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October 10, 2024

National Bankers Association 2024 Annual Conference

National Bankers Association

The Current State of M&A Activity: What to be Prepared For

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Table of Contents

I. Executive Summary

- Since the failure of Silicon Valley Bank last year, the banking industry has been focused on Washington, as politics and policy will govern the next wave of bank M&A.
  - The effect of the rulemaking process, the impact of the Federal Reserve's monetary policy decisions on interest rates, and the outcome of the 2024 presidential election are variables that will weigh heavily on the bank M&A environment.
- The Department of Justice ("DOJ"), Federal Deposit Insurance Corporation ("FDIC"), and Office of the Comptroller of the Currency ("OCC") each recently released final actions updating their rules and policies pertaining to the review of bank merger applications. Notably, the Board of Governors of the Federal Reserve System ("Federal Reserve") has not issued new guidance, but is reported to have worked with the FDIC and OCC on the DOJ's approach.
  - The coordinated actions by the DOJ, FDIC, and OCC reflect a shift towards a more expansive and rigorous evaluation of bank mergers.
  - However, the regulatory updates recognize the potential benefits of bank mergers for the public interest, the banking industry, and the financial system.
- The current economic environment, influenced by the recent Federal Reserve interest rate cut, is expected to support increased M&A activity.
  - Lower interest rates reduce loan yields, increase leverage ratios, and enhance valuations, particularly with respect to bank bond portfolios.
  - Bank stock prices have generally increased over the past few quarters, improving the ability of acquirers to use equity securities in deals.
  - The current bank M&A market is on pace to surpass 2023 performance.

II. Overview of the Bank M&A Framework

- The review process of bank merger applications is a complex process that involves the Federal Reserve, FDIC, and OCC (collectively, the "Agencies") and the DOJ. The Agencies and the DOJ work individually and collectively to ensure that, among other things, proposed mergers comply with applicable laws and regulations, do not create undue risks to the stability of the U.S. financial system, and do not adversely affect competition.
- While each Agency has its own review process, there is also a level of coordination among them. The Agencies often share information and consult with each other to ensure a comprehensive review of a merger application. They also coordinate with, and may often defer to, the DOJ with respect to the consideration of competition and antitrust issues.
- The review process for bank mergers is designed to be thorough and multifaceted, taking into account a wide range of factors to ensure that any approved merger is in the public interest. The complexity of the process reflects the importance of maintaining a competitive, stable, and fair banking system. While the DOJ focuses solely on competitive issues, the Agencies assess numerous factors including competition, the merger's impact on the U.S. financial system, and its ability to serve community needs. The collective efforts of the Agencies and the DOJ help to balance the benefits of consolidation with the need to protect consumers and maintain a healthy market structure.
- For state-chartered banks, there is an added layer of regulatory approval required at the state level. The details surrounding individual state bank merger guidelines and application are outside the scope of this presentation.

II.A. Bank Merger Act Statutory Factors

- The Bank Merger Act of 1960 (“BMA”) requires the Agencies to review a proposed bank merger under six statutory factors:

  1. **Financial and Managerial Resources and Future Prospects of the Existing and Proposed Institutions**. The analysis with respect to this factor includes an examination of the banks’ financial statements to evaluate their financial health and the adequacy of capital and reserves for loan and lease losses. The managerial aspect involves evaluating the competence, experience, and integrity of the existing and resulting banks' boards of directors and senior management. The future prospects are assessed by looking at the strategic plans of the combined entity, including how the merger will affect the institutions' financial stability and growth.
  2. **Competition**. The Agencies competitive analysis typically involves two steps:
     a. First, the Agencies generally will utilize the share of deposits in the local banking markets in which the merging parties compete and the Herfindahl–Hirschman Index (“HHI”) to assess the competitive effects of a proposed merger. Traditionally, if a proposal results in more than a 200-point increase in the HHI and the market HHI total exceeds 1800, the market would be viewed as concentrated, and the Agencies may look for some form of mitigant (*e.g.*, branch divestitures) in order to determine that a proposal would not be anti-competitive.
     b. Second, the Agencies will generally defer to the DOJ’s competitive factor review for other aspects of the competitive review. For example, the DOJ’s review often will focus on a particular market or product segment within the banks’ cluster of banking services (*e.g.*, small business lending or the credit card issuer/network market).

