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Remarks at Brookings

"Bank Mergers and Industry Resiliency"

May 9, 2022

Good morning and thank you, Aaron. It is a pleasure to be here this morning. Brookings has a long history of providing forums for thoughtful discussion and analysis of complex issues. Today's topic, bank mergers and industry resiliency, adds to that history.

Bank mergers have received significant attention this past year.[1] Concerns about the negative effects of bank mergers on competition, communities, and financial stability have prompted some to call for a moratorium on merger activity.[2] In response, others have defended the benefits of mergers. They note that the U.S. financial services market is highly competitive, and mergers allow institutions to achieve needed economies of scale and to diversify risk through geographic or product expansion.[3]

From my perspective, the frameworks for analyzing bank mergers need updating. Without enhancements, there is an increased risk of approving mergers that diminish competition, hurt communities, or present systemic risks. On the other hand, imposing a moratorium on mergers would lock in the status quo and prevent mergers that could increase competition, serve communities better, and enhance industry resiliency. To use a statistics

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[1] Exec. Order 14036, 86 Fed. Reg. 36987, 36992 (July 14, 2021); FDIC: FIL-11-2022: FDIC Request for Information on Bank Merger Act; Bank Mergers, Acquirer Choice and Small Business Lending: Implications for Community Investment | NBER; Market Deposit-Loan Imbalances and Bank M&A Outcomes by Leonid Pugachev | SSRN; Reviving Bank Antitrust by Jeremy C. Kress | SSRN

[2] Brown Urges Fed and OCC to Scrutinize Bank Mergers | Senator Sherrod Brown (senate.gov); Warren Urges More Rigorous Bank Merger Reviews as the Justice Department Looks to Update Its Guidelines | U.S. Senator Elizabeth Warren of Massachusetts (senate.gov); Waters Calls on Fed, FDIC, and OCC to Halt Mergers and Acquisitions Over $100 Billion | Chairwoman Maxine Waters (financialservices.house.gov)

[3] BPI Responds to DoJ Review of Competitive Effects of Bank Mergers | Bank Policy Institute

analogy, continuing to apply the current analytical frameworks would risk "false positives" (a type one error), while imposing a moratorium would risk "false negatives" (a type two error).

Our goal should be to minimize both types of error—to revise the frameworks for analyzing bank mergers so that bad mergers are prevented, and good mergers are allowed. In short, rather than being pro-merger or anti-merger, we need frameworks that are *smart* on mergers. Bank mergers should serve communities, support financial stability and industry resilience, enhance competition, and enable diversity and dynamism of the banking industry. Revisions to the bank merger framework would help to realize this goal.

Background

The decision criteria used by the OCC to assess bank mergers are public and described in our Licensing Manual focused on business combinations.[4] The factors for consideration under the Bank Merger Act are listed and include:

- The effect of the proposed business combination on competition ("competition prong")
- The financial and managerial resources and future prospects of the existing or proposed institutions ("safety and soundness prong")
- The probable effects of the business combination on the convenience and needs of the community served ("convenience and needs prong")
- The risk to the stability of the U.S. banking and financial system ("financial stability prong")

Other factors include the deposit concentration limit, effectiveness in combatting money laundering, and Community Reinvestment Act (CRA) performance.

[4] Licensing Manual: Business Combinations | OCC (treas.gov)

These factors and associated analytical frameworks have become dated. The Dodd-Frank Wall Street Reform and Consumer Protection Act, enacted in 2010, mandated the consideration of the risk to financial stability.[5] The safety and soundness and convenience and needs prongs were part of the original BMA in 1977 or added over time by various amendments to the BMA.[6] For its competitiveness analysis, the OCC has adopted the Department of Justice's Bank Merger Competitive Review Guidelines, which was last revised in 1995. DOJ recently sought public comment into whether it should update the Guidelines to reflect trends in the banking and financial services sector and to modernize its approach to bank merger review.[7]

The banking system has changed significantly since 1995. Industry assets, which totaled $5 trillion in 1995, now total nearly $25 trillion. At the same time, the number of insured depository institution charters has decreased by about 60 percent. As a result, the size of the average bank has increased to almost $5 billion. Assets have become concentrated in the largest banks. In 1995, the twenty-five largest banks accounted for almost 30 percent of the industry assets; in 2021 they held 65 percent of total industry assets. The largest bank in 1995 had approximately $250 billion in total assets. Today, there are 13 banks with more than $250 billion in total assets, and the largest bank has over $3 trillion in total assets.[8]

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[5] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, section 604(f), 124 Stat. 1376, 1602 (2010) (codified at 12 U.S.C. 1828(c)(5)).

