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Monthly Bank Regulatory Report (March 2024)

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From the Financial Institutions Practice Group: *We are pleased to provide you with the first edition of Gibson Dunn's monthly U.S. bank regulatory update. This monthly update will analyze legal, regulatory and policy developments in the banking industry in the United States and provide insights into how those developments impact and shape the industry.* **FDIC Proposes Revised Statement of Policy on Review of Bank Merger Transactions** On March 21, 2024, the Federal Deposit Insurance Corporation (FDIC) approved a *Federal Register* notice seeking comment on proposed updates to the FDIC's Statement of bank merger applications subject to FDIC approval under the Bank Merger Act. The proposed Statement of Policy 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 Bank Merger Act to merger transactions, including mergers in substance, involving an insured depository institution and any non-insured entity, and would revise how the FDIC evaluates various statutory factors under the Bank Merger Act, including competition, convenience and needs, financial stability, and financial and managerial resources. Comments on the proposal will be due 60 days from the date of publication in the *Federal Register*.

- **Insights:** The FDIC's proposed policy statement follows closely in time the Office of the Comptroller of the Currency's (OCC) proposal to adopt a new policy statement summarizing the OCC's approach to reviewing proposed bank merger transactions under the Bank Merger Act. Like the OCC's proposed policy statement, the FDIC's proposal provides no clarity as to the FDIC's timing expectations for its review and approval of Bank Merger Act applications. Although Acting Comptroller Michael J. Hsu says in his statement in support of the FDIC's proposal that it "is broadly consistent with the proposed policy statement issued by the OCC in January," the two proposals differ in several ways. Notably, contrary to current practice, the proposed policy statement contemplates that the FDIC Board of Directors may release a statement regarding its concerns with any transaction for which a Bank Merger Act application has been withdrawn "if such a statement is considered to be in the public interest for purposes of creating transparency for the public and future applicants."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 proposed policy statement provides that the FDIC may require divestitures to mitigate competitive concerns before allowing a merger to be consummated, a departure from historical precedent. A divestiture could itself require a separate Bank Merger Act approval, thus delaying significantly the merger transaction. Although the FDIC would not use conditions "as a means for favorably resolving any statutory factors that otherwise present material concerns" (as the OCC would), the FDIC would approve applications subject to standard and non-standard conditions pertaining to capital requirements and other factors.The proposed statement of policy would revise how the FDIC evaluates the statutory factors for a Bank Merger Act application, in certain instances seemingly beyond the statutory factor on its face—as raised by FDIC Director Jonathan McKernan in his statement in opposition of the proposal.
    - On competition, the proposal would deemphasize 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

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"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 proposal 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.

- On convenience and needs, the proposed policy statement 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 forward-looking information to the FDIC" for purposes of evaluating the statutory factor, and the FDIC would expect to require "commitments regarding future retail banking services in the community to be served for at least three years following consummation of the merger." Job losses or lost job opportunities from branching changes "will be closely evaluated."
- On the financial and managerial resources factors, the FDIC would "not find favorably … if the merger would result in a weaker IDI from an overall financial perspective" and would assess "existing or pending enforcement actions," and "issues or concerns with regard to specialty areas, including information technology and cybersecurity."

Like the OCC's proposed policy statement, the FDIC's proposed policy statement focuses in part on large bank mergers, highlighting that the agency would generally expect "to hold a hearing for any application resulting in an IDI with greater than $50 billion in assets or for which a significant number of CRA protests are received." It also states that transactions that result in a large institution (e.g., in excess of $100 billion) "will be subject to added scrutiny." (Currently, only four nonmember banks or industrial banks have total assets of $100 billion or more.)

