BANK POLICY INSTITUTE

CONSUMER BANKERS ASSOCIATION

MID-SIZE BANK COALITION OF AMERICA

May 31, 2022

Via Electronic Mail

James P. Sheesley, Assistant Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street N.W.
Washington, D.C. 20429

Re: Request for Information and Comment on Rules, Regulations, Guidance, and Statements of Policy Regarding Bank Merger Transactions (RIN 3064–ZA31)

Dear Mr. Sheesley:

The Bank Policy Institute (**BPI**),[1] the Consumer Bankers Association (**CBA**)[2] and the Mid-Size Bank Coalition of America (**MBCA**)[3] submit this letter in response to the March 31, 2022, request of the Federal Deposit Insurance Corporation (**FDIC**) for "comments regarding the effectiveness of [all aspects of] the existing framework in meeting requirements of . . . the Bank Merger Act."[4]

In the Bank Merger Act (**BMA**),[5] and its close companion the Bank Holding Company Act (**BHCA**),[6] Congress has directed the Board of Governors of the Federal Reserve System (**FRB**), FDIC and the Office of the Comptroller of the Currency (**OCC**) (which we refer to collectively as the **Federal Bank Regulators**) to consider specific aspects of proposed mergers, as well as directing the Department of Justice (**DoJ**) to report to the Federal Bank Regulators on the competitive aspects of proposed mergers. In the more than five decades since Congress harmonized the BMA and the BHCA in 1966,[7] the expert

1 BPI is a nonpartisan public policy, research and advocacy group, representing the nation's leading banks and their customers. BPI's members include universal banks, regional banks, and major foreign banks doing business in the United States.

2 CBA is the only national financial trade group focused exclusively on retail banking and personal financial services—banking services geared toward consumers and small businesses. As the recognized voice on retail banking issues, CBA provides leadership, education, research, and federal representation for its members. CBA members include the nation's largest bank holding companies as well as regional and super-community banks that collectively hold two-thirds of the total assets of depository institution.

3 MBCA is a business, economic, and financial policy alliance comprised of America's mid-size banks.

4 FDIC, Request for Information and Comment on Rules, Regulations, Guidance, and Statements of Policy Regarding Bank Merger Transactions, 87 Fed. Reg. 18,740, 18,740 (Mar. 31, 2022) (**FDIC RFI**).

5 Pub. L. No. 86-463, 74 Stat. 129, 129 (1960).

6 Pub. L. No. 84-511, 70 Stat. 133, 133 (1956).

7 *See* Pub. L. No. 89-356, 80 Stat. 7, 8 (1966); Pub. L. No. 89-485, § 7(c), 80 Stat. 236, 237–38 (1966).

career staffs at the Federal Bank Regulators and the DoJ have developed an effective framework for assessing proposed mergers under both statutes, under leadership of individuals nominated by both Democratic and Republican Administrations. The result is a U.S. financial system that is safe, competitive and serves the needs of consumers, small and large businesses, other customers, communities and the American economy.

Because the FDIC RFI raises questions about the efficacy of that longstanding bipartisan approach, three fundamental points are worth noting at the outset of this response:

> ***First***, it is Congress's role to enact any new substantive standards regarding the approval of proposed mergers, as it did, for instance, when it added financial stability as a relevant factor in The Dodd-Frank Wall Street Reform and Consumer Protection Act (**Dodd-Frank Act**).[8] Against the backdrop of decades of precedent, Congress's decision to build upon the long-standing regulatory framework with modifications it deems necessary amounts to ratification of that regulatory approach.[9] Any material change to the substantive standards must come from Congress, not the Federal Bank Regulators.
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> ***Second***, in view of the interconnectedness of the Federal Banking Regulators' and DoJ's roles under the BMA and the BHCA, it would be inconsistent with President Biden's "whole-of-government approach" called for in his July 2021 Executive Order on "Promoting Competition in the American Economy" for one Federal Banking Regulator to seek to impose fundamental changes without agreement from the others.[10] Indeed, the President expressly called for all three Federal Banking Regulators and the DoJ to be part of a coordinated review of the BMA and the BHCA in the Executive Order.[11]
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> ***Third***, as emphasized in the Background Information to the FDIC RFI, the Federal Bank Regulators "have a responsibility to promote public confidence in the banking system."[12] In order to maintain public confidence, major changes to bank merger policy must not be instituted arbitrarily; rather, such changes must be based on a sound conceptual and empirical foundation grounded in objective analysis. To state the point directly, a change in regulatory policy for the purpose of producing more denials of applications and fewer bank mergers would be contrary to the very mission that the FDIC appropriately recognizes. It would establish a precedent for future arbitrary, unilateral changes that, over time, will harm public confidence.

I. Introductory Comments on the Data Included in the FDIC RFI

Before turning to the specific questions asked in the FDIC RFI, we first address the description of the banking industry set forth in the "Background Information" and other introductory sections of the FDIC RFI. As BPI and MBCA detailed in their response to the DoJ's most recent request for comment about bank mergers,[13] the U.S. banking industry has maintained essentially unchanged

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8 Pub. L. No. 111-203, § 604(d), (e)(1), (f), 124 Stat. 1376, 1601, 1602 (2010).

9 *See FDA* v. *Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 156–158 (2000).

10 Exec. Order 14036, 86 Fed. Reg. 36,987, 36,989 (July 14, 2021) (**Executive Order on Competition**).

11 *Id*. at 36,992.

12 FDIC RFI at 18,470.

13 *See* BPI and MBCA, *Letter to the Department of Justice regarding enforcement policy respecting bank mergers* (Feb. 10, 2022), https://bpi.com/wp-content/uploads/2022/02/BPI-Responds-to-DoJ-Review-of-Competitive-Effects-of-Bank-Mergers.pdf (**2022 BPI DoJ Response Letter**). BPI incorporates into this

concentration levels at the local level for over 25 years, with that level, as measured by the weighted average Herfindahl Hirschman Index, at around 1350, which is well below the DoJ's concentration standard of 1800 (and 2500 for all other industries). In addition, the industry is unconcentrated at the national level, with the share of total sales captured by the top four banks located in the bottom half of the range across "consumer-facing" four-digit industries.[14] Moreover, the U.S. banking industry is unconcentrated relative to other advanced economies, with the percentage of bank assets held by the top five banks at 46%.[15]

Mergers can lead to substantial efficiencies and the creation of branch networks that customers value, positive contributions to the economy that Congress endorsed in the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (**Riegle-Neal Act**). The Riegle-Neal Act removed previous geographic barriers to bank mergers and authorized approval of interstate bank acquisitions if the resultant bank holding company would hold less than 10% of nationwide deposits.[16] Mergers, including those involving larger regional banks, are also an important way to promote competition by ensuring that the largest banks are not, as Acting Comptroller of the Currency Michael Hsu recently noted, "shield[ed] . . . from competition."[17]

The empirical analysis included in the FDIC RFI overstates the impact of mergers on competitive conditions and the financial stability of the U.S. economy for some of the reasons we describe below. First, the decline in the number of smaller banks, on which the FDIC RFI focuses, is driven in large part by the Riegle-Neal Act's removal of artificial and archaic barriers, and the collapse of entry into commercial banking that occurred in the aftermath of the 2008 financial crisis. Second, the analysis exaggerates the growth of larger banks by not adjusting bank size due to general economic growth and inflation. Finally, the analysis does not include other data relevant to assess the effectiveness of the existing merger framework, such as the increase in the number of bank branches, the decline in the unbanked population, and the rapid growth of entities that perform similar functions as commercial banks but are outside the bank regulatory perimeter.

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response to the FDIC RFI both its 2022 BPI DoJ Response Letter and its earlier response to another similar DoJ request for comments on bank merger policy. *See* BPI, *Response Letter regarding Department of Justice Enforcement Policy Respecting Bank Mergers* (Oct. 15, 2020), https://bpi.com/wp-content/uploads/2020/10/BPI-Comment-Letterto-the-DOJ-on-Bank-Merger-Review-October-15-2020-1.pdf (**2020 BPI DoJ Response Letter**).

14 *See* BPI, *Five Important Facts about the Competitiveness of the U.S. Banking Industry* (Feb. 24, 2022), https://bpi.com/five-important-facts-about-the-competitiveness-of-the-u-s-banking-industry/. The four-digit North American Industry Classification System (NAICS) is a standard used by Federal statistical agencies to define a given industry group. The U.S. Census Bureau sample includes 274 four-digit industry classifications.

15 *See id*. Note that total sales and/or assets data is not available for all U.S. industries and, therefore, we have used the available data for the banking industry.

16 Pub. L. No. 103-328, 108 Stat. 2338, 2339 (1994); *see also* Pub. L. No. 111-203, § 622(b), 124 Stat. 1376, 1601, 1633 (2010) (concentration limit provision of the Dodd-Frank Act establishing a 10% cap on total consolidated liabilities of any one institution in relation to all banking liabilities).

17 Acting Comptroller of the Currency Michael J. Hsu, *Financial Stability and Large Bank Resolvability*, Remarks before the Wharton Financial Regulation Conference 2022 at 6 (Apr. 1, 2022), https://occ.gov/news-issuances/speeches/2022/pub-speech-2022-33.pdf.

A. Number of Smaller Banks

The FDIC RFI relies heavily on the decline in the number of smaller banks (*i.e.*, banks with below $10 billion in assets) during the 30-year period between 1990 and 2020 (**Covered Period**) for the thesis that bank merger policy needs revision. The FDIC RFI observes that "the number of institutions with assets less than $10 billion has declined from 15,099 in 1990 to 4,851 in 2020."[18]

We believe that a banking system that best serves the public and the economy should include representation from banks of all sizes, and that the banking system benefits from a healthy stratum of smaller banks. The raw data utilized by the FDIC RFI regarding the decline in the number of smaller banks, however, result in an invalid attribution of this decline to merger activity by larger banks, thereby masking the actual regulatory and other challenges confronting smaller banks. The decline in the number of smaller banks predominantly reflects factors other than mergers into larger banks.

First, a key factor in the decline in the nominal number of smaller banks is the precipitous decline in the rate of the formation of new banks during the last decade. Between 1984 and 2007, new entrants averaged approximately 200 banks per year, excluding the years in which the U.S. economy was in a recession. After 2011, the number of newly licensed banks collapsed to five banks each year on average. As explained in further detail in Appendix 1, had new banks been created between 2012 and 2020 at the same rate as between 1984 and 2007, the decline in the net number of smaller banks would have been approximately 60% less than the actual decline observed during the 2012 to 2020 period.[19]

There are undoubtedly multiple reasons for the sharp decline in new bank formation, but some empirical analyses indicate that the primary reasons are (1) the policies of the bank regulators (federal and state) in chartering and insuring *de novo* banks and (2) the impact of regulation on smaller banks. For instance, a recent Federal Reserve Bank of Richmond study suggests that the new requirements for *de novo* banks seeking deposit insurance by the FDIC are the primary reason underlying the collapse of entry into commercial banking in the aftermath of the financial crisis.[20] In addition, a recent FDIC study suggests that the increase in regulatory burden between 2008 and 2019 has negatively impacted bank profits, especially for smaller community banks, and is a contributory factor to "the record rates at which community banks exited the banking industry in the years leading up to 2019."[21] Policy initiatives emanating from concern about the number of smaller banks in the country should try to better understand this issue and focus in the first instance on the reasons for the decline in new bank formation.

Second, the level of mergers during this period is distorted because it represented a "catch-up" for the decades when bank merger activity was artificially and deeply depressed by federal

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18 FDIC RFI at 18,740.

19 The recession years between 1984 and 2007 include 1991 to 1993 and 2001 to 2002. Using the average number of entrants between 1984 and 2007 (with no exclusions for recession years), the decline in the net number of smaller banks would have been approximately 50% less than the actual decline observed during the 2012 to 2020 period.

20 *See* R. McCord & E. Simpson Prescott, *The Financial Crisis, the Collapse of Bank Entry, and Changes in the Size of Distribution of Banks*, Vol. 100, Econ. Quarterly No. 1 (2014) (**McCord and Prescott**), The Financial Crisis, the Collapse of Bank Entry, and Changes in the Size Distribution of Banks (richmondfed.org).

21 FDIC, *FDIC Community Banking Study* (Dec. 2020), at 5-1 to 5-5, https://www.fdic.gov/resources/community-banking/report/2020/2020-cbi-study-full.pdf.

and state geographic limitations on bank mergers. As the data cited in the FDIC RFI demonstrate, the level of bank merger activity during the first half of the Covered Period, which covers the eleven years following the Riegle-Neal Act, far exceeds the level during the second half. If the first half of the period were normalized to take account of this catch-up phenomenon, the decline in the number of mergers would have been far less.

Third, the decline in the number of smaller banks also reflects the large number of bank failures during the Covered Period, the vast majority of which were smaller banks. Based on data provided by the FDIC, there were a reported 1,487 bank failures in the Covered Period, and approximately 97% of those failures were of smaller banks.[22]

Fourth, the FDIC RFI does not distinguish between mergers of two smaller banks and acquisitions of smaller banks by large banks. The FDIC's concern about the impact of mergers presumably does not apply to, or applies with much less force to, mergers between smaller banks. Approximately 84% of all bank mergers during the Covered Period involved two banks that both had less than $10 billion in assets.

Fifth, another significant factor contributing to the decline in the number of smaller banks has been a structural rather than a substantive change. As the FDIC RFI recognizes in a footnote, the decline in the nominal number of banks with assets less than $10 billion was in part the result of the choice of "many bank holding companies . . . to consolidate existing bank charters."[23] The reduction in the number of banks attributable to these affiliate mergers does not, of course, change the number of independent choices available to customers.[24]

More broadly, the adverse impact cited by the FDIC RFI as potentially related to the declining number of smaller banks (*i.e.*, reduced access to credit and other financial services) appears far more likely to occur as the result of factors other than the acquisition of smaller banks by larger banks. Indeed, in the last 10 years, banks with assets of $100 billion or over have acquired only one smaller bank.[25] Moreover, when a smaller bank fails or there are not *de novo* banks, a decline in access almost invariably occurs. In contrast, when a smaller bank is acquired, there can be improved access to credit

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22 The FDIC RFI's empirical analysis on the changes in the size distribution of banks fails to account for factors unrelated to mergers that drive bank size, such as general economic growth and inflation. As shown in Appendix 1, adjusted for economic growth and inflation, approximately 325 banks that had less than $10 billion in assets at the beginning of the Covered Period would have had more than $10 billion in assets (as measured in 2020 dollars) at the end of the Covered Period, and thereby no longer have been classified as smaller banks.

23 FDIC RFI at 18,740 n.2.

24 Relatedly, we recommend that the Federal Bank Regulators further streamline the bank merger application process relating to internal reorganizations, because such affiliate mergers would provide a benefit to financial stability by simplifying a banking organization's legal entity structure and its resolvability. These transactions are generally intended to achieve operating efficiency, risk mitigation, regulatory compliance (such as in connection with resolution planning), or organizational simplification objectives, and require regulatory approval even though they do not involve expansion and therefore present a totally different risk profile as expansionary mergers. Accordingly, proposed merger transactions between affiliates that would not adversely impact the overall satisfactory financial condition of the combined institution should be evaluated under a streamlined version of the bank merger application regulatory framework and processed in an expedited manner.

25 In comparison, although the FDIC RFI does not discuss the acquisition of smaller banks by credit unions, during this 10-year period, credit unions have acquired 37 smaller banks.

and financial services due to realized economies of scale and scope, which may include an acquirer's broader array of products and services, higher lending limits, more comprehensive community reinvestment programs, etc.

B. Number of Large Banks

The failure to account for economic growth and inflation in the empirical analysis on the changes in the size distribution of banks is perhaps even more relevant in respect of the FDIC RFI's focus on the growth of regional banks and its implications for financial stability.[26]

First, adjusting for economic growth and inflation, the analysis in Appendix 1 demonstrates that there would have been, in comparison to the 33 banks with assets exceeding $100 billion in 2020, 21 such banks in 1990 and 32 banks in 2005. These growth-adjusted numbers indicate that there has been no real growth in the number of $100 billion asset banks in the last 15 years that would justify the Federal Bank Regulators' adoption of material changes in the bank merger regulatory framework.

Second, Appendix 1 also shows that the percentage of U.S. banking assets and deposits held by banks above $100 billion and not owned by a U.S. GSIB, has remained roughly unchanged over the last 15 years. In addition, in the aftermath of the 2008 financial crisis the common equity tier 1 capital ratio of those banks rose more than 50% from 8.3% to 12.7%, and the ratio of high-quality liquid assets to total assets more than doubled from 10% to 23.3%. The increase in the levels of capital and liquidity has made those banks significantly more resilient in times of economic stress.

Third, the increase in the number of large banks in the first 15 years of the Covered Period is in large part attributable to the Riegle-Neal Act's removal of geographic barriers to market extension mergers.

Fourth, although the FDIC RFI provides relevant data, it does not discuss the sharp distinction between the first and second halves of the Covered Period with respect to the level of growth of larger banks. For example, between 1990 and 2005, the unadjusted number of banking institutions with assets of $50 billion or more increased by 400% (from 8 to 32), whereas the increase from 2005 to 2020 was only 53% (from 32 to 49).

Fifth, it is also important to place the growth of large banks in the context of broader economic trends. For example, in 1990, there were only three corporations listed in U.S. stock exchanges with a market capitalization of $50 billion or more, and no corporations with a market capitalization of $100 billion or more. Today, there are 83 corporations with a market capitalization of $100 billion or more. At the beginning of the Covered Period, the median home price was $123,900 and the median household income was $29,943. At the end of 2020, the median home price had increased to $358,700 and the median household income had increased to $67,521.

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26 The term "large bank" is not defined in the FDIC RFI. Based on the FDIC RFI's frequent references to a $100 billion asset size threshold, we have generally considered that size to be "large" for purposes of this comment letter.

C. Other Relevant Data

The FDIC RFI focuses entirely on the number of banks and contains no data on the number of bank branches or the role of nonbank competitors.

1. Increase in Branches

An assessment of the extensiveness of bank branch networks runs directly counter to a narrative that consolidation has reduced access to banking services. Between 1990 and 2020, according to FDIC data, the number of bank branches increased by approximately 40%, from 56,267 to 74,928. This means that customer access to a bank branch in communities across the country is considerably easier today than 30 years ago.[27]

2. Near-Bank Competitors

The FDIC RFI also fails to provide data relating to the rapid growth of "near banks": institutions that provide the same services as banks but operate without a bank charter and therefore outside the bank regulatory system. This is the most important change in the past two decades in the financial services industry—the change with the greatest potential to impact the American public and economy.

Examples of this rapid growth of near banks abound. The mortgage servicing business is now conducted almost entirely outside the banking system by digital mortgage lending companies, such as Rocket Mortgage (formerly known as Quicken Loans) and SoFi Technologies. Other online lending providers, like Lending Club, OnDeck, and CAN Capital, are increasingly attracting customers for personal and business loans.[28] Huge payment networks, such as Venmo and PayPal, now play a major role in the payment system.[29] Money market funds, which are promoted as an alternative to bank deposits, hold approximately $4.3 trillion in deposit-like funds.[30] And, most recently, an entire crypto-asset industry

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27 *See*, FDIC, *Historical Bank Data*, Historical Bank Data (fdic.gov); *see also* C. Celerier & A. Matray, *Bank-Branch Supply, Financial Inclusion, and Wealth Accumulation*, 32 Review of Fin. Studies 12 (2019) (generally discussing how the expansion of bank branches increases financial inclusion), Bank-Branch Supply, Financial Inclusion and Wealth Accumulation by Claire Celerier, Adrien Matray :: SSRN; P. Boel & P. Zimmerman, FRB of Cleveland, Economic Commentary - Unbanked in America: A Review of the Literature at 4, No. 2022-07 (May 26, 2022) (citing Celerier and Matray's study and describing how the "increased presence of bank branches [in poor counties] leads to a percent increase in the likelihood that a low-income household is financially included"), ec 202207 (1).pdf.

