WBA

EXECUTIVE BRIEFING

Navigating the Bank M&A Market

November 9, 2016

Wisconsin Bankers ASSOCIATION

Wisconsin Bankers Association • 4721 South Biltmore Lane, Madison, WI 53718 • P: 608-441-1200 • *www.wisbank.com*

John Knight | Boardman & Clark LLP

John Knight concentrates his practice in the area of banking and the business practices of banks and bank holding companies. In particular, he focuses on community bank mergers and acquisitions, regulatory matters affecting banks, including enforcement actions and compliance issues, bank holding company formations, subchapter S conversions, shareholder transactions, and shareholder and director issues. John serves as counsel to several Wisconsin community banks and to Bankers' Bank of Madison, Wisconsin. He is also General Counsel to the Wisconsin Bankers Association and, in that capacity, has been involved in drafting and reviewing legislation of interest to the banking industry.

John received his JD from the University of Wisconsin - Madison Law School. He is a member of the State Bar of Wisconsin, the American Bar Association and the Dane County Bar Association. He is listed in the "Best Lawyers in America" for banking and corporate law 1993 to present.

Patrick Neuman | Boardman & Clark LLP

Patrick is a member of Boardman & Clark's Banking Practice Group. He assists banks and bank holding companies with mergers, stock acquisitions, asset sales and branch acquisitions, subchapter s conversions, holding company and subsidiary formations, corporate governance, vendor contract negotiations and regulatory and compliance matters. Patrick's practice includes negotiating on behalf of Wisconsin banks to resolve issues with the FDIC, HUD, the Wisconsin DFI and the Chicago Federal Reserve. He also represents banks and other lenders in a variety of commercial loan transactions. He frequently speaks and writes about legal issues affecting Wisconsin community banks for the Wisconsin Bankers Association. Patrick received his JD from the University of Wisconsin - Madison Law School. He is a member of the State Bar of Wisconsin.

Rose Oswald Poels | Wisconsin Bankers Association

Rose Oswald Poels is the President/CEO for the Wisconsin Bankers Association, the state's largest financial industry trade association. She has worked for the WBA and the banking industry for over twenty years. As part of her work, she is a registered lobbyist advocating on behalf of Wisconsin banks with the Wisconsin congressional delegation as well as state elected officials. Regulatory advocacy is also a significant part of her work with state and federal banking regulators. She routinely speaks to the media, local civic groups and other organizations about the banking industry and has personally educated thousands of bankers over her career on a variety of banking compliance topics. Rose received her B.A. with honors from Michigan State University and her JD from the University of Wisconsin - Madison Law School. She is a member of the State Bar of Wisconsin and the American Society of Association Executives. In addition to managing WBA, she is also Chairman of the board for WBA's two subsidiaries, WBA EBC and FIPCO®, and currently serves on the Board of Trustees of the Graduate School of Banking and its Prochnow Educational Foundation as well as the Board of Directors of Green Valley Enterprises, Inc.

Wisconsin Bankers ASSOCIATION

Kirsten Spira | Boardman & Clark LLP

Kirsten is part of Boardman & Clark's full service banking group serving primarily community banks located in Wisconsin, along with their holding companies and their insurance, securities, and investment subsidiaries. She also provides legal advice to regional and out-of-state banks. Kirsten works closely with the Wisconsin Department of Financial Institutions, FDIC, Federal Reserve, OCC and various state securities regulators on behalf of her banking clients.

Kirsten has established *de novo* banks in Wisconsin and has helped form many holding companies for Wisconsin community banks. She regularly works with banks and their holding companies to acquire other banks and branches. Kirsten has helped banks, holding companies and other corporations issue common stock, preferred stock, debt securities and trust preferred securities to raise hundreds of millions of dollars capital. Kirsten successfully worked with the WBA to revise the new Wisconsin securities statutes to remove a provision that would have adversely impacted the traditional business of community banks in this state.

