Clients&FriendsMemo

FDIC Proposes Bank Merger Policy Revisions: Our Key Takeaways

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On March 21, the Federal Deposit Insurance Corporation (FDIC) published for comment a proposal (Proposal) to revise its Statement of Policy on Bank Merger Transactions (SOP). If adopted as proposed, the Proposal would modify the SOP substantially, effectively creating an entirely new policy. At its heart, the SOP would establish, or clarify the application of, rigorous merger evaluation standards, addressing all the factors the FDIC must analyze in considering an application (including competition), and conforming many of those standards to a more skeptical and demanding regulatory and supervisory environment.

The direct applicability of the Proposal would be limited to banks and savings associations supervised at the federal level by the FDIC, with the narrow exception note below under "Jurisdiction." These are the state-chartered banks that are not members of the Federal Reserve System, and certain state savings associations. For the most part, these are smaller institutions. Very few larger regional or super regional, and no GSIBs, are supervised directly by the FDIC.

The indirect importance of the Proposal could be substantial, however. In several areas of crucial significance to merger and acquisition analysis, the Proposal announces or describes standards of review that are decidedly more difficult to satisfy than has been the case and that derive from material attitudinal shifts in regulatory approaches. For example, the FDIC's stringent competition approach amplifies the earlier White House position, as stated in the 2021 Executive Order on Promoting Competition in the American Economy, that "as industries have consolidated, competition has weakened in too many markets, denying Americans the benefits of an open economy. . . ." Similarly, the revisions of the community benefit, managerial resources, and other application review factors reflect the supervisors' growing skepticism of financial institutions and markets, still fed in part by the 2007-2009 financial crisis. Additionally, the highlighting of the financial stability factor raises the stakes in banks' resolution planning.

These underlying sources of the Proposal's changes suggest that they could be adopted in substance by the other bank regulators. To this end, even before the FDIC issued the Proposal, the Comptroller of the Currency proposed changes to its application procedures that, for example, would: (a) eliminate certain abbreviated processes for qualifying transactions; (b) specify factors

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that support approval and those that support denial; and (c) indicate a factor that favored approval would be that the transaction result in an institution with assets of $50 billion or less (thus opening a question about the converse).

Despite the significance of the proposal from the perspective of the regulatory environment it reflects, the broader impact is hard to predict. It is notable that the Federal Reserve, the approval of which is needed for most any bank deal involving bank holding companies, has not issued any similar guidance or proposal. Further, in a different context, it has asserted that application of certain features of the Proposal, such as the consideration of resultant job losses, are outside the permissible scope of application review.

Below, we describe below some salient features of the Proposal, suggest some important implications, and offer some practical tips to prepare for applications.

Jurisdiction. Each of the three federal banking agencies is responsible for reviewing applications under the BMA. Their respective jurisdictions depend largely on the charter of the parties or the structure of the transaction. The FDIC acts on merger applications that involve an insured bank and any non-insured entity and those that solely involve insured banks in which the acquiring, assuming, or resulting institution is supervised by the FDIC.

In a new focus, the Proposal describes at length how the FDIC will treat transactions that it characterizes as mergers in substance. The purpose is to capture for the approval process those transactions, irrespective of the form, that would result in the target's no longer competing independently in the market. As an example, the Proposal cites a hypothetical transaction through which an insured bank "absorbs all (or substantially all)" of a target's assets and through which the target ceases to engage in the acquired activity. In another elaboration of FDIC jurisdiction, the Proposal notes that a bank's assumption of a "deposit," whether from another bank or from a non-insured entity, is likewise subject to FDIC approval "even in the absence of an express agreement for a direct assumption." The Proposal notes that such merger in substance and assumption transactions will be subject to review under the full range of statutory factors.

If the Proposal is adopted as proposed, state non-member banks should examine for status under the BMA all transactions involving the acquisition of business from another entity, no matter the nature of the governing arrangement. All banks should consider the Proposal's treatment of transfers of deposits when engaged in transactions with non-banks. This consideration would apply with equal force to internal reorganizations.

Merger Review Process. Offering more detail than the SOP, the Proposal describes components of an application that "will present significant concerns and likely result in unfavorable findings with regard to one or more statutory factors." The FDIC notes that an unfavorable finding

in any single statutory factor would result in a failure to approve. The list of possible causes of unfavorable findings is long and detailed:

- non-compliance with applicable federal or state statutes, rules, or regulations;
- unsafe or unsound condition relating to the existing or resulting bank;
- less than satisfactory examination ratings, including for any specialty areas (e.g., information technology or trust examinations);
- significant concerns regarding financial performance or condition, risk profile, or future prospects;
- inadequate management, including significant turnover, weak or poor corporate governance, or lax oversight and administration;
- incomplete, unsustainable, unrealistic or unsupported projections, analyses, and/or assumptions;
- unresolved deficiencies, issues, or concerns;
- lack of sustained performance under corrective programs, particularly when the transaction implicates the areas that are the subject of the corrective program; and
- the inability or unwillingness of the applicant to agree to proposed conditions or execute written agreements, if deemed necessary, will result in unfavorable findings and would require action by the Board of Directors on the application.

