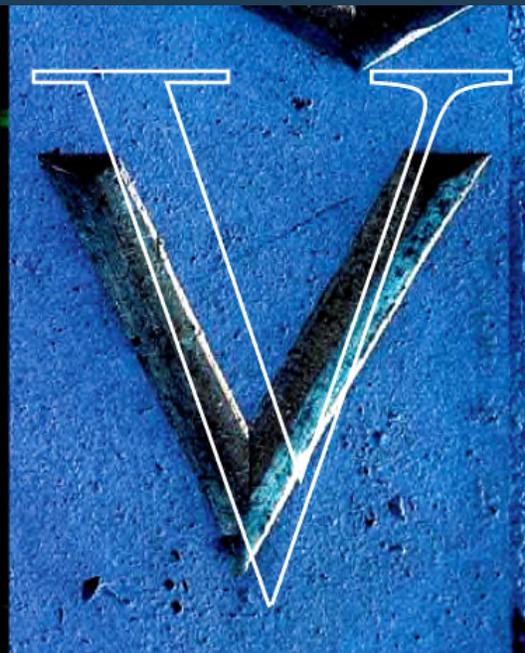
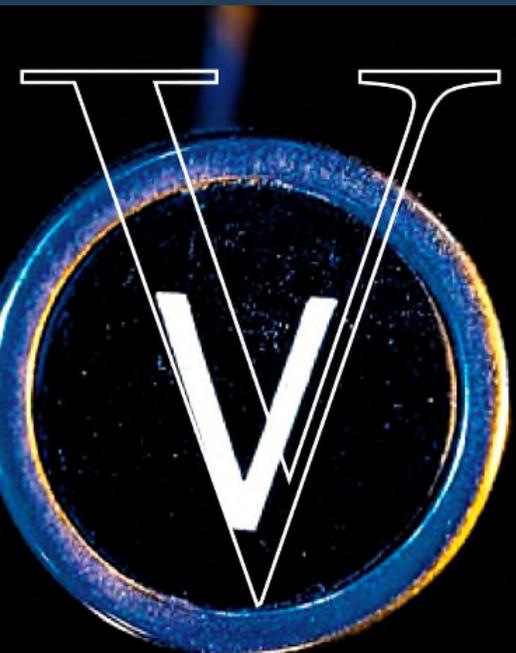


VENABLE[®]LLP

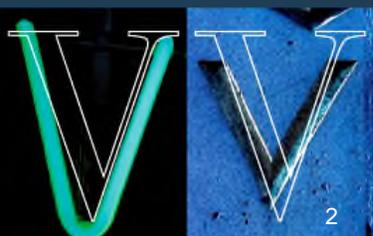
ALI-CLE: Community Bank M&A: 2014 Developments

November 13, 2014



Regulatory / Economic Climate

- 94% of banks are community banks (FDIC Community Banking Study Dec. 2012).
- Financial Crisis – After 6 years, is it over?
 - Performance of Financial Institutions.
 - Banks making money?
 - Future prospects (interest rate shocks)?
 - Competition from Nonbanks?
- Dodd-Frank – 4 years old.
 - Status of Regulatory Implementation
- Changes in the Regulatory Landscape.



Regulatory / Economic Climate

- Changes in the Legal Landscape.
 - New Regulators:
 - CFPB
 - DOJ and State Attorney Generals
 - Charter Choice.
- Impact of Regulation and Enforcement
 - on Competitors
 - on Service Providers
 - on Counter-Parties
 - on Customers
 - on Bank Directors and Officers



Why Merge or Acquire?

- The Need for Size
 - Resources to Address Regulatory Burdens
 - Strengthens Economies of Scale
 - Impact of Basel III – Capital and Liquidity
 - New standards - New timelines
 - Risk Granularity – expectations of supervisors
- Attract Private (Non-Bank) Investors?
 - The Uncertain Meaning of Source of Strength
 - FRB 2008 policy facilitates investment
 - Regulatory Resistance is Assistance?
 - No More De Novos
 - No More Bulking Up With FDIC Assets
 - Need to Exit TARP / Strategic Bankruptcies



Is Size Needed For Compliance?

- What is the Cost of Compliance?
 - Federal Reserve Bank of Minneapolis Economic Policy Paper 13-3
- Impact of Capital and Liquidity requirements.
- Risk Management – third “independent” arm
- Corporate governance and succession
- Reactions of Community Bankers to regulation
“On the Ground”: “Trickle down” supervision?



