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IN THIS ISSUE

Lessons from Equifax and Uber – Shining the Spotlight on Data Breach Incident Responses

by Elena A. Lovoy and Peter L. Cockrell

The year 2017 may have been the tipping point in data breach incidents. In September 2017, Equifax Inc. disclosed a breach exposing the names, Social Security numbers, birth dates, home addresses, and driver's license numbers of more than 140 million consumers. Two months later, Uber Technologies Inc. disclosed it had paid cybercriminals a $100,000 ransom to destroy data they stole in 2016, including the telephone numbers, email addresses, and names of 57 million Uber drivers and riders. While Equifax and Uber were stealing headlines, Anthem, Inc. reached a record $115-million class action settlement stemming from a 2015 breach that compromised the data of 80 million consumers.

These incidents will likely lead to increased data security and breach notification requirements in 2018, as well as heightened expectations from consumers, lawmakers, and others for companies' cybersecurity programs and data breach response plans. Indeed, Alabama may soon become the only remaining state without a data breach notification law. Alabama's outlier status does not mean that Alabama financial institutions are out of the spotlight. Alabama financial institutions can learn valuable lessons from other companies that have successfully or unsuccessfully navigated cybersecurity incidents.

State Developments

- ***South Dakota***

Alabama and South Dakota are the only states that have not adopted a data breach notification law, but that may change in 2018. South Dakota Senate Bill No. 62, if passed, would establish a data breach notification law in the state with requirements similar to those currently found in most other states.

- ***North Carolina***

The North Carolina Attorney General has proposed legislation to amend the state's existing data breach notification law. Although the legislation has not yet been introduced in the state legislature, a summary of the proposal has been released. If the proposed changes are adopted, including one requiring that companies notify affected individuals within 15 days after discovering a breach, North Carolina would have one of the toughest state data breach notification laws in the country. In many circumstances, such a short notification deadline will be difficult for many companies to meet. The proposal would also expand the definition of "breach" to include ransomware attacks.

Federal Developments

The recent breaches may also finally spur developments at the federal level. The Cyber

Breach Notification Act of 2017 was introduced in the House in October 2017 and the Data Security and Breach Notification Act was introduced in the Senate in November 2017. Both proposals would establish a nationwide standard for data breach notifications that would preempt the current patchwork of state breach notification laws.

Case Law Developments

Legislators and regulators have not monopolized the spotlight in the data breach landscape. Two important cases in 2017 addressed the application of the attorney-client privilege and work-product protections to a company's data breach response plans. Federal courts in Oregon and California reached different holdings under similar circumstances regarding whether the companies would be required to produce reports created by third-party computer forensic firms. The California court found the protections applied when the forensic firm was hired by outside counsel in response to a data breach. However, when the company hired the forensic firm directly, the Oregon court found the protections did not apply. Considering the high costs of litigation stemming from data breaches, how courts apply attorney-client and work product protections and how companies respond to these breaches will continue to be crucial.

Predictions for 2018

Lawmakers seldom relinquish the spotlight and the opportunity to push for reform, so we are likely to see new data breach requirements adopted in 2018. The New York Department of Financial Services' cybersecurity regulation became effective in March 2017. Other state regulators considering comprehensive cybersecurity regulations will likely refer to the New York regulation. Although meeting this high bar is not yet required for all companies, some of the requirements under the regulation are increasingly being viewed as best practices. Companies that market to or process the information of European Union data subjects must prepare for the May 25, 2018 effective date of the EU's General Data Protection Regulation. As the requirements continue to change, companies must ensure that they properly balance required consumer protections and the realities of responding to cyber incidents.

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Using UCC Purchase-Money Priority to Grow C&I Loans

by Larry Vinson and Charles Moore

If your bank is looking to grow its commercial and industrial (C&I) loan portfolio, consider taking advantage of the purchase-money priority provisions of Article 9 of the Uniform Commercial Code (the "UCC"). Those provisions, which permit a lender to obtain a "superpriority" security interest in goods that it finances under certain circumstances, may enable your bank to begin a secured lending relationship with a new customer, even if the customer has already granted a blanket lien on all of its personal property to another lender.

This article focuses on considerations related to the purchase-money financing of equipment. Purchase-money financing of inventory and livestock also can entitle a lender to "superpriority" under Article 9 and may present opportunities for your bank. However, special rules apply to purchase-money priority positions in those types of goods and are not addressed in this article.

1. "Purchase-money security interest" defined. A security interest in equipment is a purchase money security interest ("PMSI") if the security interest secures a loan made to enable the borrow-

er to acquire the equipment, and the borrower, in fact, uses the loan proceeds to fund the acquisition.