28 In the FRB's most recent Small Business Credit Survey, the FRB estimated that 27% of U.S. small businesses applied for a loan, line of credit, or cash advance from an online lender and 18% applied with a finance company. Federal Reserve Banks of Atlanta, Boston, Chicago, Cleveland, Dallas, Kansas City, Minneapolis, New York, Philadelphia, Richmond, St. Louis, and San Francisco, Small Business Credit Survey 20 (2022), https://www.fedsmallbusiness.org/medialibrary/FedSmallBusiness/files/2021/2022-sbcs-employer-firms-report. The FRB defined both online lenders and finance companies as "nonbanks." *Id.* at iii.

29 *See* P. Lone, K. Nagarajan, T. Supples, & P. Wong, *Using Distributed Ledger Technology for Payment Directories, FEDS Notes* (Feb. 3, 2022), https://doi.org/10.17016/2380-7172.3042 (discussing the widespread use of PayPal and Venmo in the U.S. as payment directories).

30 Investment Company Institute, *Investment Company Fact Book* at 68 (2021), 2021 Investment Company Fact Book (ici.org). The FDIC reported total domestic deposits of about $18.2 trillion in December 2021. *See* Statistics at a Glance - 4th Quarter 2021 (fdic.gov).

that is largely outside the regulatory perimeter, and is often promoted because of the absence of regulation, has surged exponentially.

The development of these multiple, fast-growing alternatives to traditional banks has obvious implications for the competitive environment in which bank consolidation is considered. But, just as the FDIC RFI covers a far wider variety of subjects than the competitive impact of such mergers, so too there are widespread implications of this so-called shadow banking system. Perhaps the most important relates to financial stability. Permitting wide swaths of the financial industry to operate without meaningful safety and soundness regulation is inherently a threat to financial stability.

D. Unbanked Population

We firmly endorse the work of the FDIC and the other Federal Bank Regulators to reduce the number of unbanked households in our country. This work is essential if we are to achieve the critical goal of financial, economic, and societal inclusion. BPI's members have introduced a wide variety of products and services to achieve this goal.

The FDIC RFI can be read to imply that the process of consolidation has reduced the availability of banking services and, therefore, has led to more unbanked consumers. In fact, however, the number of unbanked consumers has been declining sharply during the last 10 years. Every other year, beginning in 2009, the FDIC Survey of Household Use of Banking and Financial Services estimates the percentage of U.S. households that are unbanked, defined as no one in the household having a checking or savings account at a bank or a credit union.[31] Based on these data, the percentage of unbanked households in the U.S. has steadily declined over the past decade, falling from 8.2% in 2011 to 5.4% in 2019 (and although the percentages of unbanked among Black and Hispanic households remain disproportionately high, those percentages are also declining).[32]

This improving financial inclusion of U.S. households can be attributed in large measure to the efforts of the banking industry. For instance, the industry has made large investments in providing mobile banking services, which has been a key factor in facilitating financial inclusion, as demonstrated in BPI research.[33] In addition, through private sector offerings of no- and low-cost bank accounts and participation in pilot and partnership programs, such as The Bank On Initiative and the Model Safe Accounts Pilot, banks have contributed meaningfully to advances in banking the unbanked.[34]

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31 *See* FDIC, How America Banks: Household Use of Banking and Financial Services (2019), Data Downloads and Resources (fdic.gov).

32 *See id.*; *see also* The Clearing House *et al.*, Delivering Financial Products and Services to the Unbanked and Underbanked in the United States – Challenges and Opportunities (May 2021) at 7, (citing 2019 FDIC Survey, which noted that recent declines in the unbanked rate have been "particularly sharp" with respect to Black and Hispanic households), tch_unbanked_report_may_2021.pdf (theclearinghouse.org); P. Boel & P. Zimmerman, FRB of Cleveland, Economic Commentary - Unbanked in America: A Review of the Literature at 4, No. 2022-07 (May 26, 2022), ec 202207 (1).pdf

33 *See* P. Calem and Y. Abdul-Razeq, *Obstacles to Financial Inclusion: Do Branch Accessibility and Bank Size Matter?* BPI (May 3, 2022), Obstacles to Household Financial Inclusion: Do Branch Accessibility and Bank Size Matter? - Bank Policy Institute (bpi.com).

34 The Clearing House *et al.*, *Delivering Financial Products and Services to the Unbanked and Underbanked in the United States – Challenges and Opportunities* (May 2021) at n. 33, 22–23, tch_unbanked_report_may_2021.pdf (theclearinghouse.org); *see See* P. Calem, *Bank On Transaction*

Studies have shown that these bank-driven products and services are generally less costly than those provided by alternative service providers, such as fintechs.[35]

II. Response to RFI Questions

A. Overview

Our answers to the FDIC RFI's 10 questions are shaped, like the questions themselves, by the overall nature of the banking and financial services industries. Accordingly, this overview outlines our general views before responding to the specific questions.

We believe that the record of bank consolidation during the "past several decades," taken as a whole, has been beneficial to bank customers, the banking industry, and the overall economy. It has produced a wider variety of products and services, created the beneficial effects of networks and provided greater convenience. It has contributed to the reduced levels of the unbanked and under-banked. It has created a stronger and more resilient banking system.

The ability of the American banking system to serve and protect the economy was demonstrated during the devastation created by the COVID-19 pandemic. The banking system remained in operation to serve the public. It was able to keep lending and served as a crucial conduit for government assistance programs. Branch networks enabled banks to keep many offices open to the public notwithstanding the unprecedented staffing shortages caused by COVID-19.

Moreover, due to strong capital and liquidity positions, stress-testing and other advance-planning, the banking system did not require government assistance. In marked contrast, some large financial institutions outside the bank regulatory perimeter required government support.

There have undoubtedly been significant changes in the banking industry over the past several decades, as in virtually every industry. A modern economy both compels and demands such changes. But business changes do not inherently suggest need for change in the regulatory system itself. The over-arching question should not be whether there has been structural change, but whether that change is inimical to the best interests of the public and the economy.

Just one key point about bank branch coverage, referred to above, demonstrates the necessity of this analytical approach. During the Covered Period, the number of bank branches available to the American public has increased by approximately 40%. Moreover, a recent study from the Federal Reserve Bank of Cleveland found that within urban areas, "the average distance to a branch remained at 1.0 mile for low- and moderate-income communities, and middle-income communities saw the distance

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Accounts and Financial Inclusion, BPI (July 19, 2021), "Bank On" Transaction Accounts and Financial Inclusion - Bank Policy Institute (bpi.com).

35 The Clearing House *et al.*, *Delivering Financial Products and Services to the Unbanked and Underbanked in the United States – Challenges and Opportunities* (May 2021) at 8, tch_unbanked_report_may_2021.pdf (theclearinghouse.org).

fall from 1.8 to 1.5 miles, while upper-income neighborhoods saw this distance increase from 1.6 to 1.7 miles" since 2000.[36]

Finally, although the FDIC RFI asks questions about consolidation in general, the ultimate question for every bank merger transaction is whether, based on its individual attributes, it meets the statutory standards applicable to the merger and, more broadly, the needs of the banks involved, their various constituencies, and the banking system. It would plainly be contrary to congressional intent for regulators to assume that all mergers are automatically positive. But it would be equally wrong for there to be a pre-conceived notion, whether based on absolute size or any other factor, that a merger should be presumptively denied.

B. *Specific Questions*

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?*

Yes, the existing regulatory framework properly considers all aspects of the BMA.

Congress has mandated that the Federal Bank Regulators consider a range of factors when evaluating bank merger transactions under the BMA and the BHCA. Congress has reviewed these factors over the years since the original enactment of these statutes, and added new factors as it determined appropriate to meet national objectives. When Congress enacted the BMA in 1960, the Federal Bank Regulators were directed to "take into consideration the effect of the transaction on competition (including any tendency toward monopoly)" and to not approve any merger unless "after considering all [enumerated] factors, it finds the transaction to be in the public interest."[37] The BMA also required bank regulators to consider "the financial history and condition of each of the banks involved, the adequacy of its capital structure, its future earnings prospects, the general character of its management, the convenience and needs of the community to be served, and whether or not its corporate powers are consistent with the purposes of [the BMA]" when considering merger applications.[38] Similarly, the BHCA, which Congress previously enacted in 1956, required the FRB to take into consideration the following factors when determining whether to approve a bank acquisition transaction: "(1) the financial history and condition of the company or companies and the banks concerned; (2) their prospects; (3) the character of their management; (4) the convenience, needs, and welfare of the communities and the area concerned; and (5) whether or not the effect of such acquisition or merger or consolidation would be to expand the size or extent of the bank holding company system involved beyond limits consistent with adequate and sound banking, the public interest, and the preservation of competition in the field of banking."[39]

Congress amended the BMA and the BHCA in 1966 to streamline and conform the language of the two statutes, requiring in each case that the relevant agency (1) not approve a proposed acquisition that "would result in a monopoly" or "substantially [] lessen competition" unless the "anticompetitive effects of the proposed transaction are clearly outweighed in the public interest … in

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[36] *See* Kyle Fee and Erik Tiersten-Nyman, *Bank Consolidation and Access to Full-Service Bank Branches*, Federal Reserve Bank of Cleveland (October 7, 2021).

[37] *Id.* As discussed below in Section II.B.8, the subsequent change in this language is directly tied to the "burden of proof" question posed by the FDIC RFI.

[38] Pub. L. No. 86-463, 74 Stat. 129, 129 (1960).

[39] Pub. L. No. 84-511, 70 Stat. 133, 135 (1956).

meeting the convenience and needs of the community to be served" and (2) consider the combined organization's "financial and managerial resources and future earnings prospects," as well as "the convenience and needs of the community to be served."[40]

In 1977, Congress enacted the Community Reinvestment Act (**CRA**), which imposed an affirmative obligation on banks to meet the credit needs of the communities in which they do business.[41] The CRA requires each Federal Bank Regulator to "use its authority when examining financial institutions, to encourage such institutions to help meet the credit needs of the local communities in which they are chartered consistent with the safe and sound operation of such institutions."[42] With respect to merger transactions, the CRA provides that a Federal Bank Regulator shall "assess the 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 such institution" and "take such record into account in its evaluation" of a bank merger application.[43]

In 1994, Congress repealed the so-called Douglas Amendment to the BHCA, which had been included as Section 3(d) of the BHCA in 1956 and had prohibited bank holding companies from acquiring banks across state lines unless authorized by state law. The Riegle-Neal Act eliminated this prohibition and amended the BHCA to permit interstate mergers provided that the bank holding company was "adequately capitalized and adequately managed."[44] At the same time, Congress also amended the BMA to allow the Federal Bank Regulators to approve interstate mergers between insured depository institutions.[45] As discussed above, the removal of these geographic barriers led to a large number of geographic extension mergers that had previously been precluded.

In the USA PATRIOT Act of 2001, Congress added a specific anti-money laundering-related factor to the BMA and the BHCA, requiring the Federal Bank Regulators to consider the proposed merger parties' effectiveness "in combatting money laundering activities, including in overseas branches."[46] In doing so, the prominence of anti-money laundering considerations in the bank merger review process was enhanced from being one aspect of the Federal Bank Regulators' analyses of an applicant's "financial and managerial resources" to being a standalone factor that "may form the basis for a denial of the application."[47]

In 2010, Congress amended the BMA and the BHCA as part of the Dodd-Frank Act to require consideration of a proposed merger's effect on the stability of the U.S. banking system.[48] The amendments were part of a broader legislative initiative in the wake of the 2008 financial crisis to promote "the financial stability of the United States by improving accountability and transparency in the financial system."[49] In the lead up to the enactment of the Dodd-Frank Act, multiple representatives of

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40 Pub. L. No. 89-356, 80 Stat. 7, 8 (1966); Pub. L. No. 89-485, 80 Stat. 236, 238 (1966).

41 Pub. L. No. 95-128, 91 Stat. 1147 (1977).

42 *Id.*

43 *Id.* at 1148; *see also* Notice of Proposed Joint Rulemaking related to the CRA issued by the Federal Bank Regulators on May 5, 2022, FDIC 12 CFR Part 345 RIN 30064-AF81.

44 *Id.*

45 Pub. L. No. 103-328, 108 Stat. 2338, 2343 (1994).

46 Pub. L. No. 107-56, 115 Stat. 272, 318-319 (2001).

47 *See* FDIC, FIL-109-2001, *Merger Applications*, https://www.fdic.gov/news/financial-institution-letters/2001/fil01109.html.

48 Pub. L. 111-203, 124 Stat. 1376, 1602 (2010).

49 *Id.* at 1376.

Federal Bank Regulators gave testimony to the Senate Committee on Banking, Housing, and Urban Affairs in support of amending the bank merger review process by imposing "an independent focus on systemic risk beyond the traditional anti-trust question" to enable the Federal Bank Regulators to disapprove mergers that would create undue systemic risk.[50] Specifically, pursuant to the Dodd-Frank Act amendments, the Federal Bank Regulators are required to consider, in every case, the extent to which a proposed merger, or consolidation would result in greater or more concentrated "risks to the stability of the United States banking or financial system."[51] For purposes of evaluating the financial stability factor, the Federal Bank Regulators consider, among other things, the size of the combining firms, the substitutability of financial services offered by the combining firms, the interconnectedness between the combining firms and the larger financial system, and the extent of cross-border activities of the combining firms.[52]

The Federal Bank Regulators have developed their framework for evaluating bank mergers incrementally, under leadership appointed by both Democratic and Republican Administrations, since the enactment of the BMA and the BHCA. The changes over time have reflected both the additional congressional-added factors described above and changing competitive and other conditions. For example, as thrift institutions and credit unions gained additional powers, they were included (albeit subject to conditions and limitations) in the competitive analysis. In 2014, the FRB issued a supervisory release, popularly known as "fix it first," which provided that an institution with certain types of compliance issues should not apply to make an acquisition until the issue has been adequately remediated.[53] The Federal Bank Regulators have issued a panoply of policy statements, guidelines, supervisory letters, and manuals, and also published numerous decisions, delineating how they consider and examine the statutory criteria described above. The existing framework comprehensively takes account of each of the enumerated statutory factors and serves as the foundation of a rigorous and coordinated bank merger review process that upholds the public policy objectives Congress sought to advance through the BMA and the BHCA, including preserving competition, encouraging strong capital, liquidity, and management, reinforcing compliance, deterring mergers that would result in a weaker institution or banking system, and promoting safe, community-conscious growth in the U.S. banking sector.[54]

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50 *See Dodd-Frank Wall Street Reform and Consumer Protection Act: A Legislative History* (2010), S. Hrg. 111-109, "Modernizing Bank Supervision and Regulation - Part I" at 26-27, 309 (2009) (William H. Manz, ed.) (testimony by FRB member, Daniel K. Tarullo, in response to questions by Senator Jeff Merkley and others); *see also Dodd-Frank Wall Street Reform and Consumer Protection Act: A Legislative History* (2010), S. Hrg. 111-179, "Regulation and Resolving Institutions Considered 'Too Big to Fail'" at 59 (2009) (William H. Manz, ed.) (statement by FRB of Minneapolis President, Gary H. Stern, and Ron Feldman, Senior Vice President, Supervision, Regulation and Credit of the FRB of Minneapolis, in support of "modifying the merger review process for large banks to provide better focus on reduction of systemic risk").

51 12 U.S.C. §§ 1828(c)(5), 1842(c)(7).

52 *See*, *e.g.*, FRB, *Order Approving Acquisition of a State Member Bank*, *The PNC Financial Services Group, Inc. and PNC Bancorp, Inc.* at 10-11 (Dec. 23, 2011), https://www.federalreserve.gov/newsevents/pressreleases/files/order20111223.pdf at 10–11. *See also* FDIC, *Application Procedures Manual, Section 4 (Mergers*), at p. 4–22, Applications Procedures Manual - Section 4: Mergers (fdic.gov).

53 *See* FRB, SR 14-2/CA 14-1, *Enhancing Transparency in the Federal Reserve's Applications Process* (2014), https://www.federalreserve.gov/supervisionreg/srletters/sr1402.htm.

54 *See*, *e.g.*, Legislative History of the Riegle-Neal Act, Senate Report No. 103-240 to Accompany S. 1963 the Interstate Banking and Branching Act of 1994, 103d Congress, 2d Session (1994), at 12, 23 (noting that the

In view of the vast experience involved in the development of the current evaluation framework and approach, there should be a strong presumption against major change absent clear and convincing evidence of flaws or failures under the existing regime. We urge the FDIC and other Federal Bank Regulators to predicate material changes to the well-balanced and well-functioning regulatory regime on a clearly demonstrated need for such change. Such an approach would avoid both creating uncertainty for market participants and discouraging organizations from pursuing beneficial bank mergers that drive the innovation and economies of scale required to respond to increasing competition from largely unregulated financial technology firms and other nonbank financial services companies. Additionally, maintaining a reliable and predictable regulatory approval policy produces societal benefits, such as avoiding direct and indirect costs of a merger rejection, including employee, customer, and community anxiety, and preventing an unnecessary call on regulatory resources (as described in further detail in response to Question 7 below).

We also submit that material changes designed to effect materially revised policies should only be implemented through recommendations by the Federal Bank Regulators to Congress. As noted, Congress has established an extensive regulatory framework and revised the framework when deemed necessary, to add new factors to that framework. With due respect, it would be a usurpation of congressional authority for a Federal Bank Regulator to add new factors or to change the application of an existing factor in such a material way that the change amounts to a new factor.

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?*

The current, comprehensive regulatory regime sufficiently addresses the financial stability risk factor added by Congress. In particular, the FDIC should not impose a presumption of financial instability based on asset size because size, in itself, is not a corollary of instability.

The BMA and the BHCA require the Federal Bank Regulators to consider ". . . the risk to the stability of the United States banking or financial system" as part of their assessment of a proposed merger.[55] As discussed in Appendix 2 and summarized below, a merger will have various features that

amendments to the BMA and the BHCA would "result in greater competition within the banking industry with greater efficiency and increased geographic and industry diversification of bank loans" and "increased customer convenience"); Legislative History of the Bank Merger Amendments of 1966: P.L. 89-356: 80 Stat. 7, Senate Banking and Currency Comm. Hearings on S. 1698, at 163 (May 1965) ("With regard to banking, it has been ou[r] consistent national policy that competition is to be preserved"); House Banking and Currency Comm. Hearings on S. 1698 at 889–891 (Aug. 1965) (committee questioning of Edward J. Reddy, Assistant Chief of the FDIC Division of Examination, regarding "problem banks"—those with acute financial- and management-related vulnerabilities—and the impact of mergers involving such "problem banks").

[55] 12 U.S.C. §§ 1828(c)(5), 1842(c)(7).

relate to financial stability and can, when considered in the aggregate, either increase or decrease financial stability risk. A merger will change the characteristics of the institution, the regulatory requirements for and supervision of the institution, and the market(s) in which the institution operates. These changes will affect U.S. financial stability by changing both the cost of failure of the institution and the probability of failure of the institution. When evaluating the implications for the financial stability of a proposed merger, the FDIC should account for *all* these changes. In particular, an evaluation that is based on size of the resulting institution alone would be incomplete, inaccurate and contrary to Congress's intent.

