LUSE GORMAN
attorneys

April 3, 2024

LEGAL UPDATES AND NEWS

FDIC Proposes Statement of Policy on Bank Merger Transactions

On March 21, 2024, the Federal Deposit Insurance Corporation (FDIC) proposed revisions to its Statement of Policy on Bank Merger Transactions (SOP), which are intended to provide guidance on how the FDIC reviews merger applications under the Bank Merger Act (BMA). The SOP would replace the FDIC's current statement of policy, last revised in 2008. Comments to the proposal are due 60 days after publication of the SOP in the *Federal Register*.

The SOP is intended to reflect regulatory, legislative, and industry changes since its most recent revision before the financial crisis. In announcing the SOP, FDIC Chairman Gruenberg expressed his belief that the SOP would "update, strengthen, and clarify" the FDIC's approach to evaluating mergers under the BMA. Through the SOP, the FDIC asserted goals of introducing a more principles-based approach and providing more clarity on the application review process.

The SOP follows the Office of the Comptroller of the Currency's recently-proposed Policy Statement on the Bank Merger Act (see our Client Alert here), and is the latest in a series of initiatives from the Biden Administration to more aggressively enforce antitrust laws and overhaul applicable frameworks for reviewing mergers and acquisitions. Although the SOP was issued exclusively by the FDIC, the agency affirmed that it is working collaboratively with other federal agencies, including the Department of Justice (DoJ), to review and evaluate merger-related regulations, guidance, and instructions. However, the FDIC's interpretation of the relevant statutory factors, as well as its proposed procedures around application review, do not universally reconcile with those of the OCC in its proposed Policy Statement, and the staggered timing of the announcements suggests the agencies are not in complete alignment on their approaches.

Key Takeaways

For banks interested in potential mergers or acquisitions that require FDIC approval under the BMA, the FDIC's SOP, if finalized substantially as proposed, may materially affect transaction strategy. Banks should pay particular attention to the following aspects of the SOP:

- **Asset size.** The genesis for the SOP, at least in part, is the FDIC's perception of the recent, and rapid, growth and consolidation in the banking industry, including the increase of large insured depository institutions (IDIs). These large IDIs prompt articulated concerns related to financial stability, and the SOP details anticipated complexities for the FDIC's resolution and receivership functions in the event of failure. Accordingly, the SOP sets an asset size threshold—$100 billion—that will bring more scrutiny. Notably, this threshold is higher than the OCC's $50 billion threshold, which that agency associated with a presumption that approval would not be granted.

- **Broad coverage.** Due to an emphasis on substance of the transaction over the transaction structure, the SOP covers a variety of transaction types that on their face may not be styled as mergers or the assumption of deposits. The FDIC's expansive view of its jurisdiction under the BMA will be particularly relevant in transactions involving non-insured entities. The message emanating from the SOP is that if it looks like a transaction covered by the BMA's prongs, the FDIC will expect a role in approving the deal.

- **Pre-application preparation.** The FDIC stresses the importance of filing substantially complete applications from the outset, while simultaneously emphasizing that the initial applications contain a significant specific and nuanced detail and supporting analysis. These expectations, combined with the broad coverage of the BMA as articulated in the SOP, will likely increase the amount of upfront work needed before filing. In addition to the filing itself, the FDIC articulates its expectation that applicants engage in pre-filing meetings with the agency.

- **Publicity.** The SOP reflects a desire by the agency to involve the public more at the application stage and after any decision. Hearings are expressly considered for issues related to community needs, and—correlating to the focus on large bank transactions—hearings are presupposed as in the public interest in transactions resulting in institutions with assets greater than $50 billion. Applicants should also be aware that the FDIC may publish a statement on withdrawn applications if it would create transparency for future applicants, but the SOP does not detail the content of such a statement.

- **Integration.** Like the OCC Policy Statement, the SOP focuses not just on the acquiror's record of successfully integrating other targets, but on the forward-looking plans to integrate all aspects of operations and personnel after the closing. Therefore, an applicant may need to justify not only its past efforts, but how it will be able to ensure success in the future.

