

Revamped failed bank deals a boon for i-bankers

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By Nathan Stovall and Mac Mathews and Joe Mantone

Failed bank transactions are getting more complicated, and that could be a good thing for investment bankers who advise on the deals.

SNL data shows that buyers of failed banks have increasingly sought the advice of investment bankers on FDIC-assisted deals as the transactions have become competitive. The banks' reliance on advisers is only likely to increase now that the FDIC has introduced a new, more flexible and complex loss-share structure in failed bank deals.

"I think this will provide the need for a lot more front-end diligence," said Kenneth Segal, senior vice president and director of asset finance services at Howe Barnes Hoefler & Arnett Inc.

The new loss-share structure raises the prospect that buyers could be on the hook for a greater percentage of losses, making it more important that they do not overbid or end up with a money-draining property.

Early in the cycle, the FDIC's loss-share agreements gave buyers little cause for concern when embarking on deals. The purchase of BankUnited FSB is an often-cited example of such a favorably structured transaction. The John Kanas-led investor group entered into the typical loss-share agreement offered at the time, where the FDIC would initially absorb 80% of losses on pools of covered assets.

Once losses reached a specified threshold, the agency's absorption rate would increase to 95%.

Kanas, now BankUnited's chairman, president and CEO, told SNL in May that he believed losses would reach the point where the FDIC took 95% of the hit, but he did not seem concerned. "We'll get there," he said.

The loss-sharing agreement, which covers \$10.7 billion of the \$12.7 billion of assets purchased, is not the only reason the BankUnited deal is referenced as one of the most favorable of the cycle. The investor group purchased the assets at a discount of \$3.00 billion and did not pay a deposit premium.

In April, the FDIC changed the structure of its loss-share agreements, eliminating the 95% loss absorption portion, and now the FDIC has made more changes. The agency hopes that by offering buyers the ability to finely tailor their bids for failed banks with more than \$100 million in assets, it will minimize losses incurred by the deposit insurance fund.

The new loss-share structure has three tranches. The buyer sets the loss-absorption rates in its bid in the first and third tranches, but when the losses reach the second tranche, the purchaser has to take on a much larger percentage of losses.

The potential for buyers to absorb greater proportions of losses could make the deals look less appealing and increase buyers' motivation to bid correctly. The change also adds complexity to the

Financial advisers for FDIC-assisted transactions in 2010

Financial adviser	Number of deals*	Deposits transferred (\$M)*
Keefe Bruyette & Woods Inc.	17	7,165.3
DD&F Consulting Group	12	2,308.8
Sandler O'Neill & Partners LP	8	6,493.1
Bank of America Merrill Lynch	5	5,915.3
UBS Investment Bank	3	1,024.4
D.A. Davidson & Co.	2	274.4
Hovde Financial LLC	2	896.4
Austin Associates LLC	2	215.4
FIG Partners LLC	2	853.4
Credit Suisse (USA) Inc.	1	2,248.6
RBC Capital Markets Corp.	1	2,248.6
McColl Partners LLC	1	722.4
Morgan Stanley	1	2,380.2
J.P. Morgan Securities LLC	1	2,200.0
Banks Street Partners LLC	1	499.0
Uncredited/no adviser	57	21,714.2
Total FDIC-assisted[^]	110	51,276.9

Includes FDIC-assisted transactions between Jan. 1, 2010, and Sept. 10, 2010.

Adviser information collected on a best-efforts basis. Information received after Sept. 20, 2010, is not included.

* Deals involving multiple advisers are counted under each participating adviser. See the attached template for a complete list of deals with all known advisers.

[^] Each deal counted only once, regardless of the number of advisers.

Source: SNL Financial

Financial advisers for FDIC-assisted transactions in 2009

Financial adviser	Number of deals*	Deposits transferred (\$M)*
Keefe Bruyette & Woods Inc.	5	2,825.3
DD&F Consulting Group	4	700.7
Hovde Financial LLC	4	822.1
Howe Barnes Hoefler & Arnett	3	987.3
Sandler O'Neill & Partners LP	3	7,446.8
Credit Suisse (USA) Inc.	2	27,405.0
Goldman Sachs & Co.	2	2,217.4
Deutsche Bank Securities Inc.	2	25,736.1
Bank of America Merrill Lynch	1	2,080.0
Stifel Nicolaus & Co.	1	349.4
FIG Partners LLC	1	177.0
Barclays Capital Inc.	1	2,498.4
J.P. Morgan Securities LLC	1	11,500.0
FBR Capital Markets & Co.	1	2,013.9
Macquarie USA LLC	1	296.0
Janney Montgomery Scott LLC	1	712.1
Sheshunoff & Co.	1	471.0
Banc of America Securities LLC	1	8,252.0
Merrill Lynch & Co.	1	6,400.0
Uncredited/no adviser	81	41,950.3
Total FDIC-assisted[^]	116	125,635.7

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Source: SNL Financial

transactions and makes an already strenuous and incredibly quick bidding process even more onerous for buyers and their advisers.