The Downside of Size

- Asset Sizes Triggering Additional Regulatory Issues
 - \$500 million –
 - Audit Committee/Board Independence
 - FRB Small Bank Holding Company Policy (higher debt permitted, not subject to Basel III)
 - Exam Frequency goes from 18 months to 12 months
 - \$1.186 billion – lose CRA small bank review standards and relief from reporting
 - \$10 billion –
 - CFPB exams (each bank)
 - Debit Interchange Fee Limits (enterprise)
 - Annual Stress Tests (each bank and enterprise)
 - Increased deposit insurance premiums
 - \$15 billion – Trust Preferred become Tier 2, not Tier 1
 - \$50 billion –
 - Capital Plans (BHC)
 - Resolution Plans (bank and/or SIFI enterprise)
 - Systemic Risk Reporting (FR Y-15)
 - \$250 billion – Use Basel III Capital Advanced Approaches



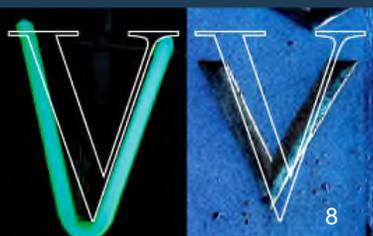
Growth Strategy: Attract Investors

- FRB 2008 Policy:
- Equity Triggers at 5%, 10%, 15%, 25%, 33%
 - Investor not a BHC, if
 - Hold under 25% voting stock and total equity less than 25%; or
 - Hold under 33% total equity if voting stock is less than 15%
- Must file passivity commitment if hold voting stock of 5% or more – no business with the bank
- Noncontrolling investors can have Board representatives
 - Board representation only in proportion to ownership
 - Representative on board cannot serve on Executive, Audit or Compensation committee
 - Representative cannot serve on any committee with less than 4 members



Acquisition As Alternative to De Novo

- FDIC asserts regularly: “No moratorium”
 - Reality: No de novos are receiving insurance
 - When economy is strong, might see change
- Alternative strategy for entering banking:
 - Acquire existing community bank
- May still be subjected to de novo standards
 - Regulator approval business plans for 7 years
 - Prior approval SEO changes
 - Prior approval dividends
 - Minimum capital 8% leverage ratio at start-up and capacity for future injections



The Regulatory Review Process

- Pre-filing Consultation
- Filing (Publication of Notice)
- Initial Review for Completeness
- Substantive Review
- Consultation on Conditions (sometimes)
- Approval
- BMA Waiting Period
- Consummation (notice to regulators)
- Post-Closing Exam



M&A/ Control Applications

- Regulator reviewing, for both target and acquiror
 - Standard issues, most importantly
 - 3 year Business plan
 - Capital
 - Quality of Management (board and officers)
 - Due diligence and risk management
 - Community needs / CRA
 - Close scrutiny - any indication of the presence of issues in these areas can cause significant delay
 - AML
 - Compliance with new consumer protection rules
 - Fair lending
 - History of mortgage loan servicing and foreclosure
 - Identification of Controlling Parties
 - Transactions with Affiliates



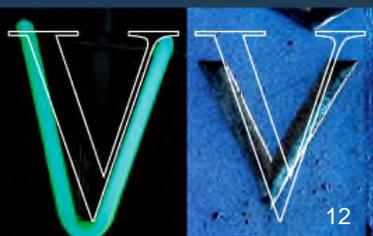
Potential Side Applications

- Individual Change of Control Notice
- Relief from supervisory orders
 - Probably not granted until after first post-merger examination
 - Dodd Frank section 612 on conversions
- Change in SEO (if a troubled institution)
- Golden parachute (if a troubled institution)
- Capital distribution
- Sale of unneeded branches
- Move headquarters
- DPC Extension



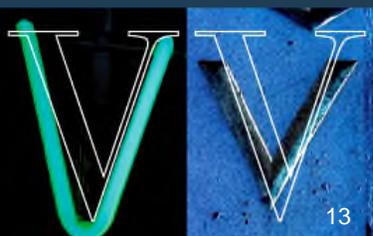
Practice tips for regulatory process

- Identify regulatory issues early (Control? Assets? ALLL? Earnings? Management?)
 - Develop strategy to address
 - Seek early comfort from regulators (if possible)
- Build strong relationship with state regulator
 - Most community banks are state chartered
 - May involve multiple state regulators
 - State can help or hurt application with Feds
- Communicate frequently
 - Hold joint calls with all regulatory stakeholders
 - Build relationships that endure
 - Manage expectations (of client and regulators)



