



## Playing catch-up

The FDIC takes first steps to modernize the Bank Merger Act

April 14, 2022

What is happening, what we have seen, and what you need to know for future deals

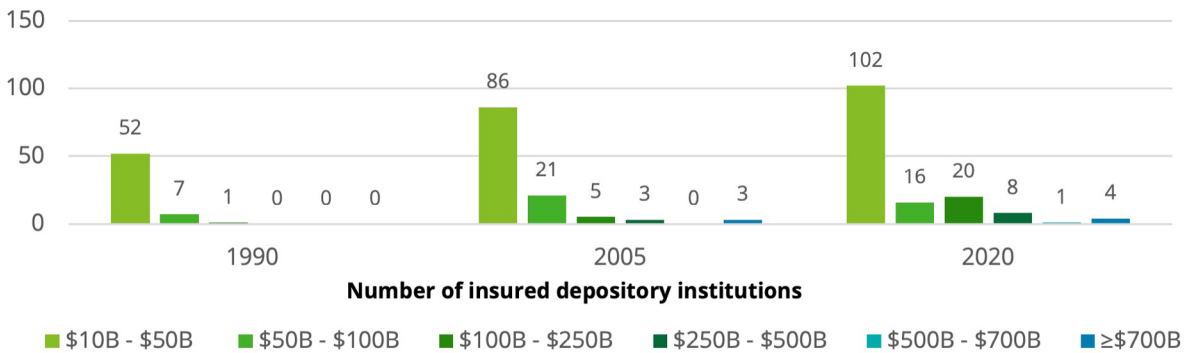
Significant changes in the banking industry and financial system over the past several decades have prompted the Federal Deposit Insurance Corporation (FDIC) to conduct a review of the regulatory framework applicable to bank merger transactions, including one or more insured depository institutions (IDIs)—banks and savings associations—and noninsured institutions, if applicable.<sup>1</sup> The FDIC recently requested comment on (a) the application of the laws, practices, rules, regulations,

guidance, and statements of policy that apply to merger transactions involving one or more insured depository institutions, including the merger between an insured depository institution and a noninsured institution and (b) the effectiveness of the existing framework in meeting the requirements of section 18(c) of the Federal Deposit Insurance Act (the Bank Merger Act or BMA). The agency initiated a 60-day comment period, concluding Monday, May 30, 2022.

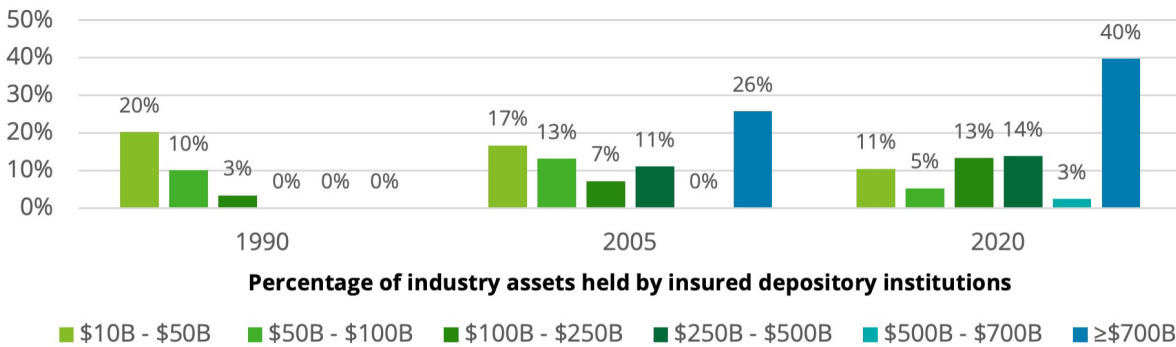
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Over the past 30 years, bank consolidation, fueled in large part by mergers and acquisitions, has transformed the composition of the banking sector—contributing to substantial growth of the number of large IDIs, especially those with total assets of \$100 billion or more (figures 1-3).

