Monthly Bank Regulatory Report

October 1, 2024

We are pleased to provide you with the September edition of Gibson Dunn's monthly U.S. bank regulatory update. Please feel free to reach out to us to discuss any of the below topics further.

KEY TAKEAWAYS

- In coordinated actions, the Federal Deposit Insurance Corporation (FDIC) and Office of the Comptroller of the Currency (OCC) issued a final policy statement and final rule, respectively, updating the agencies' approach to evaluating transactions subject to approval under the Bank Merger Act (BMA) and the U.S. Department of Justice (DOJ) announced its withdrawal from the 1995 Bank Merger Guidelines and confirmed that its 2023 Merger Guidelines "remain its sole and authoritative statement across all industries." The DOJ also issued a 2024 Banking Addendum identifying those portions of the 2023 Merger Guidelines frequently relevant to the DOJ's consideration of bank mergers.

- In a speech on September 10, 2024 at the Brookings Institution, Vice Chair for Supervision Michael Barr stated that the federal bank regulatory agencies planned "broad and material changes" to the Basel III endgame proposal and the GSIB surcharge proposal and that he intended "to recommend that the [Federal Reserve] Board re-propose" the rules. No re-proposal has been issued as of the date of publication.

- The intersection of banks and fintechs remains a focus:

    - The FDIC issued a proposal intended to enhance insured depository institutions' recordkeeping requirements for certain types of custodial accounts. Comments are due on the proposal 60 days after publication in the *Federal Register*.

- Senators Warren (D-MA) and Van Hollen (D-MD) sent a letter to the Board of Governors of the Federal Reserve System (Federal Reserve), FDIC and OCC urging the agencies to (i) prohibit entities that provide products only eligible for FDIC pass-through deposit insurance from using the FDIC name or logo in any materials, (ii) establish rules for bank partners that offer deposit-style products to safeguard customer funds and (iii) supervise, examine and take enforcement actions against those bank partners under the Bank Service Company Act.

DEEPER DIVES

FDIC Adopts Final Statement of Policy on Bank Merger Transactions. In coordination with the OCC and DOJ, on September 17, 2024 the FDIC adopted its final Statement of Policy on Bank Merger Transactions (SOP) substantially as proposed, with limited adjustments. The SOP supersedes the prior Statement of Policy on Bank Merger Transactions 30 days after publication in the *Federal Register*. The SOP is more principles based than the current Statement of Policy, last updated in 2008, affirms the FDIC's view concerning the broad applicability of the BMA to merger transactions, including mergers in substance, involving an insured depository institution and any non-insured entity, and revises how the FDIC evaluates applicable statutory factors under the BMA, including competition, convenience and needs, financial stability, and financial and managerial resources.

- *Insights*. The SOP provides no clarity as to the timing for the FDIC's review and approval of BMA applications. Contrary to current practice, the SOP retains the language from the proposal enabling the FDIC Board of Directors to release a statement regarding its concerns with any transaction for which a BMA application has been withdrawn "if such a statement is considered to be in the public interest for purposes of creating transparency for the public and future applicants." In addition, the SOP retains the proposed language that the FDIC may require divestitures to mitigate competitive concerns before allowing a merger to be consummated, a departure from historical precedent. As raised by commenters, a divestiture could itself require a separate BMA approval, thus delaying significantly the merger transaction. In sum, the SOP revises how the FDIC evaluates the statutory factors for a BMA application, in certain instances seemingly beyond the statutory factor on its face—as raised by FDIC Director Jonathan McKernan in his statement in opposition to the proposal and FDIC Director Travis Hill in his statement in opposition to the final SOP.

- A few key points to highlight:

    - On financial stability, the SOP focuses in part on large bank mergers, highlighting that, although "size alone is not dispositive," the FDIC would "generally expect" to hold a hearing for any "application resulting in an institution with greater than $50 billion in assets or for which a significant number of CRA protests are received" and adds that transactions resulting in institutions with total assets in excess of $100 billion "will be subject to added scrutiny."

