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The OCC's proposed revisions to bank merger standards – A missed opportunity for certainty

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The OCC's proposed changes to its approach to Bank Merger Act applications are a missed opportunity to provide certainty around bank mergers in an uncertain market.

The Office of the Comptroller of the Currency (OCC) released a notice of proposed rulemaking (the NPR) to:

- amend its existing procedural regulation that provides for expedited review of a limited set of business combinations involving a national bank or federal savings association; and
- adopt a new policy statement summarizing the OCC's substantive approach to evaluating Bank Merger Act (BMA) applications.

The NPR goes beyond a revision to the OCC's own procedures and reflects a decision by the OCC to wade into interagency territory by formalizing its interpretation or application of the statutory factors that are common to all BMA applications. The proposed policy statement adds to the risk of diverging views among the federal banking agencies as to how they will act on BMA applications. Comments on the NPR, which was released on January 29, 2024, will be due 60 days after publication in the Federal Register.

Under the BMA, the prior written approval of the OCC is required for an insured depository institution (IDI) to merge or consolidate with another IDI or, either directly or indirectly, to acquire the assets of or assume liability to pay any deposits made in another IDI if the acquiring, assuming, or resulting bank is a national bank or federal savings association.[1] The BMA requires the relevant banking agency acting on a BMA application to consider certain statutory factors related to financial stability, financial and managerial resources, convenience and needs of the community, competition, and the effectiveness of any IDI involved in combatting money laundering activities.[2]

The NPR arises out of a review by the OCC of its existing publications on the business combination application process, including the Comptroller's Licensing Manual booklets on Business Combinations and on Public Notice and Comments. The OCC concluded that providing greater transparency about the standards and the procedures it applies in its BMA review and approval processes would be helpful to the institutions it regulates and to the public.

The NPR comes amid a broader focus on bank merger policy not just at the OCC, but by the other federal banking agencies and the DOJ. In related remarks, Acting Comptroller of the Currency Michael J. Hsu acknowledged that the OCC must review all merger applications on a case-by-case basis, but outlined his case for developing "more effective and stable" bank merger policy by adopting a "rigorous macro view" of "what good looks like" for the U.S. banking system.

The NPR is notable for what it does not include; namely, any attempt to provide more certainty on the OCC's timing for a review of any BMA application. Having eliminated the one avenue for expedited review, the OCC could have balanced its proposal with guidance on its expectations on timing for taking action on the more complete BMA application record it now proposes for all BMA applications. No such guidance can be found anywhere in the NPR. In our view, this is a missed opportunity to provide some measure of reassurance in an otherwise uncertain bank M&A environment from the

federal banking agency that has traditionally been more transparent about its approach to bank M&A.

Process changes

Elimination of streamlined business combination application form

The NPR would eliminate the use of the streamlined application form that is currently available for certain BMA applications to the OCC. Under the OCC's existing rules,[3] the OCC generally requires BMA applicants to complete the Interagency Bank Merger Act Application form (the Interagency Form), but permits an applicant to use a streamlined application form in the following four limited situations:[4]

- between (1) an eligible bank or eligible savings association and (2) one or more eligible banks, eligible savings associations,[5] or eligible depository institutions,[6] and the target's assets are no more than 50% of the acquirer's total assets;
- the acquirer is an eligible bank or eligible savings association, the target bank or savings association is not an eligible bank, eligible savings association, or an eligible depository institution, and the filers obtain OCC approval to use the streamlined form;
- the acquirer is an eligible bank or eligible savings association, the target bank or savings association is not an eligible bank, eligible savings association, or an eligible depository institution, and the total assets to be acquired do not exceed 10% of the acquirer's total assets; or
- certain mergers of a national bank with one or more of its nonbank affiliates, where the filers obtain OCC approval to use the streamlined form and the total assets acquired are no more than 10% of the acquirer's total assets.