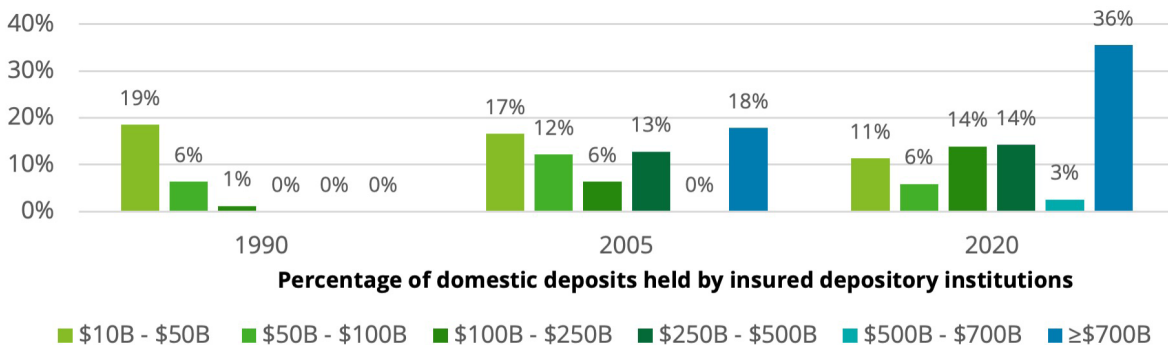
**Figure 1. Banks of \$100B or more have grown substantially between 1990 and 2020**



**Figure 2. Mega-banks (of \$700B or more) hold relative majority of assets**



**Figure 3. Deposits nearing majority at mega-banks (of \$700B or more)**





The further consolidation of the banking industry after the financial crisis allowed legislators to amend the BMA to include a financial stability factor.<sup>2</sup> The amendment required consideration of the risk posed to the stability of the US banking or financial system of a proposed bank merger. Specifically, the financial stability factor calls for the quantitative assessment of merger-related aspects including:

- The size of the resulting firm;
- The availability of substitute providers for any critical products and services offered by the resulting firm;
- The interconnectedness of the resulting firm with the banking or financial system;
- The extent to which the resulting firm contributes to the complexity of the financial system; and
- The extent of cross-border activities of the resulting firm.

The financial stability factor also places focus on potential challenges to resolution of the combined organization.<sup>3</sup>

Future revisions to the BMA are expected to focus regulatory attention on the analysis, quantification, and implications of financial stability risk in mergers and acquisitions, at a minimum. The FDIC's request for information (RFI) is broad in covering the application of the laws, practices, rules, regulations, guidance, and statements of policy that apply to merger transactions involving one or more insured depository institutions. This could initiate action by other agencies to revise their regulations in addition to the FDIC. If broad changes are made to the BMA it will likely cause

significant alteration to the application preparation process, considerations for approval, and processing timeline. To date, the Federal Reserve and Office of the Comptroller of the Currency have not issued similar requests for information on the BMA. The RFI represents the first step in a multi-step process to modernize the BMA.

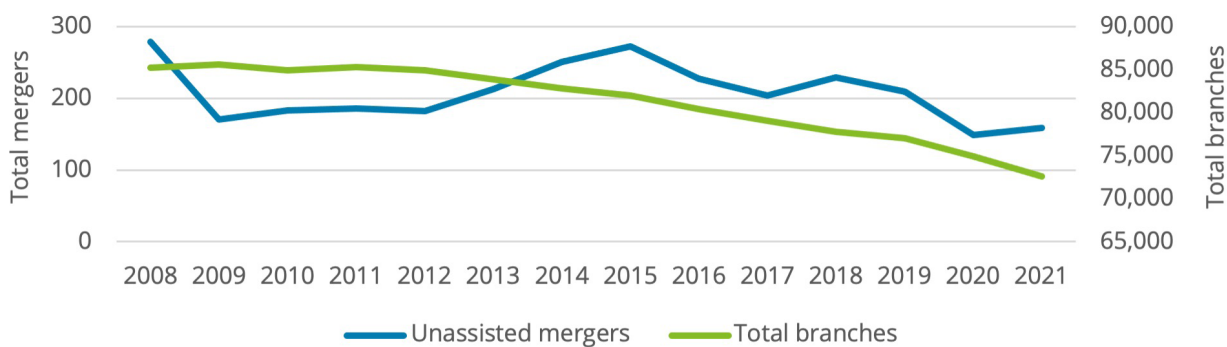
**The RFI includes ten questions covering the following areas:<sup>4</sup>**

