The Critical Issues Facing the Leadership of Today's Community Banks

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Who We Are

Luse Gorman, PC is a Washington, D.C. based law firm that specializes in representing community banks and other financial institutions.

We are a national leader in representing community banks in mergers and acquisitions, capital raising transactions, corporate governance, executive compensation, regulatory and enforcement and general corporate and securities law.

We represent over 250 financial institutions nationwide. Most are community banks ranging from $100 million to $20 billion in assets.

Who We Are

- Top 10 law firm in M&A every year since 2001
  - No. 1 in 2009, 2011, 2012 and 2015
- No. 1 nationally in community bank capital raising transactions since 2000
- Largest practice group nationally dedicated exclusively to representing financial institutions
  - 25 Attorneys, including 5 attorneys specializing in executive compensation/employee benefits
  - Represent 250+ financial institutions; 100+ mutual institutions; 90+ SEC reporting companies

Industry Update

Industry Update

- 6,058 FDIC insured banks - down more than 30% in 10 years
- Average bank size has doubled in past 10 years
- Approximately 511 mutual banks in US (traditional and private MHCs)
- Consolidation expected to continue and reduce overall numbers and lead to increasing average bank size
- Small bank replacement wave not expected:
  - De novo activity non-existent (only 2 post-Dodd Frank)
  - CU conversions non-existent (only 2 post-Dodd Frank, none on the horizon)

Industry Update

Dodd-Frank Effect on All Community Banks

- Higher capital requirements (were effectively in place since 2009 due to harsher examinations and regulatory expectations)
- Additional consumer disclosure and compliance procedures
- Increased pressure on banks to grow (improve scale)
- Increased pressure on smaller banks to consolidate (lack of scale)
- Bar raised on regulatory applications (more scrutiny, longer processing, more regulatory coordination and second guessing)
- Growth opportunities only available to those with "excess" capital
- **Overall effect – more costly to operate, more capital needed, more emphasis on scale**

Industry Update

Current Market Trends:

- Increased overall merger activity
- Increase in mutual-to-mutual mergers
- Mutual acquisitions of stock banks
- Additional Capital Raising

Industry Update

The Financial Choice Act:

- Designed as alternative to Dodd-Frank Act
- Provides relief for banks with 10% leverage ratio and 1 or 2 CAMELS rating
- Repeals Durbin Amendment
- Revises CFPB
- Passed House Financial Services Committee (30-26)

Industry Update

Wells Fargo:

- Employees secretly opened unauthorized deposit and credit card accounts
- Motivated by cross-selling targets and compensation Incentives
- Fined $185 million
- Emboldens CFPB

Mergers and Acquisitions

M&A Activity in Pennsylvania

Target/Buyer	Announce Date	Status	Completion Date	Announced Deal Value ($M)	Target Total Assets ($000)
Allegheny Valley Bancorp, Inc./Standard Financial Corp.	8/29/2016	Pending	-	53.40	434,000
Bank@lantec/Dollar Bank	6/28/2016	Pending	-	-	111,581
Polonia Bancorp, Inc./Prudential Bancorp, Inc.	6/2/2016	Pending	-	37.98	291,611
East River Bank/DNB Financial Corporation	4/4/2016	Pending	-	48.99	310,742
United-American Savings Bank/Emclaire Financial Corp.	12/30/2015	Completed	4/30/2016	14.08	90,717
Fox Chase Bancorp, Inc./Univest Corporation of Pennsylvania	12/8/2015	Completed	7/1/2016	244.34	1,098,797
Penn Liberty Financial Corp./WSFS Financial Corporation	11/23/2015	Completed	8/12/2016	101.64	649,408
Stonebridge Bank/Investor group	11/9/2015	Pending	-	0.57	121,770
Cresson Community Bank/C&G Savings Bank	11/4/2015	Completed	2/29/2016	-	58,986
Conestoga Bank/Beneficial Bancorp, Inc.	10/22/2015	Completed	4/14/2016	100.08	719,013

Source: SNL Financial

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General Reasons For Increased M&A Activity

- Buyers have unprecedentedly high (and growing) capital levels, due to higher earnings and stable credit market
- Increased cost of technology and compliance, need for efficiencies
- Pressure on NIM in current rate environment
- Need to find new sources of earnings and growth
- Stabilization of credit outlook, slight uptick in credit quality overall
- Target fatigue (for both boards and management teams)
- Merger more attractive than dilutive capital raise
- Older management teams - no desire to reinvent and move forward
- Stable market - buyers do not want to buy and sellers do not want to sell in volatile markets

Reasons for Mutual Merger Activity

- Same as general reasons but greater emphasis on:
  - ➢ Management succession issues
  - ➢ Inability to grow
  - ➢ Cost of operation and compliance

- **Newer phenomena – mergers of healthy mutuals with no asset quality or regulatory issues, recent transactions are not "white knight" deals but strategic decisions to get bigger and more efficient and more relevant**

General Issues in M&A Transactions

- "Social Issues" – compatibility of management and boards
- Different corporate cultures of combining banks
- Asset quality – due diligence more important today than ever
- Adverse regulatory issues facing either of the combining banks
- Integration of two banks and their customer markets
- Vendor agreement termination fees
- Severance payments (IRC Sections 280G and 409A)
- Target bank fiduciary rules

Principal Social Issues

- Board and committee composition:
  - ➢ Representation of boards based on equity, assets, income contribution?
- CEO/key officer succession:
  - ➢ Who will be the CEO, CFO?
  - ➢ Affected by retirement and succession plans?
- Name of resulting bank (or “division of”)
- Headquarters
- Branch closures or employee reassignments

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Typical Compensation and Benefit Issues

- Employment contracts for both banks
- Change-in-control/severance payouts
- Retirement plan enhancements (SERPs)
- Post-merger consulting contracts
- Merger transaction bonuses; stay bonuses
- Advisory/emeritus boards/board retirement plans
- Be aware of target change-in-control definitions

Increased Regulatory Scrutiny

- Regulatory risk now much greater obstacle for M&A (even larger branch deals are more difficult)
- Anticipate post-closing concentration scrutiny by regulators (commercial and CRE to capital ratios)
- Regulatory issues with respect to buyer or seller can impact or stop approvals
- "3" in any CAMELS can stop a deal, "Management" component particularly important but "3" in IT or Compliance are problematic
- Status of material MRAs will affect approvals and timing
- More community activist protests, can cause delays of 2-4 months
- Focus on integration risks and capabilities – 1st timers more at risk
- Need to demonstrate plan to replace and build capital
- Need to demonstrate due diligence process and procedures

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