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Interest rate lull could spark flurry of bank combinations

By Andrew McIntyre
Daily Journal Staff Writer

When Shakespeare's Shylock notes that Antonio "lends out money gratis, and brings down / The rate of usance here with us in Venice," he is concerned that he, too, will have to lend at a lower rate. Today banks face a problem not unlike that of the Bard of Avon's 16th century lender: With such low interest rates, they have little lending and investing flexibility. Low rates pose profitability challenges for smaller and community banks in particular, but many lawyers say they haven't yet seen the uptick in consolidations that might logically stem from such a prolonged period of low rates. That will likely change this year, say bank mergers and acquisitions deal lawyers.

"I expect that bank M&A activity is going to pick up in 2013, particularly in the middle market," said David C. Eisman, a Los Angeles-based partner at Skadden, Arps, Slate, Meagher & Flom LLP & Affiliates. "There is going to be continued consolidation. .. [Some] banks are slowly having to throw in the towel, realizing that they have to combine to survive."

Banks often experiment with ways to get around the challenges posed by low interest rates — larger banks, in particular, have tried various fee structures with varying degrees of success — but lawyers say they expect banks to look increasingly at consolidation.

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— *David M. Grinberg*

"We are already seeing transactions that are in early stages or actually getting to announcement," said James M. Rockett, a partner at Bingham McCutchen LLP in San Francisco. "My belief is that 2013 is going be a more robust M&A environment for banks in California. .. with a likelihood of that continuing well into 2014. My guess is that we'll see transactions announced second and third quarter at an accelerating rate."

While Rockett, Eisman and other bank M&A lawyers aren't yet seeing high levels of transactions, Keith T. Holmes, an attorney who does banking, real estate, corporate finance and corporate securities work at King, Holmes, Paterno & Berliner LLP in Los Angeles, says an extraordinarily busy time is already under way.

"There is more [bank M&A] deal activity than I've ever seen," Holmes said. "I've never been this busy. It's a ferocious level of activity."

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Skadden partner David C. Eisman expects consolidations to jump as lenders realize "they have to combine to survive."

Holmes and his firm worked on dozens of bank deals last year, including the merger of Visalia Community Bank and Central Valley Community Bank, PacTrust Bancorp Inc.' s acquisitions of the Private Bank of California and Beach Business Bank and the sale of National Bank of California's Glendale branch to Manufacturers Bank. In January, he represented Los Angeles National Bank in its merger with Royal Business Bank.

Holmes and other M&A lawyers, including Rockett, agree that smaller and community banks will lead the movement toward consolidation in 2013.

"Management of community banks in particular have become more understanding of the difficulties and challenges that exist to remain small in a niche market," Rockett said. "They are starting to realize that there has to be an adjustment and are seeking other alternatives, which may involve mergers. Many people are saying this is the time."

But it is not just the low interest rate environment that will drive deals in 2013, say lawyers. There's also increased interest from private equity firms.

"I think investment banks believe there will be more M&A in the financial world," said David M. Grinberg, a partner at Manatt, Phelps & Phillips LLP in Los Angeles. "Investment bankers think something is going to happen."

Case in point is the $575 million purchase of New York investment firm Keefe Bruyette & Woods Inc., which focuses primarily on the financial services industry, by Stifel Financial Corp. in November.

"The only reason another investment bank buys KBW is because they think we are on the verge of a lot of activity in the community bank sector," Grinberg said.

And David H. Sands, a Los Angeles partner at Sheppard Mullin Richter & Hampton LLP, said he's already seeing heightened interest from private equity firms.

"PE loves bank assets. They are extremely active in the mortgage space," Sands said. "There is an extraordinary amount of activity in that area. Big banks hold a huge amount of those assets."

But of course, various factors could stall or halt bank M&A deals. In addition to government debt ceiling discussions in the U.S. and the continued question of Europe's economy, heavy banking regulation could slow or cancel some transactions.

"The FDIC is pretty skittish around having any new entrance into the market," Sands said. "Approval is never a certain thing. It's hard to plan a transaction around that."

Holmes, who's kept busy with bank deals, agrees.

"The most challenging thing [about bank deals] is they take too long to get done," he said. "Not many businesses are more regulated than banks."

And just how critical is the regulatory component of bank M&A deals? Just ask Rockett.

"For the first time, the most important due diligence has become regulatory due diligence," he said.

But despite all the regulation challenges, the debt crisis and Europe's economy, lawyers hold that more banks will draft more deals this year.

"It's going to happen," Grinberg said. "Conditions are starting to get better and better for it to happen."