Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Attn: Harrel M. Pettway,
Executive Secretary

May 27, 2022

RE: Request for Comment on Rules, Regulations, Guidance, and Statements of Policy on Bank Merger Transactions (RIN 3064–ZA31) (Request)[1]

Ladies and Gentlemen:

The American Bankers Association (ABA)[2] appreciates this opportunity to provide the views of our members to the Federal Deposit Insurance Corporation (FDIC) during its review of its rules, regulations, guidance, and statements of policy regarding bank merger transactions (collectively, Banking Guidelines).[3] ABA's members comprise the entire range of the US banking industry and compete vigorously in diverse product and geographic markets to serve their customers. Preserving this diversity and enhancing delivery of financial services to the national economy is a central concern of both our industry and our nation's public policy.

ABA believes that a review of the Banking Guidelines, large parts of which are now at least 25 years old, is important to the health of the US financial system and economy. In the intervening years, the market for financial products and services has undergone tremendous change, thanks to the rise of availability and use of online banking,[4] the interstate expansion of bank branch networks,[5] enhanced market access made possible by advertising and communication innovations, and the increased market presence of nonbank financial firms, including "fintechs."

[1] *See* https://www.fdic.gov/news/board-matters/2021/2021-12-06-notational-fr.pdf (March 31, 2022).
[2] The American Bankers Association is the voice of the nation's $24 trillion banking industry, which is composed of small, regional and large banks that together employ more than 2 million people, safeguard $19.9 trillion in deposits and extend $11.4 trillion in loans.
[3] ABA previously provided comments, available at https://www.aba.com/advocacy/policy-analysis/aba-letter-to-doj-re-bank-merger-guidelines (2020 Response), in response to the September 1, 2020 request for comment by the Antitrust Division of the US Department of Justice, and at https://www.aba.com/-/media/documents/comment-letter/cldojbankmerger20220215.pdf?rev=c2e28aa2d326481494b2ca8ce331a1b8 to the Division's 2021 follow-up request.
[4] According to a FICO report, 80% of millennials use digital banking to check their account balance, 76% use digital banking to check their accounts for fraudulent charges and 65% use digital channels to make external transfers. *See* Millennial Banking Insights and Opportunities, FICO (2014)(retrieved from www.fico.com).
[5] Interstate branching was liberalized under the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, Public Law No: 103-328 (108 Stat. 2338; Date: 9/29/94).

Because of these significant changes in the financial services market, the current Banking Guidelines fail to account for significant competition in many product lines, including in many rural markets. More specifically, we urge FDIC to consider these key points:

- Competitive impact analysis should take into account financial services provided to a market through channels other than branch networks, and by nonbank firms.

- Joint guidance adopted by both the Antitrust Division of the US Department of Justice (Division) and the Federal banking agencies would be very useful because it would maintain consistency in approach of the agencies having jurisdiction over analysis of competitive impacts of mergers.

- FDIC should raise to 2500 the threshold of the Herfindahl-Hirschman Index (HHI) below which FDIC would generally not challenge proposed mergers or require divestitures of branches or other operations, to take better account of the sources of competition noted above that are not taken into account under the current methodology. This revision would align with the threshold currently applicable to all other industries under the Horizontal Merger Guidelines as adopted by the Division and the Federal Trade Commission.[6] In 2010 the Division and the Federal Trade Commission raised the concentration threshold above which competitive harm was presumed for every industry except the banking industry, while concentration in the banking industry is low relative to other relevant industries serving consumers in the United States. Reconciliation of conflicting standards between the Banking Guidelines and the more general Horizontal Merger Guidelines is necessary and appropriate.[7]

Enhancing Accuracy of Competition Analysis: Consider All Relevant Competition

Market definitions based primarily on bank branch networks omit consideration of critical features of markets in which banks operate and customer groups which they serve. Any market definition should allow these additional factors to be taken into account in assessing the relevant competitive environment:

- Online delivery of financial services by banks without a branch presence, including online mortgage companies, nonbank commercial real estate lenders, and other online lending services;
- Money-market funds (which are direct competitors for bank deposits);
- Farm Credit System institutions, thrift institutions, and credit unions; and

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[6] *See* https://www.justice.gov/atr/horizontal-merger-guidelines-08192010#4.

[7] **Appendix C** summarizes some of the discussion within the academic literature of the conceptual flaws with HHI and other metrics (Lerner index, Boone index, etc.). The reliability and even the economic relevance of these metrics for bank competition assessment are called into serious question. But given the familiarity among market participants, researchers, and regulatory staff of the HHI, there might be practical reasons to continue using it within a restricted scope. Nonetheless, given that current HHI computations systematically ignore the activity of non-bank providers of a slew of banking products, we strongly recommend that the threshold be raised.

- Fintechs and other nonbank firms, which frequently unbundle financial services traditionally provided by banks through physical branches.

In some merger applications banks have already used additional data to document such market penetration:

- Data gathered pursuant to the Home Mortgage Disclosure Act (HMDA)[8] and the Community Reinvestment Act (CRA)[9] can be used to show market activity conducted other than through branches, (as considered to some extent already in Federal Reserve geographic market definitions); and
- Evidence from traffic patterns can show customer use of services in wider areas.

FDIC should encourage the inclusion of this and similar relevant information in merger applications when appropriate to provide a more accurate picture of current market conditions.

In addition, small-business loan data under the Small Business Administration's "Paycheck Protection Program" (PPP) offers additional evidence of competition with respect to small-business lending from nonbank firms without branch presence a given market. See **Appendix A**. ABA notes that PPP loans are unusual in several respects, especially as they were originated under a novel program that was ramped up very quickly and could be forgiven if borrowers met certain program requirements. Though not typical in some respects of small-business lending generally, PPP loans do demonstrate how quickly nonbank lenders (and likely lenders more generally) can offer loan products online, and how quickly small-business borrowers can adapt to and use such channels.

Appendix B provides a more general overview of changes to the competitive landscape that the merger review process should take into account. **Appendix C** offers a summary of current academic thought relevant to bank merger assessment.

Responses to Questions in the Request

ABA offers the following specific responses to certain questions raised in the Request.

Question 1. Does the existing regulatory framework properly consider all aspects of the Bank Merger Act as currently codified in Section 18(c) of the Federal Deposit Insurance Act?

> ABA believes that the current framework includes examination of the right general questions as required by the Bank Merger Act, though, as noted above, the relevant data and information traditionally examined in assessing a potential merger's competitive impact will not in many cases adequately reflect the true competitive landscape in which the banks operate. Consideration should include financial services available other than through bank branches in appropriate cases, including online delivery of financial services (by banks, mortgage companies, and other online lenders), money-market funds,

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[8] Codified at 12 USC §2801 *et seq.*
[9] Codified at 12 USC §2901 *et seq.*

Farm Credit System institutions, thrift institutions, credit unions and fintechs and other nonbank firms.

Question 2. What, if any, additional requirements or criteria should be included in the existing regulatory framework to address the financial stability risk factor included by the Dodd-Frank Act? Are there specific quantitative or qualitative measures that should be used to address financial stability risk that may arise from bank mergers? If so, are there specific quantitative measures that would also ensure greater clarity and administrability? Should the FDIC presume that any merger transaction that results in a financial institution that exceeds a predetermined asset size threshold, for example $100 billion in total consolidated assets, poses a systemic risk concern?

There is no appropriate presumption concerning asset size and systemic risk, and FDIC should not assume that transactions involving institutions having $100 billion or more in assets automatically pose systemic risk concerns. Institutions that may present systemic risks are, to the extent Congress determined it to be necessary, subject to numerous "enhanced prudential standards," which will apply following any merger transaction when the resulting institution's systemic risk profile makes them subject to those requirements. For example, increased capital requirements (including both risk-based standards and leverage limits), liquidity requirements, exposure limitations, capital planning and stress testing, and enhanced risk governance requirements are all designed to reduce the probability of institution insolvency. In addition, resolution planning requirements, if applicable under current regulations to a resulting institution following a merger, would mitigate the consequences should a failure occur. These provisions, developed over a decade since the financial crisis and adjusted by legislation, contain all the metrics required to address systemic risks. In adding financial stability considerations to merger assessments, Congress drew no distinction between prudential requirements that become applicable to the resulting institution following a merger based on existing regulatory thresholds and other similarly situation institutions without a pending merger application.

