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BCI FINISHED THE ACQUISITION OF CITY NATIONAL BANK OF FLORIDA IN A COMPLEX TRANSACTION

Lulu Rumsey

When Madrid lender Bankia's US$27 billion bailout by the Spanish government prompted it to shed assets abroad, Chile's third-largest private bank, the ambitious, family-run Banco de Crédito e Inversiones spied a golden opportunity to become the first Chilean bank to buy a US counterpart. Lulu Rumsey learns how BCI spent two-and-a-half years convincing the Federal Reserve to accept its takeover of City National Bank of Florida, an epic task that involved splitting the bank's hugely profitable parent company in half to appease US financial regulators.

"Don't mix business with family" is a dictum dynasties that have seen their fortunes depleted by ugly family feuds would retrospectively agree with. Family-owned companies account for some 85 per cent of all businesses in Latin America, but not all survive beyond their founders' lifetimes, and very few make it into the hands of their clan's third or fourth generations in one piece. Owned by one of Chile's most powerful families – the Yarurs – Banco de Crédito e Inversiones is an exception to the rule: founded in 1937 by entrepreneur and Palestinian immigrant Juan Yarur Lolas, the bank has defied the odds to successfully pass through generations of the Yarur bloodline. Recent months have seen the bank surpass expectations in other ways too: in September 2015 BCI got approval from the US Federal Reserve for its near-US$1 billion purchase of City National Bank of Florida, after several years spent seeking approval for the tie-up from US financial regulators.

The bid to buy City National was ambitious from the get go. The acquisition tested and reshaped Chilean banking law: as well as becoming the first Chilean entity to buy a US bank, BCI broke new ground when it became the first Chilean bank to buy a foreign bank's holding company, an area completely unexplored by Chilean law. Because the deal led US regulators to rigorously assess the powers of Chilean regulators in line with strict US financial protocols, BCI's

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acquisition of City National added impetus to legislative developments that changed the way Chile's financial regulators monitor the activities of banking conglomerates. For the Yarur family, BCI's acquisition of City National necessitated a fundamental rewrite of the way it managed its assets, which encompassed interests in the textiles, pharmaceutical, beverage and slaughterhouse industries, all part of a sprawling US$2 billion family empire. Ultimately, the deal forced BCI's controlling shareholders, who had so resolutely clung on to control of the bank, to tear up the shareholders' agreement governing its holding company, and even led some of them to relinquish their voting shares in the bank.

Expansion abroad

In early 2013, Bankia engaged legal counsel as it prepared to divest Florida's City National, in accordance with the terms of its US$27 billion bailout by the Spanish government in 2012. "Bankia set out a fairly aggressive but achievable timeline for a competitive process, so we got to work right away setting up a process whereby the bank entered non-disclosure agreements with a variety of different bidders," says Bankia's counsel, Sullivan & Cromwell LLP partner Werner Ahlers. The bank received bids from several interested buyers, eventually settling on an US$883 million bid from BCI. BCI's controlling shareholders, three of Yarur Lolas's grandnephews, had been considering making a purchase in the US for some time and viewed the acquisition as a means to up their share of Florida's lucrative banking sector. BCI had opened an office in Miami back in 1999, but the purchase of City National would open the door to one of Florida's most recognised banking brands, with 26 branches across the state. In March, BCI retained regular counsel Carey in Chile, Simpson Thacher & Bartlett LLP in New York and Miami's Ávila, Rodríguez, Hernández, Mena & Ferri to prepare its bid for City National; Ávila Rodríguez partner Alcides Ávila had worked with BCI since it opened in Miami and helped it identify potential targets when the idea of making an acquisition was first mooted. At the time, City National and Bankia were Ávila's clients, and his knowledge of both parties' needs enabled him to recognise BCI would be a good fit for City National. BCI subsequently put in its bid and by May it was a done deal. "Because of the aggressive timetable, we had to ensure the process would proceed very smoothly and quickly towards signing," says Ahlers. BCI's deal to buy City National was signed in New York on 24 May 2013.

BCI's controlling shareholders were brothers Jorge Alberto, Juan Carlos and Luis Enrique Yarur Rey. The trio's ambitious bid to buy City National came during a problematic period for the family. In 2013, their cousin, the grandson of the bank's founder, filed a lawsuit alleging that one of the brothers, BCI's chairman Luis Enrique Yarur Rey, had paid below market price for shares when he took control of the bank in 1994. The very public domestic drama eventually saw the cousins reach a US$99 million settlement. However, having cemented their place as BCI's owners, the Yarur Rey brothers realised that their goal of acquiring a US bank would force two of them to greatly diminish their voting interests in the asset they had fought so hard to maintain control over. Expansion into the US meant BCI's parent company, Empresas Juan Yarur (EJY), had to get to grips with the Federal Reserve's rules governing the entry of foreign banks to the US financial sector. To win the Federal Reserve's approval for the deal the Chilean bank's legal teams needed to demonstrate that BCI and its parent holding company were subject to comprehensive supervision and regulation by Chile's financial supervisor. However, under Chilean law, banking regulators do not have direct supervision over holding companies consisting of financial and non-financial entities, something that paved the way for the biggest ownership shake-up in EJY's near 60-year history.