2. "Equipment" defined. Article 9 defines "equipment" to mean goods other than inventory, farm products, or consumer goods. Thus, "equipment" consists of finished goods used by the borrower in its business. "Equipment" does not include goods held for sale or lease, raw materials, work in process, or materials used or consumed in the borrower's business, all of which are defined in Article 9 as "inventory."
3. Effect of PMSI priority in equipment. Under Article 9, a lender that has PMSI priority in equipment has priority—sometimes referred to as PMSI "superpriority"—that puts the lender ahead of other creditors that have competing security interests in the same equipment. PMSI priority applies even if the purchase money lender knows that a conflicting security interest has been created and/or that the holder of the conflicting security interest has filed a financing statement covering the equipment.
4. Obtaining PMSI priority in equipment. The steps required for a lender to obtain PMSI priority in equipment are fairly simple: (a) the proceeds of the loan made by the lender must be used by the borrower to acquire rights in or use of the equipment, (b) the lender must obtain a security interest in the equipment that secures payment of the loan, and (c) the lender's security interest must be perfected within 20 days after the borrower receives possession of the equipment.
5. Regarding the first step, the purchase-money lender can ensure that the loan proceeds did, in fact, enable the borrower to acquire rights in or use of the equipment by disbursing the loan proceeds directly to the vendor of the equipment. As for the third step, in most cases, the lender will perfect its security interest in equipment by properly filing a financing statement on form UCC-1. If the equipment is or will be attached to real property in such a manner that it is or becomes a "fixture," a local UCC fixture filing may be required. Security interests in certain types of equipment, such as titled vehicles, cannot be perfected solely by filing a financing statement.
6. For PMSI priority in equipment, there is no requirement that notice of the purchase money lender's security interest must be given to a lender that has already filed a financing statement describing its collateral as "all equipment," "all assets," or the like.
7. Some cautions. If any of the steps required to obtain purchase-money priority are not followed exactly, the new lender's security interest in the equipment will be subordinate to existing perfected security interests of other creditors in the same equipment. For that and other reasons, purchase-money lenders should beware of several potential traps:

    a. Timing of possession. The 20-day perfection period begins to run on the day the borrower receives possession of the equipment. To the extent possible, the lender should require a signed delivery receipt or other objective evidence of delivery.
    b. Compliance with the 20-day requirement may become problematic if it is not clear when the borrower received possession of the equipment. For example, the contract of sale may require the vendor to assemble or test the equipment on the borrower's premises before the borrower is deemed to have accepted the equipment. Or, the vendor may deliver the equipment in stages over a period longer than 20 days, or some material component of the equipment may be delayed in transit more than 20 days after the other components are delivered. Difficulties also can arise in cases where the borrower has delayed applying for the purchase money loan and the lender is unable to complete the processing and funding of the loan and the filing of the financing statement or other means of perfection before the 20-day period expires.
    c. Lending against already-purchased equipment. Priority issues may arise where the borrower pays the purchase price using other resources and then wants to obtain a loan to finance the purchase price within 20 days after receiving the equipment. As noted above, the lender will obtain PMSI priority only to the extent the proceeds of the lender's loan enable the borrower to acquire rights in or the use of the equipment.
    d. Conflicts with other PMSI creditors. If the pur-

chase-money lender will be financing only a part of the purchase price of the equipment the borrower is purchasing, it is important that the lender knows how the borrower will pay the remainder of the purchase price. If the vendor of the equipment provides seller-financing to the borrower for the balance of the price, and the vendor takes a security interest in the equipment and perfects the security interest within 20 days after the borrower receives possession of the equipment, the vendor's security interest will have priority over the security interest of the purchase-money lender. Similarly, if another lender that takes the steps to qualify for PMSI priority makes a loan to the borrower to finance the balance of the purchase price, the security interest of the lender that filed its financing statement first will have priority in the purchased equipment. If the other lender that makes the loan or advance to finance the balance of the purchase price is the borrower's existing lender with a perfected security interest in the borrower's after-acquired equipment, that other lender usually will have priority because almost invariably it will have filed its financing statement first.

e. Violations of borrower's agreements with existing lender. Borrowing the purchase-money loan and/or granting the PMSI to the purchase money lender may cause the borrower to violate the terms of the borrower's agreements with an existing lender, thereby giving the existing lender the right cease making advances and/or to accelerate the borrower's obligations to it and to foreclose on its collateral. These provisions in the borrower's agreements may take the form of limitations on the borrower's incurring additional debt, granting liens or security interests to any party other than the existing lender, or incurring purchase money obligations in excess of a prescribed dollar amount. If the existing lender were to accelerate and foreclose on its collateral because of a breach of these covenants by the borrower, the purchase money lender may be put at risk of non payment of its purchase money loan, leaving it to resort solely to collateral in which it has purchase money priority. These and similar issues are often resolved by obtaining a consent and waiver from the existing lender before the purchase-money loan is made.

