

The Failing Bank Marketing Process: Whole Bank Acquisitions and Loss Share Transactions

ABA Telephone Briefing

Participant's Guide

**Wednesday,
September 2, 2009**

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(Eastern Time)**

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(Central Time)**

**12:00 p.m. – 1:00 p.m.
(Mountain Time)**

**11:00 a.m. – 12:00 p.m.
(Pacific Time)**



American Bankers Association
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PLEASE READ ALL ENCLOSED MATERIAL PRIOR TO BRIEFING.



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Speaker Biographies

Mark Tenhundfeld (*Moderator*)

Mark joined the ABA in February of 2006 as Senior Vice President, Office of Regulatory Policy. He came to the ABA from Promontory Interfinancial Network, where he served as general counsel. Prior to Promontory, Mark worked in the legal divisions of the Federal Reserve Board, Comptroller of the Currency, and the Federal Housing Finance Board, where he served as general counsel. He also has represented financial institutions in transactional and compliance matters as a partner in the law firm of Miller, Hamilton, Snider and Odom, LLC. Mark received his law degree from Vanderbilt University and his undergraduate degree from Yale University.

Kathleen Armentrout

Kathleen Armentrout began her career in banking in 1986, and joined the RTC/FDIC in 1991. Ms. Armentrout is currently a Manager in Institution and Assets Sales for DRR, the department responsible for structuring transactions and marketing potentially failing financial institutions.

Throughout her career in resolutions, Kathleen Armentrout has worked with regulators and staff at failing banks to gather information to market potentially failing banks. Ms. Armentrout has also worked as a marketing specialist, reaching out to sound financial institutions to guide them through the process of bidding and assuming the liabilities and assets of failed financial institutions. Ms. Armentrout is a certified Project Management Professional (PMP) and holds a Bachelors of Business Administration from the University of Texas at Austin.

Pamela Farwig

Ms. Farwig joined the Federal Deposit Insurance Corporation (FDIC) Division of Supervision and Consumer Protection in 1988 as a bank examiner in the Kansas City Region. She was subsequently promoted to Case Manager in the New York Regional Office in 1996. In 1999, Ms. Farwig was promoted to Assistant Regional Director for the Kansas City Region.

In 2006, Ms. Farwig was appointed Associate Director for the Franchise and Asset Marketing Branch for the Division of Resolutions and Receiverships, Dallas, Texas. The Associate Director is responsible for overseeing the resolution of failing banks and the management and marketing of failed bank and thrift assets nationwide. She is a graduate of the Graduate School of Banking, Madison, Wisconsin, and holds business administration degrees in accounting and management from Rockhurst University, Kansas City, Missouri. Ms. Farwig obtained the Certified Regulatory Compliance Manager designation in 2006.

Gary R. Miller

Gary is a Franchise Marketing Specialist in the Division of Resolutions and Receiverships. As a 2009 FDIC returnee, he brings eight years of prior resolutions experience to the Franchise Marketing department. In his current Franchise Marketing role, Gary is a subject matter expert in financial and accounting analysis and has developed demonstration tools that are utilized by the Franchise Marketing team to explain the bidding process and transaction economics to prospective bidders. Prior to rejoining the FDIC, Gary held various senior business development and consulting roles in equities trading and technology companies.

Gary is a University of Oklahoma graduate with a Bachelors of business administration degree in accounting. He currently holds designations as a Certified Public Accountant and a Certified Financial Planner.



Federal Deposit Insurance Corporation

The Failing Bank Marketing Process – Whole Bank with Loss Share Transaction

Presented By:

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FDIC - Division of Resolutions and Receiverships

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AGENDA

- Franchise Marketing Overview
- Marketing Transactions
- Whole Bank with Loss Share
- Questions

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DRR Regional Manager Contact Info

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Connecticut
New York
New Jersey
Pennsylvania
Delaware
Maryland
Puerto Rico
Virgin Islands

Washington
Oregon
Montana
Idaho
Wyoming
Utah
Nevada
California
Arizona
Alaska
Hawaii
Guam

Institution Marketing

- Primary Federal Regulator (PFR) initiates marketing process
- FDIC Division of Resolutions & Receiverships (DRR) prepares to market bank
 - Marketing Plan
 - Transactions Offered
 - Timeline
 - Bid List
 - Information gathering at the bank

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The Bid List



- List of banks invited to evaluate acquisition of potentially failing bank
 - Criteria used to develop bid list considers potential bidder's supervisory ratings, capital position, and geographic location / bidder preferences.
 - Must be a chartered financial institution or have a shelf charter approved.
- An invitation to bid is not an approval to bid. All potential bidders must obtain final approval to bid from:
 - PFR
 - FDIC Division of Supervision & Consumer Protection
 - FRB (if holding company involved in acquisition)