Kirsten is also part of Boardman & Clark's Business Law Services and Start-up and Emerging Companies groups. On behalf of banks, bank holding companies, non-profit organizations and a variety of early stage, small and mid-size businesses, Kirsten regularly assists with structuring securities offerings, preparing offering materials, and making required filings with Federal and state securities regulators. She has assisted her clients with creating various series of preferred stock and securing institutional investment. She also drafts proxy and other shareholder communications, prepares incentive plans and executive compensation agreements, reviews business contracts, assists with the formation of new companies and advises boards of directors on both day-to-day matters and extraordinary corporate transactions. Kirsten regularly speaks to different audiences regarding securities matters.

Kirsten received her JD from the University of Wisconsin - Madison Law School. She is a member of the State Bar of Wisconsin, the American Bar Association and the Dane County Bar Association.

NAVIGATING THE BANK M&A PROCESS - TOOLS, TIPS AND STRATEGIES FOR BUYING, SELLING OR REMAINING INDEPENDENT

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A. Board May Consider Alternative Plans to Remain Independent

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1. A Few Strategic Alternatives

- A few strategic alternatives to consider
  - Continue running bank
    - What is bank's strategic plan?
    - Can bank execute on the plan?
  - Shared resource arrangements
    - Contractual agreements.
    - Third party providers of services.
    - Jointly-owned operating subsidiaries.
    - According to recent *CSBS Report on Shared Resource Arrangements: An Alternative to Consolidation*, "shared resources may be a viable component to a community bank's overall strategic objectives to remain an independent provider of financial services in the local market."
    - Further, according to Report, "to the extent the bank is considering a consolidation, sharing of certain resources provides an alternative worthy of exploration."
  - Joint ventures.
  - Merger of equals.
  - Acquisition of a branch or other bank.
  - Best not to rush. Consider your options.

2. If Remaining Independent Best To Address Shareholder Concerns, If Any

- Provide for shareholder liquidity.
- Address more immediate value for shareholders than remaining independent.
- Address other immediate or near term bank concerns in strategic plan.
  - Lack of succession at management and board level?
  - Leadership vacuum?
  - Uncertainty about future?
  - Compliance concerns?
  - Do we need to be larger?

3. In All Cases Meet Board's Fiduciary Obligations to Shareholders

- Investigate.
- Be well informed.
- Have a rationale business reason for deciding selected alternative is in best long-term interests of shareholders.

B. Defensive Measures May Discourage Unsolicited Efforts to Acquire Bank

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1. In general

- Defensive measures may be helpful to maintain future of the independent bank
- Most buyers usually interested in willing sellers
- But there are no absolute show-stoppers
- Defensive measures won't help if majority of board decides it's time to sell
- An underperforming or undervalued bank may be difficult to remain independent
- Best defense is profitable bank, fairly valued stock and liquidity option

2. Consider Including These Defensive Measures in Holding Company Articles

- "Staggered Terms"
- "Removal of Directors"
- "Prior Notice Requirement"
- "Right of First Refusal"
- "Supermajority Vote"
- "Blank-check Preferred"
- "Poison Pill"
- Others

3. Defensive measures in Wisconsin's anti-takeover statutes

- Will not apply to most holding companies for community banks
- However, bank holding company may elect in its articles to be governed by one or more of Wisconsin anti-takeover statutes
  - "Fair price/supermajority" statute – Sections 180.1130 to 180.1134
  - "Control share" statute -- Section 180.1150
- Protect amendments

4. Other Defensive Strategies

- Stock redemptions through self-tender offer
- Shareholder voting agreement
- Stock option rights extended to officers and directors
- Golden parachute agreements for key management
- Shareholder communications

C. What If Board Receives Uninvited Proposal to Acquire Bank?

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1. Uninvited Solicitations to Buy Bank ("Bear hug" letters)

- Often not well received.
- Better approach for buyer may be to informally talk with and persuade selling bank.
- Most buyers want willing sellers.
- And decision should be made by Board.

2. Board Decision In Response to Uninvited Solicitation Should Be Based On Fiduciary Duties to Shareholders

- If Board receives such a letter, how should it be handled? Very carefully!
- Generally not required to negotiate with proposed buyer.
- Generally not required to merge with proposed buyer.
- Generally not required to seek alternative buyer.
- **But** Board must always act based on what is in best long-term interests of shareholders. What does that mean in this case?
- Board would be well advised to act within framework of the "business judgment rule" when making its decision.

