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Key takeaways from the FDIC's proposed statement of policy on bank mergers

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The FDIC's proposal would lead to significant change in bank M&A.

The Federal Deposit Insurance Corporation (FDIC) released a Proposed Statement of Policy on Bank Merger Transactions (the Proposal) that outlines the FDIC's views on its jurisdiction and expectations with respect to each statutory factor under the Bank Merger Act (BMA).

The Proposal is one of a series of recent efforts to revisit and modify bank merger standards, beginning with President Biden's Executive Order on Promoting Competition in the American Economy in July 2021, a statement in a speech in June 2023 by Assistant Attorney General Jonathan Kanter that the Department of Justice (DOJ) would be reassessing the prevailing approach to bank merger enforcement, and a notice of proposed rulemaking in January 2024 from the Office of the Comptroller of the Currency (OCC) on its own approach to evaluating BMA applications. The Federal Reserve has, notably, been silent.

Far from representing a coordinated, interagency approach to a federal statute (the BMA) that provides for a single set of standards and criteria for acting on a bank merger application, each of these efforts reflects the different views of each agency as to how bank merger transactions should be evaluated. This fragmented approach, especially in the absence of any finalized bank merger guidelines from the DOJ in consultation with the federal banking agencies, will likely contribute to the continued uncertain outlook for bank M&A transactions and may also lead to an increased focus on choices of acquisition structures and bank charters.

Our key takeaways are below. Beyond these key takeaways, for the reasons noted below, the details of the Proposal are worth the attention of any party considering a larger transaction in the banking sector.

Comments on the Proposal will be due 60 days after publication in the Federal Register.

Key takeaways

1. The Proposal is relevant to all near-term large bank M&A.

Although the FDIC's jurisdiction for bank-to-bank M&A is limited to transactions in which the FDIC is the acquiring bank's primary federal regulator, as well as all merger or consolidation transactions between any IDI of any size and an uninsured institution, the Proposal is relevant to all near-term large bank M&A. In particular, the Proposal's discussion of how the FDIC would evaluate the competition aspects of a proposed transaction is similar to the way in which the DOJ has indicated it would do so (in the form of Assistant Attorney General Kanter's June 2023 speech). For example, both the DOJ and the FDIC Proposal are poised to lessen emphasis on local deposit market share and, instead, focus on a wider range of metrics. The DOJ said that these factors may include fees, interest rates, branch locations, product variety, network effects, interoperability and customer service. The Proposal notes that the FDIC would: evaluate "both geographic and product markets"; "may consider concentrations in any specific products or customer segments"; and may consider "additional methods of assessing the competitive nature of markets," such as "information on the pricing of products and services to assess the competitive effects of a proposed merger when practicable and relevant."

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Because the DOJ's contemplated approach and the FDIC's Proposal share intellectual provenance, and because the DOJ has separate authority to review and challenge a proposed merger, the FDIC's Proposal provides a window into how the DOJ may approach any revisions to both its bank merger guidelines and its own analysis of any bank merger, particularly large bank M&A transactions. We therefore believe the FDIC Proposal and DOJ's intended approach need to be read together to evaluate any near-term large bank M&A. Moreover, as discussed below, the FDIC's broad approach to the application of the BMA to transactions with uninsured institutions makes the Proposal relevant to a wider range of deals than just bank-to-bank M&A.

2. The FDIC asserts a broad interpretation of its BMA jurisdiction.

Although the preamble states that the Proposal "clarifies" the FDIC's jurisdiction to review transactions under the BMA, the Proposal makes transparent the FDIC's very broad interpretation of its authority to review transactions between an insured depository institution (IDI) and a non-insured entity under the BMA. The Proposal notes that this broad jurisdiction reflects "clear congressional intent for the FDIC to review a wide array of transactions between IDIs and non-insured entities that have the potential to affect the safety and soundness of a resultant IDI or increase the potential liability of the Deposit Insurance Fund."

The BMA requires FDIC approval where the acquiring or resulting bank in a merger transaction between two IDIs is a state non-member bank, as well as where any IDI merges with a non-insured entity, assumes liability to pay any deposits made in—or similar liabilities of—a non-insured entity, or transfers assets to any non-insured entity in consideration of the assumption of liabilities for any portion of the deposits made in the IDI. The Proposal emphasizes the FDIC's expansive interpretation of what constitutes a merger or assumption of deposits requiring review.

