy is one of the most striking differences setting credit unions apart from other banking institutions.³⁴ While other similar tax exemptions have been erased over time,³⁵ the tax exemption for credit unions is continually justified by two arguments. First, credit unions are mutual institutions—meaning they have members instead of shareholders—which are operated entirely by and for the benefit of their members. Second, taxing credit unions on their shares in a manner similar to banks would burden them

29. IBM SOUTHEASTERN EMPLOYEE'S CREDIT UNION, ANNUAL REPORT FOR 2017 7 (2017), https://www.ibmsecu.org/docs/default-source/pdfs/annual-report_2017.pdf?sfvrsn=4.

30. NORTH CAROLINA STATE EMPLOYEE'S CREDIT UNION, ANNUAL REPORT FOR 2017 9 (2017), https://www.ncsecu.org/PDF/Annual/AR_2017.pdf?ver=1.2.

31. *Things to Consider Before Adding Organizations and Associations to Your FOM*, NORTHWEST CREDIT UNION ASSOCIATION (2018), <https://nwcua.org/2018/05/01/considerations-for-associations-within-a-credit-union-field-of-membership/> (providing considerations that potentially expanding credit unions should take into account when seeking to include an association in their field of membership).

32. 12 C.F.R. pt. 701 app. B ch. 2(I)(A)(1) (2018).

33. See Lauzon, *supra* note 22, at §75 (2014) (providing a summary of cases where challenged charters based on the community credit union provisions of the FCUA were upheld as valid).

34. U.S. GOV'T ACCOUNTABILITY OFF., GAO-06-220T, *Financial Institutions: Issues Regarding the Tax Exempt Status of Credit Unions: Testimony Before the Comm. on Ways and Means, H. Repts. 2* (2005) ("Congress originally granted tax-exempt status to credit unions in 1937 because of their similarity to other mutually owned financial institutions that were tax exempt at that time. While the other institutions lost their exemption in the Revenue Act of 1951, credit unions specifically retained the exemption. The legislative history on the 1951 act did not articulate a rationale for the continued exemption of credit unions.").

35. See Revenue Act of 1951, Pub. L. No. 82-183 (erasing the tax exemption for mutual savings banks).

disproportionately because credit unions are not only limited to exclusively servicing their members, but also doing so in particular ways.³⁶

B. Modern Credit Unions and Merger Activity

The credit unions of the twenty-first century look much different than those which originally served post-Depression, low-income members.³⁷ After remaining largely unchanged since their inception, the NCUA revised rules governing the field of membership requirements for federally chartered credit unions in response to an economic downturn in the early 1980s.³⁸ The revised interpretation of Section 109 of the FCUA allowed federal credit unions to acquire membership from multiple employer groups.³⁹ While this change was met with litigation from commercial banking entities in both the legislative buildings and courtrooms, this expansive interpretation by the NCUA was only the starting point to the continued liberalization of the common bond requirement.⁴⁰

An August 2018 trend report from the Credit Union National Mutual Insurance Society (“CUNA”) displayed that there was a slight drop in the overall number of credit unions from 2017.⁴¹ This matches

36. U.S. GOV'T ACCOUNTABILITY OFFICE, *supra* note 34 (quoting H.R. Rep. No. 75-1579, at 2 (1937)).

37. See CHMURA ECON. & ANALYTICS, AN ASSESSMENT OF THE CREDIT ENVIRONMENT BETWEEN CREDIT UNIONS AND BANKS, 23–24 (2004), https://www.heartland.org/_template-assets/documents/publications/15666.pdf (detailing several reports by GAO, U.S. Department of Treasury, and other sources which provide that credit unions have significantly expanded the length and type of loans that they offer, increased the types of accounts that they offer, and relaxed membership requirements); John Reosti, *Credit Unions Versus Banks: How We Got Here*, AM. BANKER, Apr. 24, 2018, <https://www.americanbanker.com/news/credit-unions-vs-banks-how-we-got-here> (showing credit union growth from an average holding of \$549 per credit union in the 1960s to the \$1.1 trillion industry it is today).

38. See Masset, *supra* note 20, at 393 (relying on testimony from then NCUA chairman before a Congressional Committee to establish the motivations for the rule change); Kelly Culp, *Banks v. Credit Unions: The Turf Struggle for Consumers*, 53 BUS. LAW. 193, 195 (1997) (“In 1982, however, the NCUA expanded its interpretation of the common bond requirement to allow ‘select employee groups’ to join a single credit union.”) (quoting Interpretive Ruling and Policy Statement (IRPS) 82-1, 47 Fed. Reg. 16,775 (Apr. 20, 1982)).

39. See *NCUA Interpretive Ruling and Policy Statement 82-1*, 47 Fed. Reg. 16,775 (1982) (stating that this interpretation was done to allow the survival of access to credit.)

40. See Reosti, *supra* note 37 (outlining a number of cases beginning in the 1970s in which banks have challenged credit union actions).