Summary of Statement of Policy

Jurisdiction and Scope

In the SOP, the FDIC broadly interprets its jurisdiction under the BMA and its implementing regulations, not just for transactions that result in an FDIC-supervised state nonmember bank or state savings association, but for a "variety of transactions" between an IDI and a non-insured entity, which will be considered "merger transactions" under the BMA even if they are not "legally structured as a merger"—what the SOP describes as "mergers in substance." The SOP makes clear that the FDIC will evaluate the substance of all facts and circumstances of the transaction and its structure and will view statutory terms expansively.

The FDIC asserts jurisdiction over merger transactions between an IDI and a credit union (which are not FDIC-insured) and also acquisitions of assets from a non-insured entity, if the acquired assets constitute all, or substantially all, of the entity's business enterprise, and that entity

dissolves, is rendered a shell, or ceases its main business operations or enterprise following the transaction. Notably, the FDIC asserts jurisdiction to review and approve transfers of assets from a non-insured entity to cover situations involving an assumption of identified liabilities, the acquisition of intangible assets, or a series of transactions. From the SOP, it is not clear which transaction in a series may prompt the required application.

The SOP takes a similarly broad view of the FDIC's jurisdiction to review transactions in which an IDI assumes liability to pay deposits of non-insured entities. Not only does the SOP interpret "deposit" broadly—covering such instruments as trust and escrow funds—but it also articulates the position that transfers of *any* deposits from a non-insured entity to an IDI, even if informal, are subject to its review.

Review of Applications

The SOP encourages applicants to engage in the agency's pre-filing process to fully understand the FDIC's expectations before submitting a BMA application. Once a party reaches the application stage, the FDIC emphasizes the importance of filing a substantially complete application, stressing that the quality and comprehensiveness of the filing are "critical" to the agency's evaluation. The FDIC expects all submitted materials, including projections and analyses, to be well supported and sufficiently detailed, and to be supported by studies and reports, including such documents that may have been prepared for a bank's board and management in the lead-up to the application. The FDIC warns applicants that incomplete filings will be "substantial" impediments to the agency's evaluation. The SOP notes that the FDIC works collaboratively with other federal regulators (including, potentially, the Consumer Financial Protection Bureau) and relevant state authorities when processing merger applications. The FDIC may consult with the DoJ if a proposed merger raises competitive concerns.

The SOP lists a series of circumstances that will present significant concerns and will likely result in unfavorable findings regarding one or more statutory BMA factors:

- Non-compliance with applicable federal or state statutes, rules, or regulations, or issued and pending enforcement actions;
- Unsafe or unsound conditions relating to the transacting parties or the resulting institution;
- Less than satisfactory examination ratings, including for any specialty areas such as IT or trust;
- Significant concerns regarding financial performance or condition, risk profile, or future prospects;
- Inadequate management, including significant turnover, weak or poor corporate governance, or lax oversight and administration;
- Incomplete, unsustainable, unrealistic or unsupported projections, analyses, and/or assumptions;
- Unresolved deficiencies, issues, or concerns, including with respect to any public comments; or

- Lack of sustained performance under corrective programs, particularly when the transaction implicates the areas that are the subject of the corrective program.

The SOP clarifies that the agency's orders on applications will be publicly posted to its website, which will address the agency's evaluation of the BMA factors and any Community Reinvestment Act (CRA) protests, and summarize any conditions imposed. If an applicant withdraws a filing, the FDIC may release a statement regarding the "concerns" with the transaction, if such a statement is considered to be in the public interest for creating transparency for the public and future applicants.

Consistent with current practice, the FDIC may impose conditions, including non-standard conditions, such as requiring capital at higher levels than otherwise applicable. The FDIC may also utilize written agreements with affiliates or other parties to address capital maintenance or liquidity or funding support. However, the FDIC asserts that it will not use conditions or written agreements as a means of favorably resolving statutory factors that otherwise present "material concerns."

For applications involving entities that are not FDIC-insured, the SOP reinforces that the transaction will be subject to the same statutory factors as any other BMA application. The FDIC will consider the nature and complexity of the non-insured entity, its scale relative to the existing institution, its current condition and historical performance, and other relevant information regarding its operations or risk profile.

