Key Legal Issues In Bank Consolidation and Capital Raising

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Consolidation

- There are really no negotiated mergers and acquisitions with financial institutions as buyers. This could change soon
- There have been a few branch transactions (see Anchor Bank – Wisconsin) and one-off deals (see Horizon Bancorp's acquisition of ATSB) done as P&A's, etc.
- There have been transactions with non-banks, e.g., BMO's acquisition of Diners-Club North America
- There have been a number of "forced recaps" by Private Equity firms with the most recent being Pacific Coast Capital by Gerald Ford

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Consolidation

- In forced recaps, Treasury/TARP, the TRUP holders, the "bank stock" correspondent lender and the public stockholders get crammed down to ¢ on the $. A rights offering for the public stockholders at the investor buy-in price is common
- Regulatory approval issues for Private Equity firms; avoiding Federal Reserve "bhc" control status and FDIC Private Equity Policy Statement. Renew focus on "change of control" and BCOCA
- Blind Pools; Club Deals – more common; some without regulatory approval
- The BIGGEST ISSUE OF ALL – how bad are the loans? How big is the hole?

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Legal/Regulatory Issues

- Dealing with shareholder voting rights of seller
- Dealing with TRUPS disclosure and consent issues – who votes and how; indentures are vague and present tactical issues
- Disclosure issues: impending doom; asset quality; ALLL, CRE
- See above for Private Equity
- Accounting issues:
  - "going concern"
  - "good will" impairment
  - " deferred tax asset"

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Bankruptcy

- Banks are not subject to the Bankruptcy Act. Bank holding companies are
- A few banking companies have tried to use bankruptcy for dealing with pending regulatory seizures and/or dealing with lien creditors (Amtrust in Cleveland)
- CIB took its TRUPS holders through a Chapter 11 successfully. But no buyer has emerged

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Capital Raising

- 2010 proposed banking legislation does not include new TARP or CPP
- Capital for healthy banks is abundant
- TARP recipients – pay off or not?
- Capital for sick banks is rare, unless they are both fixable and of a size where further "roll-ups" are likely – see Gerald Ford
- Open Bank Assistance: still legally feasible, but so rare as to be approaching myth status
- P.E. FDIC Policy on P.E. firms buying failed banks in flux; enforced on a deal by deal basis. See attachments

Capital Raising

- Private Equity firms now buying very sick banks due to FDIC policy statement and FDIC preference for failed banks to be bought by "industry partners"
- TRUPS: new issues virtually non-existent
- De Novo's: FDIC won't insure
- "Good bank" – "bad bank" – Treasury said: "not yet." FDIC said: "no"
- Correspondent bank sources: few and tough to deal with

Loss-Share

- The six most important features of the transaction documents are:
  - Loss Rate: Pursuant to the most recent loss-share agreements, the FDIC will absorb 80% of the losses and 80% of the recoveries on loss-share assets. The FDIC will no longer absorb 95% of the losses after a certain threshold
  - Administration: Acquiring bank must track charge-offs, recoveries, reimbursable expenses, etc. over 5 or 10 years depending on whether the loan is a commercial or single-family loan
  - Loan Changes: Acquiring banks have limitations on implementing amendments and restructuring of loans, e.g., acquiring banks cannot increase the principal of loss-share assets, except for certain permitted advances, or extend the term of loss-share assets beyond the term of the loss-share agreement without risking losing loss-share coverage

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Loss-Share

- The six most important features of the transaction documents are:
  - Estimated Loss: The FDIC now will estimate the total loss on loss-share agreements and will maintain the ability to "claw back" certain amounts if the ultimate losses on the loss-share agreement are lower than this estimated amount
  - First Loss Tranche: Bidding institutions must bid an amount for the first loss tranche, which cannot be less than zero. If the first loss tranche is a positive number, then loss-sharing will not commence until the losses on the loss-share assets exceed the first loss tranche
  - FDIC Audit: The acquiring bank is subject to an audit of loss-share loan administration by the FDIC's third-party auditor
  - Who can bid?
  - Accounting issues – too much negative good will
  - FDIC constantly tweaking the formula

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