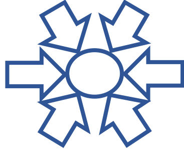

Financial Services Management

Bank Merger Policy

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FDIC, Request for Comment on Proposed Statement of Policy on Bank Merger Transactions

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Impact Assessment

- Although the FDIC has a relatively small impact on most large bank M&A, the policy takes an expansive view of its indirect authority and thus could give the agency's restrictive stand considerably greater impact on both M&A and strategic alliances.
- Prospective requirements that approval conditions are met prior to closing could create presumptions of control for acquirers, business risk for targets, and overall M&A uncertainty.
- Even small-bank deals face challenges unless it can be shown that the new bank does better for communities than the parties on their own. It is unclear if a target's weak finances would override this consideration to permit acquisition regardless of possible loss of community and consumer service.
- The subjectivity of many standards increases transaction uncertainty, likely reducing acquisition appetite in all but the most straightforward or emergency situations.
- However, the proposal also appears to preclude transactions in which a strong bank acquires a weaker one when this weakens the acquirer even at just the outset of a transaction and/or if the acquisition reduces the risk of financial instability.
- Only mergers after an IDI is taken over by the FDIC appear likely under these conditions, reducing the likelihood of private acquisitions that prevent failure and DIF cost.

Overview

Following its 2022 request for input,[1] the FDIC has released a formal proposal that would redefine the agency's bank-merger policy into one that will make it difficult for all but the smallest and simplest transactions within its jurisdiction to have the clear prospects for approval usually necessary in non-emergency transactions, subjecting other M&A applications to protracted review

[1] See **MERGER9**, *Financial Services Management*, December 16, 2021.

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with a high likelihood of denial. Strategic alliances involving nonbanks and/or nonbank affiliates and BHCs with nonbank activities may also come under critical FDIC scrutiny, complicating transactions otherwise under the FRB or OCC's review. Transactions over $100 billion would face the toughest scrutiny, but even small bank mergers could be denied if the FDIC is dissatisfied with the bank's prior supervisory, enforcement, or community/consumer record.

Impact

The FDIC's proposal follows one earlier this year from the OCC.[2] It in part codified current OCC practice to provide greater clarity, a move some have read as proposing a lax approach to larger transactions even though much in the proposal suggests the OCC is reluctant now to approve those outside a failure or near-failure situation. The FDIC's proposal incorporates aspects of the OCC's approach, leading Acting Comptroller Hsu to say that it is similar to his agency's approach when he voted to approve it. But, despite these similarities, the FDIC's policy goes further in numerous respects discussed below that could adversely affect many transactions the OCC thinks fall under its new policy or those nominally in the Fed's jurisdiction. The FRB has not updated its merger policy since 1995 and appears to have no plans to do so. As a result, its approach may or may not continue to be more generous than either the OCC's or FDIC's.

The Department of Justice also has the authority to review all bank-merger transactions it believes present antitrust risk. It will now do so under a new set of guidelines approved earlier this year with the FTC that impose an array of new standards sure to challenge larger bank-merger transactions and those with novel characteristics (e.g., a large bank acquiring a small technology or similar provider). Aspects of the FDIC's proposal track the DOJ/FTC guidelines, for example now looking not only at possible branch closings, but also at the impact this would have on local employment.

The FDIC does have authority to review certain transactions involving IDIs and any non-insured entity regardless of the IDI's charter, a provision that read broadly as the proposal does could involve the FDIC in many transactions in which a federal or state member IDI is affiliated with a non-insured institution such as a broker-dealer or similar entity in the federal IDI or parent holding company. If the FDIC exercises the power it now reinforces, deals the OCC and FRB might otherwise approve could face significant hurdles to consummation as planned and strategic partnerships or other alliances with fintechs and similar firms could be sanctioned by the FDIC as mergers in substance.

