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Why are community banks selling? Five Common Themes

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Community bank consolidation, especially in the Upper Midwest, has been brisk through the first part of 2019, and it shows no signs of slowing down. In working with boards and management, we are repeatedly seeing five primary drivers for bank sales.

Lack of shareholder liquidity

For many banks, the age of their average shareholder is approaching or exceeds 70. As shareholders engage in estate planning, many seek to sell shares. Other shareholders pass away, leaving their estate to liquidate shares. If the bank can't provide a source of liquidity, the estate will often "dump" the shares, sometimes at a steep discount. Finally, shareholders are gifting or bequeathing shares to children and grandchildren spread all over the country who have no commitment to the community or desire to hold shares in the local bank.

Another twist on the aging shareholder base is related to the many de novo banks whose shareholders initially invested during the late 1990s and early 2000s with the promise of a 10- to 15-year time horizon. They are now eager for a liquidity event.

There are many tools institutions can use to provide shareholders with increased liquidity, including:

- **Matching Programs** where clients keep "interested purchaser" and "interested sellers" lists, in order to help match prospective buyers and sellers.
- **Repurchase Programs** in the form of buyback programs and tender offers.
- **Listing** securities over-the-counter (or OTC), on the bank-specific OTCQX, or going public and listing your shares on NASDAQ or NYSE.

Each of these options has a number of important legal and regulatory implications, but community bank executives and boards should be aware of the increasing challenge shareholder liquidity is presenting to their peers and how to manage it proactively.

Technology

The costs of technology continue to rise. Regardless of its size, a community bank needs to find ways to fund various evolving delivery channels (e.g. online banking, mobile banking, P2P, bill payment, remote deposit capture, etc.). The competition for financial services is not going to slow down.

In addition to competing on the "front end," you have to invest increasingly onerous sums to defend against the many cyber threats that exist. From such things as Positive Pay and similar offerings to various hardware and software, banks need to keep up. A six-figure loss is hard to bounce back from.

Lack of succession planning

The management teams and directors of many community banks, like the shareholders they work for, are approaching (or beyond) traditional retirement age and many banks have little or no "bench strength." Attracting talented people to run many community banks is no small task. Likewise, finding skilled people willing to commit the time to be an effective bank director is surprisingly difficult. The challenges are magnified because many clients: (a) wait too long, (b) are unsure where to start, or (c) do not seek help in identifying needs and adopting a strategic approach.

Lack of scale

Many of our clients have reached the point at which they cannot grow without more capital, deposits, loans or some combination thereof. If you are geographically, strategically, or financially out of options, then what? And, with the costs of technology, compliance and fraud posing a disproportional threat to a smaller balance sheet, it can be difficult to formulate a meaningful strategic plan that doesn't involve exploring a sale.

Current Market

The multiples for banks have been high for some time. We recently attended presentations from investment bankers suggesting the market may have peaked. As lawyers, it's not our strength to speculate or time the markets. However, we have recently heard two recurring sentiments – Do we want to be doing this in five years, much less ten? And, if not, do we want to risk selling our bank under one of the potential Democratic administrations?

Conclusion

To be clear, we are huge proponents of community banking and we work with a lot of dynamic management teams and boards that are proactively tackling these challenges with creative solutions. We do not believe banks have to "get big or sell." Quite the contrary. There are a number of advantages in being smaller and nimble in this environment. However, to survive and thrive, we do believe that banks need to be considering these issues and developing realistic strategies to deal with them. Those that don't may find they have dwindling options in the years ahead.

About the Authors

Melissa Lanska is an attorney in Reinhart's Banking and Finance Practice. Recognized by the Wisconsin Law Journal as an Up and Coming Lawyer, Melissa brings fresh perspective, drive and industry savvy to the counsel she offers banks across the Midwest. Skilled in M&A, capital formation, and a wide range of complex transactions, Melissa is dedicated to achieving the most favorable outcomes for her clients.

John Reichert is an attorney in Reinhart's Banking and Finance Practice. He provides a wide array of general advice and counsel to banks, bank holding companies, and other companies involved in the financial services industry. Prior to practicing law, John worked for eight years in the banking profession where he held senior management, operations and retail banking positions, experience that provides a solid foundation and understanding of the challenges and opportunities his clients face.