

ClientAlert

Financial Markets Developments

Banking/M&A

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ICBC's Agreement to Acquire a Controlling Stake in a US Bank Is a Major Development for the US and Chinese Banking Markets

In a groundbreaking transaction, Industrial and Commercial Bank of China Limited, based in Beijing and the world's largest bank by market capitalization and profitability (ICBC), entered into an agreement with The Bank of East Asia, Limited, a major Hong Kong bank (BEA), to purchase an 80 percent common equity stake in BEA's subsidiary bank based in New York, The Bank of East Asia (U.S.A.) National Association (BEA-USA). The agreement positions ICBC to become the first mainland Chinese bank to acquire a controlling stake in a US bank.

Although the agreement, which was announced by the parties on 23 January 2011, involves a relatively small dollar amount, it evidences the global business reach of the large mainland Chinese banks, which have market capitalizations sufficient to make them major players in international mergers and acquisitions markets. If approved by US regulators, the deal would signal the opening of the US banking market to acquisitions and other equity investments by mainland Chinese banks.

Although mainland Chinese banks, including ICBC, and other foreign banks have established banking offices in the United States, to date no mainland Chinese bank has established or acquired a US bank subsidiary. Many foreign banks maintain both branch offices and FDIC-insured subsidiary banks in the United States. Foreign banks typically serve the wholesale financial markets through their US branches, and their US subsidiary banks tend to serve the middle market and small businesses and are able (unlike the uninsured US branches of the foreign bank parents) to take FDIC-insured consumer deposits.

In order to close the deal, ICBC must apply for and receive the prior approval of the Board of Governors of the Federal Reserve System (Federal Reserve) under Section 3 of the Bank Holding Company Act of 1956, as amended (the BHC Act). In order to approve the transaction, the Federal Reserve is required under the BHC Act to make a number of determinations and findings, including that ICBC, as a foreign bank applicant, is subject to "comprehensive supervision or regulation on a consolidated basis" by the bank supervisory authorities in its home country, the People's Republic of China. The Federal Reserve considers this standard met if the home country supervisor receives sufficient information on the worldwide operations of the bank and any affiliate relationships to assess the bank's overall financial condition and compliance with law and regulation. In making this type of determination—commonly referred to as a "CCS" determination—



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with respect to a foreign bank applicant, the Federal Reserve assesses, among other factors, the extent to which the home country supervisor:

- Ensures that the foreign bank has adequate procedures for monitoring and controlling its activities worldwide.
- Obtains information on the condition of the foreign bank and its subsidiaries and offices outside the home country through regular reports of examination, audit reports or otherwise.
- Obtains information on the dealings and relationship between the foreign bank and its affiliates, both foreign and domestic.
- Receives from the foreign bank worldwide, consolidated financial reports or comparable information that permits analysis of the foreign bank's financial condition on a worldwide, consolidated basis.
- Evaluates on a worldwide basis prudential standards, such as capital adequacy and risk asset exposure.

In the approximately 20 years during which the BHC Act has required a CCS determination to be made in connection with acquisitions by foreign bank acquirers, the Federal Reserve has never made a CCS determination with regard to a mainland Chinese bank. Applying an exception to the CCS determination requirement, the Federal Reserve has in recent years made several limited CCS determinations in connection with applications by certain mainland Chinese banks to establish branches in the United States, including ICBC, China Merchants Bank Co., Ltd. and China Construction Bank Corporation. That exception is available where the foreign bank's expansion proposal involves the establishment of a direct US branch of the foreign bank rather than the acquisition of a US bank subsidiary.

In the last eight years, the People's Republic of China has made significant strides in establishing a comprehensive bank supervisory regime. Those efforts have resulted in, among other things, the enactment of extensive legislation governing the permissible activities of and the operating and financial standards for Chinese banking institutions, the establishment of a central governmental regulator dedicated to supervision of Chinese banks, the adoption of capital standards in accordance with the Basel Capital Accord and the country's membership in the Basel Committee on Banking Supervision.

Federal Reserve procedures for foreign bank applications generally allow a foreign bank applicant to rely upon a prior CCS determination by the Federal Reserve for another bank in the applicant's home country, provided certain conditions are met. This increases the importance of the ICBC transaction, as a CCS determination by the Federal Reserve with regard to ICBC—i.e., the full CCS determination required under the BHC Act, rather than the limited CCS finding for a US branch application—could be relied upon by other mainland Chinese banks of the same type as ICBC in their own BHC Act applications to acquire or make equity investments in US banks.

White & Case LLP is representing ICBC in connection with the purchase of the BEA-USA shares, including the BHC Act application to the Federal Reserve. White & Case has also represented other Chinese and foreign banks with regard to their expansion in the United States, including Bank of China Limited in connection with its planned establishment of a branch in Chicago, Illinois.

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