CHAPTER 3

Foreign Bank Acquisitions of U.S. Banks and Thrifts[1]

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SYNOPSIS

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§ 3.01 Introduction

This Chapter discusses the principal federal laws, and certain other legal considerations, involved in the acquisition of an insured U.S. bank or thrift (depository institution) by a foreign bank or its parent (foreign acquirer).[2] We first introduce the federal laws governing U.S. depository institutions and the acquisition of a U.S. depository institution by a foreign bank or its parent. We then summarize a foreign acquirer's options for structuring a U.S. acquisition and briefly address certain state corporate law requirements and disclosure requirements under the federal and state securities laws that affect such an acquisition. We then set forth the federal bank or thrift regulatory approvals that would be required under each option. Finally, we summarize the significant federal laws to which a foreign acquirer will become subject upon the completion of any acquisition.

Any transaction discussed in this Chapter that involves the prior approval of one or more regulatory agencies is likely to require a substantial amount of time to consummate. A three-to-six month timetable would not be unusual. This delay arises in part because of special considerations applicable to foreign acquirers, but also because of the difficulties faced by all acquirers in navigating through the multiple application procedures devised by the several regulatory agencies involved. Early and regular liaison with the staffs of these agencies is essential to reduce to the greatest extent possible the inevitable delays and difficulties.

§ 3.02 Legal Framework

[1] U.S. Depository Institution System

Throughout this Chapter, we have assumed that most foreign banks seeking (or with a parent seeking) to acquire a U.S. bank or thrift will already have a branch, agency or commercial lending company in the United States. We refer to such a foreign bank as a foreign bank with a *U.S. commercial banking presence*.

Under the International Banking Act of 1978 [*herein* IBA],[3] a foreign bank with a

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[2] We use the term "thrift" in this Chapter to refer to any savings association, savings and loan association, savings bank or similar institution. This Chapter does not address considerations involved in the acquisition of nondepository trust companies or depository institutions the deposits of which are not insured by the Federal Deposit Insurance Corporation.

[3] International Banking Act of 1978, Pub. L. No. 95-369, 92 Stat. 607, codified at 12 U.S.C. §§ 3101 *et seq.*

U.S. commercial banking presence, and any of its parent companies, is subject to many of the laws that regulate the activities of U.S. bank holding companies, including the principal provisions of the Bank Holding Company Act of 1956 [*herein* BHC Act].[4] The BHC Act, among other things, governs interstate acquisitions by bank holding companies and imposes restrictions on their nonbanking activities and investments. As a result of a longstanding federal policy that seeks to separate commerce from banking, the activities and investments of bank holding companies are generally limited to controlling banks and engaging in, or controlling companies engaged in, activities that are "closely related to banking." Well-capitalized and well-managed bank holding companies that have elected to be treated as "financial holding companies," however, are permitted to engage in an expanded range of nonbanking activities—that is, any activities that are "financial in nature," as well as any activities that are "incidental" or "complementary" to such financial activities.[5] Even if foreign acquirers can qualify as financial holding companies, however, many of them would find that the range of activities and investments that they would be permitted to engage in and make in the U.S. is more limited than those permitted by their home countries.[6]

From the perspective of a foreign bank or its parent, the patchwork of overlapping state and federal laws applicable to U.S. banks and thrifts—known as the "dual banking system"—may appear less than rational. It is best understood as an imperfect compromise between state and federal control over U.S. banking institutions. Until the U.S. Civil War in the 1860s, banks could generally be chartered only by the states and were regulated almost solely by the states. During the Civil War, national banks were widely chartered for the first time (principally to establish a uniform national currency in the absence of a central bank), thus beginning the uneasy tension between state-chartered banks (and state regulation) and national banks (and federal regulation).

The system of regulation in the United States as it now exists arose from this dual banking system and continues to permit the organizers of a depository institution in the United States to license the depository institution under either state or federal law. At the same time, the trend during the twentieth century has been for the role of the federal government to increase in the regulation of all depository institutions. In the aftermath of the bank failures during the Great Depression, Congress created federal

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[4] IBA § 8(a); 12 U.S.C. § 3106(a). The IBA does not subject a foreign bank that has only a representative office in the United States, or any of its parents, to the provisions of the BHC Act. *Id.* We have therefore included foreign banks whose sole direct presence in the United States is a representative office in the category of foreign banks with no U.S. commercial banking presence. Throughout this Chapter, we point out the ways in which a foreign bank with no U.S. commercial banking presence may be treated differently under applicable law.

[5] The BHC Act was amended to authorize this special category of bank holding companies to engage in an expanded range of nonbanking activities by the Gramm-Leach-Bliley Act of 1999, Pub. L. No. 106-102, 113 Stat. 1338 (1999) [*herein* GLBA]. The GLBA did not amend the BHC Act's provisions relating to acquisitions of banks by domestic and foreign companies.

[6] A complete analysis of the nonbanking activities in which U.S. bank holding companies may engage is beyond the scope of this Chapter. For a further discussion, see Chapter 9 and Chapter 10 below.

deposit insurance, which is administered by the Federal Deposit Insurance Corporation [*herein* FDIC]. Following the bank and thrift failures of the 1980s and early 1990s, the resolution (*i.e*., bankruptcy) and enforcement powers of the FDIC were substantially increased. As a matter of federal law, federal deposit insurance is compulsory for national banks and federally chartered thrifts, as well as state-chartered banks that are members of the Federal Reserve System.[7] This, as well as the practical advantages of federal deposit insurance in attracting customers, has ensured that virtually all U.S. banks and thrifts are federally insured.

Given that most state-chartered banks and thrifts are now federally insured, they are subject to the FDIC's regulatory authority.[8] Most sizeable state-chartered banks are members of the Federal Reserve System and therefore also subject to the examination authority of the Board of Governors of the Federal Reserve System [*herein* Board].[9] State-chartered insured thrifts are also subject to the examination authority of the Office of Thrift Supervision [*herein* OTS], a bureau in the Department of the Treasury.[10] Because state-chartered banks and thrifts are regulated by the laws of the state in which they are chartered as well, all state-chartered insured banks are subject to the regulatory oversight of at least two supervisory authorities and many state-chartered banks and all state-chartered insured thrifts are subject to the regulatory oversight of three supervisory authorities.[11]

National banks are also subject to the regulatory oversight of three federal regulators. The Office of the Comptroller of the Currency [*herein* OCC or Comptroller], a bureau of the Department of the Treasury, is the chartering authority and primary regulator of national banks.[12] In addition, national banks that are not merely nondepository trust companies must be FDIC-insured and members of the Federal Reserve System and therefore are subject to the overlapping jurisdiction of the FDIC and, to a limited extent, the Board.[13]

Federally chartered thrifts are subject to the regulatory oversight of two federal regulators. The OTS is the chartering authority and primary regulator of federal thrifts.[14] Like national banks, federal thrifts must be FDIC-insured and therefore are

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[7] *See* 12 U.S.C. §§ 222 (national banks); 12 C.F.R. § 552.2-1(b)(3)(i) (federally chartered thrifts); Application of the Board for Membership in the Federal Reserve System, § 1 (state chartered member banks). In addition, many state banking laws require that state-chartered banks and thrifts have federal deposit insurance. *See, e.g.,* N.Y. Banking Law § 32(1)(a); Fla. Stat. ch. 658.38.

[8] *See* 12 U.S.C. § 1817(a).

[9] 12 U.S.C. § 248.

[10] 12 U.S.C. § 1463.

[11] In addition, all state-chartered insured banks, regardless of whether they are members of the Federal Reserve System, and all insured thrifts are subject to monetary reserve requirements as "depository institutions" within the meaning of the Depository Institutions Deregulation and Monetary Control Act of 1980. 12 U.S.C. § 461.

[12] *See, e.g.*, 12 U.S.C. §§ 21–27.

[13] *See, e.g.*, 12 U.S.C. §§ 248, 1817(a).

[14] *See, e.g.*, 12 U.S.C. §§ 1463-1464.

subject to the overlapping jurisdiction of the FDIC.[15]

In many cases, a foreign acquirer will acquire a U.S. bank or thrift through acquisition of a holding company, since most medium-sized and virtually all larger banks and thrifts are owned by holding companies. As a result, it is likely that the federal and state laws governing bank and thrift holding companies, which overlap the general system of depository institution regulation, will be applicable. Although bank and thrift holding companies, like state-chartered banks, are regulated under both state and federal law, we will primarily discuss the BHC Act, the Home Owners' Loan Act [*herein* HOLA],[16] and other federal laws.[17]

The BHC Act defines a *bank holding company* as a "company" that "control[s]" a bank or "control[s]" a company that itself controls a bank.[18] The Board determines "control" on the basis of a series of presumptions set forth in the BHC Act and in the Board's regulations thereunder.[19]

Section 3 of the BHC Act prohibits a company from becoming a bank holding company without the prior approval of the Board. A company that the Board deems to be a bank holding company, either because of its control of or because of its controlling influence over a U.S. bank or bank holding company, must register as such, disclose its controlling shareholders and affiliations, and comply with periodic reporting and other regulatory requirements.[20]

HOLA similarly defines a *savings and loan holding company* as a "company" that "controls" a savings association (thrift) or "controls" any other company that is a savings and loan (thrift) holding company.[21] The OTS determines "control" on the basis of a series of presumptions set forth in HOLA and in the OTS's regulations thereunder.[22]

Section 10 of HOLA prohibits a company (other than a bank holding company or certain other companies) from becoming a thrift holding company without the prior

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[15] *See, e.g.*, 12 U.S.C. § 1817(a).

[16] Home Owners' Loan Act of 1933, ch. 64, 48 Stat. 128, codified at 12 U.S.C. §§ 1461 *et seq.*

[17] State law is an important element of any potential acquisition, but is beyond the scope of this Chapter.

[18] 12 U.S.C. § 1841. The BHC Act does not apply to ownership interests in banks or bank holding companies held by natural persons, but does apply to such interests held by any "corporation, partnership, business trust, association, or similar organization" and certain other trusts. 12 U.S.C. § 1841(b). A group of natural persons may under certain circumstances constitute an entity encompassed within the definition of *company* for BHC Act purposes.

[19] *See* § 3.03[5] below.

[20] *See* 12 U.S.C. § 1844.

[21] 12 U.S.C. § 1467a(a)(1)(D). Like the BHC Act, HOLA does not apply to ownership interests in thrifts or thrift holding companies held by natural persons, but does apply to such interests held by any "corporation, partnership, trust, joint-stock company, or similar organization." 12 U.S.C. § 1467a(a)(1)(C).

[22] *See* § 3.03[5] below.

approval of the OTS.[23] There is no express exemption from this prior approval requirement for foreign banks or the parents of foreign banks that are not bank holding companies, even if they are subject to the BHC Act by virtue of having a U.S. commercial banking presence. Therefore, in the absence of regulatory relief from the OTS, a foreign bank or the parent of a foreign bank would be required to obtain the prior approval of the OTS before acquiring control of a thrift or thrift holding company, regardless of whether it otherwise has a U.S. commercial banking presence.

A company that the OTS deems to be a thrift holding company, either because of its control of or because of its controlling influence over a U.S. thrift or thrift holding company, must register as such, disclose its controlling shareholders and affiliations, and comply with periodic reporting and other regulatory requirements.[24]

Various federal restrictions govern a bank or thrift holding company's ability to engage directly or indirectly in nonbanking activities.[25] A foreign acquirer that is a bank holding company or would be "treated as" a bank holding company for purposes of Section 4 of the BHC Act would be exempt from the activities restrictions in HOLA even if it acquires a thrift or thrift holding company.[26] As discussed below in Section 3.08[1], a foreign bank or the parent of a foreign bank with a U.S. commercial banking presence that meets the conditions for a "qualifying foreign banking organization" can rely on certain exemptions [*herein* QFBO exemptions] from these nonbanking activities restrictions to continue to engage in certain largely offshore activities and investments even after it acquires a U.S. bank. The OTS has effectively extended the QFBO exemptions by regulation to the foreign parents of thrifts or thrift holding companies.[27]

[2] Interstate Acquisitions and Branching

Historically, the ability of U.S. banks, thrifts and their holding companies to expand across state lines, either by branching, merger or acquisition, was limited by a combination of federal and state law. As part of the imperfect compromise between state and federal control of U.S. depository institutions, federal law generally left the states free to determine the limits of interstate acquisitions and branching.[28] Most significantly for banks, Section 3(d) of the BHC Act, known as the Douglas Amendment, prohibited the Board from approving any application by a bank holding

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[23] *See* 12 U.S.C. § 1467a(e)(1)(B). *See also* 12 U.S.C. § 1467a(t) (bank holding companies are not subject to Section 10 of HOLA).

[24] *See* 12 U.S.C. § 1467a(b).

[25] For a more complete discussion, see §§ 3.02[2], 3.08[1], and Chapter 9 below.

[26] See 12 U.S.C. § 1467a(c)(8), which provides that the activities restrictions otherwise applicable to a thrift holding company (other than an anti-evasion rule) do not apply to "any company that is *treated as* a bank holding company" for purposes of Section 4 of the BHC Act. A foreign bank and any parent of a foreign bank with a U.S. commercial banking presence is treated as a bank holding company for purposes of Section 4 under Section 8(a) of the International Banking Act of 1978, 12 U.S.C. § 3106(a).

[27] *See* 12 C.F.R. § 584.2(b)(6)(i); 72 Fed. Reg. 72,235 (Dec. 20, 2007).

[28] See 12 U.S.C. §§ 36, 1842(d), 3103(a) (1988).

company to acquire directly or indirectly more than 5 percent of the voting stock, or all or substantially all of the assets, of a U.S. bank located outside of the state in which the bank holding company's "principal subsidiary bank" was located, unless the target state's law expressly permitted such an acquisition.[29]

The IBA subjected foreign banks with a U.S. commercial banking presence and any of their parent companies to limitations similar to those imposed on domestic bank holding companies by requiring such foreign banks and any of their parent companies to elect a "home state" and then prohibiting interstate bank acquisitions outside the home state unless the state of the target expressly permitted such acquisitions.[30] Thus, a foreign bank with a U.S. commercial banking presence generally faced the same limitations on out-of-state bank acquisitions as a U.S. bank holding company located in its home state.

The restrictions on interstate bank acquisitions and branching were substantially eroded with the passage of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 [*herein* the Riegle-Neal Act], which contained a number of provisions facilitating interstate banking and branching and thereby accelerated the trend toward nationwide banking consolidation.

First, the Riegle-Neal Act amended the Douglas Amendment to allow the Board to approve the acquisition by a bank holding company of a bank outside the holding company's home state without regard to whether the acquisition is prohibited under state law.[31] The state in which the target bank is located, however, may impose certain "minimum age requirements"—i.e., require that the target bank have been in existence for up to five years prior to the acquisition.[32] In addition, the Board may not approve an acquisition if the acquiring bank holding company would thereby control more than 10 percent of the total amount of deposits of insured depository institutions in the United States or more than 30 percent of insured deposits in any one state.[33] The 30 percent concentration limit, however, does not apply to the initial entry into a state by a bank or its affiliates, and a state may establish either higher or lower concentration limits to which the Board will defer, so long as they are not discriminatory.[34]

Second, the Riegle-Neal Act added a new section to the Federal Deposit Insurance

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[29] 12 U.S.C. § 1842(d) (1988).

[30] 12 U.S.C. § 3103(a)(5) (1988).

[31] 12 U.S.C. § 1842(d)(1).

[32] 12 U.S.C. § 1842(d)(1). As of 2005, 18 states had minimum age requirements ranging from three to five years. *See* 2004/2005 PROFILE OF STATE CHARTERED BANKING (Conference of State Bank Supervisors).

[33] 12 U.S.C. § 1842(d)(2).

[34] 12 U.S.C. § 1842(d)(2). As of 2005, 35 states had set statewide deposit caps on bank holding company acquisitions at 30 percent, and 13 states had caps ranging from ten percent to 25 percent. *See* 2004/2005 PROFILE OF STATE CHARTERED BANKING (Conference of State Bank Supervisors). Finally, in deciding whether to approve an application for an interstate acquisition, the Board is required to consider the acquiring bank holding company's record of compliance with the Community Reinvestment Act of 1977 [*herein* the CRA]. 12 U.S.C. § 1842(d)(3).

Act [*herein* FDIA], Section 44, which permits interstate merger transactions between FDIC-insured banks in different states, without regard to whether the merger is prohibited under the law of any state.[35] Such interstate merger transactions are subject to the approval of the appropriate federal regulator under the Bank Merger Act.[36] Following the merger transaction, the surviving bank is permitted to convert any of the target bank's offices into its own branches.[37] Section 44 also permits the appropriate federal regulator to approve the interstate acquisition of a branch without the acquisition of a depository institution itself, where such acquisitions are permitted by state law.[38] The surviving bank may also establish, acquire, or operate additional branches at any location where a bank involved in the transaction could have established, acquired, or operated such a branch under applicable state and federal law.[39] Although the Riegle-Neal Act permitted states to opt out of Section 44 if they did so prior to June 1, 1997,[40] none of them had any enacted an opt-out law as of that date.[41]

Third, the Riegle-Neal Act allowed (but did not require) states to permit *de novo* branching of state and national banks across state lines, thus allowing entry in the absence of an acquisition or interstate merger transaction.[42]

Because the IBA subjects a foreign bank with a U.S. commercial banking presence

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[35] 12 U.S.C. § 1831u(a)(1). As with the provisions on interstate acquisitions, the merger provisions preserve state minimum age requirements of up to five years and impose deposit concentration limits of 10 percent nationwide and 30 percent statewide. The 30 percent concentration limit does not apply to initial entry into a state by a bank or its affiliates. Section 44 also specifies that the Community Reinvestment Act of 1977 [*herein* CRA], *see* § 3.06[5] below, applies to the initial entry of a bank into a host state in a manner analogous to the case of an interstate bank holding company acquisition. 12 U.S.C. § 1831u(b)(3). Finally, under Section 18 of the FDIA, an acquired bank not yet converted into a branch of the acquiring bank may act as an agent for affiliated depository institutions in receiving deposits, renewing time deposits, closing loans, servicing loans, and receiving payments on loans. 12 U.S.C. § 1828(r).

[36] The appropriate federal regulator is the OCC, if the surviving depository institution is a national bank; the Board, if the surviving depository institution is a state member bank; the FDIC, if the surviving depository institution is an insured state nonmember bank; and the Director of the OTS if the surviving depository institution is a savings association. 12 U.S.C. § 1828(c)(2).

[37] 12 U.S.C. § 1831u(d)(1).

[38] 12 U.S.C. § 1831u(a)(4). As of 2005, 29 states plus the District of Columbia and Puerto Rico permitted the acquisition of individual branches. West Virginia, Tennessee, Texas, Oklahoma, Michigan, New Hampshire, Pennsylvania, Washington, and Indiana, however, only allowed such acquisitions on a reciprocal basis, that is, if the laws of the acquiring bank's home state permit such acquisitions by out-of-state banks. *See* 2004/2005 PROFILE OF STATE CHARTERED BANKING (Conference of State Bank Supervisors).

[39] 12 U.S.C. § 1831u(d)(2). The same rules apply to states that permit the acquisition of bank branches without acquisition of the bank itself.

[40] 12 U.S.C. § 1831u(a)(2).

[41] *See* A PROFILE OF STATE CHARTERED BANKING (Conference of State Bank Supervisors, 2000).

[42] 12 U.S.C. §§ 36(g), 1828(d). As of 2005, 23 states allowed de novo branching on at least a reciprocal basis. *See* 2004/2005 PROFILE OF STATE CHARTERED BANKING (Conference of State Bank Supervisors).

to limitations similar to those imposed on domestic bank holding companies,[43] foreign banks generally face the same federal law limitations on out-of-state bank acquisitions and branching as a U.S. bank holding company.[44] The most significant exception to this general rule is that the Board or the OCC may condition the approval of a foreign bank's application to establish branches across state lines on its doing so by establishing a separate U.S. subsidiary bank if the relevant agency finds that this is the only way to verify the compliance of the foreign bank with capital adequacy requirements equivalent to those imposed on U.S. banks.[45] Finally, if a foreign bank makes an initial interstate entry by acquiring a depository institution that was subject to the CRA[46] at the time of the acquisition, the CRA will apply to any branch of the foreign bank resulting from the acquisition, unless the resulting branch receives only deposits permissible for an Edge Act Corporation.[47]

As for thrifts, Section 10(e) of HOLA generally prohibits the OTS from approving interstate acquisitions of a thrift or thrift holding company that would result in a "multi-state, multiple thrift holding company"—i.e., a thrift holding company that directly or indirectly controls two or more thrifts in two or more states, unless the target state's law expressly permits the acquisition.[48] Section 10(e) does not, however, prohibit the OTS from approving other interstate acquisitions, such as those structured as the merger of two or more thrifts into a single surviving thrift so that a unitary thrift holding company structure is achieved. The Reigle-Neal Act did not amend Section 10(e)'s general prohibition on multi-state, multiple thrift holding companies nor did it make the OTS's approval of interstate thrift mergers effective notwithstanding contrary state law, the way it did for approvals of interstate bank mergers in Section 44 of the FDIA. As a result, interstate thrift acquisitions are more dependent on state law than interstate bank acquisitions.

While the authority of state-chartered thrifts to branch interstate is basically the same as that of state or national banks, the OTS has issued a regulation authorizing federal thrifts to branch nationwide and expressly preempting contrary state law.[49] Section 5 of HOLA limits this interstate branching authority to federal thrifts that

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[43] 12 U.S.C. § 3106(a).

[44] A foreign bank with a U.S. commercial banking presence generally is subject to the same limitations on nationwide expansion as a domestic bank holding company located in the foreign bank's home state. A foreign bank may establish branches and agencies on an interstate basis to the same extent that a domestic bank whose home state is the same state as the home state of the foreign bank could do so. 12 U.S.C. § 3103(a). In addition, a national or state bank subsidiary of a foreign bank may acquire, establish or operate branches outside the foreign bank's home state to the same extent as any other national or state bank from such home state. 12 U.S.C. § 3103(d). A foreign bank may branch directly at the same time as it controls a U.S. subsidiary bank. 12 U.S.C. § 3103(d).

[45] 12 U.S.C. § 3103(a)(6).

[46] For a discussion of the CRA, see § 3.06[5] below.

[47] 12 U.S.C. § 3103(a)(8).

[48] 12 U.S.C. § 1467a(e)(3).

[49] 12 C.F.R. § 545.92.

satisfy the qualified thrift lender (QTL) test or certain other conditions.[50]

[3] Restrictions on Foreign Ownership

[a] General

The federal banking laws do not contain any general restrictions on the foreign ownership or control of U.S. depository institutions, and there are numerous examples of the federal banking regulators approving acquisitions of such institutions by foreign persons and entities. The laws of many states also permit foreign ownership of banks or thrifts chartered by such states.

There are, however, certain restrictions on the citizenship of directors of national banks and some state-chartered banks. In general, a national bank must have not fewer than five directors, all of whom must be U.S. citizens.[51] State laws vary as to citizenship and residency requirements.[52] As a practical matter, since these restrictions apply at the bank rather than the holding company level and since most acquisitions will involve a bank holding company, the citizenship requirements should not be a substantial deterrent to an acquisition by a foreign bank.[53]

[b] Foreign Government-Controlled Organizations

A foreign government is not treated as a "company" under the BHC Act and is therefore not subject to the restrictions of the BHC Act.[54] Thus, in theory, it need not seek the Board's prior approval under the BHC Act for the acquisition of a U.S. bank or bank holding company.[55] The Board, however, has expressed concern with the ownership of U.S. banks by foreign governments that, in addition to their U.S. banking operations, own nonbanking operations, because such ownership may be incompatible with the BHC Act's separation of commerce and banking.[56]

In addition, the BHC Act's foreign government exception has been substantially

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[50] 12 U.S.C. §§ 1464(r), 1467a(m).

[51] 12 U.S.C. §§ 71, 72.

[52] For example, under New York law, at least one-half of the directors of a New York state-chartered bank must be U.S. citizens. N.Y. Banking Law § 7001(2)(a).

[53] A foreign controlled bank will be subject to certain limitations on leveraged leasing transactions involving vessels used in coastwise trade, 46 U.S.C. § 50501, and U.S. registered aircraft used primarily on international routes, 14 C.F.R. § 47.3. In addition, such a bank may be disqualified from acting as a primary dealer for U.S. government securities, 22 U.S.C. § 5342(b)(1), and may be required by some states to divest any real estate holdings in such states. A foreign controlled bank may also face limitations on transactions involving certain defense contractors and Federal Communications Commission licensees.

[54] *See* Statement of Scott G. Alvarez, General Counsel, Board of Governors of the Federal Reserve System, before the Committee on Banking, Housing, and Urban Affairs, U.S. Senate, April 24, 2008.

[55] *See* Statement of John P. LaWare, Member, Board of Governors of the Federal Reserve System, before the Committee on Banking and Finance and Urban Affairs, U.S. House of Representatives, May 8, 1992, 78 FED. RES. BULL. 495, 497 (1992).

[56] *See* Statement of John P. LaWare, Member, Board of Governors of the Federal Reserve System, before the Committee on Banking and Finance and Urban Affairs, U.S. House of Representatives, May 8, 1992, 78 FED. RES. BULL. 495, 497 (1992).

limited as a practical matter, because in 1988 the Board decided that it would generally consider foreign government-controlled business organizations to be "companies" for purposes of the BHC Act.[57] Because foreign governments generally engage in commercial activities through separate vehicles, this interpretation restricts the foreign government exception in most instances. Thus, any foreign government that seeks to acquire control of a U.S. bank through a government-controlled business organization will find that the business organization, but not the foreign government itself, will be treated as a "company" for purposes of the BHC Act.

The Board's interpretation came in connection with the proposed acquisition of Irving Bank Corporation [*herein* Irving] by Istituto per la Ricostruzione Industriale [*herein* IRI], a "financial public corporation" created by the Italian government in 1933 to hold certain industrial and financial companies in the aftermath of the Great Depression.[58] The Board concluded that IRI constituted a "company" for purposes of Section 2(b) of the BHC Act. Although the Board had previously ruled that IRI was not a "company,"[59] it reversed this position because of concerns that IRI's potential acquisition of a large U.S. bank holding company presented serious questions with respect to commercial and industrial entanglements. That is, it feared that IRI as a diversified holding company seeking to acquire a large U.S. bank holding company might breach the traditional divisions between banking and commerce and frustrate the goals of the BHC Act.[60] The Board concluded that the term "company" covered IRI because it was a "corporate-like entity" with commercial aims and not a mere regulatory "agency," and that the term would cover all similar "entities that may be used for acquiring and maintaining in perpetuity control of banks."[61] Therefore, IRI was required to file an application in connection with the acquisition.

Because of the potential impact of the reversal of its position, however, the Board also announced a permanent exemption under Section 4(c)(9) of the BHC Act from the BHC Act's activities and investment restrictions and its capital and reporting

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[57] *See* Letter from the Board of Governors of the Federal Reserve System, dated August 19, 1988, to Patricia S. Skigen and John B. Cairns [*herein* the IRI Letter]. *Cf.* Bay Bancorporation, 81 FED. RES. BULL. 791, 791 n.3 (1995) (relying on the IRI Letter in finding a Native American Indian Tribe to be a sovereign government excluded from the BHC Act's definition of *company*).

[58] *See* Letter from the Board of Governors of the Federal Reserve System, dated August 19, 1988, to Patricia S. Skigen and John B. Cairns.

[59] LITCO Bancorporation, 68 FED. RES. BULL. 423, 425 (1982). In the IRI Letter, the Board attributed its 1982 LITCO decision to a desire to avoid upsetting without warning the banking community's long-held belief that entities like IRI were exempt from provisions of the BHC Act. *See* Letter from the Board of Governors of the Federal Reserve System, dated August 19, 1988, to Patricia S. Skigen and John B. Cairns.

[60] In addition, Irving had an existing lending relationship with the Italian government and other Italian government-owned companies that, had an acquisition been consummated, would have become subject to the restrictions on transactions between affiliates contained in Sections 23A and 23B of the Federal Reserve Act. For a discussion of these restrictions, see § 3.08[3] below.

[61] *See* Letter from the Board of Governors of the Federal Reserve System, dated August 19, 1988, to Patricia S. Skigen and John B. Cairns.

requirements for all foreign government-controlled business organizations that (1) had no direct or indirect U.S. bank subsidiary (but instead conducted any banking activities in the United States solely through a U.S. branch or agency of a foreign bank) and (2) conducted the majority of their business outside the U.S.[62] By its terms, however, the exemption applied only to those foreign government-owned business organizations that controlled foreign banks as of the date of the Board's action that had U.S. branch or agency operations. The Board stated that it would consider future applications on a case-by-case basis to determine whether other foreign government-controlled business organizations qualified for a similar exemption.[63]

[c] National Security Review

The acquisition of a U.S. bank or thrift by a foreign acquirer could be subject to a national security review under Section 721 of the Defense Production Act of 1950 [*herein* Section 721] if the transaction could result in foreign control of any "critical infrastructure" or otherwise threaten the national security of the United States.[64] The Committee on Foreign Investment in the United States [*herein* CFIUS], an interagency committee chaired by the Secretary of the Treasury, would conduct the review. Critical infrastructure includes any "system or assets, whether physical or virtual, so vital to the United States that the incapacity or destruction of such systems or assets would have a debilitating impact on national security."[65] It is not limited to defense-related infrastructure. Although there is little history of subjecting U.S. bank or thrift acquisitions to a national security review, the Foreign Investment and National Security Act of 2007 [*herein* FINSA] substantially expanded the range of transactions potentially subject to review under Section 721.[66] Among other things, FINSA would require CFIUS to conduct an investigation of a transaction's effect on U.S. national security if it would result in a foreign-government controlled company (*e.g.*, a sovereign wealth fund) being deemed to control any U.S. bank or thrift, regardless of whether it involved the control of any critical infrastructure.[67]

Under the regulations implementing Section 721, a passive non-controlling investment in less than 10 percent of the voting interest of any U.S. company is generally

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[62] *See* Letter from the Board of Governors of the Federal Reserve System, dated August 19, 1988, to Patricia S. Skigen and John B. Cairns. Section 4(c)(9) of the BHC Act permits the Board to grant a foreign company the greater part of whose business is conducted outside the U.S. an exemption from the BHC Act's prohibitions on nonbanking activity, if such exemption would not be substantially at variance with the purposes of the BHC Act and would be in the public interest. 12 U.S.C. § 1843(c)(9). For a detailed discussion of Section 4(c)(9), see Chapter 9 below.

