

Publications

Branch Purchase and Sale Transactions: A Primer for Bankers

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AUTHORED ARTICLE | Spring 2012

Appeared in the Winter 2012 issue of *The Bankers' Statement*

Branch purchase and sale transactions, involving sales and acquisitions of defined assets and assumption of defined liabilities (P&A transactions) can be more complex and document-intensive than whole-bank mergers. And sometimes more challenging to implement. They are akin to stripping out and selling an operating division in the non-bank world, with the added attraction of significant bank regulatory and customer issues.

From a buyer perspective, P&A transactions can provide turn-key access to a market without many of the risks involved in a whole-bank acquisition or de novo entry. From a seller perspective they can provide a strategic downsizing vehicle and additional capital liquidity through a selective sale of a portion of the franchise.

Each P&A transaction is unique and can involve a variety of issues.

What are some of the basics and how do they work?

1. Documentation

Like most transactions, the typical P&A transaction starts with a confidentiality agreement and sometimes, but not always, a "letter of intent". Confidentiality agreements typically include no-hire and standstill commitments for the buyer as well as non-solicit and privacy commitments with respect to customers and employees. Negotiation and execution of a somewhat lengthy and complex definitive branch P&A agreement follows; defining, identifying and listing the specific liabilities being assumed, the specific assets being purchased, employee issues, transitional operating issues and other pre-closing, transitional and post-closing items that vary depending on the transaction. Actual terms of P&A transactions vary widely and may involve single or multiple branches, ATMs, drive-up facilities, loans or specific loans, owned or leased real estate and a plethora of other deal-specific issues.

Agreed closing-related forms for each of the critical elements, including liability assignment and assumption agreements, asset transfer agreements, successor custodian agreements and several other agreements relating to the transaction to be executed upon consummation are often included as schedules or exhibits to the primary P&A agreement. The more such forms are agreed to in advance, the less likelihood of last-minute haggling over how such items are to be handled and potential last-minute re-negotiation of terms. As always, the devil is in the details.

2. Liabilities assumed.

Typically, the primary liabilities assumed are deposit liabilities associated with the branch (or branches) being sold. They can be difficult to isolate and define, particularly when involving a large selling bank that may have “integrated” deposit records and then split them out several times over several years and through several acquired charters. Nonetheless identifying with specificity the deposits assumed, the type of deposits, the terms of the deposits and related issues is both critical and challenging. For some types of deposits the buyer may want to change terms that entail special “change in terms” notices to depositors timed to coincide with the transaction. Buyers are stuck with time deposit terms until maturity and must take care to transition these deposits to the buyer’s systems accordingly. IRAs, Keoughs, public funds deposits and other “special” accounts require additional care if they are part of the transaction. Early identification of the type of accounts being assumed and their impact on the buyer’s balance sheet (and pricing with the typical “deposit premium” discount in the netting process) is critical, and must be done in time to include specific requirements and identification in the P&A agreement.

Other liabilities that likely involve third-party approvals may include lease assumptions for leased branch sites, leased signs, furniture leases, leased equipment and software programs, specific vendor contractual arrangements (such as maintenance contracts, sign contracts, hardware/software and safekeeping contracts, etc.) and other ongoing operating liabilities that the buyer needs for continued branch operation.

3. Assets Purchased

The primary assets purchased are typically loans and real estate. Sometimes only “office loans” or loans associated only with assumed deposit liabilities are considered, but often additional earning assets are included to assist in the profitability of the branch for the buyer. As with any loan purchase, loan transfers involve a plethora of issues from consumer loan sale notices, change in terms notices and assignments of collateral to larger loan assignments and assumptions, third-party consents and approvals, participation consents, UCC assignment filings and other loan transfer documents and agreements.

An early and critical issue is whether there will be adequate provision for due diligence before consummation of the transaction, and/or whether there will be a loan “put” provision based on a breach of representations and warranties, post-closing loan performance and/or post-closing buyer due diligence. The timing for the “put” period as well as the terms of the “put” are important. Significant customer confusion and frustration can result from a sale followed by exercise of a “put” where the loan is transferred back to the original seller/lender. It is typically best to conduct and conclude due diligence in advance of the closing if possible, so that sold loans can be appropriately identified, documented and transferred subject to a “put” only in limited instances of seller fraud or breach of a representation.

Other assets purchased may include owned real estate, furniture, fixtures and operating equipment, where typical purchase terms would generally apply, including addressing environmental and title issues for owned and leased real property. Buyers should take the same care in purchasing the branch with regard to environmental and other issues as they would with any real estate purchase, and make certain that equipment purchased is compatible with buyers' systems and in good working order.

4. Employees

Employee issues may arise, depending on whether employees will be expected to remain with the branch. Certain non-solicit/no-hire commitments may be sought by buyers, and buyers may want to sweeten the pot for desired employees with "stay" bonuses and other incentives. Issues arise with respect to benefits including credit for vesting in certain benefit plans, and in certain instances (if employees are not to be retained) sellers may have obligations under the WARN Act and related laws. Buyers not retaining employees may desire that sellers take termination actions before consummation of the transaction, and as with other aspects of the P&A transaction, post-closing indemnification of the buyer for seller pre-closing actions is typical.