In addition, the streamlined application form states that a transaction consisting of one of the two components of the definition of a "business reorganization" in Part 5.33(d)(3) could also qualify for a streamlined application:

- a business combination between eligible banks, or between an eligible bank or an eligible depository institution, that are controlled by the same holding company or will be controlled by the same holding company prior to the combination, and
- a business combination between (1) an eligible bank and (2) an interim bank chartered in a transaction in which one or more persons exchange their shares of the eligible bank for shares of a newly formed holding company and receive after the transaction substantially the same proportional share interest in the holding company as they held in the eligible bank (except to account for the exercise of any dissenters' rights), and the reorganization involves no other transactions involving the bank.[7]

The streamlined form covers similar topics to the standard Interagency Form but requires detailed information only where an applicant answers "yes" to various yes-or-no questions on a proposed transaction. The NPR would eliminate the use of the streamlined form because "it appears that the fuller record provided through the [Interagency Form] provides the appropriate basis for the OCC to review a business combination application." The OCC does not explain, however, why in its view there should be no difference between the treatment of a business reorganization, which is effectively nothing more than an internal corporate reorganization, and a transaction involving unaffiliated institutions.

The OCC stated that elimination of the streamlined form "should not significantly increase the burden on applicants" because the OCC retains discretion to tailor the information required in the Interagency Form. Yet there are clearly some differences between the contents of a streamlined application (even if all items were checked "yes") and those of a normal BMA application. For example, a streamlined application does not require the preparation of projected balance sheets and income statements for the first three years of operation of the merged institution and the assumptions used to prepare those projections. Particularly for internal corporate reorganizations or transactions involving the acquisition of an institution whose total assets are substantially below 10% of the acquirer's assets, the utility of three years of projections may be open to question. Moreover, it is not clear how often the OCC intends to exercise this discretion outside of emergency situations, given that the only example the OCC identified as a "situation[] where discussion of all items in the [Interagency Form] may not be appropriate" is a purchase and assumption transaction from a bank in FDIC receivership.

Elimination of expedited review provisions

1. The NPR would also eliminate expedited review procedures under which business reorganizations and business combinations that qualify for a streamlined application are deemed approved 15 days after the close of the public

comment period if the OCC does not take further action.[8]
2. In the NPR, the OCC explained that the elimination of expedited review was motivated by its belief that "any business combination subject to a filing under § 5.33 is a significant corporate transaction requiring OCC decisioning, which should not be deemed approved solely due to the passage of time." Yet again the OCC does not explain its rationale for eliminating the distinctions between types of business combinations in doing away with the expedited review process: why, for example, a business reorganization or a relatively small acquisition relative to the acquirer's size should be subject to exactly the same timing procedures as a merger between two unaffiliated institutions of similar size. The NPR noted, however, that the substantive principles underlying the eligibility criteria for expedited review are reflected in its proposed policy statement "and will continue to guide OCC processing of business combination applications."

Policy statement on BMA statutory factors

The main focus of the NPR is the OCC's proposed new policy statement to "outline general principles the OCC applies when reviewing applications and provide information about how the OCC considers the BMA statutory factors of financial stability, financial and managerial resources, and convenience and needs of the community." The proposed policy statement would be attached as Appendix A to Subpart C (expansion of activities) of Part 5 of the OCC's regulations.

The proposed policy statement does not directly address the OCC's approach to the BMA statutory factors of competition and the effectiveness of an institution in combating money laundering activities. The OCC noted in the NPR that its review of the competition factor in any BMA application is guided by the 1995 interagency bank merger review guidelines. In his remarks, Hsu said "the OCC is committed to working with our interagency peers to update our bank merger analytical frameworks," including collaboration with the DOJ on the BMA competition factor, and described that work as ongoing. The proposed policy statement does, however, refer to the absence of adverse competitive effects as part of its list of indicators generally consistent with approval and to no "reduction" in the availability of substitute providers as part of its assessment of the financial stability factor. The NPR noted that the Federal Financial Institution Examination Council's BSA/AML examination manual details the OCC's examination of institutions' AML activities.

Section II: General principles of OCC review

The proposed policy statement begins by identifying indicators that are generally consistent with OCC approval and other indicators that raise supervisory or regulatory concerns and therefore make OCC approval unlikely.