[63] *See* Letter from the Board of Governors of the Federal Reserve System, dated August 19, 1988, to Patricia S. Skigen and John B. Cairns. *See also* Statement of Scott G. Alvarez, General Counsel, Board of Governors of the Federal Reserve System, before the Committee on Banking, Housing, and Urban Affairs, U.S. Senate, April 24, 2008.

[64] Section 721 of the Defense Production Act of 1950, as codified at 50 U.S.C. App. §§ 2170 *et seq.*

[65] 50 U.S.C. App. § 2170(a)(6).

[66] Foreign Investment and National Security Act of 2007, Pub. L. 110-49, 121 Stat. 246.

[67] *See* 50 U.S.C. App. § 2170(b)(2)(B)(i)(II).

exempt from CFIUS review and any action to prohibit, suspend or impose any conditions on the investment.[68]

If CFIUS finds that a proposed foreign investment or acquisition would threaten to impair the national security of the United States, the President has the authority to suspend, prohibit or impose conditions on the transaction.[69]

[4] Hart-Scott-Rodino Act

The Hart-Scott-Rodino Antitrust Improvements Act of 1976 [*herein* HSR Act] would require the parties to any acquisition by a foreign acquirer of any U.S depository institution or its holding company parent involving the acquisition of more than $63.1 million of voting securities or assets to (i) file certain information with the Antitrust Division of the U.S. Department of Justice and the Federal Trade Commission [*herein* collectively the Antitrust Agencies] and (ii) suspend consummation of the transaction for a prescribed waiting period (generally 30 days, but, in the case of an all cash tender offer, 15 days) to give the Antitrust Agencies an opportunity to analyze the proposed transaction's likely effects on competition. Following expiration (or early termination) of the waiting period, the parties would be free to close the transaction, unless they receive a second request for information.

An HSR Act filing is typically made shortly after the execution of a deal agreement or public announcement of a tender offer, but, in any event, before consummating the transaction. The filing consists of a notification form that describes both the proposed transaction and the parties' general lines of business in substantial detail. No express approval is required; only the expiration of the waiting period without objection is necessary.

The HSR Act contains an exemption for acquisitions that are subject to prior approval requirements under Sections 3 or 4 of the BHC Act, the Bank Merger Act, or Sections 5 or 10 of HOLA.[70] The Federal Trade Commission has extended this exemption, by regulation, to acquisitions that are subject to the prior notice requirements of the CIBC Act, subject to the applicant contemporaneously filing

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[68] 31 C.F.R. § 800.302(c). The question of what constitutes a passive non-controlling investment in less than 10 percent of a voting interest under Section 721 is beyond the scope of this Chapter.

[69] 50 U.S.C. App. § 2170(d).

[70] 15 U.S.C. § 18a(c)(7), (8); Federal Trade Commission Formal Interpretation 17, 65 Fed. Reg. 17,880 (Apr. 5, 2000).

In order to qualify for the exemption in the case of acquisitions subject to Section 4 of the BHC Act or Section 5 of HOLA, copies of all documents submitted to the Board must also be filed with the Antitrust Agencies. 15 U.S.C. § 18a(c)(8). There is no such requirement for acquisitions subject to Section 3 of the BHC Act or Section 10 of HOLA. 12 U.S.C. § 18a(c)(7).

If the foreign acquirer is a financial holding company and the acquisition also involves the acquisition of any non-banking (non-thrift) companies or any U.S. branches of a foreign bank, these exemptions generally would not apply to the extent of such acquisitions because they would not generally require the prior approval of the Board under Sections 3 or 4 of the BHC Act or any other federal bank or thrift regulator.

copies of the CIBC Act notice with both of the Antitrust Agencies.[71]

§ 3.03 Structuring the Acquisition

A foreign acquirer may structure the acquisition of a U.S. depository institution or bank or thrift holding company in a number of ways, depending upon applicable corporate law, regulatory and tax considerations, and whether the foreign acquirer seeks to acquire a minority investment, a controlling investment or all of the stock or operations of a target. This subsection highlights certain aspects of U.S. law that the foreign acquirer should take into account in choosing among the various methods of structuring such an acquisition or investment.[72]

There are three general approaches to structuring an acquisition: (1) a purchase of the target's stock (by tender offer or otherwise); (2) a merger; and (3) a purchase of the target's assets with a corresponding assumption of the target's liabilities. Each method raises separate corporate, regulatory, tax and securities law considerations.

Although a detailed analysis of the U.S. securities law considerations applicable to the acquisition of a target is beyond the scope of this Chapter, if the foreign acquirer has chosen a publicly-held target or if the foreign acquirer chooses to pay for the acquisition by issuing its own securities, U.S. federal securities law implications will also need to be considered in connection with the acquisition. Until recently, the practical problems involved in complying with federal and state securities laws effectively led foreign acquirers to use cash as the sole consideration in an acquisition, in contrast to acquisitions by domestic bank and thrift holding companies in which stock has been the preferred form of consideration. There has been in the last several years, however, a substantial increase in the number of foreign banks which, as a result of prior offerings of securities in the United States, are *already* subject to the Exchange Act. Such foreign banks may find an offering of dollar denominated American depository receipts representing their equity an attractive option.

If the foreign acquirer contemplates that borrowings will provide the cash used to make the acquisition (whether by way of a cash tender offer or otherwise), the Board's "margin regulations" may apply.[73] While margin regulations are an extremely technical and complex subject, their basic purpose is to limit the use of certain

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[71] 16 C.F.R. § 802.8(b).

[72] A more detailed financial, management, regulatory, and market analysis should be undertaken, however, once a likely target has been identified. As an initial matter, a foreign acquirer should determine in what manner it is permitted to acquire depository institutions in the target's state. In addition, the foreign acquirer should examine the tax consequences of particular structures, state law matters, and the securities disclosure implications of different approaches. Before settling on the structure of the acquisition, as part of its due diligence investigation of the target, the foreign acquirer also should investigate the charter, bylaws, debt instruments, and other important contracts of the target to determine whether they contain any restrictions relating to mergers or changes in control that make one or more methods impossible or impractical.

[73] *See* Exchange Act § 7, 15 U.S.C. § 78g; 12 C.F.R. pts. 207, 220, 221 & 224 (Board Regulations G, T, U, and X).

borrowed funds in the acquisition of publicly-traded securities.[74]

[1] Stock Purchases

The most common type of acquisition by a foreign acquirer is the purchase, either directly or through a subsidiary, of the stock of a U.S. depository institution or its holding company. Such an acquisition might be accomplished by a purchase of authorized but previously unissued stock of the target, by a purchase of stock from a target's holding company, by purchases of stock from current investors, or by a tender offer. The consideration offered by a foreign acquirer in any such acquisition will typically be cash.

[a] Newly Issued Stock of Target

The purchase of authorized but previously unissued stock directly from the target (whether it is the depository institution or its holding company) has been one typical method by which foreign acquirers structure acquisitions of less than 100 percent interests in both publicly-held and privately-held U.S. depository institutions and their holding companies. This structure is useful when the target's management is receptive to the foreign acquirer owning stock and either desires an increase in capital or seeks to create a large shareholding interest in friendly hands to discourage others from making undesired bids for target stock. If the target is publicly held, however, such an acquisition may be limited by restrictions on the target's ability to issue additional shares under stock exchange rules.[75]

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[74] Foreign acquirers also must examine carefully the provisions of the Investment Company Act of 1940 if they choose to offer securities in the U.S. or to use a subsidiary U.S. finance company to acquire a minority interest in a U.S. target. Investment Company Act of 1940, 15 U.S.C. §§ 80a-1 to 80a-64. Although Investment Company Act Rule 3a-6 exempts most foreign banks and related entities from the definition of *investment company* and allows them to sell their securities in the United States without registering as investment companies, under certain circumstances, a U.S. finance company subsidiary could be subject to the registration and reporting provisions of the Investment Company Act of 1940, as well as other substantive provisions and detailed regulations adopted under that law. 17 C.F.R. § 270.3a-6.

[75] A company whose stock is listed on the New York Stock Exchange must seek approval of shareholders for a proposed issuance of shares (even if already authorized but unissued) that would result in an increase of 20 percent or more of the total shares outstanding or constitute a "change of control" of the issuer (which can be implicated in certain circumstances, for example, where an investor's stake in the issuer increases above 25-30 percent and certain veto or other governance rights are granted). NEW YORK STOCK EXCHANGE LISTED COMPANY MANUAL § 312.03(c); *see also* AMERICAN STOCK EXCHANGE COMPANY GUIDE § 713 (20 percent) and Rule 4350(i) of the NASDAQ Stock Market LLC [*herein* NASDAQ] (20 percent). In addition, under New York Stock Exchange and NASDAQ rules, a company whose stock is listed or quoted may not, subject to certain exceptions, take action having the effect of nullifying, restricting, or disparately reducing the voting rights of its existing common shareholders.

Historically, the New York Stock Exchange had an exception to the Section 312.03 requirements for shareholder approval, which was commonly referred to as the "treasury share exception." Under the treasury share exception, the existence or sale of treasury shares was not considered in determining whether an issuance of shares amounted to 20 percent or more of the total shares outstanding for purposes of triggering the shareholder approval requirement. Banco Santander, S.A. and Sovereign Bancorp, Inc. relied on this exception in 2006 when structuring Banco Santander's strategic minority investment in

Any purchase of stock from a privately held target (whether it is a depository institution or a bank or thrift holding company) should be accompanied by a written agreement between the foreign acquirer and the target (and possibly certain of its larger shareholders) setting forth the parameters of their relationship following the consummation of the acquisition. The matters that such an agreement may address include: rights to board representation, voting agreements, rights to participate in decisions regarding operating matters, registration rights, standstill provisions, transfer restrictions, and exit provisions. The rights that a foreign acquirer ultimately obtains will be a product of negotiation and will depend on factors such as the percentage of the target the foreign acquirer will own and the target's need for additional capital.

[b] Subsidiary Stock from Holding Company Parent

Another common acquisition method for foreign acquirers is to purchase a target depository institution's stock directly from its parent holding company. This structure may be employed where the holding company wants to sell all or substantially all its assets and then distribute the cash received to its shareholders; where a multiple bank or thrift holding company desires to dispose of one or more of its subsidiary banks or thrifts; or where an acquirer is unwilling to acquire certain subsidiaries of the target holding company or assume certain of the target bank holding company's liabilities. If the depository institution stock sold to the foreign acquirer represents substantially all of the assets of the parent holding company, applicable state corporate law may require approval of the transaction by the shareholders of the holding company.[76]

Since the target depository institution will become a wholly owned subsidiary of the foreign acquirer in this type of transaction, there is no need for any additional agreement governing the relationship between the foreign acquirer and the target

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Sovereign Bancorp so that the transaction would not be subject to a shareholder vote. This feature of the transaction added to the controversy surrounding the transaction, which was protested by a number of Sovereign's institutional shareholders. The protesting shareholders claimed that the use of the treasury share exception led to unanticipated dilution without shareholder approval and allowed companies to circumvent shareholder approval requirements by storing up large reserves of stock. Although the NYSE ruled that Banco Santander could rely on the treasury share exception, the New York Stock Exchange subsequently amended its rule to eliminate the treasury share exception. Investors, including foreign banks, will therefore no longer be able to rely on the treasury share exception when structuring minority investments. Securities and Exchange Commission Release No. 34-54999; File No. SR-NYSE-2006-30, December 21, 2006.

Although no longer very common in the United States, some state laws and charter provisions of banks and bank holding companies may grant preemptive rights to provide shareholders the opportunity to purchase newly-issued shares. Moreover, if the target does not have sufficient authorized but unissued shares, a shareholder vote typically is required to authorize additional shares.

In the event a shareholder vote is required under stock exchange rules (or under applicable statutes or charter or bylaw provisions), a proxy or information statement must be prepared in connection with the shareholders' meeting called to approve the proposed issuance. If the target's shares are registered under the Securities Exchange Act of 1934 [*herein* Exchange Act], proxy rules promulgated under the Exchange Act or, in the case of a bank target, promulgated by the appropriate federal banking regulator, must be complied with, necessitating the preparation of certain information concerning the foreign acquirer.

[76] *See, e.g.*, DEL. CODE. ANN. tit. 8, § 271 and N.Y. BUS. CORP. LAW § 909.

depository institution or its parent holding company after consummation of the acquisition. One of the most important contractual items on which a foreign acquirer should focus in such a transaction is a post-closing indemnification commitment from the selling holding company to protect the foreign acquirer from inaccuracies in the representations and warranties made in the acquisition agreement. Such an indemnity may be difficult to obtain if the target subsidiary represents substantially all of the assets of the selling holding company, particularly if the selling holding company intends to distribute the proceeds of the sale to its shareholders.

[c] Open Market Purchases

Open market purchases are often of limited practical utility in the context of depository institution acquisitions because, as a practical matter, only a limited amount of stock can be purchased in open market purchases by a broker or dealer acting on behalf of the foreign acquirer. A foreign acquirer with a U.S. commercial banking presence may not acquire 5 percent or more of any class of voting securities of a depository institution or bank or thrift holding company without seeking prior approval from the Board under the BHC Act.[77] In contrast, a foreign bank with no U.S. commercial banking presence could, in many cases, acquire up to 9.9 percent of the voting securities of a depository institution or a bank or thrift holding company without being required to seek prior approval under the BHC Act, HOLA or the Change in Bank Control Act [*herein* CIBC Act].[78] The success of such an acquisition program would depend on there being an active and liquid trading market in the stock of the target or the availability of large private holdings.[79] In connection with any open market purchase program, a foreign acquirer must be careful that it does not inadvertently engage in activities that constitute a tender offer.[80] The consequences of a foreign acquirer inadvertently undertaking a tender offer for a publicly held bank or thrift holding company without complying with the tender offer rules and regulations promulgated by the Securities and Exchange Commission [*herein* SEC] could include an enforcement action being brought by the SEC along with a substantial likelihood of private litigation brought by shareholders of the target.[81]

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[77] 12 U.S.C. § 1842(c)(3); 12 C.F.R. §§ 225.2(c)(2), 225.11(f).

[78] *See* 12 C.F.R. §§ 225.41 (Board), 583.7 (OTS); § 3.03[5] below.

[79] If individuals or institutions own substantial blocks of a target's stock, a foreign acquirer may be able to purchase the stock in private, negotiated transactions.

[80] The term *tender offer* is not defined by the Exchange Act or the rules promulgated thereunder. The SEC takes the position that the term *tender offer* is to be interpreted flexibly and applies to special bids (bids too large to be filled in the regular auction market); purchases resulting from widespread solicitations by means of mailings, telephone calls and personal visits; and any other purchases where the conduct of the person seeking control exerts pressure on shareholders similar to that attending a conventional tender offer. *See* SEC Release No. 34-12,676 (1976).

[81] In the case of tender offers for publicly traded banks or thrifts, a foreign acquirer would be required to comply with the analogous rules, if any, of the appropriate bank or thrift regulator. Section 12(i) of the Exchange Act, 15 U.S.C. § 78l(i), transfers to the federal banking regulators the SEC's authority to administer and enforce Sections 10A(m), 12, 13, 14(a), 14(c), 14(d), 14(f) and 16 of the Exchange Act with respect to securities issued by insured banks or thrifts.

If the target is a publicly-held U.S. bank or thrift holding company, as is likely in the case of open market purchases, such a foreign acquirer will generally be required, under Section 13(d) of the Exchange Act, to file a disclosure schedule with the SEC within 10 days after the acquisition (which is broadly defined for this purpose) of more than 5 percent of the voting securities of the target[82] and a separate form within 10 days after the acquisition of 10 percent or more of such class of equity securities.[83] If the target is a publicly-held U.S. bank or thrift with no holding company, the foreign acquirer will generally be required to make similar filings with the target's federal bank regulator within the time periods established by such bank regulator.[84] Thus, in either the case of a foreign acquirer with a U.S. office or a foreign acquirer without such an office, only a limited amount of stock may be purchased before the program of open market purchases will become publicly known, with the possibility of a consequent rise in the price of a target's shares.

Before undertaking a program of open market purchases of the shares of a publicly-held target depository institution or its holding company, a foreign acquirer must determine whether or not the target has a "rights plan," also referred to as a "poison pill," in place. Generally such a determination can be made quickly by

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[82] The SEC notice, generally filed on Schedule 13D under the Exchange Act, is separate and distinct from the required CIBC Act notice. The CIBC Act notice must be filed with the appropriate bank regulator *prior* to any acquisition of "control" and will involve the Board's approval or disapproval based on information supplied by the foreign acquirer. The 13D filing must be filed with the SEC within 10 days *after* the acquisition of more than 5 percent of the voting stock of the target and its primary purpose is disclosure. No SEC approval or disapproval is involved. Such reports are usually quickly published in the financial press. The report must disclose the nature of the transaction, the background of the foreign acquirer, its parent (if any) and the management of both the acquirer and the parent, the sources of funds used for the purchase of target stock (including the identity of any foreign bank financing the purchase), the purpose of the transaction, the nature and scope of any arrangements with regard to the target's securities, and the nature of any plans for future purchases of target stock or for any major corporate transactions affecting or involving control of the target. Exchange Act § 13(d); 15 U.S.C. § 78m(d)(1). If the acquired shares are listed on a securities exchange, the Schedule 13D also must be sent to the exchange. The Schedule 13D must be amended to reflect material changes in plans as well as for each subsequent material acquisition or disposition of the same class of shares. An acquirer buying less than 20 percent of the voting securities and without an intent to effect a change of control may be eligible to file on Schedule 13G, which requires less extensive disclosures than Schedule 13D. For a more detailed discussion of the CIBC Act notice, see § 3.04[3] below.

[83] This SEC notice, required by Section 16(a) of the Exchange Act, is filed on Form 3 under the Exchange Act, and is separate and distinct from the Schedule 13D filing. Crossing the 10 percent threshold also has substantive consequences for a foreign acquirer under Section 16, which must be considered before an acquirer were to elect to do so (e.g., "short swing" profits disgorgement, prohibition on short sales, etc.). A foreign acquirer that is considering crossing the 10 percent ownership level should consult with counsel on these Section 16 issues.

[84] *See, e.g.* 12 C.F.R. § 335.331 (FDIC). Section 12(i) of the Exchange Act, 15 U.S.C. § 78l(i), transfers to the federal banking regulators the SEC's authority to administer and enforce Sections 10A(m), 12, 13, 14(a), 14(c), 14(d), 14(f) and 16 of the Exchange Act with respect to securities issued by insured banks or insured thrifts. *See also* 12 C.F.R. §§ 16.17(c), 16.20(a) (OCC - national banks); 12 C.F.R. § 208.36(a), (c) (Board - state member banks); 12 C.F.R. § 335.201(FDIC - state nonmember banks); 12 C.F.R. § 563g.18 (OTS - thrifts).

reviewing the target's publicly available SEC filings. If a foreign acquirer purchases a percentage of target stock in excess of the threshold set in the target's poison pill without approval by the target's board of directors, the poison pill will be triggered. The result will be either that shareholders of the target have rights to purchase additional shares of the target at a significant discount (thus significantly diluting the ownership interest of the foreign acquirer), or that shareholders of the target have rights to purchase shares of the foreign acquirer at a significant discount. The threshold percentage is generally set at 10, 15 or 20 percent, which can also often give rise to issues under so-called "interested stockholder" statutes under the corporate code of the applicable target's jurisdiction of incorporation.

[d] Tender Offers

If the target U.S. depository institution or holding company is a publicly-held company with widespread ownership, it is impracticable (if not impossible) for a foreign acquirer to attempt to deal with shareholders on an individual basis. In such a situation the foreign acquirer may make a public offer to shareholders to purchase their shares. Such a public offer is known as a "tender offer" if the consideration being offered is cash, or, when the consideration being offered includes a security of the foreign acquirer, an "exchange offer."[85] The offer may be conditioned upon, among other things, receiving a minimum number of tendered shares and obtaining financing. The foreign acquirer need not be obligated to take tendered shares in excess of a specified amount and may tender for less than 100 percent.[86] As discussed above, a foreign acquirer will only be able to purchase a limited amount of stock of a U.S. depository institution or bank or thrift holding company without seeking prior approval from the appropriate regulatory authority under the BHC Act, the CIBC Act, or HOLA, as the case may be.

A tender offer is often used as a first step in a two-step transaction to ultimately acquire 100 percent of the target. Inevitably, a small percentage of the shares will be

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[85] In the past, many foreign acquirers have found that offering their own securities in connection with a tender offer has been impracticable since the tender offer would constitute a "public offer" and necessitate the registration of such securities or because there was not enough liquidity in the acquirer's stock in the U.S. market.

[86] In the past, some foreign acquirers have found it advantageous to acquire (or retain) a controlling but less than 100 percent interest in a target because of (1) a desire to limit the amount (and hence the risk) of an investment to a certain level, (2) the ability to consummate an investment with greater cooperation from a target's management (who may feel less threatened by an acquirer willing to hold less than 100 percent of the target's stock), (3) a perception that a partial investment in a target may face fewer political obstacles than a complete acquisition, (4) a desire to retain a public market in a target's stock in order to be able to provide stock-based management compensation plans or to be able to sell some or all of the investment into an existing public market in the future, and (5) a desire not to have all of the target's assets, earnings, and revenues attributed to the acquirer (which would occur if the acquirer obtained ownership of 50 percent or more of the target's voting stock) for purposes of determining the acquirer's status as a "qualifying foreign banking organization" under the Board's Regulation K. *See* § 3.08 below. Notwithstanding the foregoing, a foreign acquirer that acquires less than a 100 percent interest in a target will have to accept the corresponding obligations of having other shareholders, including continuing SEC reporting obligations if the target is public, and treating the remaining shareholders fairly.

held by shareholders who fail to respond to the tender offer in a timely manner. It is therefore necessary to effect a merger following the tender offer to acquire the remaining shares (a "statutory merger"). Under the law of certain states, most notably Delaware, if the acquirer owns more than 90 percent of the shares of the target, a "short form" merger can be effected without shareholder approval and the resulting delay in consummating the "second-step" transaction. If such a merger is not possible, the acquirer must effect a traditional merger transaction requiring shareholder consent (and preparation of the related disclosure documents if the target is public).

Cash tender offers have been favored in acquisitions of U.S. publicly-held companies because, in theory, they are the quickest route to control; however, the need to obtain bank or thrift regulatory approvals can delay the closing of a tender offer. A tender offer will be subject to U.S. securities laws regulating tender offers and requiring the preparation and public disclosure of information concerning the foreign acquirer, its operations, management, business and financial condition.[87]

In addition to the federal regulatory scheme, many states have laws regulating tender offers.[88] "Control share acquisition" statutes in some states generally require that disinterested shareholders approve any acquisition of a target's common stock that would result in the acquirer holding in excess of certain specified thresholds. Not all of these statutes exempt acquisitions that are approved by the target's board of directors and thus may have to be taken into consideration even in a negotiated transaction. Other states regulate business combination transactions between the target and its large shareholders through "moratorium statutes" (that prohibit such combinations for a specified period of time unless certain board approvals have been obtained), "super-majority/fair price statutes" (that provide that such combinations may be consummated only on approval by a super-majority shareholder vote although, in some instances, these heightened voting requirements may be circumvented if the consideration to be paid in the combination is a "fair price," usually based in part on the highest price per share paid by the interested shareholder when it became such), or "cash-out statutes" (that provide that if an acquirer exceeds a specific ownership level, the other shareholders can require the acquirer to purchase their shares at a "fair value").

[2] Mergers

A foreign acquirer may structure an acquisition from its inception as a single-step

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[87] A foreign acquirer not already subject to the Exchange Act would find compliance with these disclosure requirements to be somewhat time consuming but not very difficult.

[88] In evaluating the significance of any such laws, an important threshold question is whether they are constitutional. The U.S. Supreme Court in *Edgar v. MITE Corp*., 457 U.S. 624, 102 S. Ct. 2629, 73 L. Ed. 2d 269 (1982), struck down an Illinois statute that imposed certain conditions on tender offers in addition to those imposed by federal law under the Exchange Act. The *MITE* decision cast doubt on the validity of many state antitakeover laws then in effect that imposed conditions arguably inconsistent with the relevant federal statutes and regulations. Following *MITE*, however, a number of states adopted "second generation" takeover legislation carefully designed to pass constitutional muster. One of these statutes, Indiana's "control share acquisition" law, was upheld in 1987. *See* CTS Corp. v. Dynamics Corp. of Am., 481 U.S. 69, 107 S. Ct. 1637, 95 L. Ed. 2d 67 (1987).

statutory merger or consolidation, rather than as the second step in a two-step transaction. A statutory merger or consolidation is a transaction where two merging depository institutions or holding companies are amalgamated into a single depository institution or holding company, extinguishing, upon the payment of consideration, the rights of the target's shareholders.[89] The amalgamation of the merging or consolidating companies occurs by operation of law and results in the automatic transfer and vesting of all of the assets and liabilities of the target to or in the surviving or resulting company.[90]

The choice of consideration should be made in light of several factors. First, the nature of the consideration may affect the tax consequences of the merger. In a "cash merger" (*i.e.*, a merger pursuant to which the target shareholders receive only cash), shareholders generally are taxed on the amount by which the cash received exceeds such holders' tax basis in their target stock. Alternatively, in a merger pursuant to which the shareholders receive new securities in exchange for their target stock, it may be possible to defer the payment of any taxes in connection with the transaction. Second, an obvious difference between cash and non-cash mergers is that where target shareholders are to receive securities in exchange for their stock, such shareholders will retain (although generally on a greatly reduced basis) a continuing interest in the affairs of the entity surviving the merger. Third, if there is no established or sufficiently liquid U.S. market for an acquirer's securities (as might be the case with a foreign acquirer), target shareholders may be less willing to approve a merger pursuant to

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[89] A statutory merger is a corporate transaction binding on all shareholders—including those who vote against it. A majority or two-thirds vote of approval by the shareholders of the target usually is required to effect the merger. *See, e.g.,* 12 U.S.C. § 215a(a)(2) (applicable to national banks; two-thirds vote required); N.Y. BANKING LAW § 601(2) (applicable to New York state-chartered banks; two-thirds vote required); N.Y. BUS. CORP. LAW § 903 (applicable to New York Corporations; two-thirds vote generally required); DEL. CODE ANN. tit. 8, § 251(c) (applicable to Delaware corporations; majority vote required).

In order to protect individual shareholders, many states grant a dissenting shareholder in a merger the right to claim the "fair value" of his shares in cash through a judicial proceeding. *See, e.g.*, N.Y. BUS. CORP. LAW §§ 623, 910; N.Y. BANKING LAW §§ 604, 6022; DEL. CODE. ANN. tit. 8, § 262; CAL. CORP. CODE § 1300. To assert such "appraisal" rights, a shareholder ordinarily must follow a series of detailed procedural steps that may be time-consuming and costly. However, some states provide that, under certain circumstances, holders of shares of certain publicly traded targets do not have the appraisal rights otherwise granted by statute. *See, e.g.*, DEL. CODE. ANN. tit. 8, § 262(b) (no appraisal rights if, among other things, (1) target shares or depositary receipts representing target shares are publicly traded; (2) target shareholders receive shares or depositary receipts representing shares of the surviving corporation or of another publicly traded corporation; (3) cash in lieu of fractional shares or fractional depository receipts are offered to target shareholders; and (4) any combination of shares, depository receipts and cash in lieu of fractional shares or fractional depository receipts are offered to target shareholders); *see also* VA. CODE ANN. § 6.1-43 (excluding bank mergers from application of Virginia's appraisal statute, VA. CODE ANN. § 13.1-730); Adams v. United States Distrib. Corp., 34 S.E.2d 244 (Va. 1945).

[90] For purposes of this Chapter, the term *merger* includes consolidations. In addition to merger transactions, a number of states now provide for a so-called "binding share exchange," "share exchange," or "plan of exchange," pursuant to which an acquirer corporation, as a result of a vote of target shareholders, receives authorization to acquire all of the shares of the target of one or more designated classes. *See, e.g.,* N.Y. BUS. CORP. LAW § 913.

which they are to receive such illiquid securities. Finally, the issuance of securities in the United States in connection with a merger will require compliance with the registration requirements of the Securities Act of 1933 [*herein* the 1933 Act].

If the foreign acquirer uses a merger to effect an acquisition,[91] applicable corporate laws almost certainly will require a vote of the target's shareholders.[92] If the target is a publicly held bank or thrift holding company, the form of the proxy statement issued in connection with such a vote must contain the information required by Schedule 14A issued by the SEC under the Exchange Act.[93] If the target is a publicly held U.S. bank or thrift with no holding company, the proxy statement for any necessary shareholder vote would have to comply with the proxy rules of the appropriate federal bank agency.[94] These proxy rules are substantially similar to the SEC rules.

Schedule 14A requires that any proxy statement distributed in connection with a merger involving a foreign acquirer and a bank or thrift holding company contain detailed information about the target and the terms of the transaction. Only limited information regarding the acquirer would ordinarily be necessary, however, if cash were the only consideration being offered to target shareholders.[95]

The merger of a bank or thrift holding company can be accomplished by merging it with a shell subsidiary of the foreign acquirer organized under U.S. law pursuant to a plan of merger approved by the shareholders of the target holding company. The surviving corporation would become a wholly-owned subsidiary of the foreign acquirer and the shareholders of the target holding company would receive cash or securities for their holding company stock. As a matter of corporate law, either party to the merger could be the surviving corporation. The identity of the surviving

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[91] Corporate laws of most states treat a sale of all or "substantially all" (which, in some cases, means "a substantial portion") of a company's assets in the same manner as a merger in terms of the procedures required for obtaining shareholder approval. *See, e.g.,* DEL. CODE ANN. tit. 8, § 271.

