LEGAL UPDATES AND NEWS

OCC Proposes Rule to Modify Bank Merger Regulation and Proposes Policy Statement on Bank Merger Act

Following a speech on the bank merger process by Acting Comptroller Michael J. Hsu, the Office of the Comptroller of the Currency (the "OCC") issued a proposed rule on January 29, 2024, which would amend its procedures for evaluating bank mergers. The proposed rule would incorporate, as an appendix to the regulation, a policy statement designed to summarize the principles the OCC will use when it reviews proposed bank mergers in an attempt to "increase the transparency of the standards" that apply in the OCC's merger review process. Comments on the proposal are due 60 days from the date of publication in the *Federal Register*.

After reviewing its existing public materials on the bank merger process, including various booklets from its *Comptroller's Licensing Manual*, the OCC concluded that additional transparency regarding the standards and procedures it would apply may be "helpful" to institutions and to the public. We provide our key takeaways at the bottom of this Alert.

Regulatory Changes

The OCC proposes removing the expedited review procedures contained in the existing regulation. These procedures currently allow, for certain qualifying transactions, streamlined applications to be approved as of the 15th day after the close of the public comment period, unless the OCC notifies the applicant that the filing is not eligible for expedited review or decides to extend the review process. The OCC proposes to remove the expedited procedures because mergers are "significant corporate transaction[s] requiring OCC decisioning, which should not be deemed approved solely due to the passage of time." The OCC notes that the principles behind the expedited procedures that will be removed will resurface in the new policy statement found in the proposed appendix.

The OCC also proposes to remove the streamlined application procedures contained in the existing regulation. The proposed rule articulates the OCC's view that the Interagency Bank Merger Act application provides a "fuller record" that is more appropriate for the OCC to consider when reviewing a proposed bank merger. The OCC suggests that the burden on institutions imposed by removing streamlined applications should be reduced, because the full application "may be tailored" as appropriate.

Policy Statement

As explained by the OCC, the proposed policy statement is intended to provide institutions and the public with a better understanding of how the OCC reviews applications subject to the Bank Merger Act ("BMA"), and states its goals as providing "greater transparency, facilitat[ing] interagency coordination, and enhance[ing] public engagement." The policy statement outlines the general principles the OCC will apply when reviewing applications and provides detail for its consideration of three BMA statutory factors: (i) financial stability; (ii) financial and managerial resources; and (iii)

convenience and needs of the community.[1] The policy statement also reflects the OCC's professed aim to act "promptly" on all merger applications.

General Principles

The proposed policy statement outlines the OCC's overarching view that merger applications that are "consistent with approval" generally feature all of the following 13 indicators:

1. The acquirer is well capitalized and the resulting institution will be well capitalized;
2. The resulting institution will have total assets less than $50B;
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;
5. The acquirer has a consumer compliance rating of 1 or 2;
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 (generally, considered well-managed and well-capitalized);
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.

Conversely, the OCC explains that if it finds "indicators that raise supervisory or regulatory concerns," it is unlikely to find the BMA's statutory factors are consistent with approval unless and until the applicant has "adequately addressed or remediated the concern." The policy statement lists six such indicators:

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 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, or subsidiary thereof;
5. The acquirer has open or pending Bank Secrecy Act/Anti-Money Laundering enforcement or fair lending actions, including referrals or notifications to other agencies; or
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.

[1] The policy statement does not address the BMA statutory factors of (i) competition and (ii) the effectiveness in combatting money laundering activities. The OCC explains these BMA factors are already covered by existing interagency guidance documents.

Financial Stability

Under the BMA factor related to the "risk to the stability of the United States banking or financial system," the policy statement lists elements that the OCC will examine, which the OCC considers are consistent with "longstanding" OCC practice and principles. These listed elements include a general factor designed to catch any other circumstance that "could indicate" the merger poses a risk to the U.S. banking or financial system in the OCC's view.

The policy statement explains the OCC's balancing test for considering the enumerated elements, through which the OCC will weigh the financial stability risk posed by completion of the merger against the risk posed by a denial, including consideration to whether the merger involves a "troubled" target. The policy statement also explains that the OCC will consider each element both individually and in combination, but notes that even a single element could lead the OCC to determine the entire transaction would have an adverse effect on banking or financial system stability. The OCC's review will, as it is now, incorporate the OCC's potential use of conditions imposed in writing, which may be able to mitigate risk concerns. The policy statement suggests that asset divestitures or higher minimum capital requirements are two such potential conditions the OCC may impose during the approval process.