    - On competition, the SOP deemphasizes the longstanding 1,800/200 HHI thresholds (although the FDIC does intend to coordinate with other relevant

agencies regarding any potential changes to the calculation of, or thresholds for, HHI usage). Although deposits will serve "as an initial proxy for commercial banking products and services," the FDIC "may consider concentrations in any specific products or customer segments" (e.g., small business or residential loan originations volume, activities requiring specialized expertise). The SOP also provides that the FDIC generally will require that the selling institution not enter into non-compete agreements with any employee of the divested entity nor enforce any existing non-compete agreements with any of those entities.

  - On convenience and needs, the SOP would require the resulting institution "to *better* meet the convenience and the needs of the community to be served" than would occur without the merger. To establish this, applicants will be required to provide "specific and forward-looking information" to the FDIC for purposes of evaluating the statutory factor, and the FDIC will evaluate all projected or anticipated branch expansion, closings, or consolidations for the first three years following consummation of the merger. Job losses or lost job opportunities from branching changes will be "closely evaluated" under the SOP.

  - On the financial and managerial resources factors, the SOP does not incorporate the proposal's assertion that the FDIC will not find favorably on the financial resources factor if the merger would result in a weaker institution from a financial perspective. According to the preamble, this statement was removed to avoid the suggestion that an institution that reflects a very strong financial condition would be precluded from absorbing a weaker target. That language was replaced with language affirming that a favorable finding on the financial resources factor would only be appropriate in cases where the merger results in a combined institution "that presents less financial risk than the financial risk posed by the institutions on a standalone basis."

OCC Issues Final Rule Amending its Bank Merger Reviews. In coordination with the FDIC and DOJ, on September 17, 2024 the OCC issued a final rule to amend its procedures for reviewing applications under the BMA and add a policy statement that summarizes the principles the OCC uses when it reviews proposed bank merger transactions under the BMA. The final rule is effective January 1, 2025. Like the FDIC's SOP, the OCC's policy statement provides no clarity as to the timing for the review and approval of BMA applications, although the agency acknowledges it is "mindful of the effects of the length of review periods on all relevant parties."

- *Insights*. The OCC's final rule and accompanying policy statement eliminate some of the ambiguity contained in the proposed version and suggests that the OCC does not intend a material departure from the approach it has taken in reviewing BMA applications in recent years. Although the key characteristics considered in a BMA application remain consistent, there are a few notable items to highlight:

  - Transactions in which the resulting bank will exceed $50 billion in total assets and transactions where the target's total assets are 50% of more of the acquirer's assets should expect additional scrutiny and time for review, but are not precluded from approval under the policy statement. The financial and managerial

resources and future prospects factors within the context of the prevailing economic and operating environment will be considered in a BMA application.

- The OCC specifically provides that it will focus on the integration process and that it is less likely to approve applications involving an acquirer that has engaged in multiple acquisitions with overlapping integration periods, experienced rapid growth, or is functionally the target in the transaction.

- The ability of the resulting bank to meet the convenience and needs of the community should be forward-looking and distinct from the bank's record in complying with the Community Reinvestment Act – in other words, while historic practices are indicative of a commitment, the future efforts and plan will be important in the BMA process. For instance, the OCC will more explicitly consider job losses or reduced job opportunities, community investment and development initiatives and efforts to support affordable housing and small business when reviewing a BMA application.

DOJ Announces that 2023 Merger Guidelines will be the "Sole and Authoritative Statement Across all Industries". Although the DOJ issuance does not provide detailed discussion of how the 2023 Merger Guidelines apply to the banking industry specifically, the DOJ will look to expand bank merger analysis beyond the traditional—and more predictable—assessment of local branch overlaps and HHI screens, into a "comprehensive and flexible framework" contained in the 2023 Merger Guidelines. DOJ will look to consider issues such as the impact at the branch level with respect to individual lines of business, particular customer segments, or the quality/nature of customer service, and across broader geographic regions.

