COMMENT LETTER

# Bank Merger Transactions

June 3, 2022
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James P. Sheesley, Assistant Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429
RIN 3064-ZA31

*Re: Request for Comment on Rules, Regulations, Guidance, and Statement of Policy on Bank Merger Transactions*

Dear Mr. Sheesley,

The Conference of State Bank Supervisors ("CSBS")[1] appreciates the opportunity to provide input on the Request for Comment on Rules, Regulations, Guidance, and Statement of Policy on Bank Merger Transactions (collectively, "regulatory framework") issued by the Federal Deposit Insurance Corporation ("FDIC"). The request seeks comments on the quality and effectiveness of the existing regulatory framework for bank merger transactions. CSBS supports a modernized regulatory framework that reflects the evolution of financial services, the diversity of consumer and small business needs, and the interests of community banks.

State banking supervisors have a significant stake in the analysis and evaluation of bank merger transactions. States charter and supervise 79 percent of all banks in the United States, which accounts for nearly 4,000 banks with over $8 trillion in combined assets. Many of these institutions are small community banks, some of which represent the sole banking presence in local markets, particularly in rural areas. These community banks contribute significantly to local economies throughout the country by providing access to credit including a wide array of customized loan services. This relationship-based lending allows small businesses to thrive in local marketplaces, which creates further opportunities for innovation throughout the economy.

CSBS makes the following recommendations regarding the review of the existing regulatory framework for bank merger transactions:

- The FDIC should work with the other federal banking agencies and the Department of Justice ("DOJ") to reevaluate how the Herfindahl-Hirschman Index ("HHI") is calculated in light of technological innovations, market expansion, and consumer preferences;
- The FDIC should reassess the Summary of Deposits ("SOD") data collection to more appropriately reflect the diversity of depositor location;
- The FDIC should consider creating a de minimis exception for certain transactions to preserve the viability of community banks;

- The FDIC and federal banking agencies should recognize and incorporate the role of states in the regulatory framework of bank merger transactions;
- The FDIC should explore ways to increase alignment and consistency across the federal banking agencies and the DOJ; and
- The FDIC should provide greater clarity around the objective, scope, and criteria of modernizing the regulatory framework for the benefit of other prudential and state regulators.

**I. The FDIC should work with the other federal banking agencies and the Department of Justice ("DOJ") to reevaluate how the Herfindahl-Hirschman Index ("HHI") is calculated in light of technological innovations, market expansion, and consumer preferences.**

The FDIC's Request for Comment seeks feedback on the efficacy of the HHI as a measurement of market concentration. It specifically asks whether the FDIC should consider the inclusion of other quantitative measures when reviewing a bank merger transaction. State bank regulators are concerned that the current method for calculating market share and market concentration fails to account for the evolution of banking practices and market competition over the last several decades. The assessment of market concentration should appropriately account for competition from non-depository financial institutions, credit unions, and savings institutions due to their growth throughout the financial services industry.

Under the current regulatory framework, the deposit market share of commercial banks is used to calculate concentration in a local banking market or other relevant geographic area. Savings institution deposits also factor into the concentration analysis, but to a limited extent. By relying on this restricted deposit market share to calculate market concentration, the regulatory framework 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 it is necessary to account for competition from non-depository financial institutions and credit unions in calculating market concentration for bank merger transactions. More than 29,000 state-regulated non-depository financial services companies provide products and services such as mortgages, money transmission, and consumer finance. In recent years, non-depository institutions have grown to account for $3.8 trillion worth of money transmission transactions and $2.9 trillion in mortgage origination. However, non-depository institutions are not included in the HHI calculation and bank merger competitive review analysis.

Farm Credit Associations (FCAs) are also significant competitors to banks in 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 at 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.[2] Despite the substantial competitive presence of FCAs in certain markets, they are not considered in HHI calculations. This skews the data and, thus, the analysis, which may unnecessarily prevent the completion of in-market bank mergers.

