Federal Deposit Insurance Corporation
550 17th Street NW, Washington, D.C. 20429-9990
Division of Supervision and Consumer Protection

TO: Board of Directors

FROM: Sandra L. Thompson
Director

SUBJECT: Amendments to Statement of Policy on Bank Merger Transactions

EXECUTIVE SUMMARY

The Division of Supervision and Consumer Protection (DSC) recommends that the Board of Directors (Board) amend the Statement of Policy on Bank Merger Transactions (Statement of Policy) to (i) reflect recent changes to the Bank Merger Act made by the Financial Services Regulatory Relief Act of 2006 (FSRRA); (ii) reflect the consolidation of the two former deposit insurance funds into one Deposit Insurance Fund by the Federal Deposit Insurance Reform Act of 2005 (FDIRA); (iii) conform the description of the factors to be considered in evaluating a merger more closely to the language of the Bank Merger Act; and (iv) revise the discussion of the evaluation of certain anticompetitive mergers involving failing banks.

The recommended amendments are incorporated into the revised Statement of Policy, attached as Exhibit A (redline format) and Exhibit B (clean format), and are described more fully below. In addition, DSC recommends that the Board authorize the Executive Secretary to publish in the Federal Register the notice, attached as Exhibit C, which describes the amendments in detail. The Legal Division has determined that solicitation of public comment is not necessary because the Administrative Procedure Act does not generally require public comment regarding statements of policy[1] and because the proposed revisions merely conform the Statement of Policy to the Federal statutes.

The FSRRA eliminated the need for the FDIC to obtain a competitive factors report from the other three Federal banking agencies in processing a merger application, and eliminated both the post-approval waiting period and the need to obtain any competitive factors reports when the merger solely involves an insured depository institution and one or more of its affiliates. These changes require conforming amendments to the Statement of Policy.

Concur:

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Sara A. Kelsey
General Counsel

[1] 5 U.S.C. § 553(b)(A).

Attachments

The FDIRA consolidated the former Savings Association Insurance Fund (SAIF) and the former Bank Insurance Fund (BIF) into the Deposit Insurance Fund. Among the many consequences of this legislative action, it obviated the need for special rules governing merger transactions that involved a member of the BIF and a member of the SAIF. As a result, the discussion in the Statement of Policy addressing these transactions is no longer necessary.

Technical amendments are also recommended to conform the description of the factors to be considered in evaluating a merger more closely to the language of the Bank Merger Act, to insert a reference to the anti-money laundering factor omitted from the *Introduction* section of the Statement of Policy, and to revise the discussion of the evaluation of certain anticompetitive mergers involving failing banks.

Finally, an additional technical amendment is proposed to reflect the FDIC Public Information Center's change of location and street address to the Virginia Square office.

The Statement of Policy serves as guidance to the public and the industry on bank merger applications. The Board originally adopted the Statement of Policy and two subsequent amendments, and the Board has not delegated the authority to amend this Statement of Policy. Therefore, DSC and the Legal Division are recommending that the Board adopt and approve these amendments, and authorize their publication in the Federal Register.

SECTION 606 OF THE FSRRA

Section 606 of the FSRRA amended section 18(c)(4) of the Federal Deposit Insurance Act (FDI Act) to eliminate the requirement that the Federal banking agency responsible for processing a particular merger application request and obtain a competitive factors report from each of the other three Federal banking agencies. Section 606 of the FSRRA did not, however, eliminate the requirement that the responsible agency obtain a competitive factors report from the Attorney General of the United States. In addition, section 606 also added the requirement that in processing a merger application, the Federal Reserve Board, the Office of the Comptroller of the Currency, or the Office of Thrift Supervision, as the case may be, must submit a copy of each request for a competitive factors report to the FDIC.

Section 606 of the FSRRA also made two changes to the Bank Merger Act that apply to mergers solely involving an insured depository institution and one or more of its affiliates (Affiliate Mergers). First, Section 606 eliminated the need for the responsible Federal banking agency to request any competitive factors reports for Affiliate Mergers. Second, Section 606 revised Section 18(c)(6) of the FDI Act to eliminate the post-approval waiting period for Affiliate Mergers. Prior to the FSRRA, the applicant in an Affiliate Merger had to wait up to thirty days after approval before it could consummate the transaction.