As with the OCC proposal, the FDIC's policy would now take account of factors that, while implicit in the past, have taken on new importance in the wake of last year's bank failures. These factors include whether banks have a record of poor response to bank supervisory requests, a troublesome enforcement record, a recent period of rapid growth, and/or demonstrable challenges to ensuring rapid, effective operational integration following merger consummation. These may ensure better deal quality and more resilient banks to the extent M&A is still viable and these provisions prevent repeats of the serial M&A approvals that distinguish Silicon Valley Bank, Signature, and other bank failures.

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[2] See **MERGER14**, *Financial Services Management*, February 5, 2024.

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Acquirers often promise to execute targeted divestitures, maintain bank branches, or otherwise alter the combined company to meet possible regulatory or DOJ objectives, with actions necessary to honor these commitments taken after consummation because the target company could lose significant value if it acted as planned and the acquisition then fell through or market conditions make action unnecessary to ensure continuing competition or community service. CFPB Director Chopra, a member of the FDIC board, describes post-acquisition execution of conditions as subject to a “catch-and-kill” mentality in which acquirers first destroy value in the operations they plan to divest before unloading them in order to minimize the chances of competitor advantage and the FDIC’s plans to reflect this in part by requiring participants to file internal documents and reports that may demonstrate possible monopolistic intent.

The FDIC’s approach to convenience-and-needs would also go beyond the current focus largely on CRA ratings, with a particularly novel criterion for approval being whether the combined bank would better serve the community than if the target institution remained independent. It is unclear if the target institution’s long-term financial viability as an independent entity will factor into this consideration; if it does not, then the FDIC might preserve short-term community-focused banking at long-term cost to both the community and the Deposit Insurance Fund.

The preamble to this proposal validates the proposed Statement of Policy in large part on the challenges the agency faces handling faltering and failed IDIs of size. It goes into depth about bank failures in 2023 and appears to believe it was powerless to avert them absent the systemic designation and GSIB acquisition it approved. The proposal thus appears to assume that all but the smallest banks are threats to financial stability, a conclusion that may raise questions about the extent to which the FDIC meets its over-arching mission as an IDI and systemic resolution authority.

What’s Next

The FDIC voted 3-2 to approve this policy on March 21. Comment is due sixty days after *Federal Register* publication. Finalization will take considerably more time, but the statement speaks to the views of the FDIC chair and its current majority, meaning that M&A proposals that might transgress its terms will face significant headwinds.

The FDIC plans also to revise the details of its application procedures manual (APM). This will be revised perhaps even as this policy is finalized. Aspects of the manual could have significant near-term impact if the FDIC reads its mandate as broadly as the preamble suggests it might with regard to IDI/non-insured entity affiliations.

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Analysis

A. Jurisdiction

As noted, the proposal "clarifies" the FDIC's merger jurisdiction, stating not only that current law gives the agency authority over transactions in which the acquiring entity would be a state non-member bank, but also over a "wide array" of transactions between IDIs and non-insured entities when these involve merger or consolidation with a non-insured entity, assumption of liability from the non-insured entity, or transfer by the IDI of assets to or from the non-insured entity. Assets are defined broadly to include tangible and intangible ones and even holdings not considered assets under GAAP.

This is the case even if any such transaction is not expressly structured as a merger, with agreements such as instances in which a non-insured entity encourages customers to transfer funds to the IDI or, if it is a depository, acts as agent, custodian, or trustee for the IDI. Credit unions are considered non-insured entities for purposes of this provision.

The policy also notes that its explanation of jurisdiction is not exhaustive, emphasizing that the agency looks at the substance – not form – of a transaction and urging parties to consult it to ensure that they do not evade the Bank Merger Act.

B. Application Process

The proposal appears to discourage informal applications, laying out what the FDIC expects to receive. Data should be accompanied by narratives and include any studies prepared by or for officers, directors, or deal-team leads.

Conditions would not be used as a means to rule favorably on an application, with orders and decisions made public. As noted below, public hearings are considerably more likely.

As is currently the practice, parties may withdraw a merger application following initial FDIC review. However, the FDIC reserves the right to make these actions public, buttressing its record when accusations are made related to M&A "rubber-stamping," but also creating franchise-value risk for transaction participants.