41. NCUA MUTUAL GROUP, CREDIT UNION TRENDS REPORT 5 (2018), https://www.cunamutual.com/-/media/cunamutual/about-us/credit-union-trends/public/sept_2018_cu_trends_report.pdf.

the overall national trend of credit union decline.⁴² In fact, from the peak number⁴³ of federally recognized credit unions in 1969, more than 18,000 credit unions have merged or closed since then.⁴⁴ The forecast of continued consolidation is staggering in light of that fact that at their peak, “there were more than 23,000 credit unions.”⁴⁵ During the first half of 2018, approximately eighty-six credit unions ceased to exist due to mergers, purchase and assumptions, or liquidation.⁴⁶ This is largely on track to match the average of approximately 275 credit union mergers per-year.⁴⁷ Unsurprisingly, along with the average asset size of a credit union being up nearly 10% from a year ago, the median asset size is up over 7%, which further indicates that larger credit unions are growing faster than their smaller counterparts.⁴⁸

III. THE CREDIT UNION MERGER PROCESS

The credit union merger process, as outlined by the NCUA, is effectuated through a four-step process, the specifics of which depend on the types of credit unions that will merge.⁴⁹ As a general rule, if the continuing credit union is a federal credit union, the merger must follow all the NCUA’s chartering policies.⁵⁰ If the merging credit unions are state chartered, then state regulatory approval is required and any applicable state laws must be followed, but the NCUA field of membership policies will not apply.⁵¹ Finally, if a federally insured credit union is merging into a credit union that is not federally insured, then the merger must comply with all applicable laws, both state and federal.⁵²

42. See Mike Richards, Certified Pub. Accountant, Richards & Assoc.s, NACUSAC Conference: *Recent Trends in Credit Union Mergers*. 1–2 (June 15, 2017), https://www.nacusac.org/resources/Documents/2017_Richards.pdf (outlining merger trends).

43. See NATIONAL CREDIT UNION ADMINISTRATION, 1969 ANNUAL REPORT OF THE FEDERAL CREDIT UNION PROGRAM 19 (1970) (reporting that there were 12,921 credit unions at the end of 1969).

44. Richards, *supra* note 42.

45. BROOME, *supra* note 3, at 104.

46. Richards, *supra* note 42.

47. NCUAchannel, *supra* note 7 (describing the recent trend in mergers among credit unions including key statistics on the number, reasons, and features of the mergers).

48. *Credit Union Trends Report*, *supra* note 41.

49. NAT’L CREDIT UNION ADMIN., CREDIT UNION MERGER AND CONVERSION MANUAL (2018).

50. *Id.* at 4.

51. *Id.*

52. *Id.*

A. *Merger Permissibility Under the NCUA*

Before accomplishing any merger, credit union directors should consider the permissibility of any potential merger. The NCUA guide provides an overview of the general scenarios for which a credit union of a certain type may merge with another.⁵³ First, if the continuing credit union is a state chartered credit union, a merger will be permissible if all the requisite state requirements are met.⁵⁴ Requirements will vary from state to state, but an example of this kind of merger can be found in the recent merger of Summit Credit Union, a federally insured state chartered credit union based in Greensboro, North Carolina, and Triad Partners Federal Credit Union.⁵⁵ In that case, the smaller federal credit union, with over 3,000 members and around \$30 million in assets, merged into the much larger 33,000 member and \$230 million state chartered credit union.⁵⁶

The second scenario provides that if a single common bond credit union is merging into another single common bond federal credit union, then the NCUA requires that if both credit unions share a common bond, or if it is an emergency merger (discussed in scenario 9 below).⁵⁷

The third scenario outlined in the guide is if a multiple common bond credit union aims to merge with another multiple common bond federal credit union. This scenario is more complex and is permissible only if “each select group in the merging credit union’s field of membership has fewer than 3,000 primary potential members,” or if the merger is triggered as supervisory or emergency (discussed below).⁵⁸ The next outlined scenario, which is always permissible, is when a single common bond credit union with a potential membership of less than 3,000 seeks to merge into a multiple common bond federal credit union.⁵⁹

The fifth scenario outlined in the guide is applicable where a single common bond credit union with a primary potential membership

53. *Id.*

54. *Id.*

55. See *Summit CU Announces Partnership Merger with Triad Partners FCU*, CAROLINAS CREDIT UNION LEAGUE (2018), <https://www.carolinasleague.org/news/413212/Summit-CU-announces-partnership-merger-with-Triad-Partners-FCU.htm> (detailing the October 2018 merger between the two credit unions with a brief summary of the timeline and a quote from the Summit CU CEO).