After incorporating the recommended amendments, paragraphs 4 and 5 of Section II of the Statement of Policy read as follows:

II. Application Procedures

. . . .

4. *Reports on competitive factors.* As required by law, the FDIC will request a report on the competitive factors involved in a proposed merger transaction from the Attorney General. This report must ordinarily be furnished within 30 days, and the applicant upon request will be given an opportunity to submit comments to the FDIC on the contents of the competitive factors report.

5. *Notification of the Attorney General.* After the FDIC approves any merger transaction, the FDIC will immediately notify the Attorney General. Generally, unless it involves a probable failure, an emergency exists requiring expeditious action, or it is solely between an insured depository institution and one or more of its affiliates, a merger transaction may not be consummated until 30 calendar days after the date of the FDIC's approval. However, the FDIC may prescribe a 15-day period, provided the Attorney General concurs with the shorter period.

FEDERAL DEPOSIT INSURANCE REFORM ACT OF 2005

Section 2102(a) of the FDIRA merged the BIF and the SAIF into a new fund, the Deposit Insurance Fund. Among the many consequences of this legislative action, it obviated the need for special rules governing merger transactions that involved a member of the BIF and a member of the SAIF, commonly known as “Oakar” transactions. As a result, the discussion in the Statement of Policy addressing Oakar transactions is no longer necessary. Therefore, paragraph 3 *Optional Conversion* of Section IV *Related Considerations* is deleted and the subsequent paragraphs are renumbered.

The deleted text read as follows:

> *Optional conversion.* Section 5(d)(3) of the Federal Deposit Insurance Act, 12 U.S.C. 1815(d)(3), provides for "optional conversions" (commonly known as Oakar transactions) which, in general, are merger transactions that involve a member of the Bank Insurance Fund and a member of the Savings Association Insurance Fund. These transactions are subject to specific rules regarding deposit insurance coverage and premiums. Applicants may find additional guidance in § 327.31 of the FDIC rules and regulations (12 CFR 327.31).

TECHNCIAL AMENDMENTS

Technical amendments are recommended to conform the description of the antitrust factor to be considered in evaluating a merger more closely to the language of the Bank Merger Act. In addition, staff recommends an amendment to insert a reference to the anti-money laundering factor omitted from the description of the factors to be considered in the *Introduction* section of the Statement of Policy. Accordingly, the third and fourth unnumbered paragraphs of Section I

Introduction and paragraph 4 of Section III *Evaluation of Merger Applications* are amended to read as follows. The changes are underlined.

I. Introduction

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The Bank Merger Act prohibits the FDIC from approving any proposed merger transaction that would result in a monopoly, or would further a combination or conspiracy to monopolize or to attempt to monopolize the business of banking in any part of the United States. Similarly, the Bank Merger Act prohibits the FDIC from approving a proposed merger transaction whose effect in any section of the country may be substantially to lessen competition, or to tend to create a monopoly, or which in any other manner would be in restraint of trade. An exception may be made in the case of a merger transaction whose effect would be to substantially lessen competition, tend to create a monopoly, or otherwise restrain trade, if the FDIC finds that the anticompetitive effects of the proposed transaction are clearly outweighed in the public interest by the probable effect of the transaction in meeting the convenience and needs of the community to be served. For example, the FDIC may approve a merger transaction to prevent the probable failure of one of the institutions involved.

In every proposed merger transaction, the FDIC must also consider the financial and managerial resources and future prospects of the existing and proposed institutions, the convenience and needs of the community to be served, and the effectiveness of each insured depository institution involved in the proposed merger transaction in combating money-laundering activities, including in overseas branches.

. . . .

III. Evaluation of Merger Applications.

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4. *Consideration of the public interest.* The FDIC will deny any proposed merger transaction whose overall effect likely would be to reduce existing competition substantially by limiting the service and price options available to the public in the relevant geographic market(s), unless the anticompetitive effects of the proposed merger transaction are clearly outweighed in the public interest by the probable effect of the transaction in meeting the convenience and needs of the community to be served. For this purpose, the applicant must show by clear and convincing evidence that any claimed public benefits would be both substantial and incremental and generally available to seekers of banking services in the relevant geographic market(s) and that the expected benefits cannot reasonably be achieved through other, less anticompetitive means.

