Regulation of Foreign Banks and Affiliates in the United States

7th Edition

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Editor

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Chapter 7
Foreign Bank Acquisitions of U.S. Banks and Thrifts[*]

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§ 7:1 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).[1] 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

[Section 7:1]

[1]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 (FDIC). This Chapter also does not address federal and state income tax considerations that may be relevant to the acquisition of an insured U.S. bank or thrift by a foreign acquirer.

structuring a U.S. acquisition and briefly address certain state corporate law and other requirements under the federal and state securities laws that affect such an acquisition. This includes a discussion of noncontrolling investments and acquisitions of failed depository institutions. We then describe the federal bank or thrift regulatory approvals that would be required under each option, and the factors that must be considered by the relevant regulatory authorities in reviewing the proposed 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 complete. A three-to-six month timetable would not be unusual, and recently, approvals have often taken longer. 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.

§ 7:2 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, commercial lending company, or Edge Act subsidiary[2] 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 (IBA),[3] a foreign bank with a 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 (BHC Act).[4] The BHC Act, among other things, governs interstate acquisitions by bank holding companies and imposes restric-

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[Section 7:2]

[2]An Edge Act subsidiary is a subsidiary organized under Section 25A of the Federal Reserve Act.

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

[4]IBA, Pub. L. No. 95-369, § 8(a); 12 U.S.C.A. § 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. IBA, Pub. L. No. 95-369,

tions on their nonbanking activities and investments. As a result of a long-standing 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 coexistence of 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.

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§ 8(a); 12 U.S.C.A. § 3106(a). 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.

[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 (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* §§ 10:1 et seq. and §§ 11:1 et seq.

[a] Federal Depository Institutions

Historically, there had been two federal bank regulators that chartered federal depository institutions: the Office of the Comptroller of the Currency (OCC) that chartered national banks[7] and the Office of Thrift Supervision (OTS) that chartered federal thrifts or savings associations.[8] Both agencies were divisions of the U.S. Department of the Treasury. The OCC and OTS were the primary regulators and generally responsible for conducting bank examinations, initiating supervisory and enforcement actions, and evaluating and approving branch, change of control, merger, and other applications for national banks and federal thrifts, respectively.

While the OCC continues to act in these capacities, pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act), the OTS has been abolished.[9] The Dodd-Frank Act maintains the federal thrift charter as a separate form of charter from that of national banks. However, since it eliminates the most important regulatory advantages of the charter, it is likely that most thrift charter holders will convert into bank charters to avoid certain asset restrictions applicable to thrifts. It is unlikely that the OCC will grant any federal thrift charters in the future.

On July 21, 2011, the OTS's supervisory powers were transferred to the other three federal bank regulators: the OCC, the Federal Deposit Insurance Corporation (FDIC), and the Board of Governors of the Federal Reserve System (the Federal Reserve Board), and its rulemaking powers were transferred to the OCC and the Federal Reserve Board.[10] The OCC now has supervisory and rulemaking authority over federal thrifts.[11] As a result, the OCC evaluates certain change of control, merger, and other applications relating to federal thrifts, and as of July 21, 2011, the OCC applies the OTS's change in control regulations and other regulatory interpretations and guidance that were in place prior

[7] National Bank Act § 2, 12 U.S.C.A. § 26.

[8] Financial Institutions Reform, Recovery, and Enforcement Act of 1989, Pub. L. No. 101-73, § 301, 12 U.S.C.A. § 1464.

[9] Dodd-Frank Act, Pub. L. No. 111-203, § 313 (2010).

[10] Dodd-Frank Act, Pub. L. No. 111-203, § 312 (2010).

[11] Dodd-Frank Act, Pub. L. No. 111-203, § 312 (2010). The Dodd-Frank Act also granted the OCC rulemaking authority over insured state-chartered thrifts.

to July 21, 2011, when evaluating such transactions.[12] The OCC may issue regulations or other guidance that amends or modifies such OTS regulations or guidance in the future.[13]

In addition to being supervised by the OCC as their primary regulator, national banks and federal thrifts are also regulated by the FDIC. In the aftermath of the bank failures during the Great Depression, Congress created federal deposit insurance, which is administered by the FDIC. 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.[14] 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 and subject to an additional layer of federal oversight by the FDIC.

National banks are also required to be members of the Federal Reserve System by law and therefore are subject to a third layer of overlapping jurisdiction, to a limited extent, by the Federal Reserve Board.[15]

[b] State Depository Institutions

Since most state-chartered banks and thrifts are now federally

[12]The OCC has issued an interim final rule that went into effect July 21, 2011, publishing OTS regulations that the OCC will enforce starting July 21, 2011, with their new OCC codification scheme. OCC, Office of Thrift Supervision Integration Pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act, 76 Fed. Reg. 48,950 (Aug. 9, 2011). In addition to OTS regulations, pursuant to Section 316 of the Dodd-Frank Act, existing OTS orders, resolutions, determinations, interpretative rules, guidelines, and other advisory materials will continue in effect, until modified or superseded by the Federal Reserve Board, OCC, or FDIC, as appropriate. Dodd-Frank Act, Pub. L. No. 111-203, § 316(b) (2010).

[13]The OCC's interim final rule states, "[After July 21, 2011], the OCC will consider more comprehensive substantive amendments, as necessary, to the [adopted] OTS regulations." OCC, Office of Thrift Supervision Integration Pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act, 76 Fed. Reg. 48,950, 48,951 (Aug. 9, 2011).

[14]*See* 12 U.S.C.A. § 222 (national banks), 12 C.F.R. § 152.1(b)(3)(i) (federal thrifts); Application of the Board of Governors of the Federal Reserve System 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.

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

insured, they are subject to the FDIC's regulatory authority.[16] Most sizeable state-chartered banks are members of the Federal Reserve System and therefore are also subject to the examination authority of the Federal Reserve Board.[17] State-chartered insured thrifts were also historically subject to the examination authority of the OTS.[18] Pursuant to the Dodd-Frank Act, the OTS's examination authority of state-chartered insured thrifts was transferred to the FDIC on July 21, 2011.[19] As a result, the FDIC evaluates certain change of control, merger, and other applications relating to state-chartered insured thrifts, and as of July 21, 2011, the FDIC applies the OTS's change in control regulations and other regulatory interpretations and guidance that were in place prior to July 21, 2011, when evaluating such transactions.[20] The FDIC may also issue regulations or other guidance that amends or modifies OTS regulations or guidance in the future.[21]

Because state-chartered banks and thrifts are regulated by the laws of the state in which they are chartered as well, all insured state-chartered banks and thrifts are subject to the regulatory

[16] *See* 12 U.S.C.A. § 1817(a).

[17] 12 U.S.C.A. § 248.

[18] 12 U.S.C.A. § 1463.

[19] Dodd-Frank Act, Pub. L. No. 111-203, § 312 (2010). Although none of the OTS's rulemaking powers were transferred to the FDIC under the Dodd-Frank Act, the Dodd-Frank Act amended Section 3 of the Federal Deposit Insurance Act (FDI Act), 12 U.S.C.A. § 1813, to designate the FDIC as the "appropriate Federal banking agency" for insured state-chartered thrifts. Dodd-Frank Act, Pub. L. No. 111-203, § 312(c)(1) (2010). As a result, the FDIC is authorized to issue regulations applicable to insured state-chartered thrifts pursuant to its authority as the "appropriate Federal banking agency" for insured state-chartered thrifts under the FDI Act and other existing laws. *See also* FDIC, Transfer and Redesignation of Certain Regulations Involving State Savings Associations Pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, 76 Fed. Reg. 47,652 (Aug. 5, 2011).

[20] On August 5, 2011, the FDIC issued an interim final rule that went into effect on July 22, 2011, publishing OTS regulations relating to insured state-chartered thrifts that the FDIC will enforce with their new FDIC codification scheme. FDIC, Transfer and Redesignation of Certain Regulations Involving State Savings Associations Pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, 76 Fed. Reg. 47,652 (Aug. 5, 2011).

[21] The FDIC noted that "[n]o changes are being made at this time to the substantive content of the transferred regulations . . . . FDIC staff will evaluate the transferred OTS rules and may later recommend . . . amending them, or rescinding them, as appropriate." FDIC, Transfer and Redesignation of Certain Regulations Involving State Savings Associations Pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, 76 Fed. Reg. 47,652, 47,653 (Aug. 5, 2011).

oversight of at least two supervisory authorities, if not more.[22] Accordingly, transactions resulting in a change of control of an insured state-chartered thrift may also need to be evaluated or approved by the relevant state banking regulator.[23]

[c] Holding Company Regulation

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 with 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 (HOLA),[24] and other federal laws.[25]

As discussed in greater detail in the Editor's Note Regarding Recent Developments in the beginning of this book, in December 2012, the Federal Reserve Board released a proposed rule implementing the enhanced prudential standards and early remediation requirements of Sections 165 and 166 of the Dodd-Frank Act (Proposed FBO Rule) that, if adopted as proposed, will have the effect of requiring all U.S. bank and nonbank subsidiaries of foreign banking organizations with total global consolidated assets of $50 billion or more and combined U.S. assets of $10 billion or more (excluding branch and agency assets) to be held through an intermediate holding company. The intermediate holding company would be subject to U.S. capital, liquidity and other enhanced prudential standards on a consolidated basis, similar to those applicable to U.S. bank holding companies of equivalent size. In addition, the Federal Reserve Board would have the authority to examine any intermediate holding company

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[22]Many state-chartered banks are subject to the regulatory oversight of three supervisory authorities. For instance, 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, Pub. L. No. 96-221, 12 U.S.C.A. § 461.

[23]Discussion and analysis of such state regulatory requirements are beyond the scope of this Chapter.

[24]Home Owners' Loan Act of 1933, ch. 64, 73, Pub. L. No. 43, codified at 12 U.S.C.A. §§ 1461 et seq.

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

and any subsidiary of an intermediate holding company.[26] The rule, if adopted as proposed, would apply beginning July 2015.[27] A foreign acquirer seeking to acquire a U.S. bank or thrift, should review this proposal in detail and consider the structural, capital and liquidity implications of this rule on its U.S. banking and nonbanking operations.

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.[28] The Federal Reserve Board determines "control" on the basis of a series of presumptions set forth in the BHC Act and in the Federal Reserve Board's regulations thereunder.[29]

Section 3 of the BHC Act prohibits a company from becoming a bank holding company without the prior approval of the Federal Reserve Board. A company that the Federal Reserve 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.[30]

HOLA 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.[31] Historically, thrift holding companies had been regulated by the OTS.[32] Pursuant to the Dodd-Frank Act, the OTS's supervisory and rulemaking authority over thrift holding companies was transferred to the Federal Reserve Board on

[26] Enhanced Prudential Standards and Early Remediation Requirements for Foreign Banking Organizations and Foreign Nonbank Financial Companies, 77 Fed. Reg. 76,628 (Dec. 28, 2012).

[27] 77 Fed. Reg. at 76,637.

[28] 12 U.S.C.A. § 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.A. § 1841(b). A group of natural persons may under certain circumstances constitute an entity encompassed within the definition of *company* for BHC Act purposes.

[29] *See* § 7:3[6].

[30] *See* 12 U.S.C.A. § 1844.

[31] 12 U.S.C.A. § 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.A. § 1467a(a)(1)(C).

[32] *See* Financial Institutions Reform, Recovery, and Enforcement Act of 1989, Pub. L. No. 101-73, § 301, 12 U.S.C.A. § 1464.

July 21, 2011,[33] and the Federal Reserve Board is now responsible for evaluating change of control and merger applications relating to thrift holding companies. On August 12, 2011, the Federal Reserve Board issued an interim final rule setting forth the Federal Reserve Board's regulations for thrift holding companies and their nondepository subsidiaries that was published and became effective on September 13, 2011 (the Board Interim Final Rule).[34] The Board Interim Final Rule effects the transition of the thrift holding company regulations previously issued by the OTS to the Federal Reserve Board.[35]

The Board Interim Final Rule includes a new Board Regulation LL,[36] which sets forth regulations generally governing thrift holding companies. The provisions of Regulation LL that relate to acquisition of control involving thrift holding companies closely resemble the structure of the Federal Reserve Board's regulations on the acquisition of control of banks and bank holding companies. In numerous instances, Regulation LL duplicates existing OTS regulations governing thrift holding companies with only technical modifications to account for the shift in supervisory responsibilities from the OTS to the Federal Reserve Board. In some cases, however, where the requirements or criteria found in existing OTS rules are substantively the same as those found in the Federal Reserve Board's rules, the Federal Reserve Board conforms the text and format used in Regulation LL to that of its regulations. Unlike the Interim Final Rules adopted by the OCC and FDIC, Regulation LL also incorporates several substantive changes to existing OTS regulations, including regulations applicable to change in control transactions. These regulations will be referred to throughout this Chapter.

Section 10(e) of HOLA, as amended by the Dodd-Frank Act, prohibits a company (other than a bank holding company or

[33]Dodd-Frank Act, Pub. L. No. 111-203, § 312 (2010).

[34]Federal Reserve Board, Availability of Information, Public Observation of Meetings, Procedure, Practice for Hearings, and Post-Employment Restrictions for Senior Examiners; Savings and Loan Holding Companies, 76 Fed. Reg. 56,508 (Sept. 13, 2011).

[35]The Board Interim Final Rule includes: (1) new Regulation LL, setting forth regulations generally governing thrift holding companies; (2) new Regulation MM, setting forth regulations governing thrift holding companies in mutual form; and (3) technical amendments to current Board regulations that are necessary to accommodate the transfer of supervisory authority over thrift holding companies to the Federal Reserve Board. Discussion of the Board Interim Final Rule in this Chapter focuses on Regulation LL, with particular emphasis on provisions relating to change of control.

[36]12 C.F.R. Pt. 238.

certain other companies) from becoming a thrift holding company without the prior approval of the Federal Reserve Board.[37] 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 Federal Reserve Board, a foreign bank or the parent of a foreign bank would be required to obtain the prior approval of the Federal Reserve Board 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 Federal Reserve Board 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.[38]

Various federal restrictions govern a bank or thrift holding company's ability to engage directly or indirectly in nonbanking activities.[39] 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.[40] 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 "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 had effectively extended the QFBO exemptions by regulation to the

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[37] *See* Dodd-Frank Act, Pub. L. No. 111-203, § 317 (2010); 12 U.S.C.A. § 1467a(e)(1)(B). *See also* 12 U.S.C.A. § 1467a(t) (bank holding companies are not subject to Section 10 of HOLA).

[38] *See* Dodd-Frank Act, Pub. L. No. 111-203, § 317 (2010); 12 U.S.C.A. § 1467a(b).

[39] For a more complete discussion, *see* §§ 7:2 and 7:8, and §§ 10:1 et seq.

[40] *See* Dodd-Frank Act, Pub. L. No. 111-203, § 317 (2010); 12 U.S.C.A. § 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.A. § 3106(a).

foreign parents of thrifts or thrift holding companies, and as of September 1, 2011, these regulations continue to be effective.[41]

[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 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.[42] Most significantly for banks, Section 3(d) of the BHC Act, known as the Douglas Amendment, prohibited the Federal Reserve Board from approving any application by a bank holding company to acquire, directly or indirectly, more than five 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.[43]

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.[44] 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 (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 Federal Reserve Board to approve the acquisition by a bank holding company of a bank outside the holding company's home state without regard as to whether the acquisition is

[41] *See* 12 C.F.R. § 238.51(b)(6)(i).

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

[43] 12 U.S.C.A. § 1842(d) (1988).

[44] 12 U.S.C.A. § 3103(a)(5) (1988).

prohibited under state law.[45] 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.[46] In addition, the Federal Reserve Board may not approve an acquisition if the acquiring bank holding company would thereby control more than 10% of the total amount of deposits of insured depository institutions in the United States or more than 30% of insured deposits in any one state.[47] The 30% 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 Federal Reserve Board will defer, so long as they are not discriminatory.[48]

The Dodd-Frank Act expands the 10% nationwide deposit cap by prohibiting an interstate merger transaction if the resulting insured depository institution, together with all of its insured depository institution affiliates (including bank and thrift holding companies), would control more than 10% of the total U.S. insured deposits, subject to an exception where one or more insured depository institutions is in default or in danger of default or is receiving assistance from the FDIC under Section 13 of the FDI Act.[49] The Dodd-Frank Act also institutes a new liability cap that prohibits a "financial company" from merging with or acquiring another company if the resulting company's total consolidated liabilities would exceed 10% of the aggregate consolidated liabilities of all financial companies at the end of the prior calendar year. "Financial company" is defined to include insured depository institutions, bank holding companies, thrift holding companies, foreign banks treated as bank holding companies for

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[45] 12 U.S.C.A. § 1842(d)(1).

[46] 12 U.S.C.A. § 1842(d)(1). As of August 2010, 28 states plus the District of Columbia had minimum age requirements ranging from three to five years. *See* 2010/2011 Profile of State Chartered Banking (Conference of State Bank Supervisors).

[47] 12 U.S.C.A. § 1842(d)(2).

[48] 12 U.S.C.A. § 1842(d)(2). As of August 2010, 17 states had set statewide deposit caps on bank holding company acquisitions at 30%, and 14 states had caps ranging from 10% to 25%. *See* 2010/2011 Profile of State Chartered Banking (Conference of State Bank Supervisors). Additionally, in deciding whether to approve an application for an interstate acquisition, the Federal Reserve Board is required to consider the acquiring bank holding company's record of compliance with the Community Reinvestment Act of 1977 (CRA), 12 U.S.C.A. § 1842(d)(3).

[49] Dodd-Frank Act, Pub. L. No. 111-203, § 623 (2010).

purposes of the BHC Act, and certain others.[50]

Second, the Riegle-Neal Act added a new section to the FDI Act, Section 44, which permits interstate merger transactions between FDIC-insured banks in different states without regard as to whether the merger is prohibited under the law of any state.[51] These interstate merger transactions are subject to the approval of the appropriate federal regulator under the Bank Merger Act.[52] Following the merger transaction, the surviving bank is permitted to convert any of the target bank's offices into its own branches.[53] 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.[54] 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 ap-

[50]Dodd-Frank Act, Pub. L. No. 111-203, § 622 (2010). The Federal Reserve Board was required to issue implementing regulations by October 18, 2011. However, as of December 31, 2012, it had not yet done so.

[51]12 U.S.C.A. § 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% nationwide and 30% statewide. The 30% concentration limit does not apply to initial entry into a state by a bank or its affiliates. Section 44 also specifies that the CRA (*see* § 7:6[5]) 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.A. § 1831u(b)(3). Finally, under Section 18 of the FDI Act, 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.A. § 1828(r).

[52]The appropriate federal regulator is the OCC, if the surviving depository institution is a national bank or federal thrift; the Federal Reserve Board, if the surviving depository institution is a state member bank; and the FDIC, if the surviving depository institution is a state nonmember bank or insured state-chartered thrift. 12 U.S.C.A. § 1828(c)(2); Dodd-Frank Act, Pub. L. No. 111-203, § 317 (2010).

[53]12 U.S.C.A. § 1831u(d)(1).

[54]12 U.S.C.A. § 1831u(a)(4). As of December 2011, 34 states plus the District of Columbia and Puerto Rico permitted the acquisition of individual branches. Arizona, Indiana, Tennessee, and Texas, 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* 2010/2011 Profile of State Chartered Banking (Conference of State Bank Supervisors).

plicable state and federal law.[55] Although the Riegle-Neal Act permitted states to opt out of Section 44 if they did so prior to June 1, 1997,[56] none of them had enacted an opt-out law as of that date.[57]

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.[58] The Dodd-Frank Act has further liberalized this provision to allow *de novo* interstate branching by national banks and insured state-chartered banks, if under the law of the state in which the branch is to be located, a state bank chartered by the state would have been permitted to establish the branch.[59] In addition, the federal agency reviewing the application for a *de novo* branch may approve an application for the establishment of a *de novo* branch only when the applying bank is at least adequately capitalized at the time the application is filed and will be well-capitalized and well-managed after the establishment of the branch.[60]

Because the IBA subjects a foreign bank with a U.S. commercial banking presence to limitations similar to those imposed on domestic bank holding companies,[61] foreign banks generally face the same federal law limitations on out-of-state bank acquisitions and branching as a U.S. bank holding company.[62] The most significant exception to this general rule is that the Federal

[55] 12 U.S.C.A. § 1831u(d)(2). The same rules apply to states that permit the acquisition of bank branches without acquisition of the bank itself.

[56] 12 U.S.C.A. § 1831u(a)(2).

[57] *See* 2000 Profile of State Chartered Banking (Conference of State Bank Supervisors).

[58] 12 U.S.C.A. §§ 36(g), 1828(d). As of December 2011, 25 states plus the District of Columbia allowed *de novo* branching on at least a reciprocal basis. *See* 2010/2011 Profile of State Chartered Banking (Conference of State Bank Supervisors).

[59] Dodd-Frank Act, Pub. L. No. 111-203, § 613 (2010).

[60] 12 U.S.C.A. § 1831u(b)(4)(B).

[61] 12 U.S.C.A. § 3106(a).

[62] 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.A. § 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.A. § 3103(d). A foreign bank may

Reserve 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.[63] Finally, if a foreign bank makes an initial interstate entry by acquiring a depository institution that was subject to the CRA[64] 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.[65]

As for thrifts, Section 10(e) of HOLA, as amended by the Dodd-Frank Act, generally prohibits the Federal Reserve Board 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.[66] Section 10(e) does not, however, prohibit the Federal Reserve Board 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 Riegle-Neal Act did not amend Section 10(e)'s general prohibition on multistate, multiple thrift holding companies nor did it make the 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 FDI Act. As a result, interstate thrift acquisitions are more dependent on state law than interstate bank acquisitions.

While the authority of insured state-chartered thrifts to branch interstate is basically the same as that of state or national banks, the OTS issued a regulation, which has been adopted by the OCC and therefore substantively remains in effect, authorizing federal thrifts to branch nationwide and expressly preempting contrary

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branch directly at the same time as it controls a U.S. subsidiary bank. 12 U.S.C.A. § 3103(d).

[63] 12 U.S.C.A. § 3103(a)(6).

[64] For a discussion of the CRA, *see* § 7:6[5].

[65] 12 U.S.C.A. § 3103(a)(8).

[66] Dodd-Frank Act, Pub. L. No. 111-203, § 317 (2010); 12 U.S.C.A. § 1467a(e)(3).

state law.[67] Section 5 of HOLA limits this interstate branching authority to federal thrifts that satisfy the qualified thrift lender (QTL) test or certain other conditions.[68]

Although the Dodd-Frank Act's amendment of the Riegle-Neal Act that now allows *de novo* interstate branching by national banks and insured state banks is not precisely the same as this provision, it does achieve the goal of placing banks and thrifts on generally the same footing in terms of their ability to establish *de novo* interstate branches.

[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 the state.

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.[69] The OCC may waive the citizenship requirement in its discretion, but only for a minority of the directors.[70] State laws vary as to citizenship and residency requirements.[71] 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.[72]

[67] 12 C.F.R. § 545.92 (now codified in OCC regulations at 12 C.F.R. § 145.92).

[68] 12 U.S.C.A. §§ 1464(r), 1467a(m).

[69] 12 U.S.C.A. §§ 71, 72.

[70] 12 U.S.C.A. § 72.

[71] 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).

[72] A foreign-controlled bank will be subject to certain limitations on leveraged leasing transactions involving vessels used in coastwise trade, 46 U.S.C.A. § 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.A. § 5342(b)(1), and may be required by some states to divest any real estate holdings in such states. A

[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.[73] Thus, in theory, it need not seek the Federal Reserve Board's prior approval under the BHC Act for the acquisition of a U.S. bank or bank holding company.[74] The Federal Reserve 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.[75]

In addition, the BHC Act's foreign government exception has been substantially limited as a practical matter because in 1988, the Federal Reserve Board decided that it would generally consider foreign government-controlled business organizations to be "companies" for purposes of the BHC Act.[76] 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 Federal Reserve Board's interpretation came in connection with the proposed acquisition of Irving Bank Corporation (Irving) by Istituto per la Ricostruzione Industriale (IRI), a "financial public corporation" created by the Italian government in 1933 to hold certain industrial and financial companies in the aftermath

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foreign-controlled bank may also face limitations on transactions involving certain defense contractors and Federal Communications Commission licensees.

[73] *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, Apr. 24, 2008.

[74] *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, 78 Fed. Res. Bull. 495, 497 (1992).

[75] *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, 78 Fed. Res. Bull. 495, 497 (1992).

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

of the Great Depression.[77] The Federal Reserve Board concluded that IRI constituted a "company" for purposes of Section 2(b) of the BHC Act. Although the Federal Reserve Board had previously ruled that IRI was not a "company,"[78] it reversed this position because of concerns that IRI's potential acquisition of a large U.S. bank holding company presented serious questions about commercial and industrial entanglements. 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.[79] The Federal Reserve 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."[80] 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 Federal Reserve 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 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.[81] By its terms, however, the exemption applied only to those foreign government-owned business organizations

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

[78] LITCO Bancorporation, 68 Fed. Res. Bull. 423, 425 (1982). In the IRI Letter, the Federal Reserve 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 Aug. 19, 1988, to Patricia S. Skigen and John B. Cairns.

[79] In addition, Irving had an existing lending relationship with the Italian government and other Italian government-owned companies that, had an acquisition been completed, 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* §§ 6:1 et seq.

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

[81] *See* Letter from the Board of Governors of the Federal Reserve System, dated Aug. 19, 1988, to Patricia S. Skigen and John B. Cairns. Section 4(c)(9) of the BHC Act permits the Federal Reserve Board to grant a foreign company the

that controlled foreign banks as of the date of the Federal Reserve Board's action that had U.S. branch or agency operations. The Federal Reserve 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.[82]

The Section 4(c)(9) exemption was invoked frequently during the financial crisis of 2008 as sovereign wealth funds and other sovereign corporate entities sought to make capital investments in U.S. and international financial institutions. For instance, the UK government formed UK Financial Investments Limited (UKFI) to manage the UK government's recapitalization fund. The Federal Reserve Board granted UKFI approval to acquire up to 58.1% of RBSG and become a financial holding company.[83] The approval also granted UKFI exemptions from the nonbanking restrictions of the BHC Act pursuant to Section 4(c)(9).[84] The Federal Reserve Board also granted China Investment Corporation and Central SAFE Investments Limited (known as Huijin) an exemption from the nonbanking restrictions of the BHC Act pursuant to Section 4(c)(9) in connection with their controlling interests in the Bank of China Limited, which has two insured branches in New York and one uninsured branch in California.[85]

[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

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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.A. § 1843(c)(9). For a detailed discussion of Section 4(c)(9), *see* §§ 11:1 et seq.

[82] *See* Letter from the Board of Governors of the Federal Reserve System, dated Aug. 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, Apr. 24, 2008.

[83] RBSG operates in the United States through direct offices of two subsidiary foreign banks: The Royal Bank of Scotland plc and The Royal Bank of Scotland N.V. RBSG also controls Citizens Financial Group and its subsidiary banks. In addition, RBSG operates nonbanking companies in the United States. Letter from the Board of Governors of the Federal Reserve System, Nov. 26, 2008, to Arthur S. Long, at 1–2.

[84] Letter from the Board of Governors of the Federal Reserve System, dated Nov. 26, 2008, to Arthur S. Long, at 5.

[85] Letter from the Board of Governors of the Federal Reserve System, dated Aug. 5, 2008, to H. Rodgin Cohen.

of the Defense Production Act of 1950 (Section 721) if the transaction could result in foreign control of any "critical infrastructure" or otherwise threaten the national security of the United States.[86] The Committee on Foreign Investment in the United States (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."[87] It is not limited to defense-related infrastructure.

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.[88]

Filings with CFIUS are voluntary. However, CFIUS has the authority to self-initiate a review of a transaction that could result in foreign control of a U.S. business. Although there is little history of subjecting U.S. bank or thrift acquisitions to a national security review, according to guidance issued by CFIUS, transactions involving U.S. businesses that could significantly and directly affect the U.S. financial system are among the transactions that have presented national security considerations. In addition, the Foreign Investment and National Security Act of 2007 (FINSA) and the regulations thereunder substantially expanded the range of transactions potentially subject to review under Section 721.[89] Among other things, FINSA generally requires CFIUS to conduct an investigation of a filed transaction that would result in foreign government control of a U.S. business to determine the transaction's effects on national security—a requirement that would apply to the purchase by a sovereign wealth fund of a controlling interest in a bank or thrift, among other transactions.[90]

Under the CFIUS regulations, a passive noncontrolling investment of 10% or less of the outstanding voting interest of any U.S. company is generally exempt from CFIUS review and from any

[86]Defense Production Act of 1950, § 721, as codified at 50 U.S.C.A. §§ 2170 et seq.