56. *Id.*

57. NAT’L CREDIT UNION ADMIN, *supra* note 49.

58. NAT’L CREDIT UNION ADMIN, *supra* note 49, at 5.

59. NAT’L CREDIT UNION ADMIN, *supra* note 49, at 5.

of 3,000 or more is aiming to merge into a multiple common bond federal credit union.⁶⁰ This merger will be permitted when the “continuing credit union already has within its field of membership the group served by the merging single common bond federal credit union,” or when an emergency merger is in effect (discussed below).⁶¹

Scenario six entails “a single or multiple common bond [credit union] merging into a community chartered [federal credit union].”⁶² A merger of this type will be approved when:

the merging credit union has a service facility⁶³ within the community boundaries; a majority of the merging credit union’s field of membership would qualify for membership in the community chartered federal credit union; the continuing community chartered [federal credit union] previously added an underserved area and the merging credit union’s field of membership is contained within the specific underserved area; or it is an emergency merger.⁶⁴

Additionally, in a merger of this kind, a group that is within the merging credit union’s field of membership but located outside the community boundaries of the continuing credit union may not continue being served by the credit union.⁶⁵

The seventh scenario detailed in the guide is a merger where a community chartered credit union wants to merge into a community chartered federal credit union.⁶⁶ In this scenario, a merger is permissible when “the merging [credit union’s] boundaries are entirely within the continuing [federal credit union’s] boundaries.”⁶⁷ Another way this type of merger can be permitted is if “[t]he continuing [federal credit union]

60. NAT’L CREDIT UNION ADMIN, *supra* note 49, at 5.

61. NAT’L CREDIT UNION ADMIN, *supra* note 49, at 5.

62. NAT’L CREDIT UNION ADMIN, *supra* note 49, at 5.

63. 12 C.F.R. pt. 701 app. B ch. 2(I)(A)(1) (2018) (defining “service facility” for multiple common bond credit unions as “a place where shares are accepted for members’ accounts, loan applications are accepted or loans are disbursed,” including “credit union owned branch, a mobile branch, an office operated on a regularly scheduled weekly basis, a credit union owned ATM, or a credit union owned electronic facility that meets” at least those conditions).

64. NAT’L CREDIT UNION ADMIN, *supra* note 49, at 5.

65. NAT’L CREDIT UNION ADMIN, *supra* note 49, at 5.

66. NAT’L CREDIT UNION ADMIN, *supra* note 49, at 6.

67. NAT’L CREDIT UNION ADMIN, *supra* note 49, at 6.

meets the criteria for expanding its boundaries to include the merging [credit union's] boundaries."⁶⁸ Additionally, this type of merger may be permissible if "a majority of the merging credit union's field of membership would qualify for membership in the community chartered federal credit union."⁶⁹ Finally, the seventh type of merger can be approved through an emergency merger protocol.⁷⁰

The final eighth and ninth scenarios permitted by the NCUA are the supervisory and emergency merger.⁷¹ A supervisory merger is a particular category of merger that only applies to the multiple common bond credit unions.⁷² These mergers are only authorized when there are issues such as: "abandonment of the management and/or officials and an inability to find replacements, loss of sponsor support, serious and persistent record-keeping problems, sustained material decline in financial condition, or other serious or persistent circumstances."⁷³ In order for an emergency merger to be appropriate, the merging credit union must be "insolvent or in danger of insolvency."⁷⁴ Once the NCUA has made an insolvency determination, the administration is empowered to compel a merger "without regard to field of membership, the 3,000 numerical limitations or other legal constraints."⁷⁵

B. *The Merger Package*

Assuming the credit unions that intend to merge have considered the permissibility of a merger, the next step according to the NCUA is to prepare and submit a merger package for approval.⁷⁶ The NCUA mandates that the package include details on the following: the reasons for the merger; a target effective date of the merger; extensive financial information on things such as delinquent loans, loan allowance, net worth, and share values; field of membership documentation, including

68. NAT'L CREDIT UNION ADMIN, *supra* note 49, at 6. See 12 C.F.R. pt. 701, *supra* note 63 (outlining the process by which a field of membership can be amended to expand with a merger credit union when the continuing credit union shows economic viability and any overlapping credit union approves).

69. NAT'L CREDIT UNION ADMIN, *supra* note 49, at 6.

70. NAT'L CREDIT UNION ADMIN, *supra* note 49, at 6.

71. NAT'L CREDIT UNION ADMIN, *supra* note 49, at 6.

72. NAT'L CREDIT UNION ADMIN, *supra* note 49, at 6.

73. 12 C.F.R. pt. 701 app. B ch. 2 IV.D.2 (2018).

74. 12 C.F.R. pt. 701 app. B ch. 2 II.D (2018).