Technical amendments are also recommended to Section III *Evaluation of Merger Applications* to make the discussion of the evaluation of certain anticompetitive mergers involving failing banks more consistent with the least-cost resolution requirements of the FDIC Improvement Act of 1991. The second paragraph of subsection 4 *Consideration of the public interest* of Section III *Evaluation of Merger Applications* currently reads as follows.

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> III. Evaluation of Merger Applications.
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> . . . .
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> Where a proposed merger transaction is the only reasonable alternative to the probable failure of an insured depository institution, the FDIC may approve an otherwise anticompetitive merger transaction. The FDIC usually will not consider a less anticompetitive alternative that is substantially more costly to the FDIC to be a reasonable alternative, unless the potential costs to the public of approving the anticompetitive merger transaction are clearly greater than those costs likely to be saved by the FDIC.

This paragraph can be read to indicate that the FDIC may approve a merger involving a failing bank contrary to its statutory duty to resolve an institution in the manner that results in the least cost to the Deposit Insurance Fund. Accordingly, the paragraph *is* amended to read as follows.

> Where a proposed merger transaction is the least-costly alternative to the probable failure of an insured depository institution, the FDIC may approve the merger transaction even if it is anticompetitive.

A final technical amendment is proposed to reflect the FDIC Public Information Center's change of location and address to the Virginia Square building. As such, paragraph 6 of Section II. *Application Procedures* is amended to read as follows. The change is underlined.

FDIC Statement of Policy on Bank Merger Transactions

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> II. Application Procedures
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> . . . .

6. *Merger decisions available.* Applicants for consent to engage in a merger transaction may find additional guidance in the reported bases for FDIC approval or denial in prior merger transaction cases compiled in the FDIC's annual "Merger Decisions" report. Reports may be obtained from the FDIC Public

Information Center, 3501 North Fairfax Drive, Room E-1002, Arlington, VA 22226. Reports may also be viewed at *http//www.fdic.gov*.

Staff Contacts

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Exhibit B

FDIC Statement of Policy on Bank Merger Transactions

I. Introduction

Section 18(c) of the Federal Deposit Insurance Act (12 U.S.C. 1828(c)), popularly known as the "Bank Merger Act," requires the prior written approval of the FDIC before any insured depository institution may:

(1) Merge or consolidate with, purchase or otherwise acquire the assets of, or assume any deposit liabilities of, another insured depository institution if the resulting institution is to be a state nonmember bank, or

(2) Merge or consolidate with, assume liability to pay any deposits or similar liabilities of, or transfer assets and deposits to, a noninsured bank or institution.

Institutions undertaking one of the above described "merger transactions" must file an application with the FDIC. Transactions that do not involve a transfer of deposit liabilities typically do not require prior FDIC approval under the Bank Merger Act, unless the transaction involves the acquisition of all or substantially all of an institution's assets.

The Bank Merger Act prohibits the FDIC from approving any proposed merger transaction that would result in a monopoly, or would further a combination or conspiracy to monopolize or to attempt to monopolize the business of banking in any part of the United States. Similarly, the Bank Merger Act prohibits the FDIC from approving a proposed merger transaction whose effect in any section of the country may be substantially to lessen competition, or to tend to create a monopoly, or which in any other manner would be in restraint of trade. An exception may be made in the case of a merger transaction whose effect would be to substantially lessen competition, tend to create a monopoly, or otherwise restrain trade, if the FDIC finds that the anticompetitive effects of the proposed transaction are clearly outweighed in the public interest by the probable effect of the transaction in meeting the convenience and needs of the community to be served. For example, the FDIC may approve a merger transaction to prevent the probable failure of one of the institutions involved.

In every proposed merger transaction, the FDIC must also consider the financial and managerial resources and future prospects of the existing and proposed institutions, the convenience and needs of the community to be served, and the effectiveness of each insured depository institution involved in the proposed merger transaction in combating money-laundering activities, including in overseas branches.