[92] If the foreign acquirer already controls the target at the time of a merger (or other acquisition) proposal, the SEC's detailed and onerous disclosure requirements for "going private" transactions may apply. These rules exempt "second-step" transactions following tender offers provided that certain conditions are met. Exchange Act Rule 13e-3; 17 C.F.R. § 240.13e-3.

[93] 15 U.S.C. § 78n; 17 C.F.R. §§ 240.14a-l to a-103.

[94] *See, e.g.,* 12 C.F.R. § 5.33(e)(8) (OCC - national banks); 12 C.F.R. §§ 335.221(a), 335.401 (FDIC - state nonmember banks). Section 12(i) of the Exchange Act, 15 U.S.C. § 78l(i), transfers to the federal banking regulators the SEC's authority to administer and enforce Sections 10A(m), 12, 13, 14(a), 14(c), 14(d), 14(f) and 16 of the Exchange Act with respect to securities issued by insured banks or insured thrifts. *See also* 12 C.F.R. §§ 16.17(c), 16.20(a) (OCC - national banks); 12 C.F.R. § 208.36(a), (c) (Board - state member banks); 12 C.F.R. § 335.201(FDIC - state nonmember banks); 12 C.F.R. § 563g.18 (OTS - thrifts)

[95] In general, the disclosure standard is that the proxy statement may not contain any untrue statement of a material fact or omit to state a material fact required to be stated in order to make the statements therein not misleading. The test of materiality is whether there is a substantial likelihood that a reasonable shareholder would consider the misstated or omitted fact to be important in deciding how to vote. *See* TSC Indus. v. Northway, Inc., 426 U.S. 438, 449, 96 S. Ct. 2126, 2132, 48 L. Ed. 2d 757, 766 (1976). It is important, of course, to ensure consistency of disclosures between any proxy statement and any related regulatory application.

company has significant consequences. For example, if the new subsidiary is the surviving entity, licenses of the target may not automatically transfer to such subsidiary. In addition, rights and liabilities of the target under private contracts and financial agreements may not be assumable by the new subsidiary without the consent of the other contracting parties. Finally, the tax treatment of the merger may vary depending on which entity survives.

The merger of a depository institution can also be accomplished by merging it with a shell subsidiary organized under U.S. law. But because federal law and the laws of most states provide that a depository institution is permitted to merge only with another depository institution, the shell subsidiary established by the foreign acquirer would have to be chartered as a depository institution. The use of an "interim" shell depository institution is a well-recognized method of carrying out depository institution acquisitions.[96]

[3] Asset Acquisitions

If the foreign acquirer wishes to acquire only certain branches of an existing bank, it may arrange to acquire the appropriate assets and assume the agreed liabilities directly from the target bank. If such a transaction included the assumption of insured deposit liabilities, it would generally have to be effected through a subsidiary depository institution chartered under state or federal law. If the foreign acquirer did not already control a U.S. depository institution, it would have to charter and obtain insurance for, or acquire, a U.S. depository institution in order to acquire the branches. As a result, many foreign acquirers may find this option unattractive.

The typical acquisition of all or substantially all of the assets of a depository institution is accompanied by the acquirer's assuming all or nearly all of the liabilities of the bank and is followed by the liquidation of the target and a distribution to its shareholders of the proceeds from the sale.[97] Even though an asset acquisition thus may have the same economic effect as a merger (ignoring taxes),[98] it may be substantially more cumbersome in practice because of a variety of factors, including

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[96] For example, the OCC, the OTS and many states permit special abbreviated procedures to be followed in chartering an interim bank or thrift solely for the purpose of effecting an acquisition by merger of the interim bank or thrift with an insured depository institution target, and the FDIC generally will not require a deposit insurance application for interim national banks or thrifts even when they are going to be the surviving banks (but generally will for interim state-chartered banks). *See, e.g.,* COMPTROLLER'S LICENSING MANUAL, Business Combinations 7–9 (Dec. 2006) and the Interim National Bank Charter Application; 12 C.F.R. § 303.63(c); OTS REGULATORY HANDBOOK, Applications Processing § 510 (Apr. 2001); FDIC Statement of Policy on Bank Merger Transactions (Aug. 20, 1998); Interagency Bank Merger Act Application—General Information and Instructions—Interim Charters and Federal Deposit Insurance.

[97] It is technically possible, although very unusual, for an acquirer to acquire all of the assets of a target depository institution without assuming its liabilities, except in a failed depository institution transaction.

[98] The difference between the tax treatment (both federal and state) of a merger and that of an asset acquisition may have a significant impact on the economics of a transaction, but that impact is beyond the scope of this Chapter.

the need to examine individual assets to ensure that the target can transfer good title, prepare separate instruments of transfer, and obtain necessary consents for the assignment of contract and other rights and liabilities.

[4] Deal Protection

Deal protection is designed to ensure completion of a public company transaction, make competing bids more challenging and, in the event that the target decides to pursue a higher bid between signing and closing, compensate the acquirer for the time and expense involved in negotiating the transaction. Deal protection is particularly important in cases where there is a relatively long time lapse between the date that the agreement is signed and receipt of regulatory approvals. The most common types of deal protection are so-called no-shop provisions, break-up fees and voting agreements/tender agreements. Because many of these devices restrict the actions of the target's board of directors and may, in certain circumstances, conflict with the fiduciary duties of such directors, they are subject to close scrutiny by the courts.[99] In general, U.S. courts will strike down devices which either preclude competition and prevent shareholders from receiving a better deal or coerce shareholders into accepting an agreed deal.[100]

[a] No-Shop Provisions

No-shop or nonsolicitation provisions prohibit the target's board (or both parties in a merger of equals) from encouraging or soliciting competing bids during the period between signing of the agreement and closing. In situations where the target has not already conducted an auction or discussed a transaction with other potential acquirers, the no-shop provision will be qualified by what is generally referred to as a "fiduciary-out" provision.

Fiduciary-out provisions permit the target's board to engage in discussions with other potential bidders who have made unsolicited offers which the board reasonably

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[99] *See* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985); Paramount Communications v. QVC Network, 637 A.2d 34 (Del. 1994) ("no-shop" provision and stock option agreement were inconsistent with Paramount directors' fiduciary duties). *Compare* Cottle v. Storer Communication, Inc., 849 F.2d 570 (11th Cir. 1988) *and* Buffalo Forge Co. v. Ogden Corp., 717 F.2d 757 (2d Cir.), *cert. denied,* 464 U.S. 1018, 104 S. Ct. 550, 78 L. Ed. 2d 724 (1983) (options on stock upheld) *with, e.g.*, Hanson Trust PLC v. ML SCM Acquisition, Inc., 781 F.2d 264 (2d Cir. 1986); Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261 (Del. 1989); *and* MacAndrews & Forbes Holdings, Inc. v. Revlon, Inc., 501 A.2d 1239 (Del. Ch. 1985), *aff'd*, 506 A.2d 173 (Del. 1986) (options held to be granted in breach of officer and director fiduciary duties).

[100] Among the criteria that often may be relevant are (1) whether a lock-up option is granted in an active bidding situation, (2) the extent to which a lock-up option precludes competing offers, (3) the extent to which the target already has been "shopped," (4) the number and nature of outstanding offers, (5) the "disinterestedness" of the target's board of directors, (6) the acquisition price offered by a lock-up beneficiary as compared with other offers (or, if none, as compared with the range of fairness and the likelihood of higher offers), (7) the fairness of the lock-up option exercise price, (8) the terms of a lock-up, including whether it is exercisable even if no acquisition transaction occurs and whether shareholders would be harmed by that exercise, (9) time constraints and other pressures on the target, and (10) the diligence and analysis of the target's board in granting the lock-up.

believes may lead to a "superior proposal," and to provide such bidders with confidential information which will assist such competing bidders, subject to such bidders agreeing to be bound by a confidentiality agreement. Generally, the fiduciary-out provisions state that the target's board may withdraw the recommendation of the existing transaction, and, if the merger agreement does not require the target to nevertheless hold a vote on the transaction (a so-called "force the vote" provision), pursue what it believes to be a "superior proposal" if the target's board determines in good faith, after consulting with legal counsel, that it must take such action to comply with its fiduciary duties under applicable law. As discussed in greater detail below, the target's exercise of a fiduciary-out typically triggers the obligation to pay a "break-up fee" to the original acquirer, which cannot be of sufficient size to preclude the possibility of a competing bid (generally 2–4 percent of the deal's equity value).

Under Delaware law, where many significant U.S. bank and thrift holding companies are incorporated, directors have fiduciary duties to act in the best interests of the corporation and its shareholders. Generally, the actions of directors are afforded the protection of the business judgment rule (a rebuttable presumption that the directors acted with care, loyalty and in good faith). In certain situations, such as a sale of control of a company or establishment of defensive measures that could be viewed as entrenching the existing board and management, the business judgment rule will not apply and the actions of directors will be subject to enhanced judicial scrutiny.[101] If a target has put itself up for sale or there will be a change of control (sale of the company for cash or to acquirer with a controlling shareholder), directors have a duty to secure the transaction offering the best value reasonably available to shareholders. The existence of these fiduciary duties prompts the inclusion of fiduciary-out clauses in most no-shop provisions.

Delaware courts permit no-shop provisions in the absence of a breach of fiduciary duty. However, recent decisions have implied that these provisions will be subject to close scrutiny, particularly if they do not contain a meaningful fiduciary out. Even if a transaction does not constitute a "change of control" that would trigger *Revlon* duties (for example, a stock-for-stock merger where the acquirer's stock is widely held), a target's board still has fiduciary duties to reasonably inform itself about alternative transactions after signing a merger agreement. In other words, although a board may not have a duty to negotiate with third parties, it should be informed before making a decision not to negotiate.[102] A strict no-shop provision may be appropriate under circumstances in which a target has conducted an auction or otherwise canvassed the market for other bids.[103]

Phelps Dodge, ACE Limited and several other subsequent cases have led some to question whether the Delaware law distinction between sale-of-control transactions

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[101] *See* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986); Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985).

[102] *See* Phelps Dodge Corp. v. Cyprus Amax Minerals Co., 1999 Del. Ch. LEXIS 202 (Del. Ch., Sept. 27, 1999).

[103] *See* ACE Ltd. v. Capital Re Corp., 747 A.2d 95 (Del. Ch. 1999).

and those that do not constitute a sale-of-control is as meaningful as was once widely thought. It remains clear that target directors in a sale-of-control transaction have Revlon duties to act as "auctioneers" to obtain the highest attainable price for shareholders because such a transaction is the shareholders' last opportunity to obtain a control premium for their shares. However, the duties of target directors (and the scope of flexibility accorded them) in a non-sale of control transaction are less clear, and further guidance from the Delaware courts is required before this matter comes into clearer focus.

[b] Break-up Fees

Break-up fees generally are payable by a target (or either party, in a merger of equals) upon the occurrence of certain trigger events. These trigger events are typically tied to the termination provision which gives either party the right to terminate the deal if, for example, (1) the target's board withdraws or adversely modifies its recommendation of the merger in order to accept a superior proposal (the acquirer may insist on first being given the right to match any such proposal); or (2) the shareholders vote down the deal at a time when another acquisition proposal has been made public and within a certain period of time (*e.g.*, 12 months) after such a termination, the seller enters into a superior transaction with a third party. The number of trigger events and conditions attached to each will vary depending upon the circumstances.

Recent break-up fees have ranged between one and five percent of the equity transaction value with approximately 75 percent of the break-up fees being 4 percent or less. Delaware courts will not enforce break-up fees if they are so large as to effectively prohibit (either alone or together with other defensive measures) materially better alternative transactions. However, break-up fees will be upheld if the amount can be justified as reasonably necessary to attract the acquirer in the face of competition.[104] Courts have recognized that break-up fees can serve legitimate purposes by inducing an initial bidder to enter into a transaction and by permitting the target to pursue higher bids after signing the initial agreement.[105] Courts generally look at the whole package of deal protections in determining reasonableness and will look more favorably upon their existence if a target has previously considered other bids.

[5] Stake-outs and Other Minority Investments

The acquisition structures discussed above will generally require prior regulatory approval. Some foreign acquirers, however, may wish to invest in a U.S. depository institution or bank or thrift holding company on a basis that does not require prior

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[104] The Delaware Chancery Court recently stated that a break-up fee of 3.5 percent of transaction value was within a generally acceptable range (although it was on the high end of what had previously been approved). *See* McMillan v. Intercargo Corp., 768 A.2d 492 (Del. Ch. 2000). In contrast, a break-up fee of 6.3 percent was viewed as probably going beyond the range of reasonableness. *See* Phelps Dodge Corp. v. Cyprus Amax Minerals Co., 1999 Del. Ch. LEXIS 202 (Del Ch. Sept. 27, 1999).

[105] *See In re* J.P. Stevens & Co. Shareholders Litig., 540 A.2d 1088 (Del. 1988).

approval by any federal banking regulators.[106] Such investors are limited to relatively small purchases of voting stock (and somewhat larger nonvoting investments) and may not enter into arrangements involving the "control" of a U.S. depository institution or bank or thrift holding company.[107]

These "stake-out" or other non-controlling minority investments, which do not require prior regulatory approval, require careful structuring to insure that they are deemed by the relevant federal bank or thrift regulator to be non-controlling investments. In many cases, the foreign acquirer will negotiate a written agreement with the target's management or certain of its shareholders to govern their ongoing relationship. In negotiating the terms of such an agreement, the acquirer will ordinarily seek provisions designed to protect its investment (such as arrangements for representation on the board of directors and agreements with respect to the acquirer's right to participate in decisions concerning operational matters), while the target's management typically will negotiate for the ability to make decisions and take actions autonomously and may seek to restrict the acquirer's ability to increase its ownership interest without the consent of the target's management or other shareholders. If the foreign acquirer wishes to avoid the requirement of prior regulatory approval or other regulatory consequences, care must be taken in structuring the transaction and any such agreements so that bank or thrift regulators do not deem them to give the foreign acquirer "control" over the target.[108]

The line between what the regulators will deem to be a controlling and non-

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[106] Such a foreign acquirer may view such an investment as a first step to a larger investment or may wish to avoid the expense and delay of the application procedure. In addition, a limited investment may be chosen to avoid liabilities arising from "control" of a U.S. depository institution, including the obligation to serve as a source of strength to subsidiary banks, the requirement under the Federal Deposit Insurance Corporation Improvements Act of 1991 [*herein* FDICIA] that a controlling shareholder guarantee the capital restoration plan of an undercapitalized insured depository institution, and the provision in the Financial Institutions Reform, Recovery and Enforcement Act of 1989 [*herein* FIRREA] requiring FDIC-insured depository institutions to guarantee the FDIC against losses incurred by any other FDIC-insured depository institution under common control with them. *See* § 3.08[2] below.

[107] It is also important to determine when an investment in a state-chartered depository institution or its holding company would be considered to be a controlling investment or otherwise require any approval or notice under applicable state law, and to structure the investment to avoid these state approval or notice requirements. These sorts of state-law issues are beyond the scope of this Chapter.

[108] *See, e.g.*, 12 C.F.R. § 225.31(d)(2)(i) (rebuttable presumption of control when company enters into agreement with bank that allows company to exercise "significant influence" over bank). More recently, certain foreign banks have made controlling, but less than 100 percent investments in U.S. banks, which are subject to Board Approval. *See* The Toronto-Dominion Bank, 92 FED. RES. BULL. C100 (2006), and Banco Santander Central Hispano S.A., 92 FED. RES. BULL. C151 (2006). In Banco Santander's controlling but less than 25 percent investment in Sovereign Bancorp, certain of Sovereign's institutional shareholders unsuccessfully protested Santander's application to the Board, *inter alia*, on the ground that the controlling minority nature of the investment raised particular safety and soundness concerns, in that the target bank was thereby exposed to the FDIA's cross-guarantee liability to other depository institutions controlled by the acquiring bank holding company and to the consequences of the compliance failures of the other depository institution affiliates of the acquiring group.

controlling investment will depend on the nature of the foreign acquirer and the type of depository institution involved.

The federal statutory definitions of control are basically the same for investments in any type of U.S. depository institution or bank or thrift holding company. Essentially, the relevant statutes deem an investment to be controlling if the investor (1) acquires or controls 25 percent or more of any class of voting securities of a target company, (2) has the power to elect a majority of the target's board of directors or similar body *or* (3) has a "controlling influence" over the management or policies of the target company.[109] The bank and thrift regulators treat the first two alternatives as essentially conclusive, with almost no exceptions. But the last alternative is very flexible and highly indeterminate, and its interpretation and application is dependent on the nature of the acquirer and the type of depository institution involved.

The Board staff, for example, will often deem an investor to have a controlling influence over a bank or thrift, or a bank or thrift holding company, for purposes of the BHC Act and the CIBC Act whenever it has what most persons would consider only some influence over the institution, whether the investor is foreign or not. If the investor is a bank holding company (or a foreign bank or parent of a foreign bank with a U.S. commercial banking presence), the investment will be subject to the Board's prior approval under Section 3 of the BHC Act (or in the case of a thrift or thrift holding company, Section 4 of the BHC Act), regardless of whether it is deemed controlling, if the investor acquires control of 5 percent or more of any class of voting securities of the target.[110] In contrast, if the foreign investor is neither a bank holding

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[109] See 12 U.S.C. § 1467a(a)(2) (HOLA); 12 U.S.C. § 1817(j)(8)(B) (CIBC Act); 12 U.S.C. § 1841(a)(2) (BHC Act; 12 C.F.R. § 5.50(d)(3) (OCC - CIBC Act); 12 C.F.R. §§ 225.2(e), 225.31(d), 225.41(c)(2), 225.143 (Board - BHC Act and CIBC Act); 12 C.F.R. § 303.81(c) (FDIC - CIBC Act); 12 C.F.R. pt. 574 and § 583.7 (OTS - HOLA and CIBC Act).

[110] 12 U.S.C. §§ 1842(a)(3) (bank or bank holding company), 1843(i),1843(j)(1)A),1843(k)(6)(B) (thrift or thrift holding company). An investment in less than 5 percent of any class of voting securities of a bank, thrift, bank holding company or thrift holding company will nevertheless be presumed to be non-controlling for purposes of the BHC Act under Sections 2(a)(3) and 4(c)(6) of the BHC Act, respectively. 12 U.S.C. §§ 1841(a)(3), 1841(a)(4), 1843(c)(6); 12 C.F.R. §§ 225.31(e)(1), 225.31(e)(2). On the other hand, a company will be presumed, subject to rebuttal by the company, to exercise a controlling influence over a bank if (1) the company owns, controls, or has the power to vote more than 5 percent of the voting stock, and one or more persons having policy-making functions with the company serve in the same capacity with the bank, and no other person owns, controls, or has the power to vote as much as 5 percent of the voting stock of the bank; (2) the company owns or controls more than 5 percent of the voting stock of a bank and, when shares of the bank owned by directors, officers, trustees or partners of the company or stockholders of the company owning more than 25 percent of the company's voting stock (including in each case members of their families) are added to the stock in the bank owned by the company, the total exceeds 25 percent or more of the voting stock of the bank; (3) the company, pursuant to an agreement or understanding with the bank, exercises significant influence with respect to the general management or overall operations of the bank; or (4) the company enters into an agreement under which the rights of stockholders in the bank are restricted in any manner (with certain exceptions). In addition, a company that, directly or indirectly, owns bank securities immediately convertible at the holder's option into voting stock is presumed, subject to rebuttal by the company, to control such voting securities. 12 C.F.R. § 225.31(d).

company nor a foreign bank or the parent of a foreign bank with a U.S. commercial banking presence, the investment will not be subject to the Board's prior approval under Section 3 of the BHC Act or the CIBC Act unless the investment is controlling for these purposes, and will not be subject to any prior approval requirements under Section 4 of the BHC Act in the case of a thrift or thrift holding company.[111] The Board staff generally will not treat an investment in a bank or bank holding company as "controlling" for these purposes unless the investor acquires control of at least 10 percent of any class of voting securities, or 25 percent or more of the total equity including voting securities, of the target. The Board staff generally treats total equity as including voting securities, non-voting securities and subordinated debt.

Between these two extremes—(i) 4.9 percent of any class of voting securities (in the case of an investor that is a bank holding company or a foreign bank with or the parent of a foreign bank with a U.S. commercial banking presence) or 9.9 percent of any class of voting securities (in the case of an investor that is not a bank holding company or a foreign bank with or the parent of a foreign bank with a U.S. commercial banking presence) ***and*** (ii) 24.9 percent of the total equity, of the target—the Board staff will determine whether an investor has a controlling interest based on all the facts and circumstances. The most common factors considered by the Board staff include whether (i) any rebuttable presumptions of control under the CIBC Act or Regulation Y exist that have not been rebutted,[112] (ii) the investor has the right to appoint one or more directors, (iii) the investor has entered into any agreements that require its consent before the target can take any significant corporate decisions,[113] or (iv) the

[111] Instead, an investment by such a foreign acquirer in a thrift or thrift holding company will be governed solely by HOLA and any relevant state law.

[112] See 12 C.F.R. § 225.31(d) (BHC Act); 12 C.F.R. § 225.41(d) (CIBC Act).

[113] For example, the 1982 Policy Statement on stake-outs criticized investments having agreements or "[p]rovisions that limit or restrict major policies, operations or decisions of the acquiree" or "[p]rovisions that make acquisition of the acquiree. . .by a third party. . .economically impracticable." 12 C.F.R. § 225.143(c)(1)(iii) and (iv). It also noted that "the ability to transfer rights to large blocks of voting shares, even if nonvoting in the hands of the investing company, may result in such a substantial position of leverage over the management of the acquiree as to involve a structure that inevitably results in control." 12 C.F.R. § 225.143(c)(6). To address this concern, most agreements governing nonvoting equity investments permit the investor to transfer its interest only (1) to the target of the investment, (2) in a widely dispersed public offering, (3) in a transaction pursuant to Rule 144 under the Securities Act or in a private resale where no single purchaser receives voting shares (or securities convertible into or exercisable for voting shares) equivalent to more than 2 percent of the target's outstanding voting shares, or (4) to a third party who acquires at least a majority of the target's voting shares without regard to the investor's interest. The existence of common directors, management officials, or employees between the foreign acquirer and the target may raise issues of controlling influence as well. Letter from William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, to John L. Carr, Jr. (Nov. 25, 1986). The Board may, in some situations, take the view that an investment in 15 percent or more of the target's total equity coupled with board representation results in a controlling influence. On the other hand, the 1982 Policy Statement suggested that certain features help avoid a "controlling influence" over the acquiree, including "the right of the acquiree to 'call' the equity investment," "options or warrants to assure that the covenants that may become inhibiting can be avoided by the acquiree" and "a provision granting the acquiree a right of first refusal before warrants, options or other rights may be sold and

investor has made one or more of the Board's "standard" passivity commitments with respect to the investment.[114]

As a general matter, the Board and its staff will treat an investment in up to 24.9 percent of any class of voting securities of a target as non-controlling, as long as the investor has made the standard passivity commitments, does not have the right to appoint any of the target's board of directors or similar body and does not have any business relationships or arrangements with the target that are inconsistent with a determination of non-control.[115] It may treat an investment as non-controlling (and not subject to prior Board approval under Section 3 of the BHC Act or the CIBC Act) if the investment is limited to 4.9 percent of any class of voting securities (in the case of an investor that is a bank holding company or foreign bank or the parent of a foreign bank with a U.S. commercial banking presence) or 9.9 percent of any class of voting securities (in the case of an investor that is not a bank holding company or a foreign bank or the parent of a foreign bank with a U.S. commercial banking presence), the investor has the right to appoint only one director to a board on which it has only proportional representation, and the investor does not control more than 14.9 percent

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requiring a public and dispersed distribution of these rights if the right of first refusal is not exercised." 12 C.F.R. § 225.143(d). *See also* Letter from William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, to John L. Carr, Jr. (November 25, 1986) (Sumitomo letter). A contractual right to "put" the investment back to the acquiree if management takes certain actions (such as selling an equity stake to a third party) may raise "controlling influence" concerns.

[114] Although the Board does not really have a "standard" list of passivity commitments, and the commitments required by the Board vary from order to order depending on the circumstances, the full range of commitments typically includes agreements not to do anything along the lines of the following: (1) exercise or attempt to exercise a controlling influence over the management or policies of target; (2) seek or accept representation on the board of directors of target; (3) have or seek to have any employee or representative serve as an officer or employee of target; (4) take any action that will cause target to become a subsidiary of investor; (5) acquire or retain shares that will cause the combined interests of investor and its subsidiaries, and their respective officers, directors, and affiliates, to equal or exceed 25 percent of any class of target's outstanding voting securities; (6) propose a director or slate of directors in opposition to a nominee or slate of nominees proposed by the management or the board of directors of target or any of its subsidiaries; (7) solicit or participate in soliciting proxies with respect to any matter presented to the shareholders of target; (8) attempt to influence the dividend policies or practices of target; (9) attempt to influence the investment, loan, or credit decisions or policies, pricing of services, personnel decisions, operational activities (including the location of any offices or branches or their hours of operations, etc.), or any similar activities or decisions of target; (10) dispose or threaten to dispose of shares of target or any of its subsidiaries as a condition of specific action or non-action by target; or (11) enter into any banking or nonbanking transactions with target other than in the ordinary course of business, at arm's length. For purposes of this commitment, "arm's length" is defined by reference to section 23B(a)(1) of the Federal Reserve Act. *See, e.g.*, Letter dated December 19, 2007 from the Board of Governors of the Federal Reserve System to Thomas M. Mistele, Appendix.

[115] But this will not eliminate the requirement to obtain prior board approval to acquire 5 percent or more of any class of voting securities of a bank, thrift, bank holding company or thrift holding company, if the investor is a bank holding company or a foreign bank with or the parent of a foreign bank with a U.S. commercial banking presence. Instead, its impact will be limited to whether the investor has a source of strength or capital restoration guarantee obligation with respect to any target bank or thrift. These obligations have generally been imposed only on an investor that is deemed to control the relevant U.S. depository institution.

(or 19.9 percent if there is another larger, unaffiliated, controlling investor), without being required to make any of the standard passivity commitments.

In determining the percentage of voting securities in any particular investment, the Board staff will generally treat warrants, options or other securities convertible or exercisable into voting securities as giving the holder immediate control over the underlying voting securities.[116]

The Board staff will also treat separate investors as a single company for purposes of determining whether control exists for purposes of the BHC Act or the CIBC Act, if there is any formal or informal agreement or arrangement to act in concert with respect to the target or the target's shares. Thus, if a foreign investor is making a stake-out or other non-controlling minority investment contemporaneously with other investors, the Board staff may scrutinize whether the investors are acting in concert as a group as opposed to acting truly independently.

The OCC and FDIC generally interpret and apply the definition of control and acting in concert in a similar manner for purposes of their administration of the CIBC Act.[117]

In contrast, the OTS has a series of rebuttable presumptions of control and of acting in concert for purposes of the CIBC Act and HOLA that are substantially more detailed from those of the other federal banking regulators, and in certain important respects less restrictive.[118] For example, although the OTS's regulations include rebuttable presumptions of control for an investment in (i) either 10 percent or more of any class of voting stock or 25 percent or more of any class of (voting or nonvoting) stock of a thrift or thrift holding company *and* (ii) either 25 percent or more of the stockholders' equity or 35 percent of the combined debt and stockholders' equity of a thrift or thrift holding company,[119] the OTS does not include subordinated debt in the

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[116] Under Regulation Y, a holder of securities (including debt securities) that are immediately convertible, at the option of the holder, into voting securities is presumed, subject to rebuttal by the holder, to be the holder of the underlying voting securities for purposes of determining whether the holder controls the target. 12 C.F.R. § 225.31(d)(1). However, the Board will not treat convertible securities held by other investors as voting securities for purposes of determining whether such a holder has control of the target. In addition, the Board's staff generally takes the position that a holder of options and warrants should be treated as the holder of the underlying voting securities, regardless of the exercise price of such warrants. Therefore, in certain cases, the BHC Act's 5 percent limitation may be applicable to investments in warrants exercisable for voting securities. This is particularly likely in connection with a transaction where the warrant exercise price is nominal or zero.

[117] *See* 12 C.F.R. §§ 5.50(d)(3) (OCC's definition of control), 5.50(f)(2)(ii) (OCC's rebuttable presumptions of control under the CIBC Act), 5.50(d)(2) (OCC's definition of acting in concert), 303.81(b) (FDIC's definition of acting in concert), 303.82(b)(2) (FDIC's rebuttable presumptions of control under the CIBC Act), 303.81(c) (FDIC's definition of control).

[118] 12 C.F.R. §§ 574.4(a) (conclusive control), 574.4(b), 574.4(c) (rebuttable presumptions of control and control factors), 574.4(d) (rebuttable presumptions of acting in concert), 574.4(e) (procedures for rebuttal), 574.4(f) (safe harbor certifications of non-control), 574.100 (standard form rebuttal of control agreement).

[119] 12 C.F.R. §§ 574.4(b)(1), 574.4(c)(2), 574.4(c)(3).

definition of stockholders' equity and leaves the door open for rebutting this presumption even at higher ownership levels of voting or non-voting stock or subordinated debt. In addition, the OTS's regulations contain a rebuttal of control agreement that is substantially different (though not necessarily less restrictive) than the Board's standard list of passivity commitments.[120]

As a result of these differences, it may be possible for a foreign acquirer to structure a minority investment in a larger percentage of the voting or other securities of a thrift or thrift holding company (including subordinated debt that is convertible into equity) without being deemed to control the target for purposes of the CIBC Act or HOLA. But if the foreign investor is a bank holding company or a foreign bank with or the parent of a foreign bank with a U.S. commercial banking presence, it will be subject to the Board's rules for determining whether it is required to obtain prior approval for the investment under Section 4 of the BHC Act or deemed to control the thrift for purposes of the Section 4 approval requirement or any source of strength obligation, and will not be able to take advantage of the OTS's less restrictive control rules.

[6] Public Disclosure Obligations

An early step in a friendly acquisition is the initiation by the acquirer of discussions with the target's management, board of directors or financial advisor. A target may be approached formally or informally, depending upon the nature of the relationships between the acquirer and the target. During these discussions, the acquirer may make an offer to the target's board of directors, which may then be followed by negotiations leading to the execution of a definitive agreement between the acquirer and the target.

