May 15, 2021

Federal Reserve Consideration of Bank Merger Proposals

Fed Governors Comment on Framework for Consideration of Large Bank Merger Proposals in Connection With Approval of PNC's Proposed Acquisition of BBVA USA

The Federal Reserve Board on Friday approved the application under Section 3 of the Bank Holding Company Act of 1956 (the "BHC Act") by The PNC Financial Services Group, Inc. ("PNC") to acquire BBVA USA Bancshares, Inc. ("BBVA USA").[1] The individual statements issued by two of the Governors (Vice Chair for Supervision Quarles, who voted to approve, and Governor Brainard, who abstained) regarding the approval may indicate some divergence among the Governors in their thinking about large bank mergers and the framework for their evaluation under the BHC Act.

The acquisition by PNC (the 12th largest US insured depository organization, with approximately $467 billion in assets) of BBVA USA (the 40th largest US insured depository organization, with approximately $103 billion in assets) is the largest merger in the US banking industry since the merger of SunTrust and BB&T Financial, which created Truist Financial in 2019. After the merger, PNC will be the seventh largest US bank holding company.

In evaluating a merger proposal, Section 3 of the BHC Act, 12 U.S.C. section 1842, requires the Federal Reserve Board to consider a number of factors, which include the financial and managerial resources of the acquirer and combined company, the convenience and needs of the communities served by the merging organizations and effects the merger could competition in the relevant markets. An approach for these analyses has been developed by the Federal Reserve in its regulations implementing the BHC Act, 12 C.F.R. Part 225, and in numerous orders considering merger proposals.

The Dodd-Frank Wall Street Reform and Consumer Protection Act added as a factor to be considered in merger proposals the effects on the stability of the US banking or financial system. The financial stability factor has been seen as critical to the feasibility of combinations between the largest banking organizations, as these are the most likely situations to raise systemic concerns. To assess the likely effect of a proposed transaction on financial stability, the Federal Reserve Board has established an approach under which it considers a variety of metrics designed to capture the systemic "footprint" of the combined organization and the incremental effect of the transaction on the systemic footprint of the acquiring institution.[2] The analysis of the PNC proposal, as reflected in the approval order, was fairly straightforward and consistent with Federal Reserve Board precedent.

In this light, the most striking aspect of the PNC/BBVA USA approval was not the decision itself, or anything contained in the Federal Reserve Board's order discussing the basis for the approval, but rather the separate, short statements issued by Vice Chair for Supervision Quarles and Governor Brainard. Vice Chair Quarles explained that his support of the decision was a function of the merger evaluation framework given to the Federal Reserve by Congress. Governor Brainard appeared to suggest that a review of the "framework" might be in order, although it is not clear whether her comment is specifically directed at the Congressional framework, the Federal Reserve's own framework developed under Section 3, or both.

In his statement Vice Chair Quarles referred to the "merger approval framework *given to us* by Congress." (emphasis added) "In light of [this] framework," he voted to approve the PNC Financial/BBVA transaction, seeing "improved financial stability, greater competition in the financial system, and the firm's strong performance in support of its communities."

In her separate statement, Governor Brainard referenced the "increases in banking concentration in the $250 to $700 billion asset size category."[3] She goes on to express the view that "common-sense safeguards have been weakened" with regard to these organizations and that "it might be helpful to undertake a broader review of *our framework*, since we know from experience even noncomplex banks in this size range can pose risk to the financial system when they encounter financial distress." (emphasis added) As noted above, Governor Brainard abstained from the vote to approve the proposed merger, which is a step she did not take in the SunTrust/BB&T merger.

We believe that these two statements are of particular importance as (1) Mr. Quarles' term as Vice Chair for Supervision is set to end in October and there will almost certainly be other changes in the composition of the Board and (2) some influential Democratic members of Congress have expressed skepticism towards bank consolidation. Therefore, Governor Brainard's suggestion that the framework be reevaluated might have a receptive audience, whether it be in Congress (in respect of a Congressionally established framework) or on a future Federal Reserve Board (in respect of the Board's own framework).

*   *   *

ENDNOTES

[1] Sullivan & Cromwell LLP represents BBVA USA and its parent company in connection with the proposed transaction.

[2] As noted in the approval order and in Vice Chairman Quarles' statement, the Federal Reserve Board also considered whether the proposed merger would provide any stability benefits and whether prudential standards applicable to the combined organization would offset any potential risks.

[3] There are currently 15 US bank holding companies in that category, $250 billion in assets being the size at which the Federal Reserve must apply "enhanced prudential standards".

ABOUT SULLIVAN & CROMWELL LLP

Sullivan & Cromwell LLP is a global law firm that advises on major domestic and cross-border M&A, finance, corporate and real estate transactions, significant litigation and corporate investigations, and complex restructuring, regulatory, tax and estate planning matters. Founded in 1879, Sullivan & Cromwell LLP has more than 875 lawyers on four continents, with four offices in the United States, including its headquarters in New York, four offices in Europe, two in Australia and three in Asia.

CONTACTING SULLIVAN & CROMWELL LLP

This publication is provided by Sullivan & Cromwell LLP as a service to clients and colleagues. The information contained in this publication should not be construed as legal advice. Questions regarding the matters discussed in this publication may be directed to any of our lawyers or to any Sullivan & Cromwell LLP lawyer with whom you have consulted in the past on similar matters. If you have not received this publication directly from us, you may obtain a copy of any past or future publications by sending an e-mail to SCPublications@sullcrom.com.