C. Statutory Factors

1. Monopolistic or Anti-Competitive Effects

The final rule drops the current practice of generally approving transactions if they do not exceed the current HHI threshold, instead making concentration and related determinations based on the FDIC's overall view of the transaction based on new, more stringent criteria. There would be no bright-line competitive-impact tests. As a result, there is no express HHI floor for approval and any product may be considered in addition to deposits to determine if consumers retain meaningful choices.

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The agency says that it must disapprove any merger it believes could lead to a monopoly and may only do so when there is anti-competitive impact if the convenience and needs of the community are found to outweigh this concern, and perhaps not even then.

Divestitures, branch closings, or other actions necessary to satisfy the FDIC or DOJ on monopolistic or anti-competitive effects would generally need to be concluded prior to transaction close. Selling institutions also could not enter into or import non-compete agreements with the buyer or related parties.

2. Financial/Managerial Resources, Future Prospects

Larger, weaker IDIs would generally not be approved, with no bright-line considerations laying out the criteria for this decision.

Managerial considerations will include the company's consumer-compliance record, supervisory responsiveness, enforcement record, recent rapid growth, the "reasonableness" of insider compensation, and numerous criteria related to the bank's ability to ensure effective post-merger operational integration. The consideration of future prospects generally follows that in current merger reviews.

3. Community Convenience and Need

The FDIC will continue to review CRA and consumer-compliance ratings and likely pay greater heed to public comment. Going forward, compliance with commitments made in this area may be conditions imposed on or even prior to approval, looking in all cases beyond the specifics of matters going into CRA ratings to judge the combined bank's ability to meet community needs better than would be the case in the absence of approval.

No public-benefit plans or benchmarks are demanded, but the FDIC will look at a range of issues including branch closings (now with attention to employment impact), likely fees, novel product offerings, and similar matters. Proposed community benefits should be validated with three-year time horizons, with public hearings likely for all IDI mergers of more than $50 billion.

4. Financial Stability

The FDIC's current methodology predates the Dodd-Frank Act and thus does not require consideration of financial stability.[3] The agency will now incorporate this factor, looking even at affiliate combinations if it fears these might pose a systemic threat. Mirroring aspects of the FRB's GSIB methodology,[4] financial-stability considerations would include:

[3] See **SYSTEMIC30**, *Financial Services Management*, July 22, 2010.

[4] See **GSIB22**, *Financial Services Management*, August 22, 2023.

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- size, with combinations over $100 billion getting particular attention;
- substitutability;
- inter-connectedness;
- complexity; and
- cross-border activities.

In addition, the FDIC may consider other matters such as the IDI's "regulatory framework" and cybersecurity resilience.

Much of the FDIC's analysis here mirrors its comments elsewhere in the preamble about the difficulty of resolving large regional banks. Underlying much in the proposed policy, with the preamble here describing the March 2023 failures and several large ones prior to Dodd-Frank in detail to validate the proposed approach.

5. AML Capability

This follows the law and current practice, but the FDIC seems likely to look at BSA and related issues with considerably more attention than in the past.

6. Additional Matters

Additional attention will be paid to non-traditional applications along with those involving non-insured entities – e.g., nonbank parent companies, views of relevant federal and state regulators, monoline business models.

D. Request for Comment

The proposal asks many questions, including:

- whether the proposed jurisdiction is appropriate and clear;
- how best to calculate competitive effect, especially with regard to transactions with non-insured entities;
- how other competitive-impact results could be calculated;
- if certain size thresholds (e.g., as low as $50 billion) should trigger competition concerns and if these arise any time a larger entity buys a community bank;
- the need to specify additional public benefits a request for approval would need to demonstrate;
- if specific types of mergers require different convenience-and-needs tests such as cases in which a community bank is "absorbed" by a larger bank;
- whether financial-stability criteria should include hard size thresholds; and
- use of a quantitative methodology to identify systemic risk.

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