II.A. Bank Merger Act Statutory Factors (cont'd)

3. **Convenience and Needs of the Community Served**. The Agencies evaluate how well the banks serve the community, including the provision of banking services to low- and moderate-income neighborhoods. The review includes an examination of the banks' Community Reinvestment Act ("CRA") ratings, which reflect their record of meeting the credit needs of their entire community. The Agencies also consider the banks' records in offering a range of banking services, including how the merger might improve or diminish the availability of banking products and services to the community.
4. **Risk to the Stability of the U.S. Financial System**. The Agencies consider the size and complexity of the institutions involved in the merger. They evaluate whether the resulting entity could pose systemic risks due to its size, interconnectedness, substitutability, and complexity. The review also includes the institutions' ability to manage and absorb financial and operational shocks, and the effectiveness of their risk management processes.
5. **Effectiveness in Combatting Money Laundering**. The Agencies examine the banks' anti-money laundering programs to assess the effectiveness of any involved insured depository institution's ("IDI's") combatting of money laundering.
6. **Compliance with Deposit Concentration Limits**. For interstate merger transactions, the Agencies ensure compliance with statutory deposit concentration limits. They review the amount of deposits held by the resulting institution to ensure it does not exceed the nationwide deposit cap, which is generally set at 10% of the total amount of deposits of IDIs in the United States. If the merger would result in a violation of this cap, the transaction may not be approved unless certain exceptions apply, such as a purchase during a pending financial crisis or period of severe financial distress.

II.B. Bank Merger Act v. Change in Bank Control Act

- There are two legislative acts that primarily govern bank M&A activity:
  - Bank Merger Act. Bank mergers are governed under the BMA, which aims to prevent monopolistic mergers, limit anticompetitive transactions, and ensure that the stability of the financial system is not compromised by ensuring that all mergers between IDIs are subject to approval of the primary federal banking agency of the resulting institution.
  - Change in Bank Control Act ("CBCA"). The CBCA seeks to maintain the safety and soundness of a bank by prohibiting any person from acquiring an IDI or bank holding company unless the appropriate banking agency has been notified and determines that the acquiror is fit to control the banking entity.
- Bank mergers are distinct from changes in bank control. The key differences are:
  - Scope and Purpose. The BMA deals with whole bank mergers and consolidations, while the CBCA deals with equity investments that result in a change of control of a bank.
  - Regulatory Focus. The BMA focuses on the competitive effects and public interest considerations of bank mergers, while the CBCA focuses on the qualifications and financial stability of the new controlling party in equity investments.
  - Approval Process. The BMA requires regulatory approval for mergers and consolidations, while the CBCA requires prior notice and regulatory review for changes in control through equity investments.
  - Presumptions of Non-Control. Under the CBCA, there is a rebuttable presumption of non-control where an entity is presumed not to have control of a bank or bank holding company if it acquires less than 10% of any class of voting securities (as compared to the Bank Holding Company Act's rebuttable presumption of non-control if an entity acquires less than 5% or less of any class of voting securities).

II.C. Application Overview

- Once the parties to a proposed bank merger file their BMA application with the appropriate federal banking agency, the agency will typically initiate a 30-day public comment period in which members of the public, including individuals, community groups, and other interested parties, can provide their input on the proposed merger.
- A public hearing may be held in addition to or in lieu of the public comment period, particularly if there is significant public interest in the merger or if issues raised during the comment period warrant further exploration. More recently, public hearings have been reserved for the largest bank mergers (e.g., BB&T and SunTrust, U.S. Bancorp and MUFG Union Bank, Capital One and Discover, etc.).
  - The hearing serves as a forum to provide the public with an opportunity to present their views orally, for the Agencies to gather more information, and for the banks involved to address concerns raised by the public or the regulators.
- Once the comment period closes, while there is a statutory deadline of one year, the Agencies typically endeavor to act on a "complete" application in 60 days.
  - The Agencies generally have discretion in determining when an application is actually "complete."
  - In this regard, the responsible federal banking agency often asks for additional information (*e.g.*, directly from the applicant(s), by way of extending the public comment period or scheduling public hearings), delaying the determination that the application is "complete."
  - Accordingly, it is not uncommon to see an application pending with the responsible federal banking agency for more than a year.