As the FDIC itself clearly articulates in the Proposal: "In all cases, the FDIC will evaluate the substance of all of the facts and circumstances of the transaction and any related transactions, **identify which aspects of the transaction(s) are subject to FDIC approval**, and fully evaluate the statutory factors applicable to each transaction" (emphasis added). The emphasized text is consistent with our own experience with the FDIC in recent years, in which the FDIC takes the position that, in order for the FDIC even to determine whether a BMA application is necessary, a BMA application must be filed.

3. More focus will be required for non-bank acquisitions.

The Proposal reflects a more expansive assertion of authority than the FDIC's existing 2008 statement of policy, which states that "[t]ransactions that do not involve a transfer of deposit liabilities typically do not require prior FDIC approval under the [BMA], unless the transaction involves the acquisition of all or substantially all of an institution's assets." The FDIC's more expansive view of its jurisdiction is evidenced in several instances, such as:

- The Proposal outlines the FDIC's views on what constitutes a "merger in substance" subject to FDIC approval under the BMA: "The FDIC considers transactions to be mergers in substance when a target would no longer compete in the market, regardless of whether the target plans to liquidate immediately after consummating the transaction. An example of a transaction that is a merger in substance, and therefore subject to the BMA, is when an IDI absorbs all (or substantially all) of a target entity's assets and the target entity dissolves (or otherwise ceases to engage in the acquired lines of business)."
- While the idea of treating the acquisition of a line of business as the equivalent of the acquisition of shares in a company is nothing new (*see, e.g.*, 12 C.F.R. § 225.132), the extension of the BMA to asset acquisitions that may not in practice represent all or substantially all of the assets of the selling institution represents a departure from both the FDIC's own current statement of policy, its current Application Procedures Manual and published FDIC legal interpretations.
- In the preamble to the Proposal, the FDIC states that the "all or substantially all assets" test may be met "regardless of whether" (i) there is an assumption of liabilities, (ii) the assets are non-GAAP assets (which means they could be assets held in custody or as collateral, not on the balance sheet), and (iii) the acquisitions occur "as a single transaction or over the course of a series of transactions." The last two points, in particular, mean that even if no on-balance sheet assets are acquired, and even if a single transaction does not meet the all or substantially all test, but subsequent transactions result in a cumulative satisfaction of the test, the FDIC will consider them to be BMA transactions (although it is unclear, in the case of relying on subsequent transactions to meet the test, when the BMA application would need to be submitted and what its scope would be: all of the prior transactions as well?).
- The preamble to the Proposal notes that a merger in substance may occur where the assets acquired are intangible, without regard to whether the assets would be considered assets for accounting purposes. As an example, the Proposal notes a target that is a fintech firm could fall into this category.

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- The Proposal also emphasizes the breadth of the term "deposit" under the Federal Deposit Insurance Act, and the preamble clarifies the FDIC's broad view of what constitutes an assumption of deposits.
  - For example, "[i]n cases where an IDI and a non-insured entity cooperate to arrange a transfer of deposits from a non-insured entity to an IDI, the FDIC will generally consider such an orchestration to constitute an assumption of deposits" subject to FDIC approval. As it is difficult to imagine any transfer of any deposits of an uninsured institution to an IDI being completed without the cooperation of the IDI, the FDIC's position, if interpreted literally, would apply to any transfer of any deposit from an uninsured institution to an IDI—even if initiated at the request of the relevant depositor(s) of the uninsured institution. It would be helpful if the FDIC could confirm that this literal conclusion is not its intent.
  - Likewise, "any expansion of an IDI's deposit base via acquisition" from a non-insured entity would be subject to FDIC approval—including if the assumption of deposits is not documented in the transaction agreement but customers of the non-insured entity are solicited to transfer their deposits to the IDI in connection with the transaction.
  - Another example: "Although parties seeking to engage in transferring customer accounts that consist of both custodial and deposit relationships may characterize the transaction solely as a transfer of custodial relationships, such transactions implicate the BMA if they also result in a transfer of the deposit relationship. It has therefore been the view of the FDIC that the BMA is implicated if an IDI transfers deposit relationships concurrent with, or subsequent to, a transfer of the custodial relationship. Accordingly, where customers have both a custodial and depository relationship with an IDI, an IDI may not evade the BMA by transferring custodial rights to a third party that, in its newly acquired custodial capacity, causes the customer's depository relationship to be transferred either to itself or to another entity. This is true even if such transfer was ostensibly at the direction of a non-insured entity pursuant to custodial rights acquired from the IDI."