When the parties reach an agreement, a press release should be issued setting forth its principal terms, including the structure, method of financing, timing and principal conditions to the consummation of the transaction. Nevertheless, there is always a risk that public disclosure of the negotiations will occur (or be required) prior to executing an agreement. As a result of rumors, leaks, heavy trading in the target's stock or other reasons, either of the parties (but typically the target) may decide that it has an obligation under applicable securities laws and exchange regulations to disclose the negotiations prior to the execution of the written agreement. Care must be taken to avoid triggering premature disclosure, since there is a risk that the acquirer will lose control of the process as a result.

§ 3.04 Bank and Thrift Regulatory Approvals

The bank or thrift regulatory approvals needed for any proposed acquisition depend upon both the method chosen to effect the acquisition and the nature of the depository institution or holding company to be acquired (*i.e.*, whether the depository institution is a federally-chartered or state-chartered bank or thrift and, if a state-chartered bank, whether it is a member of the Federal Reserve System and FDIC-insured). The following discussion briefly outlines the approvals required at the federal level for the various acquisition methods previously described. It is followed in §§ 3.05 and 3.06 by

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[120] 12 C.F.R. § 574.100.

a summary of the substantive requirements for obtaining such federal approvals. Although the requirements and procedures for obtaining approval of an acquisition by state regulatory agencies are beyond the scope of this Chapter, acquirers frequently must file a separate application for approval by state regulatory authorities before an acquisition of a U.S. depository institution or bank or thrift holding company may be consummated.[121]

[1] Bank Holding Company Act

In general, Section 3(a) of the BHC Act requires the Board's prior approval for the following types of transactions: (1) a transaction that results in the formation of a bank holding company; (2) a transaction that causes a bank to become a subsidiary of a bank holding company; (3) acquisition by a bank holding company of more than 5 percent of the voting stock of a bank (or bank holding company);[122] (4) acquisition of all or substantially all of the assets of a bank (except acquisitions by merger into another bank); and (5) a merger of bank holding companies.[123]

A foreign acquirer with a U.S. bank subsidiary (*i.e.*, a U.S. bank holding company) or with a U.S. commercial banking presence but no U.S. bank subsidiary is subject to all the foregoing restrictions on transactions by bank holding companies.[124] Thus, for example, both must obtain prior Board approval before acquiring more than 5 percent of any class of voting securities of a U.S. bank or bank holding company. Any foreign acquirer's acquisition of "control" of a bank or bank holding company will cause the acquirer to become a bank holding company under Section 3(a) of the BHC Act and therefore will require Board approval.[125] If the foreign acquirer has chosen a method

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[121] The legal requirements and standards for approval vary widely from state to state. Some states, however, permit the federal application to be filed along with supplementary information in satisfaction of state application requirements, thereby somewhat reducing the complexity and administrative burden of multiple application requirements. *See, e.g.*, N.Y. ADMIN. CODE tit. 3, Banking Supervisory Procedure, Commercial Banks § 105.1(f).

[122] Although Section 3(a)(3) of the BHC Act, 12 U.S.C. § 1842(a)(3), refers to acquisitions of 5 percent of the voting shares of a bank, but not 5 percent of any class of voting securities (*cf.* the BHC Act definition of *bank holding company*, 12 U.S.C. § 1841(a)(1)), the Board has interpreted this requirement to apply to an acquisition by a bank holding company of control of more than 5 percent of the outstanding shares of *any class* of voting securities of a bank or banking holding company, 12 C.F.R. § 225.11(c)(1). Moreover, while Section 3(a)(3) refers only to acquisitions of voting shares of a "bank," the Board consistently has interpreted the provision's "directly or indirectly" language to extend the prior approval requirement to acquisitions of more than 5 percent of the voting stock of a bank holding company. *See* Revision of Regulation Y, 49 Fed. Reg. 794 (1984).

[123] 12 U.S.C. § 1842(a).

[124] *See* 12 U.S.C. §§ 1842(a), 3106(a). Foreign banks with a U.S. commercial banking presence are treated as bank holding companies for purposes of Section 3(a)(3) of the BHC Act to the extent they are acting as acquirers of a U.S. bank or bank holding company, even if they do not control a U.S. bank. 12 C.F.R. § 225.11(f). But such foreign banks are not treated as bank holding companies for purposes of Section 3(a)(3) of the BHC Act to the extent they are targets of an acquisition, unless they control a U.S. bank. 12 C.F.R. § 225.2(c)(2).

[125] 12 U.S.C. § 1842(a)(3). The BHC Act requirements applicable to investments in a U.S. bank or bank holding company will also apply to investments made in any foreign company that controls a U.S.

of acquisition involving a merger or acquisition of assets using an interim bank, it also may be necessary to obtain the independent approval of one of the other federal banking agencies to charter the interim bank and merge it with the target under the Bank Merger Act.[126]

Section 4 of the BHC Act also requires a foreign acquirer that is a bank holding company or that is a foreign bank or the parent of a foreign bank with a U.S. commercial banking presence to obtain the prior approval of the Board if it acquires 5 percent or more of any class of voting securities, or otherwise acquires control, of a thrift or thrift holding company.[127] This prior approval requirement applies even if the foreign acquirer is a financial holding company.[128]

[2] Bank Merger Act

Under the terms of the Bank Merger Act, the appropriate federal bank or thrift supervisor must approve any merger involving two or more FDIC-insured depository institutions— *i.e.*, any national bank, federal thrift and most state-chartered banks or thrifts. If a national bank is to be the surviving entity in a proposed merger, the Comptroller is the appropriate federal bank supervisor. If an insured state bank that is a member of the Federal Reserve System is to be the surviving entity, the Board is the appropriate federal bank supervisor. If an insured state-chartered nonmember bank is to be the surviving entity, the FDIC is the appropriate federal bank supervisor. If an insured thrift is to be the surviving entity, the OTS is the appropriate federal bank supervisor.[129]

The Bank Merger Act also applies to transfers of assets by an FDIC-insured depository institution to a noninsured bank (or noninsured foreign bank branch), if made in consideration for the assumption of deposit liabilities, and to an insured bank's acquisition of the assets of another insured bank or institution.[130] Consequently, the appropriate federal bank supervisor's approval would be required if a foreign acquirer with or without a U.S. commercial banking presence wished to acquire only certain branches of an FDIC-insured depository institution. The Bank Merger Act also applies to an assumption of liabilities of an insured or uninsured depository institution (including deposit liabilities) by an insured depository institution (including an insured foreign bank branch).[131] The rules for determining the appropriate approving agency for such transactions are the same as for depository institution mergers. The Bank

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bank and therefore is itself a bank holding company.

[126] 12 U.S.C. § 1828(c). *See* § 3.03[2] above.

[127] 12 U.S.C. §§ 1843(i), 1843(j)(1)(A).

[128] 12 U.S.C. § 1843(k)(6)(B).

[129] 12 U.S.C. § 1828(c)(1). The FDIC is the appropriate federal bank supervisor in any case in which an FDIC-insured bank merges with any noninsured bank or institution. *Id.*

[130] 12 U.S.C. §§ 1828(c)(1), 1828(c)(2).

[131] 12 U.S.C. §§ 1828(c)(1), 1828(c)(2). The Bank Merger Act does not cover transactions between two uninsured banks.

Merger Act governs the transactions described above even when the BHC Act or HOLA also applies.[132]

[3] Change in Bank Control Act

The Change in Bank Control Act [*herein* CIBC Act][133] is designed to regulate an individual's or associated group of individuals' acquisition of "control" of a U.S. depository institution or bank or thrift holding company. It also regulates certain acquisitions by companies and other entities not subject to regulation under the BHC Act or HOLA, such as acquisitions of FDIC-insured industrial loan companies or industrial banks that are not "banks" for purposes of the BHC Act but are insured depository institutions for purposes of the CIBC Act.[134] The CIBC Act defines "control" as "the power, directly or indirectly, to direct the management or policies of

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[132] Both the Bank Merger Act and the BHC Act (or HOLA) will apply, for example, in many instances where a bank or thrift holding company is involved. Although the standards of approval under the Bank Merger Act and the BHC Act are similar, potential acquirers sometimes believe that they will receive a more favorable hearing before the Comptroller or the FDIC than before the Board and, accordingly, attempt to structure an acquisition so as to avoid submitting an application for the Board's approval under the BHC Act. If this consideration becomes relevant, it may be possible to structure the acquisition of a U.S. bank by a foreign acquirer in such a manner that it would fall under the requirements of the Bank Merger Act but not the BHC Act. *See* 12 C.F.R. § 225.12(d)(2). However, in light of the Board's general oversight responsibilities for foreign banks and parents of foreign banks in the United States, the Board may require a foreign acquirer to file an application wherever the BHC Act provides a statutory basis for it (*e.g.*, if it is necessary for tax or other reasons to acquire the target's bank holding company, even if only briefly, as part of an incidental step in a bank merger transaction), even if an application also is required under the Bank Merger Act, especially in the event the foreign acquirer or the target U.S. banking organization is of substantial size. *See, e.g.*, The Bank of Tokyo, Ltd., 74 FED. RES. BULL. 685 (1988). Although on occasion, under circumstances where it did not appear that the transaction in question would raise a particular issue under the BHC Act and a bank merger component of the overall transaction was subject to approval by another federal banking agency, the Board has indicated that a BHC Act application would not be required, *see* Board staff opinion, dated Dec. 12, 1985, FED. RES. REG. SERV. § 4-271.1 (1985) (formation of "intermediate tier" bank holding company to effect acquisition), the Board has not consistently granted this relief, and there have been indications that it will be reluctant to do so in the future.

Indeed, because of the Bank of Credit and Commerce International and Banca Nazionale del Lavoro scandals, there is an increased risk that the Board will assert jurisdiction wherever the BHC Act provides a statutory basis, particularly in light of the BHC Act's requirements that the Board disapprove any application by a foreign acquirer that is not "subject to comprehensive supervision or regulation on a consolidated basis" in its home country.

[133] 12 U.S.C. § 1817(j).

[134] *Compare* 12 U.S.C. § 1841(c)(2)(H) (exclusion of industrial loan companies, industrial banks and other similar institutions from the definition of the term "bank" for purposes of the BHC Act if certain conditions are satisfied) *with* 12 U.S.C. § 1813(a), (c)(2) (expressly including industrial banks within the term "bank" and all insured banks within the term "insured depository institution" for purposes of the CIBC Act). The CIBC Act applies to any "person, acting directly or indirectly or through or in concert with one or more other persons" who acquires control of any U.S. depository institution. 12 U.S.C. § 1817(j)(1). *Person* is in turn defined to be any "individual or a corporation, partnership, trust, association, joint venture, pool, syndicate, sole proprietorship, unincorporated organization, or any other form of entity not specifically listed herein." 12 U.S.C. § 1817(j)(8)(A). Because the BHC Act and HOLA, as noted above, regulate only acquisitions by "companies," acquisitions by individuals (not acting

an insured bank or to vote 25 per centum or more of any class of voting securities of an insured depository institution."[135] The regulations promulgated by the Board, the FDIC and the OCC under the CIBC Act, however, provide that a "person" (including a bank or company) is presumed to have control over a U.S. bank if it owns or controls 10 percent or more of the voting stock of a U.S. bank and either (1) no other person owns or controls a larger percentage of the same class of stock or (2) the bank's or its holding company parent's shares are registered under the Exchange Act. The presumption of "control" in these regulations is thus significantly more strict than that in the Board's regulations under the BHC Act.[136] In contrast, the OTS applies the same less restrictive presumptions of control for purposes of both the CIBC Act and HOLA.[137]

The CIBC Act does not apply to any transaction subject to regulatory approval under the BHC Act, the Bank Merger Act or HOLA.[138]

[4] Home Owners' Loan Act

Section 10(e) of HOLA Act requires the OTS's prior approval for (i) a foreign acquirer that is a thrift holding company (but not a bank holding company) to acquire direct or indirect control of 5 percent or more of any class of voting securities of a thrift or thrift holding company any company or (ii) any other foreign acquirer (other than a bank holding company) to acquire direct or indirect control of a thrift or thrift holding company. There is no express exemption from this prior approval requirement for foreign banks or the parents of foreign banks that are not bank holding companies, even if they are subject to the BHC Act by virtue of having a U.S. commercial banking presence. Therefore, in the absence of regulatory relief from the OTS, a foreign bank or the parent of a foreign bank that is not a bank holding company would be required to obtain the prior approval of the OTS before acquiring control of a thrift or thrift holding company, regardless of whether it otherwise has a U.S. commercial banking presence.

§ 3.05 Application Procedures

Once the basic structure and terms of the acquisition have been determined, and assuming that regulatory approval will be required, the process of preparing and filing the necessary applications for regulatory approval begins. It is generally desirable to arrange introductory meetings with the staffs of the respective state and federal agencies that have jurisdiction over the acquisition in order to obtain their preliminary views, establish working relations and, where possible, obtain agreements to waive

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together as a "company" within the meaning of the BHC Act or HOLA) were not subject to direct federal regulation prior to the passage of the CIBC Act in 1978.

[135] 12 U.S.C. § 1817(j)(8)(B). Although the definition of *control* under the CIBC Act is similar to the definition of *control* under the BHC Act, a stronger "control" connection ordinarily is required for control to be found under the BHC Act.

[136] *Compare* 12 C.F.R. § 225.41(c)(2) *with* 12 C.F.R. § 225.31(d).

[137] *See* 12 C.F.R. pt. 574. *See also* § 3.03[5] above.

[138] 12 U.S.C. § 1817(j)(17).

requirements involving unnecessary duplication of information.

This Section sets forth some of the highlights of the application procedures under the BHC Act, the Bank Merger Act, the CIBC Act and HOLA.[139]

[1] Bank Holding Company Act

With respect to applications under the jurisdiction of the Board, the precise procedures governing the application process will be determined based on whether or not the application qualifies for delegated authority provided to the Federal Reserve Banks under the BHC Act, the Bank Merger Act or the CIBC Act.[140]

In bank or bank holding company acquisitions, the foreign acquirer generally must file an application on Form FR Y-3F to acquire control of a bank or become a bank holding company. In thrift and thrift holding company acquisitions by a foreign acquirer that is a bank holding company or a foreign bank or the parent of a foreign bank with a U.S. commercial banking presence, the foreign acquirer must generally file an application on Form FR Y-4 to acquire control of a thrift or thrift holding company.[141] As an initial matter, the foreign acquirer will file the application with the Federal Reserve Bank in the district where its principal banking subsidiary is located or, if it is not a bank holding company, in the district where its banking assets are the largest.[142]

Contemporaneously with submission of the final application, a notice of the acquirer's application must be published in the target bank or thrift's geographic area requesting public comments on the application for a period of up to 30 days. The Federal Reserve Bank reviewing the application either must accept the application for processing, request additional information, or return the application as incomplete within seven days after receipt. It is at this stage, in addition to the draft review stage, that most delays occur because a request for additional information causes the

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[139] Applications under each of the BHC Act, the Bank Merger Act, the CIBC Act and HOLA will generally be publicly available pursuant to the Freedom of Information Act [*herein* FOIA], 5 U.S.C. § 552. A foreign acquirer may petition the Board to treat portions of the application as confidential and nondisclosable under FOIA. Confidential treatment will turn on whether the information sought to be precluded from disclosure qualifies for one of the several FOIA exemptions. *See* 5 U.S.C. § 552(b); 12 C.F.R. § 261.14 (Board); 12 C.F.R. § 4.12(b) (OCC); 12 C.F.R. § 309.5(g) (FDIC); 12 C.F.R. § 505 (OTS). The principal exemption likely to be available is for confidential financial and other information not otherwise available to the public. *See* 5 U.S.C. § 552(b)(4). *See also* 31 C.F.R. § 1.6 (applying restrictions on FOIA disclosure of "business information" to Treasury bureaus, including OCC and OTS).

[140] 12 C.F.R. § 265.2. Applications are generally delegated to the Federal Reserve Banks in instances when the transaction presents no novel regulatory questions, the acquisition is of relatively small size, the application is not contested and no member of the Board objects to the proposed transaction. Most acquisitions by a foreign acquirer will likely be decided by the Board, unless the foreign acquirer already controls a bank in the United States and the acquisition meets the general criteria for delegation.

[141] If the foreign acquirer is not a bank holding company or a foreign bank or the parent of a foreign bank with a U.S. commercial banking presence, the acquisition of a thrift or thrift holding company would not be governed by the BHC Act, but instead solely by HOLA or the CIBC Act, as administered by the OTS.

[142] Form FR Y-3F; Form FR Y-4; 12 C.F.R. §§ 225.3(b), 262.3(c).

timetable required by the regulations to be placed on hold. Although the Federal Reserve Bank must accept or reject an application within five business days after the applicant has supplied any additional information that may have been requested, the Federal Reserve Bank or the Board can, and often does, delay action by requesting still more information.[143]

Upon accepting an application as complete, the Federal Reserve Bank will transmit copies of the application to the Board and other interested regulatory agencies.[144] The staff should complete their work within 50 calendar days and a decision should be rendered within 60 calendar days.[145]

If an interested state or federal bank regulatory agency recommends disapproval of any application under Section 3 of the BHC Act, the Board is required to notify the applicant of such disapproval and to hold a public hearing on the application within 30 days after such notice, at which all interested parties may testify.[146]

Once the Board has approved an acquisition under Section 3 of the BHC Act or the Bank Merger Act, the applicant must wait 30 days before completing the acquisition, during which time the Department of Justice [*herein* DOJ] may object to the proposed acquisition for antitrust reasons; the DOJ may, and often does, however, consent to a shorter waiting period of 15 days.[147] The transaction generally must be completed within three months thereafter, although the Board may extend this period for "good cause."

[2] Bank Merger Act

If the foreign acquirer chooses a method of acquisition that requires the approval of

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[143] Section 343 of the Riegle Community Development and Regulatory Improvement Act of 1994 [*herein* CDRIA], which was enacted in September 1994, requires each federal banking agency to take final action on an application within a year from the date that the application is "completed"—that is, deemed informationally complete by the agency. As noted in the text, however, it may be a substantial period of time until an application is deemed informationally complete.

[144] These agencies will include the Department of Justice, which, as the federal agency charged with the general administration of the U.S. antitrust laws, will scrutinize the proposal for possible antitrust violations, *see* § 3.05[6] below; and the Comptroller, the OTS or the appropriate state bank or thrift regulator depending on whether the target depository institution is a national bank, federal thrift, or state-chartered bank or thrift. 12 C.F.R. § 225.15(b); U.S.C. § 1843(i)(4).

[145] As noted above, this 60-day calendar does not begin to run until the Board accepts the application as complete. Moreover, it is not improbable, and it has not been uncommon, for the Board to request additional information even after an application has been declared complete, thus making it "incomplete" and starting the clock over again. Section 3(b) of the BHC Act provides that if the Board fails to act within 91 days on any application for approval accepted by the Board as complete, the application is deemed approved.

[146] 12 U.S.C. § 1842(b)(1).

[147] 12 U.S.C. § 1849(b)(1). During the waiting period, the DOJ is permitted to challenge the proposed acquisition in court on antitrust grounds. If the DOJ brings a lawsuit to enjoin the acquisition, the appropriate bank or thrift regulator's order approving the application is automatically stayed unless the court directs otherwise. The reviewing court will make *de novo* findings of fact as to the competitive aspects of the acquisition.

the Board, the Comptroller, the FDIC or the OTS under the Bank Merger Act,[148] the foreign acquirer must follow another set of application procedures in addition to any other application to the Board or the OTS. The procedures established by the four federal agencies for approving bank or thrift mergers and asset acquisitions are similar to the Board's procedures for acquiring a bank holding company: the foreign acquirer submits an application to the appropriate agency on the prescribed form, an investigation is conducted and, in contested cases, a hearing is held.[149]

Once the appropriate bank or thrift regulator has approved a merger under the Bank Merger Act, the applicant must wait 30 days before completing the merger, during which time the DOJ may object to the proposed acquisition for antitrust reasons; the DOJ may, and often does, however, consent to a shorter waiting period of 15 days.[150] The transaction generally must be completed within three months, if the approving regulator is the Board; one year, if the approving regulator is the OCC; six months, if the approving regulator is the FDIC; and 120 days, if the approving regulator is the OTS.[151]

[4] Change in Bank Control Act

If a foreign acquirer seeks to acquire control of a bank or bank holding company and the acquisition is not subject to the BHC Act (*e.g.*, the target is an FDIC-insured industrial bank that is not treated as a "bank" for purposes of the BHC Act but is treated as an "insured depository institution" for purposes of the CIBC Act),[152] the acquirer must comply with the CIBC Act. The foreign acquirer will be required to give the appropriate bank or thrift regulator 60 days' prior written notice of the acquisition by providing specified information similar to that it would provide under the BHC Act.[153] The applicant also must publish the names of both the target and the acquirer and solicit public comments on the proposed acquisition in the community in which the target is located. In addition, the appropriate bank or thrift regulator may publish an announcement of the transaction in the Federal Register inviting comments within

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[148] In addition to BHC Act and Bank Merger Act applications, the foreign acquirer may have to prepare and file an application to organize an interim bank (*e.g.*, to effect a merger transaction). *See* § 3.03[2] above. If the transaction is structured as an asset purchase under the Bank Merger Act, it may be necessary to organize a new bona fide bank subsidiary as owner of the assets, depending on the structure determined. *See* § 3.03[3] above.

[149] *See* 12 C.F.R. § 5.33 (OCC); 12 C.F.R. §§ 303.60–303.65 (FDIC); 12 C.F.R. § 563.22 (OTS). The Bank Merger Act application forms for the Board, the OCC, the FDIC and the OTS are all contained in the uniform Interagency Bank Merger Act Application form.

[150] 12 U.S.C. § 1828(c)(6).

[151] *See* 12 C.F.R. § 262.3(j)(1)(iii) (Board); 12 C.F.R. § 5.33(e)(7) (OCC); 12 C.F.R. § 574.7(a)(2)(iii)(H) (OTS). *See also, e.g.*, Frontier Trust Company, Order Approving Merger (May 2000) (FDIC).

[152] *See* § 3.04[3] above.

[153] 12 U.S.C. § 1817(j). *See* 12 C.F.R. § 5.50 (the Comptroller); 12 C.F.R. §§ 303.80–303.86 (the FDIC); 12 C.F.R. §§ 225.41–225.43 (the Board).

a reasonable time.[154] If the bank regulator does not request additional information or respond with a notice of disapproval within the 60-day period (such period may be extended by notice for 30 days and, if authorized by the bank regulator, for two additional periods of not more than 45 days each), or if it issues written notice of its intent not to disapprove the transaction, the acquisition may proceed.[155] This statutory timetable is a bit misleading because the timetable resets each time the regulatory agency requests more information until the agency declares the notice to be complete.

The transaction generally must be completed within three months, if the approving regulator is the Board; one year, if the approving regulator is the OCC; six months, if the approving regulator is the FDIC; and 120 days, if the approving regulator is the OTS.[156]

[5] Home Owners' Loan Act

If a foreign acquirer seeks to acquire control of a thrift or thrift holding company, and the foreign acquirer is not a bank holding company, the acquirer must comply with the prior approval procedures of Section 10(e) of HOLA. As discussed above, in the absence of regulatory relief from the OTS, this prior approval requirement will apply to foreign banks or the parents of a foreign banks even if they have a U.S. commercial banking presence. As an initial matter, the foreign acquirer would be required to file an application on the appropriate form with the regional office of the OTS where the target is located.[157]

Contemporaneously with submission of the final application, a notice of the acquirer's application must be published in the target thrift's geographic area requesting public comments on the application for a period of up to 30 days. The OTS must accept the application for processing, request additional information, or return the application as incomplete within 30 days after receipt. It is at this stage, in addition to the draft review stage, that most delays occur because a request for additional information causes the timetable required by the regulations to be placed on hold. Although the OTS must accept or reject an application within specified period of time after the applicant has supplied any additional information that may have been requested, the OTS can, and often does, delay action by requesting still more information.

Upon accepting an application as complete, the OTS will, in the case of the acquisition of a state-chartered thrift, transmit copies of the application to interested

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[154] 12 U.S.C. § 1817(j)(2)(D).

[155] 12 U.S.C. § 1817(j)(1). In the event that a control application is disapproved, an applicant may seek judicial review, 12 U.S.C. § 1817(j)(5), provided that the acquirer exhausts all administrative remedies (*i.e.*, an administrative hearing).

[156] *See* 12 C.F.R. § 262.3(j)(1)(iii) (Board); 12 C.F.R. § 5.33(e)(7) (OCC); 12 C.F.R. § 574.7(a)(2)(iii)(H) (OTS). *See also, e.g.*, Frontier Trust Company, Order Approving Merger (May 2000) (FDIC).

[157] 12 C.F.R. § 574.6, pt. 516, Subpart A.

regulatory agencies.[158] The staff should complete their work within 50 calendar days and a decision should be rendered within 60 calendar days.

The transaction generally must be completed within 120 days after approval by the OTS.[159]

§ 3.06 Factors Considered in Applications (Bank Holding Company Act, § 3)

In determining whether to approve an application, the federal bank and thrift regulators consider a variety of factors. While there are notable differences among the factors considered depending on the statute, regulator and type of application involved, there are more similarities than differences. In order to be as comprehensive as possible while avoiding unnecessary repetition, we will describe in this section the factors considered by the Board in determining whether to approve an application to acquire a bank or bank holding company under Section 3 of the BHC Act. Then, in Section 3.07, we will highlight the significant differences between those factors and the factors considered in applications under the other statutes, including applications to acquire a thrift or thrift holding company under Section 4 of the BHC Act.

In determining whether to approve an application under Section 3 of the BHC Act by a foreign applicant, the Board considers the following principal factors: (1) the financial resources of the foreign acquirer, the most crucial of which is the level of the acquirer's risk-based capital ratios, measured on a pro forma basis by the standards set forth in the Basel Capital Accord [*herein* Basel I];[160] (2) whether the foreign acquirer is subject to comprehensive supervision on a consolidated basis in its home country; (3) whether the foreign acquirer has provided the Board with adequate assurances that it will make available to the Board such information with respect to the acquirer and any affiliate as the Board determines is appropriate to enforce compliance with the BHC Act; (4) the managerial resources of the acquirer and the target, which includes

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[158] These agencies will include the Department of Justice, which, as the federal agency charged with the general administration of the U.S. antitrust laws, will scrutinize the proposal for possible antitrust violations, and the appropriate state thrift regulator. 12 C.F.R. § 574.6(h).

[159] *See* 12 C.F.R. § 574.7(a)(2)(iii)(H).

[160] Basel Committee on Banking Supervision of the Group of 10 countries [*herein* Basel Committee], International Convergence of Capital Measurement and Capital Standards (July 1988) If the foreign bank acquirer's home country supervisor has adopted risk-based capital standards consistent with Basel I, the foreign bank's capital will be evaluated on the basis of its risk-based capital ratios as calculated under its home country standards, and not as calculated directly under the terms of Basel I. This is so even if home country standards would result in lower capital ratios than direct application of Basel I because, for example, home country standards exclude certain items from capital elements otherwise permitted by Basel I. This is also so even if the foreign acquirer uses the direct Basel I ratios for public reporting purposes, and only reports its capital ratios as calculated under home country standards to its home country supervisor. *See* § 3.06[1] below. It is not clear how the Board will adjust its rules and policies in light of the adoption of Basel II. Although the Board should be willing to allow foreign banks to calculate their capital ratios on the basis of home-country capital rules based on Basel II, the Board may require foreign bank acquirers to calculate them under home-country Basel I or subject to floors analogous to those required by the U.S. implementation of Basel II in order to compare the foreign acquirer's capital to that of U.S. banks and bank holding companies to assess whether it is equivalent.

consideration of the "competence, experience and integrity" of officers, directors, and principal shareholders; (5) the convenience and needs of the community to be served; (6) the effect of the transaction on competition; (7) the effectiveness of the acquirer in combating money laundering activities; and (8) in the case of interstate transactions, compliance with the additional conditions in Section 3(d) of the BHC Act, as amended by the Riegle-Neal Act.[161]

Neither the BHC Act nor the IBA incorporates a "reciprocal national treatment" policy that would require the home country of a potential foreign acquirer to accord to U.S. banks the same opportunities for expansion in the home country as home country banks are allowed in the United States. Similarly, the Board has endorsed the notion that principles of national treatment and competitive equity require that, "in general, foreign banks seeking to establish banks or other banking operations in the United States should meet the same general standards of strength, experience and reputation as required for domestic organizers of banks and bank holding companies."[162] Thus, at the present time, the Board does not consider whether the foreign bank's home country would permit a U.S. bank to acquire a bank in the home country.[163]

[1] Financial Resources

[a] Capital

For bank regulators in the United States and around the world, capital adequacy is a significant aspect of determining the overall safety and soundness of financial institutions. Basel I,[164] which became fully operative in the United States in 1992,

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[161] 12 C.F.R. § 225.13 (factors); 12 U.S.C. § 1842(c)(6) (anti-money laundering factor); 12 U.S.C. § 1842(d) (additional factors in the case of interstate transactions).

[162] *Policy Statement on Supervision and Regulation of Foreign-Based Bank Holding Companies,* 2 FED. RES. REG. SERV. ¶ 4-835 (1979).

[163] Although proposals have been made from time to time in Congress that would specifically authorize federal banking regulators to deny any application or disapprove any notice by a foreign acquirer based on a determination that the foreign acquirer's home country does not offer U.S. banks and bank holding companies the same competitive opportunities available to domestic banks and bank holding companies, none has ever been enacted.