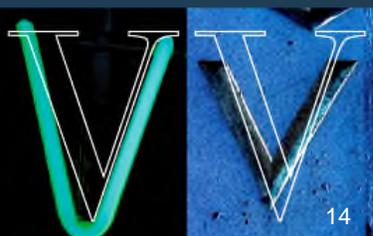
Lessons From A Recent Deal

- Future Management Can Find Investors
- FRB may treat nonvoting common as voting
- Interim Bank Can Be A 363 Stalking Horse
- Competing Bidders in Auction May Misperceive Strength for Weakness
- Small Investors Become Motivated When Big Investors Commit
- A Deal With Multiple Investors Is No Harder TO Manage Than An Existing Bank Seeking Capital
- FDIC Wants Banks To Survive



Advanced Preparation

- “Give me six hours to chop down a tree and I will spend the first four sharpening the axe.” – Abraham Lincoln
- “By failing to prepare, you are preparing to fail.” - Benjamin Franklin
- “There are no secrets to success. It is the result of preparation, hard work, and learning from failure.” -Colin Powell
- “I've always considered myself to be just average talent and what I have is a ridiculous insane obsessiveness for practice and preparation.” -Will Smith



Advanced Preparation

“Effective due diligence of consumer compliance issues is critical in every merger or acquisition transaction.” -The FDIC

-Supervisory Insights, Summer 2013, Vol. 10 Issue 1

<https://www.fdic.gov/regulations/examinations/supervisory/insights/sisum13/sisummer13.pdf>



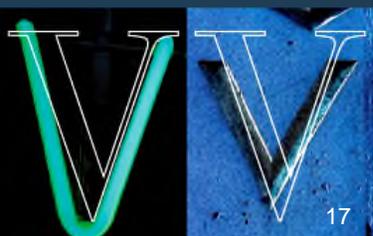
Acquisition Phases

- Planning
- Specific Target
 - Pre-Signing
 - Post Signing
- Post Closing



Planning

- Overall strategy
 - One-off Acquisition, Transformative Transaction, Merger of Equals, Series of Acquisitions
- Internal
 - Are board and management team committed to strategy?
 - Is the management team structured to embark on strategy (e.g., sufficient time and resources to commit to the effort, plan to insure current business does not suffer)
 - Are outside advisors selected and have they been informed and consulted



Planning

- Regulators
 - Proactively discuss strategy with regulators
 - Solicit regulator suggestions and concerns
- Employees
 - Who needs to/should know
- Market
 - What is message to market?
 - Risks of strategy not being successfully achieved



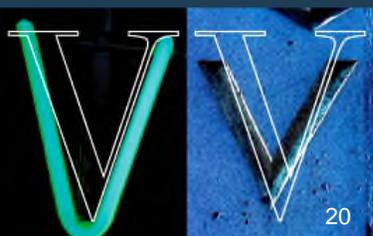
Specific Target – Pre-Signing Diligence - Generally

- Determine diligence team and roles
- Comprehensive checklist – see later pages
- Focus on potential troublesome issues early
 - Loan and other asset quality
 - ALLL issues
 - Regulatory issues



Specific Target – Pre-Signing Diligence - Checklist

- Organizational Structure and Documents
- Capitalization and Indebtedness
- Acquisitions, Dispositions, and Investments
- Regulatory Issues (to the extent materials are legally available)
- Property (Real and Personal)



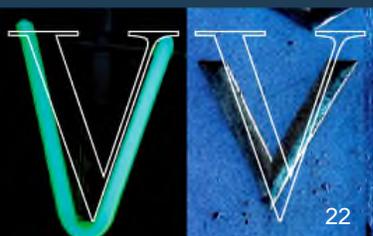
Specific Target – Pre-Signing Diligence – Checklist

- IT
- IP
- HR
- Benefit Plans
- Contracts
- Affiliated Transactions



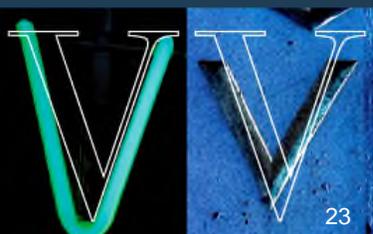
Specific Target – Pre-Signing Diligence - Checklist

- Insurance
- Tax Issues
- Litigation/Environmental Matters
- Trust and Retail Nondeposit Investment Products
- Deposit Base
- Lending and Collections Activities
- Risk Management
- Insurance Business



Specific Target – Pre-Signing Diligence – Regulatory Issues

- How is buyer viewed by regulators
- CRA, consumer protection laws and Bank Secrecy Act/anti money laundering compliance
- Capital levels on a combined basis
- Community reaction
 - Increased number of objections, even in smaller deals
 - Regulators considering these objections – results in significant delay in approval