The FDIC should also revisit its current treatment of credit unions, which do not fall under the initial market concentration screen of the HHI calculation. The influence and lending prowess of credit unions has grown exponentially in recent years. 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.

The deposit market share of savings institutions is also excluded in analyzing the competitive effects of transactions unless a savings institution is deemed an active competitor in the small business banking market. As of the end of 2021, commercial lending constituted over six percent of savings institutions lending compared to less than two percent in 1995 when the current regulatory framework was last reviewed. 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.

Competition from non-depository institutions, credit unions and savings 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. CSBS encourages the FDIC, together with the other federal banking agencies and the DOJ, to explore what existing data sources may be utilized and what additional data may be needed to account for market competition from other relevant competitors. 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 unnecessarily impede in-market bank merger and acquisition activity that would benefit rural and small communities.

## II. The FDIC should reassess the Summary of Deposits ("SOD") data to more appropriately reflect the diversity of depositor location.

Under the current regulatory framework for bank merger transactions, the Summary of Deposits (SOD) data collected by the FDIC is the primary data used in the HHI calculation to determine market concentration. However, the SOD presents deposits based on the location of the branch at which deposits are booked rather than the location of the depositor. Attributing online deposits and centrally booked deposits to the location of a branch limits the utility of the SOD data in evaluating local banking markets.

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 have an online platform that enables customers to retain banking relationship regardless of their location.
The continuation of these customer relationships in the pre-Internet era would have often been too inconvenient to maintain.

State regulators believe that the data collected and used to determine market concentration under the current regulatory framework should be modernized to account for the evolution of banking practices enabled by advances in technology. As stated earlier in this letter, CSBS recommends that the FDIC, together with the other federal banking agencies, 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.

## III. The FDIC should consider creating a de minimis exception for certain transactions to preserve the viability of community banks.

Any revisions or updates to the current regulatory framework should be appropriately tailored to avoid facilitating consolidation at the expense of smaller banks that serve local communities. CSBS strongly supports a diversified banking industry and policy measures intended to preserve the community banking business model,

including the limits on nationwide and statewide deposit concentrations placed on interstate merger transactions. For this reason, state regulators believe the FDIC should consider creating a de minimis exception for community banks seeking to merge in a way that would preserve or even improve access to banking services, particularly in rural communities.

In many rural areas, only a limited number of small banks represent the entire physical banking presence. As a result, rural markets are much more likely to be highly concentrated. This poses a barrier to in-market mergers of small banks in rural areas while easing the path for small rural banks to be acquired by large, out-of-market institutions with little familiarity of the local 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 FDIC 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 a merger 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. 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 FDIC and other federal banking agencies considering and potentially establishing a common de minimis exemption.

**IV. The FDIC and the other federal banking agencies should recognize and incorporate the role of states in the regulatory framework of bank merger transactions.**

State banking agencies charter and supervise a diverse range of financial institutions, including mid-sized regional banks and small community-focused banks. State regulators play a critical role in evaluating the impact of in-market bank mergers and acquisitions based on their knowledge of local community needs and preferences. Moreover, due to their proximity to the consumers and small businesses impacted by bank mergers, state officials have an informed perspective to assess local banking markets and the impact of a bank merger on local communities.

In enacting federal antitrust laws, Congress has recognized the state's interest in preserving competition, particularly in the banking context, by upholding the authority of states to enact and apply their own antitrust laws to bank mergers and maintaining a role for state officials in the federal approval of 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 current regulatory framework does not similarly acknowledge the role of state agencies (whether acting through their banking department, antitrust division, or both) in the bank merger review process.

The federal regulatory framework should be developed and implemented in consultation with relevant state agencies and officials. To provide clarity and certainty to parties involved in merger transactions, the role of states in the bank merger review process should be detailed in the regulatory framework issued by the federal banking agencies. CSBS encourages the FDIC to explore how the role of relevant state agencies in bank merger reviews can be better reflected in the current regulatory framework and future guidance documents.