[164] Basel I is a risk-based capital framework that applies a standard system of assessment and measurement of capital to internationally active banks from countries that are members of the Basel Committee, which meets regularly in Basel under the auspices of the Bank for International Settlements. The Accord establishes an analytical framework that relates regulatory capital requirements to differences in risk profiles among banks, including off-balance sheet exposures, and minimizes disincentives for banks to hold liquid, low-risk assets. The risk-based capital standard established by the Accord is composed of four basic elements: (1) an agreed definition of tier 1 (or core) capital, consisting primarily of common stockholders' equity and certain categories of perpetual preferred stock; (2) a "menu" of internationally agreed items constituting tier 2 capital, which supplements tier 1 capital; (3) a general framework for assigning assets and certain off-balance sheet exposures to broad risk categories, as well as procedures for calculating a risk-based capital ratio; and (4) a minimum ratio of total capital to risk-weighted assets of 8 percent (of which at least 4 percent should be in the form of tier 1 capital). In addition, the Accord requires that the risk weight assigned to a bank or bank holding company's trading account, foreign exchange and commodity positions reflect the market risk to which such assets are exposed. *See* Amendment to the Capital Accord to Incorporate Market Risks (Jan. 1996). Each of the

represented the first step in standardization of capital standards among countries subscribing to it.[165] Even in countries not subscribing to Basel I, risk-based capital standards have become the accepted international standard for the measurement of capital adequacy.

In June 1999, the Basel Committee announced a proposal for a new, more sophisticated capital accord. That proposal ultimately led to the adoption of a new capital accord in June 2006 [*herein* Basel II].[166]

Basel II has already been implemented in Europe by means of the European Capital Requirements Directive [*herein* European CRD].[167] Under the European CRD as implemented by member state law, European banks were required to start a "parallel run" in the first quarter of 2007, during which they continued to comply with Basel I but also calculated their capital under Basel II. The European implementation of Basel II does not contain any floors limiting the benefits from Basel II in terms of any reduced capital requirements.

Basel II has also been adopted in the United States, but it only became effective on April 1, 2008 [*herein* U.S. Basel II].[168] Under the U.S. Basel II, approximately 11 of the largest bank holding companies and insured depository institutions [*herein* core banks] will initially be required to calculate and report their capital ratios under the

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federal bank and thrift regulators follows this practice in its risk-based capital regulations. *See* 12 C.F.R. pt. 225 App. A and E (Board); 12 C.F.R. pt. 3 App. A and B (OCC); 12 C.F.R. pt. 325 App. A and C (FDIC) 12 C.F.R. pt. 567 (OTS).

165 The Basel Committee consists of senior representatives of bank supervisory authorities and central banks from Belgium, Canada, France, Germany, Italy, Japan, Luxembourg, the Netherlands, Spain, Sweden, Switzerland, the United Kingdom, and the United States. International Convergence of Capital Measurement and Capital Standards: A Revised Framework (Comprehensive Version June 2006) [*herein* Basel II] at 1, n.1. Countries that voluntarily subscribe to Basel I, but are not members of the Basel Committee include Australia, Austria, Finland, Hong Kong, Ireland, Israel, Korea, Mexico, and Taiwan. *See* Board of Governors of the Federal Reserve System & Secretary of the Department of the Treasury, *Capital Equivalency Report*, 13 n.6 (June 19, 1992).

166 International Convergence of Capital Measurement and Capital Standards: A Revised Framework (Comprehensive Version June 2006). Basel II consists of three pillars: (1) minimum capital requirements; (2) supervisory review; and (3) market discipline through effective disclosure of banking risks. The fundamental purpose of Basel II is to "develop a framework that would further strengthen the soundness and stability of the international banking system" by introducing "more risk-sensitive capital requirements". Basel II at 2 (paras. 4 and 5). The focus of the first pillar is on developing a more sensitive system of measuring credit risk, operational risk and market risk than Basel I. Basel II has three approaches for measuring credit risk: (i) the standardized approach, (ii) the internal ratings-based approach and (iii) the securitization framework. It has three ways to measure operational risk: (i) the basic indicator approach, (ii) the standardized approach and (iii) the advanced measurement approaches. And it has two methods of measuring market risk: (i) the standardized approach and (ii) the internal models approach.

167 European Capital Requirements Directive, which is contained in Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions (recast) and Directive 2006/49/EC of the European Parliament and of the Council of 14 June 2006 on the capital adequacy of investment firms and credit institutions (recast).

168 Risk-Based Capital Standards: Advanced Capital Adequacy Framework—Basel II, 72 Fed. Reg. 69,288 (Dec. 7, 2007).

Basel II advanced approaches.[169] All other bank holding companies and insured depository institutions will have the option to calculate their capital ratios under Basel I or the Basel II advanced approaches.[170] The core banks are required to adopt an implementation plan within 6 months after the effective date of the new rule. The plan must include a start date for a "parallel run" within two years after the effective date and for the first "transitional floor period" within three years after the effective date. During each of three transitional floor periods of at least one year, the core banks will be subject to floors equal to 95 percent, 90 percent and 85 percent of what their capital would have been under Basel I. Subject to approval from their primary federal regulator, they will be permitted to rely on the Basel II advanced approaches for their risk-based capital requirements without being subject to any floors after the last transitional floor period. However, the tier leverage capital ratio, which is not based on Basel I or Basel II, will continue to apply, as well.

It is not clear how the Board's analysis of the financial resources of a foreign bank acquirer will be affected if the bank's risk-based capital ratios are calculated under its home country's implementation of Basel II instead of Basel I. Although the Board should be willing to rely on capital ratios calculated under home-country Basel II the way it has relied on those calculated under home-country Basel I, the Board could require foreign bank acquirers to provide risk-based capital ratios calculated under home-country Basel I or subject to floors analogous to those required by the U.S. Basel II in order to compare the foreign acquirer's capital to that of U.S. banks and bank holding companies to assess whether it is equivalent.

Capital concerns are particularly important in the acquisition context. In general, the Board will not approve any significant acquisition by an acquirer unless the acquirer's capital ratios, which include Basel I or Basel II risk-weighted capital ratios and, with respect to domestic bank holding companies, a "leverage," or unweighted capital ratio, would be significantly above the minimum standard both before and after the acquisition.[171] The Board generally expects that an acquirer will maintain "strong capital levels substantially above the minimum levels specified in the Board's

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[169] Office of the Comptroller of the Currency, Regulatory Impact Analysis for Risk-Based Capital Standards: Revised Capital Adequacy Guidelines, p. 25 (2006) (Table 1).

[170] The U.S. bank regulators have also proposed a rule that would permit banks and bank holding companies that are not "core banks" to calculate their capital ratios under the Basel II standardized framework. *See* 73 Fed. Reg. 43,982 (July 29, 2008).

[171] Currently, minimum capital standards for bank holding companies in the United States are: (1) tier 1 capital must constitute at least 4 percent of total risk-weighted assets; (2) total capital must be at least 8 percent of risk-weighted assets; and (3) "leverage" (tier 1/average total unweighted assets) must be at least 3 percent or 4 percent, depending on certain factors. 12 C.F.R. § 225 App. A and App. D. A "well capitalized" bank holding company, which can generally avail itself of the Board's procedures for streamlined applications processing, must have capital ratios that meet or exceed each of the following standards: tier 1/risk-weighted assets of at least 6 percent and total capital/risk-weighted assets of at least 10 percent. 12 C.F.R. § 225.2(r). The Board has been reluctant to approve any transaction that has the effect of weakening the acquirer's consolidated capital ratios, even if such ratios remain well above minimum standards.

risk-based capital guidelines, without significant reliance on intangibles, particularly goodwill."[172]

Section 214 of FDICIA required the Board and the Treasury to publish a report establishing guidelines to be used by the Board in converting data on the capital of foreign banks to the equivalent risk-based capital and leverage requirements for U.S. banks for purposes of making determinations of capital equivalency in connection with applications by foreign banks to acquire U.S. banks. In the report published pursuant to this requirement [*herein* Capital Equivalency Report], the Board and the Treasury agreed that in assessing the capital of foreign banks in connection with applications, "capital ratios should be equivalent, but not necessarily identical, to those required of U.S. banks."[173] The report stated that an equivalency standard is consistent with the Board's existing policy, which had "recognized that strict application to foreign banks of capital standards with definitions identical to those applied to U.S. banks would disregard important differences in capital instruments and accounting practices in other countries."[174]

The Capital Equivalency Report does not provide bright-line rules for assessing the capital of foreign banks. Instead, it establishes certain informational requirements and, in the case of countries subscribing to Basel I, minimum capital standards, but leaves the Board with discretion to determine on a case-by-case basis what constitutes equivalency with U.S. capital standards. According to the Report's guidelines, banks from countries that adhere to Basel I will be required, at a minimum, to meet Basel I guidelines as administered by their home country supervisors because, in the opinion of the Board and the Secretary, Basel I standards provide a common basis for evaluating capital among banks from various countries.[175] A bank from a country not subscribing to Basel I will be required to provide (1) information regarding the capital standards applied by its home country supervisor, (2) information sufficient to evaluate the bank's capital position, adjusted as appropriate for accounting and structural differences with U.S. standards, and (3) to the extent possible, information comparable to that required by Basel I.[176] All foreign acquirers must submit detailed information supporting their capital ratios, including various components of tier 1 and tier 2 capital, a breakdown of assets by risk categories, and an explanation of any material differences between U.S. accounting standards and those employed in the home

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[172] Magna Group, Inc., 78 FED. RES. BULL. 89, 91 (1992).

[173] Board of Governors of the Federal Reserve System & Secretary of the Department of the Treasury, *Capital Equivalency Report*, 12 (June 19, 1992).

[174] Board of Governors of the Federal Reserve System & Secretary of the Department of the Treasury, *Capital Equivalency Report*, 12 (June 19, 1992).

[175] Board of Governors of the Federal Reserve System & Secretary of the Department of the Treasury, *Capital Equivalency Report*, 43 (June 19, 1992).

[176] Board of Governors of the Federal Reserve System & Secretary of the Department of the Treasury, *Capital Equivalency Report*, 45 (June 19, 1992).

country.[177] The Board will evaluate this information on a case-by-case basis to determine equivalence with U.S. capital requirements.

The requirement that a foreign bank acquirer have capital that is "equivalent" to that of a U.S. bank is in some tension with the reference in the Capital Equivalency Report to the Board's "existing policy," because in the past there have been many instances in which the Board has permitted acquisitions by foreign acquirers that did not meet the capital guidelines required for U.S. acquirers.[178] The Capital Equivalency Report thus does not eliminate uncertainty as to the manner in which the Board will evaluate the capital of a foreign bank and the weight it will give that evaluation.

[b] Other Financial Resources

Even if a foreign acquirer meets the minimum capital standards, the Board will consider other indicia of financial strength to assess the foreign acquirer's ability to support the particular operations it proposes to conduct in the U.S. and to act as a source of strength for such operations.[179] In considering whether a foreign acquirer will be in a position to support its U.S. operations, the Board has analyzed foreign capital export controls and government ownership with particular care.

The Board generally asks an applicant to provide information relating to its home country's capital export restrictions that could limit the ability of the foreign acquirer to make its financial resources available to the target.[180] The Board has relied on such

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[177] Board of Governors of the Federal Reserve System & Secretary of the Department of the Treasury, *Capital Equivalency Report*, 44 (June 19, 1992).

[178] The Board has relied on several factors as mitigating the foreign acquirer's failure to meet or exceed U.S. minimum capital guidelines, including: (1) the foreign acquirer's compliance with capital requirements in its home country; (2) views of governmental authorities in the foreign acquirer's home country as to its financial condition, resources, and future prospects; (3) whether it has a large and stable deposit base; (4) its performance history and other factors relating to asset quality and liquidity; (5) its past, present, and proposed future programs designed to raise additional capital (including any large, recent issues of equity); (6) different accounting practices (including recognition of a portion of the unrealized appreciation in a portfolio of equity securities carried at cost); (7) its equity position viewed in relation to the risk structure in its portfolio; (8) its history (if any) of U.S. operations; (9) whether the target is small in relation to the acquirer and is itself strongly capitalized; (10) its compliance with risk-based capital guidelines, or ability to meet the standards of such guidelines on or ahead of schedule; and, perhaps most significantly; (11) the foreign acquirer's commitment to maintain the target's capital above minimum capital levels (*e.g.*, as "The Board expects that BBV will maintain Banco Comercial among the more strongly capitalized banking organizations of comparable size in the United States," Banco Bilbao-Vizcaya, S.A. (Spain), 74 FED. RES. BULL. 682, 683–684 (1988)), thus somewhat reducing the need to rely on the foreign parent company as a source of financial strength. *See generally* The Bank of Tokyo, Ltd. (Japan) 74 FED. RES. BULL. 685, 687–688 (1988); ABN Stichting (the Netherlands), 74 FED. RES. BULL. 505, 506 (1988); and Bank of Montreal (Canada), 70 FED. RES. BULL. 664, 665–666 (1984).

[179] Board of Governors of the Federal Reserve System & Secretary of the Department of the Treasury, *Capital Equivalency Report*, 44–45 (June 19, 1992). For a discussion of the Board's source of strength policy, *see* § 3.08[2] below.

[180] *See* Board Form FR Y-3F, Item 16.

restrictions as a basis for rejecting an application.[181] Moreover, although the Board has not had to address the question, the political and economic stability of the foreign acquirer's home country (particularly if the acquirer is government-owned) could be a factor in the Board's decision on an acquisition application.

The Board can be expected to view as a negative factor an acquirer's proposal to finance the acquisition with debt that will result in heavy servicing requirements or with dividends from an acquirer's existing subsidiaries or proposed-to-be acquired targets.[182] In contrast, commitments to provide new equity immediately upon consummating the acquisition may be particularly influential in obtaining Board approval.[183]

Finally, the Board has been reluctant to approve acquisitions by a domestic bank holding company or foreign bank acquirer whose U.S. subsidiary banks, branches, agencies or commercial lending company subsidiaries do not meet certain standards in the rating system for domestic banks, most notably credit quality.[184]

[2] Comprehensive Consolidated Supervision

After the passage of FDICIA, the Board must disapprove any BHC Act application involving a foreign applicant that is not subject to "comprehensive supervision or regulation on a consolidated basis" in its home country.[185] A foreign bank may be considered to be subject to comprehensive consolidated supervision if the Board determines that the bank is supervised or regulated in such a manner that its home country supervisor receives sufficient information on the worldwide operations of the foreign bank, including the relationship of the bank to its affiliates, to assess the foreign bank's overall financial condition and compliance with law and regulation.[186]

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[181] *See* Corporation for Int'l Agric. Prod., Ltd., 70 FED. RES. BULL. 39, 40 (1984).

[182] *See* Cherokee Bancorp, 77 FED. RES. BULL. 324, 325 (1991); Cedar Vale Bank Holding Co., 76 FED. RES. BULL. 257, 258 (1990).

[183] *See, e.g.*, Allied Irish Banks, Ltd., 69 FED. RES. BULL. 927, 929 (1983).

[184] The U.S. branch and agency operations of foreign banks are evaluated on risk management, operational controls, compliance, and asset quality [*herein* ROCA]. A ROCA rating will be assigned to a foreign bank's total U.S. operations as well as to each individual office. *See* Board of Governors of the Federal Reserve System, Examination Manual for U.S. Branches and Agencies of Foreign Banking Organizations § 2003.1 (1997); *see also* Board of Governors of the Federal Reserve System, BANK HOLDING COMPANY SUPERVISION MANUAL § 2124.0.2.5 (2006); Board of Governors of the Federal Reserve System, Supervisory Letter SR 00-14 (SUP), Enhancements to the Interagency Program for Supervising the U.S. Operations of Foreign Banking Organizations (Oct. 23, 2000).

[185] FDICIA § 202(d), 12 U.S.C. § 1842(c)(3)(B); 12 C.F.R. §§ 225.13(a)(4), 211.24(c)(1)(ii).

[186] The Board considers, among other factors, the extent to which the home supervisor:

- Ensures that the foreign bank has adequate procedures for monitoring and controlling its activities worldwide;
- Obtains information on the condition of the foreign bank and its subsidiaries and offices outside the home country through regular reports of examination, audit reports, or otherwise;
- Obtains information on the dealings and relationship between the foreign bank and its affiliates, both foreign and domestic;
- Receives from the foreign bank financial reports that are consolidated on a worldwide basis, or

The terms "comprehensive regulation" and "consolidated basis" are sufficiently broad to leave the Board substantial latitude in determining whether to disapprove an application by a foreign bank acquirer under Section 3 of the BHC Act on the basis of insufficient home-country regulation.

In theory, the requirement of comprehensive supervision or regulation on a consolidated basis must be fulfilled on a bank-by-bank basis, not on a country-by-country basis. According to one staff member, however, "applicants chartered in the same country may rely on information previously submitted and considered by the Board on consolidated supervision in that country. Subsequent applicants need only describe the extent to which the supervision system already evaluated applies to them and how, if at all, that system has changed since the Board last considered it."[187] As a result, it is normally less difficult for the second bank from a particular country to work through the comprehensive supervision requirement with the Board.

[3] Adequate Assurances

Under Section 202(d) of FDICIA, the Board must deny an application to acquire a U.S. bank if the foreign acquirer fails to provide adequate assurances that it will make available to the Board such information on the acquirer's operations or activities as well as those of its affiliates as the Board deems necessary to enforce the BHC Act.[188] This standard is intended primarily to address bank operations in bank secrecy jurisdictions which deliberately restrict access to information in an effort to attract offshore banking business.[189] The Board has interpreted this provision not to require the Board to have access to routine customer information. Rather, information would be sought only when the Board had reason to believe that U.S. laws had been or were being violated. Moreover, the Board has narrowed the potential scope of this provision by establishing a materiality test under which an applicant need only submit information on the secrecy laws of those jurisdictions in which it or its affiliates conduct material operations.[190]

[4] Management Resources

Section 210 of FDICIA requires the Board to focus its analysis of an acquirer's

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comparable information that permits analysis of the foreign bank's financial condition on a worldwide, consolidated basis; and

- Evaluates prudential standards, such as capital adequacy and risk asset exposure, on a worldwide basis.

12 C.F.R. §§ 211.24(c)(ii)(A)–211.24(c)(ii)(E).

[187] Ann E. Misback, *The Foreign Bank Supervision Enhancement Act of 1991*, 79 FED. RES. BULL. 1, 9 (1993); *see also, e.g.*, Bank Sinopac, 83 FED. RES. BULL. 669, 669 (1997).

[188] FDICIA § 202(d), 12 U.S.C. § 1842(c)(3)(A).

[189] *See* Ann E. Misback, *The Foreign Bank Supervision Enhancement Act of 1991*, 79 FED. RES. BULL. 1, 7 (1993).

[190] *See* Ann E. Misback, *The Foreign Bank Supervision Enhancement Act of 1991*, 79 FED. RES. BULL. 1 (1993). Material operations are "defined as direct or indirect activities that, in the aggregate, account for 5 percent or more of the consolidated worldwide assets of the bank or its ultimate parent." *Id. at 7*.

managerial resources on "consideration of the competence, experience, and integrity of the officers, directors, and principal shareholders" of the acquirer.[191] The enormous discretion conferred by this provision not only gives the Board authority to require extensive disclosure of the backgrounds and identities of all persons affiliated with the acquirer, including its principal stockholders, but to derail an acquisition on the basis of this information. The Board has, in fact, on at least one occasion acted on this authority, unanimously rejecting a Section 3 application on the basis of "managerial factors" and citing Section 210 of FDICIA.[192] As a result of this provision and in the aftermath of the BCCI scandal, the Board has instituted a policy of requiring "name checks" of the top two decisionmakers and principal shareholders of any foreign bank seeking to acquire a U.S. bank. This process, which involves sending the relevant names to various U.S. law enforcement and intelligence agencies, has resulted in a general lengthening of the time required to process applications by foreign banks.

[5] Convenience and Needs of Community

In determining whether an applicant has met the BHC Act's convenience and needs requirement, the Board emphasizes performance records under the Community Reinvestment Act [*herein* CRA] and other consumer protection statutes. The CRA requires the federal financial supervisory agencies to encourage FDIC-insured banks to help meet the credit needs of their entire communities, including low- and moderate-income neighborhoods, and to take such banks' records of meeting these needs into account when evaluating bank holding company or merger applications.[193] The Board has determined that the convenience and needs of the community factor should be evaluated in light of the acquiring and, to a certain extent, the target institution's CRA performance record. In addition, the Board will consider whether an acquiring institution has satisfactorily complied with the reporting requirements of the Home Mortgage Disclosure Act [*herein* HMDA] and the Equal Credit Opportunity Act [*herein* ECOA].[194]

A foreign bank that does not own an insured depository institution or have an insured branch in the United States at the time it submits an application to acquire an FDIC-insured bank or branch is not itself required to comply with the requirements of CRA.[195] Nonetheless, the Board will consider the CRA record of the target institution

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[191] FDICIA § 210, 12 U.S.C. § 1842(c)(5).

[192] *See* First Independence Bancshares, Inc., 79 FED. RES. BULL. 509, 510 (1993). *See also* HMS Holdings, Inc., 78 FED. RES. BULL. 214, 215 (1992) (managerial factors "weigh[ed] against approval").

[193] 12 U.S.C. § 2903; *Statement of the Federal Financial Supervisory Agencies Regarding the Community Reinvestment Act,* 54 Fed. Reg. 13,742 (1989) [*herein* CRA Statement]. The CRA Statement indicates that the CRA record of an institution, as reflected in its examination reports, will be given great weight in the application process. The Board will consider the institution's entire CRA record as an integral component of the convenience and needs of the community assessment.

[194] 12 U.S.C. §§ 2801 *et seq.*; 15 U.S.C. §§ 1691 *et seq.*

[195] *See* 12 U.S.C. §§ 1813(c)(2), 2902(2) and 2903. The CRA is applicable to any direct branch of a foreign bank that results from such an acquisition when the foreign acquirer did not previously have a

as a relevant factor in its CRA analysis,[196] although there is no case in which the Board has considered the target's performance record as the determinative factor in deciding whether to approve an application by a foreign bank. In cases where CRA is a concern, moreover, the Board typically requires assurances from an acquirer that it will improve the target's CRA compliance after the acquisition is complete.[197]

Foreign banks with an office in the United States, whether or not they own an insured depository institution or have an insured branch, are required to comply with several fair lending statutes.[198] Compliance with two of these statutes (HMDA and ECOA)[199] has been considered by the Board as relevant in connection with the

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branch in the target bank's state, unless the resulting branch limits its deposits to those permissible for an Edge Act Corporation.

[196] In addition, the CRA record of any U.S. bank subsidiaries already owned by or affiliated with the foreign applicant will be considered. 12 C.F.R. § 225.13(b)(3).

[197] Once a foreign bank has acquired an insured financial institution, the CRA performance record of that institution will be relevant in any future applications submitted by the foreign bank to the Board. *See* 12 U.S.C. § 2903. As a result, a foreign acquirer anticipating future acquisitions should evaluate carefully the CRA performance record of any potential target.

[198] These statutes include: (1) limitations on brokered deposits, 12 U.S.C. § 1831f; (2) the Truth in Lending Act [*herein* TILA], which requires accurate and complete disclosure by the creditor of all terms of any consumer loan transaction, 15 U.S.C. §§ 1601 *et seq.*; (3) the HMDA, which requires institutions that are engaged in mortgage lending in urban areas to keep extensive files regarding their mortgage lending, 12 U.S.C. §§ 2801 *et seq.*; (4) the Expedited Funds Availability Act, which establishes very specific timetables for banks' acceptance and clearance in demand deposit accounts and requires disclosure of these timetables to customers, 12 U.S.C. §§ 4001 *et seq.*, *see* Johnson International Inc., 81 FED. RES. BULL. 507, 508 (1995); (5) the Electronic Funds Transfer Act, which applies to consumer banking transactions in accounts established by individuals primarily for personal purposes, and involving the use of electronics, telephones and computers, 15 U.S.C. § 1693; (6) the Truth in Savings Act, which requires banks to disclose the rates paid on depository accounts and the fees assessable against such accounts, 12 U.S.C. § 4301, *see* Johnson International Inc., 81 FED. RES. BULL. 507, 508 (1995); (7) the Federal Trade Commission Act, which generally prohibits "unfair or deceptive practices," 15 U.S.C. §§ 41 *et seq.*; (8) the Fair Debt Collection Practices Act, which prohibits a variety of misleading or high-pressure tactics against individual consumers in the collection of personal or similar loans, 15 U.S.C. § 1692; (9) the ECOA, prohibiting discrimination in the issuance of credit, 15 U.S.C. § 1691; and (10) the Fair Credit Reporting Act, which requires banks that have denied customers credit based upon a credit report prepared by a third party to disclose such information to the customer, 15 U.S.C. § 1681. *See generally* Chubb and Tahyar, *Foreign Banks and the New U.S. Banking Legislation*, 7 J. OF INT'L BANKING L. 44 (1992). The applicability of consumer protection statutes to foreign banks operating in the U.S. was affirmed in the Riegle-Neal Act, *see* § 3.02[2] above, by its amendment of Section 9(b) of the IBA, 12 U.S.C. § 3106a, expressly to subject such foreign banks to any law of the U.S. imposing requirements that protect the rights of consumers in financial transactions to the extent such foreign banks engage in activities that are subject to such laws. *See* 12 U.S.C. § 3106a.

[199] HMDA mandates that institutions that are engaged in mortgage lending in urban areas keep extensive files regarding their mortgage lending. The purpose of HMDA is to ensure that banks provide home mortgages to qualified borrowers, regardless of geographic location. HMDA and its implementing regulations, 12 C.F.R. §§ 203.1 *et seq.* (1994); 12 C.F.R. §§ 338.5 *et seq.*, require that banks report the number and amounts of mortgages and catalog such mortgages. The present regulation establishes certain *de minimis* exemptions for small institutions.

ECOA prohibits discrimination in the issuance of credit based on race, color, religion, national origin, convenience and needs of the community analysis under Section 3 of the BHC Act in certain domestic bank acquisition transactions.[200] It is reasonable to expect, therefore, that the fair lending practices of the U.S. offices of a foreign acquirer and of its U.S. target will be relevant to the Board's review of any application made by the foreign acquirer. Furthermore, the acquirer should keep in mind that it will become responsible for the *prior* fair lending violations of the acquired institution.

The Board's CRA scrutiny can be very intense, and, on occasion, it has resulted in the denial of a Section 3 application. For example, in 1995, the Board denied the Section 3 application of Totalbank Corporation of Florida because of the inadequate CRA compliance of its FDIC-insured bank subsidiaries. FDIC examiners had found that the geographic distribution of the subsidiaries' credit extensions, credit applications, and credit denials reflected disparate lending practices. The same report also indicated that there were serious weaknesses in the banks' overall compliance with CRA policies and programs. Significantly, the Board denied the application despite efforts by the banks to improve their CRA performance.[201]

In addition, in high profile bank acquisitions, the Board has held public hearings at which activist groups have been given an opportunity to speak on the acquirer's and

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sex, marital status, age, or exercise of rights under the consumer protection laws. The implementing regulations, 12 C.F.R. §§ 202.1 *et seq.*, provide guidance regarding the type of information that is impermissible for lenders to gather or consider in making credit decisions. Lenders must also provide certain credit applicants, upon written request, copies of the appraisal report used in connection with such applicants' applications for credit.

[200] *See, e.g.*, First Union Corp., 83 FED. RES. BULL. 1012, 1016–1017 (1997) (HMDA); Banc One Corp., 83 FED. RES. BULL. 520, 522, 526 (1997) (ECOA). Although compliance with HMDA is considered in the Board's review process, it is not, by itself, conclusive. In the First Union application, the Board reviewed First Union's HMDA data and noted that such data indicated noncompliance with fair lending laws and an inaccurate record of CRA-related lending. The Board further stated, however, that HMDA data alone provide an incomplete measure of an institution's lending in its community and that, absent other information, the HMDA's limitations make the data an inadequate basis for concluding that an institution has engaged in illegal lending discrimination. Noting that the other information available to it did not indicate discriminatory or other illegal credit practices, the Board ultimately found that First Union's CRA performance was acceptable. *See* First Union Corp., 83 FED. RES. BULL. 1012, 1016–1017 (1997). In the Banc One application, the Board conditioned its approval on Banc One's commitment that it would enhance its community reinvestment program by, among other things, ridding its operations of any illegal discrimination against minority credit applications in violation of ECOA. *See* Banc One Corp., 83 FED. RES. BULL. 520, 522, 526 (1997).

[201] *See* Totalbank Corp. of Florida, 81 FED. RES. BULL. 876, 877–878 (1995); *see also* First Colonial Bankshares Corp. Chicago, 79 FED. RES. BULL. 706 (1994); Gore-Bronson Bancorp, Inc., 78 FED. RES. BULL. 784 (1992). In its decision in Gore-Bronson, the Board considered the CRA rating of both the acquiring institution and the target, Water Tower Trust and Savings Bank. The Board found a consistent pattern of noncompliance with CRA by a subsidiary of Gore-Bronson and the target. The Board declined to approve the application despite commitments for future CRA improvement made by Gore-Bronson. The Board stated that such commitments would be relevant "only where the applicant otherwise has a satisfactory CRA record, where the problems identified at the bank do not indicate chronic institutional deficiencies or a pattern of CRA deficiencies, and where the applicant takes immediate and effective action to address identified deficiencies in the CRA performance of its banks." Gore-Bronson Bancorp, Inc., 78 FED. RES. BULL. 784, 786 (1992).

target's CRA record. A foreign bank acquirer should anticipate that such public hearings, if held, may take several months and slow down an application process.[202]

In sum, a foreign bank seeking to acquire an FDIC-insured bank should carefully review the CRA performance and fair lending record of the target institution.[203] In addition, any foreign bank with a U.S. commercial banking presence should pay particular attention to its own fair lending performance and, if it has an insured branch, to the branch's CRA performance, because such performance is likely to be a significant factor in any future acquisition. Moreover, the foreign acquirer should recognize that it will assume responsibility for bringing any newly acquired insured financial institution into compliance with fair lending statutes and will be held directly responsible for maintaining compliance with CRA as it relates to any future applications submitted to the Board by the foreign bank.

