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# Selling Your Bank? How to Manage the Regulatory Headaches

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In considering a merger or sale transaction, the board of directors of a bank or bank holding company must consider a variety of factors in order to fulfill its fiduciary duties, but lately, the potential for regulatory hang-ups has to be part of that mix. Over the years, price has traditionally been the primary factor in a board's consideration of a deal, however, most state corporate laws contain statutory provisions that allow a board to take into account a variety of other factors when evaluating a sale transaction, including impact on consumers, employees and local communities. Boards are also well advised to take into account the ability of the buyer to complete a transaction in a timely fashion, including whether the buyer may face any regulatory delays. **In recent years, a number of transactions have experienced significant regulatory delays, and, in a few instances, transactions have been terminated due to buyer regulatory issues.** This phenomenon has raised the stakes for boards that have not properly evaluated the regulatory risks of a transaction.

**Identify Existing or Potential Regulatory Issues**

For the seller, a protracted regulatory approval process can make it extremely difficult to continue business in the ordinary course and can damage employee relationships and morale. Moreover, a failed transaction can result in a decrease in the value of the seller's stock and damage to its ongoing business and reputation.

**The seller's board needs to be aware of any existing or potential regulatory issues facing the acquiring institution.** While a few years ago regulatory scrutiny was generally limited to financial stability, capital and liquidity levels and Community Reinvestment Act compliance, today there is an increasing focus on the scope and depth of the acquiring bank's compliance risk management. Material deficiencies identified in any area of regulatory compliance can derail an M&A transaction. Therefore, before approving a transaction, it is important that the board ensure that management has conducted adequate due diligence on the buyer, focusing on a number of key regulatory areas, including:

- **supervisory history of the buyer and the status and effectiveness** of any corrective actions that remain outstanding;
- **buyer's record of compliance and the adequacy of its programs, policies and procedures**, including "hot button" issues such as Bank Secrecy Act/anti-money laundering laws and fair lending;
- **capital levels and stress test results;**
- **potential asset quality issues;**
- **buyer's Community Reinvestment Act record** and history of consumer activism; and
- for larger institutions, the **absence of systemic risk** resulting from the proposed transaction.

The seller must also be aware of its own problems and not rely on the historical rule of thumb that a strong buyer can assuage regulatory concerns about the seller. Sell-side due diligence enables the seller to proactively identify potential issues and resolve them before they escalate, thereby minimizing uncertainty in the sale process. Buyers will be focused on these issues in the diligence phase as well, with significant regulatory issues being factored into pricing and potentially narrowing the field of potential buyers.

**Scrutinize Transaction Documents**

The seller's board should review the key terms of the transaction to ensure that the seller has the flexibility to address regulatory deficiencies that are identified in advance of signing the agreement as well as during the pendency of the transaction. Provisions that limit or restrict the seller's ability to adequately address these issues can be damaging to the institution, particularly if the transaction cannot be completed. These restrictive provisions could include overly broad negative covenants that require the seller to seek the buyer's approval before taking an action. The board must also be familiar with any termination and no-shop provisions as they may be overly restrictive if a buyer's regulatory compliance issues delay a transaction. Any provisions that serve to restrict the flexibility of the seller when the transaction may be in regulatory jeopardy could be viewed as inconsistent with the selling board's fiduciary obligations.

**Engage Independent Counsel**

It is axiomatic that when negotiating a merger transaction, the seller should engage its own counsel and not share legal counsel with the buyer.  However, a recent trend has emerged with a seller and buyer jointly engaging counsel for the regulatory application process. While sharing regulatory counsel may decrease a portion of the transaction costs, sharing counsel can create risk of conflicts when the buyer is faced with regulatory delay due to compliance issues.  If the regulatory delay causes a drop-dead date to approach, a seller is well advised to rely on independent counsel for advice on the status of the relevant regulatory issues and on the considerations involved in deciding whether to terminate or extend the transaction.

Tags: Regulation, M&A, Regulatory Issues, Fiduciary Duties

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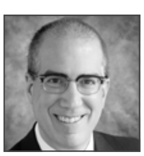

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