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M&A Transactions of Banks - From Sprint to Hurdle Race

The structuring and practical implementation of M&A transactions of banks features a multitude of specialties resulting from regulations in this sector and the banking secrecy. This is in particular true for asset deals which in the current market environment have gained in importance compared to share deals.

1 INTRODUCTION

After the financial crisis and in light of the fundamental changes in the national and international regulation of the financial sector, M&A transactions have in general become more important in this sector. Also **Swiss private banks and asset managers** are more and more affected by such transactions. In the following, selected topics will be discussed, that deserve special attention when structuring and implementing M&A transactions of Swiss banks, in particular, when carried out in the form of asset deals.

2 CHOOSING THE RIGHT TRANSACTION FORM

Swiss law provides for **several transaction forms** to take over a bank or to acquire part of a bank based in Switzerland:

For the takeover of an entire bank, a **share deal** or a **merger** are the preferred transaction forms. However, these traditional transaction forms have recently become less important due to the growing difficulties (if not impossibility) to sell an entire bank in the current market environment – not least due to so called legacy issues. This has led to an increasing tendency to sell only tailor-made parts of a bank by way of **asset deals**. Sometimes the parties even only sign a so called **referral agreement**. Further possible transaction forms, such as the prior **spin-off** of the part to be sold or the part to remain with the seller into a separate company, are generally not considered viable options. This is mainly due to time constraints and the extensive joint and several liabilities of the companies involved.

3 ASSET DEAL IN PARTICULAR

Swiss law generally provides for two different transaction forms to structure an asset deal.

3.1 INDIVIDUAL TRANSFER OF ASSETS AND LIABILITIES

According to this traditional form of an asset deal, all **assets, liabilities and contractual relationships of the bank** affected by the transfer have to be transferred to the buyer **individually**. Hence, all contractual transfer formalities as well as all transfer formalities with regard to title have to be adhered to.

With regard to **liabilities and contractual relationships**, this means in particular that the consent of the third parties involved must be obtained. Contrary thereto, the transfer of **receivables** is made by way of written assignment declarations and notification of the respective debtors.

Hence, bank customers as well as other contract parties to be transferred must individually consent to their transfer to the buyer. If such consent is not given, they remain with the transferring bank.

3.2 ASSET TRANSFER PURSUANT TO THE MERGER ACT

An **asset transfer pursuant to the Merger Act** results in the **automatic** transfer of all assets and liabilities of the bank by operation of law upon registration of the asset transfer in the commercial register. It must be borne in mind that with regard to the transferring party an asset transfer pursuant to the Merger Act is only an option for entities registered in the commercial register in Switzerland.

"The correct handling of the banking secrecy deserves special attention in the context of the due diligence of a bank."

According to the prevailing opinion amongst legal scholars also **contractual relationships** will automatically be transferred without any need to request the consent of the third parties affected by such a transfer. In section 6.3 it will be analyzed whether this is also true for bank customer relationships.

An asset transfer pursuant to the Merger Act leads to **commercial register publicity** with regard to the composition and valuation of the transferred assets and liabilities as well as with regard to the purchase price paid. Such publicity is often contrary to the parties' legitimate interest in confidentiality. Further, the transferring bank remains **jointly and severally liable**, together with the buyer, for transferred liabilities originating before the transfer date. Such liability remains valid during three years after publication of the asset transfer and for liabilities becoming due only after publication of the asset transfer during three years after such due date.

In practice, these above-mentioned issues often result in the parties foregoing the practical advantages of an asset transfer pursuant to the Merger Act. Instead they structure their transaction in the traditional form of an individual transfer of assets, liabilities and contractual relationships, in particular if they in any case follow a prudent approach regarding the banking secrecy (see below section 6.3).

4 REGULATORY ISSUES

4.1 SHARE DEAL

If a Swiss bank is sold by way of a share deal, the seller as well as the buyer of a **qualified participation** of at least 10% of the capital or the voting rights of the concerned bank need to notify the FINMA of the planned transaction prior to its execution. The same is true where a change in the participation in a bank meets, exceeds or falls short of the thresholds of 20%, 33% or 50% of the capital or the voting rights. Moreover, there exists a subsequent notification duty of the transferred bank.

In principle, the **license** of the bank to be transferred remains valid without any modification. However, it must be considered that the bank to be transferred needs to meet the license requirements at all times. Therefore, the prior approval of the FINMA must be obtained if the transaction results in a change of the bank's business activity or its administrative organization, or if the transfer of a qualified participation affects the bank's proper business conduct requirement. Furthermore, it must be taken into account that an **additional license** might be required if the bank, after completion of the transaction, is controlled by a foreign shareholder or if an existing foreign controlling participation in the bank will change.

4.2 ASSET DEAL

If only part of a bank is to be sold by way of an asset deal, from a regulatory point of view, it is relevant whether the buyer already has a **banking license** or whether the buyer only qualifies as a bank due to the asset deal and, therefore, first needs to obtain a banking license.

Whereas a buyer, only qualifying as a bank due to the asset deal needs to obtain a banking license prior to the completion of the transaction, a buyer already qualifying as a bank generally does not need to obtain a new banking license for the completion of the transaction. However, where the asset deal results in a change of the buyer's and/or the selling bank's business activity or their administrative organization, the FINMA must approve such changes and therewith, indirectly, also the transaction in question prior to its completion.