The detail offered in the Proposal will help banks understand the prospects of approval for their transactions. By the same token, it will also serve as a useful guide to prepare banks for the condition necessary to gain approval of merger or related transactions. It is possible that these standards have been applied in this fashion before. Even if that is so, the publication of this detail testifies to the seemingly ever-increasing regulatory and supervisory expectations of banks.

Competition Analysis. The BMA prohibits the FDIC from approving a merger or acquisition transaction that would result in a monopoly, would be in furtherance of an attempt to monopolize the business of banking in any part of the U.S., or that may substantially lessen competition in any section of the country, unless the anticompetitive effects of the proposed transaction are clearly outweighed in the public interest by the probable effect of the transaction in meeting the

convenience and needs of the community to be served (e.g., where a transaction is necessary to prevent the probable failure of a bank).

The Proposal marks several significant departures from prior approaches to competition analysis and treatment.

- Product Measure. The FDIC and the other federal bank regulators have generally relied on deposit concentration measures, and the changes in them resulting from a proposed transaction, as a proxy to assess the effect on competition in banking markets. In the Proposal, the FDIC makes clear that it may also rely on other measures, such as "concentrations in any specific products or customer segments, such as, for example, the volume of small business or residential loan originations or activities requiring specialized expertise." The Proposal also announces that the "FDIC may consider information on the pricing of products and services to assess the competitive effects of a proposed merger." The Proposal does not seem to indicate a protocol by which the FDIC might weigh the impact on a final competition analysis of measures that demonstrate different or even contradicting, competitive effects for a transaction.

- Divestiture. Applicants have long been able to propose divestitures to cure concentration issues in merger and acquisition proposals. Historically in such cases, a condition to approval has been the applicant's commitment to make the agreed divestitures or, more recently, its execution with a counterparty or parties of an agreement in respect of the divestiture. The Proposal might demand a more difficult standard: "The FDIC may require divestitures of business lines, branches, or portions thereof as a means to mitigate competitive concerns before allowing the merger to be consummated." The drafting leaves open the possibility that the FDIC may require that such divestiture be completed before it grants the approval of the related merger transaction. Under a related provision of the Proposal, the FDIC would prohibit the divesting bank "from entering into non-compete agreements with any employee [of any] divested entity" and from enforcing any existing non-compete agreements with such entity. The drafting here is also unclear. For example, in the case of divestiture of some of an applicant's branches, would the FDIC restrict non-compete agreements with all employees of the bank, even those not part of the branch's staff, since a branch is an indivisible part of the bank from a corporate law perspective?

Convenience and Needs. The BMA requires the federal banking agencies to take into account the convenience and needs of the community to be served when evaluating a merger transaction. The Proposal would introduce several new features of that analysis. As part of the new standard, the FDIC would "evaluate the community to be served broadly." This means it will consider the communities' needs for banking services in light of proposed retail delivery services (including any

to be removed), population (perhaps referring to demographic make-up), and proposed assessment areas. One should expect that review to be quite searching.

In another apparent escalation of standards, the applicant would also be expected to demonstrate that the merger would enable the resulting institution to *better meet* the convenience and the needs of the community to be served than would occur absent the merger. The Proposal lists examples of elements of better service, including higher lending limits, greater access to existing products and services, introduction of new or expanded products or services, reduced prices and fees, increased convenience in utilizing the credit and banking services and facilities of the resulting bank, or other means. The Proposal does not elaborate on how the FDIC will measure or define what "better" means in this context.

Financial Stability. The BMA requires the FDIC to consider the risk posed by a merger transaction to the stability of the U.S. banking or financial system. The FDIC expects that the resulting entity will not materially increase the risk to the stability of the U.S. banking or financial system. The Proposal outlines in some detail how the FDIC would analyze financial stability. It also makes express some additional considerations. For example, under the Proposal transactions resulting in "large" institutions (assets of $100 billion or more is the example given) would be reviewed with heightened scrutiny. As an additional analytical factor, the FDIC would also consider resolvability: "As part of evaluating the resulting [entity's] impact on complexity, the FDIC will also consider its resolvability in a potential failure situation. The FDIC may not be able to find favorably on this factor when the resultant [entity's] organizational and funding structure preclude its ability to: (i) continue operations and activities until they can be sold or wound down, (ii) sell key business lines or large asset portfolios, and (iii) be marketed for sale in a manner that limits the potential for losses to the [FDIC's] Deposit Insurance Fund." It might be argued that this supports the FDIC's resolution mandate, or, on the other hand, that it shows the FDIC has yet to implement a sufficient resolution protocol. Either way, it directly links successful resolution planning to successful merger execution.

Conclusion. If the Proposal is adopted as published, it will extend in concrete ways the restrictive merger control environment that bank regulators and the Department of Justice have been speaking about for several years. One can expect banking trade associations, consumer advocates and academics to offer a wide range of public comments, addressing not only the FDIC directly but also indirectly the Administration, the OCC, the Federal Reserve, and Congress.

If there is one overarching, practical way to prepare for the changes the Proposal might bring, it would be to integrate expressly into a bank's overall, resolution, and acquisition strategic planning, at the level of the board of directors, the steps necessary to deliver approval of acquisition applications. Such a step could result in routine board of directors review of a periodic, integrated

view of the bank's readiness for success in the demanding application process that is central to completing merger and acquisition transactions.

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