FEDERAL DEPOSIT INSURANCE CORPORATION (FDIC)

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Request for Comment on Proposed Statement of Policy on Bank Merger Transactions

Sheila Bair
Former Chair, FDIC

Thomas Hoenig
Former Vice Chair, FDIC

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We welcome the opportunity to comment on the proposed Statement of Policy (SOP) on Bank Merger Transactions that is relevant to all FDIC supervised insured depository institutions (IDIs). As a former Chair and Vice-Chair of the FDIC, we are concerned that the proposed SOP creates vague new standards that would impede positive M&A activity and increase risks to the Deposit Insurance Fund.

The Bank Merger Act (BMA) requires that the bank supervisory agencies review proposed mergers to assure that they do not result in a monopoly or substantially lessen competition, and that they do not leave the merged IDI or the financial system less sound. The FDIC should pursue this mandate fully. However, the proposed SOP rather than improve and clarify its review process for IDI mergers, creates confusion and uncertainty to the process. The FDIC describes its proposed SOP as principles based. However, the principles are vague, and under the rubric of flexibility, the SOP

- Fails to propose minimum standards as to when the effects of a merger of IDIs would raise significant competitive issues.
- Fails to propose minimum standards for when an IDI merger would increase the risk to financial stability sufficient to raise questions of its viability.
- Requires, without clear justification, that the merged IDI not only meet the convenience and needs of a community but results in "better" services within the community.
- Fails to recognize the impact of competition from nonbank financial institutions, which is particularly relevant in assessing M&A activity in rural areas.
- Generally, requires that bank mergers result in a financially stronger financial institution, potentially precluding acquisitions of weak banks by stronger banks which in turn, could increase bank failures and costs to the Deposit Insurance Fund.

The effect of the SOP would leave the outcome of a proposed merger unclear and primarily at the discretion of the FDIC and in doing so, makes the process increasingly arbitrary and uncertain. This will have a chilling impact on positive M&A banking activity, including among regional banks where consolidation could strengthen their ability to compete with the mega banks. The unintended consequence of the proposed SOP could be to reduce, not promote, competition in the banking industry.

Effects on Competition

The FDIC introduces its proposed SOP by noting that the number of U.S. banks has declined to 4500 from more than 12,000 in 1990, and that the number of banks with assets exceeding $100 billion has increased to 33 from just 1 and, therefore, mergers resulting in banks having more than $100 billion in assets will be subject to "special scrutiny". However, total banking assets today are $24 trillion up from a mere $3.4 trillion in 1990. A merger today resulting in an IDI having $100 billion of assets, would involve only .4% of industry assets, and its effects on industry concentration would be minor and would not necessarily require special scrutiny.

The FDIC acknowledges the established analytical framework for judging the effects on competition that result from a bank merger, which involves defining both a geographic and primary product market that would be impacted by the merger. For urban banks, the geographic market is most often defined as the Ranally Metropolitan Area (RMA); and for rural banks, it is the counties within which the merged bank would operate. The product reviewed to judge the effect of the merger on competition is IDI deposits. Current guidelines for determining whether a proposed merger would receive special scrutiny is based on the resulting changes in deposit concentration as measured by the level, and change, in the Herfindahl-Hirschman Index (HHI). DOJ guidelines provide specific HHI benchmarks to judge when a merger would receive special scrutiny.[1] In addition, the Dodd-Frank Act, section 622, establishes a financial sector concentration limit that prohibits a financial company from merging or consolidating with, or acquiring, another company if the resulting company's liabilities would exceed 10 percent of the aggregate liabilities of all financial companies. Current guidelines do not use size alone as a criterion for a merger receiving special scrutiny.

