Will Changing M&A Regulations Affect Your Strategy?

regulatory Mergers and Acquisitions

Summary: With July’s executive order to review and likely modify M&A regulations, the Federal Reserve, FDIC, and OCC are beginning to review the current process for bank mergers. While this is still in its early stages, we evaluate how this development could affect the M&A strategies of community financial institutions.

Starting in the ninth century BC, feng shui is the ancient Chinese practice of balancing people with their environments. Feng means wind and shui means water. This idea originates from an ancient poem that tells us that human life is linked to its surroundings. Harmony is the ultimate goal in feng shui.

The bank merger and acquisition (M&A) environment hasn’t always been harmonious. So, last summer, President Biden issued an Executive Order urging regulators to reassess the current M&A process. With this focus, M&A regulations are likely to be revamped in some way, shape, or form. How this could impact community financial institutions (CFIs) is still unclear, yet CFIs should be mindful of what is eventually coming down the pike.

In July 2021, President Biden issued an Executive Order prompting “*a whole-of-government effort*” to reduce “*the trend of corporate consolidation*” and increase competition in many sectors of the US economy, including banking. As part of this, the Executive Order “encourages” the DOJ, Federal Reserve, FDIC, and OCC to more robustly scrutinize bank mergers.

“*Excessive consolidation raises costs for consumers, restricts credit for small businesses, and harms low-income communities,*” the order states. “*Branch closures can reduce the amount of small business lending by about 10% and lead to higher interest rates.*”

First step has been taken

This March, the FDIC was the first regulatory agency to make a move when it issued a Request for Information (RFI) on potential changes, with comments due May 31st. Some of the questions include whether the existing regulatory framework properly assesses financial stability risk, as well as the convenience and needs of all impacted communities, and if not, what additional requirements should be included in the framework. There is also a question on whether the CFPB should be able to weigh in. Overall, is the current burden of proof required by regulators adequate to determine whether a potential acquisition complies with the Bank Merger Act or should the burden of proof be strengthened?

One industry analyst said: “*To us, changing the burden of proof would be significant. At a minimum, it likely would delay mergers as companies would need to do more than answer questions from regulators. They would have to demonstrate compliance.*”

The FDIC also posed questions specific to small institutions, including whether M&A regulations should be different for such institutions. If yes, why, how so, and what should the asset threshold be. These are areas being explored further. Since CFIs have fewer resources to manage regulatory compliance tasks, it could be difficult for many of them to consider M&A in the future with higher regulatory expectations, even if this is the best path for future success. If your institution has strong opinions on the matter, make sure you chime in before May 31st to have your opinions heard.

Impact on CFI's M&A strategies

Keep going. Industry experts aren't clear whether CFIs would be impacted by regulatory changes by any agency. It is too early to tell. Still, CFIs should nevertheless be mindful of any new updates and how they could eventually impact them down the line. For now, it's still full speed ahead for those institutions that are ready, before any changes are implemented.

"*We expect small and mid-sized regional banks to continue to announce new deals despite growing regulatory scrutiny that could result in delayed closings or even the potential termination of deals,*" writes one ratings agency. "*To the extent an announced transaction is delayed, deals can lose momentum and waste firms' time and resources, often at the expense of strategic plans and long-term goals. Failed mergers could also reduce potential earnings and ratings upside and may exacerbate key-person risk, if management or staff seek opportunities elsewhere.*"

Wait and grow organically. Alternatively, however, some CFIs may be more cautious and choose to take a different route, while they wait for the regulators to refine the details around M&A regulations. As it already is, regulatory approval for M&A deals in the last 12 months has taken over almost 5 months, according to S&P Global Market Intelligence. Furthermore, M&A deal prices could become too competitive, shrinking premiums for those looking to acquire. Of course, this would require a different growth strategy and additional efforts to expand organically.

Says another industry analyst: "*Faced with any material reduction in merger premiums, or the possible absence of a merger of equals or acquisition by a larger bank, banks with the necessary vision, capital, and personnel may decide to remain independent by growing organically with new products and services, relocating operations to growing markets, cherry-picking compatible acquisitions in desirable markets, or establishing strategic partnerships to offer white label banking products and services to companies with large customer bases.*"

While the details unfold on the executive order, many financial institutions will continue to view M&A as an option for growth, diversification, and profitability. Yet, watching the developments of M&A regulations will be important in assessing M&A risk, as regulatory scrutiny could tighten even for CFIs. We will keep you updated as these developments progress.

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ECONOMY & RATES

Rates As Of: 05/13/2022 10:45AM (GMT-0700)

Treasury	Yields	MTD Chg	YTD Chg

3M	0.96	0.11	0.90
6M	1.44	0.03	1.25
1Y	2.00	-0.10	1.61
2Y	2.62	-0.10	1.88
5Y	2.90	-0.06	1.63
10Y	2.93	-0.01	1.42
30Y	3.09	0.09	1.18

FF Market	FF Disc	IORB
0.83	1.00	0.90
SOFR	**Prime**	**OBFR**
0.79	4.00	0.82