II. Application Procedures

1. *Application filing.* Application forms and instructions may be obtained from the appropriate FDIC office. Completed applications and any other pertinent materials should be filed with the appropriate FDIC office. The application and related materials will be reviewed by the FDIC for compliance with applicable laws and FDIC rules and regulations. When all

necessary information has been received, the application will be processed and a decision rendered by the FDIC.

2. *Expedited processing.* Section 303.64 of the FDIC rules and regulations (12 CFR 303.64) provides for expedited processing, which the FDIC will grant to eligible applicants. In addition to the eligible institution criteria provided for in § 303.2 (12 CFR 303.2), § 303.64 provides expedited processing criteria specifically applicable to proposed merger transactions.

3. *Publication of notice.* The FDIC will not take final action on a merger application until notice of the proposed merger transaction is published in a newspaper or newspapers of general circulation in accordance with the requirements of section 18(c)(3) of the Federal Deposit Insurance Act. See § 303.65 of the FDIC rules and regulations (12 CFR 303.65). The applicant must furnish evidence of publication of the notice to the appropriate FDIC office following compliance with the publication requirement. See § 303.7(b) of the FDIC rules and regulations (12 CFR 303.7(b)).

4. *Reports on competitive factors.* As required by law, the FDIC will request a report on the competitive factors involved in a proposed merger transaction from the Attorney General. This report must ordinarily be furnished within 30 days, and the applicant upon request will be given an opportunity to submit comments to the FDIC on the contents of the competitive factors report.

5. *Notification of the Attorney General.* After the FDIC approves any merger transaction, the FDIC will immediately notify the Attorney General. Generally, unless it involves a probable failure, an emergency exists requiring expeditious action, or it is solely between an insured depository institution and one or more of its affiliates, a merger transaction may not be consummated until 30 calendar days after the date of the FDIC's approval. However, the FDIC may prescribe a 15-day period, provided the Attorney General concurs with the shorter period.

6. *Merger decisions available.* Applicants for consent to engage in a merger transaction may find additional guidance in the reported bases for FDIC approval or denial in prior merger transaction cases compiled in the FDIC's annual "Merger Decisions" report. Reports may be obtained from the FDIC Public Information Center, 3501 North Fairfax Drive, Room E-1002, Arlington, VA 22226. Reports may also be viewed at *http://www.fdic.gov*.

III. Evaluation of Merger Applications

The FDIC's intent and purpose is to foster and maintain a safe, efficient, and competitive banking system that meets the needs of the communities served. With these broad goals in mind, the FDIC will apply the specific standards outlined in this Statement of Policy when evaluating and acting on proposed merger transactions.

Competitive Factors

In deciding the competitive effects of a proposed merger transaction, the FDIC will consider the extent of existing competition between and among the merging institutions, other depository institutions, and other providers of similar or equivalent services in the relevant product market(s) within the relevant geographic market(s).

1. *Relevant geographic market.* The relevant geographic market(s) includes the areas in which the offices to be acquired are located and the areas from which those offices derive the predominant portion of their loans, deposits, or other business. The relevant geographic market also includes the areas where existing and potential customers impacted by the proposed merger transaction may practically turn for alternative sources of banking services. In delineating the relevant geographic market, the FDIC will also consider the location of the acquiring institution's offices in relation to the offices to be acquired.

2. *Relevant product market.* The relevant product market(s) includes the banking services currently offered by the merging institutions and to be offered by the resulting institution. In addition, the product market may also include the functional equivalent of such services offered by other types of competitors, including other depository institutions, securities firms, or finance companies. For example, share draft accounts offered by credit unions may be the functional equivalent of demand deposit accounts. Similarly, captive finance companies of automobile manufacturers may compete directly with depository institutions for automobile loans, and mortgage bankers may complete directly with depository institutions for real estate loans.

3. *Analysis of competitive effects.* In its analysis of the competitive effects of a proposed merger transaction, the FDIC will focus particularly on the type and extent of competition that exists and that will be eliminated, reduced, or enhanced by the proposed merger transaction. The FDIC will also consider the competitive impact of providers located outside a relevant geographic market where it is shown that such providers individually or collectively influence materially the nature, pricing, or quality of services offered by the providers currently operating within the geographic market.