III. Bank M&A Regulatory Outlook

- On September 17, 2024, the DOJ, FDIC, and OCC each took actions to update their respective bank merger review policies and procedures.
- The FDIC and OCC issued final policy statements regarding bank merger application procedures and how they consider statutory factors under the BMA. In addition, the OCC issued a final rule governing the procedural aspects of its review of bank merger applications, including the elimination of a streamlined application and expedited review procedures.
- The DOJ withdrew its 1995 Bank Merger Guidelines and stated that it will apply its generally-applicable 2023 Merger Guidelines to the banking industry. The DOJ also issued a Banking Addendum to the merger guidelines identifying "portions of the 2023 Merger Guidelines that [it] considers to be frequently relevant when evaluating the competitive consequences of a bank merger."
- Notably, the Federal Reserve has not issued any new guidance, but worked in partnership with the OCC and FDIC with respect to the DOJ's approach.
- The simultaneous actions by the DOJ, FDIC, and OCC reflect a coordinated government approach with regard to the respective announcements of changes to bank merger policy. These actions reflect a shift toward a more expansive evaluation of bank mergers and related transactions, and portend the possibility of greater divergence in approaches between the federal banking agencies and the DOJ.

III.A. FDIC Statement of Policy

- The FDIC board of directors, by a 3-2 vote, approved the final Statement of Policy ("FDIC Final Policy Statement") on September 17, 2024. The FDIC Final Policy Statement replaces the former Policy on Bank Merger Transactions as the FDIC's guiding framework for evaluation of bank merger applications that are subject to FDIC approval.
- The FDIC Final Policy Statement is intended to balance the potential benefits and risks of bank mergers, and to ensure that the FDIC fulfills its statutory mandate to protect the safety and soundness of the banking system, the Deposit Insurance Fund, and the interests of depositors and consumers.
- Key takeaways from the FDIC Final Policy Statement include:
  - FDIC's Expansive Interpretation of Its Jurisdiction. FDIC asserts that it has authority over all transactions that result in an IDI substantively and effectively combining with a non-insured entity ("mergers in substance"), regardless of the form or structure of the transaction, the type or nature of the assets acquired, or whether the target plans to liquidate after the transaction. These include acquisitions of lines of business where the target is no longer a viable competitor, even if the target does not plan to liquidate immediately after consolidating the transaction.
  - Heightened Scrutiny on Regional Bank Mergers. The FDIC imposes heightened scrutiny on merger transactions that would result in an institution with assets over $100 billion. However, in the FDIC Final Policy Statement, the FDIC clarified that the $100 billion threshold was not a threshold for presumptive denial. The FDIC may also impose heightened review (e.g., public hearings) on mergers where the resulting bank will be larger than $50 billion in assets.
  - Heightened Standard for "Convenience and Needs". With respect to the convenience and needs statutory factor (discussed on slides 5-6), applicants are expected to provide "specific and forward-looking information" to enable the FDIC to evaluate the expected impact of the merger on convenience and needs. The FDIC expects applicants to provide a detailed three-year plan for all projected or anticipated branch expansions, closures or consolidations following the merger, to quantify or provide information regarding anticipated job losses or reduced job opportunities and to make commitments regarding future retail banking services in the community to be served for at least three years following the consummation of the merger.

III.A. FDIC Statement of Policy (cont'd)

- Broadened Analysis of Competitive Effects. The FDIC conducts its own independent analysis of the competitive effects of the merger, but the FDIC Final Policy Statement declines to introduce any bright line metrics for when a merger is considered anticompetitive.
  - Instead, the FDIC's competitive effects analysis will continue to use deposits as an initial proxy for the cluster commercial banking products and services, but will tailor the product market definition to individual products as needed, using other analytical methods, data sources, or geographic or product market definitions "when practicable and relevant" to evaluate whether "consumers retain meaningful choices."
  - The FDIC will initially focus its competitive effects analysis on the share of total deposits held in relevant geographic markets, using the HHI to calculate market concentration, but will also consider products other than deposits.
  - The FDIC will consider all relevant market participants (including at the local, regional and national levels). The relevant markets will be defined as areas where the merging entities have an office, but may also include areas where merging entities do not have a physical presence but still provide products and services.