(a) Regulatory Framework for Assessing the Financial Stability Factor

The Federal Bank Regulators have engaged in an extensive, comprehensive analysis of the financial stability factor added by Congress in the Dodd-Frank Act. They consider multiple factors that bear on financial stability, including asset size, complexity, inter-connectedness, reliance on short-term wholesale funding, cross-border activities, and the availability of substitute providers for critical products and services. These factors have been described, often in detail, in a series of decisions by the Federal Bank Regulators,[56] and we are aware of no evidence that the Federal Bank Regulators' analysis of the financial stability factor has been incomplete or failed to include any important criteria. We also believe that there should be a strong presumption against implementing any inflexible "requirement" because the financial stability analysis is multi-faceted, and any specific requirement would inherently fail to capture all but one of the relevant facets.

(b) Measures

There is no need for any new quantitative or qualitative measures, but there could be better use of the one existing basic quantitative measure to achieve the FDIC RFI's admirable goal of "ensur[ing] greater clarity or administrability" of the financial stability factor.

The one quantitative measure cited by the Federal Bank Regulators is the systemic cost index (the "GSIB" Index) developed by the global bank regulators to calculate the GSIB capital surcharge.[57] This index generally utilizes the same financial stability factors cited by the Federal Bank Regulators in their financial stability analysis.

The GSIB Index, however, represents a highly conservative measure because it considers only the loss upon failure and fails to account for the potential financial stability benefits of a merger

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56 *See*, *e.g.*, FDIC, *Order and Basis for Corporation Approval regarding Branch Banking Trust Company's Application for Consent to Merge with SunTrust Bank, at to Establish Associated Branches* (Nov. 19, 2019), pr19111a.pdf (fdic.gov) (**FDIC BB&T-SunTrust Order**); FRB, *Order Approving M&T Bank Corporation's Acquisition of People's United Financial, Inc.* (Mar. 4, 2022), Federal Reserve Board announces approval of application by M&T Bank Corporation; OCC, *Corporate Decision #2021-01 regarding the Application for the merger of BBVA USA with and into PNC Bank, National Association* (May 14, 2021), Corporate Decision 2021-01 (occ.gov).

57 FRB, *Order Approving The PNC Financial Services Group, Inc.'s Acquisition of BBVA USA Bancshares, Inc.*, n. 46 (May 14, 2021) ("In addition the Board also considered the G-SIB Method 1 score of the combined organization. . . On consummation of the proposal, the combined organization would have a G-SIB Method 1 score of 42 points, well below the threshold (130 basis points) that identifies a financial institution as a G-SIB. Finally, this score is close to PNC's current Method 1 score, indicating that the transaction would not increase materially PNC's systemic importance."), Order Approving the Acquisition of a Bank Holding Company -- The PNC Financial Services Group, Inc. (federalreserve.gov).

that reduce the probability of failure. Although the loss given failure may be greater simply because a combined institution will be larger, the probability of loss may have been reduced because the combined institution may, among other things, be better diversified, be more profitable, have greater managerial resources, and be better able to invest in technology to reduce risk (as well as provide enhanced products, services and delivery systems to customers). A proper evaluation of systemic risk should, therefore, include a consideration of applicable failure-reducing factors. In the final analysis, systemic risk is the product of loss upon failure and probability of failure; a focus on just one of these elements of the formula (as the GSIB index does) produces an inaccurate evaluation.

To summarize certain of these potential failure-reducing factors briefly, in certain cases, the Federal Bank Regulators have previously observed how mergers may bring greater diversification in terms of product offering, geographic footprint and funding, which reduces a firm's exposure to any one industry or region and thus lowers the firm's probability of default.[58] In addition, banks' first line of defense against losses is profits, and, as documented by the economic studies cited in Appendix 2, there are considerable returns to scale in the banking industry. Further, an acquirer may have greater managerial and financial resources, and thus be more capable of not only resolving existing problems at the acquired institution but also in preventing new problems and identifying strategic opportunities. Scale also allows the merged entity to invest in technology and other resources to reduce risks, most notably operational risks, including cybersecurity risk. In almost every recent merger, management has cited rising technology costs and cyber risk as a rationale, with the merged firm better able to harness the best technology.

Of perhaps most importance, mergers often result in the combined institution being subject to more stringent regulations or higher supervisory expectations due to the larger size of the resulting institution that reduce the probability as well as systemic cost of failure. These changes are most obvious if an acquirer were to become a GSIB as a result of an acquisition, or to move to a higher prudential regulatory "tier". In particular, liquidity, capital, and recovery and resolution requirements increase as a banking institution gets larger.

Liquidity requirements to which larger banks are subject include the liquidity coverage ratio, net stable funding ratio, internal liquidity stress tests, liquidity risk management requirements, liquidity buffers, and resolution liquidity requirements. They reduce the probability of failure, as liquidity is the most frequent cause of failure. They also enable a bank to continue providing liquidity to other financial institutions, and avoid liquidation of assets at firesale prices if it comes under stress, and buy time for any failure to be orderly, reducing the systemic cost of failure.

Capital is specifically designed to limit the probability of a bank's failure. Capital requirements grow in stringency along with asset size. Most notably, the capital requirement of banks

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[58] *See*, *e.g.*, FRB, *Order Approving the Acquisition by Morgan Stanley of E*Trade Financial Corporation, a Savings and Loan Holding Company and Certain Nonbanking Subsidiaries* at 23 (Sept. 30, 2020) (acknowledging how the merger "would provide an additional stream of stable revenues for its wealth- and investment-management business and would diversify its funding structure"), Approval of notice by Morgan Stanley (federalreserve.gov); FRB, *Order Approving the Goldman Sachs Bank USA's Acquisition of Assets and Assumption of Liabilities of GE Capital Bank* at 23 (Mar. 21, 2016) (noting how the proposed merger would enhance financial stability because it "would immediately improve the stability of GS Bank's funding profile by diversifying sources of funding and increasing stable funding and would allow the bank to maintain and further improve its funding profile in the future"), Fed-Order-GoldmanSachsBank-20160321.pdf (cch.com).

with over $100 billion in assets includes an additional requirement determined in part through annual stress tests conducted by the FRB. Banks subject to the stress tests must have capital sufficient to pass minimum regulatory requirements after a nine-quarter period of severe economic stress. In addition, the largest banks are subject to a GSIB surcharge. By the FRB's calculation, an increase in capital alone strongly reduces the probability of failure. For example, the formula used to calculate the GSIB surcharge indicates that a 1.5 percentage point increase in the effective capital requirement cuts the probability of failure in half.[59]

Title I and Title II of the Dodd-Frank Act include core reforms that are designed to enable banking organizations to be resolved in an orderly manner. Their relevance should be indisputable. As the FDIC and the FRB have explained, "[t]he goal of the Dodd-Frank Act resolution planning process is to help ensure that a covered company's failure would not have serious adverse effects on financial stability in the United States . . . ."[60] As described in detail in Appendix 2, resolution requirements increase in stringency when a bank passes the $50 billion, $100 billion, and $250 billion asset size thresholds and with GSIB designation. Thus, any merger that takes the resulting company across one of these thresholds has a direct benefit for financial stability, as the firm must take increasingly comprehensive actions to ensure that it can be effectively resolved.

Despite these, or in fact because of these, flaws in the GSIB Index, it can serve as a conservative presumption in evaluating the financial stability impact of a merger. In other words, the actual impact of a metric that only uses loss upon failure, and does not use the balancing probability of failure, will be considerably less than the metric indicates. We, therefore, believe that the Federal Bank Regulators could establish a quantitative presumption based upon the combined institution's pro forma "Method 1" GSIB score. If the combined institution would not constitute a GSIB, or, if already a GSIB, would not increase its GSIB score by more than 10%, there should be a presumption that the transaction was consistent with the financial stability factor.

(c) Asset Size

We believe that a minimum asset size as a "presum[ption]" of "systemic risk concern" would be unsupported, statutorily invalid, anti-competitive and contrary to the best interests of the U.S. financial system and the public it serves. Such an approach would not merely ignore the probability of failure, but ignore all but one of the factors identified by the Federal Bank Regulators (and global regulators) as integral to evaluating expected loss upon failure. We are concerned that such a "presumption" would likely serve as an asset "cap" to implement the policy view that all mergers involving large banks are inherently undesirable. Such a policy decision is beyond the purview of the Federal Bank Regulators to make.

In the following analysis, we generally use the $100 billion asset threshold referred to in the FDIC RFI, but the fundamental flaws in the concept are applicable to any asset size presumption.

(i) Absence of Justification

Neither the FDIC RFI, nor any of the various proposals for an asset cap at $100 billion, provide any justification for that asset size limit. This number, therefore, appears entirely artificial. Asset size is *a* factor, but only one of multiple factors, that are considered in determining systemic risk.

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59 *See* FRB, *Calibrating the GSIB Surcharge* at 9, [Calibrating the GSIB Surcharge (federalreserve.gov)](https://www.federalreserve.gov).

60 84 Fed. Reg. 59194, 59194 (Nov. 1, 2019) (final rule relating to resolution plans).

An approach under which asset size is a determinative factor would be contrary to the views expressed over a 10-year period by the Federal Bank Regulators and bank regulators globally. An approach under which a bank with $100 billion in assets would be treated as creating systemic risk irrespective of all other factors is contrary to sound regulatory practice.

(ii) Contrary to Congressional Intent

Congress did not include an asset cap or presumption based on asset size when it enacted the financial stability factor in Dodd-Frank. Had Congress believed that an asset size presumption was appropriate, it would have been a simple matter to have taken such action. Indeed, there is no indication in the legislative history that such a cap was even considered as a financial stability consideration.[61]

Likewise, when Congress adopted the Economic Growth, Regulatory Relief, and Consumer Protection Act,[62] there was no effort to adopt such a presumption. Indeed, the action Congress took was to raise the minimum for enhanced prudential supervision above $100 billion. In this context, it is critical that the concepts of financial stability risk and enhanced prudential supervision not be conflated. Congress adopted asset standards for the latter but not the former, and the Federal Bank Regulators should not change that congressional decision—indeed, Congress's silence regarding specific asset standards for the former suggests its ratification of the existing approach.

(iii) Statutory Invalidity

The relevant provisions of the BMA and the BHCA (12 U.S.C. §§ 1828(c)(5), 1842(c)(7)) instruct the Federal Bank Regulators to "take into consideration" the risk to the stability of the United States banking or financial system. A presumption of a systemic risk concern at a predetermined level is likely to, and would perhaps be intended to, become a presumption of application denial. Such a presumption would, therefore, contravene the plain language of the statutes, which dictate that financial stability is only one of several statutory factors to be considered in the Federal Bank Regulators' evaluation of a bank merger application.

(iv) Relative Size

Even if a size-based presumption could conceptually make sense, which we believe it does not, any such limit must be considered in relation to the U.S. banking and financial services markets as a whole. It is unlikely, much less presumptively likely, that banking organizations that represent only a tiny fraction of those markets poses a systemic risk.

The $100 billion asset cap suggested in the FDIC RFI demonstrates this basic point. A $100 billion asset banking organization represents only about 0.4% of the assets of the banking industry and 0.2% of the assets of the financial services industry. Even a banking organization that is 10 times

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61 Section 622 of the Dodd-Frank Act did establish a cap on liabilities of any one institution, in relation to all banking liabilities, as a competitive consideration. To the extent, however, that this cap is regarded as related to financial stability, the 10% amount of the cap relating to all banking liabilities demonstrates how far removed from congressional intent a $100 billion asset cap truly is. Such an asset cap equates to less than 0.5% of all banking liabilities.

62 Pub.L. 115-174, The Economic Growth, Regulatory Relief, and Consumer Protection Act, S. 2155, 115th Cong. (2017).

that size represents less than 5% of the assets of the banking industry and only about 2% of the financial services industry.

(v) Adverse Competitive Impact

As noted above, and as Acting Comptroller Hsu has recognized, a presumption against consolidations in which the combined institution has over $100 billion would insulate the largest, nationwide banks from additional competition.

(d) Underlying Premises

We submit that the underlying premises cited by the FDIC RFI for a revaluation of the financial stability factor are invalid for two basic reasons.

First, the need for “reconsideration” of “non-GSIB large banks” is attributed to three predicates: the “increased number, size and complexity” of these banks. In fact, however, the third of those predicates is erroneous, and the first two are insubstantial.

We agree with the FDIC (and the other Federal Bank Regulators) that complexity is a key factor in determining financial stability risk. Where we disagree, however, is with the suggestion that the large regional banks have increased in complexity. These banks have not entered into new business lines, such as investment banking, or expanded their geographic scope outside the United States. Indeed, a number of these institutions have reduced their complexity by selling their investment banking or brokerage businesses. Accordingly, the complexity factor is actually a reason that there is no need for a reconsideration of the financial stability factor, rather than providing support for reconsideration.

Since 2011, the starting date utilized in the FDIC RFI for its consideration of the financial stability factor, the number of large regional banks has increased from 11 to 27, but most of these institutions, 21, are below $250 billion. Moreover, adjusted for economic growth and inflation, the increase in the number of banks greater than $100 billion has been insignificant (from 25 to 27). Likewise, adjusted for economic growth and inflation, the average size of these institutions has grown by only 8% (from $209 billion to $226 billion).

Second, the FDIC RFI, as well as other proponents of a reconsideration of the financial stability factor, relies on the precedent of the failure of Washington Mutual in 2008. Reliance on that situation as precedential, however, is misguided. Washington Mutual was not a bank, but a thrift that took advantage of a self-proclaimed “light touch” regulator.[63] That regulator enabled Washington Mutual to develop a monolinear, high-risk loan strategy and to operate with a thin capital level and limited liquidity, as well as to reject an acquisition proposal about six months before it failed. The

63 *See, e.g.*, Testimony by Patricia A. McCoy, *Consumer Protections in Financial Services: Past Problems, Future Solutions*, before the U.S. Senate Comm. On Banking, Housing and Urban Affairs (Mar. 3, 2009) at 20 (discussing how OTS’s supervision being confined to “light touch” regulation “the form of examinations, nonbinding guidances, and occasional informal agreements that ultimately did not work,” contributed to Washington Mutual’s precarious situation).

deficiencies of this regulator were so egregious that Congress abolished the regulator in the Dodd-Frank Act.[64]

(e) Conclusion

As discussed above, financial stability risk is ultimately the product of the probability of failure and the cost of failure. The analogy is the evaluation of the riskiness of a loan, which is measured by the probability of failure times the loss given default. The Federal Bank Regulators' assessment of the financial stability factor should compare this product as calculated for the merged entity to the sum of this product for each of the two merging institutions. A merger would only create a cognizable financial stability risk issue if this product for the merged institution (i) were large in itself, (ii) were materially larger than the sum of the individual institutions, and (iii) represented a material increase for the acquiring institution.

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)?*

Prudential factors should continue to be considered on a case-by-case basis, subject to the standards established by Congress.

The BMA and the BHCA require that the Federal Bank Regulators take into consideration the financial and managerial resources and future prospects of the existing and resulting institutions in reviewing a bank merger application. Having established these baseline prudential factors, Congress left to the Federal Bank Regulators the discretion as to how apply these factors in individual transactions. Congress has chosen to be prescriptive only in the application of capital standards for interstate mergers. In the Riegle-Neal Act, Congress mandated minimum capital requirements by providing that interstate merger transactions be approved only if the combined institution would be "adequately capitalized."[65] Congress enhanced this standard in 2010 as part of the Dodd-Frank Act, providing that the resulting institution had to be "well capitalized."

The Federal Bank Regulators thoroughly evaluate these prudential factors for each individual application, as set forth in formal regulations, policy statements, other guidance and numerous approval orders that explain how those factors are applied to actual transactions. Over decades, the expert staffs at the Federal Bank Regulators have crafted general standards, rather than prescriptive requirements, for evaluating the prudential factors of the BMA and the BHCA and then applied those standards on a case-by-case, comprehensive basis. For example, the FDIC's Statement of Policy on Bank Merger Transactions explains the FDIC's analytical approach:

> The FDIC does not wish to create larger weak institutions or to debilitate existing institutions whose overall condition, including capital, management, and earnings, is generally satisfactory. Consequently, apart from competitive considerations, the 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

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64 *See* Section 312 of the Dodd-Frank Act (12 U.S.C. § 5412).

65 Riegle-Neal Act, Pub. L. No. 103-328, §§ 101(a), 102(a), 108 Stat. 2338, 2339, 2346-47 (codified as amended at 12 U.S.C. §§ 1831u(b)(4), 1842(d)(1)(A) (2018)).

management, or whose earnings prospects, both in terms of quantity and quality, are weak, suspect, or doubtful. In assessing capital adequacy and earnings prospects, particular attention will be paid to the adequacy of the allowance for loan and lease losses. In evaluating management, the FDIC will rely to a great extent on the supervisory histories of the institutions involved and of the executive officers and directors that are proposed for the resultant institution. In addition, the FDIC may review the adequacy of management's disclosure to shareholders of the material aspects of the merger transaction to ensure that management has properly fulfilled its fiduciary duties.[66]

The FDIC's Application Procedures Manual requires that a case manager prepare a detailed summary of investigation (**SOI**) containing an assessment of the overall condition of each institution and the combined institution's financial resources along with information regarding available holding company support.[67] The SOI must also include an analysis of future prospects for the resultant institution based on current and projected earnings, capital and other financial and operational information for the end of the most recent quarter and for the first year of operation following consummation as well as any proposed changes to products and services offered to the combined organization's customers.[68] A case manager is also required to address (i) the ownership and active management of each institution as well as the combined institution, (ii) each institution's corporate governance practices as well as a review of its management's past responsiveness to regulatory recommendations, (iii) any proposed significant management changes, especially if the target institution is, or recently was, a problem institution and the applicant intends to retain certain senior or key management personnel of the target institution, and (iv) any insider transactions, which must be reviewed closely and discussed in detail in the SOI.[69]

The FRB and OCC provide similar application guidance for evaluating the financial and managerial resources and future prospects factors. For example, the FRB evaluates an applicant's financial condition by analyzing its current and projected capital positions and levels of indebtedness to assess whether they conform to established minimum standards.[70] Precedent FRB orders detail how these reviews involve an analysis of current and pro forma financial data from parent-only and consolidated organization perspectives, as well as from the standpoint of the subsidiary depository institutions and significant nonbanking operations involved to ensure the combined organization will be

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66 FDIC, *Statement of Policy on Bank Merger Transactions* (July 7, 1998) (as amended), FDIC Law, Regulations, Related Acts - Statements of Policy; *see also* FDIC BB&T-SunTrust Order (2019) (including a section entitled "Prudential Factors" summarizing the FDIC's analysis of BB&T and SunTrust's financial and managerial condition, including consideration of earnings, asset quality, liquidity and management strength of the existing banks and combined institution, for purposes of satisfying the statutory factor); FDIC, *Order and Basis for Corporation Approval regarding Randolph Savings Bank's Application for Consent to Merge* (June 13, 2016) (conditioning approval on resultant institution achieving higher Tier 1 leverage and total risk-based capital ratios as a result of the evaluation of prudential factors).

67 FDIC, *Application Procedures Manual, Section 4 (Mergers*), at p. 4-20, Applications Procedures Manual - Section 4: Mergers (fdic.gov).

68 *Id.* at p. 4-21.

69 *Id.* at p. 4-21.