[87]50 U.S.C.A. § 2170(a)(6).

[88]50 U.S.C.A. § 2170(d).

[89]Foreign Investment and National Security Act of 2007, Pub. L. No. 110-49, 121 Stat. 246; 31 C.F.R. Pt. 800.

[90]*See* 50 U.S.C.A. § 2170(b)(2)(B)(i)(II); 31 C.F.R. § 800.503.

action to prohibit, suspend, or impose any conditions on the investment.[91]

[4] Hart-Scott-Rodino Act

The Hart-Scott-Rodino Antitrust Improvements Act of 1976 (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 $70.9 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 (collectively the Antitrust Agencies) and (ii) suspend the completion 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 completing 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 generally contains an exemption for acquisitions that are subject to prior approval requirements under Section 3 or 4 of the BHC Act, the Bank Merger Act, or Section 5 or 10 of HOLA.[92] The Federal Trade Commission has extended this exemption, by regulation, to acquisitions that are subject to the

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[91] 31 C.F.R. § 800.302(b). The question of what constitutes an exempt passive investment under Section 721 is beyond the scope of this Chapter.

[92] 15 U.S.C.A. § 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 Federal Reserve Board must also be filed with the Antitrust Agencies. 15 U.S.C.A. § 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.A. § 18a(c)(7).

If the foreign acquirer is a financial holding company and the acquisition also involves the acquisition of any nonbanking (nonthrift) 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 Federal Reserve Board under Section 3 or 4 of the BHC Act or any other federal bank or thrift regulator. For a discussion of the require-prior notice requirements of the CIBC Act, subject to the applicant contemporaneously filing copies of the CIBC Act notice with both of the Antitrust Agencies.[93]

§ 7:3 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 Section 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.[94]

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 all or a portion 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. The practical problems involved in complying with federal and state securities laws have led foreign acquirers generally to use cash as the sole consideration in an acquisition, in contrast to acquisitions by domestic bank and thrift

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ments applicable to acquisitions by financial holding companies of companies that are not insured depository institutions, *see* §§ 11:1 et seq.

[93] 16 C.F.R. § 802.8(b).

[Section 7:3]

[94] A more detailed financial, management, regulatory, and market analysis should be undertaken, however, once a likely target has been identified. In addition, the foreign acquirer should examine the tax consequences to the target and its shareholders 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 material contracts of the target to determine whether they contain any restrictions relating to mergers, changes in control or transfers that would have negative consequences, including restrictions that could make one or more methods impossible or impractical.

holding companies in which stock has been the preferred form of consideration.[95] The exceptions tend to be those foreign banks that, as a result of pre-acquisition offerings of securities in the United States made in the 1990s, are *already* subject to the Securities Exchange Act of 1934 (the Exchange Act).

If the foreign acquirer contemplates that borrowings will provide all or a portion of the cash used to make the acquisition (whether by way of a cash tender offer or otherwise), the Federal Reserve Board's "margin regulations" may apply.[96] While margin regulations are an extremely technical and complex subject, their basic purpose is to limit the use of certain borrowed funds in the acquisition of publicly traded securities.[97]

[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,[98] by a purchase of target stock from a target's holding company, by purchases of target stock from current investors, or, in the case of a publicly held target, by a tender offer. As mentioned above, the consideration offered by a foreign acquirer in any such acquisition will

[95]Consequences of registration of a class of securities under the Exchange Act (assuming "foreign private issuer" status) include, among other things: application of annual and current reporting requirements on Form 20-F (or, for Canadian issuers, Form 40-F) and Form 6-K, respectively; application of certain provisions of the Sarbanes-Oxley Act; and application of certain provisions of the Foreign Corrupt Practices Act of 1977 (the FCPA) not only to the U.S. operations but also to the non-U.S. operations of a foreign bank. *See* FCPA, Pub. L. No. 95-213, 91 Stat. 1495 (1977), 15 U.S.C.A. §§ 78m and 78dd-1 et seq.

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

[97]Foreign acquirers also must examine carefully the provisions of the Investment Company Act of 1940 (the 1940 Act) 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.A. §§ 80a-1 to 80a-64. Although 1940 Act Rule 3a-6, as relevant here, exempts most foreign banks 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 1940 Act, as well as other substantive provisions and detailed regulations adopted under that law. 17 C.F.R. § 270.3a-6.

[98]References in this Chapter to sales of authorized but previously unissued stock of a target also generally include shares of "treasury stock," which is stock held by the target that it previously issued and thereafter repurchased.

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% 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 the target. 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.[99]

Most purchases of newly issued stock of a target (whether it is

[99] A company whose stock is listed on the New York Stock Exchange (NYSE) 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% or more of the total shares outstanding or constitute a "change of control" of the issuer (which can be implicated in certain circumstances, such as where an investor's stake in the issuer increases above 25–30%, and certain veto or other governance rights are granted). New York Stock Exchange Listed Company Manual § 312.03(c); *see also* NYSE Amex LLC Company Guide § 713 (20% or "change of control" of the issuer) and Rule 5635 of the NASDAQ Stock Market LLC (NASDAQ) (20% or "change of control" of the issuer). In addition, under NYSE 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.

Rule 312.05 of the NYSE and Rule 5635(f) of NASDAQ each provide a "financial viability" exception to the shareholder approval requirements. This exception has been used to complete a transaction without a shareholder vote in situations where the target is significantly distressed. Under the financial viability exception, a shareholder vote is not required when (1) the delay in securing shareholder approval would seriously jeopardize the financial viability of the enterprise (*i.e.*, (A) the issuer does not have the cash to sustain it through the time needed to secure shareholder approval, or (B) the issuer cannot secure financing on terms not requiring shareholder approval and the potential investor is unwilling to be subject to any material contingency or timeframe needed for shareholder approval), and (2) reliance by the issuer on the financial viability exception is expressly approved by the audit committee or a comparable body of the board of directors comprised solely of independent, disinterested directors.

One common approach to completing a transaction without the need for shareholder approval (either in connection with the shareholder approval requirements or an amendment to the target's charter to increase the amount of authorized common stock) is for the target to issue to the acquirer newly issued shares of nonvoting preferred stock of the target that largely mirror its common a depository institution or a bank or thrift holding company) are 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 completion of the transaction. The matters that such an agreement may address include rights to board representation, voting agreements, rights to participate in decisions regarding specified material matters, registration rights (in other words, rights to require the target to register under the Securities Act of 1933 (the Securities Act) the holder's shares for sale), "standstill" provisions (in other words, provisions limiting the ability of the acquirer to do things such as increase its interest in the target or attempt to change the board of the target), 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 all of a target depository institution's stock directly from its parent holding company. This structure may be used if the holding company wants to sell all or substantially all its assets and then distribute the cash received to its shareholders, if a multiple bank or thrift holding company desires to dispose of one or more of its subsidiary banks or thrifts, or if 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

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stock and automatically convert into common stock upon receipt of the required shareholder approval. Under this structure, the acquirer is often entitled to a cumulative dividend prior to conversion as an incentive for the target's shareholders to approve the issuance on conversion.

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 existing shareholders the opportunity to purchase newly issued shares that are being offered. 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 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.

acquirer represents substantially all of the assets of the parent holding company, applicable state corporate law generally requires approval of the transaction by the shareholders of the holding company.[100]

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 depository institution or its parent holding company after completion of the acquisition except that, in some cases, the acquirer and the parent holding company may enter into a transition services agreement or other arrangement in connection with the transaction. The foreign acquirer and the parent holding company will, however, enter into an agreement setting forth the terms and conditions of the purchase of the target's stock. 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 is often more 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. In such cases, it is common for acquirers to seek to escrow a portion of the purchase price for a limited period of time as recourse for a post-closing indemnification commitment.

[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 five 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 Federal Reserve Board under the BHC Act.[101] In contrast, a foreign bank with no U.S. commercial banking presence could, in many cases, acquire up to 9.9% 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,

[100] *See, e.g.*, Del. Code Ann. tit. 8, § 271 and N.Y. Bus. Corp. Law § 909.

[101] 12 U.S.C.A. § 1842(c)(3); 12 C.F.R. §§ 225.2(c)(2), 225.11(f).

or the Change in Bank Control Act (CIBC Act).[102] 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.[103] 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.[104] 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 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.[105]

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 five percent of the voting securities of the target[106] and a separate form within 10 days after the acquisi-

[102]*See* 12 C.F.R. §§ 225.41 (Board), 238.2(e) (Board/formerly 12 C.F.R. § 583.7 (OTS)); § 6:3[6].

[103]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.

[104]The term *tender offer* is not defined by the Exchange Act or the rules promulgated thereunder. The Securities and Exchange Commission (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* Tender Offers, 41 Fed. Reg. 33,004 (Aug. 6, 1976).

[105]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.A. § 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.

[106]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 Federal Reserve 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% of the voting stock of the target and its primary purpose is disclosure. No SEC

tion of more than 10% of such class of equity securities.[107] 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 the regulator.[108] 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 "shareholder rights plan," also referred to as a

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approval or disapproval is involved. These reports are usually promptly published in the financial press. The report must disclose certain specified information, including 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 (if any), the sources of funds used for the purchase of target stock (including the identity of any 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.A. § 78m(d)(1). The Schedule 13D must be amended promptly 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% of the voting securities and without an intent to effect a change of control may instead 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* § 7:4[3].

[107]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% ownership 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% ownership threshold should consult with counsel on these Section 16 issues.

[108]*See, e.g.*, 12 C.F.R. § 335.331 (FDIC); *see also* FDIC forms related to statements of beneficial ownership, *available at* http://www.fdic.gov/regulations/laws/FORMS/notices.html. Section 12(i) of the Exchange Act, 15 U.S.C.A. § 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) (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. § 197.18 (OCC—federal thrifts); 12 C.F.R. § 390.427 (FDIC—insured state-chartered thrifts).

"poison pill," in place. A poison pill is designed to prevent an unfriendly acquisition of a target by making a purchase of shares in the target above a certain threshold prohibitively expensive.[109] Generally, such a determination can be made quickly by reviewing the target's publicly available SEC filings. If an 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 that the other shareholders of the target will have either the right to purchase additional shares of the target at a significant discount (thus significantly diluting the ownership interest of the foreign acquirer) or the right to purchase shares of the foreign acquirer at a significant discount. For typical poison pills, the threshold percentage is generally set at 10%, 15%, or 20%, which can also often give rise to issues under anti-takeover provisions 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 may be impracticable (if not impossible) for a foreign acquirer to acquire its desired interest through open-market purchases. 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 an "exchange offer" if the consideration being offered includes a security of the foreign acquirer.[110] 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%.[111] As discussed in Section 7:3[6], a foreign acquirer will be able to

[109] A variation of the poison pill is a tax asset/net operating losses (NOL) preservation plan, or an "NOL pill," which is intended to reduce the risk that certain limitations on the target's use of its tax assets will be triggered. Because of the relevant provisions of federal tax law, the threshold for triggering an NOL pill is typically approximately 4.9% for shareholders owning less than 5% and any increase in ownership for shareholders owning 5% or more.

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

[111] In the past, some foreign acquirers have found it advantageous to acquire (or retain) a controlling but less than 100% interest in a target because of (1) a

purchase only 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. The considerations discussed in Section 7:3[1][c] with respect to poison pills and disclosure pursuant to Section 13(d) of the Exchange Act are also applicable to tender offers.

A tender offer is subject to U.S. securities laws regulating tender offers, which require the preparation and public disclosure of information concerning the foreign acquirer, its operations, management, business, and financial condition.[112]

A tender offer may also be used as a first step in a two-step transaction to ultimately acquire 100% of the target, and tender offers have often been favored in acquisitions of U.S. publicly held companies because, absent a lengthy regulatory clearance process, they are the quickest route to control. In the context of an acquisition of a target U.S. depository institution or holding company, however, the need to obtain bank or thrift regulatory approvals can significantly delay the closing of a tender offer. As a result, tender offers are not as commonly used to acquire these targets because a one-step merger structure often provides the opportunity to obtain shareholder consent (and therefore eliminate the risk of a topping bid by a third party) in a more timely fashion.

Inevitably, a small percentage of the shares will be held by shareholders who fail to respond to the tender offer in a timely

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desire to limit the amount (and hence the risk) of an investment to a certain level; (2) the ability to complete an investment with greater cooperation from a target's management (who may feel less threatened by an acquirer willing to hold less than 100% 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% or more of the target's voting stock) for purposes of determining the acquirer's status as a "qualifying foreign banking organization" under the Federal Reserve Board's Regulation K. *See* § 7:8. Nevertheless, a foreign acquirer that acquires less than a 100% 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.

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

manner. Therefore, if the acquirer wishes to own 100% of the target, it will be 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% of the shares of the target, a "short form" merger can be effected without shareholder approval and the resulting delay in completing 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), although if the acquirer owns the requisite percentage of the target's shares such shareholder consent is, in essence, a formality.

In addition to the federal regulatory scheme, many states have laws regulating tender offers.[113] For example, "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" or "interested shareholder" statutes (that prohibit such combinations, and certain other transactions, for a specified period of time unless certain board approvals have been obtained in advance of the initial acquisition of a substantial stake in the shares), "super-majority/fair price statutes" (that provide that such combinations may be completed 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

[113] 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, Blue Sky L. Rep. (CCH) P 71747, Fed. Sec. L. Rep. (CCH) P 98728 (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 America, 481 U.S. 69, 107 S. Ct. 1637, 95 L. Ed. 2d 67, Fed. Sec. L. Rep. (CCH) P 93213 (1987).

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 statutory merger or consolidation rather than as the second step in a two-step transaction. A statutory merger or consolidation is a transaction in which 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.[114] 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.[115]

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[114]A statutory merger is a corporate transaction binding on all shareholders—including those who vote against it. Approval by the shareholders of the target holding a majority or two-thirds (depending on the target's jurisdiction of incorporation) of the outstanding shares usually is required to effect the merger. *See, e.g.*, 12 U.S.C.A. § 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, and (2) target shareholders are not required to accept as consideration anything other than (A) shares or depositary receipts representing shares of the surviving corporation or of another publicly traded corporation; (B) cash in lieu of fractional shares or fractional depository receipts; or (C) any combination of shares, depository receipts, and cash in lieu of fractional shares or fractional depository receipts); *see also* Va. Code Ann. § 6.2-822 (excluding bank mergers from application of Virginia's appraisal statute, Va. Code Ann. § 13.1-730); Adams v. U.S. Distributing Corp., 184 Va. 134, 34 S.E.2d 244, 162 A.L.R. 1227 (1945).

[115]For purposes of this Chapter, the term *merger* includes consolidations. In addition to merger transactions, a number of states now provide for a "binding share exchange," "share exchange," or "plan of exchange," pursuant to which an

The acquisition of a bank or thrift holding company by a foreign acquirer via merger is typically accomplished in a "triangular merger" by merging the target holding company 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 becomes a wholly owned subsidiary of the foreign acquirer, and the shareholders of the target holding company 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 company can, however, have significant consequences. For example, if the new subsidiary is the surviving entity, licenses of the target may not automatically transfer to that 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 transaction to the target as well as its shareholders may vary depending on the nature of the consideration paid in the merger as well as 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. However, 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.[116]

In addition to tax consequences,[117] the choice of consideration to be used in a merger should be made in light of several factors.

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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.

[116]For example, the OCC 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 and thrifts). *See, e.g.*, 12 C.F.R. §§ 5.33(e)(4) (OCC—national banks), 152.2 (OCC—federal thrifts), 303.63(c) (FDIC—state-chartered bank and state-chartered thrift deposit insurance requirement).

[117]The federal and state tax consequences of a merger or other acquisition to the target and its shareholders, including the availability of the net operating

First, an obvious difference between cash and non-cash mergers is that if target shareholders are to receive securities of the acquirer in exchange for their stock, those shareholders will retain (although generally on a greatly reduced basis) a continuing indirect interest in the target company. Second, 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 which they are to receive 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 and, if not already the case, subject the acquirer to the consequences of registration of a class of securities under the Exchange Act.[118]

If the foreign acquirer uses a merger to effect an acquisition,[119] applicable corporate laws almost certainly will require a vote of the target's shareholders.[120] 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.[121] If the target is a publicly held U.S. bank or thrift with no holding company, the proxy statement for any necessary share-

losses or other tax assets of the target following the acquisition, will depend, among other things, on the particular tax characteristics of the target, as well as on the precise structure of the transaction and the mix of consideration. The relevant rules are complex and beyond the scope of this Chapter.

[118] *See* § 7:2.

[119] 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.

[120] 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 that promptly follow tender offers provided that certain conditions are met. Exchange Act Rule 13e-3; 17 C.F.R. § 240.13e-3.

An acquisition by a foreign acquirer that already "controls" the target prior to the commencement of the transaction will also be subject to heightened scrutiny from a corporate and fiduciary perspective. *See* Kahn v. Lynch Communication Systems, Inc., 638 A.2d 1110 (Del. 1994). In such cases, the parties customarily follow additional procedures (such as the establishment of a special committee of the board of directors of the target to negotiate and approve the transaction or conditioning the transaction on "a majority of the minority" shareholder approval) in order to reduce the risk of a successful challenge to the transaction. A full description of these issues is beyond the scope of this Chapter.

[121] 15 U.S.C.A. § 78n; 17 C.F.R. §§ 240.14a-l to a-103.

holder vote would have to comply with the proxy rules of the appropriate federal bank agency.[122] 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.[123]

[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 by the foreign acquirer 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 assumption of all or nearly all of the liabilities of the depository institution and is followed by the liquidation of the target and a distri-

[122] *See, e.g.*, 12 C.F.R. §§ 5.33(e)(8) (OCC—national banks); 335.221(a), 335.401 (FDIC—state nonmember banks). Section 12(i) of the Exchange Act, 15 U.S.C.A. § 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), 208.36(a), (c) (Board—state member banks), 335.201 (FDIC—state nonmember banks), 197.18 (OCC—federal thrifts), 390.427 (FDIC-insured state-chartered thrifts).

[123] 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 Industries, Inc. v. Northway, Inc., 426 U.S. 438, 449, 96 S. Ct. 2126, 2132, 48 L. Ed. 2d 757, 766, Fed. Sec. L. Rep. (CCH) P 95615 (1976). It is important, of course, to ensure consistency of disclosures between any proxy statement and any related regulatory application.

bution to its shareholders of the proceeds from the sale.[124] Even though an asset acquisition thus may have the same economic effect as a merger,[125] it may be substantially more cumbersome in practice because of a variety of factors, including the need to examine individual assets to ensure that the target can transfer good title, the need to prepare separate instruments of transfer and the need to obtain necessary consents for the assignment of contracts and other rights and liabilities.

[4] Deal Protection

Deal protection measures are designed to increase the likelihood of 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 (in whole or in part) for the time, expense and opportunity cost involved in negotiating the transaction. The most common types of deal protection are no-shop provisions, break-up fees, and voting or voting and tender agreements. Another type of deal protection that sometimes appears, primarily in stock deals, is a provision that requires the target to hold a vote on the transaction even if the target's board withdraws or changes its recommendation of the transaction (a "force-the-vote" provision). 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 those directors, they are subject to close scrutiny by the courts.[126] In general, U.S. courts will strike down devices that either preclude competi-

[124] It is technically possible, although very unusual (except in a failed depository institution transaction), for an acquirer to acquire all of the assets of a target depository institution without assuming its liabilities. For a discussion of acquisitions of failed depository institutions, *see* § 7:3[7].

[125] The difference between the tax treatment of a merger and that of an asset acquisition may have a significant impact on the economics of a transaction, but that topic is beyond the scope of this Chapter.

[126] *See* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, Fed. Sec. L. Rep. (CCH) P 92046, Fed. Sec. L. Rep. (CCH) P 92077 (Del. 1985); Paramount Communications Inc. v. QVC Network Inc., 637 A.2d 34, Fed. Sec. L. Rep. (CCH) P 98063 (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, Fed. Sec. L. Rep. (CCH) P 93918 (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, Fed. Sec. L. Rep. (CCH) P 92418 (2d Cir. 1986); Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261, Fed. Sec. L. Rep. (CCH) P 94401 (Del. 1989); *and* MacAndrews & Forbes Holdings, Inc. v. Revlon, Inc., 501 A.2d 1239, Fed. Sec. L. Rep. (CCH) P 92333 (Del. Ch. 1985), judgment aff'd, 505 A.2d 454, Fed.

tion and prevent shareholders from receiving a better deal or coerce shareholders into accepting an agreed deal.[127]

[a] No-Shop Provisions

No-shop or nonsolicitation provisions prohibit the target (or both parties in a merger of equals) from encouraging or soliciting competing bids during the period between signing of the agreement and closing. The no-shop provision will typically be qualified by what is generally referred to as a fiduciary-out provision.[128]

Fiduciary-out provisions permit the target's board to engage in discussions with other potential bidders who have made unsolicited offers that the board reasonably believes may lead to a "superior proposal" and to provide those bidders with confidential information that will assist them in making a bid, subject to their 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 include a "force-the-vote" provision, terminate the existing agreement and enter into a new agreement if the target's board determines in good faith, after consulting with legal counsel, that it must take that action to comply with its fiduciary duties under applicable law. As discussed in greater detail in Section 7:3[4][b], 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 so large as to preclude the possibility of a competing bid (generally from 2% to 4% of the deal's equity value is considered permissible).

Under Delaware law, where many significant U.S. bank and thrift holding companies are incorporated, directors have fidu-

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Sec. L. Rep. (CCH) P 92357 (Del. 1985), opinion issued, 506 A.2d 173, Fed. Sec. L. Rep. (CCH) P 92525, 66 A.L.R. 4th 157 (Del. 1986) (options held to be granted in breach of officer and director fiduciary duties).

[127] Among the criteria that often may be relevant are (1) whether protective measures are granted in an active bidding situation; (2) the extent to which the protective measures preclude 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 the beneficiary of the protective measures compared to other offers (or, if none, compared to the range of fairness and the likelihood of higher offers); (7) time constraints and other pressures on the target; and (8) the diligence and analysis of the target's board in granting the protective measures.

[128] Under some circumstances (rare in acquisitions of depository institutions but more common in management buyouts), the agreement will expressly permit the target to solicit other buyers, or shop itself, for a limited amount of time prior to the nonsolicitation period (a go-shop provision).

ciary 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 and 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.[129] 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 an acquirer with a controlling shareholder), directors have a duty to seek 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 could be construed as not containing 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.[130] This area of Delaware law continues to evolve.

Some have questioned whether the Delaware law distinction between sale-of-control transactions 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 seek the highest attainable price for shareholders because such a transaction is the shareholders' last opportunity to obtain a control premium for their shares. The duties of target directors (and the scope of flexibility accorded them) in a transaction that does not constitute a sale of control are less clear, although, in every case, the court will review the

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[129] *See* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, Fed. Sec. L. Rep. (CCH) P 92525, 66 A.L.R. 4th 157 (Del. 1986); Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, Fed. Sec. L. Rep. (CCH) P 92046, Fed. Sec. L. Rep. (CCH) P 92077 (Del. 1985).

[130] *See* Phelps Dodge Corp. v. Cyprus Amax Minerals Co., 1999 WL 1054255 (Del. Ch. 1999).

reasonableness of the board's judgments and actions.[131]

[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 that 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 target's 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 target 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. In some instances, a break-up fee is payable simply as a result of a failure to obtain the required vote of the target's shareholders, but in such a case, the fee is often smaller than the break-up fees payable as a result of other trigger events and conditions.[132]

Recent break-up fees have typically ranged between 1% and 5% of the equity value of the transaction with approximately 90% of the break-up fees being 4% or less.[133] 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.[134] Courts have recognized that break-up fees can serve legitimate purposes by

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[131]The Delaware Court of Chancery recently held the heightened standard of review under *Revlon* applied to a merger where shareholders were to receive 50% cash and 50% stock for their shares. In re Smurfit-Stone Container Corp. Shareholder Litigation, 37 Del. J. Corp. L. 261, 2011 WL 2028076 (Del. Ch. 2011), as revised, (May 24, 2011).

[132]In some instances the acquirer will agree to pay a "reverse break-up fee" if, for example, the transaction is not completed because the acquirer is unable to obtain required regulatory approvals.

[133]Practical Law Company, *2011 Year-end Public Wrap-up,* February 1, 2012.

[134]The Delaware Chancery Court has stated that a break-up fee of 3.5% 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% was viewed as probably going beyond the range of reasonableness. *See* Phelps Dodge Corp. v. Cyprus Amax Minerals Co., 1999 WL 1054255 (Del. Ch. 1999). In a

inducing an initial bidder to enter into a transaction and by permitting the target to pursue higher bids after signing the initial agreement.[135] 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.

[c] Voting Agreements/Tender Agreements

Voting agreements or voting and tender agreements (agreements with specific shareholders to support the transaction) are common in transactions where the target has concentrated shareholding. One of the primary negotiated issues associated with these agreements is whether the obligations of the shareholder not to support an alternative transaction survive the termination of the original transaction agreement or whether upon such termination, the shareholder is free to support an alternative transaction (the more common result).

[5] 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 relationship 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.

If the target is a publicly held company, 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 completion of the transaction. In addition, 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

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recent case, the Delaware Chancery Court stated that a break-up fee of 4.8% was permissible under unique circumstances, including the impending bankruptcy of the target. In re Complete Genomics, Inc. Shareholder Litigation, C.A. No. 7888-VCL (Del. Ch. Nov. 9, 2012) (transcript ruling).

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

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.

[6] Noncontrolling Minority Investments

The acquisition structures discussed in Sections 7:3[1] to 7:3[3] will generally result in the acquirer controlling the U.S. bank, thrift, or the bank or thrift holding company and therefore will require prior regulatory approval. Some foreign acquirers, however, may wish to invest in a U.S. depository institution or its holding company on a basis that does not result in acquiring control over the entity or that does not require prior approval by any federal banking regulators.[136]

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% or more of any class of voting securities of the target company;

(2) has the power to elect a majority of the target's board of directors or similar body; *or*

(3) exercises a "controlling influence" over the management or policies of the target company.[137]

The banking regulators treat the first two alternatives as effectively conclusive with almost no exceptions. The third alternative is less determinate.

The "controlling influence" test was added to the BHC Act in

[136]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 requirement under Section 616(d) of the Dodd-Frank Act to serve as a source of strength to subsidiary insured depository institutions, *see* 12 U.S.C.A. § 1831o-1, and the provision in the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (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* § 7:7[1].

[137]*See* 12 U.S.C.A. §§ 1841(a)(2) (BHC Act), 1467a(a)(2) (HOLA), 1817(j)(8)(B) (CIBC Act); 12 C.F.R. §§ 225.2(e) (Board—BHC Act and CIBC Act), 238.2(e) (Board—HOLA and CIBC Act), 5.50(d)(3) (OCC—CIBC Act, national banks), 303.81(c) (FDIC—CIBC Act, state nonmember banks), 174.4(a) (OCC—CIBC Act, federal thrifts), 391.43(a) (FDIC—CIBC Act, insured state-chartered thrifts).

1970.[138] The legislative history of this amendment indicates that this test was meant to capture any company that, although falling short of triggering either of the first two tests, nevertheless had "actual control" of a banking organization.[139] The Federal Reserve Board has interpreted the test as requiring a determination of whether an investor would have the power or ability to exercise a controlling influence.[140] This determination is based on both the facts and circumstances of a particular investment in a banking organization and the relationship between the investor and the banking organization.[141]

A noncontrolling investment in a U.S. bank, thrift, or bank or thrift holding company may be structured in a way that either does or does not require the prior approval of the federal banking regulators.[142]

[a] Noncontrolling Investments Not Requiring Regulatory Approval

In order to avoid the need for prior approval, an investment in a banking organization generally must be structured as follows:

- if the investor is a bank holding company, thrift holding

[138] Pub. L. No. 91-607, § 101(a) (1970).