4. Transactions over $100 billion will be subject to heightened scrutiny.

The Proposal notes that "transactions that result in a large IDI (e.g., in excess of $100 billion) are more likely to present potential financial stability concerns with respect to substitute providers, interconnectedness, complexity, and cross border activities, and will be subject to added scrutiny."

Although the Proposal states that "the FDIC will not view the size of the entities involved in a proposed merger transaction as a sole basis for determining the risk to the U.S. banking or financial system's stability," in practice it seems obvious that the FDIC's intention is to make it more difficult for transactions involving or resulting in an IDI with more than $100 billion in total consolidated assets to be approved. In case anyone missed the point, Consumer Financial Protection Bureau (CFPB) Director and FDIC Board member Rohit Chopra stated in prepared remarks: "By codifying this [$100 billion threshold], boards of directors and management at large firms can understand that the likelihood of approval of megamergers will be low."

The FDIC declined to adopt thresholds for when a resolution plan or single-point-of-entry resolution strategy would be required from a large newly merged IDI. At the same time, it appears clear that an enhanced resolution plan strategy may be required for the approval of larger transactions. The preamble clearly states the FDIC's view that "regardless of the strategy selected, the challenges associated with resolving a large bank would be significant, both operationally and financially," and specifically identifies "potential resolution impediments," including the resulting IDI's organizational structure and the "necessity and difficulty of: (i) continuing the IDI's operations and activities until they can be sold or wound down, (ii) marketing and selling key business lines and asset portfolios at the least cost to the DIF [Deposit Insurance Fund], and (iii) separating business lines and other assets to enable their sale or other disposition." The inability of the FDIC to execute these same three resolution options due to the IDI's organizational and funding structure are repeated in the Proposal itself as potentially precluding a favorable finding on the financial stability factor of complexity.

The preamble also notes that staff from the FDIC's Division of Resolutions and Receiverships and, potentially, the Division of Complex Institution Supervision and Resolution will assist in reviewing proposed larger transactions. In doing so, the FDIC "could consider the presence of support agreements from the resulting IDI's ultimate parent company, strengthened risk governance procedures, and capital maintenance requirements for the IDI." These concepts all come from U.S. global systemically important bank resolution planning practices and very well may become a prerequisite to the approval of any larger bank M&A.

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5. Applications may be subject to more outside influence: public hearings would be more common and the CFPB may play more of a role.

The Proposal notes that the FDIC generally would consider it is in the public interest to hold a hearing for merger applications resulting in an IDI with greater than $50 billion in assets or for which a significant number of Community Reinvestment Act protests are received. The Proposal does not provide further detail on what will constitute a significant number that merits a hearing.

In addition, the FDIC notes that the agency would consider the views of relevant state and federal regulators regarding the ability of the applicant to meet the convenience and needs of the community to be served. In his speech on the same day the Proposal was released, CFPB Director Chopra was somewhat more pointed, stating that the FDIC "will carefully evaluate the banks' compliance records, especially with respect to consumer law. The agency will consult with the relevant state and federal authorities, including the CFPB. Repeat offenders of consumer protection and fair dealing laws will face a steep climb to satisfy this factor."

6. Although the FDIC will still rely on deposits to assess competitive effects on commercial banking products and services, it will consider a broad range of market participants and concentrations in any specific or customer segments.

The Proposal indicates a clear intention on the part of the FDIC to take a broad approach to assessing the competitive effects of any bank merger transaction. The Proposal generally acknowledges the reality of greater competition in the provision of banking and related financial services. For example, the FDIC will consider "all relevant market participants," including "any other financial service providers that the FDIC views as competitive with the merging entities, including providers located outside the geographic market when it is evident that such providers materially influence the market." The FDIC will also identify all relevant geographic markets based both on where the merging entities operate and where customers "may practically turn to competitors for alternative products and services."

On the other hand, the FDIC states that it will use deposits as an "initial proxy for commercial banking products and services" and will "initially" measure the respective shares of total deposits held by the merging entities and various other participants with offices in the geographic market, confirming that the traditional measure of deposit concentrations based on the presence of offices in geographic markets, as measured by the Herfindahl-Hirschman Index (HHI), will continue to be an important metric. The Proposal does not, however, signal the adoption of any new HHI threshold as part of the FDIC's competitive analysis.