Comments Due April 15, 2024 on OCC's Proposed Bank Merger Act Approval Requirements

On January 29, 2024, the Office of the Comptroller of the Currency (OCC) issued a notice of proposed rulemaking that would adopt a new policy statement summarizing the OCC's approach to reviewing proposed bank merger transactions under the Bank Merger Act and make two substantive changes to its business combination regulation (12 C.F.R. § 5.33). In his speech previewing the proposed rule, Acting Comptroller Michael J. Hsu described the policy statement as laying down "chalk lines" demarcating among three groups of merger applications along a spectrum: those that are "straightforward"; those that have "significant deficiencies"; and the majority which "lie somewhere in between." The proposed policy statement would set forth thirteen (13) indicators that bank merger applications that "are consistent with approval" would generally include and six (6) indicators, any one of which would raise "supervisory or regulatory concerns" favoring denial or a request to withdraw unless "adequately addressed or remediated." The proposed rule would remove the expedited review procedures and the streamlined Bank Merger Act application form. Comments on the proposal are due by April 15, 2024.

- **Insights:** The proposed policy statement provides no clarity as to the OCC's timing expectations for its review and approval of Bank Merger Act applications. In his remarks previewing the proposal, Acting Comptroller Hsu noted only that applications including the thirteen (13) indicators in favor of approval—and presumably none of the indicators in favor of denial or withdrawal—would be "consistent with timely approval." It also does not speak to mergers that include most, but not all, of the factors in favor of approval and none of the factors in favor of denial or withdrawal, which presumably will be subject to enhanced scrutiny.The policy statement includes a bias against size and mergers of equals. The list of thirteen (13) indicators favoring approval includes (i) the "resulting institution will have total assets less than $50 billion" and (ii) the "target's combined total assets are less than or equal to 50% of acquirer's total assets" and the list of six (6) indicators favoring denial or withdrawal includes that the "acquirer is a global

systemically important banking organization, or subsidiary thereof." The policy statement also notes that a resulting institution with $50 billion or more in total assets would "inform[] the OCC's decision on whether to hold public meetings." The 50% of assets factor presumably would result in bank mergers of equals being subject to enhanced scrutiny, including even small community bank mergers of equals. In addition, "multiple acquisitions with overlapping integration periods" is viewed unfavorably, which could negatively impact community bank roll-up strategies.In his remarks, Acting Comptroller Hsu also noted the "need to develop modes of analysis for banking competition that go beyond retail deposits as a proxy for market power," though the policy statement does not propose any new antitrust guidance or modify the OCC's review of competitive factors, which Hsu said is "ongoing" with the Department of Justice. Finally, it is unclear whether the Federal Reserve or FDIC would propose similar guidance for those agencies' review of applications pursuant to the Bank Merger Act or the Federal Reserve's review of holding company merger applications pursuant to Section 3 of the Bank Holding Company Act.

Powell Testimony – "broad and material changes" coming to Basel III proposal and "nowhere near" development of CBDC On March 7, 2024, Chair of the Federal Reserve Board (Federal Reserve) Jerome Powell testified before the U.S. Senate Committee on Banking, Housing and Urban Affairs as part of his mandated semiannual discussion of the Monetary Policy Report. In response to questions regarding the proposed Basel III endgame reforms, Powell addressed the opposition to the proposed rule, noting that the Federal Reserve "hear[s] the concerns" and that Powell "expect[s]" there will be broad material changes to the proposed rule, going so far as to not rule out "re-propos[ing] parts or all of the thing." Separately, in response to questions regarding the Federal Reserve's exploration of a central bank digital currency (CBDC), Powell responded by stating that the Federal Reserve is "nowhere near recommending, let alone adopting" a CBDC in any form.

- **Insights:** With respect to the adoption of the Basel III endgame reforms, Chair Powell appears to be signaling a willingness to reconsider such proposals (or certain aspects thereof) in a meaningful way in the wake of the significant opposition. Consistent with the Federal Reserve's general skepticism of digital- and tokenized-assets, the Federal Reserve appears unwilling to consider the issuance of an on-chain CBDC at this time, creating market opportunities for other issuers (particularly stablecoin issuers) to capitalize on the market's desire for fiat-backed stablecoins that enable faster payments through immediate settlement.