70 *See* 12 C.F.R. § 225.13(b)(1).

"well capitalized" and able to absorb the costs associated with the transaction and complete effectively the proposed operational integrations.[71]

The FRB has also described common issues that have resulted in application denials and/or withdrawals, including where (i) holding companies are unable to demonstrate their ability to serve as a source of strength to their subsidiary IDIs and (ii) expansionary proposals are funded by high levels of debt or rely heavily on sustained high levels of dividends or other payments from bank subsidiaries.[72] With respect to managerial resources, the FRB considers the competence, experience, and integrity of the officers, directors, and principal shareholders of the applicant, their record of compliance with laws and regulations, and the applicant's record of fulfilling any commitments to, and any conditions imposed by, the FRB in connection with prior applications.[73] The FRB has highlighted in precedent orders that it reviews examination records and the assessments of the applicant's management, risk-management systems, and operations, and also consults with other relevant bank supervisory agencies regarding their supervisory experiences with the applicant.[74]

Similarly, in evaluating financial and managerial resources, the OCC "relies on the views of the supervisory office and information from a variety of sources, such as reports of examination of the depository institutions involved in the combination and the applicant's plans to operate the resulting bank" and "closely scrutinizes combinations that raise issues about management's ability to address increased risk to bank earnings and capital that can arise from any of the eight categories of risk that the OCC has defined for supervision purposes: credit, interest rate, liquidity, price, operational, compliance, strategic, and reputation."[75]

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71 *See*, *e.g.*, FRB, *Order Approving M&T Bank Corporation's Acquisition of People's United Financial, Inc.* (Mar. 4, 2022), Federal Reserve Board announces approval of application by M&T Bank Corporation; FRB, *Order Approving The PNC Financial Services Group, Inc.'s Acquisition of BBVA USA Bancshares, Inc.* (May 14, 2021), Order Approving the Acquisition of a Bank Holding Company -- The PNC Financial Services Group, Inc. (federalreserve.gov); FRB, *Order Approving Simmons First National Corporation's Acquisition of Liberty Bancshares, Inc.* (Feb. 12, 2015), Order Approving the Merger of Bank Holding Companies - Simmons First National Corporation (federalreserve.gov).

72 *See* FRB, SR 14-2 / CA 14-1, *Enhancing Transparency in the Federal Reserve's Application Process* (Feb. 24, 2014), The Fed - Supervisory Letter SR 14-2/CA 14-1 on Enhancing Transparency in the Federal Reserve's Applications Process -- February 24, 2014.

73 *See* 12 C.F.R. § 225.13(b)(2).

74 *See supra* note 71; *see also* FRB, SR 14-2 / CA 14-1, *Enhancing Transparency in the Federal Reserve's Application Process* (Feb. 24, 2014) (indicating that the FRB conducts "extensive reviews of the background, financial history and professional experience of the proposed principals of an organization" and how certain managerial issues, including lack of financial responsibility or insufficient banking experience tailored to the size/complexity of the resultant institution, have created significant barriers to approval), The Fed - Supervisory Letter SR 14-2/CA 14-1 on Enhancing Transparency in the Federal Reserve's Applications Process -- February 24, 2014.

75 *See* OCC, Licensing Manual for Business Combinations, at 6, Comptroller's Licensing Manual, Business Combinations (treas.gov); *see also* OCC, *Corporate Decision #2021-01 regarding the Application for the merger of BBVA USA with and into PNC Bank, National Association* (May 14, 2021), Corporate Decision 2021-01 (occ.gov); OCC, *Conditional Approval #1118 regarding the Application for the merger of Winfield Community Bank with and into Grand Ridge National Bank* (Jan. 6, 2015), Conditional Approval 1118 (occ.gov).

Beyond this guidance, the Federal Bank Regulators have promulgated various specific standards. These include risk-based capital requirements,[76] leverage requirements at or above minimum standards,[77] liquidity ratios,[78] and ratings at or above "well managed" status.[79]

We believe these general and specific standards have worked well to implement the financial and managerial resources and future prospects statutory factors, and we do not know of any evidence to the contrary. Accordingly, we believe that the existing approach does not need to be modified.

Moreover, the proper functioning of the bank merger application process requires that applicants have a consistent and predictable government approach. It is due to the agencies' long-established clarity regarding approval criteria that unacceptable mergers are avoided.

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 Federal Bank Regulators' current approach to evaluating the convenience and needs factor is appropriate.

From the initial enactment of the BMA and the BHCA, the Federal Bank Regulators have been instructed to consider "the convenience and needs of the community to be served" when determining whether to approve a bank merger application.[80] In the original BMA, a condition to approval by the relevant Federal Bank Regulators was a "finding" that the proposed merger was in the public interest.[81] The 1966 amendments eliminated this requirement, and, instead of an affirmative requirement, changed the public interest concept to an affirmative defense to a substantially lessening of competition.[82] The existing regulatory framework reflects the agencies' development of a cohesive approach to evaluating the convenience and needs factor for over 60 years.

Based on these legislative mandates, the Federal Bank Regulators have over time crafted comprehensive practices and procedures relating to the evaluation of the convenience and

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76 *See*, *e.g.*, 12 C.F.R. § 324.10(a) (FDIC); 12 C.F.R. § 217.10(a) (FRB); 12 C.F.R. § 3.10(a) (OCC).

77 *See*, *e.g.*, 12 C.F.R. § 324.10(b)-(c) (FDIC); 12 C.F.R. § 217.10(b)-(c) (FRB); 12 C.F.R. § 3.10(b)-(c) (OCC).

78 *See*, *e.g.*, 12 C.F.R. § 329.10(a) (FDIC); 12 C.F.R. § 249.10(a) (FRB); 12 C.F.R. § 50.10(a) (OCC).

79 *See infra* notes 139–140 and related discussion.

80 12 U.S.C. §§ 1828(c)(5), 1842(c)(2), 1843(j)(2)(A).

81 *See* Pub. L. No. 86-463, 74 Stat. 129, 129 (1960).

82 *See* Pub. L. No. 89-356, 80 Stat. 7, 8 (1966).

needs factor for transactions of all sizes, covering a wide variety of stakeholders. For example, the FDIC's Statement of Policy on Bank Merger Transactions states that "[i]n assessing the convenience and needs of the community to be served, the FDIC will consider such elements as the extent to which the proposed merger transaction is likely to benefit the general public through higher lending limits, new or expanded services, reduced prices, increased convenience in utilizing the services and facilities of the resulting institution, or other means."[83] The FDIC, as required by the CRA, will also "note and consider each institution's [CRA] performance evaluation record [and] [a]n unsatisfactory record may form the basis for denial or conditional approval of an application."[84] The FRB and OCC also consider a similar universe of data and resources when evaluating this factor.[85]

As part of the Federal Bank Regulators' consideration of the effects of a proposed transaction on the communities served, the Federal Bank Regulators closely examine the impact of potential branch closings and consolidations, particularly in low- and moderate-income and majority-minority neighborhoods.[86] They also consider proposed changes to products and services that may affect the access to banking services for customers in the relevant communities.[87] Moreover, the Federal Bank Regulators review consumer compliance ratings in determining the convenience and needs factor, indicating that applications involving institutions "with less-than-satisfactory consumer

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83 FDIC, *Statement of Policy on Bank Merger Transactions* (July 7, 1998) (as amended), FDIC Law, Regulations, Related Acts - Statements of Policy.

84 *Id.*; *see also* Interagency Bank Merger Application, FR 2070 at 4 (requiring that applicants describe (i) current and anticipated CRA programs, products and activities, (ii) anticipated changes to CRA assessment areas and (iii) whether the combining institutions have entered into commitments with community groups or other similar civic organizations concerning the provision of banking services to the community), FR_207020210608_f.pdf (federalreserve.gov).

85 *See BB&T/SunTrust*, FRB Order No. 2019-16, 5 (2019) (noting that the BHCA sets forth the factors that the FRB is required to consider when reviewing the merger of bank holding companies or the acquisition of banks, including the "convenience and needs of the communities to be served" and the "records of performance under the [CRA]"); OCC, *Comptroller's Licensing Manual Business Combinations*, 7 (describing the convenience and needs analysis and noting that the "convenience and needs factor is distinguished from the CRA requirements in that the convenience and needs analysis is prospective, whereas the CRA requires the OCC to consider the applicant's record of performance"), https://www.occ.treas.gov/publications-and-resources/publications/comptrollers-licensing-manual/files/licensing-booklet-business-combinations.html.

86 *See, e.g.*, *BB&T/SunTrust*, FRB Order No. 2019-16, 49-50 (2019) (considering the effect of branch consolidations and closures resulting from the merger and how these could "negatively impact LMI and rural communities," and noting that "the FDIC, as the primary federal supervisor of Truist Bank, would continue to evaluate the bank's branch closures in the course of conducting CRA performance evaluations"); *Citizens/Investors*, FRB Order No. 2022-11, 21-23 (2022) (considering the effect of branch consolidations and closures resulting from the merger with a particular focus on "LMI; distressed or underserved nonmetropolitan middle-income; and majority-minority communities").

87 *See* Interagency Bank Merger Application, FR 2070 at 4 (requiring that applicants provide detailed information regarding (i) any significant anticipated changes in services or products that will result from the consummation of the transaction, (ii) the extent to which any products or services would be offered in replacement of any products or services to be discontinued, and how they would assist in meeting the convenience and needs of the communities affected by the transaction and (iii) any enhancements in products or services expected to result from the transaction), FR_207020210608_f.pdf. (federalreserve.gov); *see also BB&T/Suntrust*, FRB Order No. 2019-16, 36 (2019) (noting that Truist Bank "would consider accessibility when making decisions on products and services and branching" and "that these efforts would make Truist Bank's products and services more accessible to all customers, including senior citizens and persons with disabilities").

compliance ratings or other significant consumer compliance issues face barriers to approval and have been discouraged."[88] In addition, M&A transactions are subject to public notice requirements to allow stakeholders outside the bank regulatory community to review and comment upon applications, especially whether the applicants meet the needs of their communities.[89] In the case of large transactions, the Federal Bank Regulators may provide a longer comment period and hold public meetings in the cities and towns where the main offices/headquarters of the applicants are located as a way to receive feedback directly from the communities most likely to be impacted by a proposed transaction.[90]

In connection with the convenience and needs factor, it has become a frequent practice in larger mergers for the applicant to enter into an agreement to make major investments (loans, investments and services) in the communities to be served by the combined organization.[91] These community investment programs are typically developed with significant input from community groups in the areas impact by the proposed merger.

Closely related to the Federal Bank Regulators' analysis of the convenience and needs factor is the parties' compliance with the CRA, which requires the Federal Bank Regulators to "assess the institution's record of meeting the credit needs of its entire community, including low- and moderate-

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88 FRB, SR 14-2 / CA 14-1, *Enhancing Transparency in the Federal Reserve's Application Process* (Feb. 24, 2014), The Fed - Supervisory Letter SR 14-2/CA 14-1 on Enhancing Transparency in the Federal Reserve's Applications Process -- February 24, 2014.

89 *See* 12 U.S.C. § 1828(c)(3) ("Notice of any proposed transaction for which approval is required under [the BMA], be published—(A) prior to the granting of approval of such transaction . . . and (D) in a newspaper of general circulation in the community or communities where the main offices of the banks or savings associations involved are located").

90 *See*, *e.g*., Press release, FRB and OCC, Agencies announce public meeting on proposed Bank of Montreal acquisition of BancWest Holding Inc. and Bank of the West; public comment period extended (May 17, 2022), Federal Reserve Board - Agencies announce public meeting on proposed Bank of Montreal acquisition of BancWest Holding Inc. and Bank of the West; public comment period extended; Press release, FRB and OCC, Agencies announce public meeting on proposed acquisition by the Toronto-Dominion Bank of First Horizon Corporation; public comment period extended (May 17, 2022), Federal Reserve Board - Agencies announce public meeting on proposed acquisition by The Toronto-Dominion Bank of First Horizon Corporation; public comment period extended; Press release, FDIC, Agencies announce two public meetings on merger of BB&T and SunTrust; public comment period extended (Mar. 14, 2019), FDIC: Press Releases - PR-17-2019 3/14/2019; Press release, FRB, Federal Reserve Board announces public meetings on the notice by Capital One Financial Corporation to acquire ING Bank (Aug. 26, 2011), https://www.federalreserve.gov/newsevents/pressreleases/orders20110826a.htm.

91 *See*, *e.g.*, *U.S. Bancorp Announces $100 Billion Community Benefits Plan* (May 9, 2022) (discussing U.S. Bancorp's five-year community benefits plan developed in connection with its acquisition of MUFG Union Bank), U.S. Bancorp Announces $100 Billion Community Benefits Plan | U.S. Bancorp (usbank.com); *PNC Announces $88 Billion Community Benefits Plan* (Apr. 27, 2021) (discussing PNC's four-year community benefits plan developed in connection with its acquisition of BBVA USA), PNC Announces $88 Billion Community Benefits Plan - Apr 27, 2021 (mediaroom.com); *see also see also* Interagency Bank Merger Application, FR 2070 at 4 (requiring that applicants describe (i) current and anticipated CRA programs, products and activities, (ii) anticipated changes to CRA assessment areas and (iii) whether the combining institutions have entered into commitments with community groups or other similar civic organizations concerning the provision of banking services to the community), FR_207020210608_f.pdf (federalreserve.gov).

income neighborhoods, consistent with safe and sound operation."[92] Indeed, the Federal Bank Regulators have denied applications based on the convenience and needs factor where an applicant's CRA rating was not at least "satisfactory."[93] Consequently, a depository institution's successful CRA performance is a predicate to approval of an application, but it is not sufficient.

Under the current approach, therefore, the Federal Bank Regulators have ample opportunity to consider thoroughly whether a proposed bank merger transaction meets the convenience and needs of the communities to be served by the combined institution. Experience shows that this mandate has been carried out appropriately and with due process.

Moreover, as BPI has previously discussed in the context of reviewing the academic literature on effects of bank mergers, there is scant evidence to suggest that the existing approach under the current regulatory framework is inadequate for preventing harmful mergers.[94] On the contrary, academic literature and data show that bank mergers often boost the availability of products and services, and yield other substantial benefits, to the communities served by the combined institution, including underserved populations and small businesses.[95]

In particular, the academic literature rejects the view, proffered in support of more restrictive merger policies, that bank mergers lead to a systematic decline in the supply of bank loans to small businesses. Overall, the academic studies demonstrate that the relationship between bank mergers and bank lending to small businesses is complex and depends on many factors, such as the bank's size, location, culture, and ownership structure, as well as the period of analysis.

Lending to small businesses often relies on building relationships and on "soft" information that is acquired over time and not easily transmitted to other lenders, and research shows that in some mergers some such relationships may be disrupted. However, BPI is unaware of any papers that show a decline in small business lending in some bank merger contexts along with providing a full, cost-versus-benefit assessment. For example, one potential offsetting benefit highlighted in the academic literature is improved risk management leading to better performing loans.[96] The convenience and needs component of the current regulatory approach is more than adequate for conducting such assessments and addressing any concerns regarding potential effects of a proposed merger on small business lending.

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92 12 U.S.C. § 2903(a)(1); *see also* 12 U.S.C. § 2902(3)(E)–(F) (applying certain CRA provisions to applications for mergers and acquisitions under the BMA and the BHCA).

93 *See, e.g.*, *Totalbank Corporation of Florida/Florida International Bank*, 81 Fed. Res. Bull. 876, 878 (1995) (denying application on convenience and needs grounds as bank "should address its CRA responsibilities and have the necessary policies in place and working well"); *First Interstate BancSystem of Montana, Inc./Commerce BancShares of Wyoming, Inc.*, 77 Fed. Res. Bull. 1007, 1009 (1991) (denying application on convenience and needs grounds as reliance on commitments for future action to address CRA concerns was not appropriate in light of past performance).

94 *See* 2022 BPI DoJ Response Letter, Appendix B (providing an overview and analysis of research relating to the effects of bank mergers).

95 *See id*.

96 *See* 2022 BPI DoJ Response Letter, Appendix B (providing an overview and analysis of research relating to the effects of bank mergers); *see also* A. Berger, A. Kashyap, and J. Scalise, *The transformation of the U.S. banking industry: what a long, strange trip it's been*, Brookings Papers on Economic Activity (1995, no. 2), The Transformation of the U.S. Banking Industry: What a Long, Strange Trip It's Been (brookings.edu).

Nor have bank mergers or the decline in the number of smaller banks slowed progress on household financial inclusion, which, as described above, has improved markedly. A new BPI research note, using a robust FDIC data set, examines why some places saw greater improvement in financial inclusion between 2013 and 2019 than others.[97] The analysis explores a range of factors potentially associated with differing financial inclusion outcomes across geographic areas, including whether a change in the number of bank branches or a change in the mix of large versus smaller banks in an area played a role. The analysis indicates that neither a reduction in bank branches nor an increase in the proportion of branches owned by large banks during this period had a material effect on household financial inclusion. Rather, material drivers are mobile access (through use of smartphones) and the level of financially disadvantaged people (measured by educational level) in the area.

Additionally, in this question, the FDIC RFI asks explicitly about the role of the CFPB in the application process. Although there may be special situations (such as where the CFPB has announced an enforcement action against the applicant) where the FDIC should consult with the CFPB on a specific matter,[98] there is no statutory basis for the Federal Bank Regulators to consult with the CFPB as a matter of course on the question of whether a proposed transaction satisfies the convenience and needs standard. Of course, the CFPB remains free to initiate contact with a Federal Bank Regulator to express the CFPB's view, and the CFPB can share consumer compliance examination reports with the Federal Bank Regulators.[99]

Moreover, participation by the CFPB in the application process would extend beyond the role that Congress delineated for the CFPB. When Congress established the CFPB in the Dodd-Frank Act, there was no suggestion in the statute or legislative history that the CFPB should have any sort of concurrent role respecting mergers, or even be accorded a special right of comment. Congress did not amend the BMA or the BHCA to give the CFPB the specific right to present its views or provide any recommendation. In marked contrast, when Congress wanted to provide another government agency with the specific authority to be consulted or comment, it did so explicitly. These rights were extended to the DoJ[100] and the acquired bank's chartering authority.[101] The absence of a similar right assigned to the CFPB should be conclusive of the question.

Moreover, the CFPB does not have the range of information to assess the question whether the transaction serves the convenience and needs of the community to be served. This is a much broader question than whether a banking organization is complying with the specific consumer protection laws that the CFPB has been authorized to review and enforce. An applicant may be fully in compliance with those laws, but the transaction would not serve the convenience and needs of the community. Conversely, even if an applicant is not in full compliance with those laws, the transaction may serve the community's convenience and needs.

A Federal Bank Regulator should not provide special consultative rights when Congress has not chosen to provide those rights, much less delegate a decision on this factor to another agency

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97 *See* P. Calem and Y. Abdul-Razeq, *Obstacles to Financial Inclusion: Do Branch Accessibility and Bank Size Matter?* Bank Policy Institute (May 3, 2022), Obstacles to Household Financial Inclusion: Do Branch Accessibility and Bank Size Matter? - Bank Policy Institute (bpi.com).

98 *See, e.g.*, *Fifth Third Bancorp*, 105 Fed. Res. Bull. 70, 81 (2019) (noting that the FRB consulted with the CFPB about Fifth Third's consumer compliance record).

99 12 U.S.C. § 5512(c)(6)(C)(i).

100 12 U.S.C. §§ 1828(c)(4); 1842(b)(1).