Conclusion. The rules governing PMSI priority in equipment provide an opportunity for a lender to establish a secured lending arrangement with a new customer as borrower, even if the borrower has an existing arrangement with another lender that has a perfected security interest in all of the borrower's personal property. To establish its "superpriority" position, however, a purchase-money lender must carefully comply with the Article 9 requirements for taking PMSI priority in equipment. The lender also should evaluate the relevant facts and circumstances before committing to or funding the loan, so that it may best protect itself against problems that can arise from competing interests of vendors and lenders to the borrower.

Larry Vinson is a partner at Bradley and regularly counsels financial institutions of all sizes on new CFPB regulations, bank regulatory and product questions, and all aspects of state and federal consumer credit compliance. On questions relating to the Uniform Commercial Code, he is a resource for the firm's clients and for other lawyers both inside and outside the firm. Charles Moore is also a partner with Bradley. He has substantial experience in commercial finance, including mortgage warehouse lending, real estate finance, and bank holding company lending. Moore also commonly handles change in bank control act matters, bank holding company act matters, formation and capital raising activities of banks and bank holding companies, and other bank regulatory matters.

Supreme Court Update

by Charles W. Prueter

Readers of this publication know that an essential aspect of staying up-to-date on the financial landscape is keeping abreast of developments in banking and financial services cases at the United States Supreme Court. The Court has the power to alter that landscape dramatically by handing down decisions in cases involving particular disputes between particular parties. But the mainstream media does not — and, frankly, cannot — cover the cases involving, say, interpretations of the Dodd-Frank Act or questions about securities transactions. So, beginning today in this *Board Briefs* article and continuing hereafter on a monthly basis in the Alabama Bankers Association's *Weekly News Byte*, the Supreme Court Update will briefly identify and discuss cases at the Court that could have an impact on banking and financial services.

Although coverage of the Supreme Court's term, which commenced in October 2017, has been dominated by wedding cakes and travel bans, the Court has before it several cases focused on financial matters. Below are three of those cases that should be on the radar of our readers. Because the Court currently is moving at a historically slow pace when it comes to issuing decisions, none of the following cases has been decided (although each has been argued at the Court). The update will have recaps of the decisions, in the *Weekly News Byte*, when they are issued later this spring.

The first case is ***U.S. Bank N.A. v. The Village at Lakeridge, LLC***, No. 15-1509, which was argued on Oct. 31, 2017. This bankruptcy case involves the difference between a debtor's transactions with an interested party (an “insider”) and a debtor’s arm’s-length transactions with a creditor, such as a bank. Here, U.S. Bank, which is owed $17.6 million by the debtor real-estate company, contends that it was disadvantaged by an “insider” transaction — a deal between the debtor and the lover of the debtor’s personal representative. The bankruptcy court found, however, that the lover was not an insider, and the court of appeals affirmed that finding. The question before the Supreme Court centers on the somewhat arcane issue of the standard of review that an appellate court should apply to a bankruptcy court’s findings on these matters, but the decision in this case will have a significant impact on how banks and other arm’s-length creditors defend their interests in bankruptcy proceedings.

Second is another bankruptcy case, ***Merit Management Group, LP v. FTI Consulting, Inc.***, No. 16-784, which was argued on Nov. 6, 2017. Bankruptcy law allows trustees to “avoid” certain pre-bankruptcy payments that, for example, improperly favor one creditor over another or outright defraud creditors by moving assets out of the estate. But the law also provides an exception, prohibiting a trustee from avoiding a transfer of securities “by or to (or for the benefit of)” a financial institution. In this case, the debtor purchased securities from Merit Management (which is not a financial institution for purposes of bankruptcy law), and that transaction passed through a financial institution. Merit Management thus argues that the payment cannot be “avoided” — and that therefore it may keep the payment — because the payment went “to” a financial institutional before being ultimately delivered. At oral argument, however, the justices were skeptical of that theory, clearly siding with the creditors seeking to have the payment avoided. The approach apparently favored by the justices rests on the simple basis that the relevant transaction is not the one to and from the financial institution intermediary but rather the overall deal between the debtor and Merit Management. The usual caveats about oral argument — i.e., that one cannot always glean the Court’s ultimate decision from the justices’ comments and questions at oral argument — certainly apply here, but the likelihood appears to be that the Court will rule in the creditors’ favor, meaning that debtors will have less wiggle room to make questionable payments that disadvantage arm’s-length creditors.