[139] The Congressman who introduced the amendment, Representative Ashley, explained that the amendment was intended to "provid[e] that actual control of any bank, even at less than 25 percent, is sufficient to require the controlling company to register as a bank holding company." 115 Cong. Rec. H10561 (daily ed. Nov. 5, 1969) (statement of Rep. Ashley). *See* H.R. Rep. No. 91-1747, 12 (1970).

[140] *See* 12 C.F.R. §§ 225.2(e)(iii) (controlling influence over bank or bank holding company), 238.2(e)(4) (controlling influence over a thrift or a thrift holding company). *See also* Patagonia Corporation, 63 Fed. Res. Bull. 288, 292 (1977) ("The Board believes that the test is, therefore, whether a company may be considered to have been so influential in the affairs of a particular company as to be considered to have been engaged in that business"); Citizens and Southern Georgia Corporation, Fed. Res. Interp. Ltr. 1981 WL 156863 (Sept. 21, 1981).

[141] Federal Reserve Board, Policy Statement on Equity Investments in Banks and Bank Holding Companies (2008) (the 2008 Policy Statement). The 2008 Policy Statement was issued as if it would be codified at 12 C.F.R. § 225.144, but it has not been published in the Federal Register or the Code of Federal Regulations. In contrast, the Federal Reserve Board's 1982 Policy Statement on Nonvoting Equity Investments by Bank Holding Companies was published in the Federal Register Code of Federal Regulations and is codified at 12 C.F.R. § 225.143 (the 1982 Policy Statement).

[142] 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. These sorts of state law issues are beyond the scope of this Chapter.

company, or a foreign bank (or the parent of a foreign bank) with a U.S. commercial banking presence, the investment must be limited to less than 5% of any class of voting securities of the target;[143] or

- for any other type of investor, the investment must be limited to less than 10% of any class of voting securities of the target.[144]

In either case, the investor may be able to acquire an additional amount of nonvoting securities. The exact amount of nonvoting securities that may be acquired without prior regulatory approval depends on the facts of the investment but, as discussed in more detail in Section 7:3[6][b], could potentially represent up to 24.9% or even 33.3% of the total equity of the target (inclusive of the

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[143] *See* 12 U.S.C.A. § 1842(a)(3), 12 C.F.R. § 225.11(c)(1) (approval required for investment by a bank holding company of more than 5% of any class of voting securities of a bank or bank holding company); 12 U.S.C.A. §§ 1843(c)(6), (i), (j)(1)(A) and (k)(6)(B), 12 C.F.R. § 225.24 (approval required for investment by a bank holding company of more than 5% of any class of voting securities of a thrift or thrift holding company); 12 U.S.C.A. § 1467a(e)(1)(A)(iii), 12 C.F.R. § 238.11(c)(1) (approval required for investment by a thrift holding company of more than 5% of any class of voting securities of a thrift or thrift holding company). As a technical matter, there is no general requirement for a thrift or a thrift holding company to obtain prior regulatory approval for an investment of less than 10% of any class of voting securities of a bank or bank holding company. However, in practice, such an investment should be discussed in advance with the Federal Reserve Board or other relevant banking regulator, which may require the thrift or thrift holding company to execute standard "passivity commitments" (discussed below) or to provide information to confirm that no presumption of control should apply or to rebut any such presumption. In general, an investment in less than 5% of any class of voting securities of a bank, thrift, or bank or thrift holding company is presumed to be noncontrolling for purposes of the BHC Act and HOLA. 12 U.S.C.A. § 1841(a)(3), (4), 12 C.F.R. §§ 225.31(e)(1) to (2) (investment by a bank holding company in a bank or bank holding company); 12 U.S.C.A. § 1843(c)(6), 12 C.F.R. § 225.22(d)(5) (investment by a bank holding company in a thrift or a thrift holding company); 12 C.F.R. § 238.21(e)(1) to (2) (investment by a thrift holding company in a thrift or a thrift holding company).

[144] *See* 12 C.F.R. § 225.41(c)(2) (Board—CIBC Act regulations for state member banks and bank holding companies; rebuttable presumption of control, requiring prior notice, if acquisition is for 10% or more of any class of voting securities, among other conditions); 12 C.F.R. §§ 238.31(c)(2) (Board—CIBC Act regulations for thrift holding companies; same), 5.50(f)(2)(iii) (OCC—CIBC Act regulations for national banks; same), 174.4(b) (OCC—CIBC Act regulations for federal thrifts), 303.82(b)(2) (FDIC—CIBC Act regulations for state nonmember banks; same), 391.43(b) (FDIC—CIBC Act regulations for insured state-chartered thrifts).

amount of voting securities acquired).[145] However, the greater the amount of nonvoting securities added to the amount of voting securities at or near the 5% or 10% thresholds discussed in Section 7:3[6][b], the likelier it is that the relevant banking regulator would review the terms of the proposed investment to ensure that it agrees that no filing of an application or notice for prior approval is required.

Even if no prior regulatory approval is necessary, in the case of an investor that acquires between 5% and 9.9% of a banking organization's voting shares, the Federal Reserve Board's practice generally is to require the investor (including its subsidiaries and affiliates) to enter into "passivity commitments." These are standard-form undertakings that the investor makes to the Federal Reserve Board and are designed to ensure that the investor will not attempt to exercise a controlling influence over the management or policies of the banking organization.[146]

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[145]The Federal Reserve Board staff generally treats total equity as including voting and nonvoting common shares, voting and nonvoting preferred stock, any securities convertible into or exchangeable for shares of common stock or other voting securities at the option of the holder or mandatorily after the passage of time, and any warrants or options (regardless of the exercise price) for shares of common stock or other voting securities. Nonvoting securities that are nonvoting while held by the investor, but convert or are convertible into voting securities upon their sale or transfer to an unaffiliated third party, will nonetheless be treated as if they were voting in the hands of the investor unless by their terms they may be transferred only (i) to an affiliate of the investor or to the target; (ii) in a widespread public distribution (which can include a Securities Act Rule 144A offering); (iii) in transfers in which no transferee (or group of associated transferees) receives 2% or more of any class of voting securities of the target; or (iv) to a transferee that would control more than 50% of the voting securities of the target without counting the securities transferred by the investor. *See* 2008 Policy Statement, § 225.144(c)(2) at 10. Under certain circumstances, some forms of deeply subordinated debt may also be included in total equity.

In calculating an investor's ownership percentage of any class of voting securities or the total equity of a bank, thrift, or bank or thrift holding company, the Federal Reserve Board and the other banking regulators generally include in the numerator: the holder's shares or other class of voting securities, plus any warrants, options, and convertible or exchangeable securities owned by the holder; and in the denominator: all outstanding shares or other class of voting securities, plus any warrants, options, and convertible or exchangeable securities owned by the holder (but not those owned by other holders).

[146]The Federal Reserve Board's standard set of passivity commitments comes in two forms: one providing for board representation and one without board representation. The passivity commitments typically include undertakings not to: (1) exercise or attempt to exercise a controlling influence over the management or policies of the target or any of its subsidiaries; (2) if the investor has board representation, to have or seek to have more than one representative serve on the board of directors of the target or any of its subsidiaries; (3) if

If other investors are acquiring comparable percentages of the

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the investor has a representative on the board of directors of the target or any of its subsidiaries, permit that representative to serve (i) as the chairman of the board of the target or any of its subsidiaries, (ii) as the chairman of any committee of the board of the target or any of its subsidiaries, (iii) as a member of any committee of the board of the target or any of its subsidiaries if the representative occupies more than 25% of the seats on the committee, (iv) as a member of an audit committee of the board of the target or any of its subsidiaries, (v) as a member of any committee of the board of the target or any of its subsidiaries that approves or reviews, or establishes policies for the approval or review of, loans or other extensions of credit, (vi) as a member of any committee of the board of the target or any of its subsidiaries if at any time such committee would have decisionmaking authority for policies or actions on managerial matters (other than decisions related to retaining third-party consultants or advisers in connection with carrying out committee duties), or (vii) as a member of any committee of the target or any of its subsidiaries if such representative has the authority or practical ability unilaterally to make, or block the making of, policy or other decisions that bind the board, any committee of the board, or management of the target; (4) have or seek to have any employee or representative serve as an officer, agent, or employee of the target or any of its subsidiaries; (5) take any action that would cause the target or any of its subsidiaries to become a subsidiary of investor; (6) own, control, or hold shares that will cause the combined interests of the investor and its subsidiaries, and their respective officers, directors, and affiliates, to equal or exceed 25% of any class of target's outstanding voting securities; (7) own or control equity interests that would result in the combined voting and nonvoting equity interests of the investor and its subsidiaries, and their respective officers and directors, to equal or exceed 25% of the total equity of the target or any of its subsidiaries, or 33.3% of the total equity if the investor and its subsidiaries, and their respective officers and directors, own or hold less than 15% of any class of voting securities; (8) 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 the target or any of its subsidiaries; (9) enter into any agreement with the target or any of its subsidiaries that substantially limits the discretion of the target's management over major policies and decisions, including, but not limited to, policies or decisions about employing and compensating executive officers; engaging in new business lines; raising additional debt or equity capital; merging or consolidating with another firm; or acquiring, selling, leasing, transferring, or disposing of material assets, subsidiaries, or other entities; (10) solicit or participate in soliciting proxies with respect to any matter presented to the shareholders of the target or any of its subsidiaries; (11) dispose or threaten to dispose (explicitly or implicitly) of equity interests of the target or any of its subsidiaries in any manner as a condition or inducement of specific action or non-action by the target or any of its subsidiaries; or (12) enter into any other banking or nonbanking transactions with the target or any of its subsidiaries except for maintaining deposit accounts with a maximum aggregate balance of $500,000 on substantially the same terms as those for unaffiliated persons. Except for the business relationship commitment, these commitments are generally not negotiable. In addition, if the investor is based outside of the United States, each member of the investor commits to (1) providing all information, without regard to whether such information is located within the United States, requested in connection with any investigation, action, or proceeding by the Federal Reserve Board re-target's voting securities in the same transaction or in related transactions, the Federal Reserve Board generally will also require each investor to make "anti-association" certifications to the Federal Reserve Board and respond to a set of information requests about the investor, how the investor came into the transaction, and the extent to which it may have had contacts or shared information with other investors about the transaction.[147] The anti-association certifications and the information requests are designed to ensure that none of the investors is acting in concert with other investors with respect to the transaction and thus does not constitute a single association or group with other investors that would require the aggregation of the relevant investors' equity interests in the target banking organization.[148] If none of the investors' proposed ownership percentages of the

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lating to: (i) enforcement or possible enforcement of the BHC Act, and (ii) the ownership or control of equity interests in the target; and (2) consenting and submitting to the personal jurisdiction of any federal court of competent jurisdiction and of the Federal Reserve Board for purposes of any investigation or possible investigation, action, subpoena, examination, or proceeding relating to the administration or enforcement of the commitments, the BHC Act, or the CIBC Act.

[147] The anti-association certifications are generally standard-form representations and covenants to the effect that: (1) the investor is not an affiliate of any other investors in the proposed transaction; (2) the investor reached its investment decision independently of the other investors; (3) the investor is not managed or advised by an investment manager or investment advisor performing the same services for any of the other investors; (4) the investor has not been and will not be part of a group, consisting of substantially the same investors in substantially the same combination of interests, that engages in any additional banking or nonbanking activities or business ventures in the U.S. without prior consultation with the Federal Reserve Board; (5) the investor has not entered and will not enter into any agreements or understandings with any of the other investors to act in concert for purposes of exercising a controlling influence over the target or any of its subsidiaries, including, but not limited to, any agreements or understandings regarding the voting or transfer of shares of the target; and (6) any director representing the investor will not collude or conspire with any other directors or shareholders of the target with respect to exercising the director's voting rights. These certifications are generally included as part of the investor's passivity commitments.

[148] The following persons are subject to a rebuttable presumption that they are acting in concert: (1) a company and any controlling shareholder, partner, trustee, or management official of the company if both own voting securities of the target; (2) an individual and the individual's immediate family; (3) companies under common control; (4) persons that are parties to any agreement, understanding, or other arrangement, whether or not in writing, regarding the acquisition, voting, or transfer of control of voting securities of the target (except for certain revocable proxies); (5) persons that make joint filings under Sections 13 and 14 of the Exchange Act and the rules thereunder; and (6) a person and any trust for which the person acts as trustee. *See* 12 C.F.R.

target's voting shares exceed the thresholds for filing an application or notice as described in Section 7:3[6][b], the Federal Reserve Board may nevertheless require the target to submit the transaction agreements and related information so that the Federal Reserve Board can review them for purposes of determining whether it concurs that no application or notice for prior approval from any of the investors is necessary.

In many cases involving "stake-out" or other noncontrolling investments that are designed to avoid the need for prior regulatory approval, the 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 may 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 strategic or 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 acquirer wishes to avoid the requirement of prior regulatory approval or other

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§§ 225.41(d) (Board—CIBC Act regulations for banks and bank holding companies), 238.31(d) (Board—CIBC Act regulations for thrift holding companies and thrifts), 5.50(f)(2)(ii) (OCC—CIBC Act regulations for national banks).

The historic OTS regulations that have been adopted by the OCC and the FDIC for federal and insured state-chartered thrifts incorporate similar rebuttable presumptions of concerted action, except that the OTS regulations:

- apply a presumption of concerted action in the case of a company and any controlling shareholder, partner, trustee, or management official of the company not only when both own voting securities of the target but also when the company provides credit to the person to purchase the target's stock, or the company pledges its assets or otherwise is instrumental in obtaining financing for another person to purchase stock of the target;
- do not apply the rebuttable presumption of concerted action in the case of persons that are parties to any agreement, understanding, or other arrangement, whether or not in writing, regarding the acquisition, voting, or transfer of control of voting securities of the target (except for certain revocable proxies) (presumption (4) above); and
- apply a presumption of concerted action where persons either (i) both own stock in the target and both are also management officials, controlling shareholders, partners, or trustees of another company, or (ii) one person provides credit to another person or is instrumental in obtaining financing for another person to purchase stock of the target.

See 12 C.F.R. §§ 174.4(d) (OCC—CIBC Act regulations for federal thrifts), 391.43(d) (FDIC—CIBC Act regulations for insured state-chartered thrifts).

regulatory consequences, care must be taken in structuring the transaction and any such agreements so that the banking regulators do not deem them to give the acquirer "control" over the target.[149]

[b] Noncontrolling Investments Requiring Regulatory Approval

An investment in a U.S. bank, thrift, or bank or thrift holding company may still be considered noncontrolling, but will require the prior approval of the relevant federal banking regulators as a noncontrolling investment, if it is structured as follows:

- if the investor is a bank holding company, thrift holding company, or a foreign bank (or the parent of a foreign bank) with a U.S. commercial banking presence, the investment

[149] An acquirer will be subject to a rebuttable presumption of control over the target if (1) the acquirer owns, controls, or has the power to vote more than 5% of the voting stock, and one or more persons having policy-making functions with the acquirer serve in the same capacity with the target, and no other person owns, controls, or has the power to vote as much as 5% of the voting stock of the target; (2) the acquirer owns or controls more than 5% of the voting stock of the target, and when shares of the target owned by directors, officers, trustees, or partners of the company or shareholders of the acquirer owning more than 25% of the acquirer's voting stock (including, in each case, members of their families) are added to the stock in the target owned by the acquirer, the total exceeds 25% or more of the voting stock of the target; (3) the acquirer, pursuant to an agreement or understanding with the target, exercises significant influence with respect to the general management or overall operations of the target; or (4) the acquirer enters into an agreement under which the rights of shareholders in the target are restricted in any manner (with certain exceptions). In addition, an acquirer that, directly or indirectly, owns securities of the target that are immediately convertible at the holder's option into voting stock is presumed, subject to rebuttal by the acquirer, to control the voting stock. *See* 12 C.F.R. §§ 225.31(d) (Board—rebuttable presumption of control over banks and bank holding companies), 238.21(d) (Board—rebuttable presumption of control over thrift holding companies and thrifts), 5.50(f)(2)(iii) (OCC—rebuttable presumption of control over national banks), 303.82(b)(2) (FDIC—rebuttable presumption of control over state nonmember banks).

A different series of rebuttable presumptions of control applies to investors in federal thrifts and insured state-chartered thrifts that are not themselves banks, bank holding companies, thrift holding companies, or foreign banks (or the parents of foreign banks) with a U.S. commercial banking presence. For a discussion of these presumptions, *see* § 7:3[6][b]. *See also* 12 C.F.R. §§ 174.4(b) (OCC—CIBC Act regulations establishing rebuttable presumptions of control over federal thrifts), 391.43(b) (FDIC—CIBC Act regulations establishing rebuttable presumptions of control over insured state-chartered thrifts).

represents 5% or more, but less than 25%, of any class of voting securities of the target;[150] or

- for any other type of investor, the investment represents 10% or more, but less than 25%, of any class of voting securities of the target.[151]

In either case, as discussed in more detail in this Section, the investor may be able to acquire an additional amount of nonvoting securities provided that its ownership percentage of the target's total equity (inclusive of the voting securities acquired) does not exceed 24.9% or 33.3%, as applicable.[152]

As noted in Section 7:3[6][a], the determination of whether a banking organization or other investor acquiring between 5% and 24.9% of any class of voting securities of a U.S. banking organization is making a noncontrolling investment or is able to exercise a controlling influence and thereby control the banking organization is based on the facts and circumstances of the investment and the investor's relationship with the banking organization.[153]

The most significant factors considered by the Federal Reserve

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[150] *See* 12 U.S.C.A. § 1842(a)(3), 12 C.F.R. § 225.11(c)(1) (approval required for investment by a bank holding company of 5% or more of any class of voting securities of bank or bank holding company); 12 U.S.C.A. § 1843(i), (j)(1)(A) and (k)(6)(B), 12 C.F.R. § 225.24 (approval required for investment by a bank holding company of 5% or more of any class of voting securities of a thrift or thrift holding company); 12 U.S.C.A. § 1467a(e)(1)(A)(iii), 12 C.F.R. § 238.11(c)(1) (approval required for investment by a thrift holding company of 5% or more of any class of voting securities of a thrift or thrift holding company). *See also* § 7:3[6][a] for a discussion of an investment by a thrift or thrift holding company in 5% or more, but less than 10%, of any class of voting securities of a bank or bank holding company.

[151] *See* 12 C.F.R. §§ 225.41(c)(2) (Board—CIBC Act regulations for banks and bank holding companies; rebuttable presumption of control, requiring prior notice, if acquisition is for 10% or more of any class of voting securities, among other conditions), 238.31(c)(2) (Board—CIBC Act regulations for thrift holding companies; same), 5.50(f)(2)(iii) (OCC—CIBC Act regulations for national banks; same), 174.4(b) (OCC—CIBC Act regulations for federal thrifts), 303.82(b)(2) (FDIC—CIBC Act regulations for state nonmember banks; same), 391.43(b) (FDIC—CIBC Act regulations for insured state-chartered thrifts).

[152] *See* 2008 Policy Statement, § 225.144(c)(2) at 8–10.

[153] *See* 2008 Policy Statement, § 225.144(a) at 4. The Federal Reserve Board has approved a number of noncontrolling investments by U.S. and foreign bank holding companies in U.S. banking organizations in recent years. *See, e.g.*, Mitsubishi UFJ Financial Group, Inc., 97(4) Fed. Res. Bull. 10, 13 (2011) and 95 Fed. Res. Bull. B34 (2009) (up to 24.9% of Morgan Stanley); Goldman Sachs Group, Inc., 97(2) Fed. Res. Bull. 22 (2011) (retention of 9.8% of Avenue Financial Holdings); China Investment Corporation, 96 Fed. Res. Bull. B31 (2010) (up to 10% of Morgan Stanley); City Holding Company, 96 Fed. Res. Bull. B21 (2010) (up to 7.5% of First United); Morgan Stanley, 95 Fed. Res.

Board in determining whether minority investors are able to exercise a controlling influence over a U.S. banking organization are summarized in its 2008 Policy Statement:

- *Director representation*. A noncontrolling investor may have one director representative on the banking organization's board of directors (and on the board of directors of any subsidiary). The director may also serve on board committees provided that he or she is not the chairman of the board or of any committee, each committee consists of at least four members, and no committee has the authority or ability to make or block policy or other decisions that bind the full board or management of the banking organization.[154] The Federal Reserve Board sometimes restricts the number of board committees on which an investor may be represented, particularly in acquisitions involving multiple investors in which more than one investor seeks board and committee representation.

  A noncontrolling investor may have two director representatives on the banking organization's board of directors if its aggregate director representation is proportionate to its total voting or equity interest but does not exceed 25% of the voting members of the board, and another, larger shareholder of the banking organization is a bank holding company that controls the banking organization.[155] The Federal Reserve Board recently permitted Mitsubishi UFJ Financial Group, Inc. (MUFG), in connection with converting its convertible preferred stock in Morgan Stanley to up to 24.9% of Morgan Stanley's common shares, to have two representatives on Morgan Stanley's board of directors even though MUFG is Morgan Stanley's largest shareholder. In approving MUFG's increased director representation, the Federal Reserve Board

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Bull. B86 (2009) (up to 9.9% of Chinatrust Financial Holding); Morgan Stanley, 95 Fed. Res. Bull. B93 (2009) (retention of 9.9% of Herald National Bank); Sky Financial Group, Inc., 92 Fed. Res. Bull. C92 (2006) (up to 9.99% of LNB Bancorp). *See also* Letter from the Board of Governors of the Federal Reserve System, dated Feb. 14, 2012, to Mark Menting, Esq. (acquisition by ING Groep N.V. of up to 9.9% of voting common shares of Capital One Financial Corporation in connection with sale of ING DIRECT Bancorp).

[154]*See* 2008 Policy Statement, § 225.144(c)(1) at 6, 8. *See also* Letter from the Board of Governors of the Federal Reserve System, dated Feb. 14, 2012, to Mark Menting, Esq., and App.; Goldman Sachs Group, Inc., 97(2) Fed. Res. Bull. 22, 23–24 and App. (2011); Morgan Stanley, 95 Fed. Res. Bull. B86, B87 and App. (2009); Mitsubishi UFJ Financial Group, Inc., 95 Fed. Res. Bull. B34, B36 (2009).

[155]*See* 2008 Policy Statement, § 225.144(c)(1) at 7–8.

considered the following factors: (1) the size, composition and expertise of the Morgan Stanley board, and the fact that a majority of its members continued to be independent of management; (2) MUFG's representatives represented less than 15% of the total membership of the board and neither director representative would be able to second a motion of the other MUFG representative; (3) MUFG only had one vote on any committee of the board; and (4) MUFG made commitments to the Federal Reserve Board to maintain the level of its voting investment in Morgan Stanley and to use its reasonable best efforts to assist Morgan Stanley in seeking additional funding from other sources.[156] In light of these factors and the exceptional circumstances in which MUFG's original investment in Morgan Stanley was made at the height of the 2008 financial crisis, it is unclear whether this will serve as a precedent for other minority investors wishing to have two director representatives in the absence of a larger, controlling shareholder that is itself a bank holding company.

- *Total equity*. As noted in this Section, a noncontrolling investor may own up to 24.9% of any class of voting securities of a banking organization. In its 2008 Policy Statement, the Federal Reserve Board explicitly addressed the issue of the extent to which an investor's ownership of nonvoting equity could affect the control analysis. The Federal Reserve Board observed that the BHC Act does not expressly limit the ownership of nonvoting shares, but stated that, "in most circumstances," ownership of 25% or more of a banking organization's total equity would give an investor "enough of the capital resources" of the banking organization to have a controlling influence.[157] Nevertheless, recognizing that the ability to exercise a controlling influence through nonvoting equity depends on the facts and circumstances of an investor's overall investment and on the capital structure of the banking organization, the Federal Reserve Board concluded that a noncontrolling investor may generally own up to 33.3% of total equity

[156] Mitsubishi UFJ Financial Group, Inc., 97(4) Fed. Res. Bull. 10, 12 and 18 n. 39 (2011).

[157] 2008 Policy Statement, § 225.144(c)(2) at 9.

provided that its ownership of any class of voting securities does not exceed 14.9%.[158]

- *Passivity commitments*. As noted in Section 7:3[6][a], the Federal Reserve Board generally requires any investor acquiring 5% or more of any class of voting securities of a banking organization to enter into passivity commitments.[159] If other investors acquire 5% or more of the banking organization's voting shares in the same transaction or in related transactions at the same time, each investor also generally will be required to make the antiassociation certifications and (in addition to the information required to be provided as part of the investor's application under the BHC Act or any notice under the CIBC Act)[160] respond to the Federal Reserve Board's information requests about the investor, how the investor came into the transaction, and the extent to which it may have had contacts or shared information with other investors about the transaction, as discussed in Section 7:3[6][a].[161]

In its 2008 Policy Statement, the Federal Reserve Board

[158] 2008 Policy Statement, § 225.144(c)(2) at 9–10. Any nonvoting securities that may not be converted into voting shares while held by the investor, but are convertible into voting shares upon their transfer to an unaffiliated third party, must be subject by their terms to the Federal Reserve Board's standard set of transfer restrictions. *See* 2008 Policy Statement, § 225.144(c)(2) at 9–10.

[159] *See* 2008 Policy Statement, § 225.144(c)(3) at 11. *See also* Mitsubishi UFJ Financial Group, Inc., 97(4) Fed. Res. Bull. 10, 11–12 (2011) and 95 Fed. Res. Bull. B34, B36 (2009); Goldman Sachs Group, Inc., 97 Fed. Res. Bull. 22, 23–24 and App. (2011); China Investment Corporation, 96 Fed. Res. Bull. B31, B32 (2010); City Holding Company, 96 Fed. Res. Bull. B21, B21 and App. (2010); Morgan Stanley, 95 Fed. Res. Bull. B86, B87 and Appendix (2009) (Chinatrust); Morgan Stanley, 95 Fed. Res. Bull. B93, B93 and App. (2009) (Herald); Sky Financial Group, Inc., 92 Fed. Res. Bull. C92, C93 and App. (2006).

[160] *See* §§ 7:5 to 7:7.

[161] As part of this exercise, the Federal Reserve Board's practice is to request information about the ownership structure of the investor and, among other items, whether any bank or bank holding company, or an entity controlled by a bank or bank holding company, owns 5% or more of any class of voting securities, voting limited partnership interests, or other voting ownership interests of the investor. The purpose of this inquiry is to determine whether any such bank or bank holding company would, as a result of the proposed investment, indirectly own 5% or more of the banking organization in which the investor proposes to acquire a noncontrolling interest, notwithstanding that the investor may not be controlled by the bank or bank holding company. *See, e.g.*, China Investment Corporation, 96 Fed. Res. Bull. B31, B34 n.21 (2010) (approving "the indirect acquisition by CIC of Morgan [Stanley]'s interests in Chinatrust and Herald"); Morgan Stanley, 95 Fed. Res. Bull. B86, B91 n.34 (2009) (approving "the indirect acquisition of the interest in Chinatrust by Mitsubishi UFJ Financial Group"); Morgan Stanley, 95 Fed. Res. Bull. B93, B96–B97 n.25

also clarified that passivity commitments do not prevent a noncontrolling investor, like any other shareholder, from communicating with a banking organization's management about the banking organization's policies and operations and even advocating for changes in them.[162]

Noting that "discussions alone are not the type of controlling influence targeted by the BHC Act," the Federal Reserve Board concluded that a minority investor would not exercise a controlling influence if the decision on the particular matter remained with the banking organization's shareholders as a group, board of directors or management, as applicable, and the investor's role in the decision were limited to voting in a shareholders' meeting or, through its director representative, at the board of directors.[163]

- *Business relationships*. The extent to which a minority investor has or proposes to have ongoing business relationships with the target banking organization is a potential control factor that is reviewed by the Federal Reserve Board or other relevant banking regulator on a case-by-case basis. The Federal Reserve Board generally permits business relationships that are "quantitatively limited and qualitatively nonmaterial" and also considers whether the business relationships are on market terms, nonexclusive, and may be terminated without penalty by the banking organization.[164]

The Federal Reserve Board's standard passivity commitments prohibit a noncontrolling investor from having any business relationship with the banking organization other than deposit accounts on market terms with an aggregate balance of $500,000.[165] However, the Federal Reserve Board is generally flexible in modifying the text of the business relationship commitment to accommodate transitional services

(2009) (approving "the retention of the indirect interest in Herald held by [Mitsubishi UFJ Financial Group]").

