CUES Directors & Dialogue

Newcleus Credit Union Advisors Presents:

Buying Bank Assets

Luse Gorman, PC

newcleus CREDIT UNION ADVISORS

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About Luse Gorman, PC – By the Numbers

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Agenda for Discussion – Buying Bank Assets

“Why”

“What”

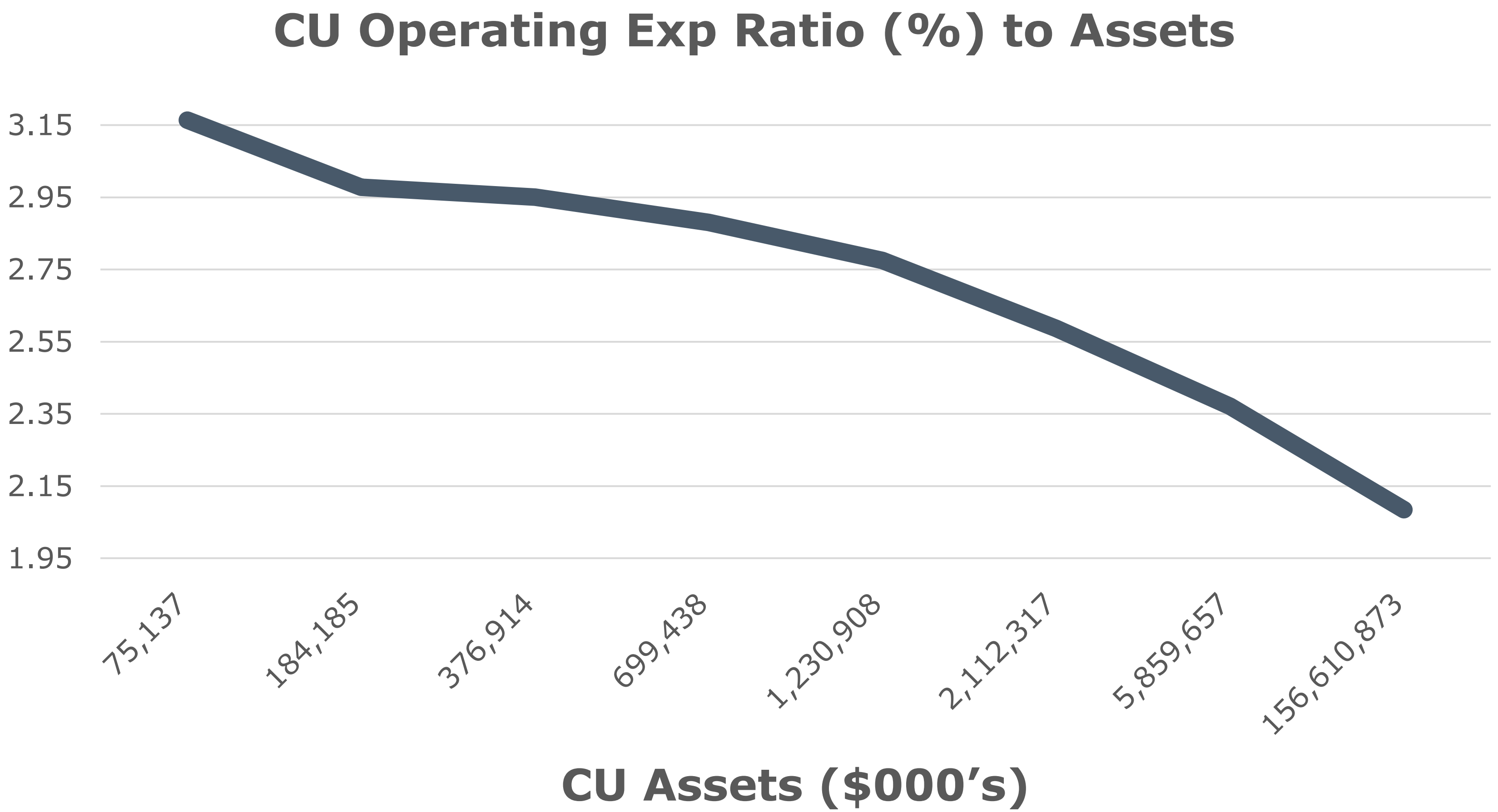
“How”

WHY?

Why?

1. Growth and increase scale - CUs faced with (i) margin compression; (ii) increased operating costs and (iii) higher capital requirements (>$500M)
2. Viable credit union merger targets dwindling
3. "Easier" to buy bank than merge with peer credit union
4. Bank valuations are down (both whole bank and branch acquisitions)
    - Cash consideration and ability to pay make Credit Union attractive acquirers.

Why?