Question 3. To what extent should prudential factors (for example, capital levels, management quality, earnings, etc.) be considered in acting on a merger application? Should bright line minimum standards for prudential factors be established? If so, what minimum standard(s) should be established and for which prudential factor(s)?

These factors are already considered in reviewing merger applications, based on the statutory requirement to consider "financial and managerial resources and future prospects of the existing and proposed institutions." Under existing policies, FDIC "normally will not approve a proposed merger transaction where the resulting institution would fail to meet existing capital standards, continue with weak or unsatisfactory management, or whose earnings prospects, both in terms of quantity and quality, are

weak, suspect, or doubtful."[10] A material risk that the resulting institution would fail to meet one or more of the applicable standards, *e.g.,* a failure to be at least "adequately capitalized," would justify imposition of explicit conditions in connection with a merger approval to address the specific circumstances of the institution, or a denial (assuming the application were not withdrawn prior to a decision, as it more commonly would be) if there were no possible conditions to approval that could reasonably address the projected deficiencies. See also the response to Question 2 above.

Question 4. To what extent should the convenience and needs factor be considered in acting on a merger application? Is the convenience and needs factor appropriately defined in the existing framework? Is the reliance on an insured depository institution's successful Community Reinvestment Act performance evaluation record sufficient? Are the convenience and needs of all stakeholders appropriately addressed in the existing regulatory framework? To what extent and how should the convenience and needs factor take into consideration the impact that branch closings and consolidations may have on affected communities? To what extent should the FDIC differentiate its consideration of the convenience and needs factor when considering merger transactions involving a large insured depository institution and merger transactions involving a small insured depository institution? To what extent should the CFPB be consulted by the FDIC when considering the convenience and needs factor and should that consultation be formalized?

The Community Reinvestment Act ("CRA") requires the federal banking agencies to assess a financial institution's record of meeting the credit needs of its entire community, including low-and moderate-income neighborhoods, consistent with the safe and sound operation of that institution. To implement this requirement, the banking agencies have adopted a regulatory framework that evaluates a bank's lending performance across income stratifications and geographies. CRA examinations also assess a bank's branch distribution and other delivery channels, its community development investments, and its community development services. Together, these assessments provide examiners with a comprehensive picture of how a bank is serving the communities in which it is doing business.

For this reason, a bank's CRA performance should be the primary source of input concerning convenience and needs of the community, though banks in many cases will provide supplementary information. Since the size of an institution is already considered in the assessment of its CRA performance, the record of that performance already reflects the institution's size, and no further consideration of size is necessary or appropriate in assessing the convenience-and-needs factor in merger analysis.

The agencies are in the process of revising the CRA regulatory framework to reflect the digitization of banking. Among other things, the agencies are contemplating the creation of a second type of assessment area called a "Retail Lending Assessment Area," which is

[10] *See FDIC Statement of Policy on Bank Merger Transactions* (July 7, 1998), *available at* https://www.fdic.gov/regulations/laws/rules/5000-1200.html.

intended to evaluate a bank's lending activity in areas where it has concentrations of loans but does not have a physical branch presence. While ABA has some preliminary concerns regarding the details of how Retail Lending Assessment Areas work in practice, we agree that the emphasis in CRA analysis on brick and mortar presence is outdated and should be revised. In addition to providing a more comprehensive view of a bank's CRA performance, expanding CRA examinations beyond a bank's physical location would help regulators have a more comprehensive view of how a bank is meeting the convenience and needs of its communities when evaluating merger applications.[11] As such, CRA performance should continue to be a significant factor in merger determinations.

The convenience-and-needs assessment should consider planned branch closings and consolidations only to the extent that they would materially affect an already "satisfactory" CRA assessment (as defined under current standards). Therefore, unless material changes in activities that CRA measures are contemplated post-merger that would suggest material negative changes in future performance, the CRA performance rating should be taken as sufficient to address the convenience and needs factor in merger assessments, regardless of the size of the parties. The FDIC and the applicants could discuss in detail any proposed branch closings and other post-merger changes as part of the dialogue during the application review process.[12]

With respect to CFPB involvement in merger reviews, the Bank Merger Act already specifies how mergers are to be evaluated, and the specific agency responsibilities are well defined, with appropriate consideration of CRA performance among them. A separate role for the CFPB would therefore be superfluous to existing considerations, inconsistent with the Bank Merger Act, and beyond the scope of the CFPB's own authorizing legislation. ABA acknowledges that serious compliance deficiencies would be appropriate considerations under the statutory criterion concerning management, but the prudential regulatory agencies are charged by Congress under the Bank Merger Act with making determinations about those issues.

Question 5. In addition to the HHI, are there other quantitative measures that the federal banking agencies should consider when reviewing a merger application? If so, please describe the measures and how such measures should be considered in conjunction with the HHI. To what extent should such quantitative measures be differentiated when considering mergers involving a large insured depository institution and mergers involving only small insured depository institutions?

See **Appendix C** - There is considerable current analytical debate about the theoretical shortcomings of HHI and other commonly employed quantitative measures of market concentration.

[11] This approach would be consistent with the concerns expressed above about the failure of current merger assessments to capture competition through channels other than physical branches.
[12] *See* responses to Questions 7 and 8 below.

Question 6. How and to what extent should the following factors be considered in determining whether a particular merger transaction creates a monopoly or is otherwise anticompetitive?

Please address the following factors:

(a) The merging parties do not significantly compete with one another;

This factor should obviously indicate a lack of competitive impediment to merger approval. Other statutory factors would be assessed separately.

(b) Rapid economic change has resulted in an outdated geographic market definition and an alternate market is more appropriate;

Rather than viewing the significant changes of recent decades as resulting in an "outdated geographic market," ABA highlights the changes in delivery channels (beyond physical branches) discussed above, as well as in the types of institutions, in addition to banks, that provide financial services.

(c) Market shares are not an adequate indicator of the extent of competition in the market;

See (b) above – market share as currently calculated based on physical branch location, as a proxy for all financial services to nearby customers, is not an adequate measure.

(d) A thrift institution is actively engaged in providing services to commercial customers, particularly loans for business startup or working capital purposes and cash management services;

See (b) above. Moreover, thrift institution competitors are relevant for more than just for commercial customers, since they may provide residential mortgages, credit cards, and other products.

(e) A credit union has such membership restrictions, or lack of restrictions, and offers such services to commercial customers that it should be considered to be in the market;

Credit unions often have a competitive impact similar to thrift institutions. The credit union industry—and the National Credit Union Administration, its regulator—have taken an aggressively expansive view of field-of-membership restrictions, to the point that field of membership is no longer a serious limiting factor for credit unions pursuing an aggressive growth strategy. Evidence of the results of these rulemakings abound, including through the growing trend of credit

unions buying taxpaying banks. Every bank customer must be eligible to join the credit union buying the bank, and these deals simply would not occur if there was a meaningful question of whether the customers could get in the front door.

Some credit unions define their businesses as serving specific geographic areas, and several credit unions serve entire states. For example, California's largest credit union, the $18.6 billion Golden 1, has a field of membership covering all of California, while the $30.4 billion Boeing Employees Credit Union serves anyone who lives, works, worships, or attends school in Washington State as well as select counties in Oregon and Idaho.

In urban areas, the National Credit Union Administration now allows large, multi-state regions called "combined statistical areas" (CSAs) to be considered "local communities" that meet the statutory test for credit union service. These 172 expansive regions across the country can be added to credit union service areas without regard to whether specific areas are underserved. For example, in the Washington area, land from West Virginia to Pennsylvania to the Delaware border to nearly Richmond can be labeled a single, local community: Washington, D.C. Any credit union with a charter based on a CSA can compete for customers in exactly the same way as banks inside those areas.