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Bid List Criteria

- ❑ Supervisory Criteria
 - Total Risk Based Capital ratio of 10% or higher
 - Tier 1 Risk Based Capital ratio of 6% or higher
 - Tier 1 Leverage Capital ratio of 4% or higher
 - CAMELS composite rating of 1 or 2
 - CAMELS Management component rating 1 or 2
 - Compliance rating of 1 or 2
 - RFI/C rating of 1 or 2
 - CRA rating of Satisfactory or Outstanding
 - Satisfactory Anti-Money Laundering Record
- ❑ Total Asset Size & Geographic Criteria
 - Total asset size threshold established for invitation is roughly double core deposits of failing bank when bidder is in geographic proximity to failing bank
 - Larger total asset size requirements when bidder is located in other states
 - Bidders may express preferences for invitation by state

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Example

- ❑ Failing bank located in "X" State with \$100 million in total assets, \$20 million in brokered deposits
- ❑ Bid List Criteria Used:
 - Insured financial institutions in "X" State with at least \$160 million in total assets (*roughly double core deposits of failing bank*)
 - Insured financial institutions in contiguous states with at least \$300 million in total assets (*roughly double criteria used above for bidders located farther away from failing bank*)
 - Insured institutions nationwide with at least \$400 million in total assets that have expressed an interest in acquiring institutions in "X" state.
- ❑ Criteria used will vary from project to project based on characteristics of potentially failing bank, time available for marketing, and other factors.

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Bidder Contacts

- Banks can use *FDICconnect* to provide M&A contact information for invitations to bid.
 - *FDICconnect* can be accessed through www.fdic.gov or at <https://www2.fdicconnect.gov/>.
- Banks may complete a survey to record their areas of geographic interest.
- Submitting geographic preferences does not imply that an institution will be notified of all potential failing institutions in that state.
- Banks may also send an email to provide contact information institutionsales@fdic.gov

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Marketing via IntraLinks

- Marketing process starts with email to prospective bidder inviting them to IntraLinks for a specific resolution project
- After executing electronic Confidentiality Agreement, bidders may read an Executive Summary & Transaction Recap
- If interested, may request access to Project's data room for information about failing bank & transaction terms
 - Deposit & Loan Downloads (Customer identifiable information redacted)
 - Premises
 - IT
 - Legal documents (bid forms, instructions, P&A documents, etc.)
 - Regulatory contact information
 - Key dates, bid instructions

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On-site Due Diligence

- Opportunities not always available, depends upon resolution timeline.
- Due diligence scheduled “first come, first serve”.
 - Time allowed averages one to two days
 - Team sizes average three to five
 - Affords the review of more detailed information
- Structured program with FDIC hosting bidder access.

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Bids

- FDIC establishes deadline for bid package
- Bid packages include:
 - Bid (on bid form provided)
 - Purchaser Eligibility Certificate
 - Board Resolution
 - Reaffirmation of Confidentiality Agreement
- FDIC selects winning bid using “Least Cost Test” (proprietary)
- Copies of winning bid and redacted copies of unsuccessful bids available via Freedom of Information Act (FOIA) Request after institution is closed by PFR

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Marketing: Transaction Structures

- Purchase and Assumption (P&A)
 - Whole Bank
 - Whole Bank with Loss Share
 - P&A with Optional Loan Pools
 - Clean P&A
- Other Resolution Methods
 - Bridge Bank
 - Deposit Payout
 - Deposit Insured National Bank (DINB)
 - Straight Payout

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P&A Transactions

- "Whole Bank" is a misnomer
- Transfers assets (including loans, ORE, private label MBS) to Assuming Bank unless items are specifically excluded
- Transfers related, bank-owned, businesses (Credit Cards, Safe Deposit Box, Trust, Acquired Subsidiaries, etc.)
- Franchise acquisitions can be for All Deposits or Insured Deposits Only
- FDIC offers 80% credit loss coverage in transactions with Loss Sharing

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Assets Typically Excluded from P&A

- Bank Premises (offered under Separate 90-Day Options)
 - D&O Liability Claims
 - Prepaid Regulatory Assessments
 - Tax Receivables
 - Loss Reserves (General and Specific)
 - Private Label Asset Backed Securities
 - Assets that may be involved in fraud
-
- If it's not specifically excluded in P&A, the asset passes to the Assuming Institution
 - Example-intellectual property – domain names, etc.

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What is Loss Share (LS)?

- Receiver & Assuming Bank share in losses & recoveries on LS assets (80/20)
- Applies to loans, ORE & (infrequently) certain securities
- Single Family LS – 10 year term
- Commercial LS – 5 year term + 3 years for recoveries
- Cannot (currently) obtain loss share without a deposit franchise

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What is Loss Share? – Cont.