Financial and Managerial Resources and Future Prospects

The policy statement sets out a number of overarching considerations and individual elements the OCC will consider in assessing the BMA statutory factors relating to the managerial and financial resources and future prospects of the involved institutions. The OCC will consider each element independently for *both* the combining and the resulting institutions, but will also consider all of the elements "holistically." Noteworthy among the enumerated overarching considerations, the OCC articulates its position that it is less likely to approve mergers when the acquirer has "experienced rapid growth" or has "engaged in multiple acquisitions with overlapping integration periods."

Next, the policy statement lists elements specific to its review of institutions' financial and managerial resources. On the financial side, mergers involving an acquirer with a strong supervisory record specifically on the capital, liquidity, and earnings ratings components will be more likely to satisfy the OCC's review for this BMA factor than those with less than satisfactory financial component ratings. On the managerial side, a "significant" number of Matters Requiring Attention (MRAs) will suggest to the OCC an institution may have insufficient managerial resources. The policy statement acknowledges that less than satisfactory ratings at the target will not preclude approval if the acquirer can employ "sufficiently robust" risk management and financial resources to correct the weaknesses.

The OCC suggests that if the acquirer's management proactively demonstrates its plans and ability to address its own previously-identified weaknesses, remediate the target's weaknesses, and exercise appropriate risk management of the resulting institution, this will facilitate the OCC's review. The policy statement articulates an OCC expectation that potential acquirers conduct sufficient due diligence not only related to the target's business model, but to systems compatibility between the two banks.

The policy statement consistently focuses on concerns related to integration, highlighting specifically that the OCC will scrutinize plans to integrate the combined institutions' operations, systems, products, services, employees, and cultures. The degree of scrutiny applied may be premised,

at least in part, on an applicant's track record of integrating acquisitions. System integration concerns can, according to the policy statement, trigger additional review; in particular, the OCC will be looking at strategies and capacity for modernizing legacy IT system as a "critical component" of integration plans. Imposition of approval conditions are viewed as a potential remedy for IT integration issues, if the OCC believes such issues represent a "significant" supervisory concern.

In terms of future prospects of the involved institutions, the policy statement notes that the OCC's review will encompass the acquirer's record of integrating acquisitions, and that the OCC will seek to pinpoint when the combined institution will be able to "function effectively as a single unit."

Convenience and Needs

Related to the final BMA statutory factor, the policy statement explains how the OCC will view the probable effects of the proposed merger on the community to be served. This aspect of the review is intended to be prospective, considering the period *after* consummation of the merger, and will cover, among other things, the combined institution's plans to close or limit branches, reductions in the availability of banking services, and job losses from branch changes. The policy statement also highlights that this forward-looking evaluation under the BMA is separate from the OCC's consideration of applicants' consideration of applicants' CRA record.

Takeaways

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

- **Asset size.** If the combined institution will be larger than $50 billion in assets, the OCC would not view the acquisition as presumptively consistent with approval, based on no other factor than size. Similarly, if the target's total assets exceed 50% of the acquirer's assets, the OCC would not view the acquisition as presumptively consistent with approval, again based only on the asset sizes of the two constituent institutions. This would significantly impact the approval timelines for mergers of equals, even if the two parties are healthy, well-rated banks.

- **Serial acquisitions and integration.** The OCC makes clear that banks that have engaged in several acquisitions are less likely to be approved for a new transaction if the integration periods are "overlapping," which is not defined by the OCC. Focus on integration capability, at a number of levels, from the hard (systems) to the soft (culture), appears several times in the policy statement. Together, this focus suggests that the OCC may require banks fully complete and integrate an acquisition before getting the green light to engage in another. The OCC wants to know when the resulting bank can function as a "single unit." The policy statement also appears to reflect the OCC's view that some integration issues could present such significant problems that they cannot be cured through a condition imposed with the approval, dooming the transaction altogether.

  Less clear is whether banks that experience "rapid growth" organically—without the embedded integration issue—will be subject to the same treatment. The current language suggests they may.

- **Job loss.** Contrary to its prior approach, the OCC now appears poised to explicitly consider whether potential job losses at the resulting institution signify the transaction should not be approved.

- **Multiple enforcement actions.** Multiple enforcement actions against an acquirer in a three-year period—even if they are not actions with tailing conditions, like a consent order—will push the acquisition into the presumptively denied box. The three-year window in the policy statement is consistent with the timeframe the OCC recently announced, through its enforcement action policy, that it would look at to determine whether elevated enforcement actions are necessary to address a bank's "persistent weaknesses."

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