In rural America, the rules allow geographically enormous areas—any area with a population of up to 1 million and an average population density of fewer than 100 persons per square mile—to qualify as a "rural district." These rules permit entire states, as well as multi-state regions, to be added as areas of credit union service. A credit union serving a rural district can compete for customers in exactly the same way as banks.

(f) There is actual competition by out-of-market institutions for commercial customers, particularly competition for loans for business startup or working capital purposes; and

Same, and competition in other lines of business is also often relevant.

(g) There is actual competition by non-bank institutions for commercial customers, particularly competition for loans for business startup or working capital purposes. With respect to the preceding factors, how and to what extent should the activity of current branches or pending branch applications be considered?

Same. Pending branch applications are also relevant, since the competitive impact that a merger would produce today is not static – it will be affected by competition following the establishment of new branches in the market, as well as by services introduced through nonbranch channels.

Question 7. Does the existing regulatory framework create an implicit presumption of approval? If so, what actions should the FDIC take to address this implicit presumption?

The existing framework does not create an implicit presumption of any particular outcome. The statutory standard (with respect to competitive factors) is that a transaction must be denied if (a) it "would result in a monopoly, or … would … monopolize or to attempt to monopolize the business of banking," or (b) its effect "may be substantially to lessen competition, or to tend to create a monopoly, or which in any other manner would be in restraint of trade, unless [the FDIC] finds that the anticompetitive effects of the proposed transaction are clearly outweighed in the public interest by the probable effect of the transaction in meeting the convenience and needs of the community to be served." Obviously creation of a monopoly, or an attempt to create a monopoly, is not only presumptively, but categorically, *disapproved.* Under the alternative test of lessening competition, tending to create a monopoly, or restraining trade, if any of those effects is, in the first place, found to exist, the FDIC must then perform a balancing test, for which no presumption of approval or disapproval is provided in the statute. If FDIC simply follows the law as written, no presumption (either for or against approval) will exist.

It should be noted that parties to a potential merger transaction frequently will engage in pre-filing conversations with their regulators. Such discussions often provide valuable insights into key aspects of the transaction, and they can surface regulatory concerns early in the consideration. To the extent that those conversations indicate that approval of the transaction may be unlikely, parties will often abandon their plans, rather than spend the time, incur the expense, and possibly experience the adverse publicity of a failed effort. Therefore, an application that seems unlikely to be approved is also unlikely to be filed in the first place. It follows that applications that are filed are often those for which approval is not controversial, but that is not because a "presumption" exists.

Moreover, as discussed in response to Question 8 below, merger applicants and regulators typically engage in extensive post-filing conversations, and applicants often provide extensive additional information to address the agency's questions. An application as filed is not the end but the beginning of a rigorous review process. When these discussions do not resolve agency concerns and significant issues exists that likely would preclude an approval recommendation by agency staff, an agency will usually encourage applicants to withdraw the application and resubmit if and when the problems have been resolved.[13]

Question 8. Does the existing regulatory framework require an appropriate burden of proof from the merger applicant that the criteria of the Bank Merger Act have been met?

[13] According to FDIC's annual transparency and accountability data on bank applications, for the 12 months ending April 30, 2022, approximately 7% of total merger applications during this period were either withdrawn or returned. Withdrawals and returns represented over 5% of total merger applications in 2021 and almost 16% in 2020. *See* FDIC: Transparency & Accountability – Bank Applications, *available at* https://www.fdic.gov/transparency/bankapplications.html.

If not, what modifications to the framework would be appropriate with respect to the burden of proof?

The requests for extensive additional information to which merger applicants typically respond as part of a rigorous and coordinated review process by the agencies evidence the fact that applicants currently provide considerable substantiation to satisfy their burden of proof that the criteria have been met. The length of time and the extensive and iterative process of submitting additional information in response to agency requests also indicate the thoroughness of consideration – applicants spend many hours with agency legal, supervisory, and other staff and engage in successive rounds of requests for highly detailed information. Applicants normally submit significant additional information after the initial application is filed in a review process that is typically months long as the agencies build out the application file to ensure that all information needed to evaluate the transaction appropriately has been provided.

Question 9. The Bank Merger Act provides an exception to its requirements if the responsible agency finds that it must act immediately in order to prevent the probable failure of one of the insured depository institutions involved in the merger transaction. To what extent has this exception proven beneficial or detrimental to the bank resolution process and to financial stability? Should any requirements or controls be put into place regarding the use of this exemption, for example when considering purchase and assumption transactions in a large bank resolution? Are there attributes of GSIB resolvability, such as a Total Loss Absorbing Capacity (TLAC) requirement, that could be put into place that would facilitate the resolution of a large insured depository institution without resorting to a merger with another large institution or a purchase and assumption transaction with another large institutions?

ABA notes that the "failing company" doctrine in general antitrust law should relieve competitive-factor concerns in most such cases. Furthermore, assuming the presence of one or more qualified acquirers, the required assessment of convenience and needs of the communities served and financial and managerial resources and future prospects of the institution should give significant weight to the consequences of closing the institution. Finally, if current Federal Reserve rules that would apply to a resulting institution would require issuance of TLAC to facilitate a resolution, those rules will apply without further action on FDIC's part. With respect to applying stricter standards than already required both to reduce the probability of failure and to mitigate losses should a failure occur, see the response to Question 2 above.

Question 10. To what extent would responses to Questions 1–9 differ for the consideration of merger transactions involving a small insured depository institution? Should the regulations and policies of the FDIC be updated to differentiate between merger transactions involving a large insured depository institution and those involving a small insured depository institution? If yes, please explain. How should the FDIC define large insured depository institutions for these purposes?

In general, there should be a level regulatory playing field. In many cases, scalability achieved through a merger transaction will be an important consideration in maintaining both adequate cost-effective financial services in particular markets and in maintaining financial stability more generally.

Additional Issues: Developments in the Financial and Regulatory Landscape

Recent the debate over the appropriate standards for assessing bank mergers has grown sharper, and some misconceptions gained traction as part of the public dialogue. ABA believes it is important to correct those misconceptions.

Bank Mergers Often Preserve Customer Choices That Market Forces Might Otherwise Constrict

Though industry consolidation has been a recurring theme in recent decades,[14] there are many drivers of this trend, and in some cases a merger transaction may blunt the impacts of these trends. For example, as Federal Reserve Chair Powell noted in his most recent confirmation hearing,[15] many rural counties have experienced serious population loss, and in many cases the bank(s) in those markets have faced severe pressure to meet fixed costs (regulation, technology investment, cybersecurity, and others) to continue servicing a shrinking customer base. In such cases a merger with another institution is often the best way to preserve banking services to the remaining customers and avoid losing entirely the bank's presence in the market. Indeed, as long ago as 1995, the Assistant Attorney General in charge of the Division noted that "[t]o the extent that a bank merger allows the merging firms to achieve significant economies of scale or scope, consumers may benefit from lower costs and/or improved services, and our competitive analysis takes into account such factors."[16] Most recently, Acting Comptroller of the Currency Michael Hsu noted that, though merger analysis should be updated to reflect the profound

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[14] *See, e.g.,* Federal Reserve Bank of Cleveland, "Has Bank Consolidation Changed People's Access to a Full-Service Bank Branch?" (October 6, 2021), *available at* https://www.clevelandfed.org/en/newsroom-and-events/publications/community-development-briefs/db-20211006-has-bank-consolidation-changed-peoples-access.aspx#:~:text=Consolidation%E2%80%94the%20combining%20of%20banking,(Rhoades%2C%201996%3B%20Adams%2C.

[15] *See* https://www.c-span.org/video/?517047-1/federal-reserve-chair-confirmation-hearing, Response to Senator Smith at 1:58:06.