<u>BMA Statutory Factors</u>

In detailing the considerations relevant to each of the statutory factors it is required to assess under the BMA, the FDIC repeatedly rejects the use of bright lines, defined thresholds, or specific metrics, revealing the FDIC's reliance on flexibility and discretion in evaluating those factors in light of each application's unique facts and circumstances.

Monopolistic or Anticompetitive Effects

Under the BMA, if the FDIC reviews an application and identifies anticompetitive effects, the agency will determine whether the applicant has established that the benefits to the convenience and needs of the community will clearly outweigh those effects. The SOP places the burden on the applicant to establish that the advantages of the merger for the convenience and needs of the community clearly outweigh those anticompetitive effects, and describes the burden as "heavy." The SOP also articulates an expectation that if a divestiture of a business line or branch is proposed to mitigate anticompetitive effects, it will be completed *before* the agency allows the merger to be consummated. Moreover, in such situations, the FDIC will now generally require the selling institution to abstain from entering into non-compete agreements with employees of the divested entities.

Under the SOP, the FDIC will evaluate competitive effects against all relevant market participants on a local, regional, and national level; a market may include areas where the merging

entities provide products and services even if they do not have a physical presence there. The FDIC will consider non-commercial bank entities offering products and services in the relevant market, including thrifts, credit unions, fintechs, and internet-based entities. While the FDIC will initially assess the product market using deposits as a proxy, the SOP notes that the agency will tailor the product market definition to individual products, as needed. In particular, the FDIC will take into account additional analytical approaches to assess competitive effects of a transaction when the entities engage in non-traditional products, services, or delivery methods.

Financial Resources and Managerial Resources and Future Prospects

The SOP affirms that the FDIC will assess the financial history, condition, performance, and managerial resources of each entity involved in a merger, as well as the combined financial resources and proposed management of the resulting institution. The FDIC highlights that an institution's overreliance on uninsured deposits or non-core funding sources may not be consistent with a favorable finding on this statutory factor, highlighting the agency's increased focus on liquidity risks and contingency funding strategies in light of 2023's regional bank failures. The SOP affirms that the FDIC's evaluation will consider the projected financial impact on related entities, including the parent organization and key affiliates, and that the agency will consider the capital position, asset quality, financial performance, and compliance and regulatory history of such entities.

The FDIC will review the recent supervisory assessments of management and the managerial performance and supervisory record of an IDI's subsidiaries and affiliates. The SOP states that the FDIC will consider the risk management and control environment of the parent organization and consider the capacity of management to successfully implement the resulting institution's strategic plan.

Under this factor, the SOP explicitly notes that the FDIC's review will assess each entity's record of compliance with consumer protection and fair lending laws and regulations, including consumer compliance ratings. As with the OCC, integration is a key concept in the SOP: the FDIC expects management to develop and implement effective plans and strategies to integrate an acquired entity, covering human capital, products and services, operating systems, policies and procedures, internal controls, audit, IT, and risk management. The FDIC will consider an institution's recent "rapid" growth and the record of management in overseeing and controlling risks associated with such growth. The resulting institution is expected to devote resources to ensuring full and timely compliance with outstanding corrective programs and supervisory recommendations. Succession planning at the resulting institution will also be a relevant consideration.

Convenience and Needs of the Community to Be Served

Under the SOP, applicants will be expected to provide forward-looking information to the FDIC to enable it to evaluate the benefits of the merger on the community to be served. The FDIC may require commitments to be made to the agency related to this factor in its final approval order,

and non-standard conditions may be imposed to address CRA weaknesses, regulator commentary, or public comments.

The FDIC will evaluate the "community" to be served broadly, to include the proposed assessment areas, retail delivery systems, populations in affected communities, and identified needs for banking services. Although the review of this factor is not limited to just the CRA record of the institutions, the SOP makes clear that a less than satisfactory CRA rating or "significant deterioration" in CRA performance may present "significant concerns," although what constitutes such a deterioration is not explained. In addition to CRA, the FDIC will consider under this factor each institution's consumer protection compliance record and the effectiveness of its compliance management system. Like CRA, a less than satisfactory consumer compliance rating may also present "significant concerns."