- Business judgment rule may help protect directors from liability for decisions made when exercising their business judgment if:
  - Board investigates proposal and alternatives, including if it chooses remaining independent and running the bank. What is in best long-term interests of shareholders?
  - Board seeks independent third party advice and information from advisors and information from management regarding management's future projections for running the bank.
  - Board is well informed regarding the proposal and the alternatives.
  - And decision by Board is supported by rationale business reasons.
  - Board may then be in position to reasonably act on uninvited solicitation, including, if it so decides, determining that uninvited solicitation is not in best long-term interests of shareholders.

3. Formalize Board Decision

- Formalize detailed Board resolutions describing Board decision on the uninvited solicitation, the basis for the decision and discussions with advisors and management.
- Consider written response to unsolicited written proposal.
- Consider Board letter to shareholders on the matter.

D. Preparing the Bank for Possible Future Acquisition or Sale

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1. Initial Considerations

- Resolve outstanding regulatory issues
  - Change in control issues
- Consider transaction structure
  - Merger or stock acquisition
  - Cash, stock or cash and stock consideration
  - Tax aspects; Consult with tax advisors
  - Engage counsel to review governance documents
  - Do governing documents of seller contain defensive measures?
  - Is there sufficient authorized stock for a stock-for-stock exchange?
- Identify transaction costs
  - Long-term vendor contracts with termination fees
    - Potential sellers should avoid long-term contracts
  - Reduced loan loss reserve
  - Employment and change in control agreements
  - Potential Employee benefit plan terminations

2. Seller's Marketing Strategies

- Board involvement is critical
- Approach strategic partners
  - Merger of equals
  - Negotiated transaction
- If auction, engage investment advisor to solicit bids

E. Third-Party Valuations

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1. Third-Party Valuations Are Useful To Seller in Certain Circumstances

- Board has a duty to be well-informed
- Valuation provides basis that price is fair for shareholders
- More prevalent in negotiated transactions

2. Options

- Existing Valuations
  - ESOP
  - Stock offering
- Third-party valuation based on market comparables
- Consult with investment advisors
- Fairness opinion
- Merger of equals with no premium (exchange ratio)

F. Selecting an Experienced Team of Advisers

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1. Investment Banker

- For a potential seller, consider engaging an financial adviser, especially if you decide to bid your bank.
- Provides a variety of services to sellers:
  - Help decide whether you are in a position to sell, and whether it makes sense to undergo a bidding process (vs staying independent).
  - Finding potential bidders.
  - Deal structure and pricing.
  - Preparing bid package.
  - Determining exchange.
- Typically, will be also able to provide a valuation and/or fairness opinion (for additional fee).

- Consult with them early in the strategic decision-making process.
  - Even before you have decided to sell, usually willing to talk to you about what's happening in the market and current prices.
- For a buyer, can help identify potential sellers, provide a fairness opinion and assist with financing (*e.g.* structuring and selling securities to finance the acquisition)
- Have an attorney review the proposed engagement letter.

2. Accountant

- You will need the assistance of an accounting firm, whether on buyer and seller side.
- Provide a variety of assistance to either side:
  - Determine deal structure for best tax impact.
  - Prepare pro forma financial statements (needed for shareholder disclosures and regulatory apps).
- Prepare/confirm financial calculations in connection with determining merger consideration for the closing.
- Can provide many of the same services as an investment bank: pricing, exchange ratio, valuation and/or fairness opinion.
- May be able to help with due diligence, such as loan review.
- Consult with them early in the strategic planning and decision-making process.

3. Attorney

- You will need the assistance of attorneys.
- We can help advise the board on the M&A process as part of strategic planning, and board fiduciary duties.
- Seek legal assistance for specific events:
  - Dealing with unexpected offer to purchase your bank.
  - Reviewing and negotiating an engagement letter with investment banker.
  - Preparing or reviewing an NDA to allow for confidential communications between potential buyers and sellers
  - Preparing the Letter of Intent.

