

UPDATE

News of Developments in the Financial Sector and Related Areas

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Consolidation in Banking

The banking industry continues to consolidate throughout the United States, but at a slower pace than in the past two decades and in particular since 2007. Consolidation occurs from a number of factors with banks experiencing loan and securities portfolio problems resulting in inadequate capital on one hand and the pricing of banks in acquisition transactions on the other hand. In some cases, the regulatory compliance cost for small community banks has caused them to seek merger partners.

The Federal Deposit Insurance Corporation ("FDIC") reports that the number of insured institutions has declined over 58% since 1992. As of July 27, 2017, there were 5,788 of FDIC insured institutions.

During the first half of 2017, there were 122 whole bank transactions announced. Based on this pace, 2017 will exceed the 243 whole bank transactions announced in 2016. The average price to tangible book was 1.59% with a price/earnings ratio of 22.4 for transactions with disclosed terms

during the first half of 2017. During the first half of 2017, there were 6 bank failures.

Recent surveys indicate that the minimum asset level a community bank must achieve to remain independent is at least \$1 billion or more. Because of regulatory reform and compliance costs, many community banks may be active in seeking a merger partner. Surveys reflect regulatory compliance continues to be an impediment for growth within community banks.

As in the past, probably one of the biggest issues facing banks during the coming year will be the ability to raise capital, not only for acquisitions, but for credit quality issues relating to loan portfolios and securities portfolios.

Capital Through Private Placement of Securities

In the early 1900s, companies often sold securities on the basis of a promise of fantastic profits without disclosing any meaningful information to investors. These conditions contributed to the Stock Market Crash of 1929. As a result of the Stock Market Crash, the United States Congress enacted federal securities laws and created the Securities and Exchange Commission ("SEC") to administer them. Under federal law, the sale of securities is governed by the Securities Act of 1933 and other applicable federal laws. Every state also has its own securities laws, which are commonly known as "Blue Sky Laws" because their purpose is

to prevent speculative schemes which have no more basis than so many feet of blue sky. Both federal law and state Blue Sky Laws require a company, as the issuer of securities, to make full disclosure of all material facts before offering securities for sale. Securities laws are designed to require companies to give investors full disclosure of all material facts in order for them to make an investment decision.

Because of the higher interest rate spreads on debt and noncumulative perpetual preferred securities with institutional purchasers, a bank holding company may want to consider the private placement of its equity, debt or hybrid (trust preferred and noncumulative perpetual preferred) securities with local investors such as board members, existing shareholders and major customers. Funds derived from the private placement of securities may be utilized for acquisitions, internal growth and increasing tier 1 capital.

Allowing the company to select investors with compatible goals and interests is one of the advantages of a private placement. Another advantage is they are less expensive and time consuming since a private placement does not require the assistance of an underwriter.

Although other exemptions from the requirements to register securities may be available, Sections 3(b) and 4(2) of the Securities Act of 1933 may be utilized in making a private placement with local investors. Section 4(2) of the Securities Act of 1933 exempts from registration "transactions by an issuer not involving a public offering." To qualify for this exemption, purchasers must:

- have enough knowledge and experience in finance and business matters to evaluate the risks and merits of the investment or be able to bear the investment's economic risk;

- have access to the type of information normally provided in a prospectus, i.e., an offering memorandum; and
- agree not to resell or distribute these securities to the public.

Section 4(2), often referred to as the private offering exemption, is one of the most frequently relied upon exemption in making private placements under the provisions of both state and federal law. This exemption has developed to include not only Section 4(2) transactions, but also transactions described in Section 3(b) [i.e., securities issued pursuant to regulations of the SEC in an aggregate amount not to exceed \$5 million]. Sections 3(b) and 4(2) are the basis for SEC Regulation D, which is designed to permit the sale of securities to sophisticated investors, which are also known as accredited investors under Regulation D.

The enactment of Regulation D sets forth the requirements for a substantial portion of private offerings. A bank holding company as issuer still may claim an exemption under Section 4(2) even though the technical provisions of Regulation D are not fully met. Although an issuer may fully comply with the requirements of federal law relating to a private placement, it must also comply with any applicable state law relating to the offer and sale of its securities.

In connection with the sale of securities through a private placement, an offering memorandum should be prepared for purposes of disclosing to potential investors information on the company including background information on management, terms of the offering (including the number of shares available, the price and the intended use of the funds), capital structure of the company before and after the sale of the securities, the risks involved in the investment and financial statements of the company.

Our firm is available to answer questions on

the benefits of issuing securities in a private placement with potential investors.