[162] 2008 Policy Statement, § 225.144(c)(3) at 11.

[163] 2008 Policy Statement, § 225.144(c)(3) at 12.

[164] *See* 2008 Policy Statement, § 225.144(c)(4)(i) at 13.

[165] *See, e.g.*, Goldman Sachs Group, Inc., 97(2) Fed. Res. Bull. 22, App. at 29–30 (2011); City Holding Company, 96 Fed. Res. Bull. B21, App. at B25 (2010).

or preexisting business relationships, sometimes subject to a limit based on percentage of revenues or assets.[166]

- *Covenants*. A noncontrolling investor may not have veto rights or contractual covenants that substantially limit the discretion or ability of a banking organization's board of directors or management to make major policy, or other, decisions. In its 2008 Policy Statement, the Federal Reserve Board identified as potentially problematic covenants regarding: (1) the employment or compensation of executive officers; (2) new business lines or substantial changes to operations; (3) the issuance of additional debt or equity capital; (4) mergers or consolidations; (5) the sale or other disposition of material subsidiaries or major assets; or (6) the acquisition of significant assets or control of another firm.[167] Permissible covenants include prohibitions on: (i) the issuance of senior debt or borrowing on a senior basis; (ii) the modification of the terms of the investor's equity interest; (iii) the liquidation of the banking organization; and (iv) the payment of dividends on more junior securities (if any) if dividends on the investor's equity interest are in arrears.[168]

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[166] *See, e.g.*, Morgan Stanley, 95 Fed. Res. Bull. B86, Appendix at B92 (2009) (Chinatrust); Morgan Stanley, 95 Fed. Res. Bull. B93, Appendix at B97–B98 (2009) (Herald). *See also* Letter from the Board of Governors of the Federal Reserve System, dated Feb. 14, 2012, to Mark Menting, Esq. (addressing business relationships following Capital One's acquisition of ING DIRECT).

[167] *See* 2008 Policy Statement, § 225.144(c)(4)(ii) at 13–14. *See also* 1982 Policy Statement, § 225.143. The 1982 Policy Statement on stakeouts 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).

[168] *See* 2008 Policy Statement, § 225.144(c)(4)(ii), at 14 (noting that the Federal Reserve Board generally allows covenants giving an investor rights that are permissible for a holder of nonvoting securities, as described in Regulation Y); 12 C.F.R. § 225.2(q)(2). A noncontrolling investor may also have covenants entitling it to "limited" financial information rights and consultation rights, 2008 Policy Statement, § 225.144(c)(4)(ii) at 14, which may be necessary if the investor accepts capital commitments from pension and retirement plans regulated under the Employee Retirement Income Security Act of 1974 (ERISA) and wishes to qualify as a Venture Capital Operating Company (VCOC). 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 requiring a public and dispersed distribution of these rights if the

> In practice, the Federal Reserve Board has evaluated minority investors' contractual covenants—whether contained in securities purchase agreements or shareholders' agreements—on a case-by-case basis and has sometimes permitted variants of covenants identified in the 2008 Policy Statement as raising control issues. It has permitted, for example, shareholders' consent provisions requiring supermajority voting, provided that no one shareholder or group of affiliated shareholders could be a blocking minority, relating to extraordinary corporate actions above certain materiality thresholds (such as mergers, dispositions of assets, incurrence of indebtedness, and issuance of additional equity or debt) provided that there are carve-outs for any such actions taken by the banking organization at the direction of any of its banking regulators.

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 for investors in national banks and state nonmember banks, respectively.[169]

In contrast, the OTS historically applied a different series of rebuttable presumptions of control and procedures for rebutting them, including a rebuttal of control agreement, relating to investments in thrifts and thrift holding companies.[170] For any investor that is not a bank holding company, thrift holding company, or a foreign bank (or the parent of a foreign bank) with a U.S. commercial banking presence that seeks to make an investment in a federal or insured state-chartered thrift, the historic OTC rebuttable presumptions of control and rebuttal of control procedures, including rebuttal of control agreements, remain in effect until further notice from the OCC and FDIC, respectively.[171] These rebuttable presumptions of control are more detailed than

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right of first refusal is not exercised." 12 C.F.R. § 225.143(d). *See also* Letter from the Board of Governors of the Federal Reserve System, dated Nov. 25, 1986, to John L. Carr, Jr. (Sumitomo letter).

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

[170] *See* 12 C.F.R. §§ 574.4(b), (c), and (e), 574.100 (former OTS regulations).

[171] Under the OCC and FDIC regulations, an investor will be subject to a rebuttable presumption of control over a federal or insured state-chartered thrift if the investor:

those of the other federal banking regulators and in some ways

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(1) Acquires more than 10% of any class of the thrift's voting stock and is subject to any of the following control factors (the control factors):
- investor would be one of the two largest holders of any class of the thrift's voting stock.
- investor would hold 25% or more of the thrift's total stockholders' equity.
- investor would hold more than 35% of the thrift's combined debt securities and stockholders' equity.
- investor is party to any agreement:
  - pursuant to which the investor possesses a material economic stake in the thrift resulting from a profit-sharing arrangement, use of common names, facilities or personnel, or the provision of essential services to the thrift; or
  - that enables the investor to influence a material aspect of the management or policies of the thrift, other than agreements to which the thrift is a party that contain customary restrictions and in the case of certain acquisition agreements.
- investor would have the ability, other than through the holding of revocable proxies, to direct the votes of 25% or more of a class of the thrift's voting stock or to vote 25% or more of a class of the thrift's voting stock in the future upon the occurrence of a future event.
- investor would have the power to direct the disposition of 25% or more of a class of the thrift's voting stock in a manner other than a widely dispersed or public offering.
- investor or the investor's representatives or nominees would constitute more than one member of the thrift's board of directors.
- investor or a nominee or management official of the investor would serve as chairman of the board of directors, chairman of the executive committee, chief executive officer, chief operating officer, chief financial officer, or in any position with the thrift with similar policymaking authority.

(2) Acquires 25% or more of any class of the thrift's stock (voting or nonvoting) and is subject to any control factor.

(3) Holds any combination of voting stock and proxies representing 25% or more of any class of the thrift's voting stock, excluding such proxies held in connection with a solicitation by, or in opposition to a solicitation on behalf of, management of the thrift, but including a solicitation in connection with an election of directors, and such proxies would enable the investor to:
- elect one-third or more of the thrift's board of directors, including nominees or representatives of the investor currently serving on such board;
- cause the thrift's stockholders to approve the acquisition or corporate reorganization of the thrift; or
- exert a continuing influence on a material aspect of the thrift's business operations.

See 12 C.F.R. §§ 174.4(b), (c) (OCC—CIBC Act rebuttable presumptions of control and control factors for federal thrifts), 391.43(b), (c) (FDIC—CIBC Act rebuttable presumptions of control and control factors for insured state-chartered thrifts).

are less restrictive.[172] For example, an investor that acquires 20% of any class of voting securities of a thrift is not subject to a rebuttable presumption of control unless it is also subject to another control factor, whereas the Federal Reserve Board's thresholds for presumptions of control can be as low as 5%. Since the presumptions of control applied by the OCC and the FDIC in their respective control regulations are aligned with those of the Federal Reserve Board,[173] it seems likely that the OTS's historical presumptions of control will eventually be abolished.

The OTS's presumptions and procedures were not incorporated into the Federal Reserve Board's Regulation LL. Consequently, for any new investment above the relevant filing thresholds under HOLA or the CIBC Act in a thrift holding company, or for any such investment in a thrift by a bank holding company, thrift holding company, or a foreign bank (or the parent of a foreign bank) with a U.S. commercial banking presence, the Federal Reserve Board's presumptions of control in Regulation LL, which are identical to those in Regulation Y for investments in banks and bank holding companies, will apply, as described in Section 7:3[6][a].[174] Reflecting its view that HOLA and the BHC Act include "virtually identical" definitions of control, the Federal

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[172] *See* 12 C.F.R. §§ 174.4(b), (c) (OCC—CIBC Act rebuttable presumptions of control and control factors for federal thrifts), 391.43(b), (c) (FDIC—CIBC Act rebuttable presumptions of control and control factors for insured state-chartered thrifts), 174.4(d) (OCC—CIBC Act rebuttable presumptions of acting in concert for federal thrifts), 391.43(d) (FDIC—CIBC Act rebuttable presumptions of acting in concert for insured state-chartered thrifts), 174.4(e) (OCC—CIBC Act procedures for rebuttal of determination of control and presumption of concerted action for federal thrifts), § 391.43(e) (FDIC—CIBC Act procedures for rebuttal of determination of control and presumption of concerted action for insured state-chartered thrifts), 174.4(f) (OCC—CIBC Act safe harbor certification of noncontrol for federal thrifts), 391.43(f) (FDIC—CIBC Act safe harbor certification of noncontrol for insured state-chartered thrifts); 12 C.F.R. Pt. 174, App. A (OCC—CIBC Act rebuttal of control agreement for federal thrifts); 12 C.F.R. § 391.48 (FDIC—CIBC Act rebuttal of control agreement for insured state-chartered thrifts).

[173] *See* discussion earlier in this Section.

[174] *See* 12 C.F.R. §§ 238.21(d) (Board—HOLA regulations), 238.31(c)(2) (Board—CIBC Act regulations for thrift holding companies and thrifts). In adopting Regulation LL, the Federal Reserve Board stated that it did not anticipate "revisiting ownership structures previously approved by the OTS," would apply Regulation LL only to "new investments," and would only reconsider the structures of past investments approved by the OTS if the target in question proposes a "material transaction, such as an additional expansionary investment, significant recapitalization, or significant modification of business plan." Federal Reserve Board, Availability of Information, Public Observation of Meetings, Procedure, Practice for Hearings, and Post-Employment Restrictions

Reserve Board indicated in the Supplementary Information for the Board Interim Final Rule that "[b]ecause of this similarity, Regulation LL includes provisions interpreting the definition of control under HOLA in the same manner as that term is interpreted under the BHC Act [and] adopts procedures for reviewing control determinations that are identical for [thrift holding companies] and BHCs . . . ."[175]

[7] Failed Bank Acquisitions

[a] Overview

In the aftermath of the recent financial crisis, widespread failures of U.S. insured depository institutions, banks and thrifts have presented strategic acquirers with opportunities to participate in FDIC-assisted transactions in numbers not seen since the early 1990s. More than 450 banks have failed since September 2008, ranging from tiny community banks to the $300 billion asset Washington Mutual Bank.[176] As of September 2011, more than 250 of these failures were resolved through loss-sharing resolution transactions.[177]

FDIC-assisted transactions can provide the opportunity to expand at relatively low cost and with relatively little risk. In the years immediately following the onset of the financial crisis, the FDIC typically offered loss-sharing protection on assets acquired in assisted transactions (*i.e.*, the FDIC agreed to reimburse the purchaser for an agreed portion of certain specified losses) and permitted the acquirer to assume only deposit and certain other liabilities. As the pace of bank failures has slowed and the ability of prospective acquirers to anticipate losses on acquired assets has increased, the FDIC has offered less attractive loss-sharing coverage or none at all. Typically all equity claims in an assisted transaction are extinguished, and certain types of liabilities, including contingent liabilities, are left behind for the FDIC to deal with.

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for Senior Examiners; Savings and Loan Holding Companies, 76 Fed. Reg. 56,508, 56,510 (Sept. 13, 2011).

[175]Federal Reserve Board, Availability of Information, Public Observation of Meetings, Procedure, Practice for Hearings, and Post-Employment Restrictions for Senior Examiners; Savings and Loan Holding Companies, 76 Fed. Reg. 56,508, 56,509 (Sept. 13, 2011).

[176]FDIC, Failed Bank List, *available at* http://www.fdic.gov/bank/individual/failed/banklist.html (last visited December 19, 2012).

[177]Office of Inspector General, FDIC Office of Audits and Evaluations, Evaluating the FDIC's Monitoring of Shared-Loss Agreements, February 2012, *available at* http://www.fdicoig.gov/reports12%5C12-002EV.pdf.

[b] Role of the FDIC in the Resolution Process

Upon the failure of a U.S. insured depository institution, the FDIC is appointed receiver of the failed institution and as such is empowered to "resolve" the failed institution by administering its liquidation.[178] As receiver, the FDIC succeeds by operation of law to all rights and powers of the institution, its officers, directors, and shareholders, and is given plenary powers to administer the affairs of the institution and to sell or transfer its assets and liabilities to any other person.[179] These powers are essentially conducted without the supervision or oversight of any court or other administrative agency.

The FDIC has a general statutory duty to resolve all failed institutions in a manner that is "least costly to the Deposit Insurance Fund of all possible methods"[180] and a policy of resolving failed institutions in a manner that maintains public confidence in the U.S. banking system and is least disruptive to depositors and other stakeholders.[181] The FDIC is also generally precluded from using the deposit insurance fund to benefit existing

[178] 12 U.S.C.A. § 1821(c)(1), (e)(1)(C). On occasion, the FDIC may also be appointed conservator of the failed institution. As conservator, the FDIC takes control of a failed institution with the intent and ability to operate the institution as a going concern. Generally, the conservator does not engage in a wholesale liquidation of the business although it may sell assets, cease lines of business, or take other similar actions. In contrast, a receiver generally operates as the liquidator of an insured institution. In FDIC practice, a conservatorship is a temporary solution, allowing the FDIC to operate an institution until it is able to complete some form of sale or liquidation. Conservatorships were common in the savings and loan crisis of the early 1990s, when approximately 700 institutions failed in a very short period of time. The only recent example of an FDIC conservatorship is the IndyMac failure in 2008; the FDIC operated IndyMac for several months until it was able to effect a sale to a group of private investors. *See* FDIC, "Press Release: FDIC Closes Sale of IndyMac Federal Bank, Pasadena, California," released March 19, 2009, *available at* http://www.fdic.gov/news/news/press/2009/pr09042.html.

[179] 12 U.S.C.A. § 1821(d)(2)(A), (B), (G).

[180] 12 U.S.C.A. § 1823(c)(4).

[181] *See* FDIC, *Resolutions Handbook*, Ch. 8, at 77 (2003), *available at* http://www.fdic.gov/bank/historical/reshandbook. If the FDIC is unable to sell all or any part of an institution before it must be closed, the FDIC can charter a new national bank or federal thrift institution to operate as a "bridge bank." A bridge bank is an entity used by the FDIC to assume all or any portion of the failed institution's business and thereby continue to operate the business as a going concern without interruption. The FDIC generally uses this option if it believes that the temporary operation and subsequent sale of the institution would be more financially attractive to the FDIC than the immediate liquidation of the institution or if it determines that temporarily operating the business through a bridge bank will facilitate financial stability. 12 U.S.C.A.

shareholders.[182]

[c] Assisted Transaction Structures

Pursuant to its statutory obligation to protect insured depositors, the FDIC will attempt to arrange for another operating institution to assume the deposit liabilities of a failed institution.[183] Because in every instance the transfer of at least the institution's insured deposits will be contemplated, the FDIC has a financial incentive to transfer as many of the institution's assets as possible to offset the costs associated with the assumption of liabilities. All FDIC transactions are essentially variations of this "purchase and assumption" transaction. To the extent that an assuming institution is unwilling to purchase certain assets, the FDIC will arrange for their sale and disposition at a later date.[184] To the extent that liabilities are not assumed, the FDIC will, as receiver, arrange for payment of those liabilities from the proceeds of the asset disposition in accordance with the claims process mandated by statute.[185] In virtually every failure, the FDIC provides some form of financial assistance in the form of cash to the acquiring institution because the liabilities assumed invariably exceed the value of the assets transferred (even when the FDIC is providing additional protection in the form of loss-sharing).[186]

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§ 1821(n)(1)(A). Bridge banks have rarely been used during the spate of bank and thrift failures in the aftermath of the 2008 financial crisis.

[182] 12 U.S.C.A. § 1821(a)(4)(C).

[183] FDIC, *Resolutions Handbook*, Ch. 3, at 19–40.

[184] The FDIC Division of Resolutions is an active seller of the assets not purchased at the time of failure. Additional information regarding the FDIC's asset disposition activities can be found at http://www.fdic.gov/buying.

[185] The FDIC administers the claims process, sorting out valid from invalid claims, determining priorities, and administering distributions from the receivership estate, which it refers to as "dividends." 12 U.S.C.A. § 1821(d)(10). When the various claims and priorities are sorted out, the FDIC satisfies accepted claims to the extent of the institution's assets in accordance with statutory priorities. 12 U.S.C.A. § 1821(d)(4)(B). Section 11 of the FDI Act authorizes the FDIC to conduct the claims process without any court supervision. 12 U.S.C.A. § 1821(d)(13)(D). The FDIC's decision to disallow a claim is unreviewable by any court although the validity of a claim is subject to *de novo* judicial consideration following completion of the administrative claims process. 12 U.S.C.A. § 1821(d)(5)(E), (d)(6)(A).

[186] A simple example: assume an acquiring bank holding company was acquiring a failed institution with $100 of deposit liabilities and assets with a value of $60. The FDIC would generally provide the acquiring bank holding company with $40 in cash so that the acquiring bank holding company would acquire $100 in assets in exchange for the assumption of $100 in liabilities. If

The FDIC has authority to determine how assisted transactions will be structured.[187] On the liability side of the balance sheet, for example, a transaction might be structured to require bidders to assume:

- insured deposits only;
- insured and uninsured deposits;
- insured and uninsured deposits, plus certain secured liabilities such as Federal Home Loan Bank advances and covered bonds; or
- all deposits plus secured liabilities plus certain other debt obligations.[188]

On the asset side of the balance sheet, bidders may be presented with the opportunity to purchase:

- cash and readily marketable securities;
- performing assets, with or without loss-sharing;
- nonperforming assets, with or without loss-sharing; and
- premises and equipment.

If the FDIC offers financial assistance to facilitate a transaction, it will virtually always be in the form of the FDIC's standard loss-sharing arrangements.[189] Under this arrangement, the FDIC will share the losses on the risk assets of the failed bank under an arrangement whereby the FDIC assumes a percentage of the losses (up to 80%) with the acquirer assuming the remainder. The FDIC may establish tranches with respect to which loss-sharing percentages vary. One technique is to have an 80%/20% split apply to the top tranche, followed by a tranche with no loss-sharing (a zero loss-share tranche), and finally, a catastrophic loss tranche with respect to which loss-sharing applies. The acquirer has an opportunity to vary the applicable percentages through its bid. The purpose of the zero loss-share

there are multiple bidders for the failed institution's deposit liabilities and the relevant assets, the winning bid would be the one that would require the least amount of cash assistance from the FDIC.

[187]In a "whole bank" transaction, virtually all of an institution's assets are purchased and all or certain of its liabilities are assumed pursuant to a purchase and assumption agreement.

[188]These other liabilities generally do not include general creditor claims, unsecured nondeposit debt or subordinated debt. They may include liabilities associated with mortgage operations.

[189]FDIC Staff Presentation, *The Failing Bank Marketing Process: Whole Bank Transactions and Loss Share Transactions*, American Bankers Association, Sept. 2, 2009; FDIC Staff Presentation, *Resolutions: The Process of Bidding on Distressed Banks in the New Millennium*, Minority Depository Institution National Conference, Jul. 18, 2008.

tranche is to give the acquirer the incentive to maximize the recoveries on the assets and avoid the application of the zero loss-share tranche.

[d] Bidding Process

The FDIC controls the bidding process very tightly. When it appears that a bank may be heading for insolvency, it begins the process of evaluating the bank, its assets, and its liabilities and determining the best structure for resolving the institution. It will also identify those institutions that are likely acquirers of the failed bank. This entire process is highly confidential.

Several weeks before the institution is scheduled to close, the FDIC will create a virtual data room through which invited prospective bidders may commence their due diligence process. In general, those bidders are limited to banks, thrifts, or bank or thrift holding companies that are "well capitalized" and in satisfactory condition.[190] However, it is possible for other bidders to participate in the auction if they obtain a *de novo* bank or thrift charter[191] or persuade the FDIC to sell them a bridge bank that will have assumed some or all of the assets and liabilities of the failed bank.[192]

In order to participate in the bidding process, a proposed bidder must generally have received assurance from its primary regulators that it will be permitted to acquire the failed institution. In order to actually submit a bid on the failed institution and have it considered by the FDIC, a bidder must satisfy a variety of conditions, including the following:

- The bidder must have all necessary state and federal regulatory approvals for the transaction before the FDIC's proposed closing of the failed bank transaction; and
- The institution resulting from the transaction must be "well

[190] FDIC Staff Presentation, *The Failing Bank Marketing Process: Whole Bank Transactions and Loss Share Transactions*, American Bankers Association, Sept. 2, 2009; FDIC Staff Presentation, *The Process of Bidding on Distressed Banks in the New Millennium*, Minority Depository Institution National Conference, Jul. 18, 2008.

[191] Known as a "shelf charter," this option is available where the FDIC and the chartering authority have indicated a willingness to activate a charter, with deposit insurance, if and when a bid from the proposed bidders is accepted. The regulators will do so only when satisfied with respect to the financial and managerial competence and business plan of the proposed bidders.

[192] *See* discussion of bridge bank transactions earlier in this Section.

capitalized" and have a fully funded allowance for loan losses as of closing.[193]

A bidder that cannot satisfy these requirements will not be permitted to bid. Accordingly, any institution desiring to participate in the bidding process would be well advised to engage in discussions with its regulators early in the process to determine its eligibility as a potential bidder.

The FDIC decides—without any input from potential bidders—which transaction structures to offer bidders based on what it believes to be the options most likely to produce the least costly result for the Deposit Insurance Fund. Thus, the FDIC will determine which assets are to be included, whether or not loss-sharing will be offered, and how certain secured liabilities will be treated. The FDIC generally does not negotiate the legal documentation that it proposes, but rather marks up its standard form purchase and assumption agreement to reflect the selected structure, and then instructs bidders to bid on that structure on a "take it or leave it" basis. In lieu of negotiating the legal documentation, bidders typically simply adjust the economics of their bids to reflect any perceived flaws in the proposed transaction's nonfinancial terms.

The bid involves advising the FDIC of the bidder's financial terms. In general, the variables of the bid include (i) any deposit premium that the bidder wishes to pay, (ii) the asset discount that it wishes to impose on the proffered assets, and (iii) if loss-sharing is provided, the relative loss-sharing percentages that it desires.

Consistent with the FDIC's statutory obligation to resolve a failed institution in a manner that is least costly to the Deposit Insurance Fund, the FDIC is required to reject all bids if none would result in a less costly resolution of the institution than a payoff of all deposits and liquidation of the assets.[194] If the FDIC receives at least one bid that would result in a lower amount of losses to the Deposit Insurance Fund than a deposit payoff and liquidation of the institution, the FDIC is required by statute to accept the highest such bid that it receives.[195]

If the FDIC receives more than one bid in a closed-bank auc-

[193] There are additional requirements for *de novo* institutions, including higher capital requirements and, under most circumstances, compliance with the FDIC's Final Statement of Policy on Qualifications for Failed Bank Acquisitions, 74 Fed. Reg. 45,440 (Sept. 2, 2009), discussed in § 7:3[7][e].

[194] *See* 12 U.S.C.A. § 1823(c)(4).

[195] *See* 12 U.S.C.A. § 1823(c)(4).

tion, it then determines which bid satisfies the least cost test,[196] clears the bid with the other relevant regulators, notifies the winning bidder, and executes the appropriate legal documentation. The chartering authority then closes the bank, typically on a Friday after the close of business, and the FDIC simultaneously announces the agreement with the winning bidder. The failed institution reopens for business under new ownership on the following Saturday or Monday.[197]

[e] The FDIC Statement of Policy

Investments in failed depository institutions, including certain investments in banking organizations that acquired failed banks or thrifts, are also subject to the requirements contained in the FDIC's Final Statement of Policy on Qualifications for Failed Bank Acquisitions, issued on August 26, 2009 (the FDIC Policy Statement).[198] The FDIC Policy Statement generally applies to the following investors:

- "private investors" in a company that proposes (including through a shelf charter) to assume deposit liabilities, or deposits and assets, from the resolution of a failed insured depository institution; and
- "applicants" for deposit insurance in the case of *de novo* charters issued in connection with the resolution of failed insured depository institutions.[199]

However, the FDIC exempts two types of investors from the FDIC Policy Statement:

- an investor that enters into a partnership with or invests

[196]The FDIC calculates its liquidation cost based upon its experience as liquidator with the type of assets it will be required to dispose of. Bids are evaluated against this liquidation cost. The best bid will be the one that ultimately costs the FDIC the least amount of money. If no bid results in a cost to the FDIC that is less than the liquidation cost, the FDIC will choose not to sell the institution and to proceed with its liquidation instead.

[197]The winning bidder must be prepared to operate the bank immediately. There is no extended period to prepare for the process of assuming operational control of the failed institution.

[198]Final Statement on Policy Qualifications for Failed Bank Acquisitions, 74 Fed. Reg. 45,440 (Sept. 2, 2009). The FDIC Policy Statement has been supplemented by two sets of FDIC questions and answers. *See* FDIC, Q&As: Statement of Policy on Qualifications for Failed Bank Acquisitions, issued on January 6, 2010 and updated on April 23, 2010, *available at* http://www.fdic.gov/regulations/laws/faqfbqual.html (FDIC Q&As).

[199]The FDIC specifically declined to define the terms "private investors" and "applicants" in the FDIC Policy Statement. *See* FDIC Policy Statement, 74 Fed. Reg. 45,440, 45,446 (Sept. 2, 2009).

directly in an existing bank holding company or thrift holding company, if the holding company has a "strong majority interest" in the failed bank or thrift and has an established record for successful operation of insured depository institutions. A "strong majority interest" is presumed by the FDIC to exist unless the new investors hold more than one-third of the total equity and the voting equity in the existing holding company or the joint venture with the existing holding company and there are no special voting or other rights provided to the investors through covenants, agreements, or similar mechanisms;[200] and

- an investor with 5% or less of the total voting power of a banking organization that acquires a failed insured depository institution provided that there is no evidence of concerted action with other investors. The FDIC presumes concerted action among 5%-or-less investors if, in the aggregate, they have over two-thirds of the total voting power of the banking organization. Consequently, other investors with an aggregate voting percentage or total equity percentage of one-third or more, together with the banking organization itself, must be subject to the FDIC Policy Statement in order for the 5%-or-less investors outside this "anchor group" to be exempted.[201]

The FDIC Policy Statement generally has the effect of imposing more onerous requirements on failed bank acquisitions involving private capital investors than those made by existing banking organizations, which remain the FDIC's preferred buyers of failed insured depository institutions.[202] The requirements include:

- *Capital*. The post-acquisition banking organization must

[200]*See* FDIC Policy Statement, 74 Fed. Reg. 45,440, 45,446, 45,448 (Sept. 2, 2009); FDIC Q&As, questions on "strong majority interest." There is also an exemption for recapitalizations of existing banking organizations, subject to a limit for a period of time on the amount of total assets the recapitalized banking organization may acquire from failed insured depository institutions. FDIC Q&As, questions on "strong majority interest."

[201]*See* FDIC Policy Statement, 74 Fed. Reg. 45,440, 45,446, 45,448 (Sept. 2, 2009); FDIC Q&As, question on "concerted action." The FDIC Q&As clarify that any 5%-or-less investor not otherwise subject to the FDIC Policy Statement may elect to be part of the anchor group that is subject to the FDIC Policy Statement in order to satisfy the one-third anchor group test. FDIC Q&As, question II.4. Any investor, including a 5%-or-less investor, that has the right to a representative on the banking organization's board of directors is subject to the FDIC Policy Statement. FDIC Q&As, question II.5.

