Simpson Thacher

Memorandum

FDIC Proposes Changes to Its Bank Merger Review Process

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On March 21, 2024, the FDIC issued a proposed Statement of Policy reflecting an updated approach to evaluating bank mergers and related transactions. The proposed Statement of Policy would adopt a principles-based approach to the FDIC's consideration of each Bank Merger Act ("BMA") statutory review factor, and would address the FDIC's expectations regarding procedural and adjudication matters such as pre-filing meetings, application withdrawals, and the use of approval conditions.

The FDIC's proposal comes two years following the agency's March 2022 request for information and comment on its bank merger review framework, and just months following the OCC's related proposal to update its own policies regarding mergers involving national banks and federal thrifts. While the FDIC's proposal includes certain merger review themes that resemble those in the OCC's January 2024 proposed policy statement, the FDIC's proposal, unlike the OCC's, expressly changes its merger review criteria and will likely exacerbate industry concerns with long and unpredictable agency processing periods to an even greater extent than the OCC's proposal.

Key Takeaways

As described by Acting Comptroller of the Currency (and FDIC Board member) Mike Hsu, the FDIC's proposal is "broadly consistent" with the OCC's January 2024 bank merger proposal. Comptroller Hsu framed the FDIC's proposal as bringing transparency to the BMA review process in support of his view that "bank merger applications exist along a spectrum—they are neither all good, nor all bad."

Despite this relatively moderate characterization by Comptroller Hsu, concurrent remarks delivered by CFPB Director (and fellow FDIC Board member) Rohit Chopra reflected a notably more hostile regulatory posture towards bank mergers and presented more aggressive intentions underlying the FDIC proposal's updates. For example, Director Chopra stated in his oral remarks at the FDIC Board meeting accompanying the proposal's release that the FDIC was "moving away from a pro-merger position," and in his speech later that day at the Peterson Institute for International Economics indicated a desire to "undo the harms from the permissive, pro-merger policy posture of recent decades."

Key new provisions in the FDIC's Statement of Policy include:

- Mergers resulting in a bank with over $100 billion in assets will receive enhanced financial stability scrutiny, which Director Chopra said means a "low likelihood" of approval.
- Applications must demonstrate with "specific and forward-looking information" that the combined institution will "better" meet the convenience and needs of the applicable community.
- Applicants must provide a detailed three year plan for all projected or anticipated branch expansions, closures or consolidations following the merger and must be prepared to make commitments for at least three years regarding future retail banking services in the relevant communities.
- Explicit provisions to move towards the open-ended antitrust analyses articulated by Assistant Attorney General Kanter last year in his Brookings Institute speech, rather than being limited to traditional deposit share analyses under the 1995 Bank Merger Guidelines for transaction within a safe harbor level. (Acting Comptroller Hsu suggested a similar approach in his comments accompanying the OCC's bank merger proposal, but the OCC's proposal itself is silent on antitrust matters.)
- Requirement that any branch or business divestitures be *completed* before the bank merger closes.
- Requirement that applicants submit with their FDIC application certain internal studies and reports related to the transaction.
- Expectation that all transactions resulting in an over-$50 billion institution, or which receive a "significant number" of adverse comments, will be subject to public hearings.

Although the FDIC is already effectuating many of the concepts outlined in the proposal, the proposed policy statement would, if adopted, result in significantly more burdensome application requirements and continue the FDIC's current trend of extremely long processing periods. FDIC Board members Travis Hill and Jonathan McKernan did not support the proposal on those grounds (in addition to noting some concerns about specific provisions of the policy), stating respectively that the proposal "moves in the wrong direction, potentially making the process longer, more difficult, and less predictable" and that the proposal "makes explicit what we all sort of already knew – the FDIC takes a quite skeptical view of bank mergers."

