Client Alert: Banks as Borrowers

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Financial Institutions

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Bank and BHC subordinated debt can be a good idea for a variety of reasons. In an industry where capital is still (and really always has been) "king," and TruPS have become a thing of the past, sub debt provides a number of the benefits of equity but without the shareholder dilution and other issues that accompany sales of equity.

The potential for increased loan limits; tax-deductibility; an advantageous current rate structure; relative simplicity and ease of issuance; lack of equity dilution; and ease of use and applicability all combine to make sub debt an attractive alternative. As regulatory agencies continue to move toward a focus on capital position as a component of their risk analysis of institutions for a reduced regulatory burden, the attractiveness is enhanced.

The gradual imposition of Basel III and pending impact of CECL, combined with an ongoing regulatory focus on capital for CRE lending, should encourage institutions to look ahead now with regard to capital adequacy generally. Sub debt can also be a relatively attractive and inexpensive vehicle for access to capital when considering strategic expansion opportunities.

Buyers for sub debt appear to be readily available and include other banks and BHCs.

So what's not to like here?

Institutions may do well to consider sub debt in their strategic planning process not only for the things that they know are coming, such as Basel III and CECL, but also to enable them to secure funding for acquisition opportunities that may favor buyers with quick and nimble responsiveness and access to capital.

Ancillary issues such as preferences, convertibility, puts, calls and other features that complicate sub debt can be a drawback to the relatively simple notion of a straight sub debt issue, and can adversely impact timing and categorization of the debt. Simple is good in most instances, but investor demand, pricing and markets will of course control. Likewise participation in large pools of institutional debt can require a conformity and loss of control over eventual holders that may be problematic to some institutions. There is no “one size fits all” in this area as in so many others.

Analyzing the overall impact on the institution and its stakeholders and creating a record of the board’s consideration is critical. It is also an important component of defending the action against potential critics should issues arise. As with any significant strategic consideration, it is important to consult with regulators and relevant professionals early on to avoid potential pitfalls.

If you have questions regarding legal matters impacting debt issuances for your institution, please contact your Vorys lawyer or Jeff Smith at 614.464.5436.