The Proposal also reflects the FDIC's intention to consider concentrations in products or services that go beyond and are narrower than deposits, including "concentrations in **any** specific products or customer segments" (emphasis added), such as small business or residential lending or "activities requiring specialized expertise." The Proposal specifies that the FDIC's analysis may incorporate other products offered by the merging entities based on whether consumers retain meaningful choices, and will also consider both the emergence of new competitors for products or services in relevant markets, as well as the expansion of products and services offered by the merging entities and other market participants.

7. Divestitures would be required before closing a transaction.

The Proposal states the FDIC may require divestitures to mitigate competitive concerns **before** allowing the transaction to be consummated and generally will not permit any non-compete agreements with any employee of the divested entity. At the FDIC's open meeting on the Proposal, FDIC staff stated that the reason for the requirement is to minimize the risk that divestiture, as a remedy for the competitive concerns, will be ineffective.

In his statement on the Proposal, Vice Chairman Travis Hill noted his concern that "[r]equiring divestitures in advance of the merger may add significant delays to the merger process [while] failing to successfully divest post-merger is extremely rare, and the FDIC has other supervisory tools to address such a concern." Vice Chairman Hill also stated that prohibiting non-compete agreements with the employees of a divested entity is a "policy which seems far outside the FDIC's jurisdiction and expertise."

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8. The FDIC expects applicants to demonstrate that a transaction will enable the bank to better meet the convenience and needs of the community.

The Proposal states that "[t]he FDIC expects that a merger between IDIs will enable the resulting IDI to **better** meet the convenience and the needs of the community to be served than would occur absent the merger" (emphasis in original). In other words, unless the merger results in an improvement in the resulting IDI's ability to meet the convenience and needs of the community to be served compared to the IDI's current ability without the merger, the FDIC's expectation for approval on this factor would not be met. The "better than current" standard appears to be an expansion of the statutory mandate to assess an institution's record of meeting the credit needs of its community and evaluating that record. The preamble to the Proposal lists specific metrics that would satisfy this standard: "higher lending limits, greater access to existing products and services, introduction of new or expanded products or services, reduced prices and fees, increased convenience in utilizing the credit and banking services and facilities of the resulting IDI, or other means." The FDIC's expectation of increases in some of these metrics will need to be balanced with the potential impact of purchase accounting principles, which may result in reduced values of loans or other assets or increased expected credit losses.

In order to meet this burden, "[t]he FDIC expects applicants to provide specific and forward-looking information to enable the FDIC to evaluate the expected benefits of the merger on the convenience and needs of the community to be served." This specific information is expected to include a three-year plan for all projected or anticipated branch expansion, closings or consolidations following the closing of the merger, "including the timing of each closure, the effect on the availability of products and services, particularly to low- or moderate-income individuals or designated areas, any job losses or lost job opportunities from branching changes, and the broader effects on the convenience and needs of the community to be served." In addition, "claims and commitments made to the FDIC to support the FDIC's evaluation of the expected benefits of the merger may be included in the Order [approving a transaction], and the FDIC's ongoing supervisory efforts will evaluate the IDI's adherence with any such claims and commitments."

The dissenting FDIC Directors offered several criticisms of the Proposal's approach to reviewing the convenience and needs factor. Vice Chairman Hill characterized this as "imposing an affirmative burden on applicants to 'demonstrate how the transaction will benefit the public'" and noted that "[b]urden-shifting can make a big difference for a legal regime." In his statement on the Proposal, Director Jonathan McKernan similarly questioned whether there was a legal basis for the "new expectation . . . that the post-merger bank do 'better' on the convenience and needs factor."

Vice Chairman Hill also pushed back on the Proposal's focus on proposed branch closures because "we should avoid presuming that more branch presence is always in the best interest of the community to be served … [because of] the tradeoffs between benefits such as more in-person service and higher costs that are passed on to customers." Director McKernan expressed a similar concern as to whether the FDIC "legally may consider 'any job losses **or lost job opportunities**' from branching changes" (emphasis in original). Finally, Vice Chairman Hill noted his skepticism that "it is the FDIC's role to 'closely evaluate[]' whom the resulting entity chooses to employ."

