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Banks Urged by OCC to Vet M&A Early with Regulators

by Robert Barba
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Considering an acquisition? Your regulators might be the first call you want to make.

Dealmakers and their advisors have long said that getting regulatory approval of a deal has become a more hands-on experience since the financial meltdown. It is widely considered bad form these days for regulators to find out about an acquisition when the ink is already dry and the press release hits the wire.

Officials at the Office of the Comptroller of the Currency reaffirmed those notions this week, making it clear that they want to be looped in early in the process. Doing so is in banks' self-interest and could narrow the time between application and approval, they said.

"It is very critical to maintain contact with us," says Bert Otto, deputy comptroller for the OCC's central U.S. district. "Before an individual files an application, tie us in. Let us get in early on the business plan. … We might be able to identify some of the landmines that need to be identified — it makes for a much smoother process."

Approvals take longer and have become more intense in recent years, observers say. A couple of deals in the Northeast — M&T Bank's (MTB) agreement to buy Hudson City Bancorp (HCBK) and Investors Bancorp's (ISBC) planned acquisition of Roma Financial (ROMA) — have had their completion dates delayed because of concerns at the Federal Reserve.

The OCC officials gave an insight into what they are looking for when an application is filed.

"We are looking at due diligence, how deep a dive they did into the bank, what kinds of controls were used, what types of products and services the acquisition is going to bring that the buyer didn't have before," says John Meade, central district risk officer and OCC risk committee chairman.

"We are looking at the operational and reputational risk that could be coming to their institution. That is what we are really focused on."

The comments were part of a conference call that the officials, based in Chicago, held Tuesday with reporters to discuss the condition and risk factors facing community banks in their region. The central district covers Illinois, Indiana, Michigan, North Dakota, Ohio and Wisconsin, as well as parts of Kentucky, Minnesota and Missouri. The OCC has sponsored calls in other regions, too.

The broad message was that the central district is stabilized and improving. The return on assets for most of the district's 526 community banks and thrifts was flat year over year, as reductions in provisions for loan losses cushion the blow from compression in net interest margins.

Additionally, the number of problem banks in the district fell to 84 at the end of the second quarter, from 106 at the end of 2012. For the OCC, problem banks are generally those with a CAMELS rating of three to five.

However, the regulators cautioned that the progress in Chicago is much slower than in the rest of the region. Two out of every five institutions in Chicago is considered a problem bank.

Overall, the regulators say that strategic risk is their top priority right now. They are examining how commercial loans have grown at a 16% annual rate with no rapid economic expansion. They are monitoring to see how flexible banks are being in order to book loans, including stretching on terms, rates or borrower projections.

Additionally, cost-cutting measures are being watched, Meade says, to make sure that banks aren't cutting corners in places like auditing or compliance functions. Such indiscriminate cuts could leave the banks vulnerable to cyberattacks and other threats, but they are tempting to make in the absence of revenue growth.

"The cuts have to be supported by sound rationale, not just cost savings," Meade says. "The danger in cutting corners is clear."

They also acknowledged that the current operating environment could lead to additional M&A.

"Simply put, community banking remains arduous," Otto says. "Margins remain tight, and to grow earnings banks need to grow organically or through partnerships — either portfolio or whole-bank acquisitions — and we just want to make sure they are not inappropriately stretching for yield."

The regulators say that, in their view, consolidation is neither good nor bad — it's simply a reality in the current operating environment. Additionally, the regulators say they are encountering more banks dealing with succession issues involving executives and board members, one of the common reasons why banks agree to sell.

"It is a bit of a struggle. Who is going to be taking over?" Otto says. "It is something that the industry is going to have deal with."