5. Transitional Matters

Post-signing/pre-closing transitional matters can be complex and can involve unforeseeable events including interim damage to the branch, deposit run-off, loan transfers, ATM and debit card issues and a number of other concerns impacting both sellers and buyers. Product-related "change in terms" notices can be confusing to customers. How these notices are handled can often make a significant impact on customer retention and overall transaction success. Deposit run-off can be a big issue following an announced branch sale especially with other seller branches in close proximity, and is an even bigger issue now with internet banking where physical location may not be as important to customers. Buyers may desire a termination right or price adjustment for certain levels of run-off and may insist on pre- and post-transaction non-solicitation by sellers. Deposit rate restrictions may be desired by buyers with regard to both the deposits being assumed as well as other marketing initiatives by sellers intended to lure deposits away. Likewise, sellers may want to prohibit buyer solicitation of seller depositors prior to consummation depending on the structure and pricing of the transaction.

Buyers and sellers may wish to secure certain interim operating covenants relating to press releases, employees, office contractual commitments, investments in fixed assets, creation of liens, deposit pricing and other aspects of operations including a pre-closing prohibition on transfers of deposits and loans to other seller branches and/or affiliates.

Both parties need to carefully consider potential termination issues and how to deal with expenses incurred prior to termination, as well as the "reputation risk" for both parties that is inherent in the termination of an announced transaction.

6. Regulatory Approvals

Buyers will need to secure appropriate regulatory approvals, which can be subject to public comment and potential CRA issues. Buyers and seller should informally review proposed transactions with regulators well in advance of proceeding in order to ascertain that regulatory problems are not likely, including an analysis of competitive issues in the event of any market overlap. Shareholder approval is typically not necessary, but both parties should check with their respective legal counsel to make certain.

7. Closing and Post-Closing Issues

Closing issues and conditions involve execution of relevant transaction documents as well as “bring-down” certificates with respect to seller and buyer representations and warranties, sometimes a “no material adverse change” certification, sometimes deposit run-off limitations and a number of other matters which vary by transaction. Obviously one post-closing issue that is important is the handling of any post-closing due diligence and loan “put” transactions. They are costly for the parties, confusing for the customers and market, and represent “reputation risk” and expense issues for both parties. Buyers should consider non-compete and non-reentry commitments from sellers, as well as non-solicitation and no-hire commitments regarding employees who stay with the branch. Non-competition must be strong enough to restrict direct and indirect customer solicitation and address issues that arise out of internet and electronic banking. Agreement provisions should be binding on buyer and seller successors or acquirers. Buyer restrictions on seller rate advertisements in the market may be considered.

Pre-paid expenses (including sometimes FDIC premiums) will likely be pro-rated to closing along with other relevant pre- and post-closing expenses.

An experienced and “hands-on” integration team is critical, and can make the difference between a successful transaction and a failure for both parties. Customer confusion and operational “glitches” can be costly, and competitors will be waiting (and hoping) for transitional problems. Transitional problems also make regulators nervous, and they will be watching to see how integration issues are handled. Buyers and sellers with a history of problem transitions may find regulatory approvals slow or denied altogether depending on their respective records in that regard. Smooth and seamless systems conversions can make or break an otherwise successful transaction.

Buyer indemnification of sellers for post-closing issues and claims (unless arising from seller’s conduct), and seller indemnification of buyers for pre-closing issues and claims (unless arising from buyer conduct), is typical for these kinds of transactions.

8. Transaction Expenses

The cost of preparing documentation relating to deposit assumption is typically not that great, and can often be handled on a “mass” assignment/assumption basis. Customer “change in terms” notifications can be expensive from the perspective of printing and mailing costs.

The cost of preparing documentation relating to assets purchased, particularly loans, can be expensive and time-consuming and is sometimes a late “surprise” to the participants. Loan assignments, consents and collateral assignments can entail extensive legal document preparation and filing fees, and are generally

done on an individual basis. The same types of expenses apply again in the event of loan “puts” or transfers by buyers back to sellers. Allocation of expenses up front is important and can make a difference in transaction pricing.

Conclusions

Branch P&A transactions vary widely, and are unique in terms of structure and practical business and legal issues. They require extensive coordination between the parties and they can be, and often are, more complex and document-intensive than full merger transactions. As a result, branch P&A deals can be a challenge for those not experienced with such transactions. Both parties should have experienced financial advisors to assist in making certain that pricing and other financial terms are appropriate, and experienced legal advisors to assist in negotiating, documenting and completing the transaction as well as with post-closing transition issues. Mistakes made in the transition can be costly not only in real dollars, but as mentioned previously through adverse “reputation risk” issues that can quickly convert to real dollar issues. The adverse consequences of a botched acquisition on the market for which the buyer is paying a premium can be severe, and the ability of a seller to reconstruct relations with customers in the event of a terminated deal, after it has been announced, can be challenging. “Troubled” branch transactions reflect badly on both the buyer and the seller and can adversely impact the ability of both the parties to conduct future transactions.