- Full coverage of the BMA by the existing framework (e.g., prudential regulation, quantitative measures, convenience and needs<sup>5</sup>)
- The need for additional requirements or criteria to address the financial stability risk factor
- Inclusion of prudential factors (for example, capital levels, management quality, earnings in merger decision-making)
- Definition and analysis of the convenience and needs factor
- Use of supplemental quantitative measures—in addition to the Herfindahl-Hirschman Index<sup>6</sup>
- Factors for determining if transactions would result in a monopoly or be anticompetitive
- The presence of an implicit presumption of approval
- Appropriateness of the burden of proof required
- BMA exceptions and the historical impact on resolutions and financial stability
- Tailoring for large and small institutions

# Key considerations on potential impacts regarding the convenience and needs factor

In its RFI, the FDIC asks several pointed questions about the convenience and needs factor. Specifically, “How should the convenience and needs factor take into consideration the impact that branch closings and consolidations may have on affected communities?” and “Is the convenience and needs factor appropriately defined in the existing framework?”<sup>7</sup>

**Figure 4. Branches declining despite merger activity**



Source: [FDIC](#)

Over the past 15 years, the number of total bank branches experienced a steady decline despite fluctuations in merger activity (figure 4). Coupled with technological advancements leading to increased use of online and alternative digital banking services, greater offerings from nonbank providers, the acceptance of crypto assets, and potential changes to the regulatory perimeter, the FDIC may need to incorporate several new or emerging aspects of banking into the assessment of the convenience and needs factor going forward.<sup>8</sup>

Based on the results of the RFI, the FDIC may need to change how it approaches the assessment of the convenience and needs factor in the future. This would likely prompt banks to change the way that they demonstrate that the convenience and needs considerations would not be adversely affected post-merger. Firms may need to perform an assessment

outlining the following on a pre- and post-merger basis:

- Products and services available to the surrounding community from various entities regardless of charter type;
- Types of delivery channels (not just physical locations) for product and service offerings; and
- The definition of the bank’s community to include those online or virtual customers as opposed to primary reliance on the Community Reinvestment Act assessment area.

# Key considerations on potential adverse impacts for large banks

When considering the details of the FDIC questions, there is potential for increased scrutiny on certain large bank (\$100B or more) proposals, which may translate to future challenges with approvals. Large banks confront a different regulatory and supervisory mix than small banks (less than \$10B) due to the complexity of their risk profiles, from capital and liquidity requirements to the scrutiny of first-line activities.

In addition, the \$100 billion asset size becomes a threshold where institutions cross into large financial institutions with additional requirements and expectations that apply (e.g., capital planning, liquidity risk management, enterprise-wide risk management, and governance requirements. Question 2 in the RFI inquires of using an automatic presumption of systemic risk concerns based on the post-transaction asset size of a resultant firm. Regarding financial stability risk, Question 2 asks:<sup>9</sup>

- a. Should the revisions include additional requirements or criteria?
- b. Should applications take into account a set of measures that assess quantitative or qualitative aspects of financial stability?
- c. Are there any quantitative measures that could be used to promote clarity and consistency?

Given that small banks are generally not deemed systemically important, and their individual failure would not likely pose a threat to overall US financial stability, the potential revisions would not be largely impactful to small banks. In contrast, these types of changes, if adopted, could be seen as creating barriers to entry preventing large banks from pursuing a range of expansionary activities.

