DATA DISPATCH

Credit unions hunting for nonbank M&A to diversify revenue

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Credit unions are increasingly looking to buy nonbanks such as insurance brokers and wealth management firms in an effort to diversify their income.

The interest in nonbanks comes at a time when credit unions, much like banks, are facing a poor revenue environment due to tepid loan growth and low interest rates. Several deal advisers said in interviews that there are active discussions between credit unions and nonbanks that do not offer depository services.

"It's becoming more common as [credit unions] grow," said Michael Bell, partner and co-leader of the financial institutions practice group at Honigman LLP.

Over the past month, three of Bell's credit union clients have expressed interest in insurance or wealth management M&A. Credit unions are interested in acquiring individual insurance or trust services businesses, or acquiring banks with those existing business lines, Bell said. On Aug. 12, Royal CU agreed to acquire Lake Area Bank, an institution that reported $30.6 million in noninterest income over the last 12 months ended in the second quarter, compared to $17.3 million in total interest income.

Credit unions' "other noninterest income" — a data field that includes miscellaneous noninterest income excluding items such as investment gains and overdraft fees — has almost tripled since 2012. It is still relatively rare for a credit union to wholly own a fee-generating line of business. But with a weak earnings landscape, a growing number of credit unions are on the hunt for acquisitions that can boost income growth.

"Even the largest credit unions are saying, 'This is getting to be too much.' So they're looking at all kinds of things," Peter Duffy, a managing director at Piper Sandler, said in an interview. Duffy said credit unions are looking at everything from title insurance to trust services, motivated by a need to increase and diversify their revenue streams.

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On the hunt for M&A

Historically, credit unions have offered products such as insurance or wealth management through a Credit Union Service Organization, or CUSO — organizations owned by credit unions that provide permitted financial services to credit unions or the members of credit unions. The CUSO typically distributes income, such as a share of commissions, to participating credit unions.

There has been a recent uptick in credit unions interested in insurance broker M&A, said Lucas Parris, a senior vice president at Mercer Capital focused on insurance and insurtech companies. Many credit unions see insurance as a "natural fit" with their consumer-heavy loan portfolios since they present cross-selling opportunities, he said. For example, a lender could offer an auto insurance policy when originating an auto loan.

Credit unions are strong competitors for nonbank deals since they have an ability to present high, all-cash offers, Parris said. Industry groups have renewed their long-running campaign against credit unions' tax-exempt status following a recent string of credit union acquisitions of banks. Banking lobbyists argue the tax exemption means credit unions can pay more to acquire banks, removing the target bank's revenue-generating assets from the tax rolls.

"Their ability to pay may be in line with some of the other competitive acquirers out there, maybe even more so," Parris said. "Credit unions entering this space can make offers that are just as compelling from both a cultural fit perspective as well as a financial perspective to potential agencies."

In addition to weak loan growth and low interest rates, credit unions have seen their consumer account fees, such as overdraft and ATM charges, stagnate over the last decade, further spurring a need for diversified revenue sources. In the second quarter, these fees accounted for 11.4% of the industry's total operating income over the last 12 months, down from 16.9% in 2012. Similar to the banking industry, credit unions are feeling both competitive and regulatory pressure to reduce overdraft income.

"Because the big guys are doing it, the rest of the market is going to have to fall in line or risk losing customers," Duffy said. "So how are they going to replace that income?"

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