- If a deal is on the table, attorneys are sometimes asked to help with due diligence review of specific documents.
  - Governing documents and board/shareholder resolutions.
  - Material contracts (very important – look for penalties/fees triggered by merger).
  - Insurance.
  - Real estate.
- Attorneys should help negotiate the definitive agreement, advise the board on the terms of the deal, prepare regulatory applications and shareholder disclosures, and consummate the transaction.

G. Conducting Due Diligence

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1. Confidentiality is key

- Certain due diligence may take place prior to letter of intent or term sheet
- Put NDA in place before providing any information
- Remind board members of duty of confidentiality
- Address internal confidentiality concerns

2. Purpose of Due Diligence

- Determine whether to move forward with the transaction
- Identify red (and yellow) flags
- Seller's problems become Buyer's problems
- Consider engaging third-party assistance for certain due diligence items

3. What to Ask For (or What Will I Be Asked to Provide)

- Loan portfolio analysis
- Governance documents
- Vendor contracts
  - Identify termination fees and anti-assignment provisions
- Employee benefit plans
  - "Unwritten plans" such as discretionary bonuses
- Executive arrangements/agreements
  - Deferred compensation
  - Change in control agreements
  - Stay bonuses

- Deposits
- Real estate
  - Don't overlook
- Employment matters
  - Cross-selling and incentive programs
- Tax returns
- Compliance practices
- Information regarding ongoing litigation
- Investment portfolio

4. Providing Due Diligence

- Onsite visits
  - After hours or weekends
- Secure Internet portal
- Disclosure Schedules
  - Organize due diligence and make it accessible
  - Electronic copies that are easily reproducible

H. Social Issues May Impact Decisions Of The Parties—How Best To Address Them

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1. Social Issues, In General

- Any aspect of proposed transaction affecting mindset of people involved in proposed transaction process.
- Names of surviving entities and locations.
- Board retention.
- Executive officer retention.
- Employee retention.
- How will employees and customers of selling bank be treated after transaction closes.
- Conversion of cultures.
- Are seller's board and executive officers committed to transaction?
- Are parties building foundation of trust and honesty that will help avoid surprises and resolve differences.

2. When And How Best To Deal With Social Issues

- Best to assess and address before or early in transaction process.
- Discussions on these issues should occur directly between the parties.
- Have negotiations soured relationship between parties, and if so how will that affect integration of people and conversion of cultures.
- Unresolved social issues may adversely affect proposed transaction and commitment of parties to move forward.

I. Anticipating Regulatory Issues

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Regulatory Issues

- More applications are going to Washington. Try to avoid.
- Federal Reserve uses the review of strategic transactions as an opportunity to look for change in control issues (e.g. one family has a controlling interest in holding company shares, and certain members have transferred their shares into estate planning trusts).
  - Fed requires a "clean up filing" but will allow it post-close, not as a condition to close.
  - As part of the merger application, merger parties must now include a pro forma shareholder list, with family relationships identified.
  - Fed may start requiring the review of trusts that are part of shareholder control groups.

- Voting agreements need to state that they terminate by their terms within statutory time period (25 years) in order to avoid being deemed a "bank holding company".
- Competitive issues – conduct a preliminary review of the impact on competition, especially in more rural areas with less competitors. Note that credit union deposits only get ½ weight for purpose of the analysis, and internet banks get no credit.
- Heightened review of trust's other "business activity" (undefined), including lending to third parties unrelated to the holding company.

- A "financial holding company" might run into issues if it acquires an institution that jeopardizes the FHC's certifications as to CAMELS, etc.
- Small Bank Holding Company Policy Statement.
  - Expanded coverage in 2015 to all entities with consolidated assets of less than $1 billion (from $500M).
  - Requires small BHCs to retire all debt within 25 years and reduce debt to 30 percent or less of equity within 12 years of incurring the debt.