- A “Stated Threshold” is developed for the covered assets; below which 80/20 (above which 95/5) sharing occurs
- Permits Assuming Bank to formulate bid to recover all or portions of at least the following (subject to competitive conditions):
 - 20% and 5% credit losses
 - Future income statement vulnerabilities from acquisition of impaired ORE/Loan/MBS “books”
 - Asset management expenses not otherwise reimbursable under the Loss Share
 - Other

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Why Loss Share

- FDIC Perspective – Least Cost Objective
 - Current market asset price dislocation
 - Better asset pricing (intrinsic value)
 - Limited asset mgt/mktg infrastructure
 - Better long term returns by managing assets in the local, private sector
 - Limited number of bidders
 - Security/Economics encourage more bidders
 - Potentially more favorable economic bids

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Why Loss Share

□ Bidder Perspective

- Confidence to bid for assets
 - Limited (or no) due diligence
 - Lower risk to own impaired assets
 - Favorable economics
 - Capital treatment LS assets (pending)
 - Purchase accounting gains may increase capital
 - Asset liability matching

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Whole Bank with Loss Share Bids

□ Bids for a Whole Bank with Loss Share Transaction are submitted in two components

- Deposit premium bid (stated as a % of adjusted, assumed deposits – i.e. All deposits, less brokered, CDARS and listing service deposits)
- Asset premium/(discount) bid (stated in \$'s)

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Whole Bank with Loss Share Bids

- At Closing, FDIC Pro Forma –
 - Prepares B/S for assuming bank (AB) listing BV's (FMV's & Fair Values for selected investments) of acquired assets and assumed liabilities
 - Net of same is "transactional equity (TE)"
 - Then nets TE with asset discount bid and deposit premium bid
 - If result is positive, AB will absorb 100% of credit losses until this sum is reached – thereafter loss sharing begins ("First Loss Tranche")
 - If result is negative, FDIC pays AB amount and loss sharing begins on the first day following bank closing

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Whole Bank w/Loss Share Bid Construction

Whole Bank with Loss Share Example Bid Construction

Sample Bank Transaction Financials:

Assets Purchased	400,000,000
Deposits Assumed	(385,000,000)
Other Liabilities Assumed	(15,000,000)
Net Worth Position ("Equity Adjustment")	20,000,000

(Securities are valued at market value)

Book Value		Financial Assumptions:	
400,000,000		Loans and ORE	350,000,000
(385,000,000)		Stated Threshold	100,000,000
(15,000,000)		Bidder's Projected Losses	110,000,000
20,000,000			

Franchise Value Factors

Franchise Value Factors	Comments	Assigned Value
Branch Location & Number		
Buy versus Build		
Net Interest Expense		
Deposit Structure & Types		
Business/Strategic Plan Fit		
Competitive Edge In Marketplace		
Total Franchise Value		7,300,000

Deposit Premium Bid (Franchise Value + Deposits Assumed)

7,300,000		Bid	
		Deposit Premium	2.00%
		Asset Premium or Discount	\$(22,875,000)
7,300,000			
2.00%			

Asset Adjustments & Transaction

Income/Expense Elements	Comments	Adjustment Value
Credit - Principal Losses @ 20%	(Threshold x 20%)	(20,000,000)
Credit - Principal Losses @ 5%	(Bidder estimates losses beyond the threshold at 5% risk)	(500,000)
Credit - Earnings Losses		(250,000)
Operating Expense		(400,000)
Reporting Expense		(75,000)
Net Interest Expense		(150,000)
Other		(1,500,000)
Total Adjustments		(22,875,000)

Asset Premium / (Discount) Bid

(22,875,000)

Whole Bank with Loss Share First Loss Tranche Calculation

Whole Bank with Loss Share
Example First Loss Tranche Calculation

(Securities are valued at market value)

<p>Sample Bank Transaction Financials:</p> <table border="0" style="width: 100%;"> <tr><td>Assets Purchased</td><td style="text-align: right;">400,000,000</td></tr> <tr><td>Deposits Assumed</td><td style="text-align: right;">(365,000,000)</td></tr> <tr><td>Other Liabilities Assumed</td><td style="text-align: right;">(15,000,000)</td></tr> <tr><td>Net Worth Position ("Equity Adjustment")</td><td style="text-align: right;">20,000,000</td></tr> </table>	Assets Purchased	400,000,000	Deposits Assumed	(365,000,000)	Other Liabilities Assumed	(15,000,000)	Net Worth Position ("Equity Adjustment")	20,000,000	<table border="0" style="width: 100%;"> <tr> <td style="width: 30%;">Book Value</td> <td style="width: 40%;">Financial Assumptions:</td> <td style="width: 30%;"></td> </tr> <tr> <td></td> <td>Loans and ORE</td> <td style="text-align: right;">350,000,000</td> </tr> <tr> <td></td> <td>Stated Threshold</td> <td style="text-align: right;">100,000,000</td> </tr> <tr> <td></td> <td>Bidder's Projected Losses</td> <td style="text-align: right;">110,000,000</td> </tr> </table>	Book Value	Financial Assumptions:			Loans and ORE	350,000,000		Stated Threshold	100,000,000		Bidder's Projected Losses	110,000,000							
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Loss Share Evolving Issues

- Regulators
 - Treatment/Consideration of capital created by purchase accounting (negative goodwill)
 - Risk-based capital treatment of loss share assets
- Assuming Banks
 - Valuing loss share assets for purchase accounting
 - Managing the loss share accounting and reporting to the FDIC



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