[6] Antitrust Considerations

[a] Summary

Another factor considered by the Board in evaluating an acquisition under Section 3 of the BHC Act is the likely impact of the proposed acquisition on competition. The Board defines the U.S. geographic markets in which either the acquirer or the target has any banking offices. It then reviews data on the impact of the proposed acquisition on the competition for banking services in those geographic markets. The Board uses each competitor's share of deposits in the relevant geographic markets as a proxy for the competitor's share of the full range of banking products and services provided in each geographic market. It generally treats commercial banks as full competitors, thrifts as half competitors, and credit unions and non-depository institutions as non-competitors within each geographic market. It uses the Herfindahl-Hirschman Index [*herein* HHI] to measure market concentration and the change in market concentration in each relevant geographic market both before and after a proposed acquisition.

As an initial matter, the Board relies on market concentration data provided by the applicant in its application to analyze the effect of the proposed transaction on competition. Using geographic market definitions obtained from the Federal Reserve Bank that will review the application (or an outside vendor), and data from the FDIC's website (or an outside vendor), the applicant lists each competitor in each relevant geographic market, the amount of its deposits (reducing each thrift's deposits by 50

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[202] In the merger between Chemical Bank and the Chase Manhattan Corporation, for example, the CRA hearing period was extended twice, giving interested persons fifty days to be heard. *See* Chemical Banking Co., 82 FED. RES. BULL. 239, 240 (1996). In the merger between NationsBank Corporation and BankAmerica Corporation, the Board convened a two-day public meeting to consider, among other things, convenience and needs factors. *See* NationsBank Corporation, 84 FED. RES. BULL. 858, 866 (1998); *see also* Travelers Group Inc., 84 FED. RES. BULL. 985, 986 (1998).

[203] The same concerns arise in the interstate merger context, because the FDIA, as amended by the Riegle-Neal Act, requires consideration of the CRA performance of the target bank in an interstate merger transaction. *See* 12 U.S.C. § 1831u(b)(3).

percent), the percentage of each competitor's (weighted) share of the (weighted) total deposits in the relevant geographic market, the square of each percentage, the HHI and the change in the HHI for each relevant geographic market both before and after the proposed transaction.

The HHI for each relevant geographic market is computed by adding the squares of each competitor's percentage market share of deposits in the relevant market. For example, if a geographic market contains three competitors—A, B and C—with deposit market shares of 10 percent, 20 percent and 70 percent, respectively, the HHI for that market would be calculated in the following manner: $10^2 + 20^2 + 70^2$. This would equal 100 + 400 + 4900, or a total of 5400. If A and B merged, they would have a combined share of 30 percent and the HHI after the transaction would be $(30)^2 + (70^2)$. This would equal 900 + 4900, or a total of 5800. The change in HHI produced by the transaction would be 5800 - 5400, or a difference of 400.

The Board and the DOJ have developed thresholds of market concentration, as measured by the HHI, which they generally treat as "safe harbors" from any further scrutiny of the transaction for anticompetitive effects. Most acquisitions do not cross these thresholds and, hence, are not subjected to antitrust analysis. The Board and the DOJ generally will not scrutinize an acquisition if the post-transaction HHI is below 1800 or, if over 1800, any increase in the HHI was less than 200 as a result of the transaction.

[b] Legal Framework

In language substantively equivalent to that of their antitrust analogs in the Sherman Act[204] and the Clayton Act,[205] Section 3 of the BHC Act prohibits monopolization[206] and generally bars approval of any acquisition that may substantially lessen competition, tend to create a monopoly, or be in restraint of trade.[207] The banking statutes only deviate materially from the antitrust statutes in their inclusion of a "public interest" exception to the prohibition on transactions that may substantially lessen competition, tend to create a monopoly, or be in restraint of trade.[208] The public interest exception is similar to the exception developed in ordinary antitrust case law

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[204] 15 U.S.C. §§ 1–7.

[205] 15 U.S.C. §§ 12–19; 15 U.S.C. §§ 21–27; 29 U.S.C. § 52–53.

[206] *Compare* 12 U.S.C. §§ 1842(c)(1) (BHC Act) *with* 15 U.S.C. § 2 (Sherman Act). *See also* 12 U.S.C. § 1828(c)(5)(A) (Bank Merger Act); 12 U.S.C. § 1817(j)(7)(A) (CIBC Act).

[207] *Compare* 12 U.S.C. §§ 1842(c)(1)(B) (BHC Act) *with* 15 U.S.C. §§ 1 (Sherman Act) and 18 (Clayton Act). *See also* 12 U.S.C. § 1828(c)(5)(B) (Bank Merger Act); 12 U.S.C. § 1817(j)(7)(B) (CIBC Act).

[208] 12 U.S.C. § 1842(c)(1)(B). *See also* 12 U.S.C. § 1828(c)(5)(B) (Bank Merger Act); 12 U.S.C. § 1817(j)(7)(B) (CIBC Act). These statutes provide that an acquisition should be allowed to proceed if its anticompetitive effects are clearly outweighed by its benefit to the convenience and needs of the community.

for acquisitions involving a failing company, but is somewhat broader than that exception.[209]

The Clayton and Sherman Acts also apply directly to bank acquisitions.[210] Despite the substantial equivalence of the antitrust laws' provisions to those of the banking laws,[211] this double coverage is quite significant. It allows bank acquisitions to be challenged on federal antitrust grounds by the Department of Justice [*herein* DOJ], state attorneys general, and private litigants, as well as the Board. The DOJ plays a significant part in bank acquisition transactions, reviewing virtually every acquisition proposed and occasionally intervening informally in the approval process itself or afterward by means of a civil action under the antitrust laws.[212] This is significant not

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[209] *See* § 3.06[6][h] below (discussion of "failing company defense"); States v. Third Nat'l Bank, 390 U.S. 171, 187 (1968) (public interest exception intended to reach banks not yet failing).

[210] United States v. Philadelphia Nat'l Bank, 374 U.S. 321 (1963) (Bank Merger Act does not preclude application of Clayton Act § 7 to bank acquisitions).

[211] As discussed above, the banking laws' public interest exception to the prohibition of transactions substantially lessening competition, tending to create a monopoly, or in restraint of trade makes these laws at least formally different from the antitrust laws. Even this formal difference is eliminated when the antitrust laws are applied to bank acquisitions, however, as the banking laws require that in any judicial proceeding attacking an acquisition approved under the banking laws on the grounds that the transaction violates the antitrust laws (other than Sherman Act § 2's prohibition of monopolization), the standards applied by the court must be the same as those applied by the bank regulators in reviewing the transaction. 12 U.S.C. §§ 1849(b)(1). *See also* 12 U.S.C. § 1828(c)(7)(B) (Bank Merger Act); United States v. Citizens & Southern Nat'l Bank, 422 U.S. 86 (1975) (Bank Merger Act) (bank acquisitions are subject to Clayton Act standards unless the public interest exception is met).

[212] The DOJ's review is facilitated by the Board's providing it with copies of Section 3 applications when they are filed and requesting the DOJ's position on the competitive effects of the proposed acquisition. If the DOJ concludes that the acquisition will have adverse competitive effects, it will attempt to negotiate a restructuring of the acquisition with the applicant during the course of the application approval process.

The Board must inform the DOJ when a bank acquisition is approved, whereupon the acquisition generally is stayed for a 30-day waiting period during which the DOJ may bring an action under the Clayton Act (there is no such time limit on Sherman Act § 2 challenges to actual monopolies). 12 U.S.C. § 1849(b)(1). *See also* 12 U.S.C. §§ 1828(c)(6), (7) (Bank Merger Act). The DOJ is usually able to resolve its competitive concerns without resort to a civil action by informally intervening in the approval process, as discussed above. This informal intervention, however, can be very disruptive and expensive. For example, in the acquisition of Security Pacific Corp. by BankAmerica Corp. in April 1992 the DOJ and the merging banks were able to agree on a plan of merger (which included the divestiture of $8.5 billion in deposits and $3.3 billion in loans) before the Board formally approved the acquisition. However, this agreement came only after a massive discovery effort by the DOJ, which included extensive interviews and the production of approximately 700 boxes of documents. *See* Michael J. Halloran, *Practical Considerations of the 'New' Antitrust Analysis: Lessons of the BankAmerica/Security Pacific Merger Process* (Annual Meeting of the American Bar Association, New York, NY Aug. 10, 1993). Under § 3(a) of the Antitrust Civil Process Act, 15 U.S.C. § 1312(a), the DOJ can issue civil investigative demands for the production of documents relevant to competitive aspects of a proposed bank acquisition. In light of how substantial a role the DOJ may play in an acquisition raising significant competitive issues, it is advisable to meet with the DOJ, as well as the appropriate bank regulators, as early as possible in the course of such an acquisition.

Under certain, very limited circumstances, filing requirements under the Hart-Scott-Rodino Antitrust only because it adds another layer of bureaucracy to the approval process but because the DOJ has developed antitrust standards different from those of the Board.[213] State attorneys general apply yet another set of antitrust standards, although their intervention in bank acquisitions historically has not been on the same level as that of the DOJ.[214]

It must be noted that the foregoing complex of antitrust laws and potential enforcers often is irrelevant to a foreign acquirer of a U.S. bank. An acquisition by a foreign bank not already active in the target bank's market does not generally raise any competitive concerns because such entry has no effect on the concentration of that market. In addition, when a foreign bank is making only a passive investment in the U.S. target, and not obtaining control, antitrust concerns that would be raised by an acquisition of control may not arise.[215]

[c] Steps in Evaluating Competitive Effect

Regardless of whether the Board, the DOJ or a state attorney general is conducting the antitrust review of a proposed bank acquisition, the basic framework of the analysis

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Improvements Act of 1976, 15 U.S.C. § 18a, could be triggered by a bank acquisition. In general, however, transactions subject to the BHC Act, the Bank Merger Act, the CIBC Act or HOLA would be exempt from all or most requirements under such Act. *See* 15 U.S.C. § 18a(c)(7)(8); 16 C.F.R. § 802.8(b). If the foreign acquirer is a financial holding company and the acquisition also involves the acquisition of any non-banking (non-thrift) companies or any U.S. branches of a foreign bank, however, an HSR Act filing will generally be required to the extent of such acquisitions because they would not generally require the prior approval of the Board under Sections 3 or 4 of the BHC Act or any other federal bank or thrift regulator.

[213] *See* 3.06[6][c] below (discussing DOJ approach to product market definition).

[214] State attorneys general theoretically may have as much influence over the shape of bank acquisitions as the DOJ because, like the DOJ, state attorneys general may seek divestiture of acquired businesses. Clayton Act § 16, 15 U.S.C. § 26; California v. American Stores Co., 495 U.S. 271, 278, 110 S. Ct. 1853, 1857, 109 L. Ed. 2d 240, 250, 1990-1 Trade Cas. (CCH) P69003 (1990). In the BankAmerica/Security Pacific acquisition, the attorneys general of Washington, California and Arizona intervened, requiring a 400 to 500 box document production and ultimately securing settlements that required divestiture beyond that called for by either the Board or the DOJ, as well as payment of the costs of the states' investigations. Michael J. Halloran, *Practical Considerations of the 'New' Antitrust Analysis: Lessons of the BankAmerica/Security Pacific Merger Process*, at 8 (Annual Meeting of the American Bar Association, New York, NY Aug. 10, 1993). This Chapter will not describe or analyze the state attorneys general antitrust standards. They are set forth, however, in the Horizontal Merger Guidelines of the National Association of Attorneys General, which are reprinted at 4 TRADE REG. REP. (CCH) ¶ 13,406 (1993).

In addition, many state statutes governing bank mergers and acquisitions also require an evaluation of the effects of a proposed transaction on competition. The antitrust provisions of state laws governing the acquisition of a bank or a bank holding company in most cases mirror federal law. *See*, *e.g.*, CAL. FIN. CODE § 703(a), (b). In some cases, however, they are formulated differently and thus might have somewhat different standards than those applied under federal law. *See*, *e.g.*, N.Y. BANKING LAW §§ 142(1) & 142-a.

[215] Christopher Holder, *The Use of Mitigating Factors in Bank Mergers and Acquisitions: A Decade of Antitrust at the Fed*, ECONOMIC REVIEW OF THE FEDERAL RESERVE BANK OF ATLANTA, Mar./Apr. 1993, at 37.

is the same. First, the relevant geographic and product markets must be defined and the institutions participating in them identified. Once the boundaries and players are established, the effect of the proposed acquisition on market concentration is measured and its likely effect on competition in the relevant market analyzed. If no competitive problems are identified, the transaction proceeds. If problems do arise, the transaction will not be permitted to proceed without either (1) a showing by the parties that the transaction's anticompetitive effects on the community are clearly outweighed by its benefits to the community, or (2) an agreement from the parties to divest sufficient assets and/or liabilities to eliminate the anticompetitive effect of the transaction.

To identify the market or markets that may be affected by the proposed acquisition it is first necessary to identify which individual products,[216] or groups of products, offered by the merging banks constitute distinct lines of commerce.[217] The Board historically has viewed the cluster of products and services offered by commercial banks as a single line of commerce. The DOJ, by contrast, considers business and consumer banking to be separate lines of commerce and business banking to have relevant product submarkets, such as cash management services for small businesses. Once the line or lines of commerce are identified, the boundaries of the geographic area in which the merging banks compete in the defined line or lines of commerce must be drawn.[218] On occasion, the Board defines the relevant geographic area as broader than that defined by the DOJ.

After the markets' product and geographic limits are established, the sellers participating in the markets must be identified.[219] The Board generally includes all commercial banks located in the market, a substantial portion of thrifts, some credit unions and, occasionally, some nondepository financial institutions. The DOJ, in contrast, will exclude even commercial banks that it does not believe compete in the defined market (*e.g.*, small banks that the DOJ believes may not actually be able to provide loans or cash management services to middle market businesses), only includes thrifts that actually offer the relevant product, and rarely includes credit unions or nondepository financial institutions.

When the market and its seller-participants are identified, the competitive effect of the proposed transaction can be analyzed.[220] The first step in this analysis is a calculation of what immediate effect the transaction will have on the distribution of market share. Using the Herfindahl Hirschman Index, or HHI, the Board or DOJ measures the concentration of market share in the market before and, on a pro-forma basis, after the proposed transaction. If, as a result of the transaction, market concentration will increase over certain threshold amounts, the transaction is likely to be further analyzed. This analysis is intended to determine whether the increased

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[216] The term *products*, as used in this Chapter, includes services.

[217] *See* § 3.06[6][c] below.

[218] *See* § 3.06[6][d] below.

[219] *See* § 3.06[6][e] below.

[220] *See* § 3.06[6][f] below.

concentration in the market will actually lead to decreased competition in the market. The regulators and the DOJ look at a number of factors here, including the capacity of other competitors in the market to expand production and the ability of and likelihood that banks outside the market would enter the market in response to an attempt by current competitors to raise their prices.

If, after consideration of all the factors that may affect competition, the bank regulator or DOJ concludes that the proposed transaction will lessen competition, the transaction may still be permitted, provided either that the parties can show that the transaction's benefits to the community clearly outweigh its anticompetitive effects, or that the parties agree to divest themselves of sufficient assets and deposits (usually whole branches) to cure the anticompetitive effect of the proposed transaction.[221] Such divestiture historically has been required before a transaction could be consummated, but more recently banks have been allowed to execute acquisitions upon a written commitment to undertake specified divestitures within a fixed period of time after the closing of the acquisition.

[d] Defining the Product Markets

The Supreme Court and the Board historically have considered the entire range of products and services typically offered by commercial banks to constitute for antitrust purposes a single cluster of products with its own independent market.[222] The Board continues for the time being to hold to this view, although the Supreme Court has not considered the issue in more than thirty years,[223] and studies by the Board seem to undercut the concept of a single cluster.[224] The DOJ, for its part, has abandoned the single cluster approach in favor of analyzing separate cluster markets for retail and small, medium-sized, and large firm business banking. As will be seen below, definition of the relevant product market largely determines which firms will be included as participants in the market and, therefore, what degree of concentration is found in the market.

The original basis for the single cluster approach to product market definition was

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[221] *See* § 3.06[6][g] below.

[222] *See*, *e.g.*, United States v. Philadelphia Nat'l Bank, 374 U.S. 321 (1963); The Connecticut Bank and Trust Co., 2-2 O.C.C.Q.J. 66 (June 1983); United Bank Corporation of New York, 64 FED. RES. BULL. 894, 896 (1978); *FDIC Statement of Policy on Bank Merger Transactions,* 63 Fed. Reg. 44,761 (Aug. 20, 1998) (revising 1989 policy).

[223] United States v. Connecticut Nat'l Bank, 418 U.S. 656, 666 (1974), is the most recent decision to consider the issue.

[224] *See*, *e.g.*, Chase Manhattan Corp., 87 FED. RES. BULL. 76, 78 (2001) (using the cluster product line approach); BankAmerica Corporation, 80 FED. RES. BULL. 623, 625 & n.11 (1994) (same); Texas Commerce Bank-Beaumont, 12-2 O.C.C.Q.J. 69, 69–70 (June 1993) (rejecting the position that cluster of products should be disaggregated). In the proposed First Security/Zions merger, however, the Board excluded certain out-of-state deposits from the merging parties' market share figures because, among other things, the parties were limited by law in their use of the deposits, and making adjustments for the merging parties "would not distort market calculations for other competitors" in the market. First Security Corp., 86 FED. RES. BULL. 122, 126–127 (2000).

the observation that consumers tended to purchase all their financial products in a cluster from the same local commercial bank.[225] The Supreme Court found that cluster purchasing resulted in part from commercial banks' competitive advantage in selling these products and in part from the added value to consumers of finding all the products in the cluster under the same roof.[226]

Studies conducted by the Board do not entirely support the notion of a single market for the full cluster of what was formerly thought of as commercial banking services. Instead, these studies show that individual consumers, as well as small and medium-sized businesses, often purchase banking products from a variety of institutions in a number of separate clusters as well as, in the case of certain products, individually.[227] Nonetheless, as noted above, the Board currently is adhering to the single cluster approach.[228]

The DOJ disaggregates the traditional cluster of products into several separate markets.[229] This disaggregation has occurred along two distinct lines. Most broadly, the DOJ has taken the position that separate "cluster" markets exist for distinct categories of customers: consumer, large business, medium-sized business, and small business.[230] In addition, the DOJ has stated that there are separate markets within each

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[225] United States v. Philadelphia Nat'l Bank, 374 U.S. 321, 356–357 (1963); United States v. Phillipsburg Bank & Trust Co., 399 U.S. 350, 360–361 (1970).

[226] United States v. Phillipsburg Bank & Trust Co., 399 U.S. 350, 360–61 (1970). *See generally* Tim McCarthy, *Note, Refining Product Market Definition in the Antitrust Analysis of Bank Mergerss*, 46 DUKE L. J. 865, 874–75 (1997).

[227] Gregory E. Elliehausen & John D. Wolken, *Banking Markets and the Use of Financial Services by Small and Medium Sized Businesses*, 76 FED. RES. BULL. 801 (1990); Gregory E. Elliehausen & John D. Wolken, *Banking Markets and the Use of Financial Services by Households*, 78 FED. RES. BULL. 169 (Mar. 1992).

[228] *See*, *e.g.*, Chase Manhattan Corp., 87 FED. RES. BULL. 76, 78 & n.12 (2001); Chemical Banking Co., 82 FED. RES. BULL. 239, 241 (1996) (rejecting arguments that individual product markets should be evaluated); Amcore Fin., Inc., 83 FED. RES. BULL. 666, 667 n.4 (1997). In the J.P. Morgan-Chase merger, the Board rejected suggestions that the enactment of the Gramm-Leach-Bliley Act required the abandonment of the product cluster approach to market definition and a focus on individual products and services. *See* Chase Manhattan Corp., 87 FED. RES. BULL. at 78 & n.12.

[229] *See*, *e.g.*, United States v. Fleet/Norstar Financial Group, Inc., 56 Fed. Reg. 33,458 (July 22, 1991) (competitive impact statement); United States v. First Hawaiian, Inc., 56 Fed. Reg. 10,916 (Mar. 14, 1991) (competitive impact statement). *See also* United States v. Texas Commerce, 58 Fed. Reg. 15,361 (Mar. 22, 1993) (competitive impact statement); United States v. Society Corp., 57 Fed. Reg. 10,371 (Mar. 25, 1992) (competitive impact statement). The DOJ rejected the single cluster approach to product market definition as long ago as 1983, United States v. Nat'l Bank & Trust Co. of Norwich, Case No. 83-CV-537 (Complaint N.D.N.Y., May 6, 1983) (defining separate commercial and retail banking markets), but did not begin its campaign in earnest until 1991, with the Fleet/Norstar and First Hawaiian acquisitions.

[230] This is the position taken by the DOJ in its competitive impact statements with respect to the First Hawaiian, 56 Fed. Reg. 10,916; Fleet/Norstar, 56 Fed. Reg. 33,458; Texas Commerce, 58 Fed. Reg. 15,361; and Society, 57 Fed. Reg. 10,371, transactions. *See also* Justice Department Requires Wells Fargo and Co. and Brenton Banks Inc. to Make Divestitures in Des Moines, Iowa (Oct. 18, 2000), *available at* www.usdoj.gov/atr/public/press_releases/2000/6778.htm (noting that a divestiture will ensure that "cus-

of these clusters for distinct products, such as cash management services and commercial loans.[231]

Despite DOJ's sometime reference to individual product markets, it generally appears to focus its competitive analysis of bank acquisitions at the relevant cluster level.[232] For example, in complaints filed by the DOJ with respect to Texas Commerce and Society Corp., the DOJ stated that the relevant product markets in which the proposed acquisition would affect competition included "*either* individually or collectively, transaction accounts, commercial loans and other banking services," but proceeded to make particularized allegations only about banking services as a group,[233] including the allegation in Society Corp. that business customers often purchase banking services in a cluster.[234]

The DOJ further narrows its focus from the Board's broad concept of the cluster of all commercial banking services by usually looking closely only at the separate cluster markets for small and medium-sized businesses, as it has found that large corporations and individual consumers are generally not adversely affected by bank acquisitions.[235] This is so because large businesses are able to obtain financial products and services from commercial banks nationwide, as well as from nondepository institutions.[236] Similarly, individuals are able to obtain financial products and services from nonbank

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tomers, including small and medium-sized businesses, will continue to have banking choices").

[231] Statement of James F. Rill, Ass't Att'y Gen'l, Antitrust Division, DOJ, before the House Committee on Banking, Finance & Urban Affairs (Sept. 24, 1991) (stating that in Fleet/Norstar and First Hawaiian, DOJ evaluated the acquisition both in the context of individual services and of clusters of services); Remarks of Janusz A. Ordover, Dept'y Ass't Att'y Gen'l for Economics, & Margaret E. Guerin-Calvert, Ass't Chief of Economic Regulatory Section, Antitrust Division, DOJ, before the Federal Reserve Bank of Chicago, May 8, 1992, at 14 (stating that DOJ has recently analyzed the likely competitive effects of bank acquisitions in individual product markets for small business operating capital loans and transaction accounts).

[232] The identity of the specific products in the subcluster may nonetheless be important. For example, the DOJ has taken the position that working capital loans (typically lines of credit not secured by real estate) are a necessary component of business banking. Texas Commerce, 58 Fed. Reg. 15,361, 15,372–15,373. This position, in turn, affects the analysis of competition in the business banking market by causing firms with limited ability to provide such working capital loans to be included in the relevant market, if at all, at only a partial weight. *See, e.g.*, the treatment of thrifts in Texas Commerce, 58 Fed. Reg. 15,361, 15,373, and First Hawaiian, 56 Fed. Reg. 10,371, 10,923.

[233] United States v. Society Corp., 57 Fed. Reg. 10,371 (Mar. 25, 1992), Complaint ¶¶ 27–30 & 32; United States v. Texas Commerce, 58 Fed. Reg. 15,361 (Mar. 22, 1993), Complaint ¶¶ 25–27 & 31.

[234] United States v. Society Corp., 57 Fed. Reg. 10,371 (Mar, 25, 1992), Complaint ¶ 22. Moreover, the proxies for market share generally utilized by the DOJ (deposits and branches) relate to markets for banking services generally, not particular products.

[235] *See* Texas Commerce, 58 Fed. Reg. 15,361, 15,372. In the merger between Bank of Boston and BayBank, the parties agreed to divest $860 million in deposits in order to lessen the anticompetitive effects the merger would have had on middle market banking. *See Mergers and Acquisitions: Bank of Boston, BayBank Reach Pact with Justice Department on Divestitures,* 66 BNA BANKING REP. 1123 (1996); Bank of Boston Corp., 82 FED. RES. BULL. 856, 858 (1996); § 3.06[6][i] below.

[236] Texas Commerce, 58 Fed. Reg. 15,361, 15,372.

depository institutions, especially thrifts.[237]

The DOJ's identification of separate and distinct clusters of banking services and products for different categories of customers and focus on the small and medium-sized business categories has significant consequences for the competitive analysis of bank acquisitions. For reasons that are discussed below, it leads to the virtual exclusion of thrifts and other nonbanks as participants in the market, and occasionally to the exclusion of certain commercial banks that the DOJ finds do not provide the relevant (*e.g.*, medium-sized business) cluster. As a result of this exclusion, the relevant market shrinks and the competitive significance of the merging banks grows. The DOJ's approach has not been fully tested by the courts yet, and at least one former DOJ official has questioned whether the approach has sufficient empirical support to withstand judicial scrutiny.[238]

[e] Defining the Geographic Markets

In order to assess the competitive effect of a merger on a particular line of commerce (or product market), it is necessary to determine the section(s) of the country (or geographic market(s)) in which the merging banks participate in the particular line of commerce. The relevant geographic market will extend as far from the merging banks as the merging banks' actual and potential customers would reasonably go to secure an alternative source of banking products.[239] The Supreme Court, the Board and the DOJ consider banking to be an essentially local business and therefore almost always define the relevant geographic market locally.[240]

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[237] Texas Commerce, 58 Fed. Reg. 15,361, 15,372. To the extent that retail banking is adversely affected, the new competition resulting from divestitures designed to cure competitive ills in the business banking market generally will benefit the consumer banking market as well. *Id.*

[238] *See* Remarks of Charles A. James, Former Acting Chief of Antitrust Division, DOJ, as reported in *Bank Merger Experts Offer Tips on Murky Scene for Acquisitions*, 8 BNA ANTITRUST TRADE REG. DAILY, Aug. 24, 1993. Mr. James, who returned to the Antitrust Division as Assistant Attorney General in 2001, stated in 1993 that the DOJ's definition of markets for banking services to small and medium-sized businesses is based on an impressionistic mix of interviews, customer records and customer impressions, rather than detailed studies. He concluded that, in the absence of hard data to support its position, the DOJ would be hard-pressed to litigate these issues.

[239] United States v. Marine Bancorporation, Inc., 418 U.S. 602, 619 (1974); DOJ and Federal Trade Comm'n 1992 Horizontal Merger Guidelines § 1.21 (Revised 1997), *reprinted in* 4 TRADE REG. REP. (CCH) ¶ 13,104; *FDIC Statement of Policy on Bank Merger Transactions,* 63 Fed. Reg. 44,761, § III.1 (Aug. 20, 1998).

[240] United States v. Philadelphia National Bank, 374 U.S. 321 (1963); First Hawaiian, Inc., 77 FED. RES. BULL. 52, 53–54 (1991); Letter from James F. Rill, Ass't Att'y Gen'l, DOJ, to Alan Greenspan, Chairman, Board of Governors of the Federal Reserve System (March 12, 1992) (stating DOJ's position with respect to the BankAmerica/Security Pacific acquisition) [*herein* BankAmerica Letter]; Michael J. Halloran, *Practical Considerations of the 'New' Antitrust Analysis: Lessons of the BankAmerica/Security Pacific Merger Process* (Annual Meeting of the American Bar Association, New York, NY Aug. 10, 1993) at 7; Gregory E. Elliehausen & John D. Wolken, *Banking Markets and the Use of Financial Services by Small and Medium Sized Businesses*, 76 FED. RES. BULL. 801 (1990) (local financial institutions are the principal source of financial services used by small and medium-sized businesses); *see also* Michael A. Greenspan, Geographic Markets in Bank Mergers: A Potpourri of Issues, 2 N.C. Bank.

The Board has developed predetermined local geographic markets that will be at least facially applicable to most bank acquisitions.[241] These markets will be entirely satisfactory from the applicant's perspective when, as is usually the case, the proposed acquisition does not affect concentration levels within the predetermined market sufficiently to raise antitrust concerns. When concentration levels are found to be excessive, however, the applicant may challenge the predetermined markets and argue for a different market definition that would yield acceptable post-transaction concentration levels.[242] There are numerous factual bases for such a challenge, including demographic and economic data, commuting patterns for employment and shopping, transportation networks, advertising practices, television, radio, newspaper and hospital service areas, geographic barriers, political barriers that might affect trade and commuting patterns, and banking practices.[243]

Conversely, it is equally possible for the Board or the DOJ to reject a predetermined geographic market that would be favorable to the applicant. In the BankAmerica/ Security Pacific acquisition, the Federal Reserve Bank of San Francisco redefined a number of the geographic markets involved, requiring the applicant to redo its

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Inst. 1 (1998) (discussing the different approaches to determining geographic markets in commercial banking). It is recognized by at least the DOJ that large corporations are not limited to local banks in obtaining credit and cash management services. For this reason, the DOJ expressly focuses its bank antitrust analysis on the effects of a merger on small and medium-sized businesses. *See, e.g.*, Letter from James F. Rill, Ass't Att'y Gen'l, DOJ, to Alan Greenspan, Chairman, Board of Governors of the Federal Reserve System (March 12, 1992), at 2.

[241] Each Federal Reserve Bank has developed predetermined markets for its region, often based on statistical proxies such as Rand-McNally (Ranally) Metropolitan Areas [*herein* RMA's]. 12 C.F.R. § 5.33(e)(1)(i)(A). *See also* Comptrollers Licensing Manual, Business Combinations, Appendix B (Apr. 2006). It suggests that an area encompassing 75 percent of the bank's business may be a suitable market area. 2 COMPTROLLER'S MANUAL FOR CORPORATE ACTIVITIES 45 (April 1998). The FDIC has not explicitly predetermined geographic markets; however, it has specified that the location of the acquiring institution's offices in relation to the offices to be acquired may be relevant to this analysis. *FDIC Statement of Policy on Bank Merger Transactions,* 63 Fed. Reg. 44,761, § III.1 (Aug. 20, 1998).

