Antitrust Division Banking Guidelines Review: Public Comments Topics & Issues Guide

COMMENT LETTER

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Department of Justice
Antitrust Division
950 Pennsylvania Avenue, NW
Washington, DC 20530

Re: Antitrust Division Banking Guidelines Review: Public Comments Topics & Issues Guide

Dear Sir or Madam,

The Conference of State Bank Supervisors ("CSBS")1 appreciates the opportunity to comment on the Antitrust Division Banking Guidelines Review: Public Comments Topics & Issues Guide (the "Guide") issued by the Antitrust Division of the Department of Justice ("DOJ"). The request for input seeks comments on whether the Division should revise the 1995 Bank Merger Competitive Review Guidelines (the "Guidelines") and modernize its approach to bank merger review under antitrust laws. CSBS supports this modernization effort and believes any potential revisions to the Guidelines should appropriately reflect the changing landscape of the marketplace and the needs of community banks to serve their communities.

State banking supervisors have a significant stake in how the competitive effects of bank mergers are analyzed and the process used for competitive reviews. State bank regulators charter and supervise 79 percent of all banks in the United States, which accounts for approximately 4008 banks with $7.1 trillion in assets. Many of these institutions are small community banks; some of which represent the sole banking presence in rural market areas.

These small banks contribute significantly to the development and expansion of communities across the country by providing greater access to credit and a wide array of personalized loan services. Bankers, academics, regulators, and policymakers continually work together to cultivate research on the opportunities and challenges facing community banks in the modern world.2 This collaborative research emphasizes the value and necessity of community banks to the economy and offers insight on the importance of relationship-based lending, especially for small businesses and rural markets.

CSBS makes the following recommendations regarding the competitive bank merger review analysis:

- The DOJ should reevaluate how the Herfindahl-Hirschman Index (HHI) is calculated in light of the evolution of banking practices and market competition;
- The DOJ should consider adopting an appropriately tailored approach to preserve the viability of community banks and creating a de minimis exception for certain transactions;
- The DOJ should explore ways to create greater alignment and consistency with the federal and state banking agencies (the "Agencies"); and
- The DOJ and the Agencies should recognize and incorporate the role and interests of states in the bank merger review process.

I. The DOJ should reevaluate how the Herfindahl-Hirschman Index (HHI) is used in light of the evolution of banking practices and market competition.

The Guide asks several questions related to whether and how institutions other than traditional commercial banks should be included in the DOJ's competitive effects analysis. These questions all ultimately center on what is and is not included in the calculation of market share and market concentration. State bank regulators are concerned that the way market share and market concentration is currently calculated fails to account for the evolution of banking practices and market competition since the adoption of the Guidelines 25 years ago.

A. *Market concentration should be measured in a manner that appropriately accounts for competition from non-depository financial institutions, credit unions and savings institutions.*

Under the Guidelines, the deposit market share of commercial banks and, to a more limited extent, savings institutions are used to calculate concentration in a local banking market or other relevant geographic area. By relying on this restricted deposit market share to calculate market concentration, the competitive analysis does not account for the presence of competition from certain depository and non-depository financial institutions in the local market area.

State bank regulators believe that it is appropriate to account for competition from credit unions and non-depository financial institutions in calculating market concentration in bank merger reviews. With respect to non-depository financial institutions, Farm Credit Associations (FCAs), for instance, represent a major competitor for banks in rural, agricultural markets. While FCAs hold a commensurate amount of agricultural loan market-share when compared to their depository counterparts, they are still not considered in HHI calculations. Researchers of the Federal Reserve Bank of Kansas City found that the hypothetical inclusion of FCA market influence in HHI calculations results in a lower degree of market concentration, which leads to an increase in the acceptance of more in-market mergers.3 Despite the substantial competitive presence of FCAs and non-depository financial institutions more generally in the marketplace, they are not considered in HHI calculations, potentially preventing the completion of in-market mergers.

State bank regulators also believe the DOJ should revisit its current treatment of credit unions in calculating HHI. In recent decades, the influence and lending prowess of credit unions has grown exponentially. The Credit Union Membership Access Act of 1998 relaxed the common bond requirements for credit union membership, creating access and appeal to a larger realm of borrowers. Additionally, the National Credit Union Administration adopted a final rule in 2017 which expanded a credit union's ability to provide commercial loans. These rulings, combined with an increased presence in real estate and automobile lending, have established credit unions as major competitors to community banks.

Despite being a major source of competition in local banking markets, the Guidelines do not include credit

unions in the initial market concentration screen, rather their presence in local lending markets is treated as a mitigating factor in subsequent analysis. Because large credit unions now have a major competitive presence in local banking markets, particularly for small banks operating in in many small and rural communities, we believe the DOJ should revisit the treatment of credit unions in the competitive effects analysis, including potentially counting them in the initial assessment of market concentration.