75. NAT'L CREDIT UNION ADMIN, *supra* note 49, at 6.

76. NAT'L CREDIT UNION ADMIN, *supra* note 49, at 8.

locations of where members will be served; notices for compliance with applicable Federal Trade Commission laws; and documentation from the merging credit union that features a notice for special meeting of the members which includes a copy of the ballot to be sent to members for merger approval.⁷⁷

Once this package is received, the NCUA considers several factors before granting a proposed merger the seal of approval. One of the primary things that regulators look to is the interest of the members.⁷⁸ Additionally, the NCUA will ensure that all statutory and regulatory requirements are satisfied.⁷⁹ Finally, a proposed merger will be considered favorably if it “minimizes undue risk to the National Credit Union Share Insurance Fund (“NCUSIF”).”⁸⁰ If a regulator denies a proposed merger, the denial notification will be accompanied by an explanation for the denial.⁸¹ Credit unions have thirty days to provide additional supplemental information for NCUA reconsideration or sixty days to appeal the decision to the NCUA Board.⁸²

C. *The Membership Vote*

After the regulators sign off on a proposed merger, the merging credit union is required to present the proposal for approval at a membership meeting.⁸³ Accordingly, the NCUA provides three options for presenting a merger proposal for vote by its members. First, the vote can take place “in person at the merging credit union’s annual meeting if that meeting takes place sixty days after NCUA approval [or] at a special meeting to be called within sixty days after NCUA approval.”⁸⁴ Alternatively, member approval can be given “by mail or electronic ballot received no later than the date and time announced for annual meeting or the special meeting called for that purpose.”⁸⁵ These requirements mirror

77. NAT’L CREDIT UNION ADMIN, *supra* note 49, at 8–10.

78. NAT’L CREDIT UNION ADMIN, *supra* note 49, at 10.

79. NAT’L CREDIT UNION ADMIN, *supra* note 49, at 10.

80. NAT’L CREDIT UNION ADMIN, *supra* note 49, at 10.

81. NAT’L CREDIT UNION ADMIN, *supra* note 49, at 10.

82. NAT’L CREDIT UNION ADMIN, *supra* note 49, at 11.

83. NAT’L CREDIT UNION ADMIN, *supra* note 49, at 11.

84. NAT’L CREDIT UNION ADMIN, *supra* note 49, at 11.

85. NAT’L CREDIT UNION ADMIN, *supra* note 49, at 11.

the general requirements for shareholder approval of a merger of a corporation.⁸⁶

Depending on the merger type, different levels of membership approval are required. If the merging credit union is a federal credit union which aims to merger with a federally insured credit union, then “a majority of the members of the merging credit union *who vote* on the proposal must approve the merger.”⁸⁷ This is distinctly different from the scenario in which a federal credit union is proposing to merge into an uninsured credit union. In this case, “a majority of the merging credit union’s *total* membership must approve the merger and termination of insurance.”⁸⁸ Additionally, this vote must be done by secret ballot and an independent entity must collect and tally the votes.⁸⁹ If the merging credit union is a federal credit union that aims to merge with a non-federally insured credit union, then only a majority of those who vote on the proposal is required, “provided at least 20 percent of the total membership participate in the voting.”⁹⁰ This vote also must be done by secret ballot and counted by an independent entity.⁹¹

D. *Completing the Merger*

After the vote is tallied and approval by the members is confirmed, the credit union needs to finalize the merger. In many cases, the continuing credit union will need to update its federal share insurance coverage, make filings with the Federal Trade Commission, and take steps to execute the merger agreement.⁹² Additionally, any merger must be completed—and the NCUA notified—within four months of approval.⁹³ This includes the cancellation of the merging credit union’s charter. In order for the merger to be effectuated, the NCUA will cancel

86. See Matt Swartz, *Mergers and Acquisitions: the basics*, A.B.A (Jun. 28, 2017), https://www.americanbar.org/groups/gpsolo/publications/gpsolo_ereport/2012/july_2012/mergers_acquisitions_basics/ (“When a company is required to take a vote of its shareholders, state corporate laws generally permit the vote to take place either at a meeting of shareholders or by written consent.”).

87. NAT’L CREDIT UNION ADMIN, *supra* note 49, at 12 (emphasis added).

88. NAT’L CREDIT UNION ADMIN, *supra* note 49, at 12 (emphasis added).

89. NAT’L CREDIT UNION ADMIN, *supra* note 49, at 12.

90. NAT’L CREDIT UNION ADMIN, *supra* note 49, at 12.

91. NAT’L CREDIT UNION ADMIN, *supra* note 49, at 12.

92. NAT’L CREDIT UNION ADMIN, *supra* note 49, at 12–15.

93. NAT’L CREDIT UNION ADMIN, *supra* note 49, at 15.

the merging credit union's charter after receiving all the proper documentation as required by the NCUA.⁹⁴