Last, ***Digital Realty Trust, Inc. v. Somers***, No. 16-1276, which was argued on Nov. 28, 2017, is a “whistleblower” case arising under the Dodd-Frank Act. On its face, the statute protects a whistleblower from retaliation if he reports an alleged securities violation to the SEC but not if he only reports such violations internally. The purported whistleblower in this case — who reported an alleged violation internally and allegedly was fired for reporting it — claims that he nevertheless should be protected by Dodd-Frank’s anti-retaliation provisions. Obviously, his former employer disagrees. The Court’s decision, either way, not only has the potential to be a forceful pronouncement on the importance of the plain language of a statute, but it also will have an impact on how financial institutions manage risk and ensure compliance in light of the web of regulations and obligations imposed by Dodd-Frank as well as Sarbanes-Oxley and other securities laws.

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The Shape of Banks to Come: Part I

by Nancy A. Bush

As we go into 2018 and face the realities of the American political and economic landscape — global headline risk, capital markets that are rocketing skyward (and provoking debate about valuation and bubbles in the process), and the rise (and fall) of new and mysterious currencies, among other things —it’s often hard to see how this pivotal year may play out. The newly-enacted tax bill will likely result in enhanced economic activity at the same time that we may see the Congress turn blue in a “wave” election. At this juncture—who knows how 2018 will go?
But there is one thing that we can say without hesitation or equivocation—the banking industry will continue to grow and

change in the coming year. We think that the present state of rising bank earnings—the actuality of lower taxes combined with the likelihood of a period of faster growth and better loan demand—should power a year of good bank stock performance and growing returns to shareholders. In the banking industry, that is an environment that inevitably gives rise to enhanced “animal spirits”, and those spirits also inevitably manifest themselves in greater merger activity.

It’s hard to believe that there could be more deals—and bigger ones—in 2018 than there were in the fevered deal environment of 2017, but we believe that could indeed be the case. For one thing, the large regional banks—which have been largely quiet on the deal front in the years since the Financial Crisis—may finally see a window of high stock prices and regulatory forbearance that will encourage them to do deals of some size. It has long been speculated, for example, that exemplary regional banks like U.S. Bancorp might finally make a move toward multi-regional dominance—and we would point to the western U.S. as the place they would most likely go—and there are others who would like to similarly expand their footprints. And while BB&T CEO Kelly King said recently that his bank will remain focused on organic growth in the near future, our belief remains that for that acquisitive bank, it is only a matter of time.

Readers know well the story of the emergence of the “mega-community” segment of banks here in the Southeast, and the tremendous success of companies like Pinnacle Financial Partners (PNFP), South State Corporation (SSB), Ameris Bancorp (ABCB), United Community (UCBI), Center State (CSFL), and others in making significant moves into new markets and into new businesses. That trend will continue unabated in 2018 (note—we did not say “may continue”), and indeed will likely quicken if the regional banks begin making incursions into the region. Terry Turner of Pinnacle Financial has already said that his company will likely be acquiring again after a two-quarter hiatus to consolidate their 2017 acquisitions, and we believe that this is likely the year that Center State (now completing two in-state deals) may choose to move out of Florida and into the Atlanta marketplace. Under any scenario, more deals are coming, and more may indeed be a LOT more in 2018.

We have been bank analysts long enough to worry that periods of rapid merger activity might result in regrets down the road, and we hearken back to the pre-crisis years when the nation’s largest banks were being formed. Readers can easily remember the torrid pace of deals in the late 1990’s, when the pattern was do a deal, slam the companies together, gather a few expense saves, declare victory—and then on to the next one. After a hiatus in the early 2000’s in the wake of the Tech Bubble and the events of September 11, 2001 deal activity and prices rose again through 2006—the acquisition of Golden West Financial by Wachovia in that year marks the apotheosis of that “why not?” time for us—and then we all know how it ended (in tears) in 2008-2009.

We want to make very clear that we (thus far, anyway) see no—repeat, no—similar warning signs in the deal activity so far in the mega-community segment, and indeed most of these deals seem to have been unusually thoughtful in their planning and execution. In almost all instances, attention has been given to expanding into contiguous markets where the customer bases are well understood and the acquirers can bring an enhanced set of products and sales skills immediately into play. The execution trend has been prompt but measured and efficiency and capital ratios have seen little (and largely temporary) impact from even the larger acquisitions.