Additionally, the deposit market share of savings institutions is not included in analyzing the competitive effects of a transactions in the small business banking market unless a savings institution is deemed an active competitor in the small business banking market. When the Guidelines were issued in 1995, commercial lending constituted less than two percent of the total loans of savings institutions. However, as of the end of 2019, commercial lending constituted over six percent of savings institutions lending. This shift towards commercial lending is reflective of the general lifting of the restrictions on the degree and scope to which savings institutions can engage in commercial lending. While the conditional inclusion of savings institutions may have once been justified, given the increased amount of commercial lending by savings institutions over time, we believe savings institutions should be included in assessing the competitive effects of all transactions in the small business banking market.

Of course, competition from savings institutions, credit unions and non-depository institutions must be accounted for in a standardized way so that banks seeking to plan and structure mergers have some degree of reliability and certainty as to how the merger will be analyzed. In the case of credit unions and non-depository financial institutions, this may require relying on additional sources of data that have not traditionally been factored into competitive reviews. While some of this data may already be collected, existing data collections may need to be revised or new data collections established to replace outdated collections.

CSBS encourages the DOJ, together with the Agencies, to explore what existing data sources may be utilized and what additional data may be needed to account for market competition from non-depository financial institutions and credit unions. Absent the inclusion of data pertaining to these sources of competition, the resultant HHI calculation will not offer an accurate assessment of the market concentration and, consequently, may impede in-market merger and acquisition activity in rural and small communities.

B. *The competitive effects analysis and the data collected and used for that purpose should be modernized to account for evolution in banking practices enabled by advances in technology.*

Importantly, what is included in the calculation of HHI is equally concerning as what is not included. The deposit market share of banks is calculated using data from the FDIC Summary of Deposits (SOD) data collection. The primary data used to construct market shares and HHIs for local banking markets are deposits obtained from the FDIC's Summary of Deposits data collection. However, the SOD shows deposits based on the location of the branch at which deposits are booked, not the location of the depositor. By attributing online deposits and centrally-booked deposits to the location of the branch, SOD data can portray a skewed representation of market concentration in the local banking market in which the branch is located.

This misrepresentation of market concentration which SOD data may produce not only affects the institution engaged in the central booking or online deposit-gathering but all other institutions with which it shares a market area and all other market areas to which those deposits would otherwise be attributed. It is also not limited to institutions solely or primarily operating online since most banks will have an online platform which enables customers to retain banking relationships - no matter where the depositor is located. The continuation of these customer relationships in the pre-Internet era would have often been too inconvenient to maintain.

State bank regulators believe that the competitive effects analysis should be modernized to account for this

evolution in banking practices enabled by advances in technology. Here, again, we believe that the DOJ, together with the Agencies, should explore how existing data sources, such as the SOD, may be revised to enable modernization of merger reviews while maintaining sensitivity to avoid undue regulatory burden in the form of excessive data collection. It's worth noting that recent efforts to modernize the Community Reinvestment Act (CRA) have dealt with similar difficulties due to the branch-based nature of SOD data. To address these issues, these reform efforts have considered creating new data collections which would attribute deposits to the location of the depositor.

However, it is perhaps more appropriate to revise the existing SOD data collection so that a single data set can be used for CRA, bank merger reviews, and other laws and regulations because, otherwise, these regulatory schemes may end up working at cross-purposes. For instance, a branch divestiture agreed to in the bank merger context may actually lead to the creation of banking deserts which is contrary to the goals of CRA simply because these two regulatory frameworks attribute the same deposits to entirely different geographic locations. Therefore, when considering how to account for online deposits and other limitations of the SOD data, we encourage the relevant federal stakeholders to consider how the SOD data collection can be improved in a comprehensive manner which balances the competing policy priorities of different regulatory schemes.

II. The DOJ should consider adopting an appropriately tailored approach to preserve community banking and creating a de minimis exception for certain transactions.

CSBS recommends that any revisions to the DOJ's analysis of the competitive effects of bank mergers be appropriately tailored to avoid facilitating consolidation at the expense of community and smaller banks that have been helping our local communities for over many decades. CSBS believes that the lesser degree of banking industry consolidation in the U.S., relative to other countries, contributes to the relative strength and resiliency of the U.S. banking system which enables it to drive growth in the U.S. economy. For this reason, CSBS strongly supports a diversified banking industry and policy measures intended to preserve its diverse nature and the community banking business model, including the limits on nationwide and statewide deposit concentration which have been placed on interstate merger transactions.

Certain revisions to the DOJ's current approach to bank merger analysis would be consistent with preserving a diverse, unconcentrated banking industry and the business model of small banks and community banks. In many rural areas, only a few small banks represent the entire physical banking presence available to communities therein. As a result, rural markets are much more likely to be highly concentrated than urban markets. This, of course, poses barriers to in-market mergers of small banks in rural areas. Due to these barriers, oftentimes the only institutions that would be allowed to acquire small rural banks are large, out-of-market institutions with little familiarity with or fidelity to the local, rural banking market. Properly tailored, a de minimis exception could allow two small banks operating in a local, highly concentrated market to merge and thereby form a moderately larger bank which retains all the connections and relationships previously maintained by the two merged banks. Therefore, CSBS recommends that the DOJ explore establishing a de minimis exception for certain transactions in highly concentrated markets.

