Antimerger Regulatory Proposals Threaten U.S. Financial Markets

The United States enjoys the world's deepest and most liquid capital markets, a success due in part to a financial regulatory regime that has evolved over the years to address new asset classes and business models. This financial system relies on strong institutions, including a mix of global-systemically important banks (GSIBs), regional banks, and smaller local banks, as well as credit unions, fintech companies, and many others. Each type of institution provides consumers and businesses that rely on the banking system with choice and promotes market competition.

Unfortunately, a recent wave of antimerger policy proposals could distort the natural evolution of bank mergers that the market desires. Inspired in part by an increasingly pervasive antimerger ideology, the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency (OCC), and the Department of Justice (DOJ) are considering proposals that would create new regulatory standards for bank mergers and increase the time required to complete the merger review process. If adopted, these proposals could discourage procompetitive mergers and exacerbate a the "barbell" market distribution in which only very large and very small banks survive—a structure that could lessen financial stability and leave consumers with fewer choices for banking services.

I. The Existing Regulatory Regime for Mergers and Acquisitions Has Created a Competitive Marketplace for Financial Services

Depending on the exact nature of the merging parties, the FDIC, OCC, Federal Reserve, and DOJ share responsibility for bank mergers. Regulators evaluate a merger's competitive impact, of course, but also five other factors: (1) community needs and compliance record with the Community Reinvestment Act, (2) effectiveness in combating money laundering, (3) financial resources and prospects, (4) managerial resources and prospects, and (5) risks to the U.S. banking or financial system or to their financial stability. Over the years, and across presidential administrations, these agencies have recognized that bank mergers generally enhance competition.[1]

Because of this regulatory approach, competition has increased substantially in credit markets in the last quarter century. The consumer credit market has seen new entrants, innovative products, aggregate growth, reinvention of incumbents, and the decline or departure of companies that could not keep pace. A recent study found that bank output was "supercompetitive" and that fees declined from 1984 to 2016.

1 https://repository.law.asu.edu/Repository/Jamie-M-Grischkan-195574/Article/Regulating-Bank-Mergers-Past-and-Present-10360.html

Consumers now have bank branches; ATMs have increased by the tens of thousands, brought banking to underserved communities, and moved banks closer to consumers in large markets. Similarly, in the past two decades, membership in credit unions has risen by about 50 million—counting 120 million members in 2019. Credit unions compete vigorously with banks on offering for deposit accounts, checking accounts, and credit products. Online banks, and the expanded geographic reach of brick-and-mortar banks with an online presence, also have significantly expanded competition in credit markets. Finally, consumers have other choices to find credit, including from certain retailers, auto lenders, and other nondepository lenders.

Consistent with the findings from the U.S. Chamber of Commerce's 2013, 2016, and 2019 surveys, businesses rely on diversity and competition within the banking system to meet their short- and long-term financing needs. Depending on their size, industry, or geographic location, businesses may use different financial situations for different reasons. A substantial number of firms also use multiple financial institutions for different products and services. For example, 37% of businesses depend on at least four financial institutions to provide cash management services, while 36% of businesses use four or more institutions for payment services.[2]

II. Bank Mergers Can Promote Competition and Financial Stability

Bank mergers have helped to facilitate this competitive landscape. A merger can free resources to protect consumer data and defend against cyberattacks; to invest, particularly in low-income communities; and to improve customer products, such as digital services. In the past, the DOJ itself recognized that the "great majority of bank mergers do not cause antitrust concerns" and that a bank merger can allow "the merging firms to achieve significant economies of scale or scope," thereby lowering costs and improving services for consumers.

Indeed, both financial institutions and consumers can benefit from scale. After Congress allowed banks to operate across state lines, many banks merged in ways that allowed them to compete more broadly and effectively in more of the country. Digitization, for instance, requires major investments in fixed capital and ongoing expenditures in digital security. Scale also can help to ameliorate compliance burdens and the need for low-cost deposit funding. At the same time, smaller banks often cannot attract the right type of talent to deal with ever-changing risks.

In addition to enhancing competition, bank mergers can improve financial stability. A merger broadens the combined institution's capital base and liquidity position.