Segal of Howe Barnes Hoefer & Arnett said that in the past, buyers received so much loss-share protection that they did not have to come up with precise estimates when predicting loan deterioration. He said many buyers chose to wait until after they completed the transaction to have loan valuation experts examine the potential losses, but he expects that to change.

Under the new loss-share structure, misjudging the amount of losses could have a material difference on the buyer's books. The increased difficulty of pre-bid analysis makes the advisory services that i-banks provide even more important.

"The new loss-sharing arrangement only further increases the importance of estimating losses when determining bid levels," Sandler O'Neill & Partners LP Principal Joe Stangl told SNL.

The general trend in SNL data, which is collected on a best-efforts basis, therefore some deals for which SNL lists no adviser information may have had advisers that were not disclosed, indicates that banks are now more regularly hiring i-banks on failed bank deals. While deal advisers would certainly welcome a continuation of that trend, they say the new loss-share structure makes it difficult to determine bids.

DD&F Consulting Group President Randy Dennis, who worked on the first announced transaction with the new loss-sharing structure, said it was much easier to put a bid together earlier in the cycle.

"In the beginning, you could have just done them blind because you're going to have 80/20 and 95/5 and the negative bids we were getting were 2x and 3x the maximum loss, but you don't see that anymore," Dennis said.

Placing a bid is only part of the process for deal advisers. Dennis said it takes about 60 days to prepare an institution to buy a failed bank. During that span, he explains to the buyer and their attorneys the bidding process, including how to get on the FDIC's bidding list and place a competitive bid, and the steps the buyer needs to take to prepare its marketing and lending teams.

The process can overwhelm some. "They're excited at first until they realize how much extra it is going to be," Dennis said.

Buyers that win the auction for a failed bank then must integrate an institution that has been shell-shocked. A distinct feature of this cycle is that struggling banks often do not know exactly when the

FDIC will close their doors, he said. It was different for many failed institutions during the last cycle because, through the Resolution Trust Corp., they were placed into conservatorship, and everyone knew they were "in hospice," he said.

Dennis occasionally suggests bringing in grief counselors to speak with employees of the failed bank because its closure often leaves them distraught. As they come to grips with the reality of the situation, Dennis said employees often ask questions such as "What about my health insurance? My son is on dialysis." [and] "What about my vacation? I'm leaving in two weeks." The lives of workers at the failed banks have been disrupted, but those people can provide a great deal of value to buyers.

"That week afterward, you can get so much value out of those employees by coming in by their side and taking their hand and telling [them] 'We've got to do this together,'" Dennis said.

Having as many qualified employees as possible to comply with the terms of loss-share agreements is certainly in every buyer's interest. Banks need to buy and install systems that help them document and track the loan pools, according to Michael Glotz, partner at Strategic Risk Associates. "It's a very complex, costly process," he said.

A lack of proper documentation could result in a bank not receiving reimbursement from the FDIC for the losses on assets that are supposed to be covered in the loss-share agreement.

"The regulators look at you with a microscope to make sure you are complying with all the reporting requirements," George Iglar, an attorney at the firm Iglar & Dougherty, told SNL.

The reporting system is so complex that Iglar believes it could give rise to a boutique advisory industry that has the sole purpose of assisting banks with loss-share agreements. The added complexity that comes with the FDIC's newest structure will further enhance the need for this type of advising service, he said.

"It's good in theory," Iglar said of the new loss-share structure. "But it's going to be fairly complex to track."

Still, Iglar was not faulting the FDIC and understands the agency is making efforts to keep its costs down. He also believes the FDIC was left a little red-faced from the deals that were extremely beneficial to buyers, such as the BankUnited transaction.

"When [the BankUnited buyers] came out and said what a great accretive deal they got for their investors, it kind of embarrassed the FDIC," Iglar said. *i*