Bank Shareholders Step Up Activist Efforts as M&A Activity Picks Up

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Bank management teams and boards of directors have made shareholder activism a key area of focus in light of significant activity in 2015. With the bank M&A market showing signs of life, the most basic end-game of investor activism in the industry — a sale of the institution — has become viable. Encouraged by activists' results in the publicly announced sales of institutions such as Metro Bank and Astoria Financial in 2015, and as the bank M&A market continues to strengthen, more bank shareholders are expected to agitate, either privately or publicly, for sales in 2016.

Activist Tactics in Banking

Many of the activist pursuits in the banking industry have involved a handful of investment funds that are focused on the sector, although there also have been situations involving more generalist activist investors, such as Nelson Peltz, who now has a representative on the board of Bank of New York Mellon. While these industry-focused funds generally are passive investors, some have sought to affect an institution's business and strategic direction.

Activist investors generally have fewer options when targeting a banking institution compared to companies in other industries. This is due to the relative simplicity of the business model of most community and regional banks as well as the industry's complex regulatory framework, which affects both the operational and financial flexibility of the banking institution and the degree to which one or more investors are legally permitted to work together to take actions that may affect control. These factors generally limit the activist's ability to propose many of the transactions or initiatives that comprise the typical activist playbook, such as splitting up the company, disposing of noncore businesses, implementing substantial cost-reduction measures or utilizing excess capital more profitably (including by returning it to shareholders). Meanwhile, industry consolidation through M&A activity continues to be the most attractive and viable means for many institutions to address their strategic and operational needs; it provides what may be the most efficient use of excess capital for the acquiring institution and the best means of addressing a selling institution's profitability and growth issues.

Several recent activist situations have involved larger banking institutions and have resulted in publicly announced sales or mergers. Based on the trading prices of the acquiring companies' stocks since announcement, the market's receptivity to those deals appears mixed. However, these cases point to the increasing viability of a sale or merger proposal as an activist tactic in the banking industry. They also sound a warning to bank management and boards across the industry that preparedness for shareholder activism should be a top priority as they manage their institutions through persistently difficult regulatory and economic conditions.

Preparing for and Responding to Activism

Even though each activist campaign is unique, the best course of action to address the activism threat is for an institution to continually analyze and seek to improve its operational and share price performance, develop and implement a long-term strategic plan and regularly communicate this information to investors, and build stronger relationships with significant investors before an activist surfaces. Oftentimes, doing so means that the institution already has considered many of the proposals an activist would suggest.

Banking institutions also should have in place a plan to more directly anticipate, identify and respond to activist investors when they surface. The plan should include a program to monitor activity in their stocks and a contingency plan for coordinating a team both within the institution and among its outside advisers to review and analyze any activist proposals and respond directly to the activist. If the activist campaign is public, the program also should include information on how to address the campaign publicly and with the institution's various constituencies.

The typical activist agenda — to improve shareholder value by demanding that the company implement one or more suggested proposals — will implicate the institution's current financial performance, business model and/or strategic direction, all of which are within the purview of the institution's board of directors. Once an activist investor has taken a position in a banking institution's stock and has begun publicly or privately agitating for change, the board of directors, with the guidance of its financial and legal advisers, will need to review and consider the appropriate response to the activist campaign. In doing so, the board will need to take into account all applicable legal and regulatory factors as well as the strategic and operational alternatives available and the expected value and risks associated with each. Depending on the circumstances, this may include consideration of an activist's demand for board representation and/or the issues involved in a possible sale of the institution.

Activism will remain a central issue for boards of directors and senior management teams of banking institutions in 2016. Given recent M&A activity in the industry, more bank shareholders are expected to enter the fray and be increasingly active in pushing their agendas, including pressuring institutions into a sale. Advance preparation for activist campaigns by boards and senior management teams will be crucial to best positioning institutions to respond to activists when they surface.