[202]*See* FDIC Policy Statement, 74 Fed. Reg. 45,440, 45,446, 45,448 (Sept. 2, 2009) (partnerships with existing banking organizations "are strongly encouraged by the FDIC").

maintain a tier 1 common equity ratio of at least 10% for the first three years and thereafter must remain "well-capitalized."[203]

- *Cross guarantee*. Cross-guarantee liability will exist if one or more investors subject to the FDIC Policy Statement own 80% or more of two or more insured depository institutions. These investors will be required to pledge their stock in the insured depository institutions to the FDIC, and if any of them fails, the FDIC may enforce its security interest to the extent necessary to recoup any losses incurred by the FDIC as a result of the failure.[204]
- *Transactions with affiliates*. All extensions of credit to investors subject to the FDIC Policy Statement, their investment funds, and any of their respective affiliates by an insured depository institution acquired by the investors under the FDIC Policy Statement are prohibited.[205]
- *Bank secrecy law jurisdictions.* An investor subject to the FDIC Policy Statement using an entity domiciled in a "secrecy law jurisdiction" may not own an interest in an insured depository institution unless the investor is a subsidiary of a company subject to comprehensive consolidated supervision as recognized by the Federal Reserve Board and agrees to certain record-keeping, disclosure and jurisdictional requirements, including the provision of information to the insured depository institution's primary federal banking regulator about the investor's non-U.S. activities, the maintenance of original or duplicate records in the United States, consent to jurisdiction in the United States, and consent to be bound by U.S. statutes and

[203]*See* FDIC Policy Statement, 74 Fed. Reg. 45,440, 45,446, 45,448 (Sept. 2, 2009). *Compare with* 12 U.S.C.A. § 1815(e) (cross-guaranty liability for commonly controlled depository institutions under the FDIA).

[204]*See* FDIC Policy Statement, 74 Fed. Reg. 45,440, 45,447 to 45,449 (Sept. 2, 2009). The FDIC Policy Statement uses the same definition of "extension of credit" as that in the Federal Reserve Board's Regulation W (*see* 12 C.F.R. § 223.3(o)), but defines "affiliate" as any company in which an investor subject to the FDIC Policy Statement owns, directly or indirectly, at least 10% of the "equity" and has maintained its ownership for at least 30 days. FDIC Policy Statement, 74 Fed. Reg. 45,440, 45,447, 45,449 (Sept. 2, 2009).

[205]*See* FDIC Policy Statement, 74 Fed. Reg. 45,440, 45,447, 45,449 (Sept. 2, 2009).

regulations administered by the appropriate U.S. federal banking agencies.[206]

- *Holding period.* An investor subject to the FDIC Policy Statement is prohibited from selling or transferring its shares in the banking organization that acquired a failed insured depository institution for three years following the acquisition, absent the FDIC's prior consent.[207]
- *Information to the FDIC*. An investor subject to the FDIC Policy Statement is expected to submit information to the FDIC about itself and all entities in its ownership chain, including information about the size of its capital fund(s), its diversification, its return profile, marketing documents, management team, and business model, as well as any other information requested by the FDIC as necessary.[208]

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[206]*See* FDIC Policy Statement, 74 Fed. Reg. 45,440, 45,447, 45,449 (Sept. 2, 2009) (defining "secrecy law jurisdiction" as any "country that applies a bank secrecy law that limits U.S. bank regulators from determining compliance with U.S. laws or prevents them from obtaining information on the competence, experience and financial condition of applicants and related parties, lacks authorization for exchange of information with U.S. regulatory authorities, does not provide for a minimum standard of transparency for financial activities, or permits offshore companies to operate shell companies without substantial activities within the host country"); FDIC Q&As, question III.1. Similarly, the Federal Reserve Board now generally requires any noncontrolling investor acquiring 5% or more of any class of voting securities of a U.S. banking organization through an entity organized under the laws of a secrecy law jurisdiction to commit to the Federal Reserve Board, in addition to its passivity commitments, that (1) it will provide all information (whether located in or outside the United States) requested by the Federal Reserve Board in connection with the Federal Reserve Board's enforcement of the BHC Act or the investor's ownership of the U.S. banking organization, and (2) it consents to the jurisdiction of the U.S. federal courts and the Federal Reserve Board.

[207]FDIC Policy Statement, 74 Fed. Reg. 45,440, 45,447, 45,449 (Sept. 2, 2009). Transfers to affiliates are excepted, provided the affiliate agrees to be bound by the FDIC Policy Statement. The three-year lockup does not apply to registered investment companies under the Investment Company Act of 1940 that issue redeemable securities and allow investors to redeem on demand. FDIC Policy Statement, 74 Fed. Reg. 45,440, 45,447, 45,449 (Sept. 2, 2009).

[208]FDIC Policy Statement, 74 Fed. Reg. 45,440, 45,449 (Sept. 2, 2009). In practice, the FDIC generally also requests information about the investor's source of funds; any existing or pending investments in other insured depository institutions; the investor's operating, partnership, investment, management, or similar agreements; any termination date on which the investor's activities will cease; any outstanding enforcement or administrative actions; any present or past affiliations, voting or investment arrangements, and joint management or advisory relationships with other investors; and questions about how the investor came into the transaction and whether it has shared due diligence or costs with any other investors. These information requests are

§ 7:4 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 Sections 7:5 and 7:6 by 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 completed.[209]

[1] Bank Holding Company Act

In general, Section 3(a) of the BHC Act requires the Federal Reserve 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% of the voting stock

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generally similar to those made by the Federal Reserve Board if multiple investors are proposing to make noncontrolling investments of 5% or more in any class of voting securities of a U.S. banking organization. *See* § 7:3[6]. Investors acquiring 5% or less of the voting power of a banking organization that acquires a failed insured depository institution are also required to be identified to the FDIC, but the information to be provided by these investors is limited to the investor's name, type of entity (*e.g.*, mutual fund, hedge fund), domicile, and amount of voting stock and total equity (including options, warrants, and convertible securities) held by the investor and its affiliates or immediate family members. *See* FDIC Q&As, question II.8.

[Section 7:4]

[209] The legal requirements and standards for approval vary widely from state to state. As a matter of practice or procedure, however, a number of states 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* N.Y. Comp. Codes R. & Regs. tit. 3, Supervisory Procedure, § 117.1(h).

of a bank (or bank holding company);[210] (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.[211]

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.[212] Thus, for example, such a foreign acquirer must obtain prior Board approval before acquiring more than 5% 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.[213] If the foreign acquirer has chosen a method 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.[214]

Section 4 of the BHC Act also requires a foreign acquirer that

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

[211] 12 U.S.C.A. § 1842(a).

[212] *See* 12 U.S.C.A. §§ 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). However, these 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).

[213] 12 U.S.C.A. § 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. bank and therefore is itself a bank holding company.

[214] 12 U.S.C.A. § 1828(c). *See* § 7:3[2].

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 Federal Reserve Board if it acquires 5% or more of any class of voting securities, or otherwise acquires control, of a thrift or thrift holding company.[215] This prior approval requirement applies even if the foreign acquirer is a financial holding company.[216]

[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 OCC 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 Federal Reserve 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 federal thrift is to be the surviving entity, the OCC is the appropriate federal bank supervisor. If an insured state-chartered thrift is to be the surviving entity, the FDIC is the appropriate federal bank supervisor.[217]

The Bank Merger Act also applies to transfers of assets by an FDIC-insured depository institution to an uninsured bank (or uninsured 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.[218] Consequently, the appropriate federal bank supervisor's approval would be required if a foreign acquirer with or without a U.S.

[215] 12 U.S.C.A. § 1843(i), (j)(1)(A).

[216] 12 U.S.C.A. § 1843(k)(6)(B).

[217] *See* 12 U.S.C.A. § 1828(c)(1). The FDIC is the appropriate federal bank supervisor in any case in which an FDIC-insured bank merges with any uninsured bank or institutions. 12 U.S.C.A. § 1828(c)(1). *See also* Dodd-Frank Act, Pub. L. No. 111-203, § 317 (2010) ("[A]ny reference in Federal law to the Director of the Office of Thrift Supervision or the Office of Thrift Supervision, in connection with any function of the Director of the Office of Thrift Supervision or the Office of Thrift Supervision transferred under section 312(b) . . . shall be deemed to be a reference to the Comptroller of the Currency, the Office of the Comptroller of the Currency, the Chairperson of the Corporation, the Corporation, the Chairman of the Board of Governors, or the Board of Governors, as appropriate . . .").

[218] 12 U.S.C.A. § 1828(c)(1), (2).

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).[219] The rules for determining the appropriate approving agency for such transactions are the same as for depository institution mergers. The Bank Merger Act governs these transactions even when the BHC Act or HOLA also applies.[220]

[3] Change in Bank Control Act

The Change in Bank Control Act (the CIBC Act)[221] 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.[222] The CIBC Act defines "control" as "the power, directly or indirectly, to direct the management or

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[219] 12 U.S.C.A. § 1828(c)(1), (2). The Bank Merger Act does not cover transactions between two uninsured banks.

[220] Both the Bank Merger Act and the BHC Act (or HOLA) will apply, for example, in many instances in which 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 OCC or the FDIC than before the Federal Reserve Board and, accordingly, attempt to structure an acquisition to avoid submitting an application for the Federal Reserve 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 Federal Reserve Board's general oversight responsibilities for foreign banks and parents of foreign banks in the United States, the Federal Reserve 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).

[221] 12 U.S.C.A. § 1817(j).

[222] Compare 12 U.S.C.A. § 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 satis-

policies of an insured bank or to vote 25 per centum or more of any class of voting securities of an insured depository institution."[223] The regulations promulgated by the Federal Reserve 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% 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 stricter than that in the Federal Reserve Board's regulations under the BHC Act,[224] but in practice, the Federal Reserve Board and the other federal banking regulators generally apply these presumptions to determine who must file a notice under the CIBC Act and apply the definition of control in the BHC Act and other relevant statutes, as discussed in Section 7:3[6], in determining whether an investment notified under the CIBC Act is controlling or noncontrolling.

The OTS historically integrated regulations implementing the provisions of both Section 10 of HOLA and the CIBC Act relating to acquisitions of thrifts and thrift holding companies into a single set of control regulations even while reflecting the same less restrictive presumptions of control for purposes of both the CIBC

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fied) with 12 U.S.C.A. § 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.A. § 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.A. § 1817(j)(8)(A). Because the BHC Act and HOLA regulate only acquisitions by "companies," acquisitions by individuals (not acting 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.

Pursuant to the Dodd-Frank Act, there is a moratorium on bank applications relating to industrial banks, industrial loan corporations, and certain other entities. Bank regulators are required to disapprove any change in control that would result in direct or indirect control by a commercial company of an industrial bank, industrial loan company, credit card bank, or trust bank, with certain exceptions, such as when the acquired institution is in danger of default. This moratorium is scheduled to expire in July 2013. *See* Dodd-Frank Act, Pub. L. No. 111-203, § 603(a) (2010).

[223] 12 U.S.C.A. § 1817(j)(8)(B).

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

Act and HOLA. The Federal Reserve Board's Regulation LL now follows the format of the Federal Reserve Board's Regulation Y and outlines separately the requirements for control determinations under HOLA and the CIBC Act. A significant difference between OTS and Board regulations under the CIBC Act was the ability of investors under the OTS's control regulations to use passivity commitments or rebuttal agreements to avoid filing a CIBC Act notice. This difference is eliminated in Regulation LL, which conforms the OTS's control and rebuttal regulations under the CIBC Act to those of the Federal Reserve Board, found in Subpart E of Regulation Y.

The CIBC Act does not apply to any transaction subject to regulatory approval under the BHC Act, the Bank Merger Act, or HOLA.[225]

[4] Home Owners' Loan Act

Section 10(e) of HOLA, as amended by the Dodd-Frank Act, requires the Federal Reserve Board'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% or more of any class of voting securities of a thrift or thrift holding company and (ii) for any other company (other than a bank holding company) to acquire direct or indirect control of a thrift or thrift holding company.[226] There is no express exemption from these prior approval requirements 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 Federal Reserve Board, 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 Federal Reserve Board before acquiring control of a thrift or thrift holding company regardless of whether it otherwise has a U.S. commercial banking presence.

§ 7:5 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 or conference calls with the staffs of the respective state and federal agencies that have juris-

[225] 12 U.S.C.A. § 1817(j)(17).

[226] *See* 12 U.S.C.A. § 1467a(e).

diction over the acquisition in order to obtain their preliminary views, establish working relations, and, where possible, obtain agreements to waive requirements involving unnecessary duplication of information.

This Section describes some of the highlights of the application procedures under the BHC Act, the Bank Merger Act, the CIBC Act, and HOLA.[227]

[1] Bank Holding Company Act

With respect to applications under the jurisdiction of the Federal Reserve 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.[228]

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

[Section 7:5]

[227] 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 (FOIA), 5 U.S.C.A. § 552. A foreign acquirer may petition the Federal Reserve 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.A. § 552(b); 12 C.F.R. §§ 261.14 (Board), 4.12(b) (OCC), 309.5(g) (FDIC). 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.A. § 552(b)(4). *See also* 31 C.F.R. § 1.6 (applying restrictions on FOIA disclosure of "business information" to Treasury bureaus, including the OCC).

[228] 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 Federal Reserve Board objects to the proposed transaction. Most acquisitions by a foreign acquirer will likely be decided by the Federal Reserve Board unless the foreign acquirer already controls a bank in the United States, and the acquisition meets the general criteria for delegation.

company.[229] 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.[230]

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 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 Federal Reserve Board can, and often does, delay action by requesting still more information.[231]

Upon accepting an application as complete, the Federal Reserve Bank will transmit copies of the application to the Federal Reserve Board and other interested regulatory agencies.[232] The staff should complete their work within 50 calendar days, and a

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[229] 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 Federal Reserve Board.

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

[231] Section 343 of the Riegle Community Development and Regulatory Improvement Act of 1994 (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.

[232] 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* § 7:2[4]); and the OCC, the FDIC, 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.A. § 1843(i)(4).

decision should be rendered within 60 calendar days.[233]

If an interested state or federal bank regulatory agency recommends disapproval of any application under Section 3 of the BHC Act, the Federal Reserve 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.[234]

Once the Federal Reserve Board has approved an acquisition under Section 3 of the BHC Act, the applicant must wait 30 days before completing the acquisition, during which time the Department of Justice (DOJ) may object to the proposed acquisition for antitrust reasons; the DOJ may, and usually does, however, consent to a shorter waiting period of 15 days.[235] The transaction generally must be completed within three months thereafter, although the Federal Reserve 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 the Federal Reserve Board, the OCC, or the FDIC under the Bank Merger Act,[236] the foreign acquirer must follow another set of application procedures in addition to any other application to the Federal Reserve Board. The procedures established by the federal banking agencies for approving bank or thrift mergers and asset acquisitions are similar

[233]This 60-day calendar does not begin to run until the Federal Reserve Board accepts the application as complete. Moreover, it has not been uncommon for the Federal Reserve 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 Federal Reserve Board fails to act within 91 days on any application for approval accepted by the Federal Reserve Board as complete, the application is deemed approved.

[234]12 U.S.C.A. § 1842(b)(1).

[235]12 U.S.C.A. § 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.

[236]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* § 7:3[2]. 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* § 7:3[3].

to the Federal Reserve 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.[237]

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 usually does, however, consent to a shorter waiting period of 15 days.[238] The transaction generally must be completed within three months, if the approving regulator is the Federal Reserve Board; one year, if the approving regulator is the OCC; one year, if the approving regulator is the FDIC in connection with insured state-chartered thrifts; and six months for all other mergers.[239]

[3] 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),[240] 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.[241] 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

[237] *See* 12 C.F.R. §§ 5.33 and 163.22 (OCC), 303.60 to 303.65 and 390.332 (FDIC). The Bank Merger Act application forms for the Federal Reserve Board, the OCC, and the FDIC are all contained in the uniform Interagency Bank Merger Act Application form.

[238] 12 U.S.C.A. § 1828(c)(6).

[239] *See* 12 C.F.R. §§ 262.3(j)(1)(iii) and 262.3(j)(3)(i) (Board), 5.33(e)(7) and 174.7(e) (OCC), 391.46 (FDIC-insured state-chartered thrifts). *See also*, *e.g.*, Frontier Trust Company, Order Approving Merger (May 2000) (FDIC).

[240] *See* § 7:4[3].

[241] 12 U.S.C.A. § 1817(j). *See* 12 C.F.R. §§ 225.41, 225.43 (Board), 5.50(f)(2), (3) (OCC—national banks), 303.80 to 303.86 (FDIC—state nonmember banks), 174.3(b), 174.6(a), (b) (OCC—federal thrifts), 391.42(b), 391.45 (FDIC-insured state-chartered thrifts).

Register inviting comments within a reasonable time.[242] 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.[243] This statutory timetable is in practice 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 Federal Reserve Board; one year, if the approving regulator is the OCC; one year, if the approving regulator is the FDIC in connection with insured state-chartered thrifts; and six months for all other mergers.[244]

[4] 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.[245] As discussed in Section 7:2[1][c], in the absence of regulatory relief from the Federal Reserve Board, this prior approval requirement will apply to foreign banks or the parents of 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 Federal Reserve Board where the target is located.[246]

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 Federal Reserve

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[242] 12 U.S.C.A. § 1817(j)(2)(D).

[243] 12 U.S.C.A. § 1817(j)(1). In the event that a control application is disapproved, an applicant may *seek* judicial review, 12 U.S.C.A. § 1817(j)(5), provided that the acquirer exhausts all administrative remedies (*i.e.*, an administrative hearing).

[244] *See* 12 C.F.R. §§ 262.3(j)(1)(iii) and 262.3(j)(3)(i) (Board), 5.33(e)(7) (OCC—national banks) and 174.7(e) (OCC—federal thrifts), 391.46 (FDIC—insured state-chartered thrifts). *See also*, *e.g.*, Frontier Trust Company, Order Approving Merger (May 2000) (FDIC).

[245] Pursuant to Regulation LL, the Federal Reserve Board has replaced OTS processing requirements for applications and notices with those currently used by the Federal Reserve Board for similar transactions.

[246] 12 C.F.R. § 238.33(a).

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 timetable required by the regulations to be placed on hold. Although the Federal Reserve Board 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 Federal Reserve Board can, and often does, delay action by requesting still more information.

Upon accepting an application as complete, the Federal Reserve Board will transmit copies of the application to interested regulatory agencies.[247] 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 three months after approval by the Federal Reserve Board.[248]

§ 7:6 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 Federal Reserve 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 7:7, 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 Federal Reserve Board considers the following principal factors: (1) the financial resources of the foreign acquirer, the most crucial of which is the

[247] These agencies will include the OCC or the FDIC, depending on whether the thrift is a federal or insured state-chartered thrift. *See* 12 C.F.R. § 238.33(e).

[248] *See* 12 C.F.R. § 262.3(j)(3)(i).

level of the acquirer's risk-based capital ratios;[249] (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 Federal Reserve Board with adequate assurances that it will make available to the Federal Reserve Board such information with respect to the acquirer, and any affiliate as the Federal Reserve Board determines is appropriate to enforce compliance with the BHC Act; (4) the managerial resources of the acquirer and the target, which includes 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; (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;[250] and (9) pursuant to the Dodd-Frank Act, the impact of the acquisition on U.S. financial stability.[251]

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 Federal Reserve Board has endorsed the notion that principles of national treatment and competitive equality 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."[252] Thus, at the present time, the Federal Reserve Board does not consider whether the foreign bank's home country would permit a U.S.

[Section 7:6]

[249] 12 C.F.R. § 225.13 (factors); 12 U.S.C.A. § 1842(c)(6) (antimoney-laundering factor); 12 U.S.C.A. § 1842(d) (additional factors in the case of interstate transactions).

[250] Dodd-Frank Act, Pub. L. No. 111-203, § 604(d) (2010).

[251] Federal Reserve Board, Policy Statement on Supervision and Regulation of Foreign-Based Bank Holding Companies, 2 Fed. Res. Reg. Serv. ¶ 4-835 (1979).

[252] 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.

bank to acquire a bank in the home country.[253]

[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. The Basel Capital Accord of 1988 (Basel I),[254] which was adopted in the United States in 1989 (US Basel I), represented the first step in the standardization of capital standards among countries subscribing to it. In June 1999, the Basel Committee on Banking Supervision (Basel Committee)[255] announced a proposal for a new, more sophisticated capital accord, which ultimately led to the adoption of

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[253]Basel Committee on Banking Supervision of the Group of 10 Countries, International Convergence of Capital Measurement and Capital Standards (July 1988). Basel I established an analytical framework that related regulatory capital requirements to differences in risk profiles among banks, including off-balance sheet exposures. The risk-based capital standard established by Basel I consists of four basic elements: (1) an agreed definition of tier 1 (or core) capital, consisting primarily of common shareholders' 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% (of which at least 4% should be in the form of tier 1 capital). In addition, Basel I 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 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; 167 (OCC); 12 C.F.R. Pt. 325, App. A and C; 12 C.F.R. Pt. 390, Subpt. Z (FDIC).

[254]At the time of Basel II, the Basel Committee consisted 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. Basel Committee on Banking Supervision, International Convergence of Capital Measurement and Capital Standards: A Revised Framework (Comprehensive Version Jun. 2006) at 1, n.1. It has since been expanded to include representatives of authorities from the following additional countries: Argentina, Australia, Brazil, China, Hong Kong, India, Indonesia, Korea, Mexico, Russia, Saudi Arabia, Singapore, South Africa, and Turkey. The Basel Committee usually meets in Basel under the auspices of the Bank for International Settlements, where its permanent Secretariat is located. Basel Committee on Banking Supervision, Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems (Jun. 2011) at 1, n.1.

[255]Basel Committee on Banking Supervision, International Convergence of Capital Measurement and Capital Standards: A Revised Framework

a revised capital accord in June 2006 (Basel II).[256] In December 2010, the Basel Committee issued new international standards on bank regulatory capital and liquidity (Basel III).[257] In June

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(Comprehensive Version Jun. 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 was 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 was on developing a more sensitive system of measuring credit risk, operational risk, and market risk than Basel I. Basel II has two general approaches for measuring credit risk: (i) the standardized approach and (ii) the internal ratings-based approach. It has three ways to measure operational risk: (i) the basic indicator approach, (ii) the standardized approach, and (iii) the advanced measurement approaches. It also has two methods of measuring market risk: (i) the standardized approach and (ii) the internal models approach.

[256] Basel Committee on Banking Supervision, Basel III: A global regulatory framework for more resilient banks and banking systems (revised Jun. 2011). Basel Committee on Banking Supervision, Basel III: International framework for liquidity risk measurement, standards and monitoring (Dec. 2010). Basel III introduces a new tier of capital—common equity tier 1 capital—and requires banks to maintain a minimum ratio of common equity tier 1 capital to risk-weighted assets of 4.5%. It requires banks to maintain a minimum ratio of tier 1 capital (the sum of common equity tier 1 and additional tier 1 capital) to risk-weighted assets of 6% (increased from the current 4%) and a minimum ratio of total capital (the sum of tier 1 and tier 2 capital) to risk-weighted assets of 8% (unchanged from the current requirement). In addition, Basel III introduces regulatory capital buffers–consisting of the capital conservation buffer and, if deployed, the countercyclical buffer—that banks must maintain above these minimum requirements in order to avoid restrictions on capital distributions and discretionary bonus payments.

In terms of the numerator of the risk-based capital ratio, Basel III narrows the eligibility criteria for regulatory capital instruments within each tier of capital and introduces new regulatory deductions from and adjustments to capital, the vast majority of which apply to common equity tier 1 capital instead of tier 1 or total capital. As for the denominator of the risk-based capital ratio, Basel III makes a number of changes to the way banks calculate risk-weighted asset amounts for over-the-counter as well as centrally cleared derivative and repo-style transactions.

Basel III also introduces a non-risk based tier 1 leverage ratio, which takes into account both on- and off-balance sheet exposures in its denominator. Basel III contains a liquidity framework that centers around two quantitative measures of liquidity: the liquidity coverage ratio and the net stable funding ratio. In general, the Basel III capital and liquidity standards will be phased in over a multi-year period.

As of December 31, 2012, certain aspects of the Basel III framework are still being calibrated by the Basel Committee. For a more detailed discussion of the Basel III requirements, *see* §§ 3:1 et seq.

[257] *See* Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions, and Prompt Cor-

2012, the federal banking regulators issued proposals to implement many aspects of the Basel III capital framework in the United States.[258]

In December 2012, the Federal Reserve Board issued the Proposed FBO Rule (discussed in detail in the Editor's Note Regarding Recent Developments). The Proposed FBO Rule will require, if adopted as proposed, certain large foreign banking organizations to consolidate their non-branch or agency operations, including any U.S. bank or thrift subsidiary, under a single intermediate holding company that will be subject to all capital and liquidity requirements applicable to U.S. BHCs of equivalent size. If adopted as proposed, compliance with the rule will be required by July 2015.[259] The Federal Reserve Board has indicated that it plans to have finalized the rules implementing the Basel III capital framework for U.S. BHCs by July 2015 and as such, the Basel III capital framework will be applicable to U.S. intermediate holding company subsidiaries of foreign banking organizations formed for the July 2015 compliance date.

Basel II has been adopted in the European Union (EU) by means of the Capital Requirements Directive (CRD).[260] Under the 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. Consistent with Basel II, the CRD provided for a series of transitional capital floors for

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rective Action, 77 Fed. Reg. 52,792 (Aug. 30, 2012); Standardized Approach for Risk-Weighted Assets; Market Discipline and Disclosure Requirements, 77 Fed. Reg. 52,888 (Aug. 30, 2012); Advanced Approaches Risk-Based Capital Rule; Market Risk Capital Rule, 77 Fed. Reg. 52,978 (Aug. 30, 2012); Risk-Based Capital Guidelines: Market Risk, 77 Fed. Reg. 53,060 (Aug. 30, 2012). The U.S. Basel III proposals do not address the liquidity requirements under Basel III. The Federal Reserve Board has stated that it intends to issue separate proposed rulemaking to implement the Basel III liquidity requirements in the United States.

[258] 77 Fed. Reg. at 76,637.

[259] The CRD comprises Directive 2006/48/EC of the European Parliament and of the Council of June 14, 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 June 14, 2006, on the capital adequacy of investment firms and credit institutions (recast).

[260] While the last transitional floor required by the original CRD expired at the end of 2009, it was reinstated until the end of 2011 by Directive 2010/76/EU of the European Parliament and of the Council of November 24, 2010, amending Directives 2006/48/EC and 2006/49/EC with respect to capital requirements for the trading book and for re-securitizations, and the supervisory review of remuneration policies (CRD III).

banks adopting the internal ratings-based approach for credit risk, which are expressed as minimum percentages of the banks' risk-based capital calculated under Basel I.[261]

In the United States, the federal banking regulators issued a final rule in 2007 (U.S. Basel II) to implement Basel II's advanced internal ratings-based approach for credit risk and advanced measurement approaches for operational risk (together, the advanced approaches)[262], but only for a small subset of U.S. banks and bank holding companies.[263] Under U.S. Basel II, the largest and most internationally active U.S. banking organizations (core banks)[264] are required to calculate their risk-based capital ratios under the advanced approaches while other U.S. banking organizations are permitted to adopt the advanced approaches if they meet the applicable qualification requirements (opt-in banks). Opt-in banks and core banks are collectively referred to as advanced approaches banks.[265] All other U.S. banks are required to calculate their risk-based capital ratios using only the general risk-based capital rules, which as of December 31, 2012, are based on Basel I.[266]

Before an advanced approaches bank may begin determining its risk-based capital requirements in accordance with the advanced approaches under U.S. Basel II, it must obtain approval from its federal banking regulator for its U.S. Basel II implementation plan and conduct a "parallel run" of at least four

[261]The advanced approaches generally permit a bank to use supervisor-approved internal models and other sophisticated methodologies to make regulatory capital calculations.

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

[263]Core banks are those with consolidated total assets (excluding assets held by an insurance underwriting subsidiary of a bank holding company) of $250 billion or more or with consolidated total on-balance-sheet foreign exposure of $10 billion or more.

[264]According to the federal banking regulators, as of the end of 2011, there were 17 core banks and one opt-in bank.

[265]In June 2012, federal banking regulators issued a proposed rule that would implement for virtually all U.S. banks a modified, U.S. version of the standardized approach for credit risk under Basel II, as revised by Basel III. Standardized Approach for Risk-Weighted Assets; Market Discipline and Disclosure Requirements, 77 Fed. Reg. 52,888 (Aug. 30, 2012).