III.B. OCC Final Rule & Policy Statement

- The OCC Final Rule and Policy Statement, effective January 1, 2025, aim to update and streamline the OCC's procedures and standards for reviewing bank merger applications under the BMA.
- **Final Rule**. The OCC Final Rule eliminates the expedited review and streamlined application processes for certain bank mergers, requiring all applicants to submit a complete application and allowing the OCC to extend the comment period under certain circumstances.
- **Final Policy Statement**. The OCC Final Policy Statement provides indicators of likely approval or disapproval based on the statutory factors (see Section II.A. Bank Merger Act Statutory Factors above).
  - Convenience and Needs. The OCC Final Policy Statement emphasizes that the OCC's review of the convenience and needs factor is prospective and based on the "probable effects" of the proposed merger, rather than past performance on the CRA. It also expects applicants to provide specific and forward-looking information on how the merger would "better meet" the convenience and needs of the community, and to make commitments regarding future retail banking services for at least three years after the merger.
  - Financial Stability. The OCC Final Policy Statement describes the OCC's approach to the financial stability factor, which was added by the Dodd-Frank Act, and the factors it considers when evaluating the potential systemic risks of a proposed merger, such as size, complexity, cross-border activities, and resolvability. It also states that the OCC may impose conditions to mitigate financial stability concerns, such as asset divestitures or higher capital requirements.
  - Competition and Anti-Money Laundering. The OCC Final Policy Statement clarifies that the OCC does not address the competition factor or the anti-money laundering factor under the BMA, as these are within the purview of the DOJ and the Financial Crimes Enforcement Network, respectively. However, the OCC coordinates and consults with these agencies as part of the bank merger review process.

III.B. OCC Final Rule & Policy Statement (cont'd)

- The OCC Final Rule and Policy Statement indicate a shift toward more expansive and rigorous evaluation of bank mergers, and may result in longer review times, more public input, more conditions, and more divergence between the OCC and the DOJ. However, they also recognize the potential benefits of bank mergers for the public interest, the banking industry, and the financial system, and do not impose a moratorium or a presumption of denial for any category of mergers.
- Acting Comptroller of the Currency Michael Hsu has expressed a positive outlook and sentiments toward bank merger activity, as long as it serves the communities, supports financial stability and industry resilience, enhances competition, and enables diversity and dynamism of the banking industry. He has also emphasized the need to update the bank merger framework and to coordinate with other regulators and stakeholders. Some of his relevant quotes and references are:

Acting Comptroller of the Currency **Michael Hsu**

"Bank mergers should serve communities, support financial stability and industry resilience, enhance competition, and enable diversity and dynamism of the banking industry."

(Remarks at Brookings on Bank Mergers and Industry Resiliency, May 9, 2022)

"Revisions to the bank merger framework would help to realize this goal. In short, rather than being pro-merger or anti-merger, we need frameworks that are smart on mergers."

(Remarks at Brookings on Bank Mergers and Industry Resiliency, May 9, 2022)

III.C. DOJ Withdrawal from Bank Merger Guidelines and Banking Addendum

- In 1995, the Agencies and the DOJ issued the 1995 Bank Merger Guidelines, which described a screening procedure used by the Agencies and the DOJ "to identify proposed mergers that clearly do not have significant adverse effects on competition" and allow them to proceed without further review.
- **Withdrawal from 1995 Bank Merger Guidelines**. On September 17, 2024, the DOJ withdrew from the 1995 Bank Merger Guidelines because they "contain modes of analysis that do not accurately reflect how the Antitrust Division currently reviews bank mergers." Instead, the DOJ will rely on the generally-applicable 2023 Merger Guidelines to evaluate proposed bank mergers.
- **Banking Addendum**. The DOJ also issued a brief Banking Addendum to the 2023 Merger Guidelines identifying "portions of the 2023 Merger Guidelines that [it]considers to be frequently relevant when evaluating the competitive consequences of a bank merger." The Banking Addendum is consistent with a June 2023 speech given by Assistant Attorney General for the DOJ's Antitrust Division, Jonathan Kanter, where he emphasized that the DOJ:

Assistant Attorney General for the DOJ's Antitrust Division, **Jonathan Kanter**

will assess the relevant competition in retail banking, small business banking, and large- and mid-size business banking, "including competition involving "fees, interest rates, branch locations, product variety, network effects, interoperability, and customer service;"

will evaluate "concentration levels across a wide range of appropriate metrics and not just local deposits and branch overlaps;"

"will carefully consider how a proposed merger may affect competition for different customer segments;"

"will closely scrutinize mergers that increase risks associated with coordinated effects and multi-market contacts. The division will also examine the extent to which a transaction threatens to entrench power of the most dominant banks by excluding existing or potential disruptive threats or rivals;" and

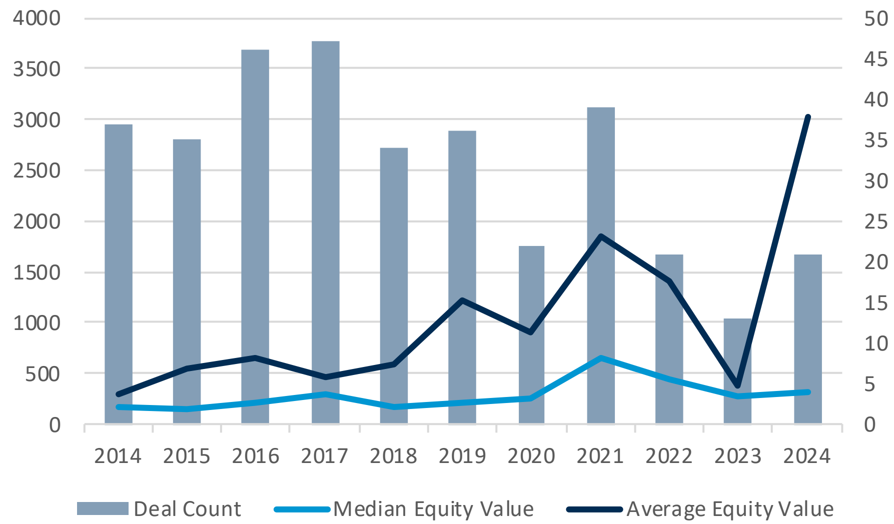
has a "high bar for the divestitures we will accept as remedies" and it believes that such "divestitures are not always adequate to address the broader range of competitive concerns, including interoperability and network effects, among many other potential areas that may be relevant to a particular review." The DOJ has "reorient[ed]" itself away from "remedies agreements with parties (as has become custom over the last many years)."

IV. Bank M&A Environment & Market Trends

- **Interest Rate Cuts**. The Federal Reserve's recent decision to cut its benchmark federal funds rate by 50 basis points will significantly influence the M&A landscape.
  - Historically, lower interest rates have been a catalyst for increased M&A activity by reducing loan yields, increasing leverage ratios, and enhancing valuations, particularly with respect to their bond portfolios.
  - Previous rate cut cycles, such as those starting in 2007 and 2019, have shown that M&A activity tends to increase following economic expansion post-rate cuts. The current environment is expected to be more supportive of M&A activity compared to past cycles, given the absence of severe macroeconomic shocks like the Global Financial Crisis or the COVID-19 pandemic. The recent rate cuts are expected to lower new loan pricing, which could fall significantly, supporting increased leverage ratios and valuation multiples. This favorable environment is likely to stimulate bank mergers and strategic activity through 2025.
- **Stock Market Surge**. Bank stock values have increased after the announcement of the Federal Reserve's interest rate cut, improving acquirers' collective ability to use their shares as currency to finance deals.
  - Capital One and Citigroup each rose 5%, followed by smaller increases in Goldman Sachs, Bank of America, Wells Fargo, JPMorgan Chase and Morgan Stanley. The KBW Nasdaq Bank Index, S&P Regional Banking ETF Index, and the KBW Nasdaq Regional Banking Index each rose by more than 2%.
  - Historically, sellers are more likely to enter transactions backed by a strong market for bank securities.