IV. MOTIVATIONS TO MERGE

A. *By the Numbers*

In light of the quick and steady decline in the number of credit unions chartered and the overall increase in membership and capital, the motivations behind credit union directors' decisions to merge is well documented.⁹⁵ During 2012–2016, 90% of credit union mergers were voluntary.⁹⁶ However, an NCUA study from 2011–2016 indicates that some credit unions which have voluntarily merged do so as a last-ditch effort to avoid an involuntary merger forced by the NCUA.⁹⁷ That study showed that 47% of all credit unions that merged had net negative member growth for three consecutive years.⁹⁸ Additionally, 26% were under prompt corrective action (“PCA”)⁹⁹ for some time during the three years prior to merger, 54% of merging credit unions were operating at a loss for three consecutive years prior to merging, and 53% had declining net worth ratios for three consecutive years prior to merger.¹⁰⁰

When polled, the most common reason cited for why a merger took place was “weak financial condition.”¹⁰¹ The next two most cited reasons were, respectively, to “increase services” and “poor management succession planning.”¹⁰² Thus, most credit unions are neither merging to increase market-share nor to drive out competition, but rather to survive.¹⁰³ Additionally, despite some of the flashy headlines

94. NAT'L CREDIT UNION ADMIN, *supra* note 49, at 15.

95. See Ray Birch, *A Merger Trend is Underway*, CU TODAY (Mar. 4, 2018 5:31 PM), <https://www.cutoday.info/THE-feature/A-Merger-Trend-Is-Underway> (detailing the recent trend in mergers among credit unions and providing certain motivations for those mergers).

96. NCUAchannel, *supra* note 7.

97. NCUAchannel, *supra* note 7.

98. NCUAchannel, *supra* note 7.

99. See 12 C.F.R. §702.1 (2016) (“The express purpose of prompt corrective action under section 1790d is to resolve the problems of federally-insured credit unions at the least possible long-term loss to the National Credit Union Share Insurance Fund.”).

100. NCUAchannel, *supra* note 7.

101. NCUAchannel, *supra* note 7 (citing 2011 Office of Small Credit Union Initiatives Merger Study).

102. NCUAchannel, *supra* note 7.

103. See RICHARDS, *supra* note 42, at 2 (“What Drives Credit Union Mergers: Weak financial condition of merged credit union, lacking products and services, not keeping pace

proclaiming billion-dollar credit union mergers,¹⁰⁴ the vast majority of mergers occur between small, community-based credit unions.¹⁰⁵

B. Economies of Scale

Credit unions have not been immune to the costs of complying with increased regulation; demand from consumers for cheaper and more efficient services; and increased technology costs.¹⁰⁶ Many small credit unions find themselves in financial constraints because they are not able to reach a “critical mass” of membership under their current structure and are driven to merge because they have insufficient resources to meet the cost of the increased regulatory burden on their own.¹⁰⁷ This “critical mass” is embodied by the concept of economies of scale.¹⁰⁸ This is a measurable concept that likely motivates many credit union directors to seek the benefits of a merger.¹⁰⁹ A 2014 study, from the Filene Research Institute, showed that of the twenty-three credit unions reporting involvement in a merger in the last five years, 57% of those responded

with technology, Increased compliance, Poor management succession planning, Field of membership disruptions, Record keeping problems.”).

104. See Nathan DiCamillo, *Massachusetts CUs merge to create a nearly \$1 billion institution*, CREDIT UNION JOURNAL (Mar. 2, 2018 5:25 PM), <https://www.cujournal.com/news/massachusetts-credit-unions-merge-to-create-a-nearly-1-billion-institution>. (detailing the pending merger between Bridgewater Credit Union, based in Bridgewater, Mass., and Merrimack Valley Credit Union, based in Lawrence, Mass.).

105. See Matthew Speed, *Updates: Credit Union Mergers & Acquisitions*, CETO & ASSOCIATES BLOG (May 8, 2018), <https://www.ceto.com/blog/updates-credit-union-merger-acquisitions> (“The majority of the [credit union] mergers are the consolidation of smaller institutions that find the need to grow rapidly. This growth is necessary so that the institutions can reach the critical mass needed to survive in a very competitive and regulation heavy industry.”).

106. See GIOVANNI FERRI & PANU KALMI, ONLY UP: REGULATORY BURDEN AND ITS EFFECTS ON CREDIT UNIONS 30 (June 2014), https://www.info-pro.com/wp-content/uploads/2015/05/331_Regulatory_Burden.pdf (figure A6) (providing that of participating credit unions that had experienced or considered a merger in the last three years, sixty-one percent of those stated increased regulatory burden was part of the reason and fifty-seven percent were seeking economies of scale).

107. See Speed, *supra* note 105 (“The majority of M & A activity happens between small (less than \$100mm in assets) community based credit unions.”).

108. See Will Kenton, *Economies of Scale*, INVESTOPEDIA (Jan. 29, 2018) <https://www.investopedia.com/terms/e/economiesofscale.asp> (defining economies of scale as a measure of cost savings that occurs as production increases).