[16] Anne K. Bingaman, Assistant Att'y Gen., Antitrust Div., U.S. Dep't of Justice, *Antitrust and Banking* (Nov. 16, 1995) (https://www.justice.gov/atr/speech/antitrust-and-banking).

financial market changes since 1995, the goal should not be to prevent mergers, but to revise assessment standards so that the broad benefits of mergers are realized.[17]

Moreover, if the additional evidence of competitive factors noted above is taken into account, such transactions could in some cases become feasible for community banks in circumstances that the current Banking Guidelines would discourage or prohibit. As Chair Powell noted, the driving forces in such a situation are demographics and technological and regulatory demands, and a merger transaction will be the bank's best option in some cases. The need for and expenses of technology investment, not just for business efficiency, but also for enhancing customer service and maintaining robust cybersecurity, raise the same questions across banking markets broadly as all banks must achieve economies of scale or scope to enable high fixed cost investments now required to compete.

Any Review of the Banking Guidelines Should Offer Adequate Opportunity for Public Review and Comment

As FDIC moves forward with updating the Banking Guidelines, it must publish any proposal for public comment. Both the requirements of the Administrative Procedure Act[18] and the critical public interest in the issues at stake make the opportunity for public review and input essential.

Conclusion

Under current application of the Banking Guidelines, small institutions may be prevented from merging if the government assumes they are the only competitors in their geographic markets, as FDIC, the other bank regulatory agencies, and the Division define those markets. This outdated conception fails to reflect the competitive impact of online channels and other means of delivering financial services that do not depend on physical branch networks and are not captured by current competitive analyses. A more comprehensive analysis of these competitive factors will provide an accurate picture of products and services available to customers and promote a healthy market and economy.

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Thank you for the opportunity to express our views on these important issues. Should you have any questions, please do not hesitate to contact the undersigned at hbenton@aba.com.

Very truly yours,

/s/
Sayee Srinivasan
Chief Economist

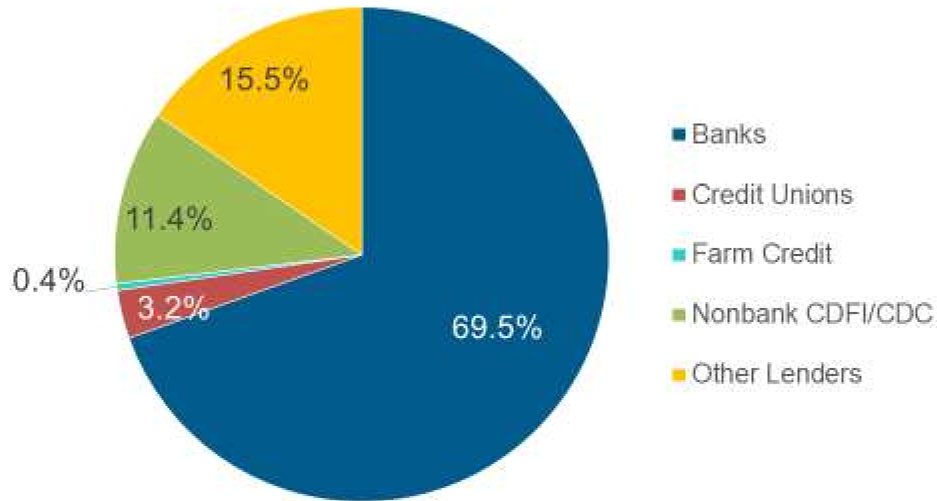
/s/
Hu A. Benton
Senior Vice President and Policy Counsel

[17] *See* https://www.occ.treas.gov/news-issuances/speeches/2022/pub-speech-2022-49.pdf.
[18] 5 USC §551 *et seq.*

APPENDIX A

Nonbanks Originated 3 in 10 PPP Loans

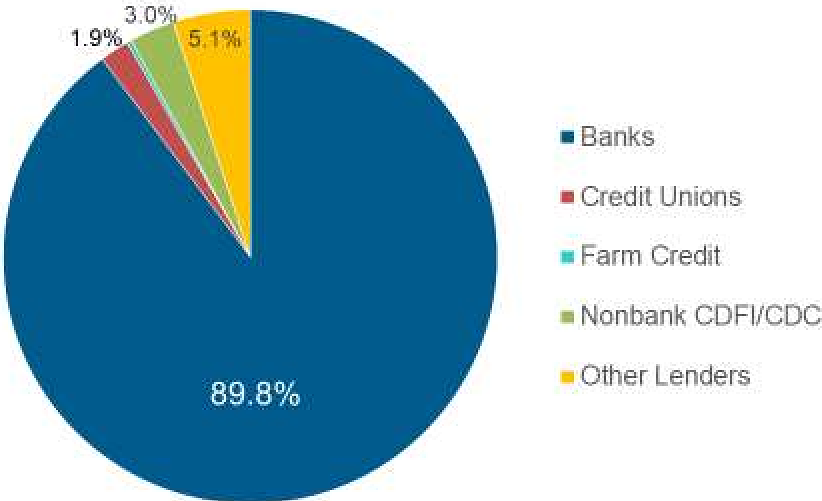
Through all rounds of the Paycheck Protection Program, nonbanks originated 3.6 million of the total 11.8 million loans delivered to small businesses



Source: SBA, data published June 8, 2021, ABA analysis

Nonbanks Delivered $82 Billion in PPP Loans

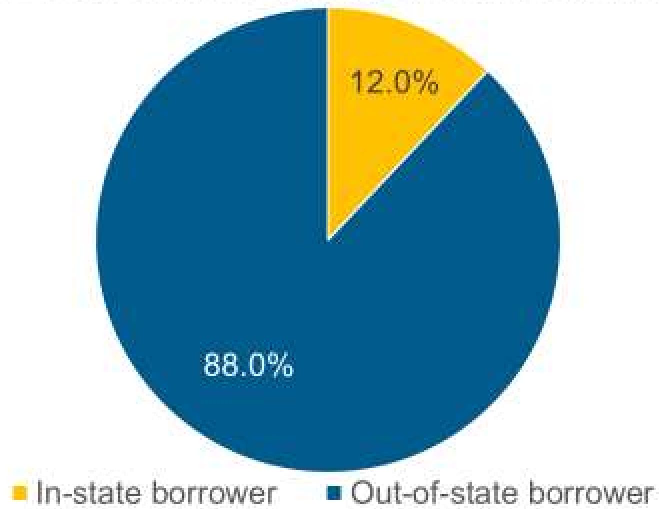
Through all rounds of the Paycheck Protection Program, nonbanks originated over 10% of the funds that were delivered to small businesses



Source: SBA, data published June 8, 2021, ABA analysis

Geographic Distribution of Other Lenders' 1.83 Million PPP Loans

Nearly 88 percent of PPP loans made by "other lenders" went to businesses located outside of the state the lender is headquartered

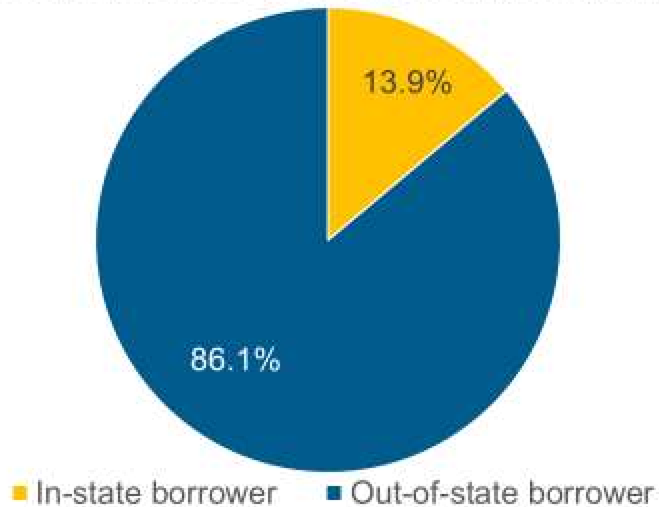


Source: SBA, data published June 8, 2021, ABA analysis

(Reflects lending by firms other than banks, credit unions, Farm Credit System institutions, CDFIs, and CDCs.)