If changes to the BMA make expansionary activities disproportionately difficult at large banks compared to small banks, are small banks positioned to benefit



from an unintended competitive advantage? In revising the BMA, the FDIC is tasked with balancing its responsibility to promote public confidence in the banking system, maintain financial stability, review proposed mergers, and resolve failing large insured depository institutions while adhering to the recent presidential executive order instructing US agencies to consider the impact that consolidation may have on maintaining a competitive marketplace.<sup>10</sup> A recent speech by Acting Comptroller of the Currency, Michael J. Hsu and an op-ed written by former Federal Reserve Board Governor Daniel Tarullo are two examples of regulators and academics offering their perspectives on certain of the FDIC's questions.<sup>11</sup> Responses to the FDIC's questions will likely cover these and other concerns and be critical in understanding the full potential impact of forthcoming revisions.



Firms may want to consider the following questions when considering the potential impact from the FDIC's request for comment and how it may influence potential revisions by all banking agencies and impact merger and acquisition transactions:

- **Does the proposed transaction present financial stability risk?**
  - If so, how much financial stability risk is inherent in the transaction and how is it measured?
  - Is there any way to structure the deal to reduce financial stability risk?
  - Can this risk be mitigated?
- **How would the proposed transaction impact standardized ratios associated with prudential factors (e.g., capital, liquidity, earnings)?**
  - If a minimum were set for pre- and post-transaction ratios, at what point would the proposed transaction become problematic?
  - Are the standardized metrics associated with these factors expected to deteriorate post-merger?
  - If minimum standards for prudential factors were set at a satisfactory level (or in-line with minimum supervisory thresholds and ratios), how would the proposed transaction fare?
  - How soon and to what extent could prudential factors be improved, if warranted?
  - What is the impact of post-merger regulatory and supervisory requirements based upon tailoring and other thresholds?
- **How has the proposed transaction accounted for convenience and needs (from physical and virtual perspectives)?**
  - If branch closures or consolidation are involved, how does the proposed transaction confirm that the surrounding communities will maintain the necessary services and related accessibility?
- **Are there any competitive analyses that can be conducted to better assess the transaction's impact on competition?**
  - Is there a tailored peer group used to perform competitive analysis?
  - What are the most meaningful characteristics of firms within the designated peer group?
- **Do the application materials present sufficient information to support approval based on the requirements of the BMA?**
  - Is there any additional support that could be used in the application process?
- **How is the target institution factored into existing or forthcoming resolution plans, as applicable?**
- **Can the applicant demonstrate a genuine understanding of the idiosyncrasies and risk profile of the target entity and consolidated surviving entities?**
- **How should the FDIC factors be addressed in the acquirer's due diligence processes on target entities?**
- **Does the integration plan post-close and other regulatory communications evidence the ability to manage significant risks and have clear escalation, reporting, and governance in place on day one?**
- **How have the institutions evaluated the impact on resources across business as usual, organic growth, remediation, and strategic initiatives?**

# Key areas of focus when planning to pursue M&A activities

While potential rule revisions will likely take a significant amount of time, current initiatives among larger institutions should be careful to address more sensitive areas to help ensure smoother processing. Expansion of portfolio and business capabilities is a common driver of recent banking M&A transactions, as firms can become more competitive in alternative markets and new industries based primarily on their future outlook<sup>12</sup>

While increased banking capabilities and customer reach may be top of mind, firms may need to anticipate regulatory scrutiny and take a proactive stance in their practices across the M&A lifecycle as early as due diligence and through regulatory reviews, deal close, and full integration. Firms should work to:

- **Proactively engage regulators** to socialize and share detailed integration plans and target state operating model.
- **Ensure foundational risk, governance and compliance** capabilities are addressed.<sup>13</sup>
- **Demonstrate that the target legal entity structure can be enabled** with management reporting, regulatory reporting, and escalation channels for governance.
- **Conduct an impact analysis to document any post-transaction changes in regulatory requirements** pursuant to Regulation YY and the OCC's heightened standards.<sup>14</sup>
- **Factor information security, governance, and cybersecurity risk into the planning process.** Determine the view on technological innovation at the resultant organization, to the extent that it is part of the deal.
- **Present conservative proforma with clear rationale to demonstrate adequacy of capital and liquidity**, and linkage to supervisory stress tests, as applicable.
- **Maintain strong emphasis on consumer compliance and protection**, by analyzing consistency with the Community Reinvestment Act, fair and responsible lending laws (e.g., the Equal Credit Opportunity Act, Fair Housing Act, Truth in Lending Act), and other compliance rules and regulations.
- **Develop a plan to assess the material risks of the target entity and remediate any existing regulatory or risk issues**, including the resources and plans to address outstanding weaknesses and broader integration needs.
- **Develop a preliminary strategic view of the combined entity** aligning prospective risk appetites and limits with the analysis of new businesses and current risks.



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# Endnotes

1. Federal Deposit Insurance Corporation (FDIC), “[FDIC: FIL-11-2022: FDIC Request for Information on Bank Merger Act](#),” March 25, 2022.
2. See Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, section 604(f), 124 Stat. 1376, 1602 (2010) (codified as 12 U.S.C. 1828(c)(5) (2018)), available at <https://www.govinfo.gov/app/details/PLAW-111publ203>.
3. Ibid.
4. FDIC, “[FDIC: FIL-11-2022: FDIC Request for Information on Bank Merger Act](#),” March 25, 2022.
5. The FDIC’s assessment of the convenience and needs factor involves consideration of: “the extent to which the proposed merger transaction is likely to benefit the general public through higher lending limits, new or expanded services, reduced prices, increased convenience in utilizing the services and facilities of the resulting institution, or other means. The FDIC, as required by the Community Reinvestment Act, will also note and consider each institution’s Community Reinvestment Act performance evaluation record. An unsatisfactory record may form the basis for denial or conditional approval of an application.” In addition, the FDIC outlines related considerations for branch closings where to the extent that “banking offices are to be closed in connection with the proposed merger transaction, the FDIC will review the merging institution’s conformance to any applicable requirements of section 42 of the FDI Act concerning notice of branch closings as reflected in the [Interagency Policy Statement Concerning Branch Closing Notices and Policies](#)”; FDIC, “[FDIC Law, Regulations, Related Acts - Statements of Policy](#),” accessed April 1, 2022.
6. FDIC, “[FDIC Law, Regulations, Related Acts - Statements of Policy](#),” accessed April 13, 2022.
7. FDIC, “[FDIC: FIL-11-2022: FDIC Request for Information on Bank Merger Act](#),” March 25, 2022.
8. Deloitte, [2022 Banking Regulatory Outlook | Deloitte US](#).
9. FDIC, “[FDIC: FIL-11-2022: FDIC Request for Information on Bank Merger Act](#),” March 25, 2022.
10. The White House, “[Executive order on promoting competition in the American economy](#),” July 9, 2021.
11. Office of the Comptroller of the Currency (OCC), “[Acting comptroller discusses Large bank resolvability](#),” news release 2022-33, April 1 2022; Daniel K. Tarullo, “[Regulators should rethink the way they assess bank mergers](#),” Brookings, March 16, 2022.
12. Max Bercum, Matt Hutton, and Jason Langan, [2022 Banking and Capital Markets M&A outlook: Firing on all cylinders](#), Deloitte, 2022.
13. Board of Governors of the Federal Reserve System, “[SR 21-3/CA 21-1: Supervisory Guidance on Board of Directors’ Effectiveness](#),” February 26, 2021.
14. National Archives, “[12 CFR Part 252 - Enhanced Prudential Standards \(Regulation YY\)](#)” last amended April 1, 2022; OCC, “[OCC Finalizes Its Heightened Standards for Large Financial Institutions](#),” news release 2014-117, September 2, 2014.





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