2 https://www.uschamber.com/assets/documents/CCMC_Survey-FinancialChallenges_Fall2023.pdf

In particular, bank mergers allow smaller and regional banks to compete effectively with the largest GSIBs and with other institutions that offer credit, thereby increasing consumer choice and reducing the risk of financial instability. Several studies have concluded that bank mergers promote competition and allow institutions to offer a wider range of products and services.[3] Similarly, in recent comments responding to the 2023 bank failures, Treasury Secretary Janet Yellen acknowledged that "more consolidation in the banking industry could be healthy." Secretary Yellen pointed out that "we have more banks, relatively speaking, in the United States than almost any country of which I'm aware." In fact, the European Union boasts more midsize banks (Categories II and III with assets greater than $250 billion) than does the U.S: The E.U. has 27, where the U.S. has only 10. Despite such discrepancy, the U.S. banking system still offers a variety of affordable financial products to customers. Increasing the number of midsize banks in the U.S. could lower costs and expand accessibility even further. In the same vein as Secretary Yellen, and undermining the need for dramatic regulatory changes, Federal Reserve Board Chair Jerome Powell recently noted that "the U.S. banking system is sound and resilient, with strong levels of capital and liquidity."

Although some regulators, including Federal Trade Commission Chair Lina Khan, contend that bank mergers have raised concentration levels in concerning ways, the data show otherwise.

In an exhaustive analysis of all available census data from the past two decades—data unavailable for most prior studies—a recent study found that many aspects of the banking and finance sectors have become less concentrated since 2002. In particular, the commercial banking, credit card issuing, and consumer lending sectors all have experienced declining concentration. Competition has increased across the economy as companies have used online tools to become more efficient and expand their reach nationwide. Moreover, most mergers involve smaller banks, which of course should raise even fewer concerns about inordinate concentration. According to the FDIC's own data, over the past two decades, "only 0.3% of merger applications acted on by the FDIC involved resulting institutions with over $100 billion in assets and only 4.4% involved resulting institutions with between $10 billion and $100 billion in assets."

In any event, and contrary to the views expressed by Chair Lina Khan and other skeptics of bank mergers, numerous studies have found that bank concentration does not impair competition. For instance, by some metrics, Houston, Texas, and Columbus, Ohio, have highly concentrated financial sectors, but both cities offer customers many choices: Houston has 92 commercial banks, while Columbus has 48 banks and 9 thrifts. Studies have found no correlation between bank mergers and branch closures.

3 See Shradha Bindal, Christa H.S. Bouwman, Shuting (Sophia) Hu, and Shane A. Johnson, Bank Regulatory Size Thresholds, Merger and Acquisition Behavior, and Small Business Lending, 62 J. Corp. Fin. 1 (2020) (noting that mergers facilitate economies of scale in terms of regulatory compliance); Charles W. Calomiris, Gauging the Efficiency of Bank Consolidation During a Merger Wave, 23 J. of Banking and Fin. 615 (1999) (noting that, for several decades, banks grew in size and complexity so as to capture economies of scope and to offer an increasingly complex array of products and services). See also U.S. Chamber, at https://www.uschamber.com/assets/documents/220215_Comments_BankMergerReview_DOJ.pdf.

More fundamentally, concentration levels are calculated based on total deposits, which are "at best loosely correlated with the various financial services that banks and thrifts provide. Because banks can readily reallocate funds from one purpose to another."[4] Ease of entry also lessens concerns, because small firms can quickly increase capacity to serve more customers.

In short, the data show rather overwhelmingly that, in the past two decades, competition has increased substantially in credit markets, many aspects of the banking and finance sectors have become less concentrated, concentration does not necessarily impede competition, and mergers can enhance competition and financial stability. Particularly on the last point, top policymakers, from a former head of the DOJ's Antitrust Division to the current Secretary of the Treasury, have publicly recognized the benefits of bank mergers.

III. Pending Regulatory Proposals Could Reduce Competition and Financial Stability

Three agencies—the DOJ, FDIC, and OCC—are considering proposals that would affect the merger review process. DOJ is in the process of revising its bank merger guidelines, last updated in 1995; based on the department's recently released broader merger guidelines for the entire economy, there is reason to suspect that the revised bank merger guidelines could declare structural presumptions against bank mergers that increase market concentration and downplay the possibility of merger efficiencies.

Reflecting this same distrust of mergers, the OCC's proposal[5] would eliminate expedited review procedures and the use of a streamlined application. In a related policy statement, the OCC indicated that it would be skeptical of any mergers involving large banks or mergers that could result in job losses.