The FDIC's analysis will focus primarily on those services that constitute the largest part of the businesses of the merging institutions. In its analysis, the FDIC will use whatever analytical proxies are available that reasonably reflect the dynamics of the market, including deposit and loan totals, the number and volume of transactions, contributions to net income, or other measures. Initially, the FDIC will focus on the respective shares of total deposits[1] held by the merging institutions and the various other participants with offices in the relevant geographic market(s), unless the other participants' loan, deposit, or other business varies markedly from that of the merging institutions. Where it is clear, based on market share considerations alone, that the proposed merger transaction would not significantly increase concentration in an unconcentrated market, a favorable finding will be made on the competitive factor.

[1] In many cases, total deposits will adequately serve as a proxy for overall share of the banking business in the relevant geographic market(s); however, the FDIC may also consider other analytical proxies.

Where the market shares of the merging institutions are not clearly insignificant, the FDIC will also consider the degree of concentration within the relevant geographic market(s) using the Herfindahl-Hirschman Index (HHI)[2] as a primary measure of market concentration. For purposes of this test, a reasonable approximation for the relevant geographic market(s) consisting of one or more predefined areas may be used. Examples of such predefined areas include counties, the Bureau of the Census Metropolitan-Statistical Areas (MSAs), or Rand-McNally Ranally Metro Areas (RMAs).

The FDIC normally will not deny a proposed merger transaction on antitrust grounds (absent objection from the Department of Justice) where the post-merger HHI in the relevant geographic market(s) is 1,800 points or less or, if it is more than 1,800, it reflects an increase of less than 200 points from the pre-merger HHI. Where a proposed merger transaction fails this initial concentration test, the FDIC will consider more closely the various competitive dynamics at work in the market, taking into account a variety of factors that may be especially relevant and important in a particular proposal, including:

- The number, size, financial strength, quality of management, and aggressiveness of the various participants in the market;

- The likelihood of new participants entering the market based on its attractiveness in terms of population, income levels, economic growth, and other features;

- Any legal impediments to entry or expansion; and

- Definite entry plans by specifically identified entities.

In addition, the FDIC will consider the likelihood that new entrants might enter the market by less direct means; for example, electronic banking with local advertisement of the availability of such services. This consideration will be particularly important where there is evidence that the mere possibility of such entry tends to encourage competitive pricing and to maintain the quality of services offered by the existing competitors in the market.

The FDIC will also consider the extent to which the proposed merger transaction likely would create a stronger, more efficient institution able to compete more vigorously in the relevant geographic markets.

4. *Consideration of the public interest.* The FDIC will deny any proposed merger transaction whose overall effect likely would be to reduce existing competition substantially by limiting the service and price options available to the public in the relevant geographic market(s), unless the anticompetitive effects of the proposed merger transaction are clearly outweighed in

[2] The HHI is a statistical measure of market concentration and is also used as the principal measure of market concentration in the Department of Justice's Merger Guidelines. The HHI for a given market is calculated by squaring each individual competitor's share of total deposits within the market and then summing the squared market share products. For example, the HHI for a market with a single competitor would be: $100^2 = 10{,}000$: for a market with five competitors with equal market shares, the HHI would be: $20^2 + 20^2 + 20^2 + 20^2 + 20^2 = 2{,}000$.

the public interest by the probable effect of the transaction in meeting the convenience and needs of the community to be served. For this purpose, the applicant must show by clear and convincing evidence that any claimed public benefits would be both substantial and incremental and generally available to seekers of banking services in the relevant geographic market(s) and that the expected benefits cannot reasonably be achieved through other, less anticompetitive means.

Where a proposed merger transaction is the least-costly alternative to the probable failure of an insured depository institution, the FDIC may approve the merger transaction even if it is anticompetitive.