In one of its most significant policy announcements, the SOP expresses the FDIC's expectation that applicants affirmatively demonstrate how a merger will enable the resulting institution to *better* meet the convenience and the needs of the community to be served than would occur absent the merger. Under the SOP, this may be demonstrated through, for example, higher lending limits, greater access to existing or introduction of new or expanded products and services, reduced prices and fees, or increased convenience in utilizing the resulting institution's facilities.

Under this BMA factor, the SOP also explains that the FDIC must consider the impact of branch closings and consolidations, particularly on low- and moderate-income neighborhoods or designated areas. The FDIC will expect applicants to detail three-year projections of branch expansions, closings and consolidations in their applications. The FDIC will also closely evaluate job losses or "lost job opportunities" from branching changes, echoing an OCC concern regarding potential loss of jobs through branch closures. The SOP makes clear that material reductions in service to low- and moderate-income communities or consumers will generally result in unfavorable findings under the BMA.

The SOP notes that the FDIC may hold hearings related to considerations relevant to this factor, and articulates the agency's view that it is generally in the public interest to hold a hearing for applications resulting in an institution with greater than $50 billion in assets or for which a "significant" number of CRA protests are received. The FDIC may also hold public or private meetings to solicit input, depending on issues raised during the comment period and the agency's assessment of the significance of the transaction to the public interest, affected communities, and banking industry.

Risk to the Stability of the United States Banking or Financial System

The SOP clarifies the FDIC perspective when conducting its analysis of the risk to the stability of the U.S. banking or financial system, a factor that was added by the Dodd-Frank Act after the last revision to the prior iteration of the statement of policy. The FDIC expects that a resulting institution will not materially increase risk to the financial stability, and while its analysis will focus on the IDI, the agency may take into account parent companies and affiliates where appropriate. While the FDIC will consider a resulting institution's regulatory framework after a

merger, the SOP notes that the framework alone will not ameliorate some financial stability-related concerns.

The SOP states the FDIC's position that, although asset size will not serve as the sole basis for evaluating this factor, transactions that result in an IDI with assets greater than $100 billion are more likely to present potential financial stability concerns, which will subject them to more scrutiny. Beyond size, the SOP delineates other relevant considerations, such as if a resulting institution provides critical products or services that may be difficult to replace, if an institution's activities are highly interconnected with other participants in the financial system or an institution's complexity. Cross-border activities are relevant to the FDIC's analysis under this factor as is whether a resulting institution's potential financial distress or rapid liquidation could cause other market participants with similar activities or business profiles to experience a loss of market confidence, falling asset values, or decreased funding options. A final, and notable, consideration under this factor is an institution's record of preventing data breaches and responding to and preventing cybersecurity threats.

Effectiveness in Combatting Money Laundering Activities

The FDIC will consider whether the resulting institution has developed an appropriate plan for the integration of the combined operations into a single, comprehensive, and effective anti-money laundering (AML) compliance program. The FDIC expects an applicant to demonstrate how the resulting institution will comply with applicable AML-related laws and regulations after consummation of the merger. As part of its evaluation of this factor, the FDIC's analysis of each entity's record with regard to AML compliance could lead to an unfavorable resolution if there are significant unresolved AML deficiencies or outstanding or proposed formal or informal enforcement actions that include AML-related provisions. The SOP acknowledges a limited circumstance for successful resolution of this factor, if an acquirer with a strong AML program replaces a less than satisfactory program at its target, and presents an appropriate plan to address the target's deficiencies.

* * * * *

Luse Gorman has acted as counsel on more than 100 bank M&A transactions during the past five years and more bank M&A transactions than any other law firm in the nation over the past 20 years. Luse Gorman regularly works with federal and state banking agencies to seek regulatory approval for business transactions, including mergers and acquisitions, and routinely handles complex and novel legal questions on behalf of its clients as they arise. If you have any questions related to this Client Alert, please contact any of our attorneys. To learn more about our firm and services, please visit our website.

© 2024 Luse Gorman, PC. Luse Gorman, PC is a Washington, DC-based law firm that specializes in representing domestic and foreign financial institutions in the United States. The information provided herein does not constitute legal advice and relates only to matters of federal law and not to any particular state law.