Although much of the commentary accompanying the proposal's release (particularly from Director Chopra) focuses on large transactions, it is important to note that the vast majority of applications processed by the FDIC has historically been for resulting institutions with less than $10 billion in assets. According to the FDIC's own data, over the past 20 years, only 0.3% of merger applications acted on by the FDIC involved resulting institutions with over $100 billion in assets and only 4.4% involved resulting institutions with between $10 billion and $100 billion in assets. This suggests that community banking organizations will likely be disproportionately impacted by these changes, while also highlighting the FDIC's general inexperience with processing merger applications involving large banking organizations as compared to the OCC or the Federal Reserve.

In the near term, this proposal, combined with the FDIC's pending proposal on corporate governance, may well result in more state nonmember banks reconsidering their charter choice or member bank election. The FDIC and OCC proposals, despite their differences, also highlight the need for banking organizations looking to grow through acquisition to be well prepared and to consider a number of key issues much earlier in their planning process than has historically been necessary regardless of the processing agency.

Application Process

The FDIC proposal includes a number of clarifications and expansions to the agency's administrative processes that should be expected to materially impact application processing times. The FDIC's proposal notes that it encourages prospective applicants to engage in a pre-filing process to discuss regulatory expectations, and emphasizes the importance of applications being substantially complete when initially filed.[1]

The proposal notes that the FDIC expects all submitted materials, including the financial projections and any related analyses, to be well supported and sufficiently detailed, and that applications should include narrative supporting the rationale for the transaction supported by "studies, surveys, analyses and reports," including those prepared by or for bank officers, directors, or deal team leads. This expectation to provide management studies, surveys, analyses and reports in support of the proposed transaction would be a significant change from current banking agency review practices, and appears to be based on the requirements in Item 4(c) of the Hart-Scott-Rodino Act notice form to provide internally generated competition and market analyses. In connection with this, the FDIC will be separately proposing an expanded list of information required to be submitted in connection with a BMA application. Banks will as a result need to exercise greater oversight of internally generated materials which may need to be submitted to the FDIC as part of the application (particularly if the FDIC does not offer these materials confidential treatment).

The FDIC also indicates in its proposal that it will generally "not approve a merger application if adverse CRA comments have not been resolved." The proposal provides no indication as to how a comment will be determined to have been resolved, and establishes no minimum materiality or other substantive criteria for the scope of adverse comments that would require resolution. The proposal further states that the FDIC would generally expect to hold a public hearing for applications involving a resulting bank with more than $50 billion in assets (regardless of whether any adverse comments were received) or where the FDIC has received a significant number of adverse comments. The FDIC also stated that it may hold "public or private meetings to receive input on the transaction," apparently providing additional avenues for public commenters to contest a merger transaction. These provisions will likely extend processing time and allow for significant leverage by protestors and activists to delay or prevent merger approval through the public comment process.

[1] Note that the FDIC typically only formally accepts applications as substantially complete late in their review process because this triggers certain time periods in which the agency must act under their regulations.

Additionally, the proposal states that orders approving applications will be posted on the FDIC's public website and that each order will include the agency's full analysis and conclusions. The FDIC notes that the agency is considering enhancing its website to include information regarding public comments received on applications as well. Taken in combination with other aspects of the proposal noted below, the FDIC proposal suggests a desire for even more public input and transparency regarding bank merger transactions.

Application Adjudication

The FDIC's proposal lists several potential sources of concern that could lead to denial of a merger application. While several such indicators of likely application disapproval are well-known (*e.g.*, legal non-compliance, unsafe or unsound condition, unsatisfactory examination ratings), the proposal includes certain factors that may result in disapproval that have not previously been articulated by the regulators, such as less than satisfactory examination ratings in any specialty areas (*i.e.*, information technology or trust examinations), and significant management turnover.

