SULLIVAN & CROMWELL LLP

July 12, 2012

Bank-Related M&A

Pre-Announcement Transaction Vetting with U.S. Bank Regulators is Critical for Both Buyers and Sellers in the Post-Dodd-Frank Era; Recent Federal Reserve Guidance Regarding Informal Pre-Filing Inquiries

The ability of U.S. banking organizations, as well as non-U.S. organizations that are subject to U.S. bank regulation ("banking organizations"), to obtain required U.S. bank regulatory approvals for acquisition transactions on a timely basis is absolutely critical to both buyers and sellers in such transactions. For a buyer, a failure to obtain the necessary approvals for an announced transaction can mean public embarrassment, a loss of confidence in management, shareholder ire, difficult disclosure issues, substantial unproductive expense, lost management time and even litigation with the seller or others. Depending on the nature and significance of the transaction, it can also mean the failure of a buyer's strategic plan and result in the buyer itself becoming vulnerable to a takeover. For a seller, a failed transaction can often be even more deleterious, as it can result in the loss of a premium to the seller's shareholders (which may not otherwise be currently available), damage the seller's ongoing business, client relationships and employee relationships and morale, make it very difficult to continue as an independent organization, and leave the seller vulnerable to takeover in unfavorable circumstances.

To assist buyers to avoid a failed transaction, we recommend that:

- Banking organizations with acquisitions as part of their growth strategy engage in a proactive and regular dialogue with their bank regulators regarding strategic acquisition plans and the viability of such plans, regardless of whether they have any specific acquisition targets in mind.
- Banking organizations that have identified a specific acquisition target vet the transaction with their bank regulators as soon as practicable and well in advance of any proposed transaction announcement. In our experience, not only do regulators welcome this vetting process, they expect it. As part of this process, buyers should be prepared to provide the bank regulators with as much of the key information that would typically be provided in the formal application process as is possible, such as the strategic rationale and benefits of the transaction, pro forma and projected balance sheet,

capital and income statement information (including, among other things, asset marks), integration plans, and, if appropriate, information and analysis regarding any systemic impact or financial stability issues presented by the transaction.

The timeline for the announcement of any transaction should allow for this process. In the current regulatory environment, a period of at least one to two weeks should be allowed for the regulators to render their view on any significant or complex proposed transaction.[1] This period could obviously be shorter or longer depending upon the identities of the parties and the relative size or complexity of the transaction. Banking organizations that have had an active and regular dialogue with their bank regulators regarding acquisitions are likely to find this process easier to accomplish. Although the bank regulators will not render a definitive view on a transaction (which can only occur through the formal application process), the vetting process should be useful in determining whether there may be any significant obstacles or issues facing a transaction that could affect a decision whether to proceed at all.

We also recommend that sellers of businesses to banking organizations make regulatory closing certainty an essential consideration in choosing a buyer and, before agreeing to a proposed transaction, conduct appropriate due diligence on the ability of a prospective buyer to obtain all required bank regulatory approvals in a timely manner. Although the restrictions on buyers providing prospective sellers with "confidential supervisory information" (such as CAMELS ratings) can pose challenges to such due diligence, we nonetheless believe that effective due diligence can and must be done.

Although the subjective nature of the regulatory process does not lend itself to any definitive checklist for assessing whether a buyer can receive regulatory approval for a transaction in a timely manner, there are some key characteristics that are typically necessary, including:

- Obtaining comfort that the buyer's overall regulatory standing does not pose a risk that the transaction will be rejected.
- Capital well above the stated minimums and equal to or above peers on a pro forma combined basis.
- Obtaining comfort as to the buyer's record of compliance, particularly consumer compliance.
- The absence of significant asset quality issues, and the existence of positive asset quality trends.
- Solid earnings.
- A "satisfactory" or better Community Reinvestment Act record and the ability to demonstrate real "public benefits" resulting from the proposed transaction.
- Favorable stress test results (whether or not the buyer is subject to mandated testing).
- The absence of systemic risk resulting from the proposed transaction.[2]

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[1] In view of the guidance referred to below, this review period could be even longer.

[2] Please see our prior memoranda to clients regarding the assessment by the Board of Governors of the Federal Reserve System (the "Federal Reserve") of systemic risk considerations in the orders for PNC's acquisition of Royal Bank of Canada's U.S. banking operations and Capital One's acquisition of ING Direct USA. "*Federal Reserve Details New Financial Stability Analysis in Approving PNC's Acquisition of RBC Bank (USA),*" dated January 18, 2012, available at: http://www.sullcrom.com/files/Publication/8385d4f0-ffb2-47e0-8129-6267e3c65d53/Presentation/PublicationAttachment/d2554887-1cc5-4918-93ff-651a2fd8c774/SC_Publication_Bank_Mergers_and_Acquisitions_01-18-12.pdf; "*Federal Reserve Board's Approval of Capital One's Acquisition of ING Direct Discusses Financial Stability Factor,*" dated February 15, 2012, available at http://www.sullcrom.com/files/Publication/9ede2769-8b81-476b-97f4-024af48d216a/Presentation/PublicationAttachment/345d6d89-8a80-46f7-be2e-03f3434d3e82/SC_Publication_Bank_Mergers_and_Acquisitions_2-15-12.pdf.

- Finally, assurance that the transaction has been presented to the relevant regulators and that no issue as to its viability has been raised.

In this regard, the Federal Reserve today issued supervisory guidance providing for a new formal optional "pre-filing" process for banking organizations and others to seek guidance from the Federal Reserve on acquisitions and other proposals. Although this new process is conceptually consistent with the approach we would counsel, it is not the avenue we would normally expect many bank holding companies to use. The guidance notes that the pre-filing process is not expected to be typically used by banking organizations that frequently file proposals with the Federal Reserve and is more focused on accommodating community banking organizations that do not file applications frequently, as well as individuals and non-banking entities. It also notes that the pre-filing process is intended to address specific requests for feedback and not intended to identify or resolve all issues or concerns or be predictive of a final outcome. The pre-filing process contemplates an actual filing with the appropriate Federal Reserve Bank of a pre-filing request.

The guidance notes that the Federal Reserve anticipates that most reviews should take considerably less than the targeted 60-day review period but that complex or novel proposals could take more time. This timeframe would be problematic in the context of many transactions, especially given the risks and consequences of leaks and disclosure obligations. Moreover, use of this pre-filing process would be chilled if the Federal Reserve is not prepared to grant a total Freedom of Information Act exemption for pre-filings.[3]

We believe that this guidance is helpful in that it formalizes an informal and helpful process that the Federal Reserve has always made available for many types of transactions. As suggested in the guidance, however, in the absence of Federal Reserve direction to the contrary, the viability of most merger and acquisitions transactions, especially those involving frequent acquirors, should be reviewed and vetted with the Federal Reserve outside of the formal pre-filing process through direct contact with relevant supervisory and legal staff as discussed above.

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[3] *See* footnote 3 in "Implementation of a New Process for Requesting Guidance from the Federal Reserve Regarding Bank and Nonbank Acquisitions and Other Proposals", *Board of Governors of the Federal Reserve System*, SR 12-12, dated July 11, 2012.

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