[6] See 12 USC 1828(c). The requirement to consider the performance of the applicant and the other depository institutions involved in the business combination in helping to meet the credit needs of the relevant communities, including low- and moderate-income neighborhoods, consistent with safe and sound banking practices is in 12 USC 2903(a)(2).

[7] Antitrust Division Seeks Public Comments On Updating Bank Merger Review Analysis | OPA | Department of Justice

[8] Reports of Condition and Income (Call Reports) | FFIEC Central Data Repository (ffiec.gov)

The broader competitive landscape has also changed significantly. Between 1995 and 2020, membership in credit unions doubled, and total assets held by credit unions grew by more than 550 percent.[9] Non-banks dominate in certain areas, like mortgage originations, in which their market share is close to 70 percent.[10] And as banking has gone digital, fintechs like PayPal, Block, Stripe, and Shopify have acquired millions of customers and collectively have processed trillions of dollars of transactions annually. Additionally, neobanks such as Chime, Current, and Aspiration have millions of customers, while big tech firms like Apple and Google have hundreds of millions of users and have expanded into payments and lending products.

The demographics of the country have changed as well. Urban areas throughout the United States have grown, with an estimated 83 percent of the U.S. population living in urban areas in 2020.[11] Nearly every American owns a cell phone, with the percentage of the population owning a smart phone at nearly 85 percent, up from 35 percent a decade ago.[12] Seventy percent of Americans look primarily to online and mobile channels for their banking needs, with the pandemic accelerating reduced reliance on branch banking.[13]

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[9] Refer to https://www.cuna.org/content/dam/cuna/advocacy/cu-economics-and-data/data---statistics/National.pdf

[10] Nonbank mortgage originators' share of the market, by origination volume, first exceeded banks' share in the mid-2010s. See FDIC Quarterly Banking Profile vol. 13-4 (fdic.gov). Nonbank mortgage lenders accounted for nearly 70% of originations in 2020. See Five trends reshaping the US home mortgage industry | McKinsey

[11] See U.S. Cities Factsheet | Center for Sustainable Systems (umich.edu), which projects 89 percent of the U.S. population will live in urban areas in 2050. Rural populations, by contrast, have continued to fall, from 21.4 percent of the U.S. population in 1990 to an estimated 17% in 2020. See 1990 Census of Population, General Population Characteristics, United States, 1990-CP-1-1 (census.gov).

[12] Demographics of Mobile Device Ownership and Adoption in the United States | Pew Research Center

[13] National Survey: Bank Customers Turn to Mobile Apps More Than Any Other Channel to Manage Their Accounts | American Bankers Association (aba.com)

Finally, economic inequality has persisted or worsened in the United States. Since 1979, the top 1 percent of earners have seen wages increase by 179 percent, and wages for the top 0.1 percent of earners leaped by 389 percent, while wages for the bottom 90% of earners grew by just 28 percent.[14] This income inequality contributes to wealth disparities. In 2019, 10 percent of families owned 76 percent of total household wealth. The middle 40 percent of families owned 22 percent of household wealth, and the bottom 50 percent owned just 1 percent of household wealth.[15] Over the same period, Black, Hispanic, and lower income families have consistently lagged behind White and upper income families in the most important wealth-building measure, homeownership.[16]

Given all these changes, the time is ripe to rethink the frameworks used to analyze bank merger applications. I do not think the statutory prongs of competitiveness, safety and soundness, meeting community needs, and financial stability need to be revisited. Rather, the modes of analysis used by regulators to apply these factors need to be improved. My sense is that the degree and nature of change required varies by prong. Let me discuss each in turn.