109. See FERRI, *supra* note 106, at 5 (“To comply with regulations, the smallest quartile of credit unions in the United States use resources that are equivalent to 43% of total FTEs[.] But for the largest credit unions [in the study], this ratio is only 4%. The majority of compliance costs reside in fixed staff costs rather than variable monetary costs, especially in small credit unions.”).

that “attempts to get economies of scale” as their primary reason for merger.¹¹⁰

When looking at credit unions by size for total compliance costs, the smallest credit unions dedicate resources that are equivalent to 43% of total full-time equivalent employees (“FTEs”) per year, whereas for the largest credit unions this ratio is only 4%.¹¹¹ This shows that the smallest credit unions have a substantially heavier burden on their resources relative to the larger credit unions. While this marker is staggering, an additional reason that credit unions may be feeling the squeeze now more than ever is the measured increase in regulatory cost over time. In fact, a look back shows that the average compliance cost from 2007 to 2012 rose from just over four FTEs to over eight FTEs.¹¹² An increase of more than double over five years is shocking.¹¹³ Much of this increase can be attributed to the financial crisis of 2008, which motivated Congress to implement sweeping regulations that largely ignored the differences in size, scale, and purpose of different lenders and financial institutions.¹¹⁴

As mentioned above, the second most cited reason for merger was to “increase services.”¹¹⁵ While this is usually interpreted as expanded financial services, the motivation to provide more services based on technological advances is echoed by other financial services institutions in the form of increased spending on technology costs.¹¹⁶ Citigroup spent \$8 billion on technology alone in 2017.¹¹⁷ The ballooning technology budgets of the largest banks, when paired with their increased market shares, suggest that “customers may be choosing the banks with the best

110. FERRI, *supra* note 106, at 30.

111. FERRI, *supra* note 106, at 13–14.

112. FERRI, *supra* note 106, at 13–14.

113. FERRI, *supra* note 106, at 13–14.

114. *See* FERRI, *supra* note 98, at 21 (citations omitted) (“[D]ifferent types of financial organizations that use different lending methodologies call for different types of regulations. This fact has often been downplayed in the post-2008 regulatory changes, which have, if anything, intensified the ‘one size fits all’ approach.”).

115. NCUAchannel, *supra* note 7; *see supra* Part IV. A.

116. Telis Demos, *Citigroup: Big Bank, Big Spender on Tech*, THE WALL ST J. BLOG (May 30, 2018 2:25 PM), <https://blogs.wsj.com/moneybeat/2018/05/30/citigroup-big-bank-big-spender-on-tech/> (“JPMorgan Chase & Co., for example, said it will spend \$10.8 billion on technology in 2018. In previous years the bank has said that roughly a third of its tech budget is spent on new investments. The bank overall employs about 50,000 people in technology-related jobs.”).

117. *Id.* (“Citigroup spent \$8 billion on technology in 2017, easily more than was invested by venture capital across all U.S. financial technology startups last year.”).

technology rather than those that offer the best deposit rates.”¹¹⁸ Additionally, traditional financial services institutions are not the only ones competing in the “increased services” space. Smart phone apps such as Acorns¹¹⁹, Robinhood¹²⁰, and even the Starbucks App¹²¹ are all reaching millions of consumers with banking-like services that credit unions are missing out on. The economies of scale pressures associated with the regulatory burden are paralleled in the implementation of these kinds of technology. Many of the costs incurred by the modern technology suites that would allow for convenient consumer interaction require massive scale in order to be cost-efficient.

V. THE IMPACT OF CREDIT UNION MERGERS

The steady pace at which credit unions continue to merge is justified by the ever-mounting motivations to merge. The question remains: what is the effect of these mergers on the continuing credit union? In particular, what benefits, or detriments, are the owner-members dealing with as a result of these mergers?

One way to measure this is through the change in economic health of a credit union before and after a merger. The NCUA produced a small-scale study researching the effect of merging credit unions on their CAMEL¹²² ratings for credit unions that merged during the 1988 through 1995 period.¹²³ This study found that “the vast majority of financially

118. Kristin Broughton, *Regionals Outflanks by Big Banks in Race for Deposits*, AM. BANKER, Apr. 18, 2018, at 1–2.

119. See ACORNS, <https://www.acorns.com/about/> (last visited Jan. 13, 2019) (featuring acorns which is a “round-up” app that allows users to link a debit or credit card to the application and has recently introduced a checking account/debit card feature).

120. See ROBINHOOD, <https://robinhood.com/> (last visited Jan. 13, 2019) (showing that Robinhood is an investment application that allows for zero-fee trades up to a certain amount and where users can link a credit/debit card and invest in offerings through the application).

121. See Suleman Din, 8 *Takeaways from Digital Banking 2018*, AM. BANKER, June 11, 2018, at 6–7 (“[M]ore than 40% of the 55 million U.S. smartphone users will have made an in-store mobile payment through the Starbucks app, and just over 23 million consumers over the age of 14 will use the app to make a point-of-sale purchase at least once every six months.”).