Geographic Distribution of Other Lenders' $40.4 Billion PPP Loans

More than 86 percent of PPP loan dollars made by "other lenders" went to businesses located outside of the state the lender is headquartered

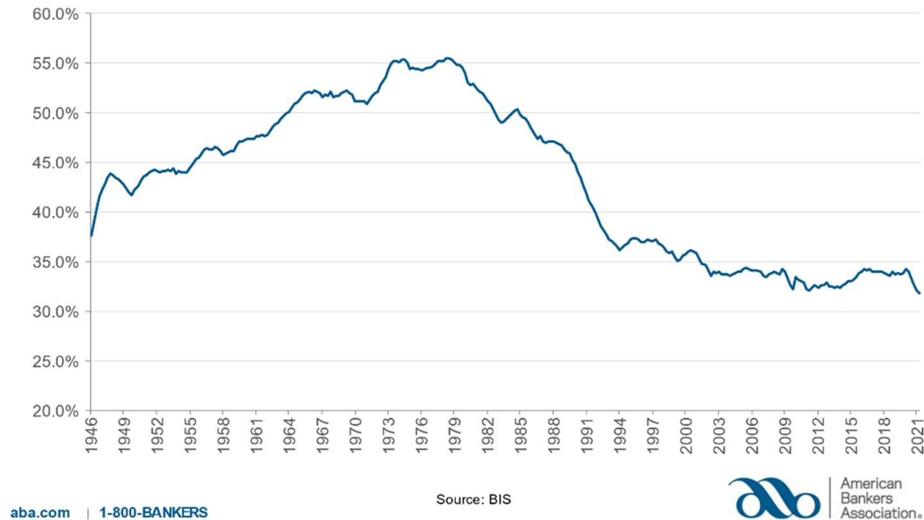


Source: SBA, data published June 8, 2021, ABA analysis

(Reflects lending by firms other than banks, credit unions, Farm Credit System institutions, CDFIs, and CDCs.)

APPENDIX B

Missing from today's bank merger review process is an acknowledgment that much "banking" activity has moved out of the banking sector. According to BIS data, banks' share of total non-financial credit[19] in the U.S. declined from 55% in 1974 to 32% in 2021. This is consistent with the findings of an FDIC report,[20] which observed that the rise of loan securitization in the 1970's coincided with the decline in banks' share of total loans across lending categories like residential and multifamily mortgages. The "banking" market is much larger than just banks.



[19] BIS defines credit to the non-financial sector as all credit to the private non-financial sector—that is non-financial corporations and households, including nonprofits serving households—and the government sector.

[20] *See* https://www.fdic.gov/analysis/quarterly-banking-profile/fdic-quarterly/2019-vol13-4/fdic-v13n4-3q2019-article1.pdf

Bank Share of Loan by Type of Loan					
	Bank Share of Loans Outstanding (%)				
Type of Loans	**1980**	**1990**	**2000**	**2010**	**2020**
Total Loans	64	49	38	35	40
excluding GSEs	73	64	55	55	63
1-4 Family Mortgages	66	40	30	25	22
CRE mortgages	51	50	49	48	49
Commercial mortgages	54	52	54	54	59
Multifamily residential mortgages	47	44	34	30	30
Consumer credit	57	52	35	45	40
Agriculture loans	23	39	51	46	40
Sources: Federal Reserve, FDIC, USDA, ABA analysis					

The growth of nonbank fintechs, in particular, has accelerated over the past decade. Since 2013, according to data from IMF,[21] the assets of global fintechs tripled while the assets of traditional nonbanks increased only 50%. In 2020, the nonbank financial intermediation sector[22] represented nearly half (48.3%) of total global financial assets, according to an FSB report[23] of non-bank financial intermediation.

While analysis is complicated by data limitations, much nonbank finance activity takes place in the U.S. According to the *2nd Global Alternative Finance Market Benchmarking Report*,[24] 30% of alternative finance activity took place in the U.S. or Canada in 2019—increasing to 65% in 2020 due to reduced

[21] *See* https://www.imf.org/-/media/Files/Publications/GFSR/2022/April/English/ch3.ashx.
[22] FSB defines nonbank financial intermediation as all financial institutions that are not central banks, banks, or public financial institutions.
[23] *See* https://www.fsb.org/wp-content/uploads/P161221.pdf.
[24] *See* https://www.jbs.cam.ac.uk/wp-content/uploads/2021/06/ccaf-2021-06-report-2nd-global-alternative-finance-benchmarking-study-report.pdf.

activity in China. Despite the scale of these firms in the U.S., fintechs and other nonbanks largely operate in the dark. They do not file quarterly call reports or other uniform data, like regulated banks, making it challenging to account for their footprint when reviewing levels of competition in a defined market.

However, from the limited data available, we know that nonbank fintechs have broad reach across the country. According to a forthcoming academic paper,[25] the volume of fintech loan originations increased eight-fold between 2013 and 2017—increasing from $453 million to $3.7 billion. Similarly, during the Paycheck Protection Program, nonbank originations reached nearly every corner of the country.

Total Volume by Region

Figure 1.3: Market Share of Alternative Finance Activity by Region

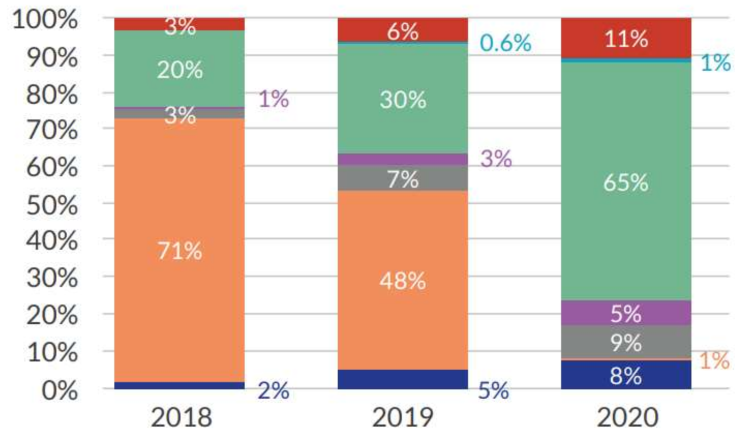
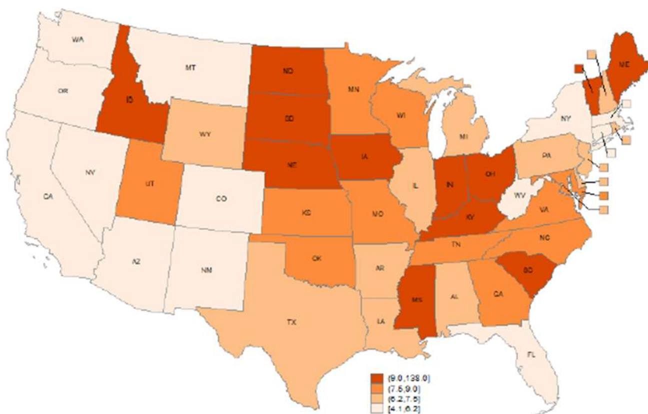
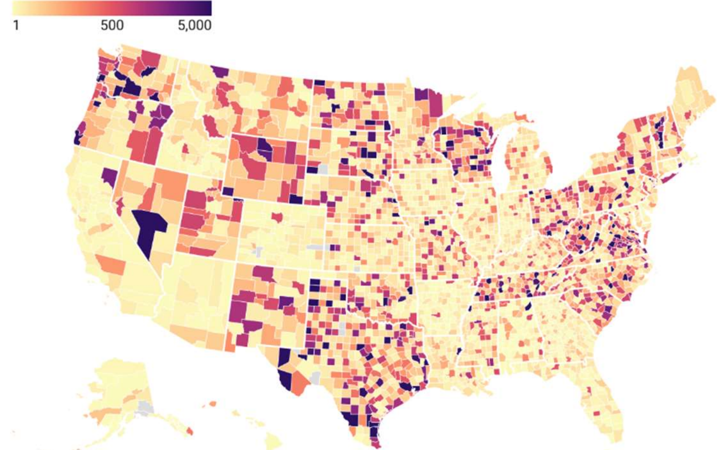


Figure 2. Fintech Volume Growth from 2013 to 2017



Nonbank First Draw PPP Loans, by County

1 500 5,000



Source: SBA, ABA analysis • Created with Datawrapper

The acceleration of online and mobile banking, which allows customers to bank conveniently and efficiently from the palms of their hands, has opened up options for households to bank with financial institutions without a local presence. Nearly all financial institutions, including 95.9 percent of community banks,[26] currently offer mobile banking—allowing them to reach beyond their immediate market as well as to provide varied product offerings and conveniences to their customers. The

[25] *See* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3224957.

