A Royal Acquisition

by Steve Brown

Why would George Clooney want to buy an English castle? "Sir George" calls his new home a manor, though from our American point of view, the 17th century-built edifice certainly looks like a castle. The regal estate sits right on the Thames River and encompasses 5,000 acres (note that the picture here isn't of his castle). Even better, it is only a short drive way from Highclere Castle, the television home of Downton Abbey. The estate which was recently listed for $16mm drew Clooney to add the title of "English Country Squire" to his already gilded resume. In that it all occurred just 9 days after his marriage to his British-born bride, we wonder if the purchase was a whim, or if we will be seeing George Clooney on PBS soon.

Making a large life-changing acquisition of any variety requires a lot of thought, especially when it comes to banks considering making an acquisition or being acquired. Some community banks are doing some window shopping of late with slow loan growth, increasing regulatory costs and heavy competition for customers. It appears this is the new normal for banking and as a result, some institutions seem more open to a sale.

According to The Wall Street Journal, 204 bank mergers took place in 2013 where the target bank had less than $1B in assets vs. 102 in 2009 (right before the passage of the Dodd-Frank Financial Reform Act) and 130 in 2011.

For banks that are in an acquiring state of mind, there are a few critical steps to take before signing on the dotted line. First, for the best success, clearly understand the primary reason for making an acquisition and identify the right bank to acquire.

For a bank hoping to acquire, normally the CEO drives the process by reaching out internally and externally to board members, industry contacts and banking executives. Consider also taking a high-tech approach to identify "hot spots" where your bank wants to be and establish a strategy to build a desired business footprint.

Identify key steps to take throughout the buying process, including selecting a target that provides reasonable achievable economies of scale, a matching culture and brand goals and strategies. Then, determine whether an investment bank is required for the process or just a fairness opinion. Also be sure to study the regulatory environment, especially the acquirer's relationship and the current condition of the potential target in relation to meeting regulatory hurdles and accounting treatment. Finally, set up internal due diligence teams and identify key bank personnel to evaluate acquisition metrics.

Be sure to develop a thorough understanding of the strategies associated with IT, systems and branch integration. There are many critical accounting decisions (like whether to base valuation on current market value or book carrying cost of the potential acquisition target), so you will need expert help to do this most likely as well. Identify assets and or liabilities that will require divestiture or to deleverage perhaps. Finally, set a target for closure of the deal.

In a dynamic banking sector, money - and titles - are changing hands fast. But bank CEOs would do well not to move too fast in acquiring another bank. After all, time may be a commodity, but it is probably better to take the time to plan your moves, conduct due diligence and get the best deal you can. It sure beats rushing in and making a regrettable deal a few years later.

George Clooney can certainly afford the Stonehenge-sized mortgage that goes along with his new English Manor and his new title, but for community bankers with more normal finances and titles, careful due diligence when doing M&A is a good policy.

BANK NEWS

Shrinking

Fed Dallas President Fisher said he thinks the Fed should allow the balance sheet to shrink gradually and discontinue the policy of reinvesting maturing securities.

Reputation Risk

A survey of global companies by Deloitte indicates that responsibility for reputation risk management resides with the CEO (36%), CRO (21%), board of directors (14%) and CFO (11%). The biggest reputation risks identified in the survey include integrity, fraud, bribery, corruption, cyber risk, product risk and third party vendors.

Cash Usage

A study of consumer transactions by the Fed finds cash is used in 40% of all transactions, followed by debit cards (25%) and credit cards (17%). Meanwhile, the average value of a cash transaction is $21 according to the study.

Risk Research

Part of the Dodd Frank Act created the Office of Financial Research (OFR). This entity was formed to assess the state of the US financial system annually and to analyze threats to financial stability. Its latest report to Congress finds: threats have risen over the past year but remain moderate; excessive risk taking is an increased concern due to low interest rates and low volatility; the market is more fragile, leading to reduced market liquidity; financial activity has migrated away from banks toward less regulated parts of the financial system.

Banker Compensation

Dodd-Frank requires regulators to issue incentive-based compensation regulations or guidelines for banks with more than $1B in assets. Banks above that threshold are required to have compensation structures that balance risk and financial rewards (by deferring payments, adjusting awards for risk, or reducing their sensitivity to short-term performance); are compatible with effective controls and risk management and supported by strong corporate governance. Specific guidance is working its way through the regulatory system and expected to be released in the next coming months.