IV. Bank M&A Environment & Market Trends (cont'd)

Rolling Annual Deal Counts and Equity Values in Millions (2024 includes 4Q23, etc.; only deals with equity value of at least $50 million charted)



- At least 85 bank M&A deals were announced through mid-September with an aggregate deal value of nearly $11 billion. This surge in bank deal announcements positions the bank M&A market to surpass last year's total of 100 deals. Today, total transaction value for 2024 more than doubled the $4.15 billion total last year.
- Notable bank M&A transactions announced in 2024 include:
  - **SouthState Corp. and Independent Bank Group**. SouthState Corp.'s acquisition of Independent Bank Group for $2 billion in stock is the largest bank deal to date in 2024.
  - **UMB Financial and Heartland Financial USA**. UMB Financial's plan to purchase Heartland Financial USA in an all-stock transaction valued at just under $2 billion is one of the largest deals of the year.
  - The Midwest has been particularly active, with notable deals such as **WesBanco's acquisition of Premier Financial** for $959 million and **First Busey Corp.'s acquisition of CrossFirst Bankshares** for $916.8 million.

IV.A. Capital Allocation and the Emergency Capital Investment Program

- The Emergency Capital Investment Program (“ECIP”) is a financial initiative established by the U.S. Department of the Treasury in 2021. It was created to support the economic recovery and stability of communities that have been disproportionately affected by the COVID-19 pandemic. The program aimed to provide capital to CDFIs and MDIs to enhance their capacity to support small businesses and consumers in underserved communities. The ECIP provided over $8.57 billion in capital to 175 CDFI and MDIs and ended in 2023.
- **Program Details**:
  - Funding. The ECIP provides direct capital investments to eligible financial institutions. These investments can take the form of preferred stock or subordinated debt, depending on the institution's structure and needs.
  - Eligibility. To qualify for ECIP, financial institutions must be certified as CDFIs or recognized as MDIs. They must also demonstrate a commitment to serving low-income and minority communities.
  - Use of Funds. The capital provided through ECIP can be used for a variety of purposes, including extending credit to small businesses, supporting affordable housing projects, and offering financial services to individuals in need. While there are no explicit restrictions on the use of funds, the U.S. Treasury expects the funds to be used for community investments and growth.
- **Key Terms from the ECIP Term Sheet**, include:
  - Investment Structure and Amounts:
    - Security and Issuance. The investment involves the issuance of senior perpetual noncumulative preferred stock ("Senior Preferred") with a liquidation preference of $1,000 per share. U.S. Treasury may agree to purchase Senior Preferred with a higher liquidation preference per share depending on the issuer's available authorized preferred shares. No fractional shares will be accepted.

IV.A. Capital Allocation and the Emergency Capital Investment Program (cont'd)

- Investment Limits: The general limit per issuer is $250 million. Additional limits are based on the issuer's total assets:
  - Issuers with total assets greater than $2 billion can receive up to 7.5% of their total assets.
  - Issuers with total assets between $500 million and $2 billion can receive up to 15% of their total assets.
  - Issuers with total assets less than $500 million can receive up to 22.5% of their total assets.
- Dividend and Redemption Terms:
  - Dividend Structure. The Senior Preferred will pay non-cumulative dividends, with no dividends accruing or due for the first 24 months following the investment date. After this period, dividends will begin to accrue, and the rate will adjust annually based on the issuer's Qualified Lending compared to a baseline. Dividends will be payable quarterly in arrears on March 15, June 15, September 15, and December 15. The term to maturity is perpetual.
  - Redemption. The Senior Preferred may be redeemed at the issuer's option on or after the fifth anniversary of issuance, subject to the approval of the appropriate federal banking agency. Redemptions must be made at a per share redemption price equal to 100% of the liquidation preference, plus accrued and unpaid dividends for the then-current dividend period. Redemptions must be in amounts equal to at least 20% of the originally issued shares or 100% of the then-outstanding shares if less than 20% of the originally issued shares.