[266]*See, e.g.*, 12 C.F.R. Pt. 225, App. G, § 21(b) to (d) (Board requirements applicable to bank holding companies.).

consecutive quarters.[267] During its parallel run, an advanced approaches bank remains subject to U.S. Basel I but simultaneously calculates its risk-based capital ratios using the advanced approaches under U.S. Basel II and reports them to its primary federal regulator.

As originally adopted, U.S. Basel II would have subjected an advanced approaches bank, upon exiting its parallel run, to three "transitional floor periods," each lasting at least four consecutive quarters. The three transitional floors would equal to 95%, 90%, and 85%, respectively, of what an advanced approaches bank's capital requirements would have been under U.S. Basel I.[268] In accordance with Section 171(b)(2) of the Dodd-Frank Act, commonly known as the Collins Amendment, however, the federal banking regulators eliminated the transitional floors and replaced them with a *permanent* capital floor that is based on the "generally applicable risk-based capital requirements." The Collins Amendment requires federal banking regulators to establish capital requirements that "shall not be less than the generally applicable risk-based capital requirements, which shall serve as a floor for any capital requirements that the agency may require, nor quantitatively lower than the generally applicable risk-based capital requirements that were in effect for insured depository institutions" as of July 21, 2010, the date of enactment of the Dodd-Frank Act.[269]

To implement the Collins Amendment, the federal banking regulators adopted a final rule (Capital Floor Rule) in June 2011 requiring advanced approaches banks to calculate their risk-based capital ratios under both the generally applicable risk-based capital requirements (U.S. Basel I as of December 31, 2012) and the advanced approaches in U.S. Basel II.[270] A core bank must then use the lower of the two tier 1 risk-based capital ratios and the lower of the two total risk-based capital ratios to determine whether it meets its minimum risk-based capital requirements.[271] As a result, until and unless U.S. Basel I is replaced as the generally applicable risk-based capital standard in the United States, it will act as a permanent capital floor for

[267] *See, e.g.*, 12 C.F.R. Pt. 225, App. G, § 21(e) (Board requirements applicable to bank holding companies.).

[268] Dodd-Frank Act, Pub. L. No. 111-203, § 171(b)(2) (2010).

[269] Capital Floor Rule, 76 Fed. Reg. 37,620 (June 28, 2011).

[270] Capital Floor Rule, 76 Fed. Reg. 37,620, 37,622 (Jun. 28, 2011).

[271] Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions, and Prompt Corrective Action, 77 Fed. Reg. 52,792 (Aug. 30, 2012).

advanced approaches banks' risk-based capital requirements.

In June 2012, the federal banking regulators proposed to replace the existing generally applicable risk-based capital requirements with two rules. The first proposed rule (Basel III Numerator Proposal)[272] would implement many of Basel III's revisions to minimum capital requirements and to regulatory capital, the numerator of a bank's risk-based capital ratios. The second proposal (Standardized Approach Proposal)[273] would implement a modified, U.S. version of the standardized approach for credit risk under Basel II. If adopted as final rules, the Basel III Numerator Proposal and Standardized Approach Proposal would together constitute the new permanent capital floor for advanced approaches banks.

The Collins Amendment does not, by its terms, apply to any foreign banking organization itself, but does apply to any U.S. intermediate bank holding company and any U.S. depository institution subsidiaries of the foreign banking organization.[274]

Capital concerns are particularly important in the acquisition context. In general, the Federal Reserve 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 non-risk based capital ratio, would be significantly above the minimum standard both before and after

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[272] Standardized Approach for Risk-Weighted Assets; Market Discipline and Disclosure Requirements, 77 Fed. Reg. 52,888 (Aug. 30, 2012).

[273] Dodd-Frank Act, Pub. L. No. 111-203, § 171(a)(3) and (b)(4)(E) (2010). The requirements of the Collins Amendment will not apply to U.S. bank holding company subsidiaries of foreign banking regulations that had previously relied on the Federal Reserve Board's Supervision and Regulation Letter SR-01-1 (which had permitted those subsidiaries to comply with applicable home-country risk-based capital requirements) until July 2015.

[274] Currently, minimum capital standards for bank holding companies in the United States are: (1) tier 1 capital must constitute at least 4% of total risk-weighted assets; (2) total capital must be at least 8% of risk-weighted assets; and (3) "leverage" (tier 1/average total unweighted assets) must be at least 3% or 4%, depending on certain factors. 12 C.F.R. § 225, App. A and D. A "well capitalized" and "well managed" bank holding company, including a bank holding company that has elected to become a financial holding company, must have capital ratios that meet or exceed tier 1/risk-weighted assets of at least 6% and total capital/risk-weighted assets of at least 10%, and can generally avail itself of the Federal Reserve Board's procedures for streamlined applications processing. *See* 12 C.F.R. §§ 225.2(r); 225.14.

the acquisition.[275] The Federal Reserve Board generally expects that an acquirer will maintain "strong capital levels substantially above the minimum levels specified in the Federal Reserve Board's risk-based capital guidelines, without significant reliance on intangibles, particularly goodwill."[276]

The Federal Reserve Board and other U.S. banking regulators historically have assessed the impact of an acquisition on the acquiring bank's consolidated risk-based capital ratios. Since the onset of the 2008 financial crisis, and particularly in the context of the acquisition of a troubled financial institution, the banking regulators have focused their attention on various metrics of asset quality. For example, both the Federal Reserve Board and the FDIC increasingly have considered the acquiring bank's pro forma classified asset ratios, in which, for example, the numerator consists of unweighted or weighted balances of assets classified as "doubtful," "substandard" and "loss," and the denominator consists of Tier 1 capital and the bank's allowance for loan and lease losses.

Section 214 of FDICIA required the Federal Reserve Board and the Treasury to publish a report establishing guidelines to be used by the Federal Reserve 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 in 1992 pursuant to this requirement (Capital Equivalency Report), the Federal Reserve 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."[277] The report stated that an equivalency standard is consistent with the Federal Reserve 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."[278]

The Capital Equivalency Report did not provide bright-line

[275]Magna Group, Inc., 78 Fed. Res. Bull. 89, 91 (1992).

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

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

[278]According to the Report's guidelines, banks from countries that adhered to Basel I were required, at a minimum, to meet the Basel I guidelines as

rules for assessing the capital of foreign banks. Instead, it established certain informational requirements and, in the case of countries subscribing to Basel I, minimum capital standards, but left the Federal Reserve Board with discretion to determine on a case-by-case basis what constituted equivalency with U.S. capital standards.[279]

In light of the implementation of Basel II in numerous countries outside the United States, it has been a common practice for the Federal Reserve Board to require a foreign bank subject to Basel II to submit, for purposes of assessing its capital resources and capital equivalency, both (1) its Basel II risk-based capital ratios calculated in accordance with home-country requirements and (2) either its Basel I risk-based capital calculated for purposes of complying with its home-country transitional floors (if applicable) or pro forma Basel I risk-based capital calculations (if transitional floors do not apply).[280]

In view of the Collins Amendment, the federal banking regulators are now squarely confronted with the question of how to make capital equivalency determinations when U.S. advanced approaches banks are subject to a permanent capital floor that is currently based on Basel I while foreign banks are not. The problem is exacerbated by the fact that, in certain foreign countries that have implemented Basel II, Basel I transitional floors no longer apply, and thus, banks in those countries no longer produce any information based on Basel I requirements. In adopting the Capital Floor Rule, the federal banking regulators specifically acknowledged these "challenges," but have concluded for now that they will continue to evaluate capital equivalency on

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administered by their home-country supervisors. A bank from a country not subscribing to Basel I was 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. All foreign acquirers were required to 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 country. Board of Governors of the Federal Reserve System & Secretary of the Department of the Treasury, *Capital Equivalency Report*, 43–45 (Jun. 19, 1992).

[279] *See* Capital Floor Rule, 76 Fed. Reg. 37,620, 37,623 (Jun. 28, 2011).

[280] Capital Floor Rule, 76 Fed. Reg. 37,620, 37,624 (Jun. 28, 2011). The banking regulators have stated that they will take into account comments received on the proposed Capital Floor Rule, including those raising a concern that foreign banks would enjoy a competitive advantage over U.S. banks. Capital Floor Rule, 76 Fed. Reg. 37,620, 37,623 to 37,624 (Jun. 28, 2011).

a case-by-case basis.[281]

At a global level, capital requirements are also changing in two ways that could potentially affect the ability of foreign banks to make acquisitions in the United States. The first development is the Basel Committee's release of Basel III. If implemented on a global level as anticipated, Basel III would generally make investments in more than 10% of the share capital of unconsolidated banking, financial, and insurance entities more expensive from a regulatory capital perspective for the acquiring bank, by raising the applicable capital requirements for the acquiring entity. At the same time, Basel III might also make weaker banks vulnerable to takeover if they experience difficulty in meeting the new capital and liquidity standards on top of other heightened financial regulatory requirements that are being implemented in major jurisdictions.

The second global development is the movement toward the adoption of enhanced prudential requirements, including heightened capital requirements, that would apply to the world's largest and most systemically important banks, commonly referred to as global systemically important banks (G-SIBs).[282] In November 2011, the Basel Committee issued a methodology for identifying G-SIBs and a framework for allocating to each G-SIB a common equity tier 1 capital surcharge ranging from 1% to 2.5% of risk-weighted assets, depending on its systemic importance.[283]

Using the Basel Committee's G-SIB methodology and 2009

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[281]In addition to the G-SIB framework, the Basel Committee has also finalized a principles-based framework for domestic systemically important banks (D-SIBs), which are to be identified by the relevant national authorities. Among other things, the Basel Committee's D-SIB principles call for national authorities to impose higher loss absorbency requirements for D-SIBs, which should be met using common equity tier 1 capital. The Basel Committee expects national authorities to begin applying requirements to D-SIBs in line with the phase-in arrangements for the G-SIB framework. Basel Committee on Banking Supervision, A framework for dealing with domestic systemically important banks (Oct. 2012).

[282]Basel Committee on Banking Supervision, Global systemically important banks: assessment methodology and the additional loss absorbency requirement, Rules text (Nov. 2011). The G-SIB capital surcharge will be phased in with the Basel III capital conservation and countercyclical buffers between January 2016 and December 2018, becoming fully effective on January 1, 2019. The G-SIB capital surcharge would function as an extension of the Basel III capital conservation buffer.

[283]Financial Stability Board, Policy Measures to Address Systemically Important Financial Institutions (Nov. 4, 2011). The initial list of G-SIBs included the following: Bank of America; Bank of China; Bank of New York

data, the Financial Stability Board (FSB) in November 2011 issued an initial list of 29 G-SIBs.[284] The FSB stated that the list of G-SIBs will be updated annually in November and the G-SIB surcharge will initially apply to those banks identified in the November 2014 list. In November 2012, the FSB issued an updated list of 28 G-SIBs using year-end 2011 data and provisionally assigned to each G-SIB a common equity tier 1 capital surcharge ranging from 1% to 2.5% of risk-weighted assets.[285]

The G-SIB capital surcharge, when effective, could affect the acquisition of U.S. depository institutions by foreign banks in a number of ways. The most obvious impact would be the increased capital costs of such acquisitions for G-SIBs, thus making such acquisitions more expensive. The development of the G-SIB framework also suggests that international banking supervisors view G-SIBs' size unfavorably, which could lead to additional scrutiny of acquisitions by G-SIBs beyond enhanced capital requirements. Finally, although the FSB's G-SIB identification process and the Basel Committee's G-SIB framework are independent of Dodd-Frank rulemaking, the G-SIB capital surcharge will likely be implemented in the United States as part of the Dodd-Frank enhanced prudential standards that the Federal Reserve Board must establish for bank holding companies with $50 billion or more in total consolidated assets and for other systemically important financial companies under the Federal Reserve Board's supervision (covered companies).[286] In its December 2011 proposal to implement Dodd-Frank enhanced prudential standards for U.S. covered companies, the Federal

Mellon; Banque Populaire CdE; Barclays; BNP Paribas; Citigroup; Commerzbank; Credit Suisse; Deutsche Bank; Dexia; Goldman Sachs; Group Crédit Agricole; HSBC; ING Bank; JP Morgan Chase; Lloyds Banking Group; Mitsubishi UFJ FG; Mizuho FG; Morgan Stanley; Nordea; Royal Bank of Scotland; Santander; Société Générale; State Street; Sumitomo Mitsui FG; UBS; Unicredit Group; and Wells Fargo.

[284] Financial Stability Board, Update of group of global systemically important banks (G-SIBs) (Nov. 1, 2012). The November 2012 list added two banks (BBVA and Standard Chartered) to and removed three banks (Commerzbank, Dexia and Lloyds Banking Group) from the November 2011 list.

[285] Dodd-Frank Act, Pub. L. No. 111-203, § 165 (2010).

[286] Board, Enhanced Prudential Standards and Early Remediation Requirements for Covered Companies, 77 Fed. Reg. 594, 602 (Jan. 5, 2012). In the Federal Reserve Board's Proposed FBO Rule discussed in the Editor's Note Regarding Recent Developments, the Federal Reserve Board indicated that it may, through a separate rulemaking, apply a quantitative risk-based capital surcharge to U.S. intermediate holding company subsidiaries of foreign banking organizations required to be formed pursuant to such rule. 77 Fed. Reg. at 76,640.

Reserve Board stated that it intends to issue a separate proposal to implement "a quantitative risk-based capital surcharge for covered companies or a subset of covered companies based on the [Basel Committee's] capital surcharge framework for G-SIBs."[287]

[b] Other Financial Resources

Even if a foreign acquirer meets the minimum capital standards, the Federal Reserve 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.[288] In considering whether a foreign acquirer will be in a position to support its U.S. operations, the Federal Reserve Board has analyzed foreign capital export controls and government ownership with particular care.

The Federal Reserve 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.[289] The Federal Reserve Board has relied on such restrictions as a basis for rejecting an application.[290] Moreover, although the Federal Reserve 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 Federal Reserve Board's decision on an acquisition application.

The Federal Reserve 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.[291] In contrast, commitments to provide new equity immediately upon completing the acquisition may be

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[287]Board of Governors of the Federal Reserve System & Secretary of the Department of the Treasury, *Capital Equivalency Report*, 44–45 (Jun. 19, 1992). For a discussion of the source of strength obligations of companies that control U.S. banks or thrifts, *see* § 7:7[1].

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

[289]*See* Corporation for Int'l Agric. Prod., Ltd., 70 Fed. Res. Bull. 39, 40 (1984).

[290]*See* Cherokee Bancorp, 77 Fed. Res. Bull. 324, 325 (1991); Cedar Vale Bank Holding Co., 76 Fed. Res. Bull. 257, 258 (1990).

[291]*See, e.g.*, Allied Irish Banks, Ltd., 69 Fed. Res. Bull. 927, 929 (1983).

particularly influential in obtaining Board approval.[292]

Finally, the Federal Reserve 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.[293]

[2] Comprehensive Consolidated Supervision

After the passage of FDICIA, the Federal Reserve 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.[294] A foreign bank may be considered to be subject to comprehensive consolidated supervision (CCS) if the Federal Reserve 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 relation-

[292]The U.S. branch and agency operations of foreign banks are evaluated on risk management, operational controls, compliance, and asset quality (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).

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

[294]The Federal Reserve 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 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)(1)(ii)(A) to (E).

ship of the bank to its affiliates, to assess the foreign bank's overall financial condition and compliance with law and regulation.[295] The terms "comprehensive regulation" and "consolidated basis" are sufficiently broad to leave the Federal Reserve 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 Federal Reserve 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 Federal Reserve Board last considered it."[296] 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 Federal Reserve Board.[297]

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[295] 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).

[296] The Federal Reserve Board has granted CCS status to banks located in Argentina, Australia, Austria, Belgium, Brazil, Canada, Chile, China, Finland, France, Germany, Greece, Hong Kong, Ireland, Israel, Italy, Japan, Korea, Mexico, Micronesia, The Netherlands, Norway, Portugal, Puerto Rico, Spain, Switzerland, Taiwan, Turkey, and the United Kingdom. *See* Edward F. Greene, Beyond Borders: Time To Tear Down the Barriers to Global Investing, 48 Harv. Int'l L. J. 85, 93 n.33 (2007); *see also* Randall Guynn, Emerging Trends and Key Developments in the Regulation and Supervision of Branches and Agencies of International Banks and in the Regulation of International Banks Themselves as Bank Holding Companies and Financial Holding Companies, Annual Regulatory Examination, Risk Management and Compliance Seminar, Institute of International Bankers (Oct. 30, 2007); Federal Reserve, "Press Release: Order Approving the Acquisition of Banks, Merger of Banks, Establishment of Branches and an Agency, and Membership in the Federal Reserve System," released November 16, 1998 (Puerto Rican bank "subject to comprehensive consolidated supervision by the appropriate federal and Puerto Rican bank supervisory agencies."). The Federal Reserve Board considers Egypt, Colombia, India, and Peru to be "actively working to establish" CCS. National Bank of Egypt, 86 Fed. Res. Bull. 344 (2000); Banco de Bogota S.A., Santafe de Bogota, D.E., 87 Fed. Res. Bull. 552 (2001); ICICI Bank, 94 Fed. Res. Bull. C26 (2008); Banco de Credito del Peru, 87 Fed. Res. Bull. 708 (2001).

[297] China Investment Corporation, 96 Fed. Res. Bull. B31 (2010). CIC controls Central SAFE Investments Limited (known as Huijin), which in turn controls three Chinese banks with branches in the United States: Bank of

The Federal Reserve Board has not yet found that banks in certain developing countries, including India, are generally subject to comprehensive supervision on a consolidated basis. In August 2010, the Federal Reserve Board found that China Investment Corporation (CIC),[298] a sovereign wealth fund organized by the Chinese government, was subject to CCS in approving CIC's investment in up to 10% of the common stock of Morgan Stanley but notably did not extend this finding to the Chinese banks indirectly controlled by CIC.

In May 2012, however, the Federal Reserve Board conferred CCS status on three large, state-owned Chinese banks in connection with (i) the application by the Industrial and Commercial Bank of China Limited and its parent companies, CIC and Central Huijin Investment Ltd., to become bank holding companies by acquiring up to 80 percent of the voting shares of The Bank of East Asia (U.S.A.), National Association, a transaction that represented the first acquisition of a U.S. insured depository institution by a Chinese bank since the introduction of the CCS requirement; (ii) the application by Bank of China Limited to establish a branch in Chicago and (iii) the application by Agricultural Bank of China Limited to establish a branch in New York. The Federal Reserve Board's approval of these applications represented the first CCS determinations with respect to a major jurisdiction in nearly ten years.[299]

[3] Adequate Assurances

Under Section 202(d) of FDICIA, the Federal Reserve 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 Federal Reserve Board such information on the acquirer's operations or activities as well as those of its affiliates as the Federal Reserve Board deems necessary to enforce the

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China, China Construction Bank, and Industrial and Commercial Bank of China. The Federal Reserve Board's order stated that, in the event of a proposed acquisition of an insured depository institution in the United States by Huijin or any of the banks owned by Huijin, the Federal Reserve Board would make a separate evaluation of whether the acquiring entity is subject to comprehensive consolidated supervision in China. China Investment Corporation, 96 Fed. Res. Bull. B31 at B34 and n.20 (2010).

[298]In granting its approval, the Federal Reserve Board permitted CIC and Huijin to continue to rely on the Section 4(c)(9) exemption previously granted, notwithstanding their becoming bank holding companies. Industrial and Commercial Bank of China Ltd., China Investment Corp., and Central Huijin Investment Ltd., Fed. Res. Bd. Order No. 2012-4 at 3 & n.10 (May 9, 2012). The Section 4(c)(9) exemption is discussed in § 7:2[3][b].

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

BHC Act.[300] This standard is intended primarily to address bank operations in bank secrecy jurisdictions that deliberately restrict access to information in an effort to attract offshore banking business.[301] The Federal Reserve Board has interpreted this provision not to require the Federal Reserve Board to have access to routine customer information. Rather, information would be sought only when the Federal Reserve Board had reason to believe that U.S. laws had been or were being violated. Moreover, the Federal Reserve 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.[302]

Following the adoption and implementation of the EU Data Protection Directive[303] in the member states of the EU, the Federal Reserve Board has, in applying this standard to EU and other foreign banks, reviewed its ability to access information about the operations of the bank and its affiliates necessary for purposes of the BHC Act and other applicable federal law. The Federal Reserve Board has often required the foreign bank to make commitments to make such information available and to cooperate with the Federal Reserve Board in obtaining any nec-

[300]*See* Misback, The Foreign Bank Supervision Enhancement Act of 1991, 79 Fed. Res. Bull. 1, 7 (1993).

[301]*See* 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." Misback, The Foreign Bank Supervision Enhancement Act of 1991, 79 Fed. Res. Bull. 1, 7 (1993).

[302]Directive 95/46/EC of the European Parliament and of the Council of the European Union of October 24, 1995.

[303]*See, e.g.*, Allied Irish Banks, p.l.c., 95 Fed. Res. Bull. B81, B83 n.17 (2009); BNP Paribas, 88 Fed. Res. Bull. 97, 98-99 (2002); Royal Bank of Scotland Group plc, 88 Fed. Res. Bull. 51, 58 (2002); Commerzbank AG, 85 Fed. Res. Bull. 336, 337 (1999); Banco Santander, S.A., 85 Fed. Res. Bull. 441, 444 (1999). *See also* Caja de Ahorros de Valencia, 97(2) Fed. Res. Bull. 4, 6 n.8 (2011) (requiring foreign bank to make information available to the Federal Reserve Board "to the extent not prohibited by applicable law"). The Federal Reserve Board has required the same commitments from foreign banks from non-EU jurisdictions as well. *See, e.g.*, Banco do Brasil, S.A., 98(3) Fed. Res. Bull. 1, 4 n.13 (2012); Bank of Montreal, 97 Fed. Res. Bull. 24, 28 n.17 (2011); Mitsubushi UFJ Financial Group, Inc., 97(4) Fed. Res. Bull. 10, 15 n.27 (2011). The Commitments are substantially identical to those required in connections with a foreign bank's application under Regulation K to establish a branch, agency, or representative office in the United States. *See* 12 C.F.R. § 211.24(c)(2)(v); Form FR K-2, Attachment E.

essary waivers or exemptions under the laws of relevant jurisdictions to obtain the information.[304]

[4] Management Resources

Section 210 of FDICIA requires the Federal Reserve Board to focus its analysis of an acquirer's managerial resources on "consideration of the competence, experience, and integrity of the officers, directors, and principal shareholders" of the acquirer.[305] The enormous discretion conferred by this provision not only gives the Federal Reserve Board authority to require extensive disclosure of the backgrounds and identities of all persons affiliated with the acquirer, including its principal shareholders, but also to derail an acquisition on the basis of this information. The Federal Reserve 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.[306] As a result of this provision and in the aftermath of the BCCI scandal, the Federal Reserve Board has instituted a policy of requiring "name checks" of the top two decision makers 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 Federal Reserve Board emphasizes performance records under the Community Reinvestment Act (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

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

[305] *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").

[306] 12 U.S.C.A. § 2903; Statement of the Federal Financial Supervisory Agencies Regarding the Community Reinvestment Act, 54 Fed. Reg. 13,742 (Apr. 5, 1989) (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 Federal Reserve Board will consider the institution's entire CRA record as an integral component of the convenience and needs of the community assessment.

applications.[307] The Federal Reserve 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 Federal Reserve Board will consider whether an acquiring institution has satisfactorily complied with the reporting requirements of the Home Mortgage Disclosure Act (HMDA) and the Equal Credit Opportunity Act (ECOA).[308]

A foreign bank that does not own an insured depository institution or have an insured branch in the United States at the time that it submits an application to acquire an FDIC-insured bank or branch is not itself required to comply with the requirements of CRA.[309] Nonetheless, the Federal Reserve Board will consider the CRA record of the target institution as a relevant factor in its CRA analysis[310] although there is no case in which the Federal Reserve 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 in which CRA is a concern, moreover, the Federal Reserve Board typically requires assurances from an acquirer that it will improve the target's CRA compliance after the acquisition is complete.[311]

[307] 12 U.S.C.A. §§ 2801 et seq.; 15 U.S.C.A. §§ 1691 et seq.

[308] *See* 12 U.S.C.A. §§ 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 if the foreign acquirer did not previously have a branch in the target bank's state unless the resulting branch limits its deposits to those permissible for an Edge Act Corporation.

[309] 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).

[310] 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 Federal Reserve Board. *See* 12 U.S.C.A. § 2903. As a result, a foreign acquirer anticipating future acquisitions should evaluate carefully the CRA performance record of any potential target.

[311] These statutes include: (1) limitations on brokered deposits, 12 U.S.C.A. § 1831f; (2) the Truth in Lending Act (TILA), which requires accurate and complete disclosure by the creditor of all terms of any consumer loan transaction, 15 U.S.C.A. §§ 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.A. §§ 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.A. §§ 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

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.[312] Compliance with two of these statutes (HMDA and ECOA)[313] has been considered by the Federal Reserve Board as

established by individuals primarily for personal purposes and involving the use of electronics, telephones, and computers, 15 U.S.C.A. § 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.A. § 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.A. §§ 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.A. § 1692; (9) the ECOA, prohibiting discrimination in the issuance of credit, 15 U.S.C.A. § 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.A. § 1681. *See generally* Chubb and Tahyar, Foreign Banks and the New U.S. Banking Legislation, 7 J. 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* § 7:2[2], by its amendment of Section 9(b) of the IBA, 12 U.S.C.A. § 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.A. § 3106a.

[312]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., §§ 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, sex, marital status, age, or exercise of rights under the consumer protection laws. The implementing regulations, 12 C.F.R. §§ 202.1 e*t 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.

[313]*See, e.g.*, Mitsubishi UFJ Financial Group, Inc., The Bank of Tokyo-Mitsubishi UFJ, Ltd., and UnionBanCal Corp., Fed. Res. Bd. Order. No. 2012-12 at 12-24 (Nov. 14, 2012) (HMDA); First Union Corp., 83 Fed. Res. Bull. 1012, 1016–17 (1997) (HMDA); Banc One Corp., 83 Fed. Res. Bull. 520, 522, 526 (1997) (ECOA). Although compliance with HMDA is considered in the Federal Reserve Board's review process, it is not, by itself, conclusive. In the First Union application, the Federal Reserve Board reviewed First Union's HMDA data and noted that such data indicated noncompliance with fair lending laws

relevant in connection with the convenience and needs of the community analysis under Section 3 of the BHC Act in certain bank acquisition transactions.[314] 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 Federal Reserve 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 Federal Reserve 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 Federal Reserve 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 Federal Reserve Board denied

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and an inaccurate record of CRA-related lending. The Federal Reserve 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 Federal Reserve Board ultimately found that First Union's CRA performance was acceptable. *See* First Union Corp., 83 Fed. Res. Bull. 1012, 1016–17 (1997). In the Banc One application, the Federal Reserve 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).

[314] *See* Totalbank Corp. of Florida, 81 Fed. Res. Bull. 876, 877—78 (1995); *see also* First Colonial Bankshares Corporation Chicago, 79 Fed. Res. Bull. 706 (1993); Gore-Bronson Bancorp, Inc., 78 Fed. Res. Bull. 784 (1992). In its decision in Gore-Bronson, the Federal Reserve Board considered the CRA rating of both the acquiring institution and the target, Water Tower Trust and Savings Bank. The Federal Reserve Board found a consistent pattern of noncompliance with CRA by a subsidiary of Gore-Bronson and the target. The Federal Reserve Board declined to approve the application despite commitments for future CRA improvement made by Gore-Bronson. The Federal Reserve 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).

the application despite efforts by the banks to improve their CRA performance.[315]

In addition, in high-profile bank acquisitions, the Federal Reserve Board has held public hearings at which activist groups have been given an opportunity to speak on the acquirer's and target's CRA record. A foreign bank acquirer should anticipate that such public hearings, if held, may slow down the application process.[316]

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.[317] 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

[315]In reviewing Capital One Financial Corporation's acquisition of ING Bank (ING DIRECT) in 2012, the Federal Reserve Board held three days of public hearings in three different cities and extended the public comment period to a total of more than 85 days. Capital One Financial Corporation, 98(5) Fed. Res. Bull. 7, 8–9 & n.6 (2012). Although the Federal Reserve Board's decision to hold public hearings and extend the comment period may have been primarily attributable to the fact that Capital One has total assets of more than $50 billion and thus that the Federal Reserve Board must, pursuant to the Dodd-Frank Act, consider the risk of an acquisition to the stability of the U.S. banking or financial system (*see* § 7:6[9]), the Federal Reserve Board declared that the purpose of the hearings was to collect information relating to all of the factors to be considered under the BHC Act, including the target insured depository institution's record under the CRA. Federal Reserve, "Press Release: Public Meetings on the Notice by Capital One Financial Corporation to Acquire ING Bank," released August 26, 2011, *available at* http://www.federalreserve.gov/newsevents/press/orders/20110826a.htm. *See also* Bank of America Corporation, 94 Fed. Res. Bull. C81, C82 (2008) (three days of public hearings and public comment period extended to more than 50 days); J.P. Morgan Chase & Co./Bank One Corporation, 90 Fed. Res. Bull. 352, 353 (2004) (two days of public hearings and public comment period extended to 81 days); Chemical Banking Co., 82 Fed. Res. Bull. 239, 240 (1996); NationsBank Corporation, 84 Fed. Res. Bull. 858, 866 (1998); Travelers Group Inc., 84 Fed. Res. Bull. 985, 986 (1998).