101 12 U.S.C. §§ 1828(c)(7); 1842(b)(1).

whose range of authority does not encompass the numerous considerations that determine the evaluation.

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?*

Maintaining HHI-based screens is appropriate as they have a demonstrated track-record of being sound measures for evaluating bank mergers.

The HHI-based screens that the DoJ and the Federal Bank Regulators have developed to help assess the likely competitive effects of a proposed bank merger (1) are consistent with Supreme Court precedent, (2) have effectively protected consumers from mergers that harm competition, and (3) are supported by analytically sound competition principles. Expert career staffs of the DoJ and the Federal Bank Regulators incrementally developed these quantitative measures over decades through evidence developed over the course of numerous investigations in all parts of the country.[102] For those reasons, they should continue to be the primary tools that are used to assess whether a proposed merger threatens harm to competition. There is no need for additional quantitative screening tools to replace or supplement the existing ones, except on a discretionary case-by-case basis, as discussed below.

(a) Product-market principles

The HHI-based screens are grounded in customers' demand that commercial banks provide a "cluster of products (various kinds of credit) and services (such as checking accounts and trust administration)."[103] The FRB has explained that the appropriate cluster contains "those bank products and services that are provided to most households and small businesses, rather than to those products that are provided to wealthy individuals or major corporations."[104]

The Supreme Court has repeatedly found that cluster of products and services to be the relevant product market for assessing the competitive effects of proposed bank mergers.[105] That is

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102 As BPI noted in its prior submissions to the DoJ, the HHI screens that are applied to bank mergers are more restrictive than those that have been applied to every other industry since 2010. *See* 2020 BPI DoJ Response Letter; 2022 BPI DoJ Response Letter. The DoJ has provided no explanation for this difference. For the reasons described in those letters, the screens should be raised to take into account the growing competition that banks with physical branches face from competitors with different business models, including fintechs and digital banks.

103 *United States* v. *Phila. Nat'l Bank*, 374 U.S. 321, 356 (1963).

104 FRB, *How do the Federal Reserve and the U.S. Department of Justice, Antitrust Division, analyze the competitive effects of mergers and acquisitions under the Bank Holding Company Act, the Bank Merger Act and the Home Owners Loan Act?*, FAQ 9 (Oct. 9, 2014) (**FAQs**), FRB: How do the Federal Reserve and the U.S. Department of Justice, Antitrust Division, analyze the competitive effects of mergers and acquisitions under the Bank Holding Company Act, the Bank Merger Act and the Home Owners Loan Act? FAQs.

105 *See, e.g.*, *United States* v. *Conn. Nat'l Bank*, 418 U.S. 656, 664 (1974) (finding that the appropriate product market is the "cluster of services provided by commercial banks"); *United States* v. *Marine Bancorporation, Inc.*, 418 U.S. 602, 618-19 (1974) (finding that "our precedents" are "in full accord" with a relevant product market consisting of "the cluster of products and services" denoted by "commercial banking"); *see also*, *e.g.*, *United States* v. *Central State Bank*, 817 F.2d 22, 24 (6th Cir. 1987) (rejecting

consistent with the approach in many other industries in which courts have also found that the appropriate product market for purposes of assessing the competitive effects of a proposed merger is a cluster market.[106] We recognize, of course, that these Supreme Court decisions are decades-old. We are unaware, however, of any compelling evidence that this otherwise binding judicial view should be overturned or that the Federal Bank Regulators are free to disregard it.

One important rationale for the cluster-of-services approach utilizing a deposit-based measure is that a bank's share of local deposits indicates the bank's capacity to engage in local lending activity as well as its competitive strength in attracting local deposits. In contrast, a bank's share as measured more narrowly by product line, such as its share of small business or commercial real estate loans may vary with the bank's current business focus and may not represent its potential to exercise competitive strength in that product line.

The DoJ and the Federal Bank Regulators nevertheless retain the discretion to investigate individual product markets in appropriate circumstances. The FRB, for instance, has noted that it may investigate the competitive effects in specific product markets "such as credit card issuance or mortgage lending . . . whose geographic markets may be regional or national in scope,"[107] and the DoJ has similarly noted that, "[o]n a case-by-case basis," it assesses "the competitive effects in other product markets, such as middle-market business banking."[108] Because products that are sold in regional or national geographic markets (for example, credit card issuance) typically have a large set of sophisticated competitors competing to serve the needs of customers, the cluster-market approach effectively captures any concerns of competitive significance in the vast majority of instances.[109]

(b) Geographic-market principles

The HHI-based screens focus on those locations where customers will experience a "direct and immediate" effect as a result of a proposed merger.[110] The FRB has divided the United States into geographic markets based on its experience analyzing mergers over many decades, and continuously updates those definitions based on a variety of evidence, including "commuting patterns,

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proposed "departure from the definition of the relevant product market as the cluster of banking services traditionally offered in the commercial banking industry").

106 *See, e.g.*, *Brown Shoe Co.* v. *United States*, 370 U.S. 294, 327-328 (1962) (clustering different kinds of shoes); *ProMedica Health Sys.* v. *FTC*, 749 F.2d 559, 568 (6th Cir. 2014) (hospital services); *FTC* v. *Staples, Inc.*, 970 F. Supp. 1066, 1080 (D.D.C. 1997) (office supplies); *California* v. *Am. Stores*, 697 F. Supp. 1125, 1129 (C.D. Cal. 1988) (groceries).

107 FAQ 9; *see also*, *e.g.*, FRB, *Order Approving the Formation of a Bank Holding Company and the Merger of The Bank of New York Company and Mellon Financial Corporation* (June 14, 2007) (considering securities and investor services as part of competition analysis), Approval of proposal by The Bank of New York Mellon Corporation (federalreserve.gov); FRB, *Order Approving Merger of First Bank System, Inc. and Bank Shares Incorporated*, 1992 WL 685207 (Nov. 30, 1992) (citing DoJ's consideration of the impact of the proposed transaction on competition for middle-market lending and small business customers in the relevant banking market).

108 FAQ 29 n.7.

109 *See, e.g.,* David Benson and Ken Onishi, *Are There Competitive Concerns in "Middle Market" Lending?* FEDS Notes (Aug. 10, 2020), https://www.federalreserve.gov/econres/notes/feds-notes/are-there-competitive-concerns-in-middle-market-lending-20200810.htm#:~:text=Instead%2C%20middle%20market%20firms%20have,of%20middle%20market%20financial%20services.

110 *United States* v. *Phila. Nat'l Bank*, 374 U.S. 321, 357 (1963).

shopping patterns, interviews with local government and business leaders, and surveys of local households or small businesses."[111]

The Supreme Court has repeatedly held that competitive effects in "localized banking markets" are the appropriate geographic markets in which courts should analyze the competitive effects of bank mergers.[112] That is consistent with the approach taken by courts in many other industries.[113]

(c) Assigning market shares within a market

In the screens developed by the DoJ and the Federal Bank Regulators, the shares of competitors in a particular market are approximated through the deposits at physical branches located within the geographic market.[114] That approximation is in keeping with the Supreme Court's use of deposits as a measure of competitive strength.[115]

As the Supreme Court has acknowledged, this method of approximating market shares has the effect of overstating the competitive significance of banks with physical branches in a particular region because it ignores, entirely, the competitive significance of "banks which do business in the [relevant] area but have no offices there."[116] Nevertheless, the screens continue to provide an effective way "to identify proposed mergers that clearly do not have significant adverse effects on competition."[117] As described in the 2020 BPI DoJ Response Letter, however, the HHI levels at which competitive harm should be presumed should be increased to better reflect the substantial sources of competition that are not taken into account under current methodology.[118]

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111 FAQ 14.

112 *United States* v. *Conn. Nat'l Bank*, 418 U.S. 656, 670 (1974).

113 *See, e.g.*, *FTC* v. *Sysco Corp.*, 113 F. Supp. 3d 1, 51 (D.D.C. 2015) (focusing on potential effects of a proposed merger involving food distributors on customers in local geographic markets); *FTC* v. *Tenet Health Care*, 186 F.3d 1045, 1052 (8th Cir. 1999) (local geographic markets used to assess hospital merger).

114 *See* FAQ 11.

115 *See*, *e.g.*, *United States* v. *Phila. Nat'l Bank*, 374 U.S. 321, 331, 364 (1963).

116 *Id.* at 364 n.40.

117 U.S. Dep't of Justice, Bank Merger Competitive Review – Introduction and Overview (1995) (**Bank Merger Guidelines**), Bank Merger Competitive Review -- Introduction And Overview (1995) (justice.gov).

118 *See* 2020 BPI DoJ Response Letter at 1–2, 7.

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; (b) Rapid economic change has resulted in an outdated geographic market definition and an alternate market is more appropriate; (c) Market shares are not an adequate indicator of the extent of competition in the market; (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; (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; (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 (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?*

The Federal Bank Regulators should, and in practice do, consider each of the above-enumerated factors in considering the competitive effects of a proposed merger transaction.

Subparts (a) through (g) of Question 6 either directly quote from or paraphrase the section of the Bank Merger Guidelines addressing how the competitive effects of transactions *exceeding* the initial HHI-based screening thresholds are assessed. That section invites merging parties to present "additional information" that helps give "a clearer picture of competitive realities in the market," including information relevant to the seven considerations addressed in subparts (a) through (g) of Question 6.

Accordingly, the DoJ considers the issues described in Question 6 as potentially relevant to the competitive analysis *only* if the initial HHI-screen is exceeded. This approach reflects the inherent conservatism of the HHI screen, which, among other things, ignores all bank competitors without a branch in the geographic market at issue, as well as all non-bank competitors, and has a considerably lower market concentration threshold than all other industries. Consequently, except in highly unusual cases, these factors should not be considered if the transition "passes" the initial screen. We also note that these seven factors are not exhaustive and the guidelines do not limit other evidence that could be considered to demonstrate that a transaction above the initial screen would not have a significantly adverse competitive effect.

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

Evidence that the merging parties do not significantly compete with one another can be relevant to the question of whether a proposed merger threatens harm to competition.[119] Evidence probative of the issue of whether merging parties directly compete "includes documentary and

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119 *See, e.g.*, U.S. Dep't of Justice & Fed. Trade Comm'n, *Horizontal Merger Guidelines* § 6.1 (2010), https://www.justice.gov/sites/default/files/atr/legacy/2010/08/19/hmg-2010.pdf.

testimonial evidence, win/loss reports and evidence from discount approval processes, customer switching patterns, and customer surveys."[120]

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

The Bank Merger Guidelines explain that both the Federal Bank Regulators and the DoJ rely in general on the geographic markets that the FRB defines, while noting that those geographic market definitions are reviewed to ensure that they "reflect fully the competitive effects of the transaction."[121] These geographic market definitions are regularly reviewed and updated by expert staff at the local Federal Reserve Banks. In order to provide consistency and predictability, we believe that a different geographic market should be used only when there has been a demonstrated and material change in market conditions since the last review by the relevant Reserve Bank.

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

Evidence that market shares are not an adequate indicator of the extent of competition in the market can be relevant to assessing the actual likely competitive effects of a proposed merger that exceeds the initial screen. For instance, the modest deposit-based share of a competitor that recently opened a branch in an area and is actively engaged in attracting new business may understate the new entrant's role in the marketplace.[122] Similarly, evidence that a competitor has been "losing market share" may indicate that its competitive significance may be less than its current deposit-based share suggests.[123]

(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;

Although thrifts historically focused on residential mortgage lending and other needs of retail customers, federal legislation in 1980[124] and 1996[125] enabled thrifts to be more active commercial lenders. In the decades since, many thrifts established substantial commercial lending operations. For this reason, thrifts that are engaged in commercial lending are, and should be, typically considered full competitors in the relevant market.[126] Moreover, even if a thrift is not a commercial lender, it can be a vigorous and effective competitor for retail customers. This competitive impact can be appropriately recognized through the FRB's approach of weighting the deposits of thrifts that do not engage in commercial lending at 50%.

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120 *Id.*

121 Bank Merger Guidelines at 2; *see also* FAQ 12 (noting that, "for any transaction," the appropriateness of the FRB's existing geographic-market definitions is "examined carefully").

122 Bank Merger Guidelines at 3.

123 *Id.*

124 The Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. 96-221, 94 Stat. 132 (Mar. 31, 1980).

125 Economic Growth and Regulatory Paperwork Reduction Act of 1996, Pub. L. 104-208, 110 Stat. 3009, 394 (Sept. 30, 1996).

126 *See* FAQs 5, 17, and 31.

(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;

Like thrifts, credit unions historically focused on the needs of retail customers. Federal legislation in 1998 recognized the ability of credit unions to make business loans to its members,[127] and in the decades since some credit unions have established substantial commercial lending operations. In addition, during the last 20 years, "membership" restrictions on credit unions have been reduced to the point of effective elimination. As noted by Acting Comptroller Hsu, between 1995 and 2020, membership in credit unions doubled, and total assets held by credit unions grew by more than 550%.[128] Moreover, credit unions are accorded a substantial competitive advantage by their tax-free status and other factors.

In light of these developments, credit unions should be treated similarly to thrifts for purposes of competitive analyses.[129] Credit unions that engage in commercial lending and have membership criteria that largely encompass the relevant geographic market should be treated as full competitors. Credit unions that have similar broad membership criteria, but do not engage in commercial lending, should have their deposits weighted at 50%.

Any debate about the direct competitive impact of credit unions has been eliminated by the record, noted above, of credit union acquisitions of banks. During the last 10 years, credit unions have acquired 37 smaller banks, whereas banks with $100 billion or more in assets have acquired only one smaller bank.

(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

The Bank Merger Guidelines recognize that banking institutions with physical locations outside a local geographic market may nevertheless compete in it. One obvious example is a banking institution that has a physical location in an adjoining geographic market.[130] This competitive presence has increased with online banking tools that allow competitors to service the needs of commercial customers remotely. Moreover, similar online banking tools increasingly enable out-of-market banking institutions to compete for in-market retail customers, and this competitive impact should be recognized.

(g) There is actual competition by non-bank institutions for commercial customers, particularly competition for loans for business startup or working capital purposes.

As detailed in the 2020 BPI DoJ Response Letter, commercial customers can and do turn to a variety of alternatives to meet their borrowing needs beyond the banks, thrifts, and credit unions that have physical branches in a locale.[131] As mentioned above, in the FRB's most recent Small Business Credit Survey, the FRB estimated that 27% of U.S. small businesses applied for a loan, line of credit, or

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127 Credit Union Membership Access Act of 1998, Pub. L. 105-219, 112 Stat. 913 (Aug. 30, 1998).

128 Acting Comptroller of the Currency Michael J. Hsu, *Bank Mergers and Industry Resiliency*, Remarks before the Brookings Institution at 4 (May 9, 2022), Acting Comptroller Discusses Bank Mergers | OCC (treas.gov).

129 *See* FAQs 18, 19, and 32.

130 Bank Merger Guidelines at 2.

131 2020 BPI DoJ Response Letter at 8-9.

cash advance from an online lender and 18% applied to a finance company.[132] (The corresponding figures are 42% and 36% for large and smaller banks, respectively.[133]) In order to reflect current competitive dynamics, the DoJ and the Federal Bank Regulators should update their analyses to better account for the substantial impact of these nonbank competitors by, for instance, gathering evidence from alternative sources of small-business lending, including such companies as Lending Club, OnDeck, CAN Capital, and PayPal Working Capital.

Moreover, this analysis should not be limited to competition for commercial customers. Nonbank lenders have already captured a major share of the retail bank lending market, and a failure to consider that competitive presence ignores competitive reality. As just one example, the leading mortgage lender in the country is Rocket Mortgage. Other prominent nonbank retail lenders include SoFi, Better Mortgage and LoanDepot.

The FDIC RFI also asks "[w]ith respect to the preceding factors, how and to what extent should the activity of current branches or pending branch applications be considered?"[134] The prospect of additional competition in the near future as a result of an entrant trying to capture business in connection with a pending branch application is a factor that should be also considered when assessing the competitiveness of a particular market.

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?*

No, the existing regulatory framework does not create a presumption of approval for bank merger transactions.

Nothing in the Federal Bank Regulators' regulations or guidance can be legitimately construed as creating a presumption of approval. Such a presumption also does not exist implicitly. To the contrary, as demonstrated by approval orders, research studies, and agency findings from over the past 60 years, the regulatory approval process for bank mergers represents a deliberative, analytical and rigorous process.[135] As detailed in a BPI publication regarding bank merger application review in practice,[136] the existing regulatory application process results in applicants being encouraged to

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132 Federal Reserve Banks of Atlanta, Boston, Chicago, Cleveland, Dallas, Kansas City, Minneapolis, New York, Philadelphia, Richmond, St. Louis, and San Francisco, Small Business Credit Survey 20 (2022), https://www.fedsmallbusiness.org/medialibrary/FedSmallBusiness/files/2021/2022-sbcs-employer-firms-report. The FRB defined both online lenders and finance companies as "nonbanks." *Id.* at iii.

133 Id.

134 FDIC RFI at 18,744.

135 For significant merger transactions, the Federal Bank Regulators' orders are typically published and contain a detailed analysis of factors underlying their decision with respect to an application. These orders generally consist of a multi-page description of the agency's consideration under each BMA or BHCA statutory factor, as well as any other supervisory matters the agencies considered in arriving at a decision. *See*, *e.g.*, FDIC BB&T SunTrust Order; FRB, *Order Approving the Merger of Bank Holding Companies, the Merger of Banks and the Establishment of Branches by M&T Bank Corporation and Manufacturers and Traders Trust Company* (Mar. 4, 2022), Order Approving the Acquisition of a Bank Holding Company -- The PNC Financial Services Group, Inc. (federalreserve.gov); OCC, *Corporate Decision #2021-01 regarding the Application for the merger of BBVA USA with and into PNC Bank, National Association* (May 14, 2021), Corporate Decision 2021-01 (occ.gov).

136 BPI, *Bank Merger Applications in Law and Practice* (Aug. 19, 2021), Bank Merger Applications in Law and Practice - Bank Policy Institute (bpi.com).

withdraw inadequate or problematic applications after consultation with agency staffs, or, in the case of certain mergers, an applicant being required to divest branches, deposits and/or assets.[137] Of most importance, the transparency of the existing application framework enables banks to avoid pursuing transactions that would be unlikely to be approved. This is a virtue, not a vice.

Indeed, the regulatory framework creates a presumption, which is close to irrefutable, of disapproval if a potential applicant does not meet any of a number of objective approval criteria highlighted in regulatory guidance. For example, the Riegle-Neal Act required an agency reviewing a proposed interstate merger transaction to determine that the resulting bank would be "adequately managed" for the application to be approved;[138] and the Dodd-Frank Act changed this standard to "well managed" in 2010.[139] Although the statute does not define "well managed," the FDIC has generally required an applicant to have a Management rating of 1 or 2 under the Uniform Financial Institution Rating System to qualify. Similarly, under SR Letter 14-2, the FRB announced that it generally does not approve merger applications filed by banks with a 3, 4, or 5 composite or Management rating, and that "proposals involving institutions with less-than-satisfactory consumer compliance ratings or other significant consumer compliance issues face barriers to approval and have been discouraged."[140] In addition, the OCC's Licensing Manual for Business Combinations also underscores that applicants with MRAs, program deficiencies or less than satisfactory ratings should consult with the appropriate OCC Licensing Division before pursuing any plans for a combination as the OCC assesses the nature of these issues in connection with merger applications—particularly whether the proposed transaction would detract from remediation, exacerbate existing problems, or create new problems for the resulting institution.[141]

There are also numerous cases in which an application is withdrawn after it has been filed. Withdrawals often happen after the agency staff has informed the applicant that a significant issue exists that likely would preclude an approval recommendation by agency staff. According to the FDIC's annual transparency and accountability data on bank applications, for the 12 months ending March 31, 2022, approximately 7% of total merger applications during this period were either withdrawn or returned (withdrawals/returns represented 5% of total merger applications in 2021 and 14% in 2020).[142] The FRB has published similar statistics—from 2011 to 2021, approximately 10% of all

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137 *See id.* for a summary of bank mergers since 2005 involving branch divestitures as a condition to approval.

