



## Shareholder Activism in the US Banking Industry

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**Editor's Note:** The following post comes to us from [William Sweet](#), partner and head of the Financial Institutions Regulation and Enforcement Group at Skadden, Arps, Slate, Meagher & Flom LLP, and is based on a Skadden memorandum.

Although the 2012 and 2013 proxy seasons saw increased (and highly publicized) shareholder activism across a range of industries, that trend has not yet made its way to the U.S. banking industry. Over the last two proxy seasons, aside from Nelson Peltz's well-publicized campaign for action at State Street Corporation, certain negative say-on-pay recommendations from ISS and shareholder proposals on governance matters at some large banking organizations (e.g., the campaign to separate the Chairman and CEO positions and to vote against certain directors at JP Morgan Chase), as well as a handful of examples of shareholder activism at community banking institutions, the banking industry has seen relatively little investor activism by comparison. And no investor has conducted a proxy solicitation against a large banking organization since Relational Investors waged a proxy battle against the management and board of directors of Sovereign Bancorp in 2005-06.

The relative absence of activist campaigns targeting banking organizations over the last several years may be explained mainly by current market conditions in the industry, which are not conducive to investor expectations for realizing a profit from an activist campaign against a bank. Most significantly, the absence of a robust bank M&A market with willing buyers that are able to execute transactions at attractive valuations (i.e., a premium to the market price at which the activist acquired the stock) has undermined one of the key exit opportunities for activist investors in the industry. The bank M&A market has been and continues to be adversely affected by uncertainties around asset quality, capital expectations, the regulatory and legislative environment, and the future prospects for the industry as a whole.

With resolution of some of these uncertainties, and some improvement in the bank M&A environment (which is becoming more active among smaller community banking institutions), banking organizations can expect greater attention from activist investors. Activist campaigns can

develop quickly in the media and the court of public opinion. Management teams and boards should assess their institution's vulnerabilities to activists and anticipate potential challenges. Familiarity with available structural defenses and the relevant regulatory scheme and development of detailed contingency plans will put management teams and boards of banking organizations in the best position to navigate a reemergence of shareholder activism.

### **Activist Tactics**

Activist campaigns can take many different forms, depending on the identity of the activist, the nature of the criticism leveled at the target, the objectives of the activist and the level of support a campaign can generate among institutional investors and proxy advisory firms. In the banking industry, the opportunities to agitate for operational or strategic change (such as changes in business lines or spin-offs of divisions) tend to be more limited. For this reason, the key objective of activists in the banking industry is often a sale of the target institution at a premium to the current trading price.

With a target in sight, activist investors may employ a variety of tactics to pursue their objectives. Their initial approach can range from private and moderate to public and hostile—and the tone and level of aggressiveness can escalate rapidly. An activist shareholder might begin a campaign by making a “friendly” approach to an executive officer or director of the target, accumulating a nondisclosable ownership stake of less than 5 percent, or privately agitating against the board or management of the target. More aggressive tactics could include leaking “ideas” to the analyst community, filing a Schedule 13D, formally submitting a shareholder proposal, conducting a withhold-the-vote campaign or demanding the formation of a committee of independent directors to review strategic alternatives for the target. An openly hostile dissident may seek to exert more substantial pressure on the target by conducting a negative public relations campaign, enlisting proxy advisory firms to support dissident action, demanding board representation or even engaging in a formal proxy contest. Activists have generally become more sophisticated in their tactics and more adept at garnering the support of media and other shareholders for their agenda.

### **Preparing for Activism**

Although activist campaigns often begin six months or more before the scheduled date for the target company's annual meeting, timing is not entirely predictable. The target of an activist campaign will be in a much better position to achieve a desirable outcome if it has proactively developed a response plan in advance rather than having to attempt to navigate the campaign in an ad hoc and reactive fashion. An effective response plan will take into account a variety of

potential activist tactics and objectives. There are a number of steps—both substantive and procedural—that a banking organization can take to give appropriate consideration to such matters and to improve its ability to drive a successful outcome against an activist campaign.

***Internal process to detect and address possible challenges.*** It is important that banking organizations put in place an internal process and infrastructure for dealing with a potential activist campaign. Within the institution, a small number of top executives and directors should be assigned to a shareholder response team and given specific responsibilities relating to activist events as well as the resources to discharge those responsibilities. The internal response team should be in a position to coordinate promptly with external advisors (legal counsel, financial advisor, public relations firm and proxy solicitor) and keep them apprised of developments in order to reduce the time required to respond. Among other things, the response team should monitor changes in the organization's shareholder base with an eye out for potential activists.

***Regular strategic reviews.*** A common theme of activist campaigns is that the target's board and management have failed to consider and pursue the best strategy for the organization. Banking organizations that have instituted a formal and documented process by which the board and senior management periodically assess the institution's strategic plan will be in a far better position to rebut this activist complaint. The periodic strategic review should include, among other things, a review of both peer group and industry financial and market data and recent M&A activity in the industry. Apart from being a valuable corporate governance practice in its own right, a periodic strategic review will prepare the company to respond proactively, efficiently and credibly to activist investor demands for changes in the company's business or its strategic direction.

***Legal and structural defenses.*** The board of directors should periodically review with counsel the company's corporate governance profile, including legal and structural defenses, as well as the duties of the board. Legal and structural defenses include state and federal laws applicable to activism and contests for corporate control and the company's charter, bylaws and other organizational documents. The periodic governance review should include a review of the institution's D&O insurance program and the relevant provisions from the company's charter and bylaws providing for indemnification of the board and management.

***Bank regulatory regime.*** The bank regulatory regime is an important element of the legal framework affecting shareholder activism in the industry. Federal and state banking laws generally prohibit any shareholder from acquiring control of a banking organization without first obtaining regulatory approval. Historically, the banking regulators generally interpreted these laws to be triggered only when a shareholder, or group of shareholders acting in concert, sought to

acquire 10 percent or more of any class of a banking organization's voting securities or to take other actions that could constitute "control" for purposes of these laws, such as seeking significant representation on the board of directors of the organization. In recent years, the Federal Reserve and other banking regulators have taken a far more expansive view of these laws—finding "control" to exist at ownership levels as low as 5 percent and under other circumstances one would not typically associate with practical control. For example, in one instance involving a proponent of a minority slate of directors, the proponent got entangled with regulators over the independence of its nominees. While the bank regulatory analysis will be highly dependent on the facts of the specific situation, developments in regulatory interpretation will likely make the bank regulatory regime a more formidable defense for banking organizations seeking to stave off activist investors.

**Communications.** In the end, most battles with activists boil down to whether the target's board and management can convince the shareholder base that they remain better stewards of the company's future and have a better plan than the activist. Banking organizations can head off some potential activist events by maintaining good relations and constructive communications with shareholders (especially major institutional investors), stock analysts and other key constituencies. The involvement of the senior executives (including the CEO and CFO) and, increasingly, of certain directors (such as the lead independent director or chair of the compensation committee) in communications with major shareholders is essential. Communicating and supporting the institution's strategic direction shows that the board and management are aligned with these constituencies and limits the ability of activists to affect their views through negative publicity.

Boards of directors and senior management teams of banking organizations have had to deal with pressures on many fronts during the current economic cycle. Shareholder activism has not been at the top of the agenda of many banking institutions. Prudent boards and senior executives of banking institutions should recognize that they may soon operate in an environment that is prone to rising levels of shareholder activism. We recommend that banking institutions prepare accordingly.