[316]The same concerns arise in the interstate merger context because the FDI Act, 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.A. § 1831u(b)(3).

[317]15 U.S.C.A. §§ 1 to 7 (prohibiting, *inter alia*, transactions which monopolize or attempt to monopolize a market).

compliance with CRA as it relates to any future applications submitted to the Federal Reserve Board by the foreign bank.

[6] Antitrust Considerations

[a] Summary

Another factor considered by the Federal Reserve Board in evaluating an acquisition under Section 3 of the BHC Act is the likely impact of the proposed acquisition on competition. The Federal Reserve 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 Federal Reserve 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 nondepository institutions as noncompetitors within each geographic market. It uses the Herfindahl-Hirschman Index (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 Federal Reserve Board relies on market concentration data provided by the acquirer 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 Web site (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%), 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%, 20%, and 70%, respectively, the HHI for that market would be calculated in the following manner: $10^2 + 20^2 + 70^2$. This would equal 100 + 400 + 4,900, or a total of 5,400. If A and B merged, they would have a combined share of 30%, and the HHI after the transaction would be $30^2 + 70^2$. This would equal 900 + 4900, or a total of 5,800. The change in HHI produced by the transaction would be 5,800 – 5,400, or a difference of 400.

As discussed in more detail in Section 7:6[6][g], the Federal Reserve 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.

[b] Legal Framework

In language substantively equivalent to that of their antitrust analogs in the Sherman Act[318] and the Clayton Act,[319] Section 3 of the BHC Act prohibits monopolization[320] and generally bars approval of any acquisition that may substantially lessen competition, tend to create a monopoly, or be in restraint of trade.[321] 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.[322] The public interest exception is similar to the exception developed in ordinary antitrust case law for acquisitions involving a failing company but is somewhat broader than that exception.[323]

The Clayton and Sherman Acts also apply directly to bank

[318] 15 U.S.C.A. §§ 12 to 19, 21 to 27; 29 U.S.C.A. §§ 52 to 53 (prohibiting, *inter alia*, transactions that may have "the effect" of "substantially [lessening] competition, or tend[ing] to create a monopoly").

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

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

[321] 12 U.S.C.A. § 1842(c)(1)(B). *See also* 12 U.S.C.A. §§ 1828(c)(5)(B) (Bank Merger Act), 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.

[322] *See* § 7:6[6][i] (discussion of failing company defense); U.S. v. Third Nat. Bank in Nashville, 390 U.S. 171, 187, 88 S. Ct. 882, 19 L. Ed. 2d 1015 (1968) (public interest exception intended to reach banks not yet failing).

[323] U.S. v. Philadelphia Nat. Bank, 374 U.S. 321, 83 S. Ct. 1715, 10 L. Ed. 2d 915 (1963) (Bank Merger Act does not preclude application of Clayton Act § 7 to bank acquisitions).

acquisitions.[324] Despite the substantial equivalence of the antitrust laws' provisions to those of the banking laws,[325] this

[324]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.A. § 1849(b)(1). *See also* 12 U.S.C.A. § 1828(c)(7)(B) (Bank Merger Act); U. S. v. Citizens and Southern Nat. Bank, 422 U.S. 86, 95 S. Ct. 2099, 45 L. Ed. 2d 41, 1975-1 Trade Cas. (CCH) ¶ 60360 (1975) (Bank Merger Act) (bank acquisitions are subject to Clayton Act standards unless the public interest exception is met).

[325]The DOJ's review is facilitated by the Federal Reserve 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 Federal Reserve 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.A. § 1849(b)(1). *See also* 12 U.S.C.A. § 1828(c)(6), (7) (Bank Merger Act). It is usual, however, for the DOJ to consent to a shorter statutory waiting period of 15 calendar days. *See* 12 C.F.R. § 225.17(h)(3). The DOJ is usually able to resolve its competitive concerns without resort to a civil action by informally intervening in the approval process. This informal intervention, however, can be very disruptive and expensive. For example, in the acquisition of Security Pacific Corp. by BankAmerica Corp. in Apr. 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 Federal Reserve 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.A. § 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 Improvements Act of 1976, 15 U.S.C.A. § 18a (the HSR Act), 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 double coverage is quite significant. It allows bank acquisitions to be challenged on federal antitrust grounds by the DOJ, state attorneys general, and private litigants, as well as the Federal Reserve 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.[326] This is significant not only because it adds another layer of bureaucracy to the approval process, but also because the DOJ has developed antitrust standards different from those of the Federal Reserve Board.[327] State attorneys general apply yet another set of antitrust standards, although their intervention in

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would be exempt from all or most requirements under the HSR Act. *See* 15 U.S.C.A. § 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 certain nonbanking (nonthrift) 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 Federal Reserve Board under Section 3 or 4 of the BHC Act or any other federal bank or thrift regulator. However, pursuant to the Dodd-Frank Act, in the case of certain nonbanking acquisitions in which the target company has $10 billion or more in assets, an HSR filing will be required. *See* Dodd-Frank Act, Pub. L. No. 111-203, §§ 163 and 604(e) (2010). For more information on these provisions, *see* §§ 11:1 et seq.

[326] *See* § 7:6[6][d] (discussing DOJ approach to product market definition).

[327] 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.A. § 26; California v. American Stores Co., 495 U.S. 271, 279–80, 110 S. Ct. 1853, 1857, 109 L. Ed. 2d 240, 250, 1990-1 Trade Cas. (CCH) ¶ 69003 (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 Federal Reserve 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,"* Annual Meeting of the American Bar Association, New York, NY, Aug. 10, 1993, at 8. 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 § 1254. 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) and 142-a.

bank acquisitions historically has not been on the same level as that of the DOJ.[328]

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 an 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.[329]

[c] Steps in Evaluating Competitive Effect

Regardless of whether the Federal Reserve Board, the DOJ, or a state attorney general is conducting the antitrust review of a proposed bank acquisition, the basic framework of the analysis 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 authorities measure the effect of the proposed acquisition on market concentration, and analyze likely effects on competition and prices in the relevant market. 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 or deposits 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,[330] or groups of products, offered by the merging banks constitute distinct lines of commerce.[331] The Federal Reserve 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

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[328] 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.

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

[330] *See* § 7:6[6][d].

[331] *See* § 7:6[6][e].

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.[332] On occasion, the Federal Reserve 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.[333] The Federal Reserve 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.[334] The first step in this analysis is traditionally a calculation of what immediate effect the transaction will have on the distribution of market share. Using the HHI, the Federal Reserve 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 to determine whether that increased concentration will actually lead to decreased market competition.

The newest version of the Horizontal Merger Guidelines, issued by the DOJ and the FTC in 2010, has emphasized factors beyond market concentration, calling the latter only "one useful indicator of likely competitive effects of a merger," and explaining that "[a] merger enhances market power if it is likely to encourage one or more firms to raise price, reduce output, diminish innovation, or otherwise harm customers as a result of diminished

[332]*See* § 7:6[6][f].

[333]*See* § 7:6[6][g].

[334]DOJ and Federal Trade Comm'n, 2010 Horizontal Merger Guidelines §§ 1, 5.3, *reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,100.

competitive constraints or incentives."[335] Regulators and the DOJ can look at a broad range of factors to determine a merger's competitive effects, including the transparency of pricing in the market, how powerful the merging companies' customers are in negotiating prices with the merger companies, the capacity of other competitors in the market to expand services, and the likelihood of new banks entering the market in response to an increase in 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 that the parties can demonstrate to regulators that the transaction has procompetitive customer benefits, *e.g.*, cost-saving efficiencies, which outweigh any anticompetitive harms.[336] Alternatively, the parties may agree to divest themselves of sufficient assets and deposits (usually whole branches) to cure the anticompetitive effect of the proposed transaction.[337] Divestitures historically were required before a transaction could be completed, 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 Federal Reserve 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.[338] The Federal Reserve Board continues to hold to this

[335] *See* § 7:6[6][h].

[336] *See* § 7:6[6][j].

[337] *See, e.g.*, U.S. v. Philadelphia Nat. Bank, 374 U.S. 321, 83 S. Ct. 1715, 10 L. Ed. 2d 915 (1963); The Connecticut Bank and Trust Co., 2-2 O.C.C.Q.J. 66 (Jun. 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) (*amended at* 67 Fed. Reg. 48,178 (July 23, 2002); 67 Fed. Reg. 79,278 (Dec. 27, 2002) and 73 Fed. Reg. 8,870 (Feb. 15, 2008)); Bank of America Corporation/FleetBoston Financial Corporation, 90 Fed. Res. Bull. 217 (2004).

[338] *See, e.g.*, J.P. Morgan Chase & Co./Bank One Corporation, 90 Fed. Res. Bull. 352, 354 n.14 (2004) (rejecting commenters' claims that credit card issuance was a separate product and reiterating that "the appropriate product market for analyzing the competitive effects of bank mergers and acquisitions is the cluster of products and services offered by banking institutions"); Bank of America Corporation/FleetBoston Financial Corporation, 90 Fed. Res. Bull. 217

view,[339] although the Supreme Court has not considered the issue in more than 35 years.[340] 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. 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 the observation that consumers tended to purchase all their financial products in a cluster from the same local commercial bank.[341] 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.[342]

(2004); Chase Manhattan Corp., 87 Fed. Res. Bull. 76, 78 & n.2 (2001) (using the cluster product-line approach and rejecting suggestions that the enactment of the Gramm-Leach-Bliley Act required the abandonment of the product cluster approach in favor of a focus on individual products and services); Chemical Banking Co., 82 Fed. Res. Bull. 239, 241 (1996) (rejecting arguments that individual product markets should be evaluated); 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 (Jun. 1993) (rejecting the position that cluster of products should be disaggregated). In the proposed First Security/Zions merger, however, the Federal Reserve 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).

[339] U. S. v. Connecticut Nat. Bank, 418 U.S. 656, 666, 94 S. Ct. 2788, 41 L. Ed. 2d 1016, 1974-1 Trade Cas. (CCH) ¶ 75124 (1974) is the most recent Supreme Court decision to consider the issue.

[340] U.S. v. Philadelphia Nat. Bank, 374 U.S. 321, 356–357, 83 S. Ct. 1715, 10 L. Ed. 2d 915 (1963); U. S. v. Phillipsburg Nat. Bank & Trust Co., 399 U.S. 350, 360–361, 90 S. Ct. 2035, 26 L. Ed. 2d 658, 1970 Trade Cas. (CCH) ¶ 73245 (1970).

[341] U. S. v. Phillipsburg Nat. Bank & Trust Co., 399 U.S. 350, 360–361, 90 S. Ct. 2035, 26 L. Ed. 2d 658, 1970 Trade Cas. (CCH) ¶ 73245 (1970). *See generally* Statement of Scott G. Alvarez, General Counsel, Board of Governors of the Federal Reserve System, before the Antitrust Modernization Commission, Dec. 5, 2005, 8–11 *available at* http://govinfo.library.unt.edu/amc/commission_hearings/pdf/Alvarez_Statement.pdf.

[342] 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 (1992).

Studies conducted by the Federal Reserve Board in the early 1990s did 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 showed 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.[343]

The Federal Reserve Board continues to adhere to the single cluster approach. However, in considering Bank of America Corporation's acquisition of Countrywide Financial Corporation and its subsidiary savings association, Countrywide Bank, FSB, the Federal Reserve Board specifically considered commenters' concern that the acquisition would reduce competition for mortgage lending and proceeded to analyze the issue by considering data for two distinct markets, one for mortgage servicing and one for mortgage originations. The Federal Reserve Board ultimately concluded that these two markets were national in geographic scope and that they would remain unconcentrated in terms of HHI.[344]

The DOJ has historically disaggregated the traditional cluster

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[343]Bank of America Corporation, 94 Fed. Res. Bull. C81, C85–C86 (2008). The Federal Reserve Board also considered the impact of the acquisition on other categories of nonbanking activities such as community development, property appraisal, and real estate settlement activities. Bank of America Corporation, 94 Fed. Res. Bull. C81, C86 (2008). *See also* Capital One Financial Corporation, 98(5) Fed. Res. Bull. 7, 11–12 (2012) (analyzing competitive impact on three separate categories of banking and non-banking activities: (i) deposit-taking and lending; (ii) investment advisory services; and (iii) securities brokerage services). *Cf.* J.P. Morgan Chase & Co./Bank One Corporation, 90 Fed. Res. Bull. 352, 354 n.14 (2004) (concluding that, even if credit card issuance was viewed as a separate market, the increase in HHI and resulting HHI would be within the DOJ's Merger Guidelines).

[344]*See, e.g.*, United States v. Fleet/Norstar Fin. Group, Inc., 56 Fed. Reg. 33,458 (Jul. 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.

of products into several separate markets.[345] This disaggregation has occurred along two distinct lines. First, and 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.[346] Second, the DOJ has stated that there are separate markets within each of these clusters for distinct products such as cash management services and commercial loans.[347] However, notwithstanding the DOJ's references to individual product markets, it has generally concurred with the Federal Reserve Board's conclusions on the competitive impact of bank mergers.

[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

[345]This was the position taken by the DOJ in its competitive impact statements with respect to the First Hawaiian, 56 Fed. Reg. 10,916 (Mar. 14, 1991); Fleet/Norstar, 56 Fed. Reg. 33,458 (Jul. 22, 1991); Texas Commerce, 58 Fed. Reg. 15,361 (Mar. 22, 1993); and Society, 57 Fed. Reg. 10,371 (Mar. 25, 1992), transactions. *See also* DOJ, "Press Release: Justice Department Requires Wells Fargo and Co. and Brenton Banks Inc. to Make Divestitures in Des Moines, Iowa," released October 18, 2000, *available at* http://www.usdoj.gov/atr/public/press_releases/2000/6778.htm (noting that a divestiture will ensure that "customers, including small and medium-sized businesses, will continue to have banking choices").

[346]Statement of James F. Rill, Assistant Attorney General, 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, Deputy Assistant Attorney General for Economics, & Margaret E. Guerin-Calvert, Assistant Chief of Economic Regulatory Section, Antitrust Division, DOJ, before the Federal Reserve Bank of Chicago, May 8, 1992, at 14 (stating that DOJ had analyzed the likely competitive effects of bank acquisitions in individual product markets for small business operating capital loans and transaction accounts).

[347]U.S. v. Marine Bancorporation, Inc., 418 U.S. 602, 619, 94 S. Ct. 2856, 41 L. Ed. 2d 978, 1974-1 Trade Cas. (CCH) ¶ 75125 (1974); DOJ and Federal Trade Comm'n, 2010 Horizontal Merger Guidelines § 4.2, *reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,100; FDIC Statement of Policy on Bank Merger Transactions, 63 Fed. Reg. 44,761, § III.1 (Aug. 20, 1998) (revising 1989 policy) (*amended at* 67 Fed. Reg. 48,178 (July 23, 2002); 67 Fed. Reg. 79,278 (Dec. 27, 2002); and 73 Fed. Reg. 8,870 (Feb. 15, 2008)).

source of banking products.[348] The Supreme Court, the Federal Reserve Board, and the DOJ consider banking to be an essentially local business and therefore almost always define the relevant geographic market locally.[349]

The Federal Reserve Board has developed predetermined local geographic markets that will be at least facially applicable to most bank acquisitions.[350] These markets will be entirely satisfactory from the applicant's perspective when, as is usually the case,

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[348]U.S. v. Philadelphia Nat. Bank, 374 U.S. 321, 83 S. Ct. 1715, 10 L. Ed. 2d 915 (1963); J.P. Morgan Chase & Co./Bank One Corporation, 90 Fed. Res. Bull. 352, 354 and App. A (2004) (identifying seven local banking markets in which the merging banks competed directly); Letter from James F. Rill, Assistant Attorney General, DOJ, dated Mar. 12, 1992, to Alan Greenspan, Chairman, Board of Governors of the Federal Reserve System (stating DOJ's position with respect to the BankAmerica/Security Pacific acquisition); *see also* Werden, Perceptions of the Future of Bank Merger Antitrust: Local Areas Will Remain Relevant Markets, 13 Fordham J. Corp. & Fin. L. 581 (2008). In recent years, the Federal Reserve Board has issued papers examining whether it should continue to analyze banking markets locally given that banking markets are becoming less local and larger in scope, arguably due to financial innovation, such as the growth of internet banking and other technological developments. To date, the Federal Reserve Board has not made any policy decision to change the current method of antitrust analysis. *See* Dean F. Amel, Arthur B. Kennickell, & Kevin B. Moore, Federal Reserve Board, Divisions of Research & Statistics and Monetary Affairs, *Banking Market Definition: Evidence from the Survey of Consumer Finances* (2008); John R. Walter & Patricia E. Wescott, *Antitrust Analysis in Banking: Goals, Methods, and Justifications in a Changed Environment*, 94 Economic Quarterly 45 (2008).

[349]Each Federal Reserve Bank has developed predetermined markets for its region, often based on statistical proxies such as Rand-McNally Metropolitan Areas (RMA's). *See* Donald P. Morgan & Megan Todd, Federal Reserve Bank of New York Banking Markets (Feb. 22, 2006). *See, e.g.*, United Bankshares, Inc., 97(4) Fed. Res. Bull. 19, 21 n.11 and n.13 (2011) (defining two West Virginia banking markets by reference to RMA and non-RMA portions of counties). *See also* Comptrollers Licensing Manual, Business Combinations, App. B (Apr. 2006). 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) (revising 1989 policy) (*amended at* 67 Fed. Reg. 48,178 (July 23, 2002); 67 Fed. Reg. 79,278 (Dec. 27, 2002); and 73 Fed. Reg. 8,870 (Feb. 15, 2008)).

[350]*See* Pennbancorp, 69 Fed. Res. Bull. 548, 549 (1983); Texas E. BanCorp, 69 Fed. Res. Bull. 636, 637 (1983). 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) (revising 1989 policy) (*amended at* 67 Fed. Reg. 48,178 (July 23, 2002); 67 Fed. Reg. 79,278 (Dec. 27, 2002); and 73 Fed. Reg. 8,870 (Feb. 15, 2008)). Third parties commenting on an acquisition application also may oppose the Federal

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.[351] 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.[352]

Conversely, it is equally possible for the Federal Reserve 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 competitive analysis and delaying the application process for approximately four months.[353]

Reserve Board's predetermined markets. *See, e.g.*, Norwest Corp., 80 Fed. Res. Bull. 455, 456–457 (1994).

[351]*See, e.g.*, First York Ban Corp., 88 Fed. Res. Bull. 251, 251–52 (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, 241–42 (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, Jan./Feb. 1993, at 26 (setting forth in detail approach of the Atlanta Federal Reserve Bank to geographic market definition).

[352]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 Federal Reserve 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 Federal Reserve Board expressly rejected applicant's contention that the RMA defined the relevant market. Bancsecurity Corporation, 83 Fed. Res. Bull. 122, 122–23 (1997).

[353]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*

[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 Federal Reserve Board, thereby tending to develop models of markets with greater concentration than those used by the Federal Reserve Board.

The Federal Reserve 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.[354] The Federal Reserve Board also includes thrifts, although the Federal Reserve 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 market for business banking services to the extent that they have been shown actually to compete in the market. The Federal Reserve Board may under certain circumstances include other types of depository institutions as well although the DOJ generally will not.

[i] Commercial Banks

The Federal Reserve Board includes as competitors all commercial banks doing business in the defined geographic market.

Considerations in Mergers and Acquisitions of Bank Holding Companies, Antitrust Rep., Feb. 1999, at 11. 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." David S. Neill, *U.S. Antitrust Considerations in Mergers and Acquisitions of Bank Holding Companies*, Antitrust Rep., Feb. 1999, at 11.

[354] The DOJ also includes commercial banks that are "rapid 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. DOJ and Federal Trade Comm'n, 2010 Horizontal Merger Guidelines § 5.1, *reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,100.

The DOJ generally does so as well,[355] 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.[356]

[ii] 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 Federal Reserve Board generally includes thrifts only as partial competitors, counting 50% of thrifts' deposits in calculating market concentration.[357] If, however, thrifts have been shown to play a more significant role in the relevant mar-

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[355]United States v. Texas Commerce, 58 Fed. Reg. 15,361, 15,374 (Mar. 22, 1993).

[356]*See, e.g.*, Sumitomo Mitsui Financial Group, Inc. and Sumitomo Mitsui Banking Corp., Fed. Res. Bd. Order No. 2012–11 at 5 n.12 (Oct. 31, 2012); Hancock Holding Company, 97(4) Fed. Res. Bull. 1, 3 n.10 (2011); Comerica Incorporated and Comerica Bank, 97(5) Fed. Res. Bull. 1, 3 n.12 (2011); J.P. Morgan Chase & Co./Bank One Corporation, 90 Fed. Res. Bull. 352, 354–355 n.20 (2004) (rejecting J.P. Morgan's contention that Washington Mutual's deposits in the Houston banking market share should be included at 100% instead of 50%). In calculating post-transaction market concentration in the context of a thrift acquisition, however, the Federal Reserve Board and the OCC generally include the acquired thrift's deposits at 100%. The rationale for this difference in treatment is that, post-acquisition, the thrift's deposits are controlled by a commercial banking organization. *See, e.g.*, Bank of America Corporation, 94 Fed. Res. Bull. C81, C83 n.15 (2008) (Countrywide's deposits were weighted at 50% pre-acquisition and at 100% post-acquisition); First Hawaiian, Inc., 77 Fed. Res. Bull. 52, 55 (1991).

[357]*See, e.g.*, River Valley Bancorp, Fed. Res. Bd. Order No. 2012-10 at 3 n.6 (Oct. 17, 2012) (full weighting of thrift deposits when "a particular thrift serves as a significant source of commercial loans and provides a broad range of consumer, mortgage, and other banking products"); Bank of Montreal, 97(4) Fed. Res. Bull. 24, 27 n.12 (2011) (deposits of thrift weighted at 100% because thrift was owned by commercial banking organization); 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).

ket, the Federal Reserve Board has included them at 100%.[358] For example, in approving the acquisition by PNC Financial Services Group of National City Corporation and its subsidiary bank, National City Bank, the Federal Reserve Board included the deposits of five thrifts in the Pittsburgh banking market at 100% because (1) two thrifts had a ratio of commercial and industrial (C&I) loans to assets of at least 5%; (2) one thrift had a ratio of C&I loans to total loans of more than 10%, comparable to the then-national average for commercial banks; and (3) the two other thrifts had C&I loan-to-asset ratios slightly below 5% but, based on discussions with personnel of the thrifts and their commercial bank competitors, were found to be active participants in the market's commercial lender sector.[359]

The DOJ has generally included thrift deposits at a 100% weight in retail banking markets.[360] In markets for business banking services, the DOJ will include 100% of the deposits of each thrift that satisfies the "2 percent test" noted in this Section but will exclude all of the deposits of each thrift that fails to meet this threshold.

[iii] 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 historically rejected the inclusion of such institutions on the grounds that they do not offer the complete line of business banking services

[358] PNC Financial Services Group, Inc., 95 Fed. Res. Bull. B1, B3 n.23 (2009). *See also* National City Corp., 84 Fed. Res. Bull. 281, 283 n.12 (1998) (weighing thrift deposits at 100% based on relatively high levels of commercial loans as a percentage of assets compared to national average for thrifts); Banco Popular de Puerto Rico, 79 Fed. Res. Bull. 979, 980 n.6 (1993) (weighting thrift deposits at 100% because thrifts in relevant market were more active in commercial lending, as a percentage of loans to total assets, than the national average for thrifts).

[359] *E.g.*, United States v. Texas Commerce, 58 Fed. Reg. 15,361, 15,373 n.9 (Mar. 22, 1993).

[360] United States v. Society Corp., 57 Fed. Reg. 10,371, 10,379 to 10,380 (Mar. 25, 1992); United States v. Fleet/Norstar Fin. Group, Inc., 56 Fed. Reg. 33,458, 33,464 to 33,465 (Jul. 22, 1991); United States v. Texas Commerce, 58 Fed. Reg. 15,361, 15,373 (Mar. 22, 1993). However, the DOJ has included credit unions as market participants in retail banking services. Letter from James F. Rill, Assistant Attorney General, DOJ, dated Mar. 12, 1992, to Alan Greenspan, Chairman, Board of Governors of the Federal Reserve System (stating DOJ's position with respect to the BankAmerica/Security Pacific acquisition), at 5.

provided by commercial banks and some thrifts.[361] The Federal Reserve Board has included credit unions or concluded that they represent a mitigating factor to the potential competitive effects of a merger if they hold a sufficient percentage of deposits within the relevant geographic market.[362]

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[361]*See, e.g.*, River Valley Bancorp, Fed. Res. Bd. Order No. 2012-10 at 4–5 (Oct. 17, 2012) (considering as a mitigating factor that three community credit unions exert a competitive influence in the relevant geographic market and performing an alternative HHI calculation based on weighting the credit unions' deposits at 50%); United Bankshares, Inc., 97(4) Fed. Res. Bull. 19, 21–22 (2011) (concluding that the deposits of a credit union that is a significant source of commercial loans should be included at 100% and performing an alternative HHI calculation based on also weighting another active credit union's deposits at 50%); Hancock Holding Company, 97(4) Fed. Res. Bull. 1, 4 (2011) (concluding that the activities of two credit unions in the relevant market were a mitigating factor and performing an alternative HHI calculation based on weighting both credit unions' deposits at 50%); PNC Financial Services Group, Inc., 95 Fed. Res. Bull. B1, B5–B6 (2009) (performing alternative HHI calculations in three relevant markets based on weighting active community credit unions' deposits at 50%); Wells Fargo & Co., 88 Fed. Res. Bull. 103, 106 & n.29 (2002) (discussing impact of strong credit union presence on post-merger HHI); BanPonce Corp., 77 Fed. Res. Bull. 43 (1991) (credit union deposits included at 50%). *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).

[362]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, Assistant Chief, Antitrust Division, DOJ, ABA Spring Antitrust Meeting, Apr. 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, Jan./Feb. 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 procompetitive 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 Federal Reserve System, 638 F.2d 1255, 1263–72, 1981-1 Trade Cas. (CCH) ¶ 63897 (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*, Mergers and Acquisitions of Banks and Savings Institutions at 3:85 (1993); Hawke and Fein, Training Tomorrow's Banking Lawyers, 91 Mich. L. Rev. 1578, 1581 (1993).

[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 Federal Reserve 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 be increased by the proposed acquisition.[363] Because there is no practical way directly to measure market share of banking services, the Federal Reserve Board and the DOJ generally turn to market share of deposits as a proxy.[364]

As already explained in Section 7:6[6][a], concentration is gauged with the Herfindahl-Hirschman Index, or HHI, which measures market concentration along a continuum from near zero to 10,000. The Federal Reserve 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.

