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Upcoming Uptick in Bank M&A Activity?

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On March 14, 2018, the U.S. Senate approved the Economic Growth, Regulatory Relief and Consumer Protection Act, a bipartisan bill that would repeal or modify certain provisions of the Dodd-Frank Act and eliminate or ease a number of regulatory burdens on superregional, regional and large community banks. Under the act, which was adopted in 2010, bank holding companies (BHCs) with more than $50 billion in total consolidated assets were deemed systemically important financial institutions (SIFIs) and were made subject to stricter oversight and more burdensome regulatory requirements, including the Federal Reserve Board's enhanced prudential standards. The Senate's proposed legislation, which would have to be approved by the House of Representatives before being signed into law by President Donald Trump, would increase the total assets threshold for BHC SIFI designation from $50 billion to $250 billion and would relax certain reporting and supervision requirements applicable to banks with total assets of less than $10 billion. With the expectation of lower compliance costs and more flexibility in managing capital, many of the BHCs benefiting from this legislation can be expected to take a renewed interest in M&A as a means of enhancing shareholder value.

The Act

Under the proposed legislation, BHCs with less than $100 billion in total consolidated assets immediately would be exempt from supervisory stress testing and other enhanced regulatory requirements. BHCs with assets between $100 billion and $250 billion would continue to be subject to supervisory and company-run stress testing and other enhanced regulatory requirements for up to 18 months following enactment of the legislation, after which they would remain subject to periodic supervisory stress tests and the Federal Reserve's discretion to impose enhanced regulatory requirements on an individual case basis.

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Federal Reserve Chairman Jerome H. Powell has indicated that the Federal Reserve would issue a notice of proposed rulemaking regarding application of prudential standards to BHCs with between $100 billion and $250 billion in assets, but also stated that the new legislation would in no way restrict the Federal Reserve's authority to apply enhanced prudential standards to BHCs in this asset category when appropriate. Any BHC, regardless of asset size, that has been identified as a global systemically important BHC will remain subject to the enhanced prudential

standards. The legislation also is not intended to exempt foreign banking organizations with total global assets of $250 billion or more from the enhanced prudential standards.

Potential Effects for BHCs Over $50 Billion in Assets

Raising the SIFI threshold to $250 billion would immediately remove 15 BHCs from the SIFI designation, although the majority of those institutions would remain subject to enhanced prudential standards for up to 18 months following enactment. These BHCs would appear to be most positively affected by the legislation, as immediately upon enactment, BHCs with less than $100 billion in assets would no longer be subject to any supervisory or company-run stress tests, or any of the enhanced prudential standards applicable to SIFIs (other than risk committee requirements, which will continue to apply to publicly traded BHCs with $50 billion or more in assets). BHCs with over $100 billion in assets would no longer automatically be subject to company-run stress tests or any of the enhanced prudential standards (other than risk committee requirements) following the 18-month transition period or earlier receipt of a relief order from the Federal Reserve.

To the extent that over time the market rewards these companies with higher trading values as a result of the relaxed regulatory burdens and reduced compliance and capital costs, they should be in a better position to generate M&A opportunities that are attractive from a financial standpoint both for themselves and their counterparties. In addition, in recent years, a number of BHCs in this asset category have been willing and able to participate in the M&A market but have been reluctant to acquire other BHCs not also subject to Dodd-Frank stress testing requirements. With company-run stress test requirements removed for all BHCs with less than $100 billion in assets immediately upon enactment of the bill and for BHCs with assets between $100 billion and $250 billion following the 18-month transition period, this concern should be eliminated in most situations.

Competing Factors

Several competing factors should continue to dampen the prospect of a more widespread wave of M&A activity involving these larger BHCs in the near term, however. These factors include lingering effects of other types of stricter regulatory scrutiny imposed on larger BHCs in the wake of the financial crisis, which will continue to keep a number of them on the M&A sidelines in the short term. Some of these companies are subject to regulatory orders and ongoing remediation obligations relating to deficiencies in their compliance infrastructure, in particular regarding compliance functions surrounding anti-money laundering and the Bank Secrecy Act, as well as consumer finance compliance. Such issues generally prohibit these companies from making substantial expansionary acquisitions or investments, which also reduces the universe of potential BHC buyers in the bank M&A market.

In addition, larger banking organizations have been forced to reconsider the value of their brick-and-mortar banking franchises because of advances in technology affecting the manner in which many banking and payments services can be delivered, as well as an increasing generational shift toward alternative delivery of banking services, such as online banking and payment methods. Banking institutions have been forced to more actively evaluate and pursue opportunities for acquiring or investing in, or partnering with others who can provide, technological platforms that can help them keep pace with these developments. Indeed, many of

the largest banking institutions are actively rationalizing their branch office networks, eliminating branches that they can determine to be less profitable. For this reason, multistate or regional banking franchises with broad branch banking footprints may not command the same valuations and buyer interest as they have historically.

Potential Effects for BHCs Between $10 Billion and $50 Billion in Assets

The higher SIFI threshold may impact bank M&A activity most significantly by removing the additional regulatory burdens that BHCs now immediately face when considering a transaction that would cause them to cross the $50 billion asset threshold. There are close to 70 BHCs with between $10 billion and $50 billion in total assets, and M&A activity involving these BHCs very likely will get the biggest boost from the legislation. In recent years, very few transactions have involved two BHCs each under $50 billion in assets merging to form a combined company north of the $50 billion asset threshold, and those few that were announced were met with significantly negative market reaction. Astoria Financial Corporation's proposed merger into New York Community Bancorp, which would have pushed New York Community over the $50 billion asset mark, was abandoned, and Astoria ultimately was sold to Sterling Bancorp, which at roughly $30 billion in assets remains well below the $50 billion threshold. And CIT Group's acquisition of OneWest Bank, which at closing resulted in a combined BHC with approximately $65 billion in assets, was met with substantial negative investor reaction. Eliminating the prospect of immediate increased regulatory burdens and compliance costs for BHCs that cross the $50 billion asset threshold on a combined basis should permit potential M&A transactions in this category to be evaluated more purely on the basis of their business merits, which should result in more such deals being pursued going forward.

Whatever the near-term effects on bank M&A activity may be, the proposed banking reform legislation confirms that the banking industry has entered a phase of deregulation, which in the long run can only be a positive development for BHCs that view the M&A market as one important means of enhancing shareholder value.