FDIC Vice Chairman Travis Hill Speech on Tokenization On March 11, 2024, Vice Chair Travis Hill gave a speech titled, "*Banking's Next Chapter? Remarks on Tokenization and Other Issues*" at the Mercatus Center. The prepared remarks focused specifically on tokenization, or the "representation of 'real-world assets' on a distributed ledger, including, but not limited to, commercial bank deposits, government and corporate bonds, money market fund shares, gold and other commodities, and real estate." Vice Chair Hill lauded the potential benefits that tokenization offers, including 24/7/365 operations, programmability, "atomic settlement, or the simultaneous exchange and settlement of payment and delivery…" and immutability, while also highlighting associated risks that could develop and challenges to development, including increased speed and intensity of bank runs, interoperability and legal uncertainty. The Vice Chair then addressed regulatory challenges, namely the need for effective guidance that provides banks with clear answers on questions like when tokenized deposits differ from traditional deposits and "crypto."

- **Insights:** Vice Chair Hill's remarks tend to counteract the "general public perception that the FDIC is closed for business" when it comes to blockchain or distributed ledger technology by offering clear thoughts and proposals on future regulation and guidance. Vice Chair Hill recognizes that experimentation and testing, particularly in areas with no material risk, is neither harmful nor requires a lengthy approval process, and cautions that an overly restrictive approach

historically could have stifled development of credit cards in the U.S., which was initially “disastrous” but soon after, “revolutionize[d] how millions of Americans pay for things.” These remarks illustrate Vice Chair Hill’s desire to foster greater innovation in banking.Vice Chair Hill also advocated for a more formal regulatory approach to certain bank-friendly approaches, and signaled disapproval of other approaches, indicating disagreement on both process and substance between the FDIC and other regulators. Specifically, Vice Chair Hill embraced a more formalized rulemaking approach over the “bank-by-bank approval process” if the FDIC decides that tokenized deposits differ from traditional deposits, and urged agencies to “distinguish between ‘crypto’ and the use by banks of blockchain and distributed ledger technologies” that are merely “a new way of recording ownership and transferring value.” He contrasted these positions with those taken by the Securities and Exchange Commission (SEC) in issuing Accounting Bulletin 121 (SAB 121), which Vice Chair Hill criticized for making it “prohibitively challenging for banks to engage in [crypto-asset] activity at any scale” and failing to distinguish between “blockchain-native assets” and “tokenized versions of real-world assets.” He also cited the SEC’s approach in SAB 121 as “a clear example of why it is generally constructive for agencies to seek public comment before publishing major policy issuances,” further indicating his preference for industry collaboration and input.

CFPB Issues Final Rule on Credit Card Late Fees On March 5, 2024, the Consumer Financial Protection Bureau (CFPB) issued a final rule governing late fees charged by “Larger Card Issuers” (those with one million or more open credit card accounts). The final rule effectively caps the amount such Larger Card Issuers can charge in late fees at $8 per incident, subject to an exemption for fees to cover a portion of actual collection costs. The rule also eliminates the automatic annual inflation adjustments to allowable fees, providing instead that the CFPB will “monitor the market” and adjust the $8 threshold as necessary. Notably, the final rule actually increases the amount smaller card issuers can charge in late fees, from $30 to $32 for initial violations, and from $41 to $43 for subsequent violations. The final rule has an effective date of May 14, 2024.

- **Insights:** The final rule will create challenges for issuers, including operationalizing changes resulting from the final rule, amending cardholder agreements, customer disclosures, and more broadly, marketing materials, and issuing any required change in terms notices or adverse action notices to customers resulting from changes to customer terms arising from the final rule. The final rule also will not permit issuers to recover full collection costs or take into account deterrence or consumer conduct, factors Congress expressly directed the CFPB to consider. On March 7, 2024, just two days after the final rule was announced, a coalition of industry trade groups filed suit, challenging the rule on multiple grounds. The trade groups argue, among other things, that the rule violates the CARD Act, the Dodd-Frank Act, the Administrative Procedure Act, and the Truth in Lending Act. As noted, the final rule has an effective date of May 14, 2024, subject to the current litigation which may impact the final rule’s effective date.