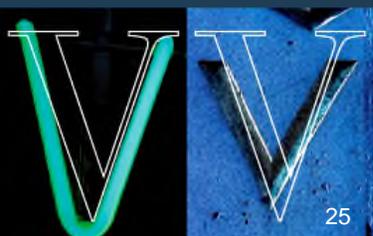
Specific Target – Pre-Signing Diligence – Regulatory Issues

- Supervisory Insights, Summer 2013, Vol. 10 Issue 1:
 - Truth in Lending – Regulation Z
 - Fair Credit Reporting Act/Fair and Accurate Credit Transactions Act
 - Secure and Fair Enforcement for Mortgage Licensing Act (SAFE Act)
 - Fair Lending Regulations
 - Expedited Funds Availability Act-Regulation CC
 - Community Reinvestment Act
 - Deposit Insurance – customer at both banks
 - Unfair or Deceptive Acts or Practices
 - Non-Deposit Investment and Insurance Products



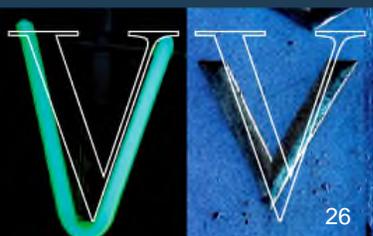
Specific Target – Pre-Signing Addressing Key Issues

- Resolve up front
 - Saves unnecessary diligence time
 - Avoids risk of having failed deal known to market, regulators
 - In a merger of equals, results in better post closing integration



Specific Target – Pre-Signing Alternative Deal Structures

- Cash v. equity deal
 - Equity deals allow better pricing as both sides have shared interest
 - More capital supporting deal
 - Better market reception
- 363 Bankruptcy



Specific Target – Pre-Signing Third Party Advisors

- Accountants
 - Are there tax asset issues to consider, such as NOLs and built-in losses?
 - How will transaction affect these assets (e.g., will change of control limit use of tax assets)
 - Bring in at the outset; additional cost worth avoiding delay
- Loan Review
 - Will loan review be handled by 3rd party
 - Who will pay?
- Other third party advisors or diligence experts



Specific Target – Pre-Signing Capacity Issues

- Do you have sufficient capacity to diligence, negotiate and close a transaction without detracting from business
- Consider best method for assuring this



Specific Target – Pre-Signing Regulators

- Involve regulators before signing
 - They are happy, and expect, to be involved
- Allow time in process for pre-signing regulator review
 - Rushing the regulators is neither successful nor wise
- While definitive approval can and will not be given, it will help uncover issues and provide a better sense of timing to close
- Have the applications near final



Specific Target – Pre-Signing

Be prepared for regulator questions

- Have documented ERM analysis of how combined company will operate
- Be able to demonstrate to regulators resulting entity Camels rating
- Have complete and comprehensive due diligence memo so that you can easily, quickly and completely respond to regulator diligence questions



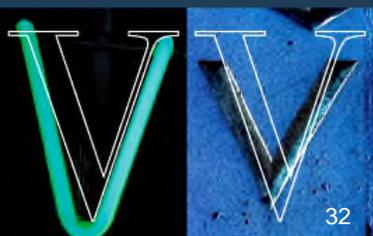
Specific Target – Post Signing Regulators

- Be ready to file application immediately
- Make sure application is complete
- Respond promptly and completely to questions



Specific Target – Post Signing Consents and other closing conditions

- Have clearly defined responsibilities for closing conditions
- Do not lose momentum



Specific Target – Post Signing Constituencies

- Have a consistent message, though tailored slightly to the audience, for:
 - Customers
 - Employees
 - Media



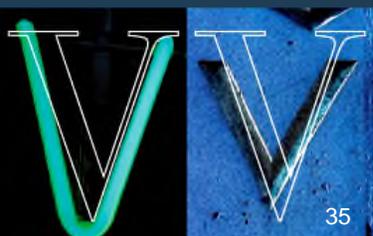
Specific Target – Post Closing Integration

- Timeline post closing
 - Immediate on-boarding of employees
 - Timetable for customers
 - Full integration date
 - Clear message to employees, market, customers



Specific Target – Post Closing Deal Effectiveness Evaluations

- After closing and completion of integration:
 - Evaluate the process
 - Document best practices and problem areas



contact information

YOUR VENABLE TEAM

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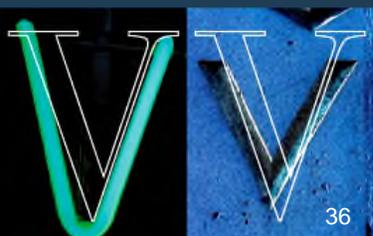
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