Prudential Factors

The FDIC does not wish to create larger weak institutions or to debilitate existing institutions whose overall condition, including capital, management, and earnings, is generally satisfactory. Consequently, apart from competitive considerations, the FDIC normally will not approve a proposed merger transaction where the resulting institution would fail to meet existing capital standards, continue with weak or unsatisfactory management, or whose earnings prospects, both in terms of quantity and quality, are weak, suspect, or doubtful. In assessing capital adequacy and earnings prospects, particular attention will be paid to the adequacy of the allowance for loan and lease losses. In evaluating management, the FDIC will rely to a great extent on the supervisory histories of the institutions involved and of the executive officers and directors that are proposed for the resultant institution. In addition, the FDIC may review the adequacy of management's disclosure to shareholders of the material aspects of the merger transaction to ensure that management has properly fulfilled its fiduciary duties.

Convenience and Needs Factor

In assessing the convenience and needs of the community to be served, the FDIC will consider such elements as 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.

Anti-Money Laundering Record

In every case, the FDIC will take into consideration the effectiveness of each insured depository institution involved in the proposed merger transaction in combating money-laundering activities, including in overseas branches. In this regard, the FDIC will consider the adequacy of each institution's programs, policies, and procedures relating to anti-money laundering activities; the relevant supervisory history of each participating institution, including their compliance with anti-money laundering laws and regulations; and the effectiveness of any corrective program outstanding. The FDIC's assessment may also incorporate information made available to the FDIC by the Department of the Treasury, other Federal or State authorities,

and/or foreign governments. Adverse findings may warrant correction of identified problems before consent is granted, or the imposition of conditions. Significantly adverse findings in this area may form the basis for denial of the application.

Special Information requirement if applicant is affiliated with or will be affiliated with an insurance company.

If the institution that is the subject of the application is, or will be, affiliated with a company engaged in insurance activities that is subject to supervision by a state insurance regulator, the applicant must submit the following information as part of its application: (1) The name of insurance company; (2) a description of the insurance activities that the company is engaged in and has plans to conduct; and (3) a list of each state and the lines of business in that state which the company holds, or will hold, an insurance license. Applicant must also indicate the state where the company holds a resident license or charter, as applicable.

IV. Related Considerations

1. *Interstate bank merger transactions.* Where a proposed transaction is an interstate merger transaction between insured banks, the FDIC will consider the additional factors provided for in section 44 of the Federal Deposit Insurance Act, 12 U.S.C. 1831u.

2. *Interim merger transactions.* An interim institution is a state- or federally-chartered institution that does not operate independently, but exists, normally for a very short period of time, solely as a vehicle to accomplish a merger transaction. In cases where the establishment of a new or interim institution is contemplated in connection with a proposed merger transaction, the applicant should contact the FDIC to discuss any relevant deposit insurance requirements. In general, a merger transaction (other than a purchase and assumption) involving an *insured* depository institution and a *federal* interim depository institution will not require an application for deposit insurance, even if the federal interim depository institution will be the surviving institution.

3. *Branch closings.* Where banking offices are to be closed in connection with the proposed merger transaction, the FDIC will review the merging institutions' conformance to any applicable requirements of section 42 of the Federal Deposit Insurance Act concerning notice of branch closings as reflected in the *Interagency Policy Statement Concerning Branch Closing Notices and Policies*. See 2 FDIC Law, Regulations, Related Acts 5391.

4. *Legal fees and other expenses.* The commitment to pay or payment of unreasonable or excessive fees and other expenses incident to an application reflects adversely upon the management of the applicant institution. The FDIC will closely review expenses for professional or other services rendered by present or prospective board members, major shareholders, or other insiders for any indication of self-dealing to the detriment of the institution. As a matter of practice, the FDIC expects full disclosure to all directors and shareholders of any arrangement with an insider. In no case will the FDIC approve an application where the payment of a fee, in whole or in part, is contingent upon any act or forbearance by the FDIC or by any other federal or state agency or official.

5. *Trade names.* Where an acquired bank or branch is to be operated under a different trade name than the acquiring bank, the FDIC will review the adequacy of the steps taken to minimize the potential for customer confusion about deposit insurance coverage. Applicants may refer to the Interagency Statement on Branch Names for additional guidance. See FDIC, Financial Institution Letter, 46--98 (May 1, 1998).