- If a share exchange, need to find a securities exemption to issue the shares to the target shareholders (may need to restrict shares from going to target shareholders who are not WI residents, or who are not "accredited" to avoid SEC registration).
- Work with your attorney and tax advisors, and possibly the regulators, to identify possible problems and address these issues early in the process.

J. Informal Regulatory Communications

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- Your applications are your formal communications to regulators.
- Most holding company mergers include a related bank merger, and will require applications to the Federal Reserve, the bank's Federal regulator, and DFI.
- We recommend reaching out to the regulators informally, early in the process.
  - Should you or can you put yourself out for bid?
  - Should you or can you buy another holding company or bank?
  - Should you or can you sell one or more particular branches?
  - Likelihood that a particular transaction would be approved.
  - Red flags that should be addressed prior to a transaction, or as part of the definitive agreement.
  - Competitive concerns, especially in rural areas and less competitive markets.

K. When Best To Identify And Resolve Employment Issues

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1. Identify Employment Issues

- Plans for director retention and integration.
- Plans for executive officer retention and integration.
- Plans for employee retention and integration.
- Are employment agreements in place and will they be terminated or assumed.
- Are stay bonuses in place for certain of selling bank employees and if so which party pays for that expense.
- Are change in control agreements in place at selling bank and if so which party pays for that expense.

- Are deferred compensation agreements in place at selling bank and if so which party pays for that expense.
- Are severance agreements in place at selling bank and if so which party pays for that expense.
- Are non-competition agreements in place at selling bank, and if not should such agreements be required at selling bank with respect to key employees and directors.
- What are intentions of parties regarding pension plans at selling bank, and will they be terminated and paid out or assumed by purchasing bank.

2. When Should Employment Issues Be Addressed By Parties

- These employment matters are an important part of transactions.
- Best to address early in process so that all parties understand what they are and how they are to be addressed.
- Best be addressed by boards and executive officers of respective parties, and in turn will then become part of transaction and legal documentation between parties.

L. Verbal "Understandings" and the Legal "Deal"

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1. Negotiating Deal Points

- When negotiating transactions, banks often verbally agree on certain matters
  - Bonus payments
  - Officer and board positions
  - Employee retention
  - Employment agreements
  - Benefit plan

2. Include in the Final Agreement

- Important to communicate verbal understandings with your lawyers
- If it's not in the final agreement, it's likely not binding on the parties
- Changed circumstances often result in disputes involving "handshake" deals

M. Bank Integration Issues to Address Prior to Signing the Agreement

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1. Data Processing System Conversion

- Data processing conversion can drive structure and timing of transaction
- Schedule system conversion as soon as possible
- Identify associated conversion costs for Buyer and Seller
- Who is responsible for paying conversion costs?
  - Be aware of "hidden fees"
- Buyer may need to request approval extension from regulators
- Delay bank consolidation

2. Pension and Benefit Plans

- What will happen to Seller's benefit plans
  - Timing matters if plans will be terminated
  - Merging plans include potential risks to surviving plan assets
  - Comprehensive due diligence, and communication with plan providers early can avoid complications down the road

3. Employee Retention

- Identify key employees
- Employment agreements
- Non-competition agreements
- Stay bonuses
- Timing matters

4. Third-party vendors

- Identify duplicative services
- Determine which services can be terminated
- Flag applicable notice requirements

N. Shareholder Communications

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1. In General

- Press release at the signing of the definitive agreement.
- Periodic letters about status (although caution if the merger will involve a share exchange).
- Proxy statement.
- Prospectus.

2. Proxy Statement

- For any whole-entity merger (as opposed to a branch sale), a seller *will* and a buyer *may* have to hold a special shareholder meeting to seek approval of the transaction
- When possible, a transaction will be structured using a merger subsidiary (a newly-created sub of the buyer) to avoid a shareholder vote on buyer side. Seller is merged into the subsidiary, and the subsidiary is immediately merged into the buyer.

- Proxy statement:
  - Board: fiduciary duty to fully disclose the terms of the deal and the merger agreement, as well as shareholder rights, to the shareholders.
  - Not quite as onerous as securities disclosures, but close.
  - Need to include clear disclosure of pricing, and possible adjustments to price (especially downward adjustments).
  - Very long documents; expensive and time consuming to prepare.
  - Will include the notice of special meeting and proxy form.

