

Sensible Rigor Makes a Comeback in Bank M&A

BPI Staff | May 7, 2025

Introduction

Capital One Financial Corp. recently obtained federal approval to acquire Discover Financial Services. While the process took 14 months, the eventual approval suggests that federal regulators may have ended their unspoken moratorium on allowing mergers above some unspecified size, even when those mergers were fully consistent with law.

For many years, bank deals have languished, and potential deals chilled. Part of that chill came from uncertainty about whether regulators would approve any deal, regardless of merit, and concern that a multi-year wait for approval would result in the unraveling of the target. More directly – more hard freeze than chill – bank regulators have adopted an opaque supervision regime whereby a low Management rating – which could be the result of any examiner complaint about the acquiror or target – is an effective bar to a merger. So, too, any low consumer compliance or AML rating, or even in some cases just unresolved compliance issues. This regime has no statutory or regulatory basis, but with two-thirds of large banks rated unsatisfactory for purported governance and controls issues, the majority of large banks would be blocked from doing any deal.

Adding insult to injury, a myth persists that regulators in the past have rubber-stamped mergers and plan to do so again. Even when it is working well, the process for obtaining bank merger approval is a long and unduly complex one – unlike that imposed on any other industry. That process has also created an industry of protesters who can threaten delay if its demands are not met; regulators have abetted this tactic by putting protested applications on a very different track than ones where protesters' demands are met.

The Capital One approval is a sign of life in a system long plagued with long timelines, uncertain outcomes and inconsistent expectations. The approval marks an encouraging step in the right direction, but lasting reform will take time and effort.

BPI published an analysis in January outlining bank M&A policy reforms needed now and in the medium and long term. The recent approval offers an opportunity to revisit these recommendations and see how the path back to a rational merger framework can advance further.

What's Been Accomplished

Rescinding bad policy: Partially achieved. *The FDIC has proposed to rescind its problematic M&A policy statement. The OCC should do the same.*

The OCC and FDIC under the prior administration issued policy statements on M&A that exacerbated uncertainty and subjectivity in bank merger review. In a welcome step, the FDIC proposed to rescind its policy statement. The OCC should follow suit and rescind both its policy statement and a final rule it issued last year revising its M&A standards. In the case of both agencies, the public should have an opportunity to comment. The "what" and the "how" were equally problematic with these banking-agency actions – the policy statements functioned as binding rules that added requirements inconsistent with the statutes.

Areas for Improvement

Supervision reform: Not yet achieved. *The Fed should clarify that only material issues would preclude a bank from receiving M&A approval. More broadly, the banking agencies should:*

- *Modernize their ratings systems.*
- *Refocus examiner attention and authority on objective financial metrics.*
- *Reform supervisory practices to focus on material risks.*

Supervision, the on-site oversight and examination of banks for compliance with laws and rules, is often used as a barrier to M&A. While policymakers have taken encouraging steps on supervision recently, like eliminating reputational risk as the basis for supervisory sanctions, more progress is needed to focus supervision on the risks that matter most. In M&A, each of the federal banking agencies should concentrate supervision on material issues and make both of the two key ratings systems – CAMELS and LFI frameworks – more transparent and sensible. The Fed should ensure that only material problems affecting a bank's financial health would prevent deal approval.

In addition to overhauling its LFI framework, the Fed could also take another concrete step toward effective M&A oversight: rescinding decade-old guidance that effectively disqualifies banks from M&A if they have any unfinished business in supervision or compliance.

These steps would be a helpful start, but supervision needs more comprehensive reform as well. The CAMELS rating system should be modernized, particularly by removing or reforming the "Management" component of the framework. It should incorporate objective measures and eliminate subjective elements. In addition, examiner authority should be limited to evaluating material financial risks.

Coordination and efficiency: Not yet achieved*. The agencies and DOJ should coordinate on bank M&A, eliminate duplicative merger reviews and jointly update the government's competition guidelines*.

There are too many cooks in the kitchen on bank M&A in the United States – particularly when it comes to competition reviews undertaken by multiple federal agencies using different rubrics (or no rubric). The Department of Justice and the three prudential regulators all play a role. To increase efficiency and avoid duplicative reviews, the competition review undertaken by a federal banking agency should take precedence, preempting application of any federal or state antitrust law to the same transaction. There is no justification for the banking industry to undergo the most severe scrutiny of any industry in the country when it is more competitive and less concentrated than many other major industries, such as aviation and telecom.

If multiple federal agencies continue to conduct the same competition review in bank transactions, the banking agencies need to coordinate with the Department of Justice on guidelines used to conduct competition reviews for proposed transactions. The previous administration left a legacy of inconsistent guidance from different regulators governing the same provisions of law. This incoherence needs to be corrected to form a cohesive competition review framework for bank mergers, starting with a return to 1995 bank merger guidelines as a stopgap measure promoting consistency and predictability for bank boards considering transactions.

***Timing: Not yet achieved**. Legislation in the House would create a "shot clock" for merger approvals, but the banking agencies still must commit to clear, expeditious timelines to make the process more predictable and transparent. The agencies should commit to reasonable but firm processing timelines and issue a joint rulemaking establishing such timelines.*

There remains a need for the banking agencies to commit to expeditious timelines and clear review expectations. Delays and uncertain timelines in M&A cause customers and employees to leave and investors to worry; they cost money and make future planning impossible. In the longer term, regulators should undertake a rulemaking establishing clear and durable timelines for merger review to provide much-needed predictability and help prevent unnecessary delay.

Conclusion

The Capital One-Discover approval is a welcome development toward a return to rationality in bank M&A, but more work remains for comprehensive reform of the bank M&A rulebook. Clear timelines, coordination between agencies, reversals of policy missteps and supervision reform are all necessary tasks on the road to a more rational M&A framework. The recent approval signals that reform is a priority for today's policymakers – a welcome sign given the importance of M&A in banks' investments in products and services and the growth of the economy.