

## **Structuring Bank Mergers and Acquisitions: Overcoming Capital Requirement Hurdles and Other Regulatory Demands**

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# Current Trends and Opportunities in Bank M&A

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# Trends

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- Mergers of equals
  - ▶ Lower premium deals, generally
  - ▶ Social issues
- Core deposit funding and net interest margin pressures as a driver for M&A
  - ▶ Funding “cliff”
- Limited auctions versus negotiated deals
- Credit fears and “hiccups” in public announcements
- Dwindling number of acquirors?



## Trends *(continued)*

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- Fear of political and economic future
- Credit union acquisitions of banks — mergers versus P&As (differing state laws)
- Timing is crucial for sellers
  - ▶ Monitor dead flow and status of acquirors
- Regional banks merging – bigger is better (?)



# Opportunities

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- Enhanced liquidity for both sets of shareholders
  - ▶ OTCQX listing as an interim step
  - ▶ Limited lock-ups
- Means of entering new markets
  - ▶ Geographic
  - ▶ Demographic
- Infusion of talent, and means of addressing succession
  - ▶ Employment Agreements
  - ▶ Retention programs





# Opportunities

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- Strategic partnerships, especially where new products are introduced for cross-selling
- Continued growth and diversification of risk
- Buying is faster than building
- “Sweet spot” in public trading multiples



# Legal and Regulatory Issues

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- HHI considerations and dispositions
  - ▶ “Burdensome Conditions”
  - ▶ Any changes are typically scheduled
- Federal Reserve “control” limitations
  - ▶ Negative covenants
  - ▶ Change in Bank Control Act
- Employee matters
  - ▶ Employment Agreements
  - ▶ Change-in-Control Agreements
  - ▶ Retention Agreements
  - ▶ Severance Policies
- 280G



## Legal and Regulatory Issues *(continued)*

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- Benefit plans
- Expedited treatment of application / 5(c) waiver
- Core processor conversion
- Acquisitions of S corps
- Merger litigation
- Forward versus reverse triangular merger structures



# Due Diligence

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- Typical M&A sequencing
  - ▶ Teaser
  - ▶ NDA
    - Mutual?
    - Negative covenants?
  - ▶ CIM
  - ▶ VDR that provides very limited, high level diligence
  - ▶ Initial bids in the forms of Letter of Intent
  - ▶ Exclusivity Agreement
    - Duration
    - Sharing of communications
  - ▶ Full-blown diligence, including loan review



## Due Diligence (*continued*)

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- Loan review — third party engagement and level of penetration
- On-site management interviews
- Regulatory discussions (and permissibility)
- Disclosure of customer information
- Reverse due diligence in equity deals
- Rare to see representation and warranty insurance
- Describing due diligence process to regulators in the application materials



# Merger Agreement

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- Price
- Form of consideration
- Mechanics fo exchange and merger
- Representations and Warranties
- Conditions to Closing
  - ▶ Approvals
  - ▶ Employment Agreements
  - ▶ Lease Extensions
- Negative Covenants



## Merger Agreement (*continued*)

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- Pricing adjustments, if any
- Termination / termination fees
- Fiduciary out provisions / Superior Proposals
- No indemnity
- D&O tail insurance
- Disclosure Schedules
- Ancillary agreements



# Pricing and consideration

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- Securities law considerations
  - ▶ Public companies
    - S-4 Disclosure Requirements
  - ▶ Private Companies
    - No exemption for mergers
    - Bank securities
    - Private placement
    - Fairness hearings
- Tax implications for cash consideration
- Role of deal metrics in analyst community, as cash can help reduce TBV dilution / earn-back period





## Pricing and Consideration (*continued*)

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- Tax free reorganization opinions
- Ability of shareholders to elect form of consideration; allocation challenges, especially with transfer agent
- S corps — interim tax distributions; AAA distribution; closing the books; accruals . . .
- Paying / Exchange Agent



# Exchange Ratio

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- Fixed price / floating exchange ratio
- Fixed exchange ratio / floating price
- Collars
- Price Protection



## Exchange Ratio (*continued*)

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- Role of adjustments (e.g., disposition of SNC portfolio)
- Minimum equity test
- Other adjustments



# Representations and Warranties

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- Loans
- Mortgage operations
- Consumer lending
- Compliance
- Capitalization



## Representations and Warranties (*continued*)

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- Insurance operations
- Regulatory status
- Role of disclosure schedules
  - ▶ Disclosure schedules submitted with regulatory applications, but excluded from size filings
- Qualifiers and bring-down



# Covenants

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- Loans and renewals – consider Fed “control” limitations
- Asset dispositions
- Publicity
- Cooperation for regulatory applications and merger proxy



# Closing Conditions

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- Shareholder approval
- Regulatory approval
- No MAE; reps and warranties true
- Employment agreements
- Closing timing
- Deal-specific items, such as material contract renewals / terminations



# Termination Provisions

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- “Drop-dead” date; regulatory kick-out extension
- Mutual termination
- Kill-or-fill price protection provisions
- MAE
- Fiduciary out for Superior Proposal
- Termination fee
  - ▶ When payable
  - ▶ Typical amount





# Other Considerations

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- Confidentiality
- Regulation M
- Repurchase program implications under 10b-18 and 10b5-1
- Social issues
- Indemnity provisions
- Survival of representations and warranties
- Accrual for CIC payments and other deferred compensation agreements