[242] *See* Pennbancorp, 69 FED. RES. BULL. 548, 549 (1983); Texas E. BanCorp, 69 FED. RES. BULL. 636, 637 (1983); InterFirst Corp., 69 FED. RES. BULL. 383, 384–385 (1983). As noted above, OCC applicants are expressly permitted to propound a relevant geographic market without reference to the OCC's predetermined markets. The FDIC is similarly flexible. *See FDIC Statement of Policy on Bank Merger Transactions,* 63 Fed. Reg. 44,761, § III.1 (Aug. 20, 1998). Third parties commenting on an acquisition application also may oppose the Board's predetermined markets. *See, e.g.*, Norwest Corp., 80 FED. RES. BULL. 455, 456–457 (1994).

[243] *See*, *e.g.*, First York Ban Corp., 88 FED. RES. BULL. 251, 251–252 (2002) (focusing on, commuting patterns, newspaper circulation, and transportation system); Amcore Financial, Inc., 83 FED. RES. BULL. 666, 667 n.4 (1997) (employment and commuting data, shopping patterns, newspaper circulation and traffic patterns); ANB Holding Co., Ltd., 83 FED. RES. BULL. 902, 903 n.7 (1997) (commuting patterns, newspaper, radio and television coverage); Chemical Banking Corp., 82 FED. RES. BULL. 239, 241–242 (1996) (commuting patterns and population density). *See generally* Christopher L. Holder, *Competitive Considerations in Bank Mergers and Acquisitions: Economic Theory, Legal Foundations, and the Board,* Federal Reserve Bank of Atlanta Economic Review, January/February 1993, at 26 (setting forth in detail approach of the Atlanta Federal Reserve Bank to geographic market definition).

competitive analysis and delaying the application process approximately four months.[244] The DOJ took similar steps in challenging the Board-approved acquisition of Society Corporation and Ameritrust Corporation, rejecting the Board's finding of what amounted to a Cleveland metropolitan area market and determining instead that there were a number of relevant geographic markets at the county level within this metropolitan area.[245] As a result, Society was required to divest 28 branches, $1.05 billion in deposits and approximately $40 million in small business loans in the Cleveland area, while the Board had required no divestiture whatsoever.[246] The DOJ justified its market definition as based on an investigation that disclosed that small businesses operating in two particular counties could only obtain business banking services in "areas reasonably approximated by their home counties."

[f] Identifying the Relevant Competitors

The last step in laying the factual foundation for analysis of the competitive impact of a proposed acquisition is the identification of the institutions that compete in the identified geographic and product markets, or would be likely to so compete in the event of a small but significant nontransitory increase in price for the relevant product(s). This is a very significant step, as the more competitors that are included the less concentrated the market becomes. Consistent with their approaches in the areas of product and geographic market definition, the DOJ tends to include fewer institutions as competitors than does the Board, thereby tending to develop models of markets with greater concentration than those used by the Board.

The Board and the DOJ are generally in agreement that all commercial banks within the geographic market should be included, although the DOJ may exclude smaller commercial banks from the market for business banking services to medium-sized businesses.[247] The Board also includes thrifts, although the Board may do so giving only partial weight to the thrifts' deposits in analyzing market concentration. The DOJ includes thrifts in the market for retail banking services, but only includes them in the

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[244] Michael J. Halloran, *Practical Considerations of the 'New' Antitrust Analysis: Lessons of the BankAmerica/Security Pacific Merger Process* (Annual Meeting of the American Bar Association, New York, NY Aug. 10, 1993), at 2. In its 1997 decision rejecting the application of Bancsecurity Corporation to acquire Marshalltown Financial Corporation, the Board defined a smaller geographic market than that proposed by the applicant, basing its decision on the residence of the acquirer and target's customers, commuting patterns, shopping patterns and a Federal Reserve Bank survey. The Board expressly rejected applicant's contention that the RMA defined the relevant market. Bancsecurity Corporation, 83 FED. RES. BULL. 122, 122–123 (1997).

[245] United States v. Society Corp., 57 Fed. Reg. 10,371, 10,379–10,380 & n.4 (Mar. 25, 1992) (competitive impact statement).

[246] United States v. Society Corp., 57 Fed. Reg. 10,371, 10,381 (Mar. 25, 1992).

[247] One author has commented that since 1995 the DOJ has applied a "2 percent test," which is "based on the ratio of an institution's total C&I [commercial & industrial] loans to assets." David S. Neill, *U.S. Antitrust Considerations in Mergers and Acquisitions of Bank Holding Companies,* ANTITRUST REP. at 11 (Feb. 1999). Under this test, "[a]ny institution (bank or thrift) which fails to meet the 2 percent C&I loan-to-asset threshold is *entirely* excluded from the [DOJ's] analysis of *deposit* market concentration." *Id.*

market for business banking services to the extent they have been shown actually to compete in the market. The Board may under certain circumstances include other types of depository institutions as well, although the DOJ generally will not.

Commercial Banks

The Board includes as competitors all commercial banks doing business in the defined geographic market. The DOJ generally does so as well,[248] but it has also excluded small commercial banks from the market for business banking services to medium-sized businesses. For example, in analyzing the market for banking services to medium-sized businesses (the relevant product market) in Midland Texas (the relevant geographic market), the DOJ concluded that although seven commercial banks provided business banking services in Midland, only five could provide the amounts of credit and sophisticated cash management services required by medium-sized businesses.[249]

Thrifts

The extent to which thrifts are included as competitors can be a significant factor in whether a proposed acquisition will be found to have anticompetitive effects, as thrift deposits may account for a substantial portion of total deposits in a geographic market. The Board generally includes thrifts only as partial competitors, counting 50 percent of thrifts' deposits in calculating market concentration.[250] Where, however, thrifts have been shown to play a more significant role in the relevant market, the Board has included them at 100 percent.[251] For example, in approving the acquisition by Banco Popular of five Virgin Island branches of CoreStates Bank, the Board included thrifts at 100 percent because thrifts in St. Thomas (the relevant geographic market) are more active in commercial lending (6.5 percent of total assets) than is typical of thrifts nationwide (1 percent of total assets).[252]

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[248] The DOJ also includes commercial banks that are "uncommitted entrants" in the relevant market, by which it means banks that are not currently providing the relevant product in the market (either because they are not located in the market or are offering other products in the market) but would be likely to begin to do so promptly, without incurring significant sunk costs, in response to an anticompetitive price increase by the market incumbents. *See* DOJ and Federal Trade Comm'n 1992 Horizontal Merger Guidelines § 1.32 (Revised 1997), *reprinted in* 4 TRADE REG. REP. (CCH) ¶ 13,104.

[249] Texas Commerce, 58 Fed. Reg. 15,361, 15,374.

[250] Christopher Holder, *The Use of Mitigating Factors in Bank Mergers and Acquisitions: A Decade of Antitrust at the Fed*, Economic Review of the Federal Reserve Bank of Atlanta, March/April 1993, at 36; 2 COMPTROLLER'S MANUAL FOR CORPORATE ACTIVITIES 68 (Apr. 1998). In calculating post-transaction market concentration in the context of a thrift acquisition, however, the Board and the OCC generally include the acquired thrift's deposits at 100 percent. First Hawaiian, Inc., 79 FED. RES. BULL. 966, 967 n.12 (1993); 2 COMPTROLLER'S MANUAL FOR CORPORATE ACTIVITIES 68 (Apr. 1998). *See also* Federal Reserve Bank of Boston, Elements of Antitrust Analysis, *available at* www.bos.frb.org/bankinfo/struct/antitrst.htm (as of May 2002).

[251] Wells Fargo & Co., 88 FED. RES. BULL. 103, 106–107 (2002); Fleet/Norstar Financial Group, Inc., 77 FED. RES. BULL. 750, 752–753 (1991); BanPonce Corp., 77 FED. RES. BULL. 43 (1991).

[252] Banco Popular de Puerto Rico, 79 FED. RES. BULL. 979, 980 n.6 (1993). *See also* National City Corp., 84 FED. RES. BULL. 281, 283 n.12 (1998) (weighing thrift deposits at 100 percent based on

The DOJ generally includes thrifts at 100 percent weight in retail banking markets.[253] In markets for business banking services, the DOJ will include 100 percent of the deposits of each thrift that satisfies the "2 percent test" noted above, but will exclude all of the deposits of each thrift that fails to meet this threshold.[254]

Nondepository Institutions and Credit Unions

Competition from credit unions and from nondepository financial institutions, such as finance companies, brokerage firms and factoring firms, generally does not play a significant part in the analysis of bank acquisitions. The DOJ has repeatedly rejected the inclusion of such institutions on the grounds that they do not offer the complete line of business banking services provided by commercial banks and some thrifts.[255] The Board has included credit unions where they hold a significant percentage of deposits within the relevant geographic market,[256] but generally limits its analysis to commercial banks and some portion of in-market thrifts.[257]

[g] Measuring the Change in Market Concentration

Once the markets (geographic and product) have been delineated and their players (competitors and uncommitted entrants) identified, the antitrust analysis proper begins. The first step in this analysis, both for the Board and the DOJ, is to determine (1) how concentrated the relevant market is—that is, over how many different participants (and in what proportion) is the output of the product (some cluster of banking services) spread in the relevant geographic market—and (2) how much this concentration will

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relatively high (compared to national average for thrifts) levels of commercial loans as a percentage of assets).

[253] Texas Commerce, 58 Fed. Reg. at 15,373 n.9.

[254] One author has commented that since 1995 the DOJ has applied a "2 percent test," which is "based on the ratio of an institution's total C&I [commercial & industrial] loans to assets." David S. Neill, *U.S. Antitrust Considerations in Mergers and Acquisitions of Bank Holding Companies,* ANTITRUST REP. at 11 (Feb. 1999). Under this test, "[a]ny institution (bank or thrift) which fails to meet the 2 percent C&I loan-to-asset threshold is *entirely* excluded from the [DOJ's] analysis of *deposit* market concentration." *Id.*

[255] Society Corp., 57 Fed. Reg. 10,371, 10,379–10,380; Fleet/Norstar, 56 Fed. Reg. 33,458, 33,464–33,465; Texas Commerce, 58 Fed. Reg. 15,361, 15,373. The DOJ has included credit unions as market participants in retail banking services, however. Letter from James F. Rill, Ass't Att'y Gen'l, DOJ, to Alan Greenspan, Chairman, Board of Governors of the Federal Reserve System (March 12, 1992) (stating DOJ's position with respect to the BankAmerica/Security Pacific acquisition), at 5.

[256] BanPonce Corp., 77 FED. RES. BULL. 43 (1991) (credit union deposits included at 50 percent). *See also* First Hawaiian, Inc., 77 FED. RES. BULL. 52 (1991) (treating credit unions and industrial loan companies as a procompetitive factor but not including their deposits in the market concentration analysis); Wells Fargo & Co., 88 FED. RES. BULL. 103, 106 & n.29 (2002) (discussing impact of strong credit union presence on post-merger HHI).

[257] The *FDIC Statement of Policy on Bank Merger Transactions,* 63 Fed. Reg. 44,761, § III.2 (Aug. 20, 1998), advocates inclusion of nondepository institutions as market participants, and the OCC has done so on at least one occasion. *See* Peoples National Bank of Central Pennsylvania, 4-1 O.C.C.Q.J. 22 (Mar. 1985).

be increased by the proposed acquisition.[258] Because there is no practical way directly to measure market share of banking services, the Board and the DOJ generally turn to market share of deposits as a proxy.[259]

Concentration is gauged with the Herfindahl-Hirschman Index, or HHI, which measures market concentration along a continuum from near 0 to 10,000. The HHI for a market is computed by adding the squares of the market share (expressed as a percentage) of each participant in the market.

The Board and the DOJ have developed thresholds of market concentration, as measured by the HHI, below which they generally will not scrutinize a transaction for anticompetitive effects. Most acquisitions do not cross these thresholds and, hence, are not subjected to antitrust analysis. The Board and the DOJ generally will not scrutinize an acquisition if the post-transaction HHI is below 1800 or, if over 1800, the HHI increases less than 200 points as a result of the acquisition. Although the DOJ had previously applied a somewhat more stringent HHI threshold, in April 1994 it indicated that it would employ the 1800/200 test as well.[260] In 1995, the DOJ and the Board jointly published their Bank Merger Competitive Review, which states that both agencies will apply the 1800/200 test, although "[i]n some cases, the [DOJ] may further review transactions which do not exceed the 1800/200 threshold," particularly where the threshold "does not reflect fully the competitive effects of the transaction in

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[258] When a potential acquirer is neither a participant nor an uncommitted entrant in the relevant market, market concentration will be unaffected by the transaction. Under these circumstances, the bank regulators and the DOJ are generally unconcerned about any adverse effect on competition. *See* Remarks of Margaret E. Guerin-Calvert, Asst. Chief, DOJ Antitrust Division (ABA Spring Antitrust Meeting April 1, 1993); Christopher L. Holder, *Competitive Considerations in Bank Mergers and Acquisitions: Economic Theory, Legal Foundations, and the Board*, Federal Reserve Bank of Atlanta Economic Review, January/February 1993, at 28 (in the absence of increased concentration as a result of a proposed acquisition, Federal Reserve banks generally approve the acquisition application). Nonetheless, acquisitions by an out-of-market bank that either (1) presently exerts a pro-competitive influence on the market because of the likelihood of its entry into the market or (2) might in the future enter into the market in some less anticompetitive way than the present transaction have on occasion been challenged on antitrust grounds under "potential competition" theories. *See, e.g., Mercantile Texas Corp. v. Board of Governors of the Federal Reserve System*, 638 F.2d 1255, 1263–1272 (5th Cir. 1981). These challenges have generally been unsuccessful, and, indeed, the potential competition doctrine is viewed by many practitioners as no longer viable. *See* Keith Fisher, *Regulatory Aspects of Bank Mergers and Acquisitions* in MERGERS AND ACQUISITIONS OF BANKS AND SAVINGS INSTITUTIONS at 3:85 (1993); John Hawke & Melanie Fein, *Training Tomorrow's Banking Lawyers*, 91 MICH. L. REV. 1578, 1581 (1993).

[259] The number of branches located, or dollar value of loans written, in the relevant geographic market are other proxies, *see* Society Corporation, 57 Federal Register at 10380–81 (March 25, 1992) (analyzing concentration using branches as proxy, as well as deposits), but are not often employed. In several Board merger applications, the Board found that total deposits were not an accurate indicator of market share and so used a subset of total deposits (such as nongovernmental deposits) as the proxy for market share. Christopher Holder, *The Use of Mitigating Factors in Bank Mergers and Acquisitions: A Decade of Antitrust at the Fed,* Economic Review of the Federal Reserve Bank of Atlanta, Mar./Apr. 1993, at 37.

[260] *See* Remarks of Robert E. Litan, Deputy Assistant Attorney General of Antitrust Division, DOJ, before Antitrust Section of ABA (Apr. 6, 1994).

all relevant markets."[261]

[h] Additional Factors

Measuring a transaction's effect on market concentration is only the first step in evaluating the transaction's likely competitive effect. Many acquisitions with "bad" HHI numbers ultimately withstand antitrust scrutiny.[262] When an acquisition involves market concentration in excess of the applicable HHI threshold, the bank regulator or DOJ will analyze the market and the parties to the acquisition to try to determine whether, as a result of the acquisition, there will be a significantly increased likelihood of either monopoly pricing by the acquiring bank or coordinated pricing among two or more of the banks remaining in the market after the acquisition.[263] The fact of a certain level of market concentration in excess of the applicable thresholds is only one factor considered in assessing the competitive effects of the acquisition.

Two other significant factors are (1) the competitive significance of the institutions remaining in the market after the acquisition, and (2) the likelihood that a bank from outside the relevant geographic market would, in the event of attempts by incumbent banks to raise prices, enter into competition in the market.[264] It is very common for the Board to evaluate the future competitive significance of the institutions remaining in the market.[265] Although the number of remaining competitors alone is reflected in the HHI and so would not seem to be a factor mitigating a high HHI,[266] the Board often

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[261] *See* BANK MERGER COMPETITIVE REVIEW (1995); *see also* David S. Neill, *U.S. Antitrust Considerations in Mergers and Acquisitions of Bank Holding Companies,* ANTITRUST REP. at 10 (Feb. 1999) (discussing BANK MERGER COMPETITIVE REVIEW).

[262] Of 139 merger applications received by the Board between November 1982 and December 1992 that exceeded the relevant concentration thresholds in 297 local banking markets, applications were ultimately denied as to only 6 markets. In 162 of these markets, however, the applicants agreed to some amount of divestiture to lessen antitrust concerns. Christopher Holder, *The Use of Mitigating Factors in Bank Mergers and Acquisitions: A Decade of Antitrust at the Fed*, Economic Review of the Federal Reserve Bank of Atlanta, Mar./Apr. 1993, at 33–34.

[263] *See* DOJ and Federal Trade Comm'n 1992 Horizontal Merger Guidelines § 2 (Revised 1997), *reprinted in* 4 TRADE REG. REP. (CCH) ¶ 13,104. The Board generally conceptualizes this analysis as a question of what factors might mitigate HHI numbers in excess of the Board's thresholds.

[264] The second of these factors, ease of entry, is considered by the DOJ to be a separate analytic step from the analysis of the likelihood of anticompetitive behavior in the market. *See* DOJ and Federal Trade Comm'n 1992 Horizontal Merger Guidelines § 3 (Revised 1997), *reprinted in* 4 TRADE REG. REP. (CCH) ¶ 13,104. The Board does not make this distinction.

[265] For example, in over half the concentrated banking markets subject to Board merger decisions over the 10 years ending December 31, 1992, the number of competitors remaining after a proposed acquisition has been cited as a factor mitigating increased concentration levels. Christopher Holder, *The Use of Mitigating Factors in Bank Mergers and Acquisitions: A Decade of Antitrust at the Fed*, Economic Review of the Federal Reserve Bank of Atlanta, Mar./Apr. 1993.

[266] The number of market participants remaining after an acquisition may affect the likelihood that such participants will be able to coordinate pricing. *See, e.g.,* Letter from Charles A. James, Acting Ass't Attorney Gen'l, DOJ, Antitrust Division, to Alan Greenspan, Board Chairman, at 5 (Oct. 16, 1992) (acquisition of Bank Shares, Inc. by First Bank System, Inc.). If the acquisition reduces the number of the most significant suppliers in the market, the likelihood of coordinated pricing is considered greater. *See*

looks not simply at the number of remaining competitors but at their capacity for future competition.[267] This capacity—the financial and managerial wherewithal to respond to an attempt by competitors in the market to exercise market power—is not necessarily reflected in the HHI, which measures historical market share, not the ability of competitors to increase market share.[268] This factor is similarly significant to the DOJ, as was demonstrated by its decision not to oppose the Comerica/Manufacturers National acquisition, despite the fact that the HHI concentration figures in that transaction were as elevated as in the Society/Ameritrust acquisition, where the DOJ sued to block an acquisition approved by the Board.[269]

A second significant factor in the analysis is the likelihood of entry into the market by out-of-market institutions. This factor has played an important role in Board merger decisions.[270] The likelihood of new entry is also a significant factor for the DOJ in determining whether an acquisition will in fact result in reduced competition,[271] although the DOJ seems more likely than the Board to conclude that, even where new entry is likely, it will not be timely enough, or of sufficient magnitude, to counter attempts by in-market banks to exercise market power.[272]

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id.; Texas Commerce, 58 Fed. Reg. 15,361, 15,375.

[267] *See*, *e.g.*, ANB Holding Co., 83 FED. RES. BULL. 902, 904 (1997); Marshall & Ilsley Corp., 80 FED. RES. BULL. 556, 558 (1994); Deposit Guaranty Corp., 80 FED. RES. BULL. 543, 544 (1994); NationsBank Corp., 79 FED. RES. BULL. 969, 971 (1993); First Bank System, Inc., 79 FED. RES. BULL. 534, 535 (1993); Barnett Banks, Inc., 79 FED. RES. BULL. 44, 47 (1993). In Bancsecurity Corporation, the Board discounted the significance of the number of remaining competitors and the relatively significant financial and organizational resources of certain of these competitors in light of the dominant market share of the entity that would result from the proposed acquisition. 83 FED. RES. BULL. 122, 125–126 (1997).

[268] In this respect the banking industry is arguably different than many other industries evaluated by the antitrust agencies under the HHI. A bank's current deposits do not necessarily represent a limit on its ability to win new deposits as, for example, a factory's current capacity might limit its future production. Because banks do not face such capacity restraints, a bank's current market share is arguably a less reliable indicator of its future competitive significance—that is, its ability to increase market share by lowering prices and winning new customers.

[269] Remarks of Margaret E. Guerin-Calvert, Asst. Chief, DOJ Antitrust Division (ABA Spring Antitrust Meeting Apr. 1, 1993), at 3–4. *See also* DOJ and Federal Trade Comm'n 1992 Horizontal Merger Guidelines § 1 (Revised 1997), *reprinted in* 4 TRADE REG. REP. (CCH) ¶ 13,104.

[270] For example, in 16 percent of the concentrated banking markets subject to Board merger decisions over the 10 years ending December 31, 1992, the likelihood of entry by new competition was cited as a factor mitigating increased concentration levels. Christopher Holder, *The Use of Mitigating Factors in Bank Mergers and Acquisitions: A Decade of Antitrust at the Fed,* Economic Review of the Federal Reserve Bank of Atlanta, Mar./Apr. 1993, at 35. For more recent examples of the significance of the likelihood of entry, *see* Wells Fargo & Co., 88 FED. RES. BULL. 103, 105–108 (2002); First Security Corp., 86 FED. RES. BULL. 122, 127–129 (2000); Norwest Corp., 82 FED. RES. BULL. 580, 582 (1996); Marshall & Ilsley Corp., 80 FED. RES. BULL. 556, 558 (1994); Deposit Guaranty Corp., 80 FED. RES. BULL. 543, 544 (1994).

[271] DOJ and Federal Trade Comm'n 1992 Horizontal Merger Guidelines § 3 (Revised 1997), *reprinted in* 4 TRADE REG. REP. (CCH) ¶ 13,104; Remarks of Margaret E. Guerin-Calvert, Asst. Chief, DOJ Antitrust Division (ABA Spring Antitrust Meeting Apr. 1, 1993), at 3.

[272] *See, e.g., Texas Commerce,* 58 Fed. Reg. 15,361, 15,375; Letter from James F. Rill, Ass't Att'y

A number of other factors form a part of the Board's and the DOJ's antitrust analysis, although they do not seem to play as significant a part as the factors discussed above. These factors include: (1) competition from financial institutions that are not included in the HHI concentration analysis; (2) efficiencies that would be achieved from consolidating the operations of the target and the acquirer;[273] (3) evidence that either or both of the institutions to be combined have experienced or are likely to experience significant deposit runoff since deposits were last measured; (4) the fact that the acquisition will create an institution capable of competing with large banks currently dominating the market without opposition;[274] (5) whether a merger is likely to affect small or middle-market businesses;[275] and (6) whether a merger is likely to create a tiered market with one or two dominant firms and a fringe of smaller banks unable to compete significantly for small and medium-sized business loans.[276]

[i] Failing Company Defense

In both bank and other antitrust analyses, a merger that adversely affects competition may under certain circumstances be permitted to go forward when the effect of the acquisition will be to rescue a failing company. This defense arises, in the case of bank antitrust analysis, from provisions in the BHC Act that an acquisition may be approved, despite anticompetitive effects, if such effects are clearly outweighed in the public interest by the probable effect of the transaction in meeting the convenience and needs of the community. In ordinary antitrust analysis, the exception originated with the Supreme Court's decision in *International Shoe v. Federal Trade Commission*.[277]

Gen'l, DOJ, to Alan Greenspan, Chairman, Board of Governors of the Federal Reserve System (Mar. 12, 1992), at 7.

[273] As is the case for ease of entry, the DOJ treats efficiencies as analytically distinct from competition analysis proper, while the Board does not. *See* DOJ and Federal Trade Comm'n 1992 Horizontal Merger Guidelines § 4 (Revised 1997), *reprinted in* 4 TRADE REG. REP. (CCH) ¶ 13,104.

[274] Christopher Holder, *The Use of Mitigating Factors in Bank Mergers and Acquisitions: A Decade of Antitrust at the Fed,* Economic Review of the Federal Reserve Bank of Atlanta, March/April 1993, at 34.

[275] *See* Remarks of Constance K. Robinson, Director of Operations of Antitrust Division, DOJ, before 31st Annual Banking Law Institute (May 30, 1996) ("In the banking industry, in particular, we have emphasized the availability of banking services, including loans and credit, to small and medium-sized businesses") [*herein* Robinson Remarks]; *Bank Merger Competitive Review* at 1–2 (1995) (more stringent review may be applied in mergers involving banks that lend to "small and medium-sized businesses"); David S. Neill, *U.S. Antitrust Considerations in Mergers and Acquisitions of Bank Holding Companies,* ANTITRUST REP. at 16 (Feb. 1999) ("Since 1996, the [DOJ] has showed renewed concern about the impact of bank mergers on middle-market banking.").

[276] *See* Remarks of Constance K. Robinson, Director of Operations of Antitrust Division, DOJ, before 31st Annual Banking Law Institute (May 30, 1996); *see also* David S. Neill, *U.S. Antitrust Considerations in Mergers and Acquisitions of Bank Holding Companies,* ANTITRUST REP. at 13 (Feb. 1999) (noting that DOJ may object to a tiered market "even where the mergers to not otherwise exceed [the DOJ's HHI] thresholds as applied to banking").

[277] International Shoe v. Federal Trade Commission, 280 U.S. 291, 299–303, 50 S. Ct. 89, 91–92, 74 L. Ed. 431, 441 (1930).

These considerations have played a factor in the Board's review of transactions.[278] The Board has applied this principle both when it was certain that the target bank would fail and when it considered that the target bank was weak and might fail in the future.[279]

The DOJ imposes more rigorous requirements on the failing company defense than the Board and has on occasion rejected the Board's application of the defense. In order to allow an otherwise uncompetitive acquisition under the failing company defense, the DOJ requires evidence that the failing company (1) is unlikely to be able to meet its financial obligations in the near future, (2) has no hope of successful reorganization, (3) has no less anticompetitive purchaser available to it, and (4) absent the acquisition the assets of the failing company will leave the relevant market.[280]

In its 1991 order approving the acquisition of the Bank of New England, N.A. (BE) by Fleet/Norstar Financial Group, Inc. despite probably substantial anticompetitive results in three of the affected markets, the Board concluded that the benefit to the community of keeping the failed BE subsidiary banks in their communities outweighed any competitive harm. The Board bolstered its conclusion with the fact that the Fleet/Norstar bid represented the lowest cost to the Bank Insurance Fund of all the bids made.[281] The DOJ then challenged the acquisition of BE and rejected Fleet's assertion of the failing company defense, reasoning that the FDIC's preference for the selected bidder did not justify the rejection of a less anticompetitive bid.[282]

[j] Divestiture

When competitive concerns raised by an acquisition cannot be resolved within the confines of the foregoing analysis, it is often possible to reduce these concerns

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[278] For example, these considerations were a factor in 14 percent of the markets with respect to which a merger decision was made by the Board between 1982 and 1992. Christopher Holder, *The Use of Mitigating Factors in Bank Mergers and Acquisitions: A Decade of Antitrust at the Fed,* ECONOMIC REVIEW OF THE FEDERAL RESERVE BANK OF ATLANTA, Mar./Apr. 1993, at 34.

[279] For example, in the decisions between 1982 and 1992 that addressed these issues, the Board was certain that the target bank would fail in only 27 percent of the markets. In the others, the Board found only that the target was weak and might fail in the future. Christopher Holder, *The Use of Mitigating Factors in Bank Mergers and Acquisitions: A Decade of Antitrust at the Fed,* ECONOMIC REVIEW OF THE FEDERAL RESERVE BANK OF ATLANTA, Mar./Apr. 1993, at 39.

[280] DOJ and Federal Trade Comm'n 1992 Horizontal Merger Guidelines § 6 (Revised 1997), *reprinted in* 4 TRADE REG. REP. (CCH) ¶ 13,104. Although the public interest exception applicable in bank acquisition analysis is supposed to be broader than the standard antitrust failing company defense, the DOJ believes the standard defense applies in the bank acquisition context as well. *See* Remarks of Margaret E. Guerin-Calvert, Asst. Chief, DOJ Antitrust Division (ABA Spring Antitrust Meeting April 1, 1993), at 10.

[281] Fleet/Norstar Fin. Group, Inc., 77 FED. RES. BULL. 750, 754 (1991).

[282] United States v. Fleet/Norstar Fin. Group, Inc., 56 Fed. Reg. 33,458, 33,465 (1991) (competitive impact statement). *See also* Texas Commerce, 58 Fed. Reg. 15,361, 15,375. The DOJ's position is supported by the Supreme Court's decision in United States v. Third Nat'l Bank, 390 U.S. 171, 88 S. Ct. 882, 19 L. Ed. 2d 1015, 1968 Trade Cas. (CCH) P72372 (1968), where the Court held that the public interest exception is only available were no less anticompetitive solution is available. 390 U.S. at 190.

substantially by divesting branches in the problem markets. Divestiture of branches changes the structure of the market by decreasing the post-transaction market share of the proposed combined entity and, possibly, increasing the market share of a competitor of the combined entity in the market. By so doing, HHI numbers are reduced and, in some cases, the competitive ability of a third party is increased, thereby improving the overall competitiveness of the market.

Very often, the parties to a bank acquisition realize at the time they first apply for regulatory approval that some divestiture will be required. Under these circumstances, it is common to propose such divestitures in the application itself. If the parties do not propose divestiture at the beginning of the application process, it may be arrived at by negotiation with the regulators or the DOJ[283] or through litigation with the DOJ.[284] Both the Board and the DOJ will review the "competitive suitability" of proposed divestitures.[285] In order for a divestiture to be competitively suitable, it may not be sufficient simply to reduce the post-transaction HHI. Rather, it may be necessary to ensure that, as a result of divestiture, "new and viable" competitors are created, so that the post-acquisition market is as competitive as it was before.[286] This requires divesting branches that are active in the relevant market (probably small and middle-market business banking) to institutions that, as a result of the divestiture, will be capable of competing in that market.

