

BankDirector

**Breakout 1:
Creative Solutions for
Addressing Deal
Certainty in Uncertain
Times**

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#A0BA24

Acquire or Be Acquired 2024

Creative Solutions for Addressing Deal Certainty in Uncertain Times

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Who We Are

Washington, D.C. based law firm specializing in the representation of community banks and other financial institutions.

National leader in representing community banks in corporate restructuring, mergers and acquisitions, capital raising transactions, corporate governance, executive compensation, regulatory and enforcement and general corporate and securities law matters.

We represent over 300 financial institutions nationwide. Most are community banks ranging from \$100 million to \$25 billion in assets.

Agenda

- M&A Environment
- Potential Deal Roadblocks, Delays and Failure Points
- Current Regulatory Processing Issues
- Preparing for and Mitigating Delays and Roadblocks
- New DOJ Merger Guidelines

M&A Environment - General

- M&A activity down substantially – 96 in 2023, 161 in 2022; 202 in 2021
- Lower overall deal value – \$4.21B in 2023 compared to \$8.95B in 2022 and \$76.69B in 2021
- Lowest activity since 2009 during financial crisis
- Some regions very low activity - New England only 5 announced transactions in 2023
- Lower median deal value to TCE: 124% - 2023, 153% - 2022, 151% - 2021
- Average deal closing period (signing to closing) 162 days in 2023
- Increased regulatory comments and requests for information

M&A Environment - General

- Why Decreased Activity?
 - Lower stock prices limited buyers' ability to utilize their currency
 - AOCI
 - Loan interest rate marks
 - Turmoil in early 2023 - bank failures and liquidity crisis
 - Uncertainty – inflation, interest rates, credit quality

What Creates Deal Uncertainty and Delays?

- Regulatory Processing Issues
 - Potential Problematic Seller Characteristics (CRE concentration or Loan Exposures)
- Compensation Structuring Issues
- Non-traditional Buyers (Credit Unions, Investor, Fintech)
- Large Fair Value Marks
- Unexpected or larger than expected movements in the market

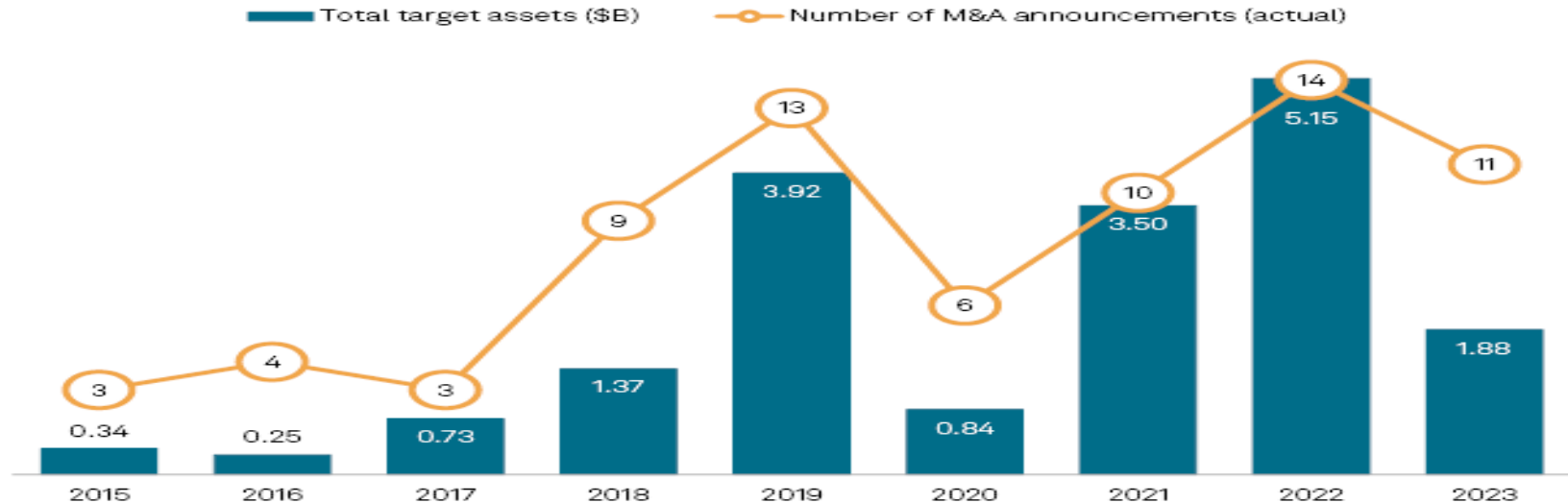
Roadblocks, Delays and Failure Points

Regulatory Processing Issues:

- Unresolved Acquiror MRAs, MRBAs and Enforcement Issues
- Unresolved Target MRAs, MRBAs and Enforcement Issues (MOEs, Separate Bank Sub)
- Public Protests and Comments
- Low Pro Forma Capital and/or Liquidity (Day 1 and 1,2,3 Years Out)
- Loan Concentration Issues
- Background / IBFR Issues for Control Persons (Investor, Fintech)
- Sources of Funding (Investor, Fintech)
- General “hot button” issues identified by regulators (ex. OCC semi-annual risk guide)
- Novel Issues (Credit Union Authority / Accounting Acquiror)

Non-traditional Buyers - Credit Unions

US credit union-bank M&A deals



Data compiled Dec. 27, 2023.