On the one hand, the proposed policy statement states that BMA applications that are consistent with approval generally feature **all of the following 13 indicators**:

1. The acquirer is well capitalized under 12 C.F.R. § 5.3 and the resulting institution will be well capitalized;
2. The resulting institution will have total assets less than $50 billion;
3. The acquirer has a Community Reinvestment Act (CRA) rating of Outstanding or Satisfactory;
4. The acquirer has composite and management ratings of 1 or 2 under the Uniform Financial Institution Ratings System (UFIRS) or risk management, operational controls, compliance, and asset quality (ROCA) rating system;
5. The acquirer has a consumer compliance rating of 1 or 2 under the Uniform Interagency Consumer Compliance Rating System, if applicable;
6. The acquirer has no open formal or informal enforcement actions;
7. The acquirer has no open or pending fair lending actions, including referrals or notifications to other agencies;
8. The acquirer is effective in combatting money laundering activities;
9. The target's combined total assets are less than or equal to 50% of the acquirer's total assets;
10. The target is an eligible depository institution as defined in 12 C.F.R. § 5.3;
11. The proposed transaction clearly would not have a significant adverse effect on competition;
12. The OCC has not identified a significant legal or policy issue; and
13. No adverse comment has raised a significant CRA or consumer compliance concern.

Nowhere in the proposed policy statement or in the preamble of the NPR is there any discussion of why total assets of less than $50 billion is a relevant metric for the OCC's consideration of a BMA application.

On the other hand, the proposed policy statement states that "[i]f certain indicators that raise supervisory or regulatory concerns are present, the OCC is **unlikely** to find that the statutory factors under the BMA are consistent with approval **unless and until the applicant has adequately addressed or remediated the concern**." The OCC identified the following six examples of indicators that raise supervisory or regulatory concerns:

1. The acquirer has a CRA rating of Needs to Improve or Substantial Noncompliance;

2. The acquirer has a consumer compliance rating of 3 or worse;
3. The acquirer has UFIRS or ROCA composite or management ratings of 3 or worse or the most recent report of examination otherwise indicates that the acquirer is not financially sound or well managed;
4. The acquirer is a global systemically important banking organization (G-SIB), or a G-SIB subsidiary, which we read to include both a U.S. and a non-U.S. G-SIB;
5. The acquirer has open or pending BSA/AML enforcement or fair lending actions, including referrals or notifications to other agencies; and
6. Failure by the acquirer to adopt, implement, and adhere to all the corrective actions required by a formal enforcement action in a timely manner; or multiple enforcement actions against the acquirer executed or outstanding during a three-year period.

Although neither the proposed policy statement nor the preamble of the NPR explains how an applicant that is a G-SIB can adequately address or remediate the OCC's apparent concern with the applicant's status as a G-SIB, consistent with past OCC approvals presumably the path for doing so is the financial stability factor or showing that the transaction is a merger between affiliates and thus is an internal corporate reorganization.

These two groupings of indicators are aligned with what Hsu described in his remarks as two ends of the spectrum of BMA applications, with some being "straightforward because the acquiring bank is a model of safety and soundness and has earned the trust of the community and its supervisors," and others having "significant deficiencies." Hsu said that the majority of BMA applications "lie somewhere in between and require varying degrees of scrutiny and multiple rounds of inquiry." Unlike Hsu's speech, the proposed policy statement does not address this middle category that reflects numerous BMA applications. Presumably the OCC intended for the policy statement to do so, and the final policy statement will be clearer that applications in the middle category can also be approved if they satisfy the statutory factors of the BMA.

Section III: Financial stability

Section III of the proposed policy statement identifies seven factors the OCC considers in evaluating the risk posed by a transaction to the stability of the United States banking or financial system as required by the BMA.[9] Those factors are consistent with existing OCC practice and current OCC guidance in the Comptroller's Licensing Manual. Section III also states that the OCC considers the recovery planning impacts of a proposed transaction as part of its review of the statutory financial stability factor.

Section III also clarifies that the OCC applies a balancing test in analyzing the statutory financial stability factor, weighing the financial stability risk posed by a proposed transaction against the financial stability risk posed by denial of the proposed transaction, particularly if the proposed transaction involves a troubled target. It also states that the OCC may consider the impact of related transactions that are the subject of concurrent applications (e.g., a Bank Holding Company Act application to the Federal Reserve) in its review of the financial stability factor.