122. See NATIONAL CREDIT UNION ADMINISTRATION, NCUA’S CAMEL RATING SYSTEM I (2018) (“The CAMEL rating system is based upon an evaluation of five critical elements of a credit union’s operations: Capital Adequacy, Asset Quality, Management, Earnings, and Liquidity/Asset-Liability Management. CAMEL is designed to take into account and reflect all significant financial, operational, and management factors examiners assess in their evaluation of a credit union’s performance and risk profile.”).

123. See Harold O. Fried et. al., *The Impact of Mergers on Credit Union Service Provision*, 23 J. OF BANKING & FIN. 367, 369 (1999) (summarizing the findings of the 1989 NCUA report).

healthy (CAMEL 1 or 2) credit unions involved in a merger experienced a decline in their rating during the two years following the merger” and that “some financially weak (CAMEL 4) credit unions involved in a merger experienced an improvement in their financial condition following a merger.”¹²⁴ Another study looking at 1997 through 2007, and suggested that the difference in any economic strength is largely uncorrelated when compared to those pursuing growth by internal expansion.¹²⁵

Looking more directly at the impact on the stakeholders is another way to observe the effects of credit union mergers. Credit union mutuality limitations mean that, unlike a commercial bank, the owners mainly benefit by a merger if the continuing credit union yields an improvement in both the deposit and lending rates offered to members.¹²⁶ However, the member-owners are not the only stakeholders in the credit union merger marketplace. The NCUA is also a major stakeholder here.¹²⁷ With such a high degree of coordination required and no obvious benefit for the members in terms of lower rates, the NCUA stands out with a unique benefit in the outcome of a merger.¹²⁸ The benefit to the regulator as a stakeholder is that by guiding an institution to merge instead of liquidate, they avoid the criticism and economic hit of having to make a payment from the federal insurance.¹²⁹

VI. STRATEGIES FOR EFFECTIVE MERGERS

Despite the steady pace of mergers in the credit union market, credit unions have largely failed to outpace the growth of banks in any meaningful economic way.¹³⁰ From the credit union perspective, this is

124. *Id.*

125. See DAVID ELY & NIKHIL VARAIYA, *IMPACT OF CREDIT UNION MERGERS ON MEMBER SERVICES 2–3* (2009) (unpublished manuscript) (examining “the effects of credit union industry consolidation on credit union efficiency through mergers in the U.S. over the time period 1997–2006”).

126. Keldon J. Bauer et. al, *The Effect of Mergers on Credit Union Performance*, 33 J. OF BANKING & FIN. 2267, at 2267 (2009).

127. See *id.* (arguing that the only rational motivation for the high-pressured merger activity is regulator desire to avoid insurance payouts).

128. *Id.*

129. See *id.* at 2274 (“Our study supports the thesis that most mergers are instigated by regulators to avert using insurance funds to bail out failing institutions.”).

130. See CREDIT UNION NATIONAL ASSOCIATION, *MARKET SHARE OF DEPOSITORY INSTITUTION ASSETS*, at 1 (1992 to 2017), <https://www.cuna.org/About-Credit-Unions/Credit-Union-Data—Statistics/> (last visited Sept. 16, 2018) for a chart showing the trend in market

likely for the best, given that the credit unions seek to maintain their tax exempt status.¹³¹ Economic indicators aside, criticism of the merger process would be greatly alleviated by an increase in transparency toward the members and public generally.¹³²

Best practices for voluntary mergers needs to begin with an increase in the knowledge of the potential deal. The NCUA actively encourages credit unions that aim to be involved in a voluntary merger to seek out and engage in active negotiations before preparing a merger package.¹³³ In order to address this, commenters have suggested a best practice that would require: “the board to notify credit union members and the general public anytime a board or managers is seeking a merger,” and use public announcements to solicit offers from applicable credit unions “if the board and management believe a merger is in the credit union’s best interest.”¹³⁴

Another key criticism—which is marginally supported by research—is that many of these mergers only reward management in the form of bonuses and other incentives received as part of a merger agreement. In order to combat this, credit unions should publish to members: bonuses and incentives offered to the board and management; terms of any employment promises or severances; projections for the continuing credit union’s new rates; an updated business model that expresses changes in operating standards, technology, and services; and

share of total assets from 1992–2007 for credit unions, large banks, and small banks where large banks are defined as the top 100 largest banks.

131. See Wendy Cassidy, *The Case for a Credit Union Reinvestment Act*, 100 COLUM L. REV. 331 (2000) (arguing that credit union depository growth rate and membership increases warrant a Credit Union reinvestment Act); White, *supra* note 9, at 1367 (concluding that credit unions must demonstrate a commitment to their original charge of serving communities of “small means” in order to justify the continuance of the tax exemptions); *Senator Questions CU Tax Exemption as Bankers Blast ‘Credit Union Power Grab’*, CUTODAY.INFO (Sept. 3, 2018), <https://www.cutoday.info/Fresh-Today/Senator-Questions-CU-Tax-Exemption-as-Bankers-Blast-Credit-Union-Power-Grab> (outlining a recent letter from Sen. Orrin Hatch directed to NCUA chairman wherein Sen. Hatch questioned the continued justification for the tax exemption).