Analysis limited to whole-bank and franchise deals announced between Jan. 1, 2015, and Dec. 26, 2023, with a US credit union buyer and US bank or thrift target; excludes terminated deals.

Total target assets are as of the most recent quarter-end prior to deal announcement for all deals announced that year.

Source: S&P Global Market Intelligence.

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Non-traditional Buyers - Credit Unions

- Represents about 13% of all bank M&A transactions during 2023
- Mostly in Midwest and Southeast – none in New England
- Why are credit union “preferred” buyers?
 - All cash consideration
 - Less pricing discipline
 - Tax exempt status
 - Substantive mission-driven aspects and field of membership requirements of the credit union charter have eroded, if not ended
 - Not subject to Community Reinvestment Act

Non-traditional Buyers - Credit Unions

Typical Issues:

- Greater Execution Risk – Over 15% of bank deals with CU buyers since 2011 terminated, 3.8% for traditional bank deals
- State authority, processing and policy concerns
- Converted thrift liquidation account
- Structural pricing and dissolution issues

Non-Traditional Buyers - Investor Groups

- Playing largest role in bank M&A in over a decade
- Represents almost 10% of all transactions
- Why?
 - Avoids costly and time-consuming process of starting a de novo bank
 - Quicker and cheaper way to enter the industry
 - Even more attractive because depressed valuations and lack of options for sellers (especially smaller banks)

Non-traditional Buyers - Investor Groups

- Additional Diligence
 - Confirmation of funds to complete the transaction
 - Escrow transaction funds before signing
 - Pre-signing regulatory meeting
- Merger Agreement Provisions
 - Timing requirements – for filing and completion of transaction
 - Reverse break-up fees
 - Principal guarantees and representations and warranties
- Among 10 terminations in 2023, 4 were “investor group” transactions

MOEs and Mutual-to-Mutual Acquisitions

- Represent over 5% of M&A transactions
- For Mutual-to-Mutual Acquisitions, added benefit of ability to keep banks separate
- Why Currently Attractive?
 - These transactions are not price sensitive
 - Strategic
 - Solve for management succession issues

MOEs and Mutual-to-Mutual Acquisitions

General Observations and Issues:

- Much longer “gestation” period because heavier reliance on social issues
- Greater focus on C-Suite succession, Board succession, maybe as granular as board committee designations
- Greater focus on pro-forma budget and collective cost saves and preferred vendors
- Most of “integration” and “post-closing governance” discussions should be addressed pre-execution rather than post-execution

Anticipating Delays and Issues

- Pre-planning, diligence and pre-signing regulatory meetings are first line of defense to ensure a deal will happen and minimize delays
- Anticipate and plan for possible failure points and delays
- Use of creative or non-standard merger terms can mitigate effect of deal uncertainties due to regulatory, market and economic events
- Plan for delays and mitigate through merger agreement terms – simple example is addressing how core processing integration delays will be handled
- Do not leave material matters/events for “post-execution” – example, “finalize” all compensation matters for key employees

Diligence

- Cannot disclose confidential supervisory information
 - Need to rely on legal professionals to uncover thematic issues / potential road blocks without violating regulations
- Need to qualify deal costs
 - Data processing contract – may need to bring data processor over the wall
 - Need to calculate all 280G and other severance benefits
 - Will require in-depth discussion of post-closing organizational chart
- Need to identify all required third-party consents

Regulatory Meetings

- Must be with appropriate agency “decision-makers”
- Provide summary business plan (with basic pro formas) of resulting institution
- Identify: (1) any new product lines or services or (2) larger than usual growth expectations
 - Especially important in investor transactions
- Include Post-Closing governance structure

Creative Transaction Structures

- Non-push down accounting with separate banking subs
- Reverse or reciprocal termination fees
- Locking up larger stockholders with voting and support agreements
- Closing price adjustments for material fair value adjustments
- Minimum capital or net worth closing requirements
- Use of “Material Adverse Event” to address certain adverse events
- Using “target” as “accounting acquiror” for fair value purposes
- Use of external sources to “fill” interest rate mark hole
 - Sale of asset (e.g., insurance subsidiary)
 - Addition of replacement capital

Creative Transaction Structures

Selecting “Target” for Fair Value Adjustments:

- Accounting “target” and “acquiror” does not need to be same as “functional” or “legal” target and acquiror
- Interest rate marks may be measured at execution but really count at closing
- If close to same size (and other deal attributes are fairly equal), parties may be able to structure deal so mark-to-market less dramatic

New DOJ Merger Guidelines

- Merger guidelines (for all industries) being updated by DOJ. First update since 1995.
- Historically, role of the DOJ is to provide factors to the appropriate federal agency. Federal agency conducts initial screening – only goes to DOJ if fail that screening
- As part of this process, DOJ is updating its bank merger review process to better account for all competition – including factors like fees, interest rates, branch locations, product variety, network effects and even customer service (and recognizing a greater list of competitors)

New DOJ Merger Guidelines

May Result in More DOJ Involvement:

- Significantly lowering the standards by which the DOJ presumes a merger is substantially likely to lessen competition
 - Previously, the markets with HHIs in excess of 2,500 points were “highly concentrated” (and required an increase of 200 points). The New Guidelines will treat markets with HHIs of 1,800 points as highly concentrated (and require an increase of 100 points) — a significantly lower threshold.
- A merger that creates a combined share over 30% presents an “impermissible threat of undue concentration” if HHI increases of 100 points
 - Very restrictive when the market can be a county or MSA

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