Section III further highlights the possibility of the OCC imposing enforceable conditions on its approval of a particular transaction that are motivated by concerns related to financial stability, such as requiring asset divestitures by the resulting institution or imposing higher minimum capital requirements.

Although the financial stability factors described in the proposed policy statement are similar to those cited by the Federal Reserve in multiple orders approving acquisitions under Sections 3 and 4 of the Bank Holding Company Act or under the BMA, and although the OCC specifically cites some of the Federal Reserve's orders in the preamble of the NPR, it fails even to mention the presumption against financial stability concerns first articulated by the Federal Reserve in 2012 and repeated multiple times since then. In a 2012 order, the Federal Reserve specifically noted that certain types of transactions would likely have a *de minimis* impact on an institution's "systemic footprint" and therefore would not be likely to raise concerns about financial stability. Specifically, the Federal Reserve stated that "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 the transaction would result in a significant increase in interconnectedness, complexity, cross-border activities, or another risk factor.[10]

Section IV: Financial and managerial resources and future prospects

Section IV of the proposed policy statement states that the OCC considers the managerial resources, financial resources, and future prospects of the combining and resulting institutions both holistically and as independent factors. It provides certain details on the evaluation of these factors that are not currently included in the Comptroller's Licensing Manual.

With respect to overarching considerations in its review of these factors, Section IV states that the OCC is less likely to approve a BMA application when, among other things, the acquirer has experienced rapid growth or has engaged in multiple acquisitions with overlapping integration periods (the latter obviously reflecting a broader emphasis on integration issues, as noted below).

In its discussion of the financial resources factor individually, Section IV describes the OCC's review of various capital, liquidity and other financial measures and of management's ability to address any increased risks resulting from the proposed transaction.

With respect to the managerial resources factor individually, Section IV notes that where either the acquirer or the target has a significant number of matters requiring attention or other supervisory issues, that suggests there may be insufficient managerial resources to manage the resulting institution. It also identifies various supervisory ratings that the OCC considers in this factor. Section IV states, however, that "[l]ess than satisfactory ratings at the target do not preclude the approval of a transaction, provided that the acquirer can employ sufficiently robust risk management and financial resources to correct the weaknesses at the target." In other words, the OCC continues to recognize that an M&A transaction with a stronger-rated institution can be a structural way to address and remediate supervisory issues at a weaker-rated institution.

Section IV also reflects the OCC's focus on integration plans, especially in relation to information technology systems, and a transaction's impact on business continuity resilience. The proposed policy statement specifically lists "integration issues" as being a basis for denial if they present significant supervisory concerns that "cannot be resolved through appropriate conditions or otherwise." Section IV of the proposed policy statement also considers the proposed governance structure of the resulting institution, including with respect to risk management and change management.

In its discussion of the future prospects factor, the proposed policy statement notes that the OCC's degree of scrutiny of the proposed operations of the resulting institution will reflect an acquirer's track record in prior integrations. The OCC will consider factors such as whether the integration of the combining institutions will "allow it to function effectively as a single unit" and the potential impact of the transaction on the resulting institution's continuity planning and operational resilience.

Section V: Convenience and needs

Section V clarifies that the OCC's consideration of the impacts of any proposed combination on the convenience and needs of the community is forward-looking and separate from the OCC's evaluation of an applicant's CRA record of performance. It describes factors that the OCC will consider in this analysis, which include not only plans to change branch locations and service offerings, but also "job losses or reduced job opportunities resulting from branch staffing changes" including from bank closures or consolidations.

Section VI: Public comments and meetings

Finally, Section VI details the OCC's procedures related to public comments and public meetings on BMA applications.

BMA applications are generally subject to a 30-day public comment period after the applicant publishes a notice of its filing. Section VI identifies three circumstances in which the OCC may extend the 30-day comment period: (1) when an applicant fails to file all required publicly available information on a timely basis or makes a request for confidential treatment not granted by the OCC; (2) when requested and the OCC determines that additional time is necessary to develop factual information necessary to consider the filing, including if an applicant's response to a comment does not fully address the matters raised in the comment and the commenter requests an opportunity to respond; and (3) when the OCC determines that other extenuating circumstances exist, including novel or complex transactions.

