



Regulatory Approvals for Bank M&A

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The Federal Reserve's approval last week of M&T's pending acquisition of Hudson City has prompted a great deal of speculation as to the current state of the regulatory approval process for bank mergers and acquisitions. Announced over three years ago, on August 27, 2012, the M&T/Hudson City transaction has taken longer to receive Federal Reserve approval than any other bank merger. Many in the industry have interpreted the delay in receiving approval for the merger as representing a policy change by the Federal Reserve. As discussed below, we view the transaction as largely an idiosyncratic event that is a result as much of timing as any policy shifts by the Federal Reserve. With this approval, taken together with the others that the Federal Reserve has issued over the past several months, there is now more clarity and certainty to the regulatory approval process for bank M&A. With the exception of the largest systemically important banks, there is no regulatory policy impeding bank mergers.

While the regulators have not given a flashing green light for all bank mergers, in view of the series of Federal Reserve approval orders issued over the past several months, we are increasingly optimistic about the prospects for well structured transactions. To be sure, the manner by which the Federal Reserve now processes bank merger applications has changed markedly following the financial crisis. The Federal Reserve now expects to review detailed due diligence reports, including identified weaknesses and plans for remediation, as well as integration plans that delineate post-merger compliance and risk management systems and programs. There is also intense focus on consumer compliance, CRA and BSA/AML and the CFPB's views are increasingly important. Bank holding companies that would, as a result of a merger, approach or exceed the \$10 billion or \$50 billion thresholds—which result in additional regulatory obligations—should also provide detailed plans showing how they will handle them. Banks subject to CCAR—the Federal Reserve's annual stress test for banks with \$50 billion or more in assets—must also think carefully about timing and process. All of this makes it vitally important for prospective acquirers to carefully diligence their own potential issues and present detailed presentations to the regulators well in advance of signing a merger agreement.

As for the M&T/Hudson City approval, it is best understood in a broader context. Less than three months after M&T filed its application with the Federal Reserve requesting permission to acquire Hudson City in September 2012, the Federal Reserve in conjunction with the U.S. Department of Justice and other governmental agencies, issued enforcement actions of historic proportions against Standard Chartered and HSBC relating to BSA/AML violations. The Standard Chartered action was accompanied by deferred prosecution agreements and HSBC received the largest

civil money penalty that the Federal Reserve had yet issued directed at BSA/AML compliance. These were followed in rapid succession by enforcement actions against JPMorgan Chase, Citigroup, Bank of Montreal and numerous other banking organizations also relating to BSA/AML.

In June 2013, M&T entered into a formal enforcement action with the Federal Reserve relating to BSA/AML. In a sharp and meaningful departure from precedent, M&T Bank's state regulator, the New York State Department of Financial Services, did not join in the action. Where a bank is regulated by both the Federal Reserve and a state banking regulator, such as M&T Bank, the regulators typically act in lockstep when it comes to enforcement actions. Rarely does the Federal Reserve act alone. Equally notable is that the Federal Reserve did not wait for M&T's enforcement action to be terminated before approving the Hudson City transaction—the enforcement action remains in place today.

The Federal Reserve's approval of the M&T/Hudson City transaction is undeniably positive for M&T and for bank mergers generally. Despite this, there has been broad speculation about the meaning of a "footnote" to the approval order. There, the Federal Reserve noted that it took the unusual step of allowing M&T's application to remain pending while M&T addressed the concerns identified by the regulators, but that it does not expect to do so again in future applications. The Federal Reserve commented that "if issues arise during processing of an application, the Board expects that a banking organization will withdraw its application pending resolution of any supervisory concerns."

A number of commentators have conjectured that this seemingly harsher stance on withdrawals marks a fundamental change. In fact, it is not. It has long been the Federal Reserve's practice to require that an application be withdrawn if materially adverse issues arise. The Federal Reserve highlighted this longstanding position in supervisory guidance issued in February 2014, "there are instances when substantive issues are not resolved during the application review process, and Federal Reserve staff recommends that the Board deny the proposal. In such cases, the Federal Reserve's general practice has been to inform the filer before final Board action that staff would recommend denial of the proposal to the Board in order to provide the filer the option to withdraw the application or notice."

A more accurate barometer of the current state of the regulatory approval process for bank M&A is the steady stream of approvals that the Federal Reserve Board has been issuing over the past several months. It is a very positive signal that the merger approval logjam has been cleared. Typically, bank M&A applications are approved by the local Federal Reserve Banks acting under delegated authority. Applications that present substantive issues are processed by Federal Reserve Board staff in Washington and these approvals are issued much less frequently and the process is more time consuming. Commencing with its approval of BB&T's acquisition of Bank of Kentucky in early June, the Federal Reserve Board has issued from Washington a dozen approvals for transactions by Sterling Bancorp, Cathay General Bancorp, CIT Group, Banner Corporation, PacWest Bancorp and many others. Two of these applications, CIT's acquisition of OneWest Bank and Banco de Credito Inversiones' acquisition of City National Bank of Florida, had been pending for a year or more and presented complex substantive and procedural issues such as foreign cross-holdings and a public hearing.

Taken together, these transactions are a clear and unmistakable signal that the bar for bank M&A transactions—even those involving large banks—has stopped rising. To the contrary, properly

structured transactions by experienced and skilled acquirers that understand the evolving new regulatory expectations can receive approval on a reasonable and predictable timeline.