The FDIC's proposal is even more expansive.[6] Similar to what the OCC proposed, the FDIC would require more detailed information as part of the application process. More significantly, the FDIC proposes to approve a merger only if the merged bank would "better meet the convenience and the needs of the community to be served than would occur absent the merger." This proposed higher standard for merger review appears to contravene historical practice, which is to approve mergers unless the evidence shows that the merger would reduce competition. In another change, the FDIC proposes to require any divestitures before allowing a merger to close rather than allowing a reasonable window of time in which a divestiture can occur after closing.

Throughout its proposal, the FDIC focuses heavily on concentration levels. The FDIC intends to use bank deposits as an initial proxy for concentration levels and then to consider whether the merger would increase concentration "in any specific products or customer segments," such as small business or residential lending or "activities requiring specialized expertise."

4 See U.S. Chamber, Public Comment on Bank Merger Competitive Analysis (citing CFPB Task Force Report), at https://www.justice.gov/atr/page/file/1474331/dl?inline.
5 https://occ.treas.gov/news-issuances/news-releases/2024/nr-occ-2024-7.htm
6 https://www.fdic.gov/sites/default/files/2024-04/2024-03-21-notice-dis-b-fr.pdf

Although the FDIC notes that it will consider competition from "all relevant market participants," including nonbank competitors, the focus on concentration levels and specific products appears to minimize the ease with which financial institutions can lend to customers across the economy.

Collectively, these proposals could delay or derail many bank mergers, particularly those involving small banks, which may lack the legal and compliance resources of their larger counterparts. The fragmented regulatory approach, with three proposals from three different agencies, likely would contribute to the continued uncertain outlook for bank mergers. Moreover, by increasing filing requirements and insisting on pre-closing divestitures, the proposals would add upfront costs and could significantly delay many transactions—even after any competitive concerns have been resolved.

Even more fundamentally, these antimerger proposals could the U.S. financial sector into a "barbell banking sector where only community banks and GSIBs survive." In a recent, former FDIC Chair Sheila Bair explained that an antimerger agenda could reduce the financial stability of regional banks and thereby lessen competition faced by larger banks: "I'm very concerned about current efforts to discourage M&A activity among regional banks. ... We should be doing just the opposite. If we want to prevent regional failures, we should be encouraging the healthy ones to buy the weaker ones and not the opposite direction, which is what we're doing."

Bair and other scholars have further explained that regional banks remain important providers of financial services for small and mid-sized business and of collateralized deposits for local governments and nonprofits. The regulators' antimerger agenda discourages investment, particularly in technology, and pushes customers to seek capital outside the banking system.

Two FDIC officials emphasized that the agency's proposal could undermine competition and financial stability. Vice Chairman Travis Hill explained that, if interpreted literally, the proposal "could effectively serve as a prohibition on a broad range of bank mergers ... any time an acquiring institution is on stronger financial footing than a target institution, the resulting [bank] will initially look worse from a balance sheet perspective." By reducing the ability of large banks to acquire smaller ones, the FDIC's proposal, as well as the OCC's proposal, could lead to more "zombie" banks with no exit strategy before they reach the point of failure.

Similarly, Director Jonathan McKernan pointed out that the FDIC's proposal ignores mergers' benefits. The proposal "does not consider ways in which a merger could decrease risk to financial stability by, for example, fostering competition with the largest banks or improving the financial condition of a weaker bank." Instead of this approach, Hill emphasized that "we should work to develop a regulatory framework that allows banks of all sizes and various business models to flourish, is not biased in favor of one class of bank over others, and otherwise leaves it up to the market and the American people to determine how banking assets are allocated across the system."

Conclusion

Before policymakers transmute the process for reviewing bank mergers, they should ask themselves what problem they are trying to solve, whether less drastic means could address the perceived problem, and whether the proposed solution might create other risks. On the first question, the data strongly suggest that there is no competition problem: In the past two decades, competition has increased substantially in credit markets, and many aspects of the banking and finance sectors have become less concentrated. On the last question, many senior policymakers agree that shifting to an antimerger approach could create a suboptimal “barbell” financial system primarily populated by GSIBs and small banks, with relatively few regional banks, and that such a system would reduce financial stability, cybersecurity, and the credit available to many local customers.