**V. The FDIC should explore ways to increase alignment and consistency across the federal banking agencies and the DOJ.**

Although the FDIC and the other federal banking agencies, as applicable, conduct concurrent analyses of bank merger applications, they employ different processes. 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 results. The delays and uncertainty negatively impact the subject banks, their employees and the communities they serve.

Recently, the Antitrust Division of the Department of Justice ("DOJ") reissued its request for comment on revisions to the 1995 Bank Merger Competitive Review Guidelines (the "Guidelines"). The request sought input on whether the Division should revise the Guidelines and modernize its approach to bank merger reviews under antitrust laws. CSBS submitted a comment letter to the DOJ in October of 2020, which emphasized the need for regulatory alignment of bank merger analyses among the DOJ and federal banking agencies.[3] State regulators appreciate that the FDIC and other federal banking agencies have different statutory mandates and responsibilities but support joint guidance addressing the regulatory framework of bank mergers and acquisitions to improve consistency.

Furthermore, state bank regulators recommend that the FDIC along with the DOJ and other federal banking agencies explore methods to obtain greater alignment in approaches to provide greater certainty for market participants as well as state regulators. For example, the FDIC and other federal banking agencies could perform a joint review of any proposed merger or acquisition. This would increase the likelihood of a consistent determination to the proposed combination.

Another possible approach would involve either the FDIC or appropriate regulatory 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 encourages the FDIC, the other federal banking agencies and the DOJ to explore and consider these approaches and other options that could provide greater consistency in the evaluation of bank merger transactions.

## VI. The FDIC should provide greater clarity around the objective, scope, and criteria of modernizing the regulatory framework for the benefit of other prudential and state regulators.

The FDIC along with the other federal banking agencies have not reviewed the current regulatory framework for bank merger transactions in almost three decades. It is imperative that the FDIC provide clarity around the objective and scope for modernizing the regulatory framework, promote regulatory alignment across the federal banking agencies and increase certainty about the requirements for state regulators, the banking industry and the public.

Specifically, state bank regulators request transparency around how the FDIC will determine financial stability, define community benefits, and address bank resolvability. The current regulatory framework contains a fair amount of ambiguity regarding the specific criteria required of financial institutions seeking a merger or acquisition. This uncertainty often leaves banking institutions and state regulators with no information as to the opposition or concerns delaying a potential bank merger or acquisition. The FDIC and other federal banking agencies should clarify the precise commitments needed from banking institutions with regard to competitiveness, community benefits, safety and soundness, and risk of resolution. This transparency would improve communication among the banking institutions and regulators and provide consistent expectations for the bank merger review process.

Additionally, the FDIC should provide more contextual information regarding the size of merged institutions and the commitments necessary to address resolvability concerns. The current bank merger review process lacks specificity around the requirements banking institutions need to meet to mitigate resolvability risk and promote safety and soundness. The current framework also fails to define an asset threshold that purports anticompetitive conduct. Increased clarity of the competitive review factors would improve consistency in implementation, result in more timely review of applications, and ensure confidence in the efficacy of the bank merger review process.

## VII. Conclusion

In conclusion, CSBS supports the modernization of the regulatory framework governing bank merger transactions. State regulators play a central role in the regulation and supervision of banks subject to the regulatory framework and, thus, have a significant stake in its future implementation. CSBS believes that the inclusion of relevant market competitors in the HHI calculation, the reassessment of the SOD data to consider depositor location, a de minimis exception for small bank mergers, the incorporation of the role of state agencies, increased regulatory alignment, and overall contextual clarity on the requirements of financial institutions would significantly improve the regulatory framework of bank merger transactions.

Sincerely,

James Cooper
Acting President & CEO

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*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 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.*

*3 The Conference of State Bank Supervisors, Comment Letter on the Antitrust Division Banking Guidelines Review: Public Comments Topics & Issues Guide (October 16, 2020), https://www.csbs.org/policy/statements-comments/csbs-comment-letter-antitrust-division-banking-guidelines-review-public.*

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