9. The FDIC would require applicants to supply more information as part of a BMA application.

The Proposal would require BMA applicants to provide more detailed information as part of their applications, whether to meet the requirement of a "substantially complete" application or to enable the FDIC to assess one or more of the statutory factors, than the FDIC has generally required in the past. While these categories of information may have been included in past applications, either on the initiative of the applicant or pursuant to additional information requests from the FDIC, the Proposal indicates a clear expectation on the part of the FDIC to receive this information in all BMA applications to the extent relevant. For example:

- As a general matter, the narrative portion of any application must be supported by studies, surveys, analyses and reports, including those prepared by or for officers, directors or deal team leads;
- Transactions involving the acquisition of low-quality assets or the transfer of any assets from an uninsured institution to an IDI should include independent appraisals or valuations to support the projected value of any businesses or assets to be transferred to the IDI;
- As part of assessing the resulting IDI's future prospects, the FDIC will review not only pro forma financial projections and their underlying assumptions (as currently), but also any accompanying valuations (e.g., for the target entity, goodwill, or other assets);

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- As part of reviewing managerial resources, the FDIC will review the adequacy of succession planning; the reasonableness of fees, expenses and other payments made to insiders; and
- As already noted above, as part of reviewing the convenience and needs factor, a three-year plan for branch expansion, closings or consolidations. In the preamble to the Proposal, the FDIC states that the Proposal "advises applicants to be prepared to make commitments regarding future retail banking services in the community to be served for at least three years following consummation of the merger." It is unclear whether this refers solely to the three-year branch plan or to a broader set of commitments.

In the preamble to the Proposal, the FDIC states that it is seeking comment on proposed revisions to its supplement to the Interagency BMA application form. Although these proposed revisions have not yet been published, we expect them to include the information requirements described above and to be published concurrently with the Proposal in the Federal Register. CFPB Director Chopra suggested in his prepared remarks that the revisions may adopt certain items from the Hart-Scott-Rodino Act premerger notifications, such as requiring "production of the analyses of the deal conducted for the banks' directors and officers, either internally or by third-party investment bankers or consultants" because these deliberations "are critical to understand deal rationale and may reveal anticompetitive intent."

10. The message on the use of commitments to facilitate approval is muddled.

The Proposal states that although the FDIC will approve applications subject to standard and non-standard conditions, which may include higher capital requirements or written agreements addressing capital maintenance requirements, liquidity or funding support, affiliate transactions or "other relevant provisions," it will not use conditions as a means for favorably resolving any statutory factors that otherwise present material concerns. In his statement on the Proposal, OCC Comptroller and FDIC Board member Michael J. Hsu agreed generally with the FDIC's approach to conditions, but also stated his view that, "[a]t the same time, in some instances targeted conditions can mitigate specific risks from a proposed merger transaction. These should be considered when they will be effective and where appropriate."

11. Integration planning would become an important part of an application.

As part of the managerial resources factor, the Proposal notes that the FDIC expects management to have sufficient managerial and operational capacity to integrate the acquired entity, including with respect to: "human capital; products and services; operating systems, policies and procedures; internal controls and audit coverage; physical locations; information technology; and risk management programs." As a result, up-front evidence to the FDIC of the applicant's record in integrating prior acquisitions and its integration planning for the merger covered by the application will become more important during the application process.

12. The FDIC may issue a public statement when an applicant withdraws its application.

The Proposal states that "[i]f an applicant withdraws their filing, the FDIC Board of Directors may release a statement regarding the concerns with the transaction if such a statement is considered to be in the public interest for purposes of creating transparency for the public and future applicants." This is a departure from current practice where an applicant may choose to withdraw an application to avoid a public denial, even though the fact of a withdrawal is publicly disclosed by the FDIC.

CFPB Director Chopra also provided viewpoints on this issue. For instance, CFPB Director Chopra stated that: "[r]ather than deny mergers and publish orders describing the rationale for denial, there has been an informal understanding between the regulators and the industry that applicants will be allowed to withdraw their application instead of receiving a denial. Under many, if not most, circumstances, this has struck me as quite inappropriate." Even when applications are withdrawn, CFPB Director Chopra was concerned that "the banking agencies do not provide any public communication about the rationale for non-approvals depriving the public and market participants of transparency."

Although he "appreciate[d] the desire to provide more transparency to the public regarding why certain mergers do not get approved," Vice Chairman Hill was concerned about "imposing reputational damage on applicants." Furthermore, he noted that the Proposal was "consistent with longstanding practice" in that applicants could withdraw an application rather than face a public denial. Public statements on withdrawals, according to Vice Chairman Hill, "would seem to defeat the purpose of allowing an institution to withdraw."

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