

## **M&T Bank/Hudson City: Merger Application Expected to Receive Regulatory Approval Despite Fed's Anti-Money Laundering Concerns and Ongoing Enforcement Action Against M&T; Termination Date Extended to October 31**

### **Timing and Process Update**

On April 17, M&T Bank Corp. and Hudson City Bancorp, Inc. announced that the two bank holding companies had further extended their proposed merger's termination date to October 31<sup>st</sup>, 2015, from the previous target of April 30<sup>th</sup>. This delay – the third for this deal since being proposed in August 2012 – stems from an ongoing, separate enforcement action against M&T by the Federal Reserve, the same regulator that will ultimately also decide on M&T/Hudson City's merger application.

Despite yet another delay, and despite recent speculation about a DOJ/CFPB investigation into discriminatory lending practices at Hudson City, sources we spoke to remain convinced that the merger will likely eventually be approved by regulators. Sources believe that the Fed's enforcement action is well on its way to being resolved, and that the Justice Department, which also must sign off on the deal, is highly unlikely to raise antitrust concerns. And as for the alleged investigation of Hudson City's lending practices, M&T's good record for fair lending could potentially encourage the Fed to approve the merger, if anything – with the expectation that M&T's good practices will be implemented at Hudson City.

For this report, we interviewed two attorneys with expertise in regulation of the financial services and banking industries. We also spoke to a former financial services attorney who now advises companies on oversight and risk management, as well as to the Executive Director of New Jersey Citizen Action, the state's largest consumer watchdog coalition.

### **In Depth: Potential DOJ/CFPB Investigation of Discriminatory Lending at Hudson City**

**Even if the investigation of Hudson City uncovers fair lending violations (for which M&T would assume contingent liability), consummation of the merger will not be impacted.** An April 15 Bloomberg [article](#) revealed that, according to two people familiar with the matter, Hudson City faces an investigation by DOJ/CFPB into the bank's allegedly discriminatory lending practices. The article goes on to question whether the investigation could affect the proposed transaction between M&T and Hudson City, noting that “the Justice Department's fair-lending unit has emphasized cases involving credit for minorities, and state and local officials have pursued related lawsuits.”

As a starting point, stakeholders should note that bank merger review does include an analysis of “convenience and needs considerations,” in which the Federal Reserve Board considers the effects of the proposed merger on “the convenience and needs of the communities to be served,” and must take into account the parties' lending records under the Community Reinvestment Act (CRA; see M&T/Wilmington approval [order](#)). Under the CRA, the Fed is required to encourage banks to help meet the credit needs of local communities, including low- and moderate-income (“LMI”) communities.

Fair lending issues, in particular, have recently become a “hot button” issue for bank and consumer protection regulators, according to our sources. But here, our sources note that because the fair lending violations supposedly plague the target bank, and not the buyer, the investigation (and any enforcement action that may be pursued in

response) is unlikely to pose a problem as far as approval of the merger. Of course, this is not to say that the violations will somehow disappear into thin air: if the investigation eventually uncovers fair lending violations at Hudson City, M&T will need to deal with those consequences, as it will assume all contingent liabilities of its target when the companies merge.

**M&T could potentially use the fair lending issues at Hudson City to encourage the Fed to approve the merger, by pointing to its own relatively good record for fair lending practices and giving assurance that it will improve Hudson City's fair lending record.** According to Elliot Berman, a financial services attorney and consultant who advises companies on oversight and risk management: "If you're the buyer, and your target is facing an investigation, you need to give regulators comfort and assurance that you can help fix the issues of the target bank. Here, M&T has likely been giving the Fed assurances that it will take the actions needed to improve fair lending issues at Hudson City."

*The Capitol Forum* also spoke to Phyllis Salowe-Kaye, executive director of New Jersey Citizen Action (NJCA), a community watchdog coalition that advocates for the LMI community in New Jersey. "NJCA has been trying to work with Hudson City for more than 15 years, because we've been very concerned with their lack of products and services that are geared to meet the needs of LMI communities," says Salowe-Kaye. "We were previously met with the attitude that Hudson City wasn't the least bit concerned."

In stark contrast, M&T has been more than willing to work with NJCA to bolster its fair lending products and services in New Jersey, according to Salowe-Kaye. "In fact, M&T reached out to us first, trying to find out how we view the needs of the LMI community, and expressing a desire to develop products – in a variety of product lines – to meet those needs." Salowe-Kaye told us that as a result, NJCA has written a letter to the Fed in support of the merger. "We wanted to make sure that when regulators look at this merger, they realize that M&T will be repairing the damage that Hudson City has caused by thumbing its nose at the LMI community's needs for so many years," says Salowe-Kaye.

As further assurance for the Fed that M&T will improve fair lending practices at Hudson City, M&T can point to its Fair Banking Program ("a coordinated and comprehensive effort within M&T Bank that includes oversight, training, procedures, monitoring and analysis, and testing" with respect to fair lending requirements and regulations), just as it did in acquiring Wilmington Trust Corporation in 2011. M&T's experience in developing and implementing its Fair Banking Program will be directly applicable to Hudson City's operations, which may encourage the Fed to see the merger as helpful in resolving any fair lending concerns that the DOJ/CFPB investigation may uncover.