- *Insights*. The commentary does not include any reference to the 1995 Bank Merger Guidelines' HHI thresholds currently used to screen bank merger applications for possible competitive impacts or possible data sources for analyzing a wider array of product markets outside of the FDIC's Summary of Deposits data. However, the 2023 Merger Guidelines do contain a HHI threshold (1,800/100) and a market share threshold (30% plus change in HHI of 100) for establishing a rebuttable presumption of anticompetitive harm. Importantly, the commentary also specifically states that the "banking agencies may, at their discretion, use their own methods for screening and evaluating bank mergers."

Vice Chair for Supervision Barr Previews the Federal Banking Agencies' Revised Basel III Endgame and GSIB Surcharge Proposals. On September 10, 2024, in a speech titled "The Next Steps on Capital," Vice Chair for Supervision Michael Barr indicated that "broad and material changes" to the Basel III endgame and GSIB surcharge proposals "are warranted" and that he "intend[s] to recommend that the Board re-propose the Basel endgame and GSIB surcharge rules." Notably, Barr's remarks evidence a return to tiering. Large banks with assets between $100 and $250 billion would no longer be subject to the endgame changes, other than the requirement to recognize unrealized gains and losses of their securities in regulatory capital. For large banks with assets between $250 and $700 billion that are not GSIBs or internationally active, the re-proposal would apply the new credit risk and operational risk requirements; however, it would apply the frameworks for market risk and CVA frameworks only to firms that engage in significant trading activity. Further, the re-proposal would revert to the simpler definition

of capital – the numerator in the capital ratio – for firm's currently within that capital framework, with the exception of applying the requirement to reflect unrealized losses and gains on certain securities and other aspects of AOCI. GSIBs and other internationally active banks would be subject to the most stringent set of requirements as may be re-proposed (e.g., the re-proposal would (i) no longer adjust a firm's operational risk charge based on its operational loss history, (ii) reduce operational risk capital requirements for investment management activities to reflect smaller historical operational losses, (iii) extend the reduced risk weight for low-risk corporate exposures to certain regulated entities that a bank judges to be investment grade but which are not publicly traded).

- *Insights*. As signaled by Vice Chair for Supervision Barr, the changes are potentially significant, particularly for non-GSIBs, and reflect an understanding across agency leadership of the potentially broad and significant unintended consequences of the proposals. Thus far, no re-proposal has been issued, with some media reports citing competing objections to any re-proposal from members of the FDIC Board of Directors resulting in any re-proposal not having sufficient votes in support. The re-proposal would also delay any final rule until after the election, putting its path to finality at risk if there is a change in the administration. Any final rulemaking also potentially remains subject to legal challenge.

FDIC Proposes Deposit Insurance Recordkeeping Rule for Banks' Third-Party Accounts. On September 17, 2024, the FDIC issued a proposed rule that would establish new recordkeeping requirements at insured depository institutions (IDIs) for "custodial deposit accounts with transactional features." The proposal would define a "custodial deposit account with transactional features" as a deposit account that meets three requirements: (1) the account is established for the benefit of beneficial owner(s); (2) the account holds commingled deposits of multiple beneficial owners; and (3) a beneficial owner may authorize or direct a transfer through the account holder from the account to a party other than the account holder or beneficial owner. IDIs holding deposits in such accounts would be required to maintain records identifying (i) the beneficial owners of those deposits, (ii) the balance attributable to each beneficial owner, and (ii) the ownership category in which the deposits are held. IDIs that hold such accounts would be required to establish and maintain written policies and procedures and complete an annual certification of compliance that the IDI has implemented and tested compliance with the rule's recordkeeping requirements. IDIs also would be required to complete an annual report that (1) describes any material changes to information technology systems relevant to compliance with the rule; (2) lists account holders that maintain such accounts, the total balance of those custodial deposit accounts, and the total number of beneficial owners; (3) sets forth the results of the institution's testing of its recordkeeping requirements; and (4) provides the results of the required independent validation of any records maintained by third parties. Comments on the proposal will be due 60 days from the date of publication in the *Federal Register*.