But with our strong belief that “forewarned is forearmed”, we took the time to talk to some banking industry insiders—including some regional bank CEOs who have done their share of large deals—about the lessons that they had learned throughout their careers and about the ways that “this time may be different” in a period of rapid consolidation. Those observations surprisingly all centered upon the concept of “process”, and there was a general belief that there will simply be a greater emphasis on processes as the key to deal execution and minimization of risks during a time of rapid consolidation. How about the regulatory view of the frenetic deal activity in this segment? We spoke with one industry observer who is very familiar with the regulatory view of community banks, and his observation was that there will be increased scrutiny from both Wall Street and from regulators as these companies continue on their acquisition programs. He sees one area of regulatory concern as the acquisition of specialty business lines within acquired banks—especially lines like indirect auto lending, where a "marginal borrower" is often the customer—and the regulators will require that such activities be "professionalized" by strong talent and systems. Indeed, the whole risk management process (note that the word "process" pops up again) for these companies is being emphasized right now, and the regulators have "sharpened their pencils" in the approval process.

Well, so far and so good on the mega-community growth path and on what we may see in 2018, and we are somewhat mollified on our concerns in this area. But that still leaves one big question—what happens to all those community banks that get left behind? And especially what happens to the community banks under $1 billion in assets, a size that has been deemed uneconomic by many industry observers? That's why we have deemed this piece to be Part I of "The Shape of Banks to Come". Stay tuned for Part II, where we will tear into the subject of the fate of the smaller community banks.

To read NAB Research's disclosures for the preceding commentary, please follow this link:
http://www.BushOnBanks.com/disclosure.shtml

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M&A in the New Year: A Resolution for Success

by Phil Moore

Like a lot of us, New Year's resolutions for many community banks are based around improvement and growth. Spurred by the recent tax reform bill, many are looking to a possible merger or acquisition as a way to meet their business needs and improve their long-term growth for the coming year.

However, banks can have a difficult time working through this process effectively, and for some, knowing where to start can be equally daunting. Our own experience has shown us that most successful mergers tend to come from a combination of careful and thorough planning, meticulous review, strong and consistent communication, solid execution and a willingness to learn from the experiences of others.

Recognizing Your Needs & Knowing Your Goals

Before you start planning and executing on any merger and/or acquisition (M&A), it's imperative that bankers have a solid idea of both what they are looking for, and what they are not. By taking a strategic and focused approach to your initial research and discussions (and then throughout the entire process), bankers are better positioned to effectively identify those elements that will help them succeed while eliminating more of the roadblocks and possible dead ends.

In addition to reviewing factors including lines of business, geography, financial compatibility, work force talent, and customer expectations, it is critically important to complete a thorough assessment of the cultural alignment for both organizations. Going into this process while attempting to combine two mismatched cultures can often prove a challenge too steep to overcome and significantly diminish the overall value of the merger. Having the wrong cultural fit such as major differences in governance processes, compensation, customer service philosophies, work arrangements, and feedback can destroy a deal faster than any other factor. Rather, making sure these elements are aligned from the start can create a much smoother path to success.

Diligent Planning & Early Strategy

Once you know your needs and goals, the next step in any successful M&A is making sure you have full buy-in and understanding from all involved parties prior to the merger taking place. Once this is confirmed, it is vitally important that both institutions ensure their internal processes and operations are in good order beforehand. Additionally, banks must consider the resulting demands on their team and review their capacity to handle the additional responsibilities that will inevitably come from combining two previously disparate financial institutions.

Examples range from handling increased customer transaction volume to the need (and ability) to rationally determine which processes and/or systems will remain and which ones should be removed or changed. Not only will employees be facing an increased workload of "new" customers, but they may also be working under a completely different organizational and operational system, including technology. Proper planning with both teams is a key factor in setting them up for success prior to the merger, and ensuring agreement among all levels of the new organization moving forward.

Communication Is Key

As with any relationship – interpersonal, corporate or otherwise – consistent, open and direct lines of communication between all parties is critical to the success of an M&A scenario. With sincere and honest dialogue as the foundation, both organizations can build the necessary trust to effectively address any potential issues that might naturally occur along the way, while also forming the vital connections that are needed beyond the initial discussion phase.

Both parties should always strive to be candid and honest throughout the entire process. It is important to remember that an M&A can be a stressful experience for both parties and emotions will likely run high for all involved. Recognizing this and that some parties may not be as open to the M&A as others, banks must ensure the lines of communication stay open and everyone remains on the same page. This will be crucial to their ability to work through key details as they become agreed upon and documented.