138 *See* Pub. L. 103-328, 108 Stat. 2347, § 102(a) & 103 (Sept. 29, 1994) (codified at 12 U.S.C. §§ 1831u(b)(4), 36(g)(2)(A), & 1828(d)(4)(B)(i)).

139 *See* Pub. L. 111-203, 124 Stat. 1608, § 607(b) (July 21, 2010).

140 *See also* FRB, SR 15-11 / CA 15-19, *Examinations of Insured Depository Institutions Prior to Membership or Merger into a State Member Bank* (Oct. 13, 2015) (requiring that IDIs seeking to become, or resulting in, state member banks in connection with mergers must meet certain eligibility criteria to avoid a pre-merger safety-and-soundness and consumer compliance examination, including meeting Regulation H's "eligible bank" criteria (*e.g.*, composite CAMELS and consumer compliance ratings of 1 or 2, well-capitalized under the Prompt Corrective Action framework, have a CRA rating of "outstanding" or "satisfactory", etc.) and certain additional safety-and-soundness criteria (*e.g.*, management component of CAMELs is rated 1 or 2, current and projected annual growth in assets is under 25%, etc.), The Fed - Supervisory Letter SR 15-11 / CA 15-9 on Examinations of Insured Depository Institutions Prior to Membership or Merger into a State Member Bank -- October 13, 2015 (federalreserve.gov).

141 *See* OCC, Licensing Manual for Business Combinations, at 7-8, 27, Comptroller's Licensing Manual, Business Combinations (treas.gov).

142 *See* FDIC, *Transparency & Accountability – Archive of Overviews of Application Activity*, FDIC: Transparency & Accountability - Bank Applications.

bank merger and acquisition applications were withdrawn.[143] The FRB reports that many of these applications were withdrawn due to significant issues that would have resulted in FRB staff recommending withdrawal.[144] For example, the FRB reported that of the 19 proposals withdrawn in the second half of 2020, 12 proposals were withdrawn by the applicants after consultation with FRB staff.[145]

In addition, as mentioned above, an application for a bank merger transaction is the subject of extensive review by the Federal Bank Regulators over a lengthy period, especially for applications involving large banks or that receive adverse public comment. According to FDIC data, for the twelve months ending March 31, 2022 the average processing time from the application filing date to decision date is 68 days (with average processing times of 64 days in 2021 and 77 days in 2020).[146] Furthermore, even for those applications that qualify for expedited processing under the FDIC's regulations as a result of the applicants meeting certain heightened prudential criteria, the FDIC makes clear that its failure to act within the expedited processing period "does not constitute an automatic or default approval" of the bank merger application.[147] The latest FRB Semiannual Report on Banking Applications Activity presents data that are consistent with these FDIC processing averages, but also includes specific data demonstrating how applications that receive adverse public comments are subject to a significantly longer processing time as compared to those that do not.[148] In the second half of 2020, the FRB reports that it approved M&A proposals that did not receive adverse public comments on average in 67 days, whereas it took on average 232 days to approve those which had received adverse

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143 *See* FRB, *Semiannual Reports on Banking Applications Activity*, The Fed - Semiannual Reports on Banking Applications Activity (federalreserve.gov) (providing information regarding the applications filed by banking organizations and reviewed by the FRB as of the most recent reporting period ending on June 30 and December 31 of each calendar year). The most recent FRB Semiannual Report on Banking Applications Activities covers applications activity from July 1 to December 31, 2020. *See also* FRB, *Enhancing Transparency in the Federal Reserve's Applications Process*, SR 14-2/CA 14-1 (Feb. 24, 2014), ("When Federal Reserve staff identifies substantive issues under the statutory factors that must be evaluated in an application or notice, staff typically will inform the applicant or notificant and request additional information. Often, these issues are resolved through the provision of additional information about or changes to the proposal, and the Federal Reserve ultimately approves or does not object to the application or notice. However, there are instances when substantive issues are not resolved during the application review process, and Federal Reserve staff recommends that the Board deny the proposal. In such cases, the Federal Reserve's general practice has been to inform the filer before final Board action that staff would recommend denial of the proposal to the Board in order to provide the filer the option to withdraw the application or notice . . . The majority of [withdrawn] filings were [] at the prerogative of the filer; however, more than a third of the withdrawals were due to significant issues identified by Federal Reserve staff during the application review process that would have led to staff recommending denial to the Board. The issues identified have most often been related to the safety and soundness of the financial institution or consolidated organization, or to a failure to meet another statutory requirement for approval"), The Fed - Supervisory Letter SR 14-2/CA 14-1 on Enhancing Transparency in the Federal Reserve's Applications Process -- February 24, 2014.

144 *See id.*

145 *Id.*

146 *See* FDIC, *Transparency & Accountability – Archive of Overviews of Application Activity*, FDIC: Transparency & Accountability - Bank Applications.

147 12 C.F.R. § 303.64(a)(3) (No automatic approval).

148 The most recent FRB Semiannual Report on Banking Applications Activities covers applications activity from July 1 to December 31, 2020. *See also* FRB*, Enhancing Transparency in the Federal Reserve's Applications Process*, SR 14-2/CA 14-1 (Feb. 24, 2014), The Fed - Supervisory Letter SR 14-2/CA 14-1 on Enhancing Transparency in the Federal Reserve's Applications Process -- February 24, 2014.

public comments.[149] Moreover, virtually every transaction by a large bank involves an application processing time that is a multiple of the average. For example, based on publicly available information, the average processing time over the last 10 years for bank merger applications where the combined organization had over $100 billion in assets and the target bank had at least $10 billion in assets was approximately 224 days for the FRB, 188 days for the OCC and 194 days for the FDIC.

The notion that there is a presumption of approval for bank merger transactions is, therefore, contrary to the FDIC's own regulations, policies and procedures (as well as those of the other Federal Bank Regulators and the DoJ), as well as actual bank merger application review practices over the past several decades. The low rates of denials is not due to the existence of any presumption of approval, but rather is a testimony to the agencies' longstanding transparency about the robust process, scrutiny and specific standards to which these applications are subject—including from antitrust, community reinvestment, financial resources, managerial competence, and financial stability perspectives, as well as the withdrawal procedure. A higher rate of denials would not reflect more rigorous regulatory scrutiny, but less regulatory transparency. Certain bank mergers should be foreclosed because they fail objective rational criteria and not because a regulatory approval policy based on subjectivity and opacity creates uncertainty.

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

Congress has not imposed an applicant-specific burden of proof under the BMA or the BHCA—if such a burden is to be established, then it is for Congress to do so.

Under the BMA and the BHCA, Congress has chosen not to delineate express or implied burdens of proof on applicants for bank merger transactions. Where the BMA and the BHCA have imposed a burden of proof, it has been placed on the Federal Bank Regulators to find that a proposed transaction would result in the creation of a monopoly or a substantial lessening of competition in order to deny a bank merger—an aspect of the statutory construct that Congress has chosen to maintain the same over the past 60 years.[150] The language used by Congress with respect to all other factors is neutral—the Federal Bank Regulators shall "take into consideration"—without any assignment of a burden of proof.

Congress knows how to impose burdens of proof on banks when it so desires, and has not chosen to do so in BMA or the BHCA bank merger application context. In other banking statutes, Congress has expressly imposed a burden of proof, including among others: (i) in the context of failures to meet certain reporting requirements, insured state nonmember banks and certain foreign banks "have the burden of proving an error [resulting in a reporting violation] was inadvertent and that a report was inadvertently transmitted or published late";[151] (ii) for loan originators applying for licensing and registration, they must "demonstrate financial responsibility, character, and general fitness such as

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149 *Id.*

150 Likewise, for a Federal Bank Regulator to invoke the "public interest" exception to the competitive analysis, there must be a finding that the anti-competitive 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." 12 U.S.C. § 1828(c)(5)(B) (emphasis added).

151 12 U.S.C. § 1817(a)(1).

to command the confidence of the community";[152] and (iii) with respect to applicants for assistance from the Community Development Financial Institutions (**CDFI**) Fund, such applicants must submit a business plan that "demonstrates that the applicant will be properly managed" and must also prove to the CDFI Fund they "substantially met [their] performance goals" and have a "record of success in serving investment areas or targeted populations."[153] That Congress has not taken similar in the BMA or the BHCA to impose express burdens of proof or rebuttable presumptions on applicants is evidence that Congress is satisfied that statutory requirements are being appropriately met under the existing construct.

Moreover, any possible argument that the applicant has, or should have, a burden of proof is precluded by the 1966 amendments to the BMA. As described above, in the original BMA, a condition to approval by the relevant Federal Bank Regulators was a "finding" that the proposed merger was in the public interest.[154] The 1966 amendments eliminated this requirement, and, instead of an affirmative requirement, changed the public interest concept to an affirmative defense to a substantial lessening of competition.[155]

The current framework requires that an applicant provide comprehensive and fulsome information (the volume and detail of which vary from transaction to transaction depending on deal-specific complexities, etc.) to the Federal Bank Regulators to enable them to determine that an application is complete and all relevant material needed for a decision has been received. As discussed in response to Question 7, once internal processing of an application has begun, the FDIC and other Federal Bank Regulators will request additional information from an applicant, in certain cases over the course of several months, before they determine they have received the necessary information required to resolve the statutory factors favorably (or, they have not and request that the applicant withdraw its application).

In sum, Congress has chosen that no applicant-specific burden of proof should apply under the BMA or the BHCA, and the creation of one is unnecessary in light of the agencies' long-established application review practices, which reflect built-in eligibility criteria and informational requirements. For the FDIC or the other Federal Bank Regulators to take action to implement a burden of proof would contravene the plain language of the statutes.

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152 12 U.S.C. § 5104(b)(3).

153 12 U.S.C. §§ 4704(b)(2)(A), (b)(4)(A), (b)(5)(A).

154 *See* Pub. L. No. 86-463, 74 Stat. 129, 129 (1960).

155 *See* Pub. L. No. 89-356, 80 Stat. 7, 8 (1966).

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?*

Congress established two separate statutory regimes to govern (1) the bank merger review process; and (2) the resolution planning process—the Federal Bank Regulators should not conflate the two, particularly because imposing GSIB-specific requirements to non-GSIB institutions would impose significant costs on these institutions without generating meaningful public policy benefits.

Question 9 includes two sets of questions that we believe are unrelated and, therefore, we will address separately.

The first question relates to the availability of "exception[s]" to the BMA and the BHCA. These very limited and infrequently used exceptions[156] are designed to provide a "safety valve" to reduce the risks to financial stability and to the Deposit Insurance Fund (**DIF**). We are aware of no reason why the Federal Bank Regulators' flexibility should be diminished by eliminating (or further limiting) these exceptions. The FDIC RFI does not suggest any evidence, and there appears to be none, that the exceptions have encouraged undesirable behavior by banks, or undue risk-taking, or that there have been any other undesirable consequences.

The limited exceptions provided through the BMA are designed to provide the Federal Bank Regulators with optionality in approving a transaction. They are subject to safeguards and by no means act as a bypass of the bank resolution process. The existence of an exception does not mean that the Federal Bank Regulators would automatically or frequently use it, but simply that they would have the option to do so when it served public policy goals, including financial stability.

The second question relates to whether certain special attributes of the GSIB resolution framework, specifically TLAC, should be expanded to a considerably larger number of banks. We submit that the answer to this second question is clearly "no." The GSIB resolvability framework was specifically designed to address unique challenges that would arise in the context of a GSIB failure and resolution. To the extent elements of that framework are not already shared with non-GSIB institutions, imposing these elements on non-GSIBs would carry significant costs without generating offsetting benefits.[157] Moreover, we are unaware of any material changes since the GSIB framework was adopted

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[156] As discussed below, we believe that the FDIC RFI may be actually intending to refer to four statutory exceptions, although the only two substantive exceptions do not contain the cited language.

[157] For example, all institutions with an insured depository institution (**IDI**) of at least $100 billion in assets are already subject to some form of resolution planning requirements. In June 2021, the FDIC announced that it would lift the moratorium on IDI resolution plans pursuant to 12 C.F.R. § 360.10 for IDIs with $100 billion or more in assets. The moratorium continues to apply for IDIs with $50 billion or more but less

by all the Federal Bank Regulators seven years ago that would argue for a major extension of that framework.

(a) Ambiguity of Question 9

We are not sure as to the scope or intent of Question 9 because it refers to "an exception to [the BMA's] 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". The only exception(s) that contain this language are two procedural exceptions that should be non-controversial. There are, however, two potentially more substantive exceptions that do not contain this language but may actually be the actual focus of the FDIC RFI.

In all, then, there are four separate exceptions from certain BMA requirements that relate to the condition of one of the banks, and this letter covers all four.

Requirement	Conditions for Exception
Public notice[158]	The responsible Federal Bank Regulator finds that it must act immediately in order to prevent the probable default of one of the institutions involved
Report from the DoJ on competitive factors[159]	The responsible Federal Bank Regulator finds that it must act immediately in order to prevent the probable failure of one of the institutions involved
10% nationwide deposit concentration limit[160]	The transaction involves an institution in default or in danger of default, or with respect to which the FDIC provides assistance under 12 U.S.C. § 1823[161]

than $100 billion in assets. *See* FDIC Statement on Resolution Plans for Insured Depository Institutions (June 25, 2021), *available at* https://www.fdic.gov/resources/resolutions/resolution-authority/idi-statement-06-25-2021.pdf.

158 12 U.S.C. § 1828(c)(3); *see also* 12 U.S.C. § 1842(b)(1).

159 12 U.S.C. § 1828(c)(4)(C); *see also* 12 U.S.C. § 1842(b)(1).

160 12 U.S.C. § 1828(c)(13); *see also* 12 U.S.C. § 1842(d)(5).

161 Such assistance is authorized to prevent default, to restore a bank in default to normal operation, or when "severe financial conditions exist which threaten the stability of a significant number of insured depository institutions or of insured depository institutions possessing significant financial resources" in order to "lessen the risk to the [FDIC] posed by such insured depository institution under such threat of instability." 12 U.S.C. § 1823(c)(1).

Prohibition on approval if effect may be to "substantially to lessen competition, or to tend to create a monopoly, or which in any other manner would be in restraint of trade"[162]	The responsible Federal Bank Regulator 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.[163]

(b) The Four Exceptions

These four exceptions (which we will refer to collectively as the failing bank exceptions) serve to enhance the flexibility and options at the disposal of the Federal Bank Regulators to address a potential or actual bank failure by allowing for a private sector transaction without the need to utilize the extraordinary powers of the FDIC and possible draws on the DIF under the FDIC's receivership authority, and therefore serve to enhance financial stability without impacting the bank resolution process.

Pursuant to the BMA, the responsible Federal Bank Regulator (depending on charter and FRB membership status of the acquiring bank), must provide prior written approval before any IDI may merge or consolidate with, purchase or otherwise acquire the assets of, or assume any deposit liabilities of another IDI.[164] As discussed above, in deciding whether to provide such written approval, the Federal Bank Regulators must take into account multiple statutory considerations including the impact on competition, the convenience and needs of the community to be served, the financial and managerial resources of the existing and proposed institution, any risk to the stability of the United States banking or financial system, and the institution's effectiveness in combatting money laundering. Under the FDIC's Statement of Policy on Bank Merger Transactions,[165] the FDIC's intent and purpose in reviewing any of these factors is to "foster and maintain a safe, efficient, and competitive banking system that meets the needs of the communities served." The BMA also imposes certain administrative and procedural requirements that the applicant and the relevant Federal Bank Regulator must meet prior to approval of any application.

As shown in the table above, the BMA exceptions for failing banks by no means represent a wholesale exemption from the substantive statutory factors the relevant Federal Bank Regulator must consider in determining whether to approve any merger transaction. The first two

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162 12 U.S.C. § 1828(c)(5)(B); *see also* 12 U.S.C. § 1842(c)(1)(B).

163 Specifically, the BMA prohibits the responsible Federal Bank Regulator from approving any transaction whose 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* it 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." (emphasis added) Although this provision is not technically an exception, given its relevance to topics addressed in Question 9 and the FDIC's application of this language (discussed below), this weighing requirement is included, along with the three other exceptions in the statute, in our general discussion of the BMA's "exception" for situations involving a probable bank failure.

164 12 U.S.C. § 1828(c).

165 63 Fed. Reg. 44762, August 20, 1998, effective October 1, 1998; *amended at* 67 Fed. Reg. 48178, July 23, 2002; 67 Fed. Reg. 79278, December 27, 2002; 73 Fed. Reg. 8871, February 15, 2008.

exceptions simply shorten the timeframe within which a Federal Bank Regulator can approve a merger—which would otherwise be a minimum of 10 days, but could extend to more than 30 days—without changing the substantive factors the Federal Bank Regulator must consider.[166] In a crisis situation, the ability to shorten the approval timeframe may be the difference between facilitating a going concern transaction and having to utilize the extraordinary powers of the FDIC through the bank receivership process, with possible losses to the DIF.

The third exception is from a quantitative limit on the relative size of the acquirer but does not exempt the responsible Federal Bank Regulator from analyzing any of the qualitative substantive statutory factors, including the competitive effects factor and the financial stability factor.[167] Finally, the fourth exception is more correctly viewed as a weighing requirement rather than an exception, because it does not entirely absolve the agency from analyzing the competition factor. Nonetheless, the FDIC has interpreted it as altering the general statutory analysis in the context of a failing bank, so we include it as an exception in our consideration of this Question 9. Specifically, the FDIC's Statement of Policy elaborates on this weighing requirement in the context of a probable bank failure and notes, "where a proposed merger transaction is the least costly alternative to the probable failure of an [IDI], the FDIC may approve the merger even if it is anticompetitive."[168]

The BMA exceptions provide the relevant Federal Bank Regulators with a heightened degree of flexibility and optionality for dealing with an institution at imminent risk of failure before it fails—without limiting the chartering authority's ability to revoke the institution's license if conditions for failure are met and appoint the FDIC as receiver to execute a resolution transaction—and are therefore prescribed in a manner that is beneficial to financial stability. Furthermore, and as described above, if a Federal Bank Regulator determines it appropriate to use any one of the exceptions, it may help avoid the bank resolution process—and the risks and costs associated with it—entirely. Therefore, the exceptions do not directly bear on the quality of the bank resolution process but can empower a Federal Bank Regulator to achieve better outcomes—whether with respect to financial stability, competition, the convenience and needs of the community, or any other statutory factor.

Furthermore, use of the exceptions is entirely discretionary, and their existence in no way precludes the chartering authority from withdrawing the failing institution's license and appointing the FDIC as receiver. There is no statutory requirement that the responsible Federal Bank Regulator depart from the standard merger consideration process even if the conditions for the exceptions (as noted in the table above) are met. In considering any particular transaction involving a failing institution, the responsible Federal Bank Regulator could—and in fact is still required to—consider, weigh and act upon key factors under the BMA. Putting further controls on the exceptions beyond the statutory conditions noted above would simply serve to limit the Federal Bank Regulators' optionality in

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[166] Although the agency may not have the benefit of the DoJ's competitive factors analysis, it would still be required to consider competitive factors in determining whether to approve the transaction. 12 U.S.C. § 1828(c)(5); 12 U.S.C. § 1842(c)(1).