5 CHARACTERISTICS OF THE DUE DILIGENCE

The correct handling of the banking secrecy deserves special attention in the context of the **due diligence** of a bank, irrespective of the chosen transaction form.

Data protection and confidentiality of data to be disclosed to the interested buyers already set high standards for a not bank-specific due diligence. Often, data protection and the concerned company's confidentiality obligations towards its employees and other contractual partners are diametrically opposed to the extensive need of information of the interested buyers.

The **banking secrecy** aggravates this basic conflict of interests in the context of a due diligence of a bank. In principle, customer related information may not be

disclosed in the course of the due diligence without the prior consent of the respective clients. However, given that the quantity as well as the quality of a bank's clientele constitutes the most important value driver for the acquisition of a bank, a careful buyer will insist on examining this attentively beforehand.

In practice, the method to call upon a **consulting firm** (chosen by the interested buyer, but formally mandated by the concerned bank) to conduct the due diligence of the bank customers to be acquired is well established. In such a case the consulting firm and its consultants are bound by the banking secrecy. However, when reporting the results of the due diligence to the interested buyer it must be ensured that any information protected by the banking secrecy is made anonymous beforehand.

6 CHARACTERISTICS OF THE EXECUTION

6.1 IN GENERAL

Depending on the chosen transaction form the banking secrecy also presents challenging implications for the **execution** of an M&A transaction in the banking sector.

In general, the execution of a share deal does not entail any specific difficulties in this regard, as the party bound by the banking secrecy, i.e. the target company, remains the same even after execution of the transaction. However, with regard to an asset deal the situation is different as the bank customer information protected by the banking secrecy is transferred from one party to another at the latest when the M&A transaction is executed.

6.2 BANKING SECRECY AND INDIVIDUAL TRANSFER OF ASSETS AND LIABILITIES

As already stated above, bank customers transferred by way of an **individual transfer of assets and liabilities** need to **consent** to such transfer. However, due to the banking secrecy only the selling bank – and under no circumstances the buyer – may contact the bank customers to be transferred in order to obtain their consent.

"In the current market environment, asset deals in M&A transactions in the financial industry have gained in practical importance as compared to share deals."

Unless the transaction provides in any case for a "re-papering" of the bank customer relationships, in this context the question arises whether an explicit or even a written consent of the bank customers is required under the banking secrecy or whether their implicit or implied consent suffices. This question must be assessed while taking into account the circumstances of each particular case. With regard to bank customers using the bank's hold mail service special arrangements need to be considered in any case.

Needless to say, the requirement for individual – and under certain circumstances even explicit or written – consent of all bank customers to be transferred makes this transaction form especially complicated and cumbersome. This is particularly the case where the transaction involves the transfer of a broad and, as the case may be, global customer portfolio.

6.3 BANKING SECRECY AND ASSET TRANSFER PURSUANT TO THE MERGER ACT

With regard to bank transactions in the form of an **asset transfer pursuant to the Merger Act**, practice shows an increasing trend to consider the clients' bank relationships, including any customer data protected by the banking secrecy, to be **automatically** transferred to the buyer upon registration of the asset transfer in the commercial register. According to such practice it is sufficient to subsequently inform the affected bank customers of the completed transfer.

"In cross-border transactions the universal transfer of the banking business by way of an asset transfer pursuant to the Merger Act is often not a viable option."

However, as of today there is no law as well as no case law which regulate the aforementioned. In particular, the component of the banking secrecy protected by criminal law entails certain risks. Therefore, it is advisable to assess in each particular case of an asset transfer pursuant to the Merger Act, whether at least the implied consent of the bank customers needs to be obtained, although the contractual relationship will be transferred automatically.

Further, the asset transfer pursuant to the Merger Act requires to provide the commercial registry with, inter alia, a list of the contractual relationships to be transferred. Such documents can be reviewed and even copied by any person without having to provide any proof of interest. In order to prevent a qualified violation of the banking secrecy in this context, the selling bank must ensure that the customer relationships to be transferred will only be listed in a **general-abstract manner and anonymized**, to the extent possible and tolerated by the commercial registry.

7 CROSS-BORDER TRANSACTIONS

In particular where M&A transactions involve foreign banking institutions, difficult questions arise in relation to the **applicable law**. This is already the case for the sale of the Swiss banking business operated by the Swiss branch of a foreign banking institution to a Swiss buyer, given that from a legal perspective the foreign banking institution acts as the seller, and not its Swiss branch.

In such cross-border transactions, the universal transfer of the banking business by way of an asset transfer pursuant to the Merger Act is often not a viable option. Instead, the parties have to resort to the cumbersome individual transfer of assets and liabilities, the implementation of which also entails complex questions regarding the conflict of laws.

8 CONCLUSION

In the current market environment – and not least in light of the so called legacy issues – asset deals in M&A transactions in the financial industry have gained in practical importance in comparison to share deals. For this reason, the parties have to complete more and more frequently a hurdle race rather than a sprint.

In general, asset deals can be structured in two different forms: the universal asset transfer pursuant to the Merger Act or the individual transfer of assets and liabilities. With regard to both transaction forms special attention should, in particular, be given to the banking secrecy when conducting the due diligence and executing the transaction.

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