The FDIC's proposed SOP would apply a more discretionary approach to its review of IDI mergers. Mergers involving assets greater than $100 billion are deemed subject to special scrutiny. Under the criterion of flexibility, it would use a more ad hoc approach in its analysis. It, for example, would compute the HHI, but it proposes no benchmark for judging when the level, or change, in concentration within a market would raise concerns for the merger's effects on competition. The implication being that the FDIC will rely primarily on its judgement in weighing such effects, especially if the resulting IDI is greater than $100 billion in assets. The long-term consequence of such an approach is to introduce a greater degree of arbitrariness and uncertainty to the review process.

An additional consequence of the proposed SOP would be to protect the very largest U.S. banks from regional banks gaining scale and competing with them more directly. Currently the largest

[1] Antitrust Division, U.S. Department of Justice (DOJ), Merger Guidelines, December 2023. These guidelines would cause the DOJ to give special scrutiny to mergers in which the HHI was greater than 1800 and its change was greater than 100, or that the effect was to give the merged firm a 30 percent concentration ratio and a change in the HHI greater than 100.

5 U.S. banks control nearly 50 percent of industry deposits. In contrast, the next two largest regional banks if they merged, would control less than 4 percent of deposits in a limited number of markets across the nation. Thus, the SOP, as proposed, could artificially inhibit bank mergers among regional banks, and have the unintended effect of reducing competition across geographic and product markets.

Finally, in judging the effects on competition within markers, the FDIC should take note of the significant decline in new bank charters. Prior to the GFC the number of new bank entrants to the industry averaged over 150 per year. Since then, with the passage of hundreds of new rules restrictions on bank activities and the accompanying increase in cost and regulatory burden, this average has fallen to less than 10, and over time is as likely to reduce market competition as is bank mergers.[2]

While we agree that anti-trust laws should be strongly enforced and competition promoted within markets, it should be done in a consistent manner, using well researched, measurable standards of analysis and defined expectations.

Effects on Bank Soundness

The SOP notes that the BMA requires it to consider the financial resources of the existing and proposed entities involved in a merger transaction, but then goes on to require that the resulting IDI be a financially stronger financial institution. Certainly, it is essential for the FDIC to require that the resulting IDI meets acceptable performance standards, including capital, asset quality, earnings, liquidity, and sensitivity to market risk, as described in the Uniform Financial Institution Rating System. However, to require that the merger or acquisition result in a stronger institution will essentially preclude stronger banks from acquiring weaker ones during periods of economic distress. Encouraging bank M&A has been an important, and essential tool, used by the. FDIC and other bank regulators in stabilizing the banking system and reducing the number of bank failures. Acquisitions by strong banks of weaker ones can prevent failures, while protecting communities from the disruption of banking services that inevitably comes with the liquidation of a failed bank. Preventing bank failures also minimizes costs to the Deposit Insurance Fund, consistent with the FDIC’s statutory obligations.

Having set out these financial standards that banks of all sizes and complexity must meet, then bank merger candidates that meet the standards should expect to be approved, barring other competitive, or convenience and needs issues.

Financial Stability

The proposed SOP notes that the BMA requires the responsible agency to consider the risk to the stability of the U.S. banking or financial system when evaluating a proposed bank merger. The FDIC’s proposed SOP states that it will review bank merger proposals to ensure that the

[2] For further insights into how regulation inhibits market entry, and protects the largest firms within an industry see, James Bailey and Diana Thomas, Regulating Away Competition, Working Paper, Mercatus Center, George Mason University, September 2015.

resulting IDI would not present any new or unforeseen stability risks that may not have existed when the merging entities operated on a standalone basis. It also indicates that mergers resulting in banks with assets greater than $100 billion will receive special scrutiny. We would note that any bank failure today in which uninsured depositors are not bailed out will cause uninsured depositors at nearly all banks to take flight. This was confirmed during the failure of the Silicon Valley Bank. Its failure - notwithstanding (or perhaps because of) regulators' determination that the bank was systemic - caused large numbers of uninsured depositors to flee both regional and community banks. Thus, even a bank failure of relatively modest size can precipitate a banking crisis depending on how the government reacts to its failure.

