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Chinese Bank Transaction May Open the Door for M&A

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Editor's Note: Edward Herlihy is a partner and co-chairman of the Executive Committee at Wachtell, Lipton, Rosen & Katz. This post is based on a Wachtell Lipton firm memorandum by Mr. Herlihy, Richard K. Kim, Lawrence S. Makow and Patricia A. Robinson.

Last week, Industrial and Commercial Bank of China announced that it had entered into an agreement to purchase 80 percent of the outstanding common stock of the U.S. subsidiary bank of The Bank of East Asia, Limited, a privately held Hong Kong-based bank. Bank of East Asia also has an option to sell to ICBC its remaining 20% interest in the U.S. bank for a period of 10 years following the acquisition. Although relatively small in size, this transaction is a most significant precedent. The ICBC deal would mark the first control acquisition by a mainland Chinese bank of a U.S. bank since Congress passed a law in 1991 substantially tightening the regulation of foreign banks operating in the U.S. following the collapse of BCCI. The transaction could be the start of a very significant new dynamic in U.S. bank M&A.

Chinese banks have tried for years to try to persuade U.S. regulators to permit them to acquire a U.S. bank. The primary regulatory obstacle has been that, by law, the Federal Reserve may not approve an acquisition by a foreign bank of a U.S. bank unless the Federal Reserve determines that the foreign bank is subject to comprehensive supervision or regulation on a consolidated basis by its home country supervisor. To do so, the Federal Reserve must find that the foreign bank is supervised or regulated so that its home country supervisor receives sufficient information on the worldwide operations of the bank, including its relationship to any affiliates, to assess the bank's overall financial condition and its compliance with law and regulation.

An initial determination by the Federal Reserve that a foreign bank regulator exercises comprehensive consolidated supervision is highly fact dependent and can take years of analysis and deliberation. Here, the analysis is made more challenging by significant factors specific to China, including the unique structure of the Chinese political system, and the extremely rapid pace of change in China's economy and financial markets. That being said, once the Federal Reserve has determined that a foreign bank regulator meets this standard, the determination becomes much less of an issue in subsequent acquisitions by the same bank or by other banks from that country.

The transaction is subject to regulatory approval, and both the U.S. Committee on Foreign Investment in the U.S. (an interagency committee headed by the Secretary of the Treasury) and the Federal Reserve will certainly give it a close review. However, given the larger political context and the events surrounding the announcement of the deal, it seems likely that the parties have carefully vetted this transaction from all relevant angles.