According to Andrew Friedman, an attorney at business law firm Butzel Long who primarily represents clients involved in government investigations: "Just as regulatory issues can drag a company down, they can also raise it up. If M&T is going to be the larger of the two entities and has a good record for fair lending practices, the Fed may be encouraged to approve the merger as a way to improve the fair lending situation at Hudson City," said Mr. Friedman.

### **In Depth: Next Steps for Merger to Close**

**According to our sources, the Fed will not make a decision on M&T and Hudson City's merger application until its enforcement action against M&T is resolved.** The [enforcement action](#), which involves firm wide anti-money laundering (AML) and Bank Secrecy Act (BSA) related compliance issues at M&T, will need to be

resolved to the Fed's satisfaction before M&T will be allowed to acquire Hudson City. "Generally speaking, the Fed will not make a decision to approve a pending acquisition where the buyer has an open enforcement action," says Berman. Friedman agreed, reasoning that "the Fed doesn't want to weigh in on any merger until it can be confident that the acquiring bank has its regulatory house in order."

According to Thomas Brooks, Of Counsel to the law firm Clark Hill PLC and former General Counsel to the Federal Deposit Insurance Corporation (FDIC), the enforcement action was probably the result of a routine examination by the NY Fed, which is required annually for an entity like M&T. "In examining M&T, the Fed seemingly found several areas where there were deficiencies in firm wide compliance with respect to applicable AML rules and regulations, including compliance with the Bank Secrecy Act" said Mr. Brooks. In response, the Fed issued a [written agreement](#) to M&T, requiring adoption of a "firm-wide compliance risk management program."

Our sources emphasized that the primary function of the Fed is to make sure that banks are operating under the appropriate rules and regulations, and that merger review is secondary. "When banks are merging, the most important thing – to the Fed – is to end up with a resulting institution that is good and solid," says Brooks. "So in this case, because there is an ongoing enforcement action against the larger, acquiring bank, the merger was just caught up in that process."

**In order for the written agreement to be "terminated," M&T's BSA/AML practices must be deemed "satisfactory" by the Fed.** Currently, as per the written agreement, M&T is being required to produce quarterly reports and undergo routine review by the NY Fed. "The NY Fed will examine M&T again, as part of an annual targeted BSA review. If the Fed finds a clean bill of health, M&T will get a report that the examination was 'satisfactory,'" says Berman. Only at this point will the Fed make a decision on M&T and Hudson City's merger application.

As far as where M&T currently stands in terms of completing the written agreement, our sources noted that written agreements generally take a couple of years from start to termination – which appears to explain the considerable hold up of the merger. Brooks explains that "in order for a written agreement to be terminated, not only does the financial institution have to do everything that the Fed has asked and show that everything is fine, but it really has to show everything *being* fine for a time." Brooks noted the tone of M&T's March 2015 shareholder [letter](#). "M&T seems to be saying that while it may not have yet reached its goal of fully satisfying the Fed's written agreement, it has made considerable progress and has gotten indications that it's moving along in the right direction. And if the Fed has said it's going to act in September, it likely just wants to make sure that the compliance program now in place continues to be effective."

Berman agreed, telling us that "M&T has probably been getting unofficial indications from the Fed that they're on the right track in terms of clearing up the AML/BSA problems. In addition to that, it's probably gotten some indication about whether or not the Fed will eventually come in and do an on-site review related specifically to the merger application." As for the merger, Brooks noted that "almost never does the Fed deny a merger – if it were going to do so, it would rather tell the parties to withdraw the application."

**Review of the merger application will involve antitrust review by DOJ, which makes a recommendation to the Fed regarding potential anticompetitive concerns.** As the Fed processes M&T and Hudson City's merger application, it will need to consider whether the merger triggers antitrust concerns. The two relevant statutes are the Bank Holding Company Act (BHC Act), under which M&T and Hudson City will be merging, and the Bank

Merger Act (BMA), which will be triggered by the two BHCs combining their respective banks, M&T Bank and Hudson City Savings Bank.

Our sources explained that in making this determination, the Fed looks to DOJ to provide a recommendation regarding antitrust concerns. “The antitrust division of DOJ has done, or will do, an antitrust review, to determine whether or not it views the merger to be anticompetitive,” says Berman. “If DOJ finds reason for concern, it will make a recommendation to the Fed that it shouldn’t approve the merger. If the Fed disagrees and approves the merger anyway, then DOJ has a limited window during which it could potentially go into federal court and attempt to enjoin the merger.” The BMA gives DOJ the authority to challenge the legality of a bank merger on anticompetitive grounds, even if the Fed seeks to approve the transaction.