- Proxy statement disclosures:
  - For all-cash transaction, provide detailed information about seller (so shareholders can decide if it makes more sense to sell or continue independent operations).
  - Clearly disclose risks.
  - Provide board's reason for recommending the transaction.
  - Include copy of any valuation or fairness opinion.
  - Explain benefits to insiders that could have influenced their support of transaction (change in control payouts or future employment with buyer).
  - Board needs to review the disclosures, provide input, and approve; board and executives are ultimately legally responsible for its content.

3. Prospectus

- A share exchange is a securities transaction.
- Buyer must comply with the securities laws.
  - Registration/exemption.
  - Disclosure of all material information.
- Goal: avoid having to register with the SEC.
  - Typically, merger consideration paid in stock must be limited to WI residents only OR to "accredited investors" only.
  - If buyer is publicly traded, SEC registration is required and seller must help prepare an SEC registration statement - a very big job
- Board: fiduciary duties AND securities law requirements

- Proxy statement for seller and prospectus for buyer are combined into one document, called "prospectus/proxy statement"
- Securities disclosures are similar to those in a proxy statement for an all-cash deal, but contain even more information because shareholders of the seller will become shareholders of buyer
- E.g., will include a lot of financial and operational information about the buyer, projected information about the combined organization going forward, and lengthy risk factors.

O. Realistic Timeframes For Getting The Deal Done

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1. Working With Regulators To Get Approval Of Transaction

- Once agreement is signed buyer (and its counsel) drafts and files applications with its regulators: 20 – 30 days after agreement is signed. The agreement likely will impose a deadline.
- Different regulators have different filing and publication of notice requirements: DFI, FDIC, Federal Reserve, OCC (all done concurrently).
- If both seller and buyer qualify for expedited treatment, usually approved within 45 – 60 days from time application is deemed "informationally complete"; work with regulators to respond to questions.
- After application is approved, FDIC, OCC and Federal Reserve have 15 (sometimes 30) day waiting period before parties can close.

2. Communicating With Shareholders

- Prepare proxy materials: 30-60 days after agreement is signed; same time as regulatory approval process. We recommend the agreement require "as soon as practicable."
- Must give shareholders minimum of 20 days' notice but more time might be prudent to collect proxies.
- Identify key bank personnel to manage proxy process.
- Will you use proxy companies? If so, contact them as soon as possible.
- Dissenters?

3. Closing the Deal

- Bidding process (finding a buyer): 60-90 days.
- Negotiating a letter of intent: 10 days.
- Negotiating an agreement: 30-45 days.
- Obtaining regulatory and shareholder approval: 60 – 90 days.
- Getting ready to close:
  - Terminating/assuming major contracts.
  - Data process conversion. These days, bank merger is often happening months after holding company merger because of conversion backlog.
  - Dealing with pension and retirement plans.
  - Employees (who is staying; who is leaving).
  - Real estate issues.

- Closing: the actual merger is usually scheduled within 15 days after month end – need month end amounts.
  - Last minute issues.
  - Closing certificates – bring down of representations and warranties.
  - Exchange of funds or stock. Engage an exchange agent.
  - Final notices to regulators after closing.

WBA education

Focused on *Wisconsin bankers*

WBA Executive Briefing: Navigating the Bank M&A Environment – Tools, Tips and Strategies for Buying, Selling or Remaining Independent

November 9, 2016

12:00 p.m. – 1:30 p.m. CT

Attorney Information:

Name: _____

Address: _____

City: _____

State: _____

Zip Code: _____

Daytime Phone: _____

Email: _____

TO BE COMPLETED BY ATTORNEY:

By signing below, I certify that I participated in the WBA Executive Briefing: Navigating the Bank M&A Environment – Tools, Tips and Strategies for Buying, Selling or Remaining Independent and am entitled to claim the CLE credit hours that are approved.

_____ _____

Attorney Signature Date

_____

Attorney Name (Printed)

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