In 1995, the DOJ published its Bank Merger Competitive Review guidelines (Bank Merger Guidelines), which state that the DOJ generally will not scrutinize a bank merger or acquisition, in the absence of other factors indicating anticompetitive effects, unless the post-transaction HHI is at least 1800, and the transaction increases the HHI by more than 200 points.[365] The Bank Merger Guidelines also stated that "[i]n some cases, the

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[363] The number of branches located, or dollar value of loans written, in the relevant geographic market are other proxies, *see* United States v. Society Corp., 57 Fed. Reg. 10,371, 10,380 to 10,381 (Mar. 25, 1992) (analyzing concentration using branches as proxy, as well as deposits), but are not often employed. In several Board merger applications, the Federal Reserve 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*, Federal Reserve Bank of Atlanta Economic Review, Mar./Apr. 1993, at 37.

[364] *See* DOJ, Bank Merger Competitive Review (1995) (current as of Sept. 13, 2000), *available at* http://www.justice.gov/atr/public/guidelines/6472.pdf; *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).

[365] DOJ, Bank Merger Competitive Review, § 1 (1995).

[DOJ] may further review transactions which do not exceed the 1800/200 threshold," particularly if the threshold "does not reflect fully the competitive effects of the transaction in all relevant markets."[366]

In their 2010 Horizontal Merger Guidelines, the DOJ and the FTC indicated that they would ordinarily not scrutinize a merger or acquisition if the post-transaction HHI is below 1500, or the HHI increases by less than 100 points as a result of the transaction.[367] However, the DOJ has confirmed that its Bank Merger Guidelines were not modified by the 2010 Horizontal Merger Guidelines.[368]

The Federal Reserve Board has been willing, under limited circumstances, to adjust HHI calculations by excluding deposits booked to an office in the relevant market from outside the market. For example, in reviewing the J.P. Morgan Chase/Bank One merger in 2004, the Federal Reserve Board found that the deposit data for the Houston banking market, on the basis of which the HHI exceeded the Banker Merger Guidelines, overstated the competitive effect of the transaction in that market.[369] The Federal Reserve Board found that over half of J.P. Morgan Chase's deposits in the market were deposits from national or international business lines and had been transferred to the bank's main Houston branch from New York for business reasons unrelated to its efforts to compete in the Houston market; less than 5% of the deposits were held for customers with addresses in the market; and approximately half of the deposits were subject to practical restrictions that constrained their use in support of general banking activities.[370] As a result, the Federal Reserve Board performed two alternative sets of HHI calculations, one based on measures of concentration other than deposits and the other based on excluding various amounts of the national business line deposits, and concluded that the alternative HHI

[366] DOJ and Federal Trade Comm'n, 2010 Horizontal Merger Guidelines § 5.3, *reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,100.

[367] *See* Comerica Incorporated and Comerica Bank, 97(5) Fed. Res. Bull. 1, 2–3 and n.13 (2011); Bank of Montreal, 97(4) Fed. Res. Bull. 24, 26, 27 and n.13 (2011); First Niagara Financial Group, Inc., 97(2) Fed. Res. Bull. 15, 16–17 and n.10 (2011).

[368] J.P. Morgan Chase & Co./Bank One Corporation, 90 Fed. Res. Bull. 352, 354–356 (2004).

[369] J.P. Morgan Chase & Co./Bank One Corporation, 90 Fed. Res. Bull. 352, 352–355 (2004).

[370] J.P. Morgan Chase & Co./Bank One Corporation, 90 Fed. Res. Bull. 352, 355–356 (2004).

calculations were all within the Bank Merger Guidelines.[371]

The Federal Reserve Board reached similar conclusions in the PNC/National City and Bank of America/Countrywide acquisitions in 2008.[372] In all of these transactions, the Federal Reserve Board stated that it would only make such adjustments when the evidence supported a finding that the excluded deposits were not legally available for use in the relevant market, and data were available to make comparable adjustments to the market shares for all market participants.[373]

[h] Additional Factors

Measuring a transaction's effect on market concentration is only the first step in evaluating the transaction's likely competitive effect. The antitrust agencies will further analyze whether the result of the transaction would be (1) a potential for the acquisition to create or amplify the strengths of the merged company so that it could exert power over others (unilateral effects), or (2) a potential to increase the possibility of collusion or coordinated pricing among the banks remaining in the market af-

[371] PNC Financial Services Group, Inc., 95 Fed. Res. Bull. B1, B4–B5 (2009) (alternative HHI calculations excluded deposits placed by out-of-market customers from PNC's head office deposits in the Pittsburgh banking market, based in part on decrease in loan market share in comparison to significant increase in deposits held by head office from out-of-market customers); Bank of America Corporation, 94 Fed. Res. Bull. C81, C84–C85 (2008) (alternative HHI calculations excluded deposits placed by out-of-market customers from Countrywide Bank's Forth Worth branch deposits, based in part on very low loan-to-deposit ratio of Countrywide Bank in the Fort Worth banking market).

[372] PNC Financial Services Group, Inc., 95 Fed. Res. Bull. B1, B4 (2009); Bank of America Corporation, 94 Fed. Res. Bull. C81, C84–C85 (2008); J.P. Morgan Chase & Co./Bank One Corporation, 90 Fed. Res. Bull. 352, 355 (2004). *See also* First Security Corp., 86 Fed. Res. Bull. 122 (2000).

[373] *See* DOJ and Federal Trade Comm'n, 2010 Horizontal Merger Guidelines §§ 6–7, *reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,100.

The Federal Reserve Board generally conceptualizes this analysis as a question of what factors might mitigate HHI numbers in excess of the Federal Reserve Board's thresholds. *See, e.g.*, J.P. Morgan Chase & Co./Bank One Corporation, 90 Fed. Res. Bull. 352, 355 (2004) (J.P. Morgan's concentration of deposits in the Houston banking market, which was affected by the booking of out-of-market deposits from national business lines, did not affect deposit interest rates in market: average interest rate on deposits did not deviate significantly from average rates offered in three other major Texas banking markets, and J.P. Morgan's interest rates on deposits in market did not deviate significantly from those of its competitors).

ter the acquisition (coordinated effects).[374]

The antitrust agencies will also look beyond market definition to analyze (1) the capacity of the banks remaining in the market after the acquisition to increase their services and compete with the merged company, or (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 the market to compete.[375] 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,[376] the Federal Reserve Board often consid-

[374] *See* DOJ and Federal Trade Comm'n, 2010 Horizontal Merger Guidelines §§ 5.1, 9, *reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,100.

[375] 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 Assistant Attorney General, Antitrust Division, DOJ, dated Oct. 16, 1992, to Alan Greenspan, Chairman, Board of Governors of the Federal Reserve System, at 5 (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. United States v. Texas Commerce, 58 Fed. Reg. 15,361, 15,375 (Mar. 22, 1993).

[376] *See, e.g.*, River Valley Bancorp, Fed. Res. Bd. Order No. 2012-10 at 5 (Oct. 17, 2012) (finding three insured commercial bank competitors and in total six other insured depository institutions, including credit unions, would remain in the market, some having a significant presence); United Bankshares, Inc., 97(4) Fed. Res. Bull. 19, 20–21 (2011) (finding that eight other commercial banking competitors would remain in market, with the next largest controlling 22% of deposits and three others controlling from 9% to 17% of deposits, and the competitive activities of two active community credit unions); PNC Financial Services Group, Inc., 95 Fed. Res. Bull. B1, B5–B6 (2009) (assessing, in three markets with HHI calculations exceeding thresholds, the number of remaining competitors, their market share of deposits, and their number of branches); J.P. Morgan Chase & Co./Bank One Corporation, 90 Fed. Res. Bull. 352, 356 (2004) (finding that a large number of depository institutions would remain in market, including three with more than 6% of market deposits, with second and third largest competitors in market ranking among five largest bank holding companies in United States); 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 Corporation, 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 Federal Reserve 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). *See also* Christopher Holder, *"The Use of Mitigating Factors in Bank Mergers and Acquisitions: A Decade of Antitrust at the Fed,"* Federal Reserve Bank of Atlanta Economic Review, Mar./Apr. 1993.

ers both the number of remaining competitors and their capacity for future competition.[377] 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.

The antitrust agencies will further consider the likelihood of entry into the relevant market, including the actual history of recent entries into the market by out-of-market institutions. This factor has played an important role in Board merger decisions.[378] 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.[379]

Finally, the antitrust agencies will consider whether any procompetitive, transaction-specific benefits might counter a merger's potential to harm customers in the relevant market.[380] A number of other factors have historically formed a part of the

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[377]*See, e.g.*, Mitsubishi UFJ Financial Group, Inc., The Bank of Tokyo-Mitsubishi UFJ, Ltd., and UnionBanCal Corp., Fed. Res. Bd. Order. No. 2012-12 at 6 (Nov. 14, 2012) (finding that a community bank had entered the market in 2005 from a neighboring market); River Valley Bancorp, Fed. Res. Bd. Order No. 2012-10 at 5 (Oct. 17, 2012) (noting that the market may be attractive for entry by bank competitors); United Bankshares, Inc., 97(4) Fed. Res. Bull. 19, 21–22 (2011) (finding that five depository institutions had entered market *de novo* since 2000 and that market's annualized rates of deposit and income growth had exceeded averages for other urban areas in West Virginia and all metropolitan areas in the United States in 2003-08); PNC Financial Services Group, Inc., 95 Fed. Res. Bull. B1, B5 (2009) (finding that six banking organizations had entered one market in preceding four years and two depository institutions had entered another market); J.P. Morgan Chase & Co./Bank One Corporation, 90 Fed. Res. Bull. 352, 356 (2004) (finding that seven *de novo* banks had been chartered in market since 1998, five existing banking organizations had entered market through branching since 2000, and population growth in Metropolitan Statistical Area (MSA) had exceeded average population growth in all other Texas MSAs); 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). *See also* Christopher Holder, *"The Use of Mitigating Factors in Bank Mergers and Acquisitions: A Decade of Antitrust at the Fed,"* Federal Reserve Bank of Atlanta Economic Review, Mar./Apr. 1993, at 35.

[378]*See* DOJ and Federal Trade Comm'n, 2010 Horizontal Merger Guidelines § 5.1, reprinted in 4 Trade Reg. Rep. (CCH) ¶ 13,100.

[379]*See* DOJ and Federal Trade Comm'n, 2010 Horizontal Merger Guidelines § 10, *reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,100.

[380]The DOJ treats efficiencies as analytically distinct from competition analysis proper while the Federal Reserve Board does not. *See* DOJ and Federal

Federal Reserve Board's and the DOJ's antitrust analysis, including: (1) efficiencies that would be achieved from consolidating the operations of the target and the acquirer;[381] (2) 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; (3) the fact that the acquisition will create an institution capable of competing with large banks currently dominating the market without opposition;[382] (4) whether a merger is likely to affect small or middle-market businesses;[383] and (5) 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.[384]

[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 excep-

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Trade Comm'n, 2010 Horizontal Merger Guidelines § 10, *reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,100.

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

[382] *See* Remarks of Constance K. Robinson, Director of Operations, 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"); DOJ, 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.").

[383] *See* Remarks of Constance K. Robinson, Director of Operations, 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 do not otherwise exceed [the DOJ's HHI] thresholds as applied to banking").

[384] International Shoe Co. v. Federal Trade Commission, 280 U.S. 291, 299–303, 50 S. Ct. 89, 91–2, 74 L. Ed. 431, 441 (1930).

tion originated with the Supreme Court's decision in International Shoe v. Federal Trade Commission.[385] These considerations have played a factor in the Federal Reserve Board's review of transactions.[386] The Federal Reserve 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.[387]

The DOJ imposes more rigorous requirements on the failing company defense than the Federal Reserve Board and has on occasion rejected the Federal Reserve Board's application of the defense. In order to allow an otherwise uncompetitive acquisition under the failing company defense, the DOJ requires evidence that "(1) the allegedly failing firm would be unable to meet its financial obligations in the near future; (2) it would not be able to reorganize successfully under Chapter 11 of the Bankruptcy Act; and (3) it has made unsuccessful good-faith efforts to elicit reasonable alternative offers that would keep its tangible and intangible assets in the relevant market and pose a less severe danger to competition than does the proposed merger."[388]

[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 substantially by divesting branches in the problem markets. Divestiture of branches

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

[386] *See* Christopher Holder, *The Use of Mitigating Factors in Bank Mergers and Acquisitions: A Decade of Antitrust at the Fed*, Federal Reserve Bank of Atlanta Economic Review, Mar./Apr. 1993, at 39.

[387] *See* DOJ and Federal Trade Comm'n, 2010 Horizontal Merger Guidelines § 11, *reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,100.

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 that the standard defense applies in the bank acquisition context as well. *See* Remarks of Margaret E. Guerin-Calvert, Assistant Chief, Antitrust Division, DOJ, ABA Spring Antitrust Meeting, Apr. 1, 1993, at 10.

[388] *See, e.g.*, DOJ, "Press Release: Justice Department Reaches Agreement with Berkshire Hills Bancorp and Legacy Bancorp on Divestitures," released May 18, 2011, *available at* http://www.justice.gov/atr/public/press_releases/2011/271411.htm; *see also* 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.

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 that 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[389] or through litigation with the DOJ.[390] Both the Federal Reserve Board and the DOJ will review the "competitive suitability" of proposed divestitures to determine whether, in addition to reducing HHI, they will allow for sufficient competition in the relevant markets.[391] This requires divesting branches that are active in the relevant markets to institutions that, as a result of the divestiture, will be capable of competing in those markets.

[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 Federal Reserve Board is now required, "in every case," to take into consideration "the effectiveness of the company . . . in combating money laundering, includ-

[389]*See, e.g.*, United States v. First Hawaiian, Inc., 56 Fed. Reg. 10,916, 10,924 (Mar. 14, 1991) (explanation of final judgment).

[390]*See, e.g.*, Hancock Holding Company, 97(4) Fed. Res. Bull. 1, 3—4 (2011) (commitment to divest eight branches in two markets would reduce HHI below Bank Merger Guidelines thresholds; Board also considered number of remaining competitors in markets); The Toronto-Dominion Bank, 96 Fed. Res. Bull. B36, B37–B38 (2010) (commitment to divest branches to out-of-market insured depository organization would reduce HHI but leave it above Bank Merger Guidelines thresholds; Board also considered number of remaining competitors in market and competitive influence of three community credit unions); PNC Financial Services Group, Inc., 95 Fed. Res. Bull. B1, B2–B6 (2009) (commitment to divest 61 branches in five markets would reduce HHI below Bank Merger Guidelines thresholds in two markets but leave it above thresholds or with market share over 35% in three markets; Board also considered remaining competitors, record of new market entrants, and activities of credit unions). *See also* 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.

[391]12 U.S.C.A. § 1842(c)(6).

ing in overseas branches."[392] As a practical matter, this should not place additional burdens on most foreign acquirers since even before the amendment, the Federal Reserve Board generally inquired 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 Federal Reserve Board or the OECD's Financial Action Task Force on Money Laundering. The Federal Reserve Board will also consider a foreign acquirer's compliance with U.S. economic sanctions laws and the related U.S. Treasury Office of Foreign Assets Control (OFAC) regulations.[393]

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[392]This has been particularly the case in light of recent investigations by the DOJ and the New York County District Attorney into foreign banks' processing of U.S. dollar payments for beneficiaries or on behalf of payors located in countries that are the subject of U.S. economic sanctions programs, which have resulted in several deferred prosecution agreements. *See* DOJ Press Releases, "Lloyds TSB Bank Plc Agrees to Forfeit $350 Million in Connection with Violations of the International Emergency Economic Powers Act," released Jan. 9, 2009, *available at* http://www.justice.gov/opa/pr/2009/January/09-crm-023.html; "Credit Suisse Agrees to Forfeit $536 Million in Connection with Violations of the International Emergency Economic Powers Act and New York State Law," released Dec. 16, 2009, *available at* http://www.justice.gov/opa/pr/2009/December/09-ag-1358.html; "Former ABN AMRO Bank NV Agrees to Forfeit $500 Million in Connection with Conspiracy to Defraud the United States and with Violation of the Bank Secrecy Act," released May 10, 2010, *available at* http://www.justice.gov/opa/pr/2010/May/10-crm-548.html; "Barclays Bank PLC Agrees to Forfeit $298 Million in Connection with Violations of the International Emergency Economic Powers Act and the Trading with the Enemy Act," released Aug. 18, 2010, *available at* http://www.justice.gov/opa/pr/2010/August/10-crm-933.html; "ING Bank N.V. Agrees to Forfeit $619 Million for Illegal Transactions with Cuban and Iranian Entities," released June 12, 2012, *available at* http://www.justice.gov/opa/pr/2012/June/12-crm-742.html. *See also* information regarding Standard Chartered Bank's settlement with the New York Department of Financial Services ("Statement from Benjamin M. Lawsky, Superintendent of Financial Services, Regarding Standard Chartered Bank," released August 14, 2012, *available at* http://www.dfs.ny.gov/about/press/pr1208141.htm; and "Order Pursuant to Banking Law § 39," dated August 6, 2012, *available at* http://www.dfs.ny.gov/banking/ea120806.pdf). Public reports indicate ongoing investigations of Standard Chartered Bank by other agencies, including the Federal Reserve Board, OFAC, the Department of Justice and the Manhattan District Attorney's Office.

[393]*See* 12 U.S.C.A. § 1842(d)(1)(B), (2). It also requires the Federal Reserve Board to consider the CRA compliance record of both the acquirer and the target banks, 12 U.S.C.A. § 1842(d)(3), but the Federal Reserve 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* § 7:6[5].

[8] Interstate Acquisitions

If the transaction involves an interstate acquisition, the Riegle-Neal Act also requires the Federal Reserve 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.[394] As discussed more fully in Section 7:2[2], the Riegle-Neal Act prohibits the Federal Reserve 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).[395] The Riegle-Neal Act also prohibits the Federal Reserve 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).[396]

The Dodd-Frank Act expands the 10% nationwide deposit cap by prohibiting an interstate merger transaction between insured depository institutions, an interstate acquisition of a thrift by a bank holding company, or an interstate acquisition of an insured depository institution by a thrift holding company if, in each case, the resulting insured depository institution, together with all of its insured depository institution affiliates, would control more than 10% of the total amount of insured deposits of insured depository institutions in the United States.[397] This prohibition is subject to an exception where one or more insured depository institutions is in default or in danger of default or is receiving assistance from the FDIC under Section 13 of the FDI Act.[398] The Dodd-Frank Act also institutes a new liability cap that prohibits a "financial company" from merging with or acquiring another company if the resulting company's total consolidated liabilities would exceed 10% of the aggregate consolidated liabilities of all

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

[395] *See* 12 U.S.C.A. § 1842(d)(2).

[396] Dodd-Frank Act, Pub. L. No. 111-203, § 623 (2010).

[397] Dodd-Frank Act, Pub. L. No. 111-203, § 623 (2010).

[398] Dodd-Frank Act, Pub. L. No. 111-203, § 622 (2010). The Federal Reserve Board was required to issue implementing regulations by October 18, 2011. However, as of December 31, 2012, it had not yet done so.

financial companies at the end of the prior calendar year. "Financial company" is defined to include insured depository institutions, bank holding companies, thrift holding companies, foreign banks treated as bank holding companies for purposes of the BHC Act, and certain others.[399]

[9] Financial Stability

Pursuant to the Dodd-Frank Act, Section 3 of the BHC Act has been amended to require the Federal Reserve Board to consider, as an additional factor, the extent to which a proposed acquisition would result in greater or more concentrated risks to the stability of the U.S. banking or financial system.[400] The same factor has been added for Board review of acquisitions by bank holding companies of thrifts and other entities engaged in nonbanking activities under Section 4(j) of the BHC Act.[401]

The Federal Reserve Board has considered the financial stability factor in its review of several recent applications. It uses the following non-exhaustive criteria, both individually and in combination, in evaluating an acquisition's risk to the broader economy: (i) the size of the resulting firm; (ii) the availability of substitute providers for any critical products and services offered by the resulting firm; (iii) the interconnectedness of the resulting firm with the financial system; (iv) the extent to which the resulting firm contributes to the complexity of the financial system; and (v) the extent of the cross-border activities of the resulting firm.[402] In addition, the Federal Reserve Board has considered qualitative factors indicative of the difficulty of resolving the resulting firm, such as the opaqueness and complexity of the

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[399] Dodd-Frank Act, Pub. L. No. 111-203, § 604(d) (2010).

[400] Dodd-Frank Act, Pub. L. No. 111-203, § 604(e) (2010). *See also* Dodd-Frank Act, Pub. L. No. 111-203, § 163(b)(4) (2010) (risk to global or U.S. financial stability or to the U.S. economy added as a factor to be considered by the Federal Reserve Board in reviewing any acquisition by a bank holding company with total assets of $50 billion or more of a company with total assets of $10 billion or more, other than an insured depository institution, engaged in activities that are financial in nature under Section 4(k) of the BHC Act).

[401] Mitsubishi UFJ Financial Group, Inc., The Bank of Tokyo-Mitsubishi UFJ, Ltd., and UnionBanCal Corp., Fed. Res. Bd. Order. No. 2012-12 at 25 (Nov. 14, 2012); Capital One Financial Corp., 98(5) Fed. Res. Bull. 7, 23 (2012); The PNC Financial Services Group, Inc. and PNC Bancorp, Inc., 98(3) Fed. Res. Bull. 16, 21 (2012); Capital One Financial Corporation, 98(5) Fed. Res. Bull. 7, 24–27 (2012).

[402] Mitsubishi UFJ Financial Group, Inc., The Bank of Tokyo-Mitsubishi UFJ, Ltd., and UnionBanCal Corp., Fed. Res. Bd. Order. No. 2012-12 at 25 (Nov. 14, 2012); Capital One Financial Corp., 98(5) Fed. Res. Bull. 7, 24 (2012).

institution's internal organization.[403]

In considering the financial stability factor in its order approving the acquisition by Capital One of ING Direct, the Federal Reserve Board further explained that certain types of transactions would likely have only a *de minimis* impact on the "systemic footprint" of the institution, thereby not likely raising concerns regarding financial stability.[404] According to the Federal Reserve Board, "a proposal that involves an acquisition of less than $2 billion in assets, results in a firm with less than $25 billion in total assets, or represents a corporate reorganization may be presumed not to raise financial stability concerns" unless there is "evidence that the transaction would result in a significant increase in interconnectedness, complexity, cross-border activities, or other risk factor."[405]

§ 7:7 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 Federal Reserve 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, unsound banking practices, or risk to the stability of the United States banking or financial system."[406] In performing this cost-benefit analysis, the Federal Reserve Board considers the following factors, which are substantially similar to four 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,

[403] Capital One Financial Corp., 98(5) Fed. Res. Bull. 7, 24 (2012).

[404] Capital One Financial Corp., 98(5) Fed. Res. Bull. 7, 24 (2012). *See also* Industrial and Commercial Bank of China Ltd., China Investment Corp., and Central Huijin Investment Ltd., Fed. Res. Bd. Order No. 2012-4 at 29 (May 9, 2012).

[405] 12 U.S.C.A. § 1843(j)(2)(A).

[Section 7:7]

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

internal controls, and risk management systems; (3) the effect of the transaction on competition; and (4) the impact on U.S. financial stability.

Although the Federal Reserve Board is not specifically required to consider the remaining factors mandated in a Section 3 application,[407] the Federal Reserve Board is free to 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 Section 3.[408] The Federal Reserve Board also historically had a practice of conditioning approval of such acquisitions on the acquirer agreeing to be a source of strength to its insured thrift subsidiaries.[409] Pursuant to the Dodd-Frank Act, all companies that directly or indirectly control an insured depository institution, including a thrift, are required to serve as a source of strength for the institution.[410]

[2] Bank Merger Act

In deciding whether to approve a Bank Merger Act application, each of the bank regulators is required to consider substantially the same factors as those considered by the Federal Reserve Board in processing applications under Section 3 of the BHC Act.[411] 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 if the Federal Reserve Board has not previously had an opportunity to do so.

Moreover, in performing their competition reviews, the FDIC

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[407] 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 (April 2008).

[408] *See, e.g.*, Banco Santander Central Hispano, 92 Fed. Res. Bull. C151, C154 n.26 (2006).

[409] Dodd-Frank Act, Pub. L. No. 111-203, § 626 (2010). The Dodd-Frank Act defines "source of financial strength" as the ability of a company that directly owns or controls an insured depository institution to provide financial assistance to such institution in the event that it experiences financial distress.

[410] *See* 12 U.S.C.A. § 1828(c)(5); 12 C.F.R. § 5.33(e)(1) (OCC).

[411] *See* 12 U.S.C.A. § 1817(j)(7); 12 C.F.R. §§ 5.50(f)(5) (OCC—national banks), 308.111 (FDIC—state nonmember banks), 174.7(d) (OCC—federal thrifts), 391.46(d) (FDIC-insured state-chartered thrifts).

has, and the OTS historically had, treated thrifts as full competitors of commercial banks and gave their deposits 100% credit in their HHI analysis of any relevant markets. In contrast, as discussed in Section 7:6[6][f], the Federal Reserve Board, the DOJ, and the OCC generally treat thrifts as only partial competitors of commercial banks, weighting their deposits at 50% 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 Federal Reserve Board in processing applications under Section 3 of the BHC Act.[412] They are not, however, required to consider the comprehensive consolidated supervision, adequate assurances, convenience and needs of the community, or anti-money laundering factors.[413] Moreover, in performing their competition reviews, the FDIC does and the OTS historically had treated thrifts as full competitors of commercial banks whereas the Federal Reserve Board, the DOJ, and the OCC generally treat thrifts as only partial competitors.

In the case of an application to acquire control of an industrial loan corporation or industrial bank, the FDIC would be 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 Federal Reserve Board.[414] However, pursuant to the Dodd-Frank Act, there is a moratorium on bank applications relating to industrial banks, industrial loan corporations, and certain other entities. Bank regulators are required to disapprove any change in control that would result in direct or indirect control by a commercial company of an industrial bank, industrial loan company, credit card bank, or trust bank, with certain exceptions, such as when the acquired institution is in danger of default. This moratorium is scheduled

[412] 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 with 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).

[413] *See* Moratorium on Certain Industrial Loan Company Applications and Notices, 71 Fed. Reg. 43,482 (Aug. 1, 2006); Moratorium on Certain Industrial Bank Applications and Notices, 72 Fed. Reg. 5,290 (Feb. 5, 2007).

[414] *See* Dodd-Frank Act, Pub. L. No. 111-203, § 603(a) (2010).

to expire in July 2013.[415]

[4] Home Owners' Loan Act

In deciding whether to approve an application under Section 10 of HOLA, the Federal Reserve Board is required to consider substantially the same factors that it considers 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.[416] The Federal Reserve Board is not, however, required to consider the effectiveness of the acquirer or the target in combatting money-laundering activities,[417] although it is free to do so.

§ 7:8 Consequences of ownership of a U.S. bank or thrift

A foreign acquirer of a U.S. bank or thrift will become subject to additional U.S. banking laws and regulations.[418] The more significant additional laws to which a foreign acquirer will become subject to once it acquires a U.S. bank or thrift include restrictions on nonbanking activities,[419] the requirement that the foreign acquirer guarantee a capital restoration plan of the U.S. target, commonly referred to as "source of strength" requirement[420] and restrictions on transactions between the U.S. target and its affiliates.[421] In addition, the Federal Reserve Board's Proposed FBO Rule, if adopted as proposed, would, among other things, require foreign banks to establish an intermediate holding company to hold all U.S. bank and nonbank subsidiaries. The intermediate holding company would be subject to all capital and liquidity requirements, as if it were a U.S. bank holding company, along with additional Dodd-Frank enhanced prudential standards on a consolidated basis, as discussed in the Editor's Note

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[415] *See* 12 C.F.R. § 238.15.

[416] 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).

[417] *See* §§ 1:1 et seq. for a general description of U.S. bank regulators' supervision of foreign banks operating in the United States.

[Section 7:8]

[418] *See* §§ 10:1 et seq. for information on restrictions on nonbanking activities and investments of bank holding companies.

[419] *See* § 7:7[1] for information on "source of strength" obligations.

[420] *See* §§ 6:1 et seq. for information on restrictions on transactions between affiliates.

[421] *See* 77 Fed. Reg. 76,628.

on Recent Developments.[422] Accordingly, part of a foreign acquirer's analysis of the desirability of an acquisition of a U.S. target should include a determination of whether the foreign acquirer is willing to become subject to a broader framework of U.S. banking laws and regulations.

§ 7:9 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 in 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. However, 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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[422] *See* 77 Fed. Reg. 76,628.