# BANKING NEW YORK

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# Winds OF CLIMATE CHANGE TO AFFECT BANKS

## READY OR NOT, HERE IT COMES

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# Will My Bank be Sold?

## What to Watch for if CEO is Ready to Retire

I want my surgeons and my pilots to have a touch of grey. The same applies to bank CEOs. However, every banker will age and eventually retire. The question that many customers and investors often ask is this: Does a bank CEO's age suggest that his or her financial institution may be quietly readied for sale?

Mary Buffett

Since the economy rebounded from the 2008 financial meltdown, larger banks are looking to expand again. As bank regulations were relaxed during the mid-1980s, a number of mid-sized and larger banks went on a spending spree. Within a decade, our banking institutions went through a period of great consolidation. Many great financial brands found themselves in the dustbin of history.

Today, it's the same old story. Smaller and regional banks position themselves as counterpoints to the mega banks. They will give customers the time, care and feeding that larger banks cannot offer. In many cases, the CEO is only a phone call away. When these smaller banks are purchased, customers are often the last to know. Bank staff might know that there are acquisition rumors in the air but they often discover an ownership change once senior management inks the new agreement.

Healthy bank mergers are back. Many of the mergers that took place during the meltdown were designed to find healthy homes for failed institutions. They were more like shotgun marriages than traditional mergers, because the policy goal was to keep the American banking system afloat. Between 2008 and today, the general populace has forgotten how close the American economy came to total collapse. But also since then, things have improved dramatically.

### WHY ACQUIRE?

Why do smaller community and larger regional banks remain delicious acquisition targets? It's all about attracting business customers, the most profitable piece of any banking portfolio. Larger bank brands might conclude that it's cheaper to purchase a bank (and its customers) than growing business clients organically. That's also why when healthy community banks are sold, it's often for far more than book value.

Just because a community bank CEO may be eyeing retirement, it does not necessarily mean that anybody is putting the "For Sale" sign in the window. However, there might be several clues that investors, staff and customers might wish to ponder if they think that a particular institution might be up for sale in the near term.

Here are some red flags that should resonate with staff, investors and customers alike.

**Look at the gene pool.** If the financial institution is family-owned or family-controlled, take a good look at the gene pool. Is there a family member who is being groomed to be the next generation of bank leadership? If the senior leadership team is in their 60s and seeking a soft and smooth exit, they should have designated an heir apparent to carry on the family business. When the third generation of any family institution comes onto the scene, they are often tossed and turned by the inevitable family dynamics that cuts across several generations. If the next generation has been assigned to the bank's foundation (which gives away money as opposed to making it), it is a signal that the family's genetic predisposition for banking has petered out.

If the next generation of leadership is not family, look closer still. Thanks to LinkedIn, you can look at the successor's background and determine whether that person is a short-term or long-term player. Based on what we have seen with recent community and regional bank acquisitions, that person will be richly rewarded.

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**Look at the senior management team.** If they are a closely held or family controlled institution, look at the ages of the entire senior management team. Time takes its toll on everybody and we all are put out to pasture at some point. Wise companies engaged for the long term will have a constant rotation within their C-level suites. If the senior management team of a financial institution continues to age without any new blood added into the mix, it is a sure sign that its long-term prospects might be very limited.

**How is the bank organized?** If the bank has an environment where the percentage of shares is highly concentrated within a few shareholders, it's likely to be organized as an S corporation. If so, it is a sure red flag for a future sale. Unlike a traditional corporation, S corporations pass the taxable profits and losses directly back to the shareholders (as opposed to the corporation's bottom line). By law, the timeline of an S corp has a beginning, middle and an end. When it matures, often after a 10-year period, the shareholders have some very big decisions to make. They could renew the S corporation structure, alter it or simply sell. After surviving on the dangerous rapids of the last couple of years, the idea of a happy and wealthy retirement might be completely irresistible.

**Finally, look at the bank's product offering.** Smaller community and regional banks often have an incomplete portfolio of customer and commercial products when compared to large banks. Smart Realtors will "stage" a house to prepare it for sale by adding a number of features that will attract a top flight buyer. It is no different within the world of banking. If senior management is making a concerted effort to quickly add a number of new programs and products, it could mean that they are trying to complete against the big boys. However, it could also mean that the bank is being "staged" for a future sale.

Smaller community banks and other regional institutions became quite profitable as a result of the 2008 banking collapse. Average balances within these institutions are often 50 percent higher than what you find in the larger mega banks. Because banking programs offer so many hooks that make it harder to steal away business clients, it becomes far easier to buy the entire bank. In a nutshell, that is what is driving the endless waves of bank acquisitions, not solely the age of retirement potential of a CEO. ■

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