Old money

Like other banks in Latin America, BCI was part of a complex structure of family-affiliated non-banking companies. A blend of tax, security, privacy and inheritance factors make it common for families in the region to choose to hold their interest in banking assets through several different companies. In this case, EJY controlled BCI through a four-tier structure that reflected the parent company's interests in industries outside banking. "In the US it's not common to have complicated ownership structures for family banks – there are family groups that have a mix of banking and non-banking businesses, but they typically have just one or two layers of companies above the bank," says Ávila. BCI's multifaceted ownership structure presented an entirely different ballgame for US financial regulators. "It's just not a structure that is typical in the US," continues Ávila. "We knew it would raise issues because of regulatory requirements, so we knew the ownership of BCI would have to be restructured." For BCI's Chilean counsel, a mammoth task lay ahead. "We had to spin off the financial and non-financial businesses to separate them, we had to collapse a company that had several tiers

into one with a single tier and we had to terminate the shareholders' agreement and replace it with one drafted following the guidelines of the Fed," says Francisco Ugarte, partner at Carey. "All of that would take close to three years."

The first step was to separate the Yarur family's banking and non-banking businesses. On 25 April 2013, EJY's shareholders agreed to carve out a new company that would house all the Yarur family's financial assets – including BCI and its affiliated insurance companies: BCI Seguros Generales, BCI Seguros Vida and Zenit Seguros Generales. The new company kept the title EJY, while other non-banking activities previously owned by EJY were spun off into a separate company called Empresas JY. JY controls pharmacy chain Salcobrand, wine company Grupo Belén and non-financial holdings in multiple other businesses. The process made EJY the sole parent company of BCI, with BCI constituting 98 per cent of EJY's assets.

After splitting EJY's predecessor company in half, the next step required BCI's shareholders to transform the way their family controlled the bank. Before the reorganisation, BCI's controlling interest was held by the three brothers, but in a leap of faith two of them agreed to lower their ownership of voting shares to avoid the Federal Reserve determining that they also controlled BCI. Had that been the case, they would have had to register their respective companies as bank holding companies in accordance with the US Bank Holding Company Act. As the brothers owned assets outside the banking sector, they would have had to separate their financial and non-banking assets in the same way EJY had done, which would have been a time-consuming process in a deal that was already drawn out. The reshuffle saw Jorge Alberto and Juan Carlos Yarur agree to drastically lower their combined voting shares in the bank to below 5 per cent and take the rest of their interest in non-voting stock, leaving Luis Enrique with full voting control. "These three brothers have their own families, companies and investments [so] it was a hugely difficult decision," says Ávila. "It showed incredible commitment on the part of the family to undertake that kind of restructuring; it was complicated, it was expensive, and it had significant consequences from a tax perspective," he says.

No going back

Aside from family politics, there were other hurdles that needed to be overcome to get the deal through. By March 2014 the parties had

Chilean regulatory approval, having gotten the go-ahead from the Chilean Central Bank and the Superintendency of Banks and Financial Institutions. Getting their approval represented a watershed moment for local regulators. "[It] marked a milestone in Chilean banking law as it was the first time Chilean regulators had authorised the purchase of a US bank," says Ugarte. The deal is only the second example of a Chilean financial institution buying outside of its home country (Corpbanca, which bought Colombia's Helm Bank for US$1.28 billion in 2012, was the first). Moreover, BCI's acquisition was the first time a Chilean bank had bought a bank abroad indirectly, by buying the bank's holding company. That meant BCI had to convince local regulators that its acquisition of CM Florida Holdings, City National's parent company, was legal, even though Chilean regulations allowing banks to acquire other banks abroad do not expressly regulate the possibility of holding company acquisitions.

BCI's plot to buy City National came when Chile's financial regulators were open to new ideas. At the time, they were considering a redesign of the way financial companies operating in Chile were monitored, recognising that the sector required greater scrutiny. Their bid to remodel financial regulation in Chile led to the passing of a new law in November 2014, which in turn helped sway US regulators in favour of the BCI deal. The law granted legal status to a Financial Stability Council (CEF) designed to impose greater scrutiny over financial conglomerates. CEF is composed of the minister of finance, who chairs the council, and the superintendent of securities and insurance, the superintendent of banks and financial institutions and the superintendent of pensions. The chair of the Chilean Central Bank may also sit as an adviser. "The regulators understood that the financial system in Chile required passing a law like that and the government took prompt action," explains Ugarte. The council's composition put paid to the Federal Reserve's concern that Chile lacked one single entity monitoring financial conglomerates that could share information on the sector between different authorities. "They were worried about whether regulators would take a common view and combine their efforts when approaching conglomerates like BCI," says Ugarte. "The new law created a council where all the different regulators could get together and share information and let each other know financial risk they foresee from a given group, so it really helped us in the approval process with the Fed."

By the final quarter of 2015, the Federal Reserve's board of governors gave their assent to the deal, cementing the biggest investment by a

Chilean company in the US since the 2008 financial crisis. In acknowledgement of interest accrued over the lengthy waiting period, BCI agreed to top up its initial bid, adding some US$63 million to the asking price. The deal finally closed on 16 October 2015. Lawyers predict BCI won't be the last Chilean bank to make the leap to buy in the US. "The most important precedent of this deal is that it got the Fed's approval," says Ahlers. "In terms of future acquisitions, every deal will be considered on its own merits, but whenever you have a bank from a country getting approval for the first time to acquire, that is a significant precedent."

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