The FDIC proposal does not expressly include any size thresholds for transactions that would be presumptively consistent—or inconsistent—with approval (unlike the OCC's recently proposed policy statement), but does note that transactions resulting in banks with over $100 billion in assets are more likely to present financial stability concerns. Although as noted below, the Statement of Policy says that size alone would not indicate disqualifying financial stability risk, in his prepared remarks at the Peterson Institution, Director Chopra stated that the FDIC's heightened scrutiny for these transactions was intended to signal to boards of directors and management at large firms "that the likelihood of approval…will be low."

According to the proposal, if an application does not meet the FDIC's standards for approval, the FDIC will not use conditions or written agreements as a means of favorably resolving material concerns with any statutory factors. However, the FDIC notes that it may require non-standard conditions to enhance capital, liquidity or to address other supervisory needs (including through capital maintenance or funding support commitments by affiliates or investors), and the inability or unwillingness to enter into proposed conditions or written agreements will result in unfavorable findings on the application.

In addition, the proposal introduces some doubt as to whether the FDIC would permit applicants to withdraw applications that present material concerns, noting that the agency "may" offer applicants the opportunity to withdraw the filing "at the FDIC's discretion." If an applicant withdraws its filing, the proposal notes that the FDIC may describe the agency's concerns with the transaction in a public statement. This apparent disfavoring of application withdrawals, together with the avoidance of conditions to resolve application concerns, will likely result in an increasing number of application denials by the FDIC (after no application denials by the FDIC since at least 2004).

Statutory Approval Factors

The proposed policy statement also provides guidance on how the FDIC will evaluate some of the required factors under the Bank Merger Act. Similar to the OCC's proposed policy statement, many of the considerations discussed in the FDIC's proposal are well understood and reflect long-held practices of the federal banking agencies. However, the FDIC was clear that the proposed policy statement is intended to strengthen and not simply clarify previous practice. Indeed, the proposed policy statement adds some considerations that are novel or provide a new gloss on previous practices, including by shifting and increasing evidentiary burdens.

COMPETITIVE EFFECTS

- After several years with no interagency movement on updating the 1995 Bank Merger Guidelines, the proposal notes several significant changes to the FDIC's competitive review process that align with concepts previously outlined by Department of Justice (the "DOJ") antitrust head Jonathan Kanter. Historically, the FDIC has taken a relatively hands-off approach to the review of competitive factors on applications that also involve an application with the Federal Reserve. The proposal represents a clear shift in this approach.
- The FDIC stated that it will continue to use the traditional framework for reviewing the competitive effects of a bank merger, including by using deposit data and standard HHI thresholds. However, the traditional review would not serve as a presumption that the transaction is consistent with approval and the FDIC will also consider concentrations in products beyond deposits and in geographies beyond a bank's physical branch network. The proposal states that the agency's competitive review will be tailored to each transaction and consider all relevant market participants to ensure that customers retain "meaningful choices" for products and services. The proposal did ask for comments on whether the HHI or a specific HHI threshold should be a definitive factor for evaluating the competitive effects of a proposed transactions.
- Similar to current banking agency practice, the FDIC may require divestitures of business lines or branches to mitigate competitive issues. Past practice of the DOJ and the Federal Reserve requires parties to have an executed contract with a buyer for the branches to be divested prior to consummation of the merger. However, unique to this proposal, the FDIC will require all divestitures to be complete *prior* to consummation of the bank merger. Although there is no evidence that the current divestiture process is ineffective, Director Chopra expressed concerns regarding possible "sabotage" of divestiture buyers by the selling bank and noted that the proposal would not permit any non-compete provisions between the selling bank and employees transferred with the divested branches. This process shift will cause material delays in consummation of transactions requiring divestitures unless applicants are more proactive with respect to seeking out and securing appropriate counterparties at an earlier point in the applications process (since these counterparties must themselves obtain regulatory approval to consummate the acquisition of the divested branches).

