BIG MAC AND MAC CLAUSES

by Steve Brown

McDonald's has made lots of money selling Big Mac hamburgers over the years because buyers know what to expect when they order one. Consistency is everything, which is why bankers have inserted about as many material adverse change or "MAC" clauses into their loan documentation, as McDonald's has sold Big Mac's.

In banking, a MAC clause gives the lender a way to make commitments to borrowers, while still providing an "out" in the event something changes significantly. The MAC clause can be invoked from the time the commitment is made until the transaction actually closes. Usually, a MAC clause is structured so it applies to a material change in the property, tenants, borrower, or key principals.

Following the credit crisis, many banks have been taking a harder look at their MAC clauses to include adverse changes in financial, real estate or capital markets. In these cases, the MAC clause is really there to give the lender the right to renegotiate terms prior to closing. This can include increasing the spread or cancelling the deal entirely, based upon market gyrations. The typical example of a MAC clause is a loan commitment that contains wording similar to "the issuance of this commitment and the closing of the loan are subject to the absence of any material adverse change, as determined by the lender, in the property, borrower, financial marketsÃ¢Â€Â¦".

There are some problems with MAC clauses, however. For instance, very few judges have a standard test to determine exactly when a "material adverse" event has occurred. As such, banks finding themselves in court are often at the whim of the judge. In addition, the success of a bank to back out of a loan commitment rests on the event cited as having a "material adverse effect" on the transaction. Again, this is left up to a judge, which can be dicey. The bottom line: a MAC clause that is very specific runs the risk of having a judge throw out anything not included, while a clause that is too general can be triggered by some unknown event.

The most famous examples of MAC clause invocation occurred in 2001. Back then, Tyson Foods lost when it tried to pull out of a merger with beef packing company IBP. The court ruled that Tyson knew about or had implicitly accepted the risk of financial and regulatory difficulties at IBP that Tyson later cited as MACs. In the next example, September 11, the financial markets closed for 4 consecutive business days due to terrorism. That led many people to invoke MAC clauses on pending transactions and most were honored. The final example was Dynegy's victory over its pending acquisition of Enron. Dynegy invoked the MAC clause, backed out of its deal with imploding Enron and was successful.

In short, MAC clauses are an important tool in everyday bank lending. They allow banks to pull out of (or at least renegotiate) transactions that would otherwise materially damage the company. Used properly, MAC clauses are an invaluable way for community banks to spread the risk of adverse events (between the signing and closing of a loan) to the other party.

As with McDonald's consistency with the Big Mac hamburger, community banks can consistently use the MAC clause to protect their franchise during these difficult and volatile times.

BANK NEWS

Basel Draft

Basel Committee published draft guidance to increase supervision and management of liquidity risks. The 17 proposed principles emphasize broadened stress tests and improving how banks measure off balance sheet risks.

FICO Products

In response to FICO score criticisms, Fair Isaac is creating alternative products specifically for mortgages. FICO scores and data from alternative sources will be used to measure default risk. Mortgage lenders have reduced the weight of FICO scores in underwriting and are focusing now more on other consumer data.

Mobile Banking

A report by IMS research, expects mobile banking to expand to over 880mm users worldwide, conducting 62B mobile transactions by 2012. Today's mobile banking consumers check balances, pay bills and transfer funds.

Robbery

After hitting lows, due to the economy, robberies this year are on the rise. In some towns, the number of robberies has already exceeded their total in 2007. According to the FBI, robbers on average run off with approximately $10k in cash, checks and other property.

Matchmaking

Consumers can now use moneyaisle.com to bid on rates and terms of savings accounts and CDs. Participating banks set rates and terms they are willing to offer.

Online Security

ING Bank is now providing security software to online banking customers. The software encrypts information between the customer's pc and the bank's website, preventing external programs from accessing data. Consumers value this additional security according to a Gartner survey, which found over 75% of people rank extra security as "very" or "extremely" important in deciding to bank online.

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