Section VI also describes the OCC's process for deciding whether to hold a public meeting on a BMA application. It states that the OCC will balance the public's interest in a proposed transaction with the value or harm of a public meeting to the OCC's decision-making process. Relevant criteria include the significance of the transaction to the banking industry, including the asset sizes of the institutions involved and concentration of the resulting institution in one or more markets, public interest in the transaction, and whether a public meeting would provide useful information that the OCC would not otherwise be able to obtain in writing.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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[1] 12 U.S.C. § 1828(c)(2)(A). The Federal Reserve is responsible for approving such transactions if the acquiring, assuming, or resulting bank is a state member bank, and the FDIC is responsible for approving such transactions if the acquiring, assuming, or resulting bank is a state nonmember bank or state savings association. *Id.* § 1828(c)(2)(B)–(C). Under the BMA, the FDIC is responsible for approving any transaction involving a merger or consolidation between an IDI and an uninsured institution, including an assumption by an IDI of deposit liabilities from an uninsured institution and a transfer by an IDI of assets to an uninsured institution as consideration for an assumption of liabilities for deposits made in the IDI. *Id.* § 1828(c)(1)(A)–(C).

[2] 12 U.S.C. § 1828(c)(5)(11).

[3] 12 C.F.R. § 5.33(j).

[4] In all four situations, the resulting national bank or federal savings association must be well capitalized immediately following the transaction.

[5] "Eligible bank or eligible savings association" means a national bank or federal savings association that: (1) is well capitalized under 12 C.F.R. § 5.3; (2) has a composite rating of 1 or 2 under the Uniform Financial Institutions Rating System (CAMELS); (3) has a Community Reinvestment Act rating of Outstanding or Satisfactory, if applicable; (4) has a consumer compliance rating of 1 or 2 under the Uniform Interagency Consumer Compliance Rating System; and (5) is not subject to a cease and desist order, consent order, formal written agreement, or prompt corrective action directive or, if subject to any such order, agreement, or directive, is informed in writing by the OCC that the bank or savings association may be treated as an eligible bank or eligible savings association. 12 C.F.R. § 5.3.

[6] "Eligible depository institution" means (1) with respect to a national bank, a state bank or a federal or state savings association that meets the criteria for an eligible bank or eligible savings association under § 5.3 and is FDIC-insured; and (2) with respect to a federal savings association, a state or national bank or a state savings association that meets the criteria for an eligible bank or eligible savings association under § 5.3 and is FDIC-insured. 12 C.F.R. § 5.3.

[7] See OCC, Streamlined Business Combination Application, "Authority To File a Streamlined Submission," at iii, available at https://www.occ.treas.gov/static/licensing/form-business-combo-app-streamlined-v2.pdf.

[8] 12 C.F.R. § 5.33(i).

[9] Those factors are: (1) whether the proposed transaction would result in a material increase in risks to financial system stability due to an increase in size of the combining institutions; (2) whether the proposed transaction would result in a reduction in the availability of substitute providers for the services offered by the combining institutions; (3) whether the resulting institution would engage in any business activities or participate in markets in a manner that, in the event of financial distress of the resulting institution, would cause significant risks to other institutions; (4) whether the proposed transaction would materially increase the extent to which the combining institutions contribute to the complexity of the financial system; (5) whether the proposed transaction would materially increase the extent of cross-border activities of the combining institutions; (6) whether the proposed transaction would increase the relative degree of difficulty of resolving or winding up the resulting institution's business in the event of failure or insolvency; and (7) any other factors that could indicate that the transaction poses a risk to the U.S. banking or financial system.

[10] Capital One Fin. Corp., 98(5) Fed. Res. Bull. 7, 24 (2012). The Federal Reserve has continued to cite this order in recent M&A approval orders. *See, e.g.*, Bank of Montreal, FRB Order No. 2023-1 (Jan. 17, 2023); Citizens Fin. Grp., Inc., FRB Order No. 2022-11 (Mar. 22, 2022); M&T Bank Corp., FRB Order No. 2022-10 (Mar. 4, 2022).