132. See Chip Filson, *How to Stop Exploiting Members in Mergers*, CREDIT UNIONS.COM BLOG (Feb. 14, 2017), <https://www.creditunions.com/blogs/commentary/how-to-stop-exploiting-members-in-mergers/> (arguing that in order to preserve the nature and benefits of credit unions, the merger process needs to be more transparent).

133. NAT’L CREDIT UNION ADMIN., *supra* note 49 (detailing the process for credit union merger); David Ritter, *8 Phases to Making Credit Union Mergers Successful: From Planning to Integration*, VIEW POINT BLOG (Jul. 13, 2016) (outlining the credit union merger process from a business perspective in which the directors meet in “step 4” and members are not required to be notified until “step 7”).

134. Filson, *supra* note 132.

any special payments to member-owners, and how that was calculated.¹³⁵ Increases in disclosure will likely not be a complete fix.

A full and public solicitation of merger partners has the potential to further accelerate mergers and ramp up consolidation. Hopefully any side-effect of this sort would be mitigated by the dramatic increase in exposure. For credit unions, mutuality should only be a justification for tax exemption when the benefit of that exemption can be felt directly by the members and community. Allowing insider sales and mergers that fail to deliver any tangible benefits to members is clearly an abuse of the original mandate, and a failure of the NCUA.

VII. CONCLUSION

From their inception in nineteenth century Germany, credit unions were intended to serve the communities that created them by providing access to credit at an affordable rate where it would otherwise likely not be available.¹³⁶ Growth, federal recognition, and the influence of the United States administrative state have shaped credit unions in the United States to an extent that has caused some to argue the original intent has been lost.¹³⁷ Usually, these arguments are accompanied by a removal of tax exemptions and other protections afforded by the FCUA.¹³⁸

In truth, modern credit unions are not too dissimilar to banks in the services that can be offered. Economic indicators such as merger

135. Filson, *supra* note 132.

136. See HISTORICAL TIMELINE, *supra* note 19 (detailing the history of the NCUA, credit unions, and the regulation surrounding the institution).

137. See Edge, *supra* note 10, at 29 (arguing that modern credit unions are not “true consumer organizations with real common bonds of membership” by displaying financial trends and detailing how the diverse membership of modern credit unions is far different than originally intended).

138. White, *supra* note 9, at 1367 (concluding that credit unions must demonstrate a commitment to their original charge of serving communities of “small means” in order to justify the continuance of the tax exemptions); *Senator Questions CU Tax Exemption as Bankers Blast ‘Credit Union Power Grab’*, CUTODAY.INFO (Sept. 3, 2018) <https://www.cutoday.info/Fresh-Today/Senator-Questions-CU-Tax-Exemption-as-Bankers-Blast-Credit-Union-Power-Grab> (outlining a recent letter from Sen. Orrin Hatch directed to NCUA chairman wherein Sen. Hatch questioned the continued justification for the tax exemption).

rates,¹³⁹ membership/customer growth rate,¹⁴⁰ and asset growth¹⁴¹ among credit unions have nearly paralleled those of the big banks. Despite these similarities, expansions of the common bond, and numerous challenges from the banks, the benefits of increased credit union mergers to the community on the overall banking services industry is largely unclear.¹⁴² In order to dispel critics of “inside sales,” increase public awareness, and provide the regulators with accurate information, a best practices protocol which mandates more disclosures for the credit union merger process should be implemented.

T. NUTE THOMPSON*

139. Reosti, *supra* note 7 (“Nearly 670 credit union mergers took place between 2015 and 2017. That volume wasn’t too far off from the 774 bank deals announced over the same time period.”).

140. See CREDIT UNION NATIONAL ASSOCIATION, *supra* note 130 (providing a chart showing the trend in market share of total assets from 1992–2007 for credit unions, large banks, and small banks where large banks is defined as the top 100 largest banks).

141. See CREDIT UNION NATIONAL ASSOCIATION, *Frequently Requested Credit Union and Bank Comparisons*, <https://www.cuna.org/About-Credit-Unions/Credit-Union-Data—Statistics/> (last visited Sept. 16, 2018) (providing a pdf containing a series of charts detailing a comparison between credit unions and banks on economic indicators such as insurance fund ratio, net income ratio, equity capital ratio, average size, average growth, and asset growth over time).

142. See James Disalvo & Ryan Johnston, *Credit Unions’ Expanding Footprint*, FED. RES. BANK OF PHILA RESEARCH DEP’T: BANKING TRENDS 22 (2017), https://www.philadelphiafed.org/-/media/research-and-data/publications/banking-trends/2017/bt-credit_unions.pdf?la=en (showing credit union mergers and market share trends).

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