[167] We note that this exception applies both to a transaction involving a bank at risk of failure and to a transaction involving a bank that is "in default" and therefore already failed; however, even when applied in a failed bank scenario, use of this exception remains discretionary on the part of the Federal Bank Regulator, and the exception therefore continues to create optionality without undermining any financial stability or other public policy concerns.

[168] 63 Fed. Reg. 44762, August 20, 1998, effective October 1, 1998; *amended at* 67 Fed. Reg. 48178, July 23, 2002; 67 Fed. Reg. 79278, December 27, 2002; 73 Fed. Reg. 8871, February 15, 2008.

the case of a probable (or, in the case of the third exception, an actual) bank failure, which could, among other issues, increase costs to the public associated with the failing bank or harm financial stability.

Specifically with respect to the fourth exception, given this requirement's construct under the BMA and the further elaboration of its conditions of use in the FDIC's Statement of Policy, it is clear that approval of a merger in reliance on this exception cannot be used simply to avoid a receivership. This exception requires the Federal Bank Regulators to weigh convenience and needs of the community in relation to the possible anticompetitive nature of the transaction; however, per the FDIC policy relating to avoidance of a bank failure, it is also backstopped by a least cost test—where approving the private transaction is the least costly alternative to resolution. This condition on use squarely serves wider financial stability and public policy purposes, as it provides that an open bank transaction that would otherwise be seen as anticompetitive can only happen where it is the least costly transaction, thereby protecting the DIF and ultimately minimizing any impact on taxpayers if the institution were to be placed into receivership. Under the BMA and the Statement of Policy, if the proposed merger were to result in a weakened institution, the FDIC could not use the exception, as doing so would potentially result in an institution that would pose greater risks to the DIF and the taxpayer. The FDIC in such a case would need to rely on the traditional receivership process: the failing institution's license would be revoked under the normal processes for the appointment of the FDIC as receiver, and the FDIC would be held to the least cost test under the FDIA in executing the resolution.

The least cost condition for using the fourth exception suggests that a transaction resulting from the use of this exception would always be in the best interests of financial stability because it would keep assets in the banking system through a transaction that requires no government intervention or support (through use of the DIF or otherwise). If the FDIC were to further elaborate on the use of this exception, the most logical expansion would be in further articulating the least cost test and how the least cost test under the exception is measured against the cost of the IDI's failure.

It is also important to note that, to the extent the characteristics of the institution resulting from the transaction would differ materially from those of either of the pre-merger institutions (such as in the example cited by the FDIC involving a large bank purchase and assumption transaction),[169] the existing, broadly applicable prudential regulatory framework would operate to automatically subject the resulting institution to higher tailored prudential requirements and supervisory expectations. For example, if the bank merger would cause the acquiring institution's parent to shift from a Category IV to a Category III institution under the FRB's tailoring framework, it would automatically be subject to heightened capital and liquidity requirements and would become subject to single-counterparty credit limits.[170] In light of this existing framework, the BMA approval process is not the appropriate venue for addressing any regulatory goals other than the statutory factors set forth in the text of the statute.

The exceptions from BMA requirements in the case of a failing bank are narrow, entirely at the discretion of the responsible agency, and provide the agency with additional flexibility and optionality to address the situation. An agency may use this option to preserve financial stability or to

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169 The question specifically references "purchase and assumption transactions in a large bank resolution," but, as discussed above, this exception actually does not apply in a resolution scenario.

170 For further discussion of the regulatory consequences of a merger and their resultant reduction in financial stability risk, *see* Greg Baer, Bill Nelson, and Paige Paridon, *Financial Stability Considerations for Bank Merger Analysis* (May 16, 2022), *available at* https://bpi.com/financial-stability-considerations-for-bank-merger-analysis/.

achieve other outcomes that it determines are desirable from a public policy perspective. Imposing additional requirements or controls on the use of these exceptions would limit flexibility and reduce optionality, thereby narrowing the range of possible outcomes.

(c) Imposing GSIB-like resolvability requirements on "large" IDIs[171] *is unwarranted and would be unnecessarily costly.*

The second part of Question 9 appears to contemplate the imposition of additional GSIB-like prudential standards in mergers intended to address resolvability concerns that would apply across institutions under business-as-usual conditions. We focus on the substantive merits (or lack thereof) of such standards in this letter; however, we must also stress how inappropriate it would be to arbitrarily impose additional requirements that depart from existing generally applicable standards by imposing TLAC or other GSIB-like resolution or other requirements on particular institutions on an *ad hoc* basis through the M&A approval process. Such an approach would lack the transparency and opportunity for public comment required by the Administrative Procedure Act, would result in different, competitively disparate requirements for similar institutions, and would make it impossible to predict the costs associated with a merger in advance. Furthermore, from a public policy perspective, outcomes achieved in this manner would likely be sub-optimal given the complexity of designing resolvability requirements (which, in the case of GSIBs, took years of intense international collaboration) and the lack of careful consideration involving all affected stakeholders.

(i) The existing resolution planning and prudential framework applicable to large IDIs provides regulators with an appropriate and realistic level of optionality in determining how best to resolve a failing large IDI.

In a hypothetical resolution involving an institution with a large IDI, regulators would already have options other than a merger with or sale to another large financial institution, which the question seems to imply would be the only option. Additional requirements that assume only a single option are therefore not necessary. Supported by detailed analysis and informational requirements, the existing resolution plans of large IDIs and their holding companies are feasible and, as a practical matter, equip the Federal Bank Regulators to pursue a variety of resolution options.

Because institutions with large IDIs typically house the vast majority of their assets and activities in the primary IDI, resolution plans of top-tier holding companies with large IDIs generally provide for liquidation of the holding company through Chapter 11 bankruptcy and placement of the IDI in receivership. Plans with respect to large IDIs vary somewhat, but, in many cases, contemplate at least two options for resolution: the sale of the large IDI to another institution; or the separation of parts of the IDI business and sales of those parts to multiple purchasers (the basis of possible separation (*e.g.*, regional, business lines, etc.) varies across IDIs). In addition to these two purchase and assumption resolution options, separability analysis requirements also support an option to combine or disaggregate portfolios and discrete "objects of sale" or "franchise components" as needed to allow the FDIC to dispose of various components in different ways in response to prevailing market forces. The FDIC could

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171 As noted above, the threshold for treatment as a "large" institution is not clear based on the text of the FDIC RFI, so it is difficult to consider the FDIC's question in precise terms. Based on the FDIC RFI's frequent references to a $100 billion asset size threshold, we have generally considered that size to be "large" for purposes of this comment letter. In addition, references in this letter to a "large" institution generally do not include GSIBs or their subsidiaries, as the FDIC's question seems to consider these to be an entirely separate category.

execute these options over the timeframe it deemed appropriate, whether over a "resolution weekend" or over a longer period after establishment of a bridge bank.

Furthermore, in light of the myriad regulatory and supervisory improvements since the 2008 financial crisis, it is unlikely that broad systemic failure of underwriting and risk management would lead to losses across all of a large IDI's portfolios, which tend to be diversified in nature; therefore, losses would likely be concentrated in a particular portfolio, thereby making it easier to isolate and effectuate a sale of the IDI's valuable assets.

The detailed information generated by the resolution planning requirements developed by the Federal Bank Regulators would provide the FDIC with the practical information necessary not only to execute one of these common resolution strategies, but also to craft a unique strategy as may be appropriate to address any idiosyncratic situation. Specifically, the relevant regulations and guidance include requirements relating to, among other topics, planning for operational continuity,[172] mapping of business lines to critical functions,[173] and separability analysis.[174] Firms must also provide detailed information pertaining to organizational structure[175] and management information systems[176] so that regulators have the practical information necessary to meaningfully evaluate options and operate the entity as long as is necessary to execute the chosen resolution strategy.[177]

Because, as noted, existing prudential and resolution planning requirements provide the FDIC with a variety of realistic options for handling the resolution of a large IDI, the suggestion that the only viable option is a purchase and assumption transaction with another large institution is inaccurate and should not serve as a basis for a major revision of the resolution framework applicable to these institutions.

(ii) The GSIB resolution framework, including the international TLAC standard, is designed for GSIBs, and its key attributes are not necessarily suited for the resolution of a large IDI.

Following on from the 2008 financial crisis, the international regulatory community under the auspices of the Financial Stability Board (**FSB**), which includes the FDIC, as well as FRB and the OCC, set about developing a broad framework to promote global financial stability and end "too big to fail." TLAC requirements were developed through the FSB's international standard-setting process, resulting in the release of the international standard in November 2015[178] and the FRB's adoption of

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172 12 C.F.R. § 243.5(c)(1)(iv). *See generally* 12 C.F.R. § 360.10(c)(2).

173 12 C.F.R. § 243.5(c)(1)(iv); 12 C.F.R. § 360.10(c)(2)(iii); Federal Deposit Insurance Corporation, *Statement on Resolution Plans for Insured Depository Institutions* at 6 (Jun. 25, 2021), *available at* https://www.fdic.gov/resources/resolutions/resolution-authority/idi-statement-06-25-2021.pdf (**FDIC IDI Plan Guidance**).

174 *See* 12 C.F.R. § 243.3(c)(5); *FDIC IDI Plan Guidance* at 6.

175 12 C.F.R. § 243.5(e); 12 C.F.R. § 360.10(c)(2)(ii).

176 12 C.F.R. § 243.5(f); *FDIC IDI Plan Guidance* at 8.

177 As discussed further below, the FDIC reviews each IDI plan and has not found any large IDI plan to be not credible.

178 FSB, *Principles on Loss-absorbing and Recapitalisation Capacity of G-SIBs in Resolution: Total Loss-absorbing Capacity (TLAC) Term Sheet* (Nov. 9, 2015), available at https://www.fsb.org/wp-content/uploads/TLAC-Principles-and-Term-Sheet-for-publication-final.pdf.

TLAC requirements for U.S. GSIBs in December 2016.[179] As noted, the TLAC standard was part of a broader set of regulatory initiatives and reforms, including the development of resolution strategies for GSIBs, designed to minimize the risk that a GSIB resolution could have broader global, systemic consequences.[180] The FSB has cited TLAC requirements as among the key too-big-too-fail reforms for GSIBs,[181] and the FRB explained that its TLAC rule is intended to "help to reduce risks to financial stability" and "address the too-big-to-fail problem" relating to GSIBs.[182]

In the United States, the eight U.S. GSIBs, with strong encouragement from their regulators, have adopted the "single-point-of-entry" or "SPOE" strategy as their preferred resolution strategy. The FDIC has also worked to develop the SPOE strategy for implementation under Title II of the Dodd-Frank Act.[183] This strategy is not unique to U.S. institutions and has been adopted by the majority of GSIBs globally to address many of the complexities involved in carrying out a multifaceted cross-border resolution transaction involving organizations that typically have multiple material entities, such as a bank and large securities subsidiaries. U.S. regulators have acknowledged the efficacy of the SPOE strategy, paired with TLAC requirements, in addressing the unique challenges of a GSIB resolution.[184]

In a U.S. SPOE resolution, the top-tier holding company would enter bankruptcy proceedings under Chapter 11 of the U.S. Bankruptcy Code or a receivership under Title II of the Dodd-Frank Act. The principal operating subsidiaries, including domestic and foreign bank and broker-dealer subsidiaries, would continue operating without entering receivership, bankruptcy, insolvency or other resolution proceedings. The SPOE strategy is designed to impose resolution-related losses on shareholders and creditors of the top-tier holding company. The creditors of the principal operating subsidiaries, including any IDIs, would not suffer losses because those subsidiaries would continue to operate as going concerns through the internal recapitalization process. Preserving the principal operating subsidiaries of GSIBs as going concerns is intended to minimize risks to financial stability, including by, among other things, supporting the continuation of a GSIB's critical operations and preserving the value of its business lines.

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179 FRB, 82 Fed. Reg. at 8266, 8274.

180 Other initiatives and reforms include the FSB's publication of its Key Attributes of Effective Resolution Regimes for Financial Institutions in October 2014 and its Guidance on Arrangement to Support Operational Continuity in Resolution in August 2016; the ISDA resolution stay protocols for derivatives and securities financing transactions, along with related regulatory requirements regarding permissible cross-default and close-out provisions in these contracts; recovery and resolution planning requirements, along with resolvability assessments; increased clearing and margining requirements for derivatives; and numerous Basel Committee standards on capital and liquidity, including the GSIB surcharge.

181 FSB, *Evaluation of the Effects of Too-Big-Too-Fail Reforms* (Apr. 1, 2021), *available at* https://www.fsb.org/wp-content/uploads/P010421-1.pdf.

182 FRB, Total Loss-Absorbing Capacity, Long-Term Debt, and Clean Holding Company Requirements for Systemically Important U.S. Bank Holding Companies and Intermediate Holding Companies of Systemically Important Foreign Banking Organizations 82 Fed. Reg. 8266 (Jan. 24, 2017).

183 FDIC, Resolution of Systemically Important Financial Institutions: The Single Point of Entry Strategy, 78 Fed. Reg. 76614 (Dec. 18, 2013).

184 In a recent speech, Acting Comptroller Hsu noted that GSIBs' SPOE resolution strategies "avoid[] the chaos of multiple proceedings," and that TLAC requirements "serve[] as an important buffer, so that if the firm fails, private investors absorb the firm's losses and are "bailed in" instead of taxpayers footing the bill for a bailout[.]" Michael J. Hsu, *Financial Stability and Large Bank Resolvability* (Apr. 1, 2022), *available at* https://www.occ.gov/news-issuances/speeches/2022/pub-speech-2022-33.pdf.

The SPOE strategy is designed to avoid or mitigate impediments to an orderly resolution that could potentially arise in the specific context of a GSIB resolution. As noted above, GSIBs often have significant operations and assets across multiple jurisdictions and types of legal entities, including both banks and broker-dealers in the United States and other countries. In addition, GSIBs are often critical participants in a variety of financial markets and financial market infrastructure and are important providers of liquidity, as well as intermediation and other services, to other financial market participants.

If, instead of an SPOE resolution, the principal operating subsidiaries of a GSIB entered receivership, insolvency, bankruptcy or other resolution proceedings, there would be multiple concurrent proceedings worldwide, conducted by different resolution authorities under varying legal frameworks. Given the nature of GSIB operations, these concurrent proceedings could present a variety of risks in the United States and elsewhere, including with respect to disruptions to critical operations or the provision of other services to third parties and affiliates, loss of franchise value, ring-fencing in host-countries, and funding and liquidity shortfalls (including due to "trapped" liquidity at one subsidiary being inaccessible to address a funding or liquidity need at another subsidiary)—all of which were witnessed to some degree during the 2008 financial crisis. Concurrent proceedings would also present heightened risks relating to the allocation of loss-absorbing capacity among the principal operating subsidiaries. Prior to resolution, the actual distribution of losses and resource needs among the subsidiaries in resolution would not be certain. An SPOE resolution is designed to preserve flexibility for a GSIB to allocate loss-absorbing capacity and liquidity resources among its principal subsidiaries based on their actual losses, outflows and needs in a resolution scenario. There could be significantly less (and potentially no) flexibility to deploy financial resources among the principal operating subsidiaries based on their actual losses, outflows and needs if they all entered separate proceedings.

SPOE, and the associated TLAC requirement, as parts of the post-crisis regulatory package were purposefully designed and intended for GSIBs—they are *not* appropriate or needed for the orderly resolution of a large IDI and its affiliates. First, as recognized by the FRB and the other Federal Bank Regulators, large IDIs and their affiliates (which affiliates are almost never large or international) do not present a comparable systemic risk. Consistent with international standards, the FRB uses the Basel Committee's GSIB assessment methodology to identify U.S. GSIBs. When the FRB adopted this methodology in 2015, it noted that "across many potential metrics, there is a clear separation in systemic risk profiles between the eight U.S. [GISBs] and other bank holding companies," including "a large drop-off between the eighth-highest score (146) and the ninth-highest score (51)" under the Basel Committee methodology (Method 1 of the FRB's rule).[185] The threshold for identification as a GSIB is a Method 1 score of 130. The FRB explained that "[d]rawing the cut-off line within [the range of 51 to 146] is reasonable because firms with scores at or below 51 were much closer in size and complexity to financial firms that had previously been resolved in an orderly fashion than they were to the largest financial firms, which had scores between three and nine times as high and are significantly larger and more complex."[186]

The FRB and other Federal Bank Regulators have also indicated that the "clear separation in systemic risk profiles" between GSIBs and other banking organizations means that, among U.S. firms, the U.S. GSIBs are the only systemically significant institutions at the domestic level as well as at the global level. Specifically, the Federal Bank Regulators indicated that they "consider[] the US G-

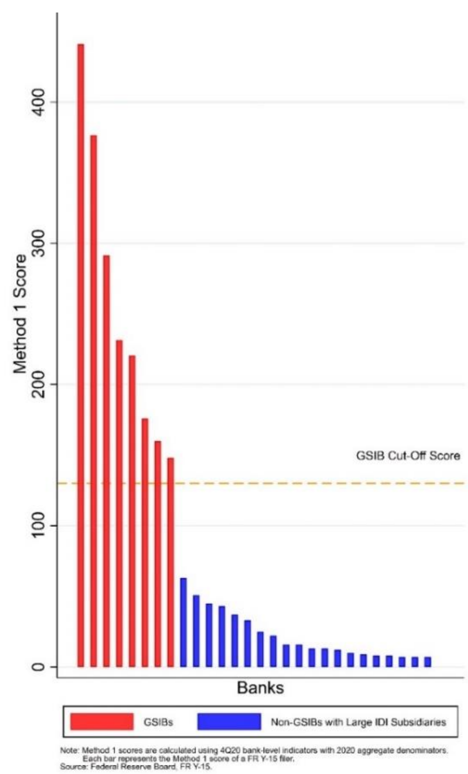
185 Federal Reserve, 80 Fed. Reg. at 49084 (Aug. 14, 2015).
186 *Id*.

SIBs to be those banks that would be designated as US [domestic systemically important banks (D-SIBs) under the Basel Committee D-SIB framework].”[187] The Federal Bank Regulators expressed this view given “the significant difference between the scores for the G-SIBs and the scores for other banks,” which means that “there is, effectively, no difference in the firms identified as G-SIBs and those that would be designated as US D-SIBs.”[188]

Crucially, we are aware of no evidence that this thorough analysis was flawed or that material changes have occurred in the last seven years that would render this analysis no longer valid. We believe that there should be a heavy burden of proof on those who would advocate for a repudiation of this prior analysis. In particular, the failure of Washington Mutual and the other failures and near-failures of large, non-systemic IDIs that occurred during the 2008 financial crisis were well-known to the policymakers who adopted the GSIB framework.

The “large drop-off” in GSIB Method 1 scores between U.S. GSIBs and other U.S. banking organizations has persisted, as shown in Figure 1 below. Currently, the lowest GSIB score is 148, while the highest non-GSIB score is only 63.

Figure 1: Method 1 Scores of GSIBs and Non-GSIBs with a Large Bank Subsidiary[189]



187 Basel Committee, Regulatory Consistency Assessment Programme (RCAP): Assessment of Basel III G-SIB framework and review of D-SIB frameworks – United States (Jun. 2016), available at https://www.bis.org/bcbs/publ/d369.pdf.