Bold & Thorough Execution

As suggested earlier, any successful merger or acquisition begins with knowing what exactly your institution is (and is not) looking to achieve from the process. Employees will look to leadership to set the overall tone, so banks must identify and communicate their goals early in the discovery process to guide and define how operations are executed and ensure that staff responds accordingly. This, in turn, creates the standard for how business will be done in the newly combined organization once the process is complete.

Operations – Making the Right Choices

Combining multiple operational teams and systems infrastructures requires a great deal of attention to detail over a host of moving parts – requiring continuous and comprehensive analysis and evaluation. Making decisions based around which team is acquiring the other (or internal politics) is a counter-productive approach and one that we have seen severely limit the success of a merger or acquisition. Rather, bankers should assess with an unbiased eye focused on ensuring that decisions related to systems and processes are in the best business interest of the institution that they seek to become through the merger.

Leveraging the Right Partners

Finally, and what may be the most important step for a successful M&A, is effectively leveraging the relationships you may have with those who have previously been through a similar process. The banking industry has witnessed much M&A activity over the past few years, and the experiences of your peers could closely match your own plans – creating a perfect sounding board for input.

It can be invaluable to have a trusted resource you can share your opinions, ideas and concerns with, and identifying that perfect resource early can be a game changer for any bank. In turn, this will require an open-mind and the willingness to listen to, learn from and utilize any feedback that is offered.

As you evaluate your future merger opportunities, keeping these suggestions in mind for your process will help you be better prepared, ensure a smoother transition and position you for success.

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Need More Capital? Relief May be on the Way

by Andrew S. Nix

Life as a community bank has become increasingly challenging in recent years, with massive increases in regulatory burdens, compliance costs and capital requirements on top of industry consolidation and impediments to quality asset growth. There are a number of regulatory reforms currently percolating in the halls of Congress that attempt to address, in some form or fashion, these difficulties. One in particular – H.R. 4771, the Small Bank Holding Company Relief Act of 2018 – recently passed the House and has been received by the Senate. H.R. 4771 would require the Federal Reserve to change its Small Bank Holding Company Policy Statement to apply to bank (and savings and loan) holding companies with total consolidated assets of less than $3 billion, instead of the current $1 billion ceiling.

The policy statement was developed originally by the Federal Reserve in 1980 to allow for the formation and expansion of small bank holding companies in a manner consistent with bank safety and soundness. Although the Federal Reserve has generally discouraged the use of debt by bank holding companies to finance acquisitions based on the concern that high debt levels can impair the ability of holding companies to serve as a source of strength to their subsidiary banks, the Board of Governors has also acknowledged that small bank holding companies have less access to equity financing than larger bank holding companies and that the transfer of ownership of small banks often requires the use of acquisition debt. The policy statement attempts to facilitate the transfer of ownership by allowing small bank holding companies to operate with higher levels of debt than would normally be permitted.

The small bank holding companies that qualify for the policy statement are excluded from the Federal Reserve's consolidated capital requirements; however, their depository institution subsidiaries continue to be subject to minimum capital requirements, and all institutions must continue to meet certain qualitative requirements, including those pertaining to non-banking activities, off-balance sheet activities and publicly-registered debt and equity. Additionally, in accordance with the policy statement, small bank holding companies may use debt to finance up to 75 percent of the purchase price of an acquisition, subject to certain ongoing requirements and restrictions. Because of the increased likelihood of failure of banking institutions with higher levels of debt, the Federal Reserve may, in its discretion, exclude any bank holding company, regardless of asset size, from the policy statement if such action is warranted for supervisory purposes.

Proponents of H.R. 4771 view the expansion of the Small Bank Holding Company Policy Statement as a targeted way to promote economic growth in the markets served by community banks while minimizing regulation that increases burden without corresponding benefit. If enacted, the bill would make it easier for community banks to raise additional capital needed to form new holding companies, fund existing holding companies and make acquisitions by issuing debt at the holding company level – all important to ensure that these institutions have the resources that they need to continue to grow and lend to their local communities. All community bank holding companies that may qualify for the relief provided by the expanded Small Bank Holding Company Policy Statement should continue to monitor this legislation.

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Trump "Bump" or "Jump?"
2017 Bank M&A Scorecard

by Michael Rediker

The election of Donald Trump in November 2016 was heralded by many as a positive for the banking industry and for bank M&A in particular. During 2017 the bank M&A arena saw an increase in both deal activity and pricing after several years of stagnation. In the early part of 2017 this uptick was referred to as the "Trump Bump." With the rise in activity and pricing proving sustained over the entire year and not ephemeral, some pundits are now calling this phenomenon the "Trump Jump."