**In M&T and Hudson City’s case, antitrust issues are highly unlikely to be a stumbling block for the deal, as any potential anticompetitive effects can likely be remedied through a divestiture agreement.** Our sources believe for a number of reasons that DOJ is highly unlikely to find and raise competitive concerns to the Fed, or to act on its own to block the deal. First, Friedman noted that the “nature of the industry” yields a high level of competition, thereby lessening the threat of anticompetitive effects. “There are a lot of banks and a lot of BHCs – there is so much competition in the space that competition-related concerns aren’t really a driving issue. I don’t think the Fed is usually in the business of knocking down bank mergers because of competition issues.”

Second, an “acquisitive” company such as M&T (which has acquired more than 20 banks in the last 30 years) is likely to be very knowledgeable about the standards for antitrust review and could easily plan around foreseeable significant antitrust concerns. According to Brooks, “I’m sure the banks ran the antitrust numbers backwards and forwards – they wouldn’t have gone anywhere near this deal if they knew it was egregious.” The lack of substantial geographic overlap between the two banks supports this notion. For Buffalo-based M&T, which has branches concentrated in upstate New York, Pennsylvania, and the mid-Atlantic states, “one of the attractions of this deal was that by acquiring Hudson City, it would gain a big foothold in the tri-state area of New York, New Jersey, and Connecticut – particularly in the key market of New Jersey,” says Friedman.

Third, even if DOJ were to determine that the merger would have anticompetitive effects in certain markets, this could easily be resolved through divestiture of branches in those problem areas. According to Brooks, “unless the whole merger is grossly anticompetitive – in which case the merger agreement wouldn’t really have been formed in the first place – antitrust issues can be quickly resolved by getting rid of branches.” The Fed – in conjunction with the Antitrust Division of DOJ – issued formal [guidance](#) in October 2014 regarding bank merger analysis and their current standards for review, which confirms Brooks’ view. According to the guidance, when a transaction is likely to have anticompetitive effects, DOJ is usually able to resolve its concerns by seeking divestiture of physical branches to another bank, including associated deposits and loans.

The remedy is implemented through a Letter of Agreement (LOA) that sets forth the terms and conditions of the divestiture agreement. Based on the geographic concentrations of M&T and Hudson City’s banks, any such divestiture agreement is unlikely to be onerous, meaning the parties will still be left with an attractive deal when all is said and done.

### **Deal Snapshot**

**Outlook: Merger Approval Likely Once Enforcement Action Against M&T is Resolved**

<b>Reasons for Merger Clearance</b>	<b>Reasons for Collapse/Challenge</b>
<p align="center"><b><u>Most Compelling Narrative</u></b></p> <p>Given the highly competitive nature of the banking industry and the lack of geographic overlap between the two companies' branches, DOJ is unlikely to raise significant competitive concerns to the Fed. Even if DOJ anticipates anticompetitive effects in certain markets, the parties and DOJ can easily resolve those concerns through divestiture of branches. Any such divestiture agreement is unlikely to be burdensome to the parties.</p>	<p align="center"><b><u>Most Compelling Narrative</u></b></p> <p>If M&amp;T is unable to resolve the Fed's anti-money laundering concerns at the root of its enforcement action by the October 31 termination date, Hudson City could potentially walk away from the deal. Alternatively, either party could walk away from the deal if the Fed's conditions for approval are more burdensome than the parties are willing to face.</p>
<p align="center"><b><u>Analysis</u></b></p> <p>-If a potential DOJ/CFPB investigation reveals discriminatory lending practices at Hudson City, M&amp;T's relatively good fair lending record and existing fair lending compliance program could encourage regulators to approve the merger as a way to improve Hudson City's fair lending practices.</p> <p>-The parties are likely to pass the first step of DOJ's competitive analysis, an initial screening based on market shares and market concentration, due to the parties' relatively smaller size and the high concentration of banks in the relevant markets.</p> <p>-M&amp;T and Hudson City show limited geographic overlap, as M&amp;T's branches are concentrated in upstate New York, Pennsylvania, and the mid-Atlantic states, while Hudson City's branches are concentrated in the tri-state area of New York, New Jersey, and Connecticut.</p> <p>-Even if DOJ's analysis suggests that the proposed merger will have anticompetitive effects in one or more local banking markets, those concerns can easily be resolved through divestiture of branches in those markets.</p>	<p align="center"><b><u>Analysis</u></b></p> <p>-Although sources indicate that resolution of the enforcement action against M&amp;T could be within reach, termination is open-ended and based entirely on M&amp;T's ability to satisfy the Fed's standards for anti-money laundering compliance.</p> <p>-Sources note that enforcement actions generally take several years to resolve, making the Fed's September 30 target date for acting on the merger application a moving target.</p> <p>-As DOJ and the Fed have slightly different standards for merger review (most notably that DOJ's banking markets are specifically defined for each merger application, whereas the Fed has predefined local banking markets), the regulators could potentially find more antitrust-related concerns and therefore require more onerous conditions/divestitures than the parties had anticipated.</p>
<p align="center"><b><u>Timeline</u></b></p> <p>-September 30: The Federal Reserve is expected to make a decision on parties' merger application.</p> <p>-October 31: Parties' new termination date, after which either party may terminate merger agreement if closing has not occurred.</p>	