[7] Anti-Money Laundering

The USA PATRIOT Act amended Section 3 of the BHC Act to add an additional required factor to be considered in all applications under Section 3. The Board is now required, "in every case," to take into consideration "the effectiveness of the company. . .in combatting money laundering, including in overseas branches."[287] As a practical matter, this should not place additional burdens on most foreign acquirers, since even before the amendment the Board tended to inquire into an applicant's anti-money laundering policies and procedures in some detail. Some foreign acquirers, however, may be adversely affected: those from countries whose anti-money laundering laws and regulations have been found to be lacking by the Board or the OECD's Financial Action Task Force on Money Laundering.

[8] Interstate Acquisitions

If the transaction involves an interstate acquisition, the Riegle-Neal Act also

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[283] *See* Michael J. Halloran, *Practical Considerations of the 'New' Antitrust Analysis: Lessons of the BankAmerica/Security Pacific Merger Process* (Annual Meeting of the American Bar Association, New York, NY Aug. 10, 1993).

[284] *See, e.g.*, United States v. First Hawaiian, Inc., 56 Fed. Reg. 10,916, 10,924 (1991) (explanation of final judgment).

[285] Michael J. Halloran, *Practical Considerations of the 'New' Antitrust Analysis: Lessons of the BankAmerica/Security Pacific Merger Process* (Annual Meeting of the American Bar Association, New York, NY Aug. 10, 1993) at 4.

[286] Letter from James F. Rill, Ass't Att'y Gen'l, DOJ, to Alan Greenspan, Chairman, Board of Governors of the Federal Reserve System (Mar. 12, 1992), at 7.

[287] 12 U.S.C. § 1842(c)(6).

requires the Board to consider, as additional factors, the age of any banks being acquired and the effect of the transaction on state and nationwide deposit limits.[288] As discussed more fully in § 3.02[2] of this Chapter, the Riegle-Neal Act prohibits the Board from approving any application for an interstate acquisition if it would "have the effect of permitting an out-of-State bank holding company to acquire a bank in a host State" that does not satisfy the minimum age requirements established by the host State (up to a maximum of five years).[289] The Riegle-Neal Act also prohibits the Board from approving any interstate acquisition if the transaction would result in the acquirer controlling "more than 10 percent of the total amount of deposits of insured depository institutions in the United States," or "30 percent or more of the total amount of deposits of insured depository institutions in" any state in which both the acquirer and the target had a branch (or such lower percentage as that state may have established on a basis that does not discriminate against out-of-state banks.[290]

§ 3.07 Factors Considered in Other Applications

[1] Bank Holding Company Act, § 4

In determining whether to approve an application by a foreign applicant to acquire a thrift or thrift holding company under Section 4 of the BHC Act, the Board considers whether the target's activities "can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, and gains in efficiency that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interest, and unsound banking practices." In performing this cost-benefit analysis, the Board considers the following factors, which are substantially similar to three of the factors considered in Section 3 applications: (1) the financial resources of the foreign acquirer, including its capital; (2) the managerial resources of the acquirer, including its management expertise, internal controls and risk management systems; and (3) the effect of the transaction on competition.

Although the Board is not specifically required to consider the rest of the factors mandated in a Section 3 application,[291] the Board is free to do so and will likely do so because a thrift, like a bank, is an insured depository institution, and therefore the same considerations that are applicable in the Section 3 context are applicable to a thrift acquisition. In addition, the instructions to Form FR Y-4 state that applications must satisfy the same informational requirements as an application processed under

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[288] *See* 12 U.S.C. § 1842(d)(1)(B), (2). It also requires the Board to consider the CRA compliance record of both the acquirer and the target banks, 12 U.S.C. § 1842(d)(3), but the Board already considers that factor as part of its assessment of the impact of the proposed transaction on the convenience and needs of the communities that are affected. *See* 3.06[5] above.

[289] *See* 12 U.S.C. § 1842(d)(1)(B).

[290] *See* 12 U.S.C. § 1842(d)(2).

[291] In particular, while Section 327 of the USA PATRIOT Act amended the BHC Act to require anti-money laundering reviews in connection Section 3 applications, it did not require them in Section 4 applications. USA PATRIOT Act, Pub. L. No. 107-56, 115 Stat. 272 (2001).

Section 3.[292] The Board also has a practice of conditioning approval of such acquisitions on the acquirer agreeing to be a source of strength to its insured thrift subsidiaries.[293]

[2] Bank Merger Act

In deciding whether to approve a Bank Merger Act application, each of the bank and thrift regulators is required to consider substantially the same factors as those considered by the Board in processing applications under Section 3 of the BHC Act.[294] The most significant exception is that they are not required to consider whether a foreign bank acquirer is subject to comprehensive consolidated supervision or whether a foreign acquirer has given adequate assurances of access to information. They are, however, free to do so and might under appropriate circumstances where the Board has not previously had an opportunity to do so.

Moreover, in performing their competition reviews, the FDIC and the OTS treat thrifts as full competitors of commercial banks and give their deposits 100 percent credit in their HHI analysis of any relevant markets. In contrast, the OCC, the Board and the DOJ treat thrifts as only partial competitors of commercial banks, weighting their deposits at 50 percent for purposes of HHI calculations.

[3] Change in Bank Control Act

In deciding whether to approve a notification under the CIBC Act, each of the bank and thrift regulators is required to consider factors substantially similar to the financial and managerial resources and antitrust factors considered by the Board in processing applications under Section 3 of the BHC Act.[295] They are not, however, required to consider the comprehensive consolidated supervision, adequate assurances, convenience and needs of the community or anti-money laundering factors.[296] Moreover, in performing their competition reviews, the FDIC and the OTS treat thrifts as full competitors of commercial banks, whereas the OCC, the Board and the DOJ treat thrifts as only partial competitors.[297]

In the case of an application to acquire control of an industrial loan corporation or industrial bank, the FDIC is likely to consider whether the acquirer's activities are limited to those that are financial in nature or incidental or complementary to a financial activity, as defined by the Board.[298]

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[292] Instructions for Preparation of Notification by a Bank Holding Company to Acquire a Nonbank Company and/or Engage in Nonbanking Activities FR Y-4, GEN-2 (Apr. 2008).

[293] Banco Santander Central Hispano, 92 FED. RES. BULL. C151, C154 n. 26 (2006).

[294] *See* 12 U.S.C. § 1828(c)(4); 12 C.F.R. § 5.33 (OCC).

[295] *See* 12 U.S.C. § 1817(j)(7); 12 C.F.R. § 5.50(f)(4) (OCC).

[296] While Section 327 of the USA PATRIOT Act amended the BHC Act and the Bank Merger Act to require anti-money laundering reviews in connection Section 3 and Bank Merger Act applications, it did not similarly amend the CIBC Act. USA PATRIOT Act, Pub. L. No. 107-56, 115 Stat. 272 (2001).

[297] *See* 3.06[6][e] above.

[298] *See* Moratorium on Certain Industrial Loan Company Applications and Notices, 71 Fed. Reg.

[4] Home Owners' Loan Act

In deciding whether to approve an application under Section 10 of HOLA, the OTS considers substantially the same factors considered by the Board in processing applications under Section 3 of the BHC Act, including in the case of a foreign bank applicant whether the foreign bank is subject to comprehensive consolidated supervision.[299] The OTS is not, however, required to consider the effectiveness of the acquirer or the target in combatting money laundering activities,[300] although it is free to do so. Moreover, in performing its competition reviews, the OTS treat thrifts as full competitors of commercial banks, whereas the OCC, the Board and the DOJ treat thrifts as only partial competitors.[301]

§ 3.08 Consequences of Ownership of a U.S. Bank or Thrift

In this Section we address briefly the extent to which preexisting operations or investments in the United States may be affected by the acquisition of a U.S. target. We then summarize some of the more significant additional laws to which a foreign acquirer will become subject once it acquires a U.S. bank or thrift. These include the risk that the U.S. bank or thrift regulators may, under certain circumstances, require that the foreign acquirer guarantee a capital restoration plan of the U.S. target and restrictions on transactions between the U.S. bank or thrift and its affiliates.

[1] Restrictions on Nonbanking Activities

A foreign bank or the parent of a foreign bank with no U.S. commercial banking presence may find that acquiring a U.S. bank or thrift may cause its indirect investments in the United States to raise issues under the BHC Act or HOLA. As noted above, until very recently, all bank holding companies with operations in the United States were generally not permitted to own more than 5 percent of the voting securities of any company other than a company whose activities were "so closely related to banking or managing or controlling banks as to be a proper incident thereto." The potential extraterritorial impact of these provisions, however, was limited in part by exemptions for "qualifying foreign banking organizations" [*herein* QFBOs], which are permitted to engage in any activity outside the United States and in certain activities in the United States, which, although more limited than is customary in many countries, are more varied than those permitted to domestic bank holding companies.[302] The QFBO exemptions fall into four general categories: (1) activities

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43,482 (Aug. 1, 2006); Moratorium on Certain Industrial Bank Applications and Notices, 72 Fed. Reg. 5,290 (Feb. 5, 2007). Although the moratorium has expired, the FDIC staff has signaled that the FDIC is likely to continue to distinguish between financial and non-financial applicants in deciding whether to approve an application to acquire control of an industrial loan corporation or industrial bank.

[299] *See* 12 C.F.R. § 574.7(c).

[300] While Section 327 of the USA PATRIOT Act amended the BHC Act and the Bank Merger Act to require anti-money laundering reviews in Section 3 and Bank Merger Act applications, it did not similarly amend HOLA. USA PATRIOT Act, Pub. L. No. 107-56, 115 Stat. 272 (2001).

[301] *See* 3.06[6][e] above.

[302] The qualifying foreign banking organization concept is found in the Board's Regulation K, which

conducted directly or indirectly wholly outside the United States; (2) certain (a) direct or indirect activities conducted in the United States, including a foreign bank's own banking activities through its U.S. branches or agencies and (b) direct or indirect activities "incidental" to international or foreign business or activities (such as would be permitted to an Edge Act Corporation); (3) minority noncontrolling investments in foreign companies doing business in the United States; and (4) certain controlling investments in foreign companies principally engaged in business outside the United States (though also doing business in the United States) under specified conditions.[303] In general, this fourth exemption permits foreign bank holding companies to conduct certain nonbanking activities in the United States if the activities are related, but subordinate, to businesses they conduct abroad[304]

With the passage of the GLBA in November 1999, however, foreign banks or parents of foreign banks that qualify as financial holding companies have greater latitude to conduct nonbanking activities in the United States. Financial holding companies may engage in all activities "financial in nature" and in activities "incidental and complementary to" such activities.[305] The GLBA provides that "financial" activities include, inter alia, securities underwriting and dealing, insurance underwriting, and merchant banking and derivatives activities; additional activities will undoubtedly be determined to be financial in nature as practice under the GLBA develops.[306]

For a foreign bank or the parent of a foreign bank to qualify as a financial holding company, the foreign bank must be found by the Board to be well-capitalized and

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implements in part the statutory exemptions from the BHC Act's coverage set forth in Sections 2(h)(2) and 4(c)(9) of the BHC Act. An analysis of the several statutory exemptions available to foreign banks is beyond the scope of this Chapter. *See* Chapter 9 for a more extended discussion. To be a qualifying foreign banking organization, more than half of a foreign institution's worldwide business (*excluding* the portion of such business attributable to U.S. banking operations) must be banking, and more than half of its worldwide banking business must be outside of the United States. 12 C.F.R. § 211.23(b).

[303] 12 C.F.R. § 211.23(f). The Board's regulations permit a foreign-chartered nonbanking subsidiary of a foreign bank holding company, either directly or through a domestic or foreign subsidiary, to engage in activities in the United States if it meets certain conditions, including that (1) a majority of its consolidated assets and revenues are located and derived from outside of the United States; (2) it does not engage, directly or indirectly, or have more than a 10 percent voting interest in, a company engaged in the business of underwriting, selling, or distributing securities in the United States (except to the extent permitted to domestic bank holding companies); and (3) it does not, without prior Board approval, engage in activities in the United States that directly or though a majority-owned subsidiary consist of banking or financial operations (*e.g.*, insurance underwriting and real estate investment and brokerage activities) or "closely-related-to-banking" activities covered by BHC Act § 4(c)(8). 12 C.F.R. § 211.23(f)(5).

[304] If, as a result of the acquisition of a very large U.S. subsidiary bank, more than half of a foreign acquirer's worldwide banking business was conducted in the United States, the acquirer would be treated as a domestic (rather than foreign) bank holding company.

[305] Gramm-Leach-Bliley Act of 1999, Pub. L. No. 106-102, 113 Stat. 1338, § 103 (1999). For a discussion of the GLBA and the expanded range of nonbanking activities that financial holding companies may conduct, see Chapter 10 .

[306] For a full discussion, see Chapter 10.

well-managed. Under the Board's rules implementing the GLBA, the Board will apply one of two tests in determining whether a foreign bank is well-capitalized. If the foreign bank's home country supervisor applies the risk-based capital standards in Basel I, the foreign bank will be considered well capitalized if it has and maintains: (1) a ratio of total capital to risk-weighted assets of at least 10 percent; (2) a ratio of Tier 1 capital to risk-weighted assets of at least 6 percent; and (3) the foreign bank's capital is comparable to the capital required for a U.S. bank owned by a financial holding company. Alternatively, if the foreign bank's home country supervisor does not apply the risk-based capital standards in Basel I, then the foreign bank will only be considered well capitalized if it obtains a determination from the Board that its capital is equivalent to the capital that would be required of a U.S. bank owned by a financial holding company.[307] A foreign bank with a U.S. commercial banking presence is well-managed if: (1) it received at least a satisfactory composite rating of its U.S. branch, agency and commercial lending company operations at its most recent assessment; (2) its home country supervisor consents to the foreign bank expanding its activities in the United States to include activities permissible for a financial holding company; and (3) the Board determines that the management of the foreign bank meets standards comparable to those required of a U.S. bank owned by a financial holding company.[308] Finally, if the foreign bank operates an insured branch in the United States, that branch must have received at least a satisfactory CRA rating at its most recent examination.[309]

For a foreign bank or the parent of a foreign bank with a U.S. commercial banking presence and thus already is subject to the restrictions in the BHC Act, acquisition of a U.S. bank subsidiary should not affect its direct banking presence but may affect any direct or indirect nonbanking activities conducted by the acquirer in the United States. Any such activities that have grandfather status under the IBA (*e.g.*, a grandfathered securities or insurance subsidiary) will lose that status two years after the foreign acquirer becomes a bank holding company under the BHC Act.[310] It is quite likely that if such a foreign acquirer gains a controlling position in a U.S. target, it will be required to sell any grandfathered operations or bring them into compliance with the

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[307] 12 C.F.R. § 225.90(b). It is not clear how the Board will apply its well-capitalized requirement to foreign banks that calculate their capital ratios under their home country implementations of Basel II. Although the Board should be willing to allow foreign banks to satisfy the well-capitalized test based on capital ratios calculated under home-country Basel II, the Board could require foreign bank acquirers to continue calculating them under home-country Basel I or subject to floors analogous to those required by the U.S. Basel II in order to ensure capital equivalency.

[308] 12 C.F.R.. § 225.90(c).

[309] 12 C.F.R. § 225.92(c)(2). A foreign bank that, in addition to its commercial banking presence, controls one or more U.S. bank subsidiaries must also meet the requirements for financial holding company status that apply to a U.S. bank holding company. Each U.S. bank subsidiary must maintain a total capital to risk-weighted assets ratio of at least 10 percent; a Tier 1 capital to risk-weighted assets ratio of at least 6 percent; and a leverage ratio of at least 5 percent. In addition, each U.S. bank subsidiary must have received at least a satisfactory composite rating and at least a satisfactory rating for management, and at least a satisfactory CRA rating, at its most recent examination. 12 C.F.R. § 225.81(c)(2).

[310] 12 U.S.C. § 3106(c)(2). The Board may extend this period for up to three years. *Id.*

BHC Act. If such a foreign acquirer files a declaration to become a financial holding company, its authority to engage in nonbanking activities that are permissible for financial holding companies pursuant to the IBA's grandfather provisions will terminate immediately, but financial holding company status should allow the acquirer to continue those activities subject to any prudential limitations imposed by the Board on financial holding companies generally.[311]

As noted above, foreign banks or the parents of foreign banks that are either bank holding companies or otherwise "treated as" bank holding companies for purposes of Section 4 of the BHC Act are exempt from the activities restrictions applicable to thrift holding companies, even if they acquire control of a thrift of thrift holding company.[312] In contrast, other foreign acquirers are generally subject to these activities restrictions if they acquire control of a thrift or thrift holding company. The OTS has, however, extended the QFBO exemptions to such foreign acquirers by regulation.[313]

[2] Source of Strength and Capital Guarantees

For domestic bank holding companies, the Board has stated repeatedly as a "fundamental and long-standing principle" that "bank holding companies should serve as sources of financial and managerial strength to their subsidiary banks."[314] The only U.S. court to consider this issue held that the Board did not have the statutory authority to enforce the source of strength requirement by ordering a bank holding company to transfer capital to its bank subsidiaries.[315] The court did, however, suggest that the Board has the authority to condition approval of an acquisition on a commitment from the acquirer to maintain its subsidiary banks or thrifts to some degree of financial soundness.[316] Following the decision, the Board made it clear that it will continue to impose a source of strength requirement on bank holding companies, at least in the context of approving an acquisition of a U.S. bank or thrift.[317]

The practical importance of the source of strength policy, however, has been overshadowed by the enactment of two statutory requirements that bank or thrift holding companies support their depository institution subsidiaries under certain

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[311] *See* 12 U.S.C. § 3106(c)(3). *See also* Grupo Financiero Banorte, S.A. de C.V., 92 FED. RES. BULL. (2006) (approving application to become a bank holding company upon acquisition of 70 percent of a bank holding company and determination that simultaneous election to become financial holding company will become effective upon consummation of the proposed acquisition).

[312] 12 U.S.C. § 1467a(c)(8). A foreign bank and the parent of a foreign bank with a U.S. commercial banking presence are subject to Section 4 of the BHC Act as if it was a bank holding company under Section 8(a) of the International Banking Act of 1978, 12 U.S.C. § 3106(a).

[313] 12 C.F.R. § 584.2(b)(6)(i); 72 Fed. Reg. 72,235 (Dec. 20, 2007).

[314] Policy Statement on Responsibility of Bank Holding Companies to Act as Sources of Strength to Their Subsidiary Banks, 52 Fed. Reg. 15,707 (Apr. 30, 1987). *See also* 12 C.F.R. § 225.4(a)(1).

[315] MCorp Fin. Inc. v. Board of Governors of the Fed. Reserve Sys., 900 F.2d 852, 862 (5th Cir. 1990), *aff'd in part and rev'd in part*, 502 U.S. 32 (1991).

[316] MCorp Fin. Inc. v. Board of Governors of the Fed. Reserve Sys., 900 F.2d 852, 862 n.5 (5th Cir. 1990), *aff'd in part and rev'd in part*, 502 U.S. 32, 112 S. Ct. 459 (1991).

[317] *See* Banc One Corp., 78 FED. RES. BULL. 159, 161 (1992).

circumstances. Under FDICIA, a company controlling an undercapitalized depository institution will be required to enter into a capital restoration guarantee for that depository institution; under FIRREA, a depository institution must guarantee the FDIC against losses incurred by any other depository institution under common control with such institution. These two statutory requirements have significantly altered the responsibilities of bank and thrift holding companies to their federally-insured depository institution subsidiaries.

When a foreign acquirer is deemed to have acquired "control" over a U.S. bank or thrift, it will become subject to FDICIA's controlling company capital restoration guarantee provisions.[318] FDICIA mandates the adoption of a capital restoration plan acceptable to the appropriate federal bank or thrift agency[319] by any insured depository institution that becomes "undercapitalized." To be accepted by the relevant agencies, this plan must be guaranteed by any "company having control" of the insured depository institution until such time as the insured depository institution has satisfied all applicable capital standards for four consecutive quarters.[320] FDICIA limits the aggregate liability of all controlling companies to the lesser of:

(1) 5 percent of the depository institution's total assets at the time it became "undercapitalized"; or

(2) the amount which is necessary (or would have been necessary) to bring the institution into compliance with all capital standards with respect to such institution as of the time the institution fails to comply with a plan under this subsection.[321]

Although not targeted specifically at foreign banks, the impact of this provision should be analyzed carefully by any foreign acquirer that plans a controlling investment in a U.S. depository institution. If the foreign acquirer cannot or is unwilling to guarantee the capital restoration plan, it may, among other things, be required to divest itself of the U.S. depository institution or to forego receiving dividends from the U.S. depository institution.[322] Moreover, certain minority investments bearing indicia of control could subject a foreign investor to the risk that for a capital restoration plan to be acceptable to the appropriate federal bank or thrift agency, the investor would have to guarantee compliance with that plan or accept possible divestiture or seizure of the target. Accordingly, it may be sensible, under some circumstances, for a foreign investor contemplating a direct or indirect minority investment in a depository institution to explore with the appropriate federal bank or thrift regulatory agency and the FDIC whether the foreign investor would be deemed to control the depository institution.

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[318] FDICIA § 131(e)(2)(C)(ii); 12 U.S.C. § 1831o(e)(2)(C)(ii).

[319] The appropriate federal bank or thrift agency could be the FDIC, the OCC, the Board, or the OTS, depending upon the type of U.S. bank or thrift involved.

[320] FDICIA § 131, 12 U.S.C. § 1831o(e)(2)(C).

[321] FDICIA § 131; 12 U.S.C. § 1831o(e)(2)(E)(i).

[322] FDICIA §§ 131(f)(2)(H) & (I); 12 U.S.C. §§ 1831o(f)(2)(H) & (I).

With respect to majority investments or wholly-owned bank or thrift subsidiaries, the controlling company capital restoration provision of FDICIA changes what may be seen to be a business imperative to restore the capital of a banking subsidiary into a potential legal obligation to invest additional funds up to an amount equal to 5 percent of the depository institution's assets. The foreign acquirer may find that home country law and practice require disclosure in prospectuses and listing applications of the possibility of being required to execute a controlling company capital restoration guarantee.

FDICIA permits a controlling company not to guarantee a capital restoration plan. In that event, however, the controlling company would face the loss of the bank or thrift either through a compulsory divestiture or seizure by the appropriate bank regulator. Some commentators have suggested that giving holding companies a choice whether to guarantee their troubled subsidiaries' capital restoration plans and limiting the holding companies' guarantee liability is somewhat inconsistent with the source of strength doctrine. There is not yet any sign, however, that the Board will cease to impose the source of strength requirement as a condition for approval of an application to acquire a U.S. depository institution.

Finally, in the event that a foreign acquirer obtains control of more than one U.S. depository institution, the foreign acquirer's subsidiary depository institutions would become subject to FIRREA's "cross guarantee by commonly controlled institution" provision.[323] This provision establishes the liability of depository institutions to the FDIC for the loss or anticipated loss to the FDIC that arises from the default or failure of a commonly controlled depository institution or assistance provided to such an institution in danger of default or failure.

[3] Transactions Between Affiliates

If a foreign acquirer acquires a U.S. bank or thrift subsidiary, the subsidiary will be subject to the limitations on transactions with affiliates imposed by Sections 23A and 23B of the Federal Reserve Act.[324]

Banks and thrifts subject to Section 23A face significant restrictions on their ability to (1) make loans or other extensions of credit to their affiliates, (2) invest in or purchase securities issued by affiliates, (3) purchase assets, including assets subject to repurchase agreements, from affiliates, unless such assets are real or personal property specifically exempt from purchase restrictions by Board order or regulation, (4) accept securities issued by affiliates as collateral for a loan or extension of credit to any person

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[323] FIRREA § 206; 12 U.S.C. § 1815(e). The Act defines "commonly controlled" to mean institutions that share the same holding company or one insured depository institution which is controlled by another. 12 U.S.C. § 1815(e). *See also FDIC Statement of Policy Regarding Liability of Commonly Controlled Depository Institutions*, 55 Fed. Reg. 21,934 (1990).

[324] 12 U.S.C. §§ 371c and 371c-1. Although on their face, Sections 23A and 23B apply only to national banks and state-chartered member banks, Section 18(j)(1) of the Federal Deposit Insurance Act, 12 U.S.C. § 1828(j)(1), extended them to state nonmember banks, and Section 11(a) of HOLA, 12 U.S.C. § 1468(a), extend them to thrifts.

or company, or (5) issue guarantees, acceptances, or letters of credit, including endorsements of a standby letter of credit, on behalf of affiliates (each a "covered transaction").[325] For purposes of Section 23A, affiliates of a foreign acquirer's subsidiary bank would include the foreign acquirer itself (regardless of whether the foreign acquirer is itself a bank in its home country), along with any branches or agencies of the acquirer in the United States or elsewhere, and any other company, wherever located, of which more than 25 percent of any class of voting securities is owned, directly or indirectly, or otherwise controlled by the foreign acquirer.[326]

Section 23A specifically prohibits a covered bank from engaging in a covered transaction with any affiliate, and any transaction with any person where the proceeds of such transaction are used to benefit an affiliate, when the amount of aggregated transactions with a single affiliate will exceed 10 percent of the bank's capital and surplus. The Section also prohibits a covered bank from engaging in covered transactions when the aggregate value of all transactions with all affiliates exceeds 20 percent of its capital stock and surplus. In addition, Section 23A requires that a covered bank engage in no covered transaction with any affiliate unless secured by collateral in the form of (1) U.S. government and agency obligations, U.S. government- or agency-guaranteed obligations, money market instruments eligible for rediscount or purchase by a Federal Reserve Bank, or a segregated deposit account, each having a market value equal to 100 percent of such transaction; (2) obligations of any state or political subdivision thereof having a market value of at least 110 percent of such transaction; (3) other debt instruments and receivables having a market value of at least 120 percent of such transaction; or (4) stock, leases, or other real or personal property having a market value of at least 130 percent of such transaction.[327]

Certain types of transactions are exempt from the restrictions mentioned above, including: (1) deposits to the credit of an affiliated depository institution or affiliated foreign bank in the ordinary course of correspondent business; (2) giving of immediate credit to an affiliate upon uncollected items received in the ordinary course of business; (3) purchases of assets having a readily identifiable and publicly available market quotation and purchased at such quotation, and purchases of certain loans on a nonrecourse basis from affiliated depository institution; (4) covered transactions secured by obligations issued or fully guaranteed as to principal and interest by the U.S. government or its agencies or by a segregated, earmarked deposit account; (5) purchases from an affiliate of a loan or extension of credit that the covered depository institution originated and sold to the affiliate subject to a repurchase agreement or with recourse; (6) investments in certain subsidiaries of any parent bank holding company to engage in bank servicing and certain other limited activities under Section 4(c)(1)

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[325] 12 U.S.C. § 371c(b)(7).

[326] 12 U.S.C. §§ 371c(b)(1), (3). Section 23A also prohibits a covered bank from purchasing low-quality assets from an affiliate unless the bank, pursuant to an independent credit evaluation, committed itself to purchase such asset prior to the time it was acquired by an affiliate. 12 U.S.C. § 371c(a)(3).

[327] 12 U.S.C. § 371c(c).

of the BHC Act; and (7) any transaction with a subsidiary of such depository institution or with another depository institution owned or controlled or under common control with such covered depository institution that is also subject to Section 23A.[328]

Section 23B of the Federal Reserve Act provides that a depository institution may only (1) engage in any "covered transaction" with an affiliate, (2) sell securities or other assets to an affiliate, including assets subject to an agreement to repurchase, (3) pay money or furnish services to an affiliate under contract, lease, or otherwise, (4) engage in any transaction where an affiliate acts as an agent or broker or receives a fee for its services to the bank or to any other person, or (5) engage in any transaction or series of transactions with a third party if an affiliate has a financial interest in the third party or if an affiliate is a participant in such transaction or series of transactions, if the terms and conditions of the transaction are substantially the same or at least as favorable to the bank as those prevailing at the time for comparable transactions with nonaffiliated companies.[329] For purposes of Section 23B, affiliates of a foreign acquirer's subsidiary depository institution would include all persons that would constitute "affiliates" for purposes of Section 23A, but would not include certain entities exempt from the definition of affiliate in Section 23A or any U.S. bank.

Section 23B specifically provides, among other things, that any transaction by a U.S. depository institution or its subsidiary with any person will be deemed to be a transaction with an affiliate of such depository institution if any of the proceeds of the transaction are used for the benefit of, or transferred to, such affiliate. Section 23B also prohibits a bank or any subsidiary or affiliate of a depository institution from publishing any advertisement or entering into any agreement stating or suggesting that the bank is in any way responsible for the obligations of its affiliates.

The Board, through mandatory annual reports, monitors loans and extensions of credit by U.S. subsidiary depository institutions to foreign affiliates.[330]

§ 3.09 Conclusion

In sum, acquiring a U.S. bank or thrift, or bank or thrift holding company, involves successfully navigating through detailed regulatory requirements and the approval of several bank regulatory agencies and, possibly, the Department of Justice. The process is lengthy and complex even a purely domestic context, and foreign acquirers are required to make certain showings—that they are supervised on a comprehensive and consolidated basis, for example—that are not required of domestic acquirers. This said, despite the complexity of the process, and its length and expense, ongoing bank consolidation in the United States should continue to provide fruitful acquisition opportunities for foreign banks.

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[328] 12 U.S.C. § 371c(d).

[329] 12 U.S.C. § 371c-1. In the absence of comparable transactions, the terms and circumstances must be those that in good faith would be offered, or would apply, to nonaffiliated companies.

[330] Additional restrictions on loans by member banks and insured nonmember banks to "insiders" (including executive officers, directors and principal shareholders) are contained in the Financial Institutions Regulatory and Interest Rate Control Act of 1978, Section 22(g), (h) of the Federal Reserve Act, 12 U.S.C. §§ 375a and 375b. *See also* 12 C.F.R. pt. 215 (Regulation O of the Board).