Competition

There are compelling studies on both sides of the bank merger competitiveness debate. Proponents of a merger moratorium argue that mergers reduce competition and exacerbate the effects of banking industry consolidation on all consumers, particularly the most vulnerable low-

[14] Wage inequality continued to increase in 2020: Top 1.0% of earners see wages up 179% since 1979 while share of wages for bottom 90% hits new low | Economic Policy Institute (epi.org)

[15] Wealth Inequality in America over Time: Key Statistics | St. Louis Fed (stlouisfed.org)

[16] Nine Charts about Wealth Inequality in America (Updated) (urban.org); Housing Vacancies and Homeownership (CPS/HVS) Historical Tables (census.gov)

and-moderate-income (LMI) communities. They argue that the current approach to mergers, with a narrow focus on prices and efficiencies, has perversely increased the cost of financial products without delivering efficiency gains. Moreover, according to this view, the traditional competitive analysis overlooks other forms of consumer harm, including branch closures, funding subsidies that distort competition, and excessive industry concentration.[17]

Other studies, by contrast, conclude that mergers are pro-competitive. They contend that mergers allow banks to achieve economies of scale and scope, broadening product offerings and reducing prices for consumers. They counter the reduction in the absolute number of banks over the last four decades by pointing out that the number of bank branches has doubled over the same time frame, thereby offering consumers greater access to banking services. In addition, the advent of mobile banking, making products and services available even in those markets where a bank does not have a branch, is indicative of competitive, not concentrated markets.[18]

Most of these studies, which are cited in support of anti-merger or pro-merger positions, are difficult to operationalize for bank merger analysis purposes. Perhaps for that reason, I have found myself drawn to Harvard University Law School Professor Daniel Tarullo's approach to competition, which was recently published by Brookings.[19] He argues for a much deeper and more granular analysis that differentiates by types of lending, considers broader industry dynamics, and considers local, regional, and national markets. For example, he notes, "while a merger between two banks might not result in competitive harm for some bank products, it could

[17] Jeremy Kress, Modernizing Bank Merger Review (yale.edu); Reviving Bank Antitrust by Jeremy C. Kress | SSRN; Brown Urges Fed and OCC to Scrutinize Bank Mergers | Senator Sherrod Brown (senate.gov)

[18] BPI Responds to DoJ Review of Competitive Effects of Bank Mergers | Bank Policy Institute

[19] Regulators should rethink the way they assess bank mergers (brookings.edu)

do so for others." Such a conclusion, which seems easily imaginable, could not be reached under existing analytical frameworks, which utilize Herfindahl-Hirschman Index (HHI) screens. HHI is a blunt tool because it is measured at the geographic market level based on deposit activity rather than on a more granular basis, such as based on individual banking products.

Under the Bank Merger Act, the DOJ and the appropriate federal banking agency have shared responsibility for assessing the competitiveness impact of a proposed merger. DOJ's recent request for public comment clearly signals a desire to update its guidelines and analytical framework. OCC staff has been engaging with DOJ staff, as well as staff of other federal agencies, on this.

Convenience and Needs of the Community

Bank mergers have had a range of effects on the convenience and needs of communities served, from branch closures to changes in product offerings and terms.

One analytical element of the convenience and needs prong that likely does *not* need updating as part of the BMA review relates to the CRA. The OCC takes into account an acquiring bank's CRA rating and performance. Banks with unsatisfactory CRA ratings are highly unlikely to receive merger approval. Last week the banking agencies issued a notice of proposed rulemaking (NPR) to strengthen and modernize the CRA.[20] Under the NPR, CRA performance assessments would become more granular, more objective, and less prone to grade inflation. The proposal would encourage acquiring banks to increase their attention on CRA

[20] Agencies Issue Joint Proposal to Strengthen and Modernize Community Reinvestment Act Regulations | Office of the Comptroller of the Currency (occ.gov)

performance, which would increase their activities serving community needs, an intended consequence.

CRA performance and ratings are only a starting point, however. Community feedback on the impact of a proposed merger also is important. I recall meeting with a bank CEO who was touting the extraordinary success of a branch the bank had recently opened in a low-income neighborhood. I asked what prompted them to open that branch. He acknowledged it was requested by community organizations in a meeting related to the bank's most recent merger. Without that community feedback, that branch would not have been opened.