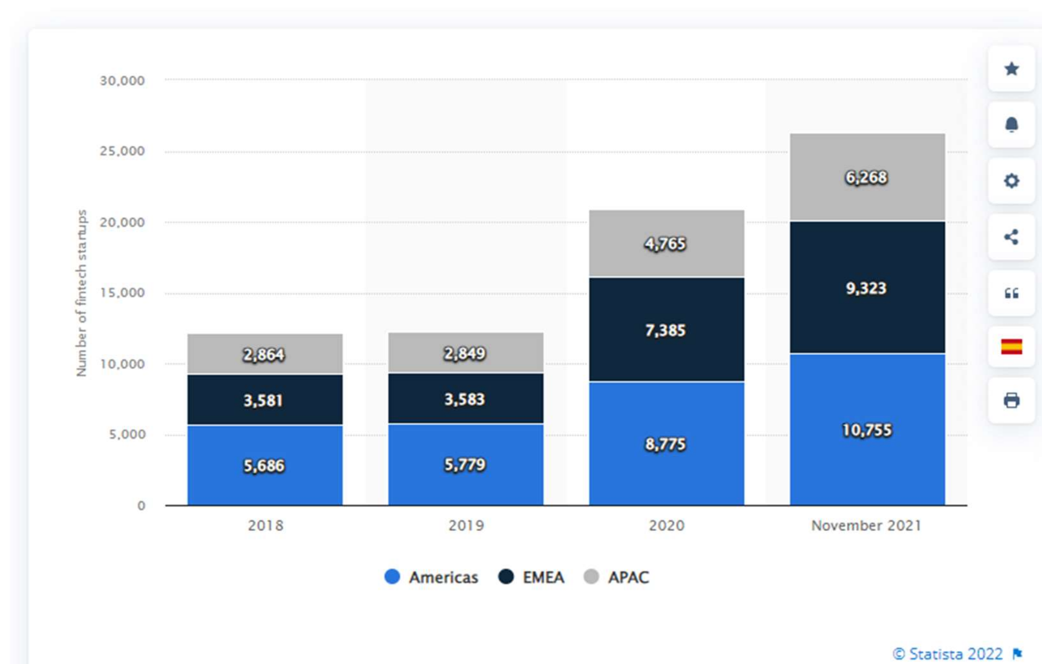
[26] *See* https://bankingjournal.aba.com/2021/09/community-bankers-eye-historic-deposit-levels-amid-pandemic-csbs-survey-finds/.

pandemic accelerated this trend. According to recent research from PwC,[27] "digital banks" now make up 20 percent of all primary bank relationships in the U.S., up from 10 percent in 2019.

The textbook definition of competitive markets has low entry and and exit barriers as key attributes. Banking is one of the most highly regulated sectors, and the extensive regulatory requirements to get a bank charter serve as a critical entry barrier. But if the scope of the banking business is defined more broadly to include businesses offering specific banking products (for simplicity, all products and services except for deposit taking), it is instructive to look at some emerging data which are more symptomatic of a market with low barriers to entry.

The chart below from Statistica shows the number of fintech startups is growing globally.

Number of fintech startups worldwide from 2018 to November 2021, by region[28]



A recent study published by the BIS[29] shows that "while total fintech deals numbered less than 600 in 2010, for a total value of around $11 billion, the total capital raised by fintechs in 2019 exceeded $218 billion, through almost 5,000 individual deals". Further, the chart below from this study shows that the U.S. continues to dominate in terms of fintech investments. Reflective of the symbiotic relationship between banks and new entrants, the start-ups attract innovation both from traditional VCs as well as banks themselves. The RHS chart below also reveals the broad scope of capabilities being funded through these investments.

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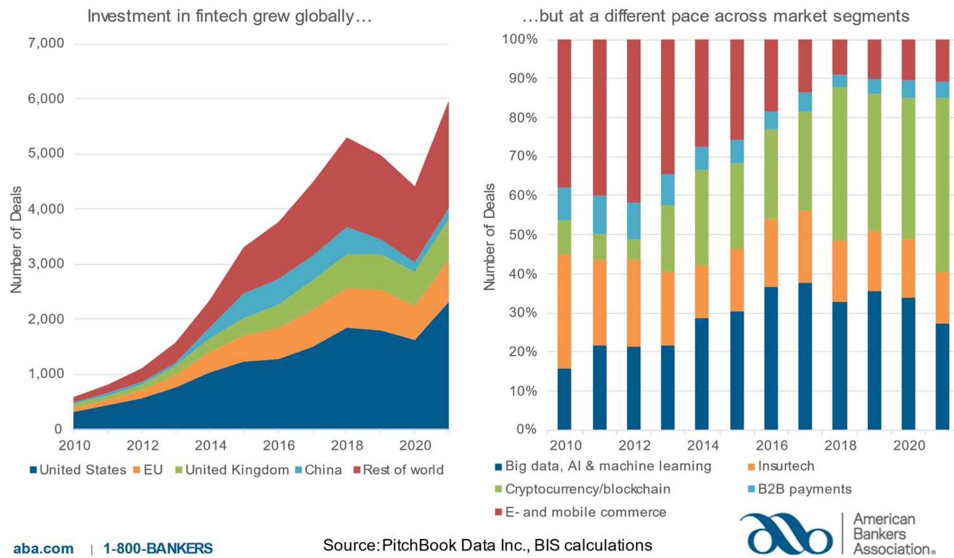
[27] *See* https://www.pwc.com/us/en/industries/banking-capital-markets/library/digital-banking-consumer-survey.html.

[28] Source: https://www.statista.com/statistics/893954/number-fintech-startups-by-region/#:~:text=As%20of%20November%202021%2C%20there,in%20the%20Asia%20Pacific%20region, accessed on May 5, 2022.

[29] "Funding for fintechs: patterns and drivers", https://www.bis.org/publ/qtrpdf/r_qt2109c.pdf.

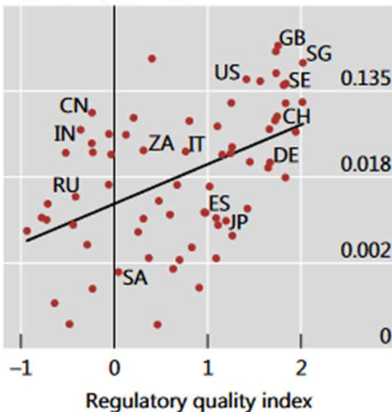
Tracking investment in fintech



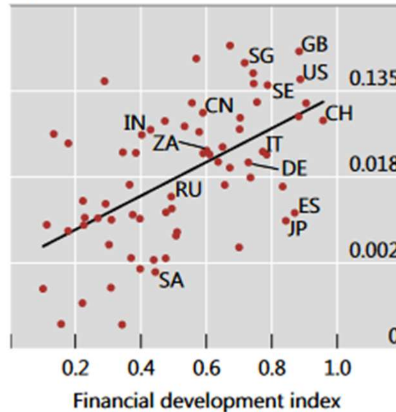
Interestingly, the study provides data highlighting that a robust base – in terms of breadth, depth, and health – is a necessary condition for innovation.

Fintech investment is correlated with institutional and financial development[1] Graph 4

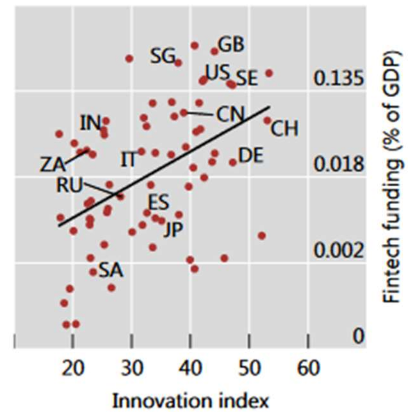
Fintech funding increases with higher regulatory quality…



…better developed financial markets…



…and higher innovation capacity



[1] Each dot corresponds to a country average over 2010–19 for 68 countries. Fintech funding to GDP is winsorised at the 1st and 99th percentiles. Fintech funding relative to GDP is shown on a logarithmic scale.