There are a variety of different approaches that could be taken in designing a de minimis exemption. One possible approach would be to exempt an institution based on the asset size of the resulting institution. This approach has the benefit of specifically addressing the scenario mentioned above in which two small banks in a highly concentrated market seek to merge. Another approach would be to exempt transactions in communities with a population below a certain level. This approach seems to be that which the OCC has taken with respect to communities located in areas with less than 10,000 residents. Further consideration would be needed to assess the costs and benefits of different types of de minimis exemptions, but state bank regulators generally welcome the DOJ, and the Agencies, considering and potentially establishing a de minimis exemption.

III. The DOJ should explore ways to create greater alignment and consistency with the Agencies.

Although the DOJ and the Agencies concurrently conduct competitive review analyses of bank mergers and acquisitions, they employ the two-step screening process in different ways. This inconsistency creates confusion and uncertainty for the banks attempting to complete a merger or acquisition. Additionally, it leads to increased costs for both the governmental entities and regulated financial institutions, lengthy delays in processing applications, and unpredictable analysis results. CSBS appreciates that the DOJ and the Agencies have different statutory mandates and responsibilities, but we would support the DOJ and Agencies jointly issuing guidance addressing the competitive bank merger review analysis to improve consistency in implementation.

Furthermore, state bank regulators recommend that the DOJ along with the Agencies explore methods to obtain greater alignment in approaches in order to provide greater certainty for market participants as well as state regulators. For example, the DOJ and the appropriate Agency could perform a joint review of any proposed merger or acquisition. This approach would have the benefit of increasing the likelihood of a consistent determination from the DOJ and the Agency related to the combination.

Another possible approach would involve either the DOJ or the appropriate Agency functioning as the lead agency, resulting in the non-lead agency reviewing the findings for consistency with its statutory requirements. This approach would ensure that the review is conducted with a common directive from the outset, which in turn should lead to more consistent outcomes. In short, CSBS encourage the DOJ and the Agencies to explore and consider these approaches and the wide array of other steps that could be taken to engender greater consistency among the DOJ and the Agencies with respect bank merger reviews.

IV. The DOJ and the Agencies should recognize and incorporate the role and interests of states in the bank merger review process.

For states, competition is vital to local economies and protecting free competition is a public policy of the first magnitude. Indeed, well before the federal government even first enacted antitrust laws, states enacted their own antitrust laws and empowered state officials to enforce them. The interest of states is particularly acute in the context of bank mergers because, ultimately, the most significant impact of banking activities is on local communities. Moreover, due to their proximity to the consumers and small businesses impacted by bank mergers, state officials are in a unique position to assess the actual workings of local banking markets and the impact of a bank merger on local communities.

Due to the state's interest in preserving competition generally but, particularly in the banking context, Congress has, in enacting federal antitrust laws, recognized this interest both by preserving the authority of states to enact and apply their own antitrust laws to bank mergers and preserving a role for state officials in the federal approval of a bank mergers. This role can range from concurrent review and approval to the ability to intervene and challenge a federal approval. Despite the relevant laws governing bank mergers preserving the role of states in bank merger review and approval, the Guidelines do not similarly acknowledge the role of state agencies (whether acting through their banking department, antitrust division or both) in the bank merger review process.

State bank regulators believe that the federal bank merger analysis and review process should be aligned with, and conducted in consultation with, relevant state agencies and officials. To provide clarity and certainty to parties to merger transactions, the role of states in the bank merger review process should be specified in the Guidelines and any analogous guidance issued by the Agencies. We encourage the DOJ and the Agencies to explore how the role of relevant state agencies in bank merger reviews can be better reflected in existing processes and guidance documents.

V. Conclusion

In conclusion, CSBS supports the DOJ's goal of modernizing their bank merger review process and competitive effects analysis. CSBS and its members play a central role in the regulation and supervision of banks subject to this bank merger analysis and thus have a significant stake in its implementation. CSBS believes that the inclusion of relevant market competitors in the HHI calculation, greater consistency between the DOJ and the Agencies, and a de minimis exception would significantly improve the bank merger review process and analysis.

Sincerely,

John Ryan
President & CEO

Footnotes

1 CSBS is the nationwide organization of state banking and financial regulators from all 50 states, American Samoa, the District of Columbia, Guam, Puerto Rico, and the U.S. Virgin Islands. CSBS supports the state banking agencies by serving as a forum for policy and supervisory process development, by facilitating regulatory coordination on a state-to-state and state-to-federal basis, and by facilitating state implementation of policy through training, educational programs, and exam resource development.
2 The Conference of State Bank Supervisors, the Federal Reserve System, and the Federal Deposit Insurance Corporation sponsor an annual Community Banking Research and Policy Conference which gathers industry and stakeholders to discuss the latest research on community banks.
3 Eric Hogue, Charles S. Morris, & James Wilkinson, 2015. "Competition in Local Agricultural Lending Markets: The Effect of the Farm Credit System," Economic Review, Federal Reserve Bank of Kansas, Q IV, 51-78.

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