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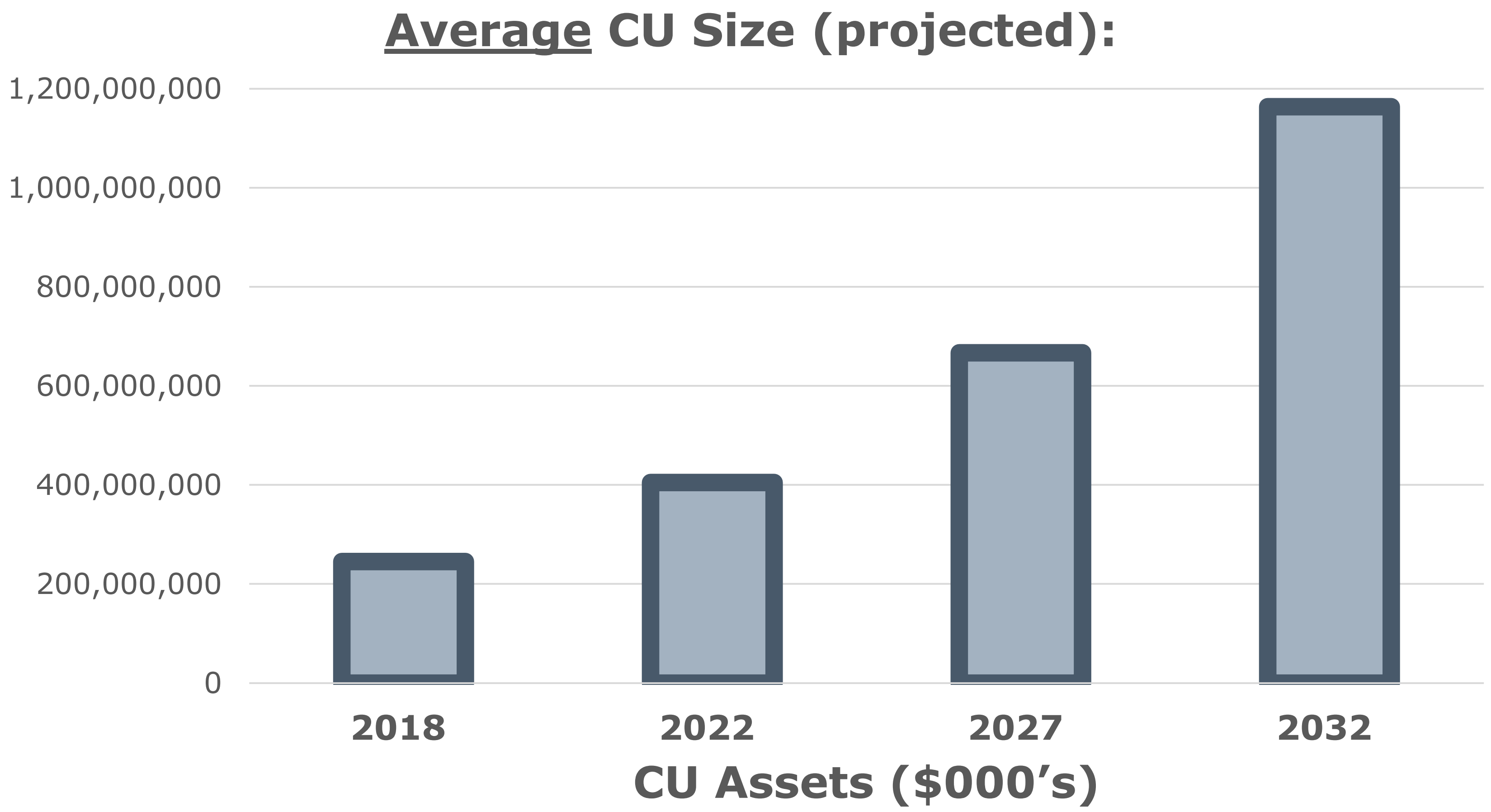
Why?



Projection developed by
Newcleus CU Advisors 2018

WHAT?

1. Deal Structure – P&A Transaction

- Purchase and Assumption ("P&A") – Purchase of assets and an assumption of liabilities.
  - Federal law and most state laws do not allow for a direct merger of a bank into a credit union
  - Target Bank generally must be dissolved.
- "All Cash" Deal – Cash is the only "consideration" that a credit union can offer the stockholders of a target bank.

2. P&A Transaction - "Double Taxation"

- P&A Transaction will result in a "double taxation" to the stockholders of the selling bank.

  - In contrast, a bank-to-bank merger generally will <u>not</u> result in double taxation because there is typically no tax at corporate level.

- As a result, a credit union bidder is at a "disadvantage" compared to a bank bidder and a "credit union" bid will need adjust.

