

CHARTER MIGRATION, THE OTHER WAY INTO BANKING

Acquiring and relocating a small-market charter to a metro market

By Joshua McNulty, Jason Jean, and William Anderson, Bracewell LLP



Attend any banking conference or skim any banking publication, and you will inevitably hear or read about the dramatic decrease in the number of U.S. banks.

It is no mystery what happened: Bank acquisitions and failures far outpaced the number of de novo bank charters granted in the last 50 years. Since 2009, the number of banks has been cut in half and the downward trend shows no signs of slowing. Industry pundits and insiders suggest why there are so few de novo banks: increased capital requirements, compliance burdens, low interest rates, the lengthy application approval process, and inability to generate an adequate rate of return for

investors.

One factor often overlooked is the continued use of the charter migration structure as an alternative to the de novo charter.

Migration concept

The charter migration structure is simple: an investor group that wants to own and operate a community bank acquires a small one headquartered in a less populous, often rural, market. The group converts the acquired bank's main office into a branch, and relocates the acquired bank's headquarters to a major metropolitan market.

The charter migration model is not new. However, it grew in significance after the financial crisis, during the moratorium on

approving applications for deposit insurance, as investor groups that would have traditionally pursued a de novo charter needed a different path to owning and operating a community bank.

The charter migration structure provides a number of benefits:

- **Cost.** The structure allows an investor group to acquire a bank platform without having to pay a significant multiple that generally accompanies banks in larger markets.

- **Staffing.** Rather than starting a new bank, the investor group can utilize the acquired bank's staff, rather than having to hire all new staff. This can be particularly helpful in the initial phases after consummating the acquisition.

• **Internal infrastructure.** Additionally, the acquired bank will have policies, procedures, and practices that are (or should be) in compliance with regulatory requirements. The new owners will need to update many of these policies, procedures, and practices. But that is usually a less onerous task than creating it all in the first instance.

• **Technology.** The acquired bank will also have third party vendors, data processing, and other tech systems in place. These can be used while getting other aspects of the operations up and running.

In other words, the new owners and operators can hit the ground running and rely on the acquired bank's structure and staff to help operate the bank in the first few weeks and months after closing the acquisition.

Another key reason: Migration provides an entry into community banking for investor groups that remain skeptical about proceeding through the regulatory de novo application process. Migration is more certain and predictable because investor groups have used this structure over the past decade, while only a handful of de novo applications have been filed or approved since the financial crisis.

Other side of migration

While there are numerous benefits, charter migration is not without issues.

• **Cost.** The multiples paid on community banks in less populous markets are, generally, smaller than those in large, metropolitan markets; however, the investor group is still utilizing capital to pay for that multiple.

• **Structure.** Depending on the structure of the acquisition, the investor group will, at the very least, have to file a bank holding company application with the Federal Reserve. Such applications are not immune from getting bogged down in the approval process.

• **Capital.** In addition, in recent years regulatory agencies are requiring that an investor group

relocating a charter to a metropolitan market raise significantly larger amounts of capital than in the past.

• **"Inheritance."** Finally, the investor group inherits all of the issues of the acquired bank and, to the extent previous management is not retained in any capacity, must manage the staff and operations from a distant location.

It remains to be seen when, or if, applications for de novo bank charters will make a comeback. In the past year, FDIC has made a concentrated effort to inform the banking industry that it is open for business with respect to de novo bank deposit insurance applications. However, the fact that people continue to use charter migration is evidence that bankers remain wary of the FDIC process.

As bankers remain skeptical and uncertainty looms over the prospects of success for de novo applications, bankers will continue to find and use other avenues in their pursuit to acquire, own, and operate a community bank. The charter migration model will continue to be one of those avenues.

About the authors

Joshua T. McNulty is an associate in Bracewell LLP's Dallas office, and Jason M. Jean and William S. Anderson are partners in the firm's Houston office.

McNulty's practice primarily focuses on regulatory compliance, mergers and acquisitions, and securities law matters for financial institutions. josh.mcnulty@bracewell.com

Jean is experienced in advising public and private financial institutions with respect to mergers and other business combinations, asset and stock purchases and sales, and restructurings. jason.jean@bracewell.com

Anderson, chair of the firm's financial institutions practice and co-chair of the firm's corporate and securities department, regularly

advises bank holding companies and other financial institutions on capital markets transactions and mergers and acquisitions. will.anderson@bracewell.com