The proposed SOP raises legitimate financial and stability issues when a merger results in a large, complex, and interconnected IDI, that carries more systemic risk and becomes too big to fail. Be that as it may, the Dodd-Frank Act and BMA do not require that such IDIs be broken-up but that they come under additional regulatory and supervisory standards. Thus, if under the BMA a merged IDI is judged sound and able to meet the required standards, they should be approved.

In this regard, rather than holding IDIs greater than $100 billion for special scrutiny, the FDIC and other banking supervisors would promote financial stability more effectively by strengthening the financial standards for all large systemically important financial institutions and then, holding merged IDIs that would become larger and more complex, to those same high standards. Research consistently shows that IDIs that rely on greater levels of investor funding – equity capital – are more resilient through the business cycle. Data show that among all size groups of IDIs, the most systemically important IDIs are also the most leveraged. For example, as of December 31, 2023, Tier 1 capital to total assets of U.S. globally systemically important banks (GSIBs) averaged only 7.1 percent; by comparison, regional and community banks averaged between 9 and 10 percent. As we argued in our previous comment letter, a 10% leverage ratio would be far more effective in promoting financial stability. It would also give systemically consequential acquisitions a higher hurdle to meet, but without entrenching the mega banks' current market dominance.

Thus, the FDIC would do more to enhance financial stability by raising the amount of investor capital requirements for the largest systemically important banks than by preventing mergers among regional banks under the mistaken notion that prohibiting mergers among large regional banks would enhance financial stability.

Nonbank Financial Institutions

The SOP arguably stretches the FDIC's authority in its expansion of review of acquisitions of non-depository institutions by the banks it insures. At the same time, it misses an opportunity to improve current policy with consideration of nonbank lending activity when evaluating the competitive impact of a proposed acquisition. This is particularly important in rural areas, where only a few depository institutions may provide financial services, but they may face substantial competition from nonbanks, including online lenders, credit unions, and the Farm Credit System. Failure to consider these nonbanks in assessing the competitive effects of an acquisition could impede M&A among smaller local banks while permitting acquisitions by larger banks outside of the community.

Convenience and Needs of the Community to be Served

The SOP states that the FDIC expects a merger between IDIs will enable the resulting IDI to *better* meet the convenience and the needs of the community to be served than would occur absent the merger. Such an expectation is unnecessary and leaves the matter of determining whether it does so primarily at the discretion of the FDIC. A more objective analysis would recognize that if each of the IDIs proposing to merge have historically met the needs of their community and have records of compliance with consumer laws and other regulations, there is no statutory requirement to demand that the resulting IDI do *better*. Similarly, if each IDI has a satisfactory or outstanding community reinvestment act (CRA) rating, they should not be expected to do *better* as a condition for approval.

Summary and Conclusion

The MBA requires that the FDIC review proposed bank mergers to assure that they do not violate antitrust laws, result in unsafe and unsound institution, or unduly increase risk to the financial system. These are important factors and place a heavy responsibility on the FDIC. However, the FDIC also has an obligation to apply its SOP in a consistent manner across all IDIs. The banking industry already has large, complex, and systemically important IDIs that carry significant risk to the financial system. IDIs seeking to achieve a similar scale through merger should be required to meet the competitive, financial, and service standards currently in place, but they should not be held to a higher standard than apply to systemically important IDIs already in operation. To do otherwise will lead to a two-tier banking system in which the largest are protected from new entrants and allowed to grow ever larger and systemically important while the second tier are throttled from competing at a higher level.

Finally, under the SOP's umbrella standard of "flexibility" within the process, the FDIC will become increasingly discretionary in its review of IDI mergers. This can only lead applicants to search for the most well-connected law or consulting firms to manage them through the process to approval. Such an approach would become arbitrary and inconsistent, dependent on those in power, not on established specific criteria determined through research and the rule of law.