Deal Flow is Up

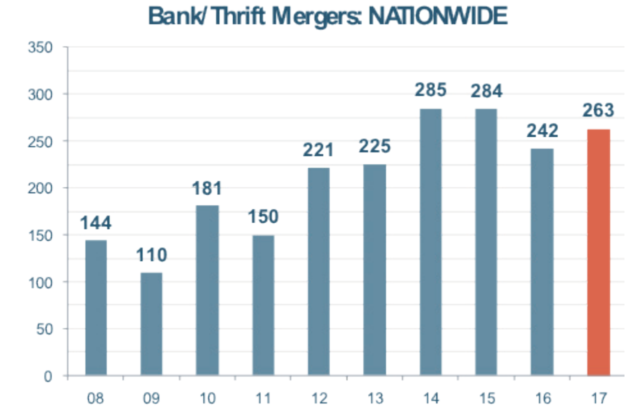
Nationally there were 263 bank M&A deals announced in 2017, which represents a 9 percent increase over the 242 deals announced in 2016. As seen in the top two charts to the right, deal activity in the southeast was up even more with 72 deals announced in the region compared to 56 announced in 2016 (a 29 percent increase).

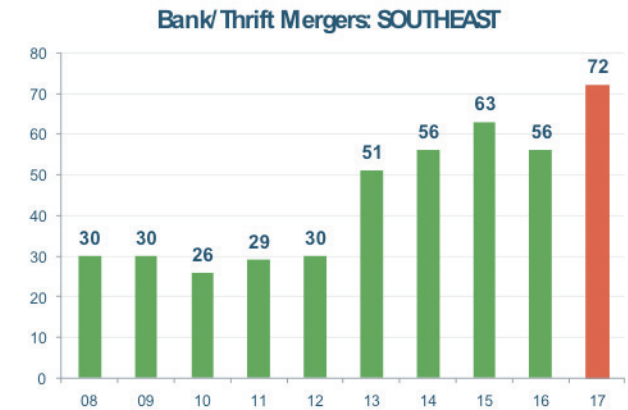
Not only did deal activity rise from 2016 to 2017 in absolute terms, it rose in relative terms as well. The third chart on the right shows that M&A deals as a percentage of total banks spiked noticeably from 2016 to 2017 (coincident with Trump's inauguration) and that 2017 was the most active year for bank M&A on a relative basis over the last quarter century. For instance, in the southeast (dotted green line) slightly more than 7 percent of all banks in the region sold during 2017. Put another way, roughly 1 out of every 14 southeastern banks were sold during 2017. The next most active year for bank M&A in the southeast was all the way back in 1998 when 5.9 percent of southeastern banks were sold.

Deal Pricing Rises Too

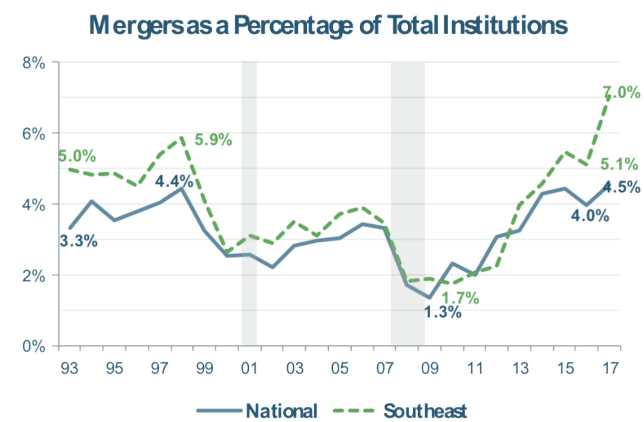
The right edges of the two charts below graphically show the "Trump Jump" manifesting itself in noticeably higher deal pricing in 2017 compared to 2016. In the first chart which shows the Price/Book median by year, the national median (solid blue line) jumped from 1.31x in 2016 to 1.61x in 2017 (a 23 percent increase). In the second chart which shows the Price/Deposits median by year, the same was true: the national median (solid blue line) rose from 16.2 percent in 2016 to 19.6 percent in 2017 (a 21 percent increase).