In recognition of the value that public input can provide on mergers, the OCC is considering options to facilitate such input. For example, for mergers involving larger banks, , the OCC is considering adopting a presumption in favor of holding public meetings. We partnered with the Federal Reserve to hold a public meeting in March for the proposed U.S. Bank and MUFG/Union bank merger. Over 120 community members attended and shared their views on the needs of the community and how they may be impacted by the merger.[21]

The role of community benefit agreements (CBA) or community reinvestment plans (CRP) in bank mergers also warrants consideration and discussion. On the one hand, they can serve as transparent and clear mechanisms for banks and communities to discuss and agree on what the needs of the community are. Banks have entered into CBAs in connection with several bank mergers.[22] On the other hand, questions may arise as to the representativeness and

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[21] Refer to Transcript: Joint Virtual Public Meeting

[22] For example, the 2016 merger of Key Bank and First Niagara included a $16.5 billion CBA. In 2021, First Citizens Bank announced a $16 billion CBA entered into in conjunction with its merger with CIT Bank

motivations of the organizations negotiating on behalf of the communities served.[23] Greater transparency and consistency in the governance of how CBAs are negotiated could help mitigate such concerns.

Financial Stability

The analytical framework for assessing the financial stability risks of bank mergers under the Bank Merger Act needs significant work. As I discussed in a recent speech at the Wharton School of the University of Pennsylvania, I believe there is a resolvability gap for large regional banks.[24] Unless and until that gap is addressed, the approvals of large bank mergers risk creating a new set of too-big-to-fail (TBTF) firms.

The issue for large regional banks can be boiled down to a simple question: "If one were to fail, how would it be resolved?" If the answer is: It would have to be sold to one of the four megabanks, then, I would posit, we have a financial stability problem.

Fortunately, we know how to address this problem. Several of the resolvability requirements for the U.S. global systemically important banks (GSIB) can be tailored and applied to large regionals to make them more resolvable—for instance, related to single-point-of-entry, total loss absorbing capital, and separability.[25] Implementing such changes will require action by the FDIC and Federal Reserve.

In the meantime, the large bank merger pipeline is active and will likely remain so for the foreseeable future. What should regulators do? Should we simply apply the traditional financial

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[23] The promises and perils of community benefits agreements: evidence from public comments to a large bank merger: Journal of Community Practice: Vol 28, No 4 (tandfonline.com)

[24] Acting Comptroller Discusses Large Bank Resolvability | Office of the Comptroller of the Currency (occ.gov)

[25] Ibid.

stability analysis and approve such mergers with the hope that the resolvability gap will be addressed in the future? Or should we reject all large bank merger applications until there is a clear set of financial stability rules in place that address the resolvability gap for merged banks of that size?

There are risks under either approach. One way to mitigate the TBTF risk while preserving opportunities for otherwise healthy mergers would be to condition approval on credible and verifiable commitments to achieving resolvability, tailored to the resolution risks of the resulting bank. This is something we are actively considering. Without such conditions, our approval of such mergers could increase financial stability and TBTF risks. These risks give me significant pause and are ones I would need to consider very carefully before approving a large bank merger.

Financial and Managerial Resources

In healthy mergers, the acquiring bank can improve the risk management and controls of the target bank, and ensure that the integration of systems, processes, and people is executed in a timely manner as planned, and the business model unfolds as projected. Such cases are win-win: Communities are better served, and the resulting institution is more safe and sound than the two banks individually. Bank supervisors are generally well-positioned to assess whether the financial and managerial resources of the acquiring bank are capable of executing a merger effectively and efficiently. As such, I do not see a need at this time for significant changes in how supervisors assess this prong.

With that stated, too-big-to-manage is a risk with mergers, especially for banks engaged in serial acquisitions. A review of institutions that grew through multiple mergers could reveal additional factors for supervisors to consider when assessing banks' financial and managerial resources.

Conclusion

It is time to rethink how we analyze bank mergers. In addition to offering some thoughts on this subject today, I have directed senior members of my staff to work with DOJ and the other federal banking agencies to review our merger frameworks. In the meantime, we will continue to review merger applications on a case-by-case basis and consistent with the statutory factors discussed above. In our actions, we will take into account changes in the banking industry and apply our best judgment to approve only applications that would promote competition, would not threaten financial stability, and would facilitate the convenience and needs of all the communities served by the banks.