FINANCIAL AND MANAGERIAL RESOURCES AND FUTURE PROSPECTS

- In addition to traditional considerations around the adequacy and sustainability of a bank's business plan, financial condition, supervisory status and managerial strength, the proposal explicitly notes that the FDIC will consider managerial succession planning, management's perceived responsiveness to supervisory recommendations, rapid growth and management's record of overseeing and controlling the risks associated with that growth, as well as payments to insiders.
- Similar to the OCC proposed policy statement, the proposal also indicates that the FDIC will give greater consideration than under its historical practice to overall integration planning, 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.
- The proposal also states that the FDIC will evaluate the effect of "organizational relationships" (referring to a bank's parent holding company and affiliates) on the bank, including "the condition, performance, risk profile, and prospects of the organization as a whole." The proposal discusses the potential evaluation of the overall operations, managerial resources, financial condition, capital and liquidity resources and compliance record, among other things, of the bank's holding company and affiliates. Although the FDIC likely considered some of these elements in connection with specific factual situations, the explicit articulation is novel. Additionally, the proposal does not condition any of its statements regarding this review of holding companies or affiliates on whether there is or isn't a parallel review by the Federal Reserve of an application under the Bank Holding Company Act.

CONVENIENCE AND NEEDS

- Similar to the OCC proposed policy statement, the proposal clarifies that the FDIC views the Convenience and Needs factor as forward-looking and distinct from the bank's record in complying with the Community Reinvestment Act. Significantly, the proposal also states that applicants must affirmatively demonstrate with "specific and forward-looking information" (as opposed to mere "puffery" as noted by Director Chopra) that the combined organization would *better* [emphasis included] meet the convenience and needs of the community. The proposal further states that the FDIC will expect applicants to demonstrate such enhanced community benefits "through 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." This is a material change from current practice and goes beyond the statutory requirement that the federal banking agencies "take into consideration" the convenience and needs of the community to be served. Given the emphasis on this point in the proposal as well as in statements made during the FDIC's board meeting, this shift could have a very significant impact on application processing. Although many bank mergers do include many or most of the benefits listed in the FDIC proposal, the proposal provides no metric for determining how the agency will quantify benefits or balance and weigh the different aspects of a proposal to determine if it better meets the needs of the community.

- The FDIC will continue to consider planned branch closures and consolidations generally and in low-or-moderate-income areas and changes to availability or cost of services in evaluating this factor. However, in a significant shift, the proposal states that the FDIC will evaluate "all projected or anticipated branch expansion, closings, or consolidations for the first three years following consummation of the merger."
- The proposal also states that the FDIC (similar to the OCC proposal) will now consider job losses or reduced job opportunities in connection with branch closures under this factor. Historically, federal banking regulators have not directly considered job losses in connection with bank merger applications, and have clearly stated that job losses are beyond the statutory factors that they are authorized to consider under applicable bank merger statutes.
- Although the proposal does not require a forward-looking community benefit plan for the resulting bank, the FDIC notes that it can condition an approval on representations made to the agency during the application process, which could include those provided in a community benefit plan. The proposal also states that applicants should 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." The FDIC did not provide any details regarding the scope of these possible commitments. It is possible that such commitments could have a significant impact on bank activities, including limiting branch closures and consolidations, requiring new or expanded products and services, or requiring growth in bank metrics in key areas that are relevant to the convenience and needs factor, such as mortgage lending, small business lending, as well as community development lending, investment and services, similar to what has been included in recent community benefit plans.

FINANCIAL STABILITY

Since 2012, the federal banking agencies have utilized a consistent set of criteria to determine satisfaction of the "financial stability" factor (added to the BMA by the Dodd-Frank Act). These criteria include (i) the size of the entities involved in the transaction; (ii) the availability of substitute providers for any critical products and services to be offered by the resulting firm; (iii) the resulting firm's degree of interconnectedness with the U.S. banking or financial system; (iv) the extent to which the resulting firm contributes to the U.S. banking or financial system's complexity; and (v) the extent of the resulting firm's cross-border activities. The FDIC's proposal would continue to rely on these criteria for the agency's "financial review" analysis, but with the following notable guidance to its assessment approach:

- While the Federal Reserve currently presumes that a transaction would not raise material financial stability concerns if the resulting firm would have less than $100 billion in total assets (or if the acquired assets are less than $10 billion), the FDIC's proposal signals an inversion of this presumption (even though the proposal notes that size should not be the sole factor in determining systemic risk), with the agency considering a resulting bank with more than $100 billion in total assets as more likely to raise financial stability concerns requiring added scrutiny. As noted above, Director Chopra separately commented that crossing this size threshold means a "low likelihood of approval."