Another interesting observation from these charts is the almost flat trajectory in pricing during the Obama administration and the spike in 2017 upon Trump's inauguration. Perhaps this speaks to the severity of the Great Recession. Unlike the sharp rebounds in pricing following the 1990-91 and

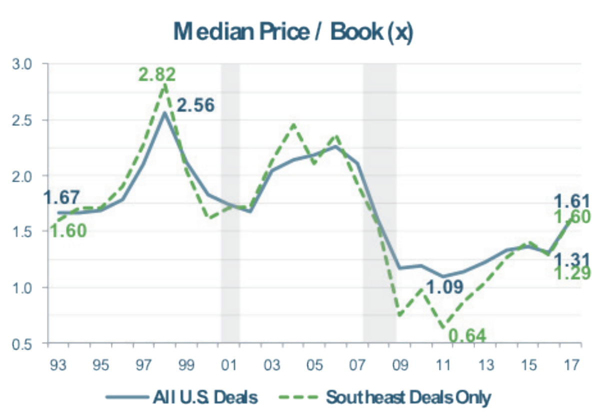


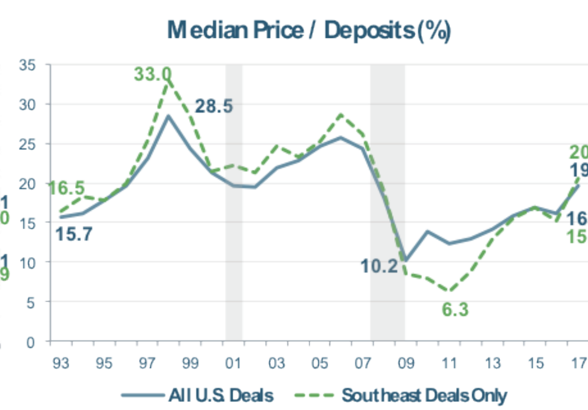


Note: All chart data courtesy of SNL Financial.
Southeast: AL, AR, FL, GA, MS, NC, SC, TN, VA and WV.



Grey bars represent recessions (Mar01-Nov01; and Dec07-Mar09). Percentages were calculated by dividing mergers in a given year by total institutions at Dec. 31 of the prior year. Southeast: AL, AR, FL, GA, MS, NC, SC, TN, VA and WV.





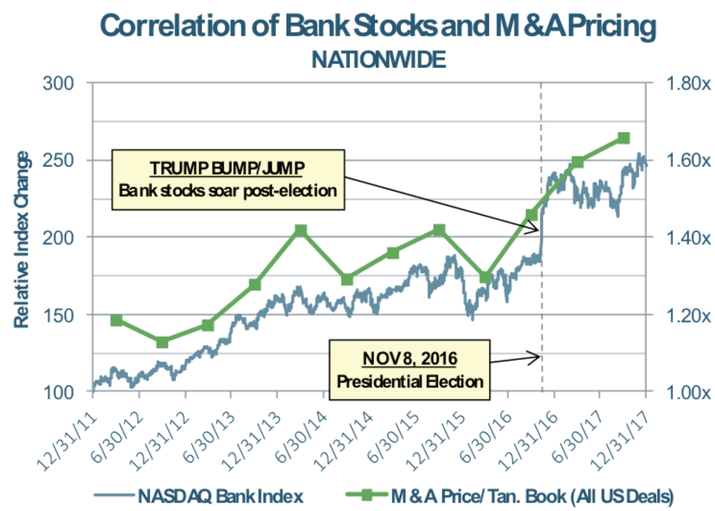
Grey bars represent recessions (Mar01-Nov01; and Dec07-Mar09). Southeast: AL, AR, FL, GA, MS, NC, SC, TN, VA and WV. Note: Price-Earnings multiples not shown due to the abnormally high preponderance of sellers with little or negative earnings in the 2009-11 period.

2001 recessions, the recovery in pricing after the Great Recession was tepid at best. While pricing is not currently like the halcyon days of the late 90s, it clearly has improved (at least for sellers) since the Great Recession.

Will the Trump Bump/Jump Continue to Lift M&A Pricing?

Something to keep an eye on as we move through 2018 is where banks stocks trade. One school of thought in the bank M&A world is that bank M&A pricing "tags along" with bank stock prices: as stocks rise, M&A multiples rise and vice versa.

Beginning on the day immediately following the election (Nov. 9, 2016), bank stocks took off like a rocket ship in what was initially referred to as the "Trump Bump." The explanation behind this phenomenon was that the newly elected candidate was viewed as far-friendlier to the banking industry than his opponent, and market participants reflected this thinking in their trading of bank stocks. The chart to the right shows the almost vertical rise of bank stocks (blue line) from Nov. 9, 2016 into early 2017. After some ups and downs in 2017 bank stocks ended the year even higher on a relative basis than they were at year-end 2016.



If the school of thought regarding the stocks-M&A multiples relationship holds, and if bank stocks are experiencing a sustained "Trump Jump" (and not just a fleeting "Bump"), M&A pricing in 2018 could push even higher.

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