Federal Reserve Governor Bowman Speaks on Tailoring On March 5, 2024, Federal Reserve Governor Michelle W. Bowman gave a speech titled “*Tailoring, Fidelity to the Rule of Law, and Unintended Consequences*.” In her speech, Governor Bowman states that tailoring, being the setting of regulatory priorities and allocation of supervisory resources in a risk-based manner, ensures a focus on the most critical risks over time, avoiding the over-allocation of resources or imposition of unnecessary costs on the banking system. Governor Bowman further claimed that “the current regulatory agenda includes many … regulatory reform proposals [that] lack sufficient attention to regulatory tailoring and thereby fail to further statutory directives to tailor certain requirements and, more importantly, to address the condition of the banking system.” Governor Bowman cites both the pending Basel III endgame reforms and the final climate guidance as regulatory actions that deviate from the principle of tailoring.

- **Insights:** Governor Bowman's speech on tailoring is not net-new for her, following on her January 2024 speech to the South Carolina Bankers Association, in which she called for a "renewed commitment to [the Federal Reserve's] Congressionally mandated obligation to tailoring." In making this call for a renewed commitment to tailoring, Governor Bowman notes "all banks are affected when policymakers shift away from or deemphasize tailoring. When we fail to recognize fundamental differences among firms, there is a strong temptation to continually push down requirements designed and calibrated for larger and more complex banks, to smaller and less complex banks that cannot reasonably be expected to comply with these standards."In expanding on her prior critique of Basel III, in her March 5th speech, Governor Bowman stated that "the federal banking agencies have proposed several reforms to the capital framework, among them the Basel III 'endgame' and new long-term debt requirements that would apply to all banks with over $100 billion in assets. I have expressed concern with both of these proposals on the merits, in terms of striking the right balance between safety and soundness and efficiency and fairness, and out of concern for potential unintended consequences. Another concern is whether these proposals show fidelity to the law, which requires regulatory tailoring above the $100 billion asset threshold."

Federal Reserve Governor Bowman Speaks on Bank Regulation On March 7, 2024, Federal Reserve Governor Michelle W. Bowman gave a speech titled "*Reflections on the Economy and Bank Regulation*," in which she shared her thoughts on monetary policy, the economy, and the path of regulatory reform. In the speech, Governor Bowman made several key observations: (1) regulatory reforms within bank mergers and acquisitions should prioritize speed and timeliness; (2) when considering new liquidity requirements, the Federal Reserve must consider not only calibration and scope, but also the unintended consequences of such requirements; and (3) the Federal Reserve must manage its supervisory programs and teams to ensure effective and consistent supervision.

- **Insights:** Governor Bowman states that to accomplish these goals, the Federal Reserve should aim to conduct supervision "in a manner that respects due process and provides transparency around supervisory expectations." Due process, transparency, calibration of supervision, and the communication of supervisory expectations are consistent themes of Governor Bowman as it relates to proper oversight and supervision by regulators. As it relates to current bank M&A procedures and policies, a footnote in Governor Bowman's speech directs readers to provide feedback through the recently launched mandatory review of regulatory burdens under the Economic Growth and Regulatory Paperwork Reduction Act of 1996.

The following Gibson Dunn attorneys contributed to this issue: Jason Cabral, Rachel Jackson, Zach Silvers, Karin Thrasher, Andrew Watson, and Nathan Marak. 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, any member of the firm's Financial Institutions or Global Financial Regulatory practice groups, or the following: Jason J. Cabral, New York (212.351.6267, jcabral@gibsondunn.com) Stephanie L. Brooker, Washington, D.C. (202.887.3502, sbrooker@gibsondunn.com) M. Kendall Day, Washington, D.C. (202.955.8220, kday@gibsondunn.com) Jeffrey L. Steiner, Washington, D.C. (202.887.3632, jsteiner@gibsondunn.com) Sara K. Weed, Washington, D.C. (202.955.8507, sweed@gibsondunn.com) Ella Capone, Washington, D.C. (202.887.3511, ecapone@gibsondunn.com) Rachel Jackson, New York (212.351.6260, rjackson@gibsondunn.com) Chris R. Jones, Los Angeles (212.351.6260, crjones@gibsondunn.com) Zack Silvers, Washington, D.C. (202.887.3774, zsilvers@gibsondunn.com) Karin Thrasher, Washington, D.C. (202.887.3712, kthrasher@gibsondunn.com)

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