- *Insights*. Although by its nature a recordkeeping rule, the proposal, if finalized substantially as proposed, could require significant compliance uplifts for IDIs and their third-party partners. For example, an IDI could maintain account records itself or through a direct contractual arrangement with a third party. To do so through a third party, the IDI would be required to (1) have direct, continuous, and unrestricted access to the records, (2) have continuity plans, including backup recordkeeping, (3) implement internal controls

to (i) accurately determine the respective beneficial ownership interests associated with the accounts and (ii) conduct reconciliations against the beneficial ownership records *no less frequently than as of the close of business daily*, and (4) have a contractual arrangement that would (i) define roles and responsibilities for recordkeeping and (ii) require periodic validation of the third party's records by a person independent of the third party.

OTHER NOTABLE ITEMS

Speech by Governor Michelle Bowman on the Future of Stress Testing and the Stress Capital Buffer Framework. On September 10, 2024, Governor Michelle W. Bowman gave a speech titled "The Future of Stress Testing and the Stress Capital Buffer Framework." In her speech, Governor Bowman highlighted the value of stress testing on bank safety and soundness and financial stability, her concerns about the current implementation of the stress test, and the need for a "fundamental rethink and strategic reform of stress testing." Governor Bowman then shared four principal issues—volatility, the link between stress testing results and capital and the short capital implementation compliance time frame, the lack of transparency, and the overlap between the global market shock in stress testing with the market risk test of Basel III—that should be "addressed" and "prioritized" in the "ongoing evolution of the stress testing framework and stress capital buffer requirements."

FDIC, Federal Reserve and OCC Extend Comment Period on RFI on Bank-Fintech Arrangements. On September 13, 2024, the federal bank regulatory agencies announced they will extend until October 30, 2024 the comment period on the request for information on bank-fintech arrangements involving banking products and services.

Federal Reserve Board Requests Comment Around Operational Practices of the Discount Window. On September 9, 2024, the Federal Reserve issued a request for information and comment regarding the operational uses of the Discount Window and intraday credit. In particular, the request solicits feedback regarding the collection of legal documentation, processes associated with pledging and withdrawing collateral, processes associated with requesting, receiving, and repaying discount loans, intraday credits and Federal Reserve communication practices. Comments on the request are due by December 9, 2024.

CFPB Proposes Amendment to Remittance Transfer Rule. On September 20, 2024, the Consumer Financial Protection Bureau (CFPB) proposed amendments to the Remittance Transfer Rule concerning disclosure requirements associated with certain international remittances. Specifically, the proposed amendment would require clearer disclosures about the kinds of inquiries that should first be submitted to the remittance provider before contacting the CFPB or applicable state regulator. Comments on the proposed rule are due by November 4, 2024.

CFPB Publishes Guidance on Overdraft Fees Highlighting the Importance of Obtaining and Retaining Client Affirmative Consent to Opt-in. On September 17, 2024, the CFPB published guidance directed at state and federal consumer protection agencies concerning overdraft fees based on "phantom opt-in arrangements" which, according to the published guidance, occur when financial institutions assert they have customer consent to charge overdraft

fees but there is no proof they obtained such consent. The thrust of the guidance emphasizes that the Electronic Funds Transfer Act and its counterpart Regulation E are violated if overdraft fees are charged without proof of affirmative consent to enroll in services involving overdraft fees. In its press release announcing the guidance, the CFPB encourages regulators to “assume consumers have not opted into overdraft unless the banks can prove otherwise.”

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Gibson Dunn’s lawyers are available to assist in addressing any questions you may have regarding the issues discussed in this update. Please contact the Gibson Dunn lawyer with whom you usually work or any of the member of the Financial Institutions practice group:

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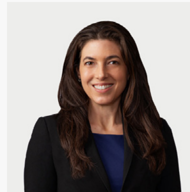

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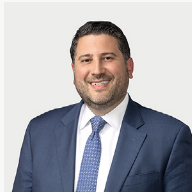

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