- The FDIC's proposal notes that the agency's merger approval process would involve a "separability" analysis of the resulting bank by agency staff, to identify potential purchasers for the resulting bank or its component parts (as well as possible impediments to resolution) in the event of its failure. The proposal also indicates that the FDIC may consider parent support agreements, risk governance enhancements and capital maintenance requirements, as well as information included in previously filed resolution plans, as part of its resolvability analysis.
- Under the proposal, the FDIC would consider the institutions' records with respect to cybersecurity and data breaches as part of its financial stability assessment.

AML COMPLIANCE

- Under the proposal, the FDIC would consider whether the resulting bank in a merger has developed an appropriate plan for the integration of the combined operations into a single, comprehensive and effective program to combat money laundering, and would expect the applicant to demonstrate the ability of the resulting bank to comply with AML requirements following the merger. Significant AML compliance issues or AML enforcement actions (even if proposed or informal) at either party may result in an application's denial, unless sufficient mitigating factors exist (such as a strong acquirer's ability to remediate a target's compliance issues).

FDIC Jurisdiction Under the Bank Merger Act

The FDIC's proposal describes several of the FDIC's interpretive positions on the scope of transactions subject to its jurisdiction under the Bank Merger Act. Under the FDIC's interpretations described in the proposal, FDIC approval is required for:

- Any transaction that results in an insured depository institution "substantively and effectively combining with a non-insured entity," even if not legally structured as a merger (codifying the FDIC's long-held but informal "de facto merger" doctrine). Under this view, the FDIC would be expected to require a BMA application for acquisitions of all or substantially all of a non-insured entity's assets or "business enterprise," despite the agency's acknowledgement that it lacks statutory jurisdiction over asset acquisitions under the BMA, and regardless of whether the transaction involves the assumption of identified liabilities, the acquired assets are tangible or intangible, or the acquisition occurs as a single transaction or over the course of a series of transactions.
- Any expansion of an insured depository institution's deposit base via acquisition, regardless of whether a formal written agreement exists to transfer deposits or similar liabilities and regardless of the amount of deposits assumed. Under this view, the FDIC will generally consider any orchestration or cooperation to arrange a transfer of deposits or similar liabilities (such as trust funds and escrow funds) from a non-insured entity to an insured bank to require the FDIC's approval, including where a custodian or trustee

transfers funds for which it serves as depository to an insured bank, and including any solicitation of deposit customers in connection with an arrangement or agreement to which an insured bank is a party.

- Any transfer of custodial relationships that involve a concurrent or subsequent transfer of related customer deposit relationships by an insured bank to a non-insured entity.

For further information regarding this memorandum, please contact any member of the Firm's Financial Institutions Group, including those listed below:

NEW YORK CITY

Louis H. Argentieri
+1-212-455-7803
louis.argentieri@stblaw.com

Timothy Gaffney
+1-212-455-7182
timothy.gaffney@stblaw.com

Lee A. Meyerson
+1-212-455-3675
lmeyerson@stblaw.com

Ravi Purushotham
+1-212-455-2627
rpurushotham@stblaw.com

Sebastian Tiller
+1-212-455-3956
stiller@stblaw.com

WASHINGTON, D.C.

Amanda K. Allexon
+1-202-636-5977
amanda.allexon@stblaw.com

Spencer A. Sloan
+1-202-636-5870
spencer.sloan@stblaw.com