Sources: Svirydzenka (2016); IMF, *World Economic Outlook*; WIPO; World Bank; PitchBook Data Inc; authors' calculations.

Increasing digitization of financial services and the growing role of nonbank fintechs complicates analysis of banking concentration in local geographic markets. The findings of both the 2021 Bank Director Technology Survey report[30] and the 2021 CSBS Community Banking report[31] underscore this point. The ankDirector survey asked banks to select the top 3 greatest competitive threats to their bank. Over a third of respondents selected digital payments providers like Square and PayPal (36%) or digital nonbank business lenders like Kabbage or BlueVine. A significant share also identified neobanks, like Chime (31%), and bigtech firms like Google and Apple (23%).

The Conference of State Bank Supervisors' 2021 Community Banking report asked similar questions about sources of competition for deposits and loans. While competition for deposits is strongest among in-market community and regional banks, a significant share of respondents—15.9% and 21.7%, respectively—indicated they primarily compete with nonbanks for transaction and nontransaction deposits. Out-of-market competitors were identified by between 17.7% to 23.2% of bankers as a dominant secondary source of competition for both deposit categories.

Community Banks' Sources of Competition, 2021

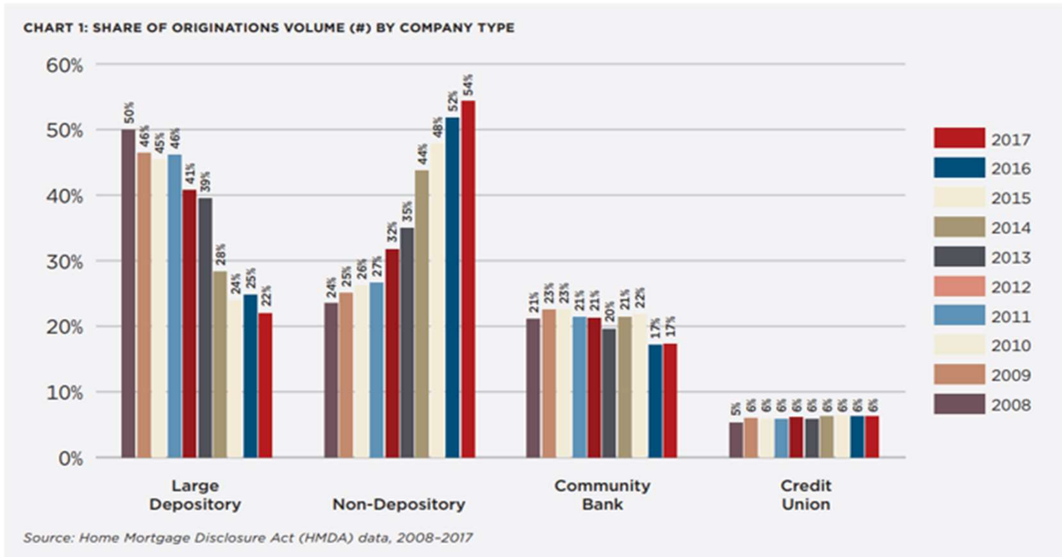
Category	Primary competitors		Secondary competitors	
	Nonbanks	Out-of-market	Nonbanks	Out-of-market
Small business loans	9.5	6.1	24.7	21.3
CRE loans	7.3	5.6	19.4	19.9
1-4 family mortgage	41.0	27.0	39.9	26.9
Agriculture loans	30.8	10.0	26.5	16.9
Transaction deposits	15.9	4.2	29.8	17.7
Nontransaction deposits	21.7	9.8	31.5	23.2

Source: Conference of State Bank Supervisors
Note: reflects percentage of banks that listed nonbanks or out-of-market competitors as a primary or secondary source of competition for the given category

Similarly, banks face particularly strong competition from nonbanks and fintechs for residential mortgages. Two-in-five respondents listed nonbanks as both their greatest primary and secondary source of competition for mortgage loan opportunities. This is no surprise, as nondepositories' market share of mortgage originations rose from 24% in 2008 to more than half of all originations in 2017, according to MBA analysis of HMDA data. The IMF found that competition from nonbank fintechs in the mortgage space has grown over the past decade and that these lenders are more prevelant amoung younger borrowers. Competition from nonbanks, they find, has had a significant effect on banks' mortgage income.

[30] *See* https://www.bankdirector.com/wp-content/uploads/2021-Tech-Report.pdf.
[31] *See* https://bankingjournal.aba.com/2021/09/community-bankers-eye-historic-deposit-levels-amid-pandemic-csbs-survey-finds/.

MBA: Rising Role of Non-depositories



Source: [MBA: The Rising Role of the Independent Mortgage Bank - Benefits and Policy Implications]

APPENDIX C

A high-level summary of the evidence from academic literature on bank M&A and consequences

The literature on bank consolidation, concentration, market power and consequences for household and business customers, economic growth and financial stability is vast in scope. While the research dates back to Schumpeter (1911)[32], it has has struggled to keep up with changes in regulations, evolution of the broader financial intermediation system, and technological innovations; worse, as discused earlier, there are critical gaps in data availability for non-bank sources of funding, which now accounts for close to two-thirds of economic activity by the non-financial sector, a.k.a., Main Street America.

While the HHI continues to be the most favored metric in the popular press as a measure of competition for a given sector, the academic world has moved away from it. The HHI might be relatively easy to calculate, but it does not tell us whether firms in so-called highly concentrated markets have any market power. A more recent favorite has been the Lerner Index[33] as it is seen to be a better measure of market power among firms in an industry – the ability of firms to increase prices and reduce quantities which can drive higher rents to them and reduce social welfare relative to that in a competitive marketplace.

A recent paper by Shaffer and Spierdijk (2020)[34] lists close to 50 recent papers published between 2013 and 2020 using different versions of the Lerner index to collectively study the banking industry in specific countries as well as cross-sectionally across different jurisdictions. Symptomatic of other papers which seek to review academic work on banking, this paper concludes that "literature has offered mixed predictions about the effects of banking competition on economic outcomes." While the paper proceeds to explore new variations of the Lerner Index in the quest to draw more conclusive evidence on this issue, we believe that academic research suffers from some serious shortcomings:

- The research tends to define the footprint of the banking market as that of banks. Non-banks who are now a much more important source of funding to the broader US economy are not systematically included in the empirical and theoretical research. This despite the fact that the share of banks as a source of funding to the non-financial sector in the US has been in the decline since 1970s.

- In recent years, we have seen new research focusing on fintech and more generally, competition between banks and these non-banks. Unfortunately, these are partial equilibrium models using data from narrow slivers of specific products and firms.

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[32] Schumpeter J. (1911), The Theory of Economic Development: An Inquiry into Profits, Capital, Interest, and the Business Cycle, Translated from the German by Redvers Opie, New Jersey: Transaction Publishers, 1983.
[33] Lerner, A. (1934). The concept of monopoly and the measurement of monopoly power, Review of Economic Studies, 1, 157–175.
[34] Shaffer, S., & Spierdijk, L. (2020). Measuring multi-product banks' market power using the Lerner index. Journal of Banking & Finance, 117, [105859].

Consequently, the collective findings tend to be ambiguous and not generalizable to the broader banking industry.