3. Potential Target Banks - Expectations

- Target banks for credit unions have been historically small (<$400 million in assets, with most common asset size between $50 million and $250 million in assets).

- Important for credit unions pursuing a bank acquisition strategy to have realistic expectations of the size of the bank that will likely be acquired. Pro forma capital position will dictate size limits.

4. Credit Union Bid v. Bank Bid

- Because of the P&A structure - a "credit union bid" will be an amount for <u>the asset and liabilities</u> of a target bank.

- Because of the merger structure - a "bank bid" will be an amount for <u>all the stock</u> of the target bank.

- As a result, a target bank in comparing a credit union bid to a bank bid will want to understand how taxes, costs, transaction expenses will affect the "**<u>net amount</u>**" eventually received by stockholders.

5. Credit Union Offer Will Likely Be "Shopped"

- The board of target bank must exercise its fiduciary duty to obtain the best price reasonably available for its stockholders for "all cash deals" (since it is a "sale of control").
- As a result, a Credit Union should expect that its offer will be tested against other offers (i.e., a market check) to satisfy Revlon Duties.
- This is different from typical mergers between CUs.

6. Advantages - Credit Union

Credit Unions have an advantage over other banks bidding for a target bank because the Credit Union is "member owned" and has "no stockholders."

- Credit Unions can "pay more" because (1) no stockholder pressures; and (2) have more favorable tax treatment.
- Key metrics to consider:
  - (1) dilution on net worth
  - (2) accretion to earnings/cost saves.
- A competing bank buyer must be more careful as they will be criticized (or worse) by stockholders if they pay too much.

7. Disadvantages - Credit Union

- **Credit Unions can only pay cash.**
  - Banks can offer either cash or stock (or combination of both).
  - "Stock Bids" generally do not have to be the "highest bid."
- **P&A Structure –** this could result in target bank shareholders receiving "less" based on "net amount" received.
- **Higher fiduciary standards –** target bank boards generally have a fiduciary duty to get the "best price reasonably available" for an "all cash deal."

8. Loans & Deposits of Target Bank

- Transferred bank deposits must be immediately insured by the National Credit Union Share Insurance Fund upon closing.
  - Federal and State may have different rules.
- Borrowers must be "memberized."

9. Impermissible Assets

- You MUST evaluate the Target Bank for impermissibles
- Examples:
  - 15 year + Commercial loans
  - Concentration of Commercial loans to assets
  - Deposits that may not be permissible for the CU
- Good news – NCUA generally gives a post-transaction period (up to 6 months) to bring into compliance (or sell into the secondary market) non-conforming loans.

HOW?

Life Cycle of a Bank Acquisition

- Planning phase.
- Due diligence of potential target bank.
- Negotiating/executing a definitive P&A Agreement.
- **Required regulatory and/or stockholder/depositor approvals, depending on type of transaction.**
- Closing of the transaction/integration of target bank/employees/customers.

Board Role During Process

- Board must attest to (for both whole and branch acquisitions):
  - ➢ Impact of purchase on the credit union's net worth
  - ➢ How the purchase price was determined
  - ➢ How transaction is beneficial to members
- Recommend independent advice to board on complex items
  - ➢ Investment Bankers – independent deal analysis
  - ➢ Independent Legal Review of Compliance Risks of Acquisition and Regulatory Process
  - ➢ Independent Contract Review/Execution

Understand the Solicitation Process

- Generally, two types: (1) informal process; (2) formal solicitation process
- If interested, Buyer provides a <u>non-binding</u> letter of intent

Key Takeaway – you need to be “known” as a potential buyer

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Evaluate Corporate Structure - Strategy

- As part of the strategic process, important to consider:
  - State charter v. federal charter
  - Low income designation – (1) easier to effectuate a merger; and (2) utilize "secondary capital" to offset dilution of bank asset acquisition
  - Field of membership change or expansion

In Summary

- Growth is imperative to stay relevant & survive

- Bank purchases are very different from CU Mergers

- Strategy is key to successful execution of the process

About Luse Gorman, PC

Luse Gorman, PC is a law firm that specializes in counseling credit unions and other financial institutions.

We are a national leader in representing financial institutions in mergers and acquisitions, charter expansions/conversions, capital raising transactions, corporate governance, executive compensation and regulatory and enforcement matters.

We represent approximately 300 financial institutions nationwide.

About Luse Gorman, PC

- Top 10 law firm in financial institution M&A every year since 2001
  - No. 1 in 2019, 2018, 2017, 2016 and 2015
  - Structured the first transaction of a stock bank acquired by a credit union and been involved in four transactions involving sales by banks to credit unions in 2019 alone.
- Largest practice group (21 attorneys) nationally dedicated exclusively to representing financial institutions.

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