- Banking is the most heavily regulated sector in the US (and globally too), and the recent G-20 reforms have resulted in hundreds of thousands of pages of new rules and regulations for US banks. It is impossible to model these regulations, especially in any general equilibrium models focused on banking and impact on growth and financial stability. Coccorese (2017)[35] for instance attempts to capture it via what is called a regulation quality index "which provides a measure of the perceptions about the ability of the government to formulate and implement sound policies and regulations that allow private sector development." Such variables are incredibly coarse, and simply do not reflect the highly prespective nature of the current banking regulatory framework. It is not surprising that "Both theoretical and empirical economic literature have not reached a clear-cut consensus on the way banks contribute to economic growth in either a more competitive or more concentrated environment."[36]

- Earlier we alluded to the challenges in measuring concentration and market power in the banking sector. Abstracting away from the fact that any measure which excludes non-banks offering the same set of products and services is economically irrelevant, measures like the HHI and Lerner index have been shown to be conceptually flawed. Van Leuvensteijn, *et al* (2011)[37] recognizes that one of the many reasons HHI is flawed is that it fails to capture the fact that "concentration may also be due to consolidation forced by severe competition" and references cross-country studies[38] which have shown that "bank concentration was positively (instead of negatively) related to competition." It is not even obvious that the HHI is a representative measure of concentration. Similarly, the various versions of the Lerner Index have been shown to be unreliable measures of market power among banks. As the HHI and Lerner are firm-wide measures and hence not relevant metrics for product or segment-specific competition analysis, the authors use an alternative index called the Boone-indicator[39]. They note that this index ignores idiosyncratic differences in bank product quality and design, in other words, core elements that firms spend considerable resources on in the real world. These core assumptions are particularly problematic in a world where banks – large and small – are spending considerable sums of money on technology, both to raise their productivity as well as to compete with new entrants – fintech and Bigtech who rely largely on smarter

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[35] Coccorese, P. , (2017), Banking competition and economic growth. In: Bikker, J., Spierdijk, L. (Eds.), Handbook of Competition in Banking and Finance. Edgar El- gar, pp. 230–263.
[36] Coccorese (2017)
[37] M Van Leuvensteijn, JA Bikker, AA Van Rixtel, CK Sørensen (2011), A new approach to measuring competition in the loan markets of the euro area, Applied economics 43 (23), 3155-3167.
[38] Claessens, S., and L. Laeven, 2004, What drives bank competition? Some international evidence, Journal of Money, Credit, and Banking 36, 563–583.
[39] Boone, J., 2004, A New Way to Measure Competition, CEPR Discussion Paper Series No. 4330. This measure relies on firm efficiency, and is based on the idea that in oligopoly models, the profit difference between efficient and inefficient firms increases with the degree of competition.

applications of new technologies like machine learning and AI to grow and capture market share from incumbent banks.[40]

We have also studied the literature on bank consolidation and implications for financial stability. As discussed above, research from the past great financial crisis (GFC) struggles to model and control for the complex and highly prescriptive regulatory framework in place. Fernholz and Koch (2017) [41] is a good example of a recent effort to assess bank-specific idiosyncratic risk being transmistted to the broader economy. They interpret their findings as implying that "one important source of contagion—idiosyncratic volatility—has diminished, even as another more obvious source—bank asset concentration—has increased." Interestingly, the 'integrated econometric model' they introduce in their paper does not factor in regulations, especially the whole Basel III regime which targets systemic risk with a view to ensuring that failures at banks, especially G-SIBs, do not threaten the stability of the global financial system.

But there is growing evidence that the new regulatory framework has caused changes, some by design and others unintentional, among banks. In the context of the mortgage origination business, the data presented earlier is a clear indicator that the new framework caused banks to exit and/or reduce their presence in this market. And reflective of the strong entrepreneurial urges in the competitive US financial markets, other players have entered, the so-called non-banks. The GFC has been recognized to have been caused by fragilities in the residential real estate market; and the new capital requirements presumably wanted to ensure that banks hold more capital to cover risk exposures from the mortgage market. The consequence, presumably unintended, was to cause banks to reduce their footprint in this market, to the benefit of new entrants, who are not subject to the stringent capital and regulatory oversight as banks. Favara, Ivanov and Rezende (2021)[42] find that capital surcharges on G-SIBs decrease lending to firms. While these do not have any real effects on the large economy, presumably due to the corresponding growth in the footprint of non-banks, they find that banks "subject to higher surcharges reduce loan commitments relative to other banks."

Non-banks who have stepped into the vacumm created by the withdrawal of large banks have been called shadow banks – to capture the fact that they operate outside the regulatory perimenter of banks. They don't need to seek any approvals in the form of bank charters to set up shop, they are not subject to any capital requirements, no obligation to send quarterly reports to various regulatory authorities, can enter, merge, and exit at will. Irani, *et al* (2018) find that

[40] The focus on efficiency measures is also relevant to informing our thinking related to concerns about economies of scale, whether from organic growth, or through acquisitions. Unfortunately, the findings are not conclusive. Related, to extent current financial stability framework is in place to address risk factors emerging from size, it is not obvious that these concerns should be address through the merger approval process. Instead, we should re-assess the more direct entity-level regulation for systemically important financial institutions to see if there is a need to update them to capture risks any residual risks from large banks emerging from the M&A process.

[41] Ricardo T. Fernholz and Christoffer Koch (2017), Big Banks, Idiosyncratic Volatility, and Systemic Risk, American Economic Review: Papers & Proceedings 2017, 107(5): 603–607

[42] Giovanni Favaraa, Ivan Ivanov, Marcelo Rezende, (2021) GSIB surcharges and bank lending: Evidence from US corporate loan data, Journal of Financial Economics, Volume 142, Issue 3, December 2021, Pages 1426-1443.

"less-capitalized banks reduce loan retention and nonbanks step in, particularly among loans with higher capital requirements and at times when capital is scarce."[43]

While we are not looking to survey the literature on the post-GFC regulatory requirements, to the extent that there are policy concerns about bank consolidation posing financial stability risks, it might be instructive to study the emerging literature which provides strong evidence that as banks change their behavior in response to the new regulatory requirements, other players who are clearly not subject to any of these regulatory burdens have stepped in. Viewed in the context of the broader point that banks now account for less than a third of funding to the US non-financial sector, it might be helpful to re-examine the current approach which aspires to achieve financial stability goals mainly through banks. Is this akin to the case of the person who lost the car key elsewhere in the dark and is searching for it under the street-light?

Similarly, policymakers often focus on bank branches when measuring, among other things, market concentration and levels of bank access across different communities. We address above how this paints an incomplete picture of market concentration. Granular analysis from both the ABA and the Bank Policy Institute demonstrate that branch closures have not reduced access to financial services, despite frequent claims that these closures lead to banking deserts. There is extensive research on this issue, attempting to study the complex and evolving factors driving the dynamics of banks' decisions to open and close branches. These studies deliberately control for the Riegle Neal Act of 1994 as well as the growth in recent years of trends in mobile banking. We have presented some relevant data elsewhere in this submission to highlight some of these trends, both among providers of financial services as well as their consumers. Kuehn (2021) is symtomatic of the challenges in drawing broad conclusions regarding banking deserts being created due to consolidation in the banking industry. The paper finds that "some bank types are more likely to open additional branches if their rivals do." Illustrative of the sophisticated, complex calculus driving banks' branching strategies and decisions, the paper also finds that mergers might actually result in over-branching, which while on one hand could increase market power for some banks, could also be clearly welfare improving for customers. These complex dynamics have been noted in earlier papers, with Acharya, Imbs and Sturgess (2011)[44] serving a good illustration. To quote them: "The findings suggest that improving bank access to branching affects the sectoral specialization of output, in a manner that depends on the variance-covariance properties of sectoral returns, rather than on their average only." In plain English, the details matter, and there is a complex set of dynamic factors – internal and external - impacting bank branching decisions.

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[43] Rustom M. Irani, Rajkamal Iyer, Ralf R. Meisenzahl, and José-Luis Peydró, 2018, The Rise of Shadow Banking: Evidence from Capital Regulation, Finance and Economics Discussion Series (FEDS), available at https://www.federalreserve.gov/econres/feds/the-rise-of-shadow-banking-evidence-from-capital-regulation.htm.

[44] Viral V. Acharya, Jean Imbs, Jason Sturgess, 2011, Finance and Efficiency: Do Bank Branching Regulations Matter?, Review of Finance, Volume 15, Issue 1, January 2011, Pages 135–172.