188 *Id.* at 17.

189 Population comprised of FR Y-15 filers, which include U.S. BHCs and covered SLHCs with total consolidated assets of $100 billion or more, FBOs with combined U.S. assets of $100 billion or more, including, if

In fact, in some ways, the presence of large IDIs and their affiliated institutions in the U.S. banking sector enhances financial stability. As discussed above, a firm's probability of failure is a key factor in assessing the risk that the firm poses to financial stability; all else being equal, the lower a firm's probability of failure, the lower the risk it poses to financial stability. Large institutions tend to be more diversified than smaller ones, which has been shown to reduce their risk of failure.[190] In addition, larger institutions tend to be more profitable than smaller ones, and this increased profitability also reduces an institution's probability of failure.[191] Scale also allows larger entities to invest in technology and other resources to reduce risks, most notably operational risks, including threats to cybersecurity.[192] Thus, all else being equal, larger size may decrease overall risk to financial stability.

In addition, and perhaps more importantly in the case of institutions with large IDIs, the presence of many large firms in the market may reduce the systemic risk presented by *other* large firms. Specifically, institutions with large IDIs are likely to offer products and services on a scale and at pricing that enables them to be feasible substitutes for other providers of such products and services—including GSIBs. Therefore, by increasing substitutability for other firms (which is one of the factors taken into account for purposes of the Method 1 GSIB score methodology discussed above), the presence of firms with large IDIs reduces the financial stability risks posed by their competitors, thereby increasing overall financial stability. In this regard, we note Acting Comptroller Hsu's recent speech in which he observed, "[P]rohibiting [mergers involving large IDIs] could shield the GSIBs from competition, potentially helping to solidify their dominance in various markets."[193] For all these reasons, large IDIs and their affiliates do not present systemic risk.

The second reason for which SPOE, and the associated TLAC requirement, are not appropriate or needed for the orderly resolution of an institution with a large IDI is that, for these institutions, resolution strategies other than SPOE are viable and suited to their activities and organizational structures. The vast majority of activities and assets of the banking organizations with large IDIs are typically conducted and held through a single U.S. IDI subsidiary. In addition, banking organizations with large IDIs do not engage in broker-dealer or capital markets activity, either domestically or overseas, that is in any way near comparable to that of GSIBs, whether on an absolute basis or relative to their other activities. As a result, these organizations do not play a similar role as providers of liquidity, intermediation and other services to other financial market participants. Banking

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applicable, any U.S. IHC of the FBO regardless of the size of the IHC, and U.S.-based organizations designated as GSIBs that do not otherwise meet the consolidated assets threshold.

190 Joseph Hughes, Loretta Mester and Choon-Geol Moon, Are scale economies in banking elusive or illusive?: Evidence obtained by incorporating capital structure and risk-taking into models of bank production, 25 J. Banking & Fin. 2169 (2001) (finding that large banks achieve a better risk-profit trade-off than smaller banks because diversification reduces their risk).

191 Numerous studies have found positive returns to scale in the banking industry. *See*, *e.g.*, Guohua Feng and Apostolos Serletis, Efficiency, Technical Change, and Returns to Scale in Large U.S. Banks: Panel Data Evidence from an Output Distance Function Satisfying Theoretical Regularity, 34 J. Banking & Fin. 12 (Jan. 2010).

192 In fact, French central bank governor, François Villeroy de Galhau, recently admonished his EU counterparts for not enacting policies to strengthen the EU banking market by encouraging more mergers of EU banks. François Villeroy de Galhau, Governor of the Banque de France, *Looking up to achieve a Financing Union* (Feb. 23, 2022), *available at* https://www.banque-france.fr/sites/default/files/medias/documents/looking_up_to_achieve_a_financing_union.pdf.

193 Michael J. Hsu, *Financial Stability and Large Bank Resolvability* (Apr. 1, 2022), *available at* https://www.occ.gov/news-issuances/speeches/2022/pub-speech-2022-33.pdf.

organizations with large IDIs also typically focus on activities in the United States and, accordingly, have relatively limited foreign operations and assets. Therefore, resolving these institutions by, for example, liquidating the holding company through Chapter 11 bankruptcy, placing the IDI in receivership, and separating and selling its businesses over a "resolution weekend" or over a longer period after establishment of a bridge bank would not present the same coordination or funding risks that may have been present for GSIBs prior to the post-crisis resolvability reforms.

In light of these characteristics of large IDIs and their affiliates, the risks that an SPOE resolution strategy is designed to avoid or mitigate are not likely to be significant in the context of a resolution involving one of these organizations. These organizations predominately engage in activities through the large IDI itself. As a result, even in the highly unlikely event of failure, a single resolution framework—the receivership provisions of the FDIA—would apply to the vast majority of the businesses, assets and liabilities of one of these organizations. This centralized resolution means that many of the practical difficulties that an SPOE strategy is designed to address—such as coordination of multiple completing insolvency proceedings—are simply not present in the large bank context. In addition, there are no systemically important nonbank entities (*e.g.*, securities broker-dealers) within the organization that could need to continue as going concerns for financial stability purposes. Moreover, for the typical large IDI and its affiliates, there are not significant risks relating to the allocation of loss-absorbing capacity or liquidity among many different principal operating subsidiaries in a resolution scenario. Due to the high concentration of a large IDI institution's activities and assets in the principal U.S. bank subsidiary, there is little, if any, uncertainty as to the distribution of losses and outflows among legal entities in resolution.

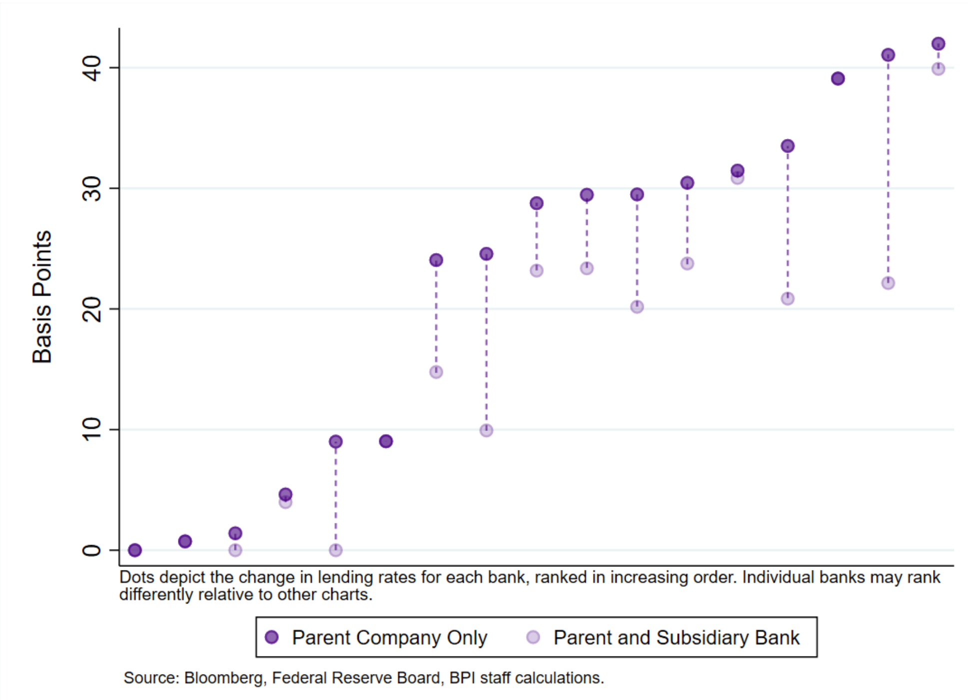
Finally, size should not be—and following a multi-year process of notice-and-comment rulemaking to adopt the GSIB methodology and tailoring framework, is not—the sole determining factor for whether attributes of the prudential regulatory framework applied to GSIBs should be extended to large IDIs and their affiliates. Rather, the application of any attribute of the GSIB regulatory framework to these institutions, like the application of any prudential regulatory requirement, should be based on the risk profile of the applicable firms and whether the particular requirement would be fit for purpose. Given the substantial differences between the operations and potential resolution of a GSIB and a large IDI and its affiliates, the mandatory application of an SPOE strategy and associated TLAC requirement to large IDIs and their affiliates would be neither fit for purpose nor commensurate with the risk profiles of those firms as the Federal Bank Regulators themselves have determined.

(iii) The costs and disadvantages of imposing GSIB-like resolvability requirements on large IDIs would not offset any benefits.

The GSIB resolvability framework discussed above, and in particular TLAC requirements, carry significant costs and disadvantages for financial institutions, their customers, and the broader financial system. Given the extremely low risk that a large IDI would fail, particularly in light of the myriad post-crisis regulations applicable to this group of institutions, the benefits of imposing such requirements are extremely small and do not outweigh the costs. Furthermore, unlike in the case of GSIBs, where the unique challenges of a GSIB resolution arguably may outweigh the costs and disadvantages associated with the framework, in the case of large IDIs, these costs and disadvantages are not offset by a compelling policy goal.[194]

The costs and disadvantages of a GSIB-like resolvability framework are broad and significant.[195] The most apparent and broadly felt cost would be that on the bank and ultimately on its customers. Requiring large IDIs, or their top-tier holding companies, to issue TLAC debt would require these institutions to shift a portion of their funding mix from low-cost deposits to higher-cost borrowing. Large IDIs would need to seek higher returns commensurate with this higher cost of funding, as demonstrated in Figure 2 (the analysis supporting these estimates is included in Appendix 3 to this comment letter).

Figure 2: Estimated Impact on Lending Rates[196]



194 This cost/benefit mismatch is also true with respect to the current calibration of the internal TLAC requirement applicable to U.S. IHCs of non-U.S. GSIBs. Although the FSB's international internal TLAC standard provides that the requirement should be between 75% and 90% of the TLAC requirement that would apply had the material subgroup (in the U.S., the IHC and its subsidiaries) been a resolution group (typically, the global parent), the U.S. rule set the requirement at the upper limit of this range. For many of the same reasons discussed in this letter with respect to large IDIs, the costs of setting such a high calibration for IHCs' internal TLAC requirements do not offset the limited benefits, given that their U.S. operations are much less significant than those of U.S. GSIBs, that the global parents generally already have SPOE resolution strategies designed to enable material subsidiaries, including the U.S. IHCs, to continue operating in the event of a parent failure, and that they meet other international resolvability standards that significantly reduce the risk that they would fail.

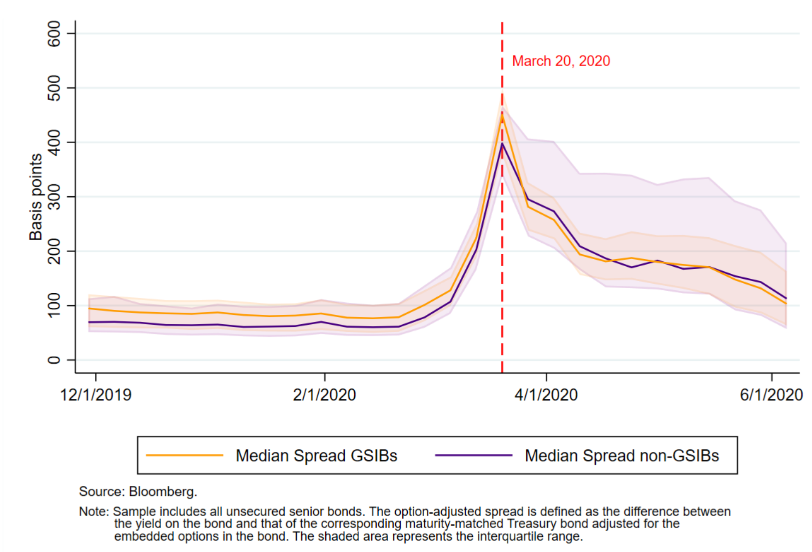
195 The costs discussed in this section would be equally applicable to IDI-level TLAC requirements in the context of a multiple-point-of-entry or MPOE resolution strategy.

196 In Figure 2, there are four banks with one dot because in those cases only the parent company issues LTD.

Figure 2 shows the estimated effect on lending rates across all institutions with large IDIs. When only the LTD issued by the parent company is TLAC-eligible, our results show a median increase in loan rates of 29 basis points. For a few banks, we estimate the increase in lending rates is at or above 40 basis points. When all LTD issued by the parent company and the subsidiary bank is TLAC-eligible, the median increase in lending rates is still about 20 basis points. Notably, the estimated increase in lending rates is significantly higher than the increase to lending rates estimated by the BCBS as a result of the introduction of TLAC requirements for GSIBs. For instance, in 2015, the BCBS estimated that the median increase in lending rates varied between 5 and 10 basis points, which is significantly lower than the estimates shown in Figure 2. This is because the banks in our sample are mainly deposit funded, and the cost of replacing deposits with LTD is more costly relative to the replacement costs faced by the GSIBs in the BCBS study that were already more likely to be using wholesale funding when TLAC was adopted. In practice, these increased rates may simply narrow the number of attractively priced options available to borrowers and drive more activity to other lenders, including less regulated non-bank providers, which presents a variety of issues discussed further below.

Requiring banks to shift a portion of their funding from deposits to debt would also shift their funding from a stable source to a market-dependent source. This increased reliance on a more volatile funding source would weaken the safety and soundness of large IDIs. Indeed, Figure 3 plots the behavior of unsecured bond spreads of all Category I through IV firms around the COVID-19 event.[197] Going into the pandemic, median bond spreads were about 100 basis points for GSIBs and approximately 80 basis points for non-GSIBs. In March 2020, bond spreads widened suddenly to around 450 basis points for GSIBs and 400 basis points for non-GSIBs. Thus, not only do banks' funding costs rise in normal times as shown above, but a deterioration in the economic outlook would also result in much higher funding costs for those banks and exacerbate the costs of TLAC.

Figure 3: Option-Adjusted Unsecured Bond Spread



197 For details on the construction of the time series *see* Francisco Covas and Gonzalo Fernandez, *Putting "Too Big to Fail" to Rest: Evidence from Market Behavior in the COVID-19 Pandemic* (Sep. 9, 2020), *available at* https://bpi.com/putting-too-big-to-fail-to-rest-evidence-from-market-behavior-in-the-covid-19-pandemic/.

In addition, the imposition of a TLAC requirement could harm financial stability by increasing procyclicality and thereby aggravating the speed and severity of a financial downturn. As we saw during the onset of the COVID-19 event, banks' balance sheets increase in periods of stress due to draws on credit lines from corporate customers and the expansion of the FRB's balance sheet. This balance sheet growth would reduce banks' TLAC ratios and require them to issue more TLAC—at the same time bond spreads are widening as shown above—during these periods. Unlike any potential benefits of TLAC, which would only be realized with respect to specific banks in the highly unlikely event of their failure, this undermining of financial stability would occur across affected institutions in every period of financial stress.

Moreover, imposing a TLAC requirement could further harm financial stability by driving more activity to less regulated non-bank providers rather than heavily regulated banks. Large IDIs—and in fact all IDIs—are increasingly competing with non-bank providers, which do not face the same level of regulation, to provide core banking products and services. As noted above, increasing banks' funding costs will require them to increase the costs of their products and services, particularly loans. Non-bank competitors, which will not face such funding cost increases, may be able to offer more attractive pricing for core banking products and services, and thereby attract a greater share of customers. Despite engaging in virtually identical activities as banks, these non-bank providers are not subject to the robust capital, liquidity and other prudential standards that mitigate risks to providers' safety and soundness and to the financial system. Nor are they subject to the same type of regular, direct supervision as banks for consumer protection or BSA/AML requirements. As such, they pose risks to the financial system, consumers, and national security that our current system and approach does not adequately address.[198] By increasing the costs of bank-provided products and services, imposing a TLAC requirement on large IDIs will likely serve to increase the pervasiveness of these non-bank providers.

There is also an extremely low risk that a large IDI would fail, particularly in light of the many prudential reforms and increased capital and liquidity requirements implemented over the last decade. Existing capital regulations (most notably the stress capital buffer) require the institutions to have extra capital to account for potential losses from relatively riskier activities (a few BHCs of large IDIs have SCBs above 2.5%, the minimum requirement under the FRB's regulations). Not surprisingly, as a result of post-crisis reforms, large IDIs have common equity capital levels (the strongest form of capital) and liquidity levels that are sharply above levels prior to the financial crisis. Specifically, large IDIs had average common equity tier 1 capital ratios of 8.3% in 2005, compared with 12.7% in 2020, and had an average ratio of liquid assets to total assets of 10% in 2005, compared with 23.3% in 2020. These capital and liquidity requirements significantly reduce the risk that these firms would fail, even under severely stressful conditions.

Figure 4 shows the combined loss absorbing resources of non-GSIB DFAST participants to demonstrate that those banks would already be able to sustain very severe stress while continuing to make loans to households and businesses. Based on the most recent stress test results, the combined net losses of the largest 15 non-GSIBs that participated in DFAST 2021, over a nine-month period under

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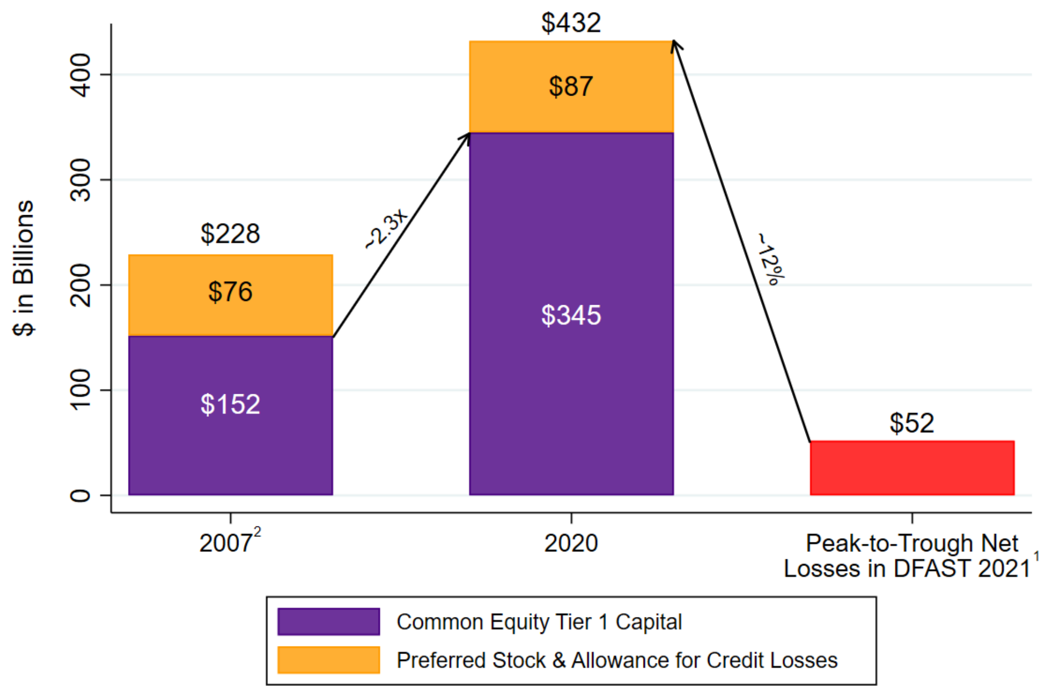
198 For more detailed discussion of some of the risks associated with certain non-bank providers of core banking products and services, *see* Bank Policy Institute, Comment Letter to the CFPB regarding Notice and Request for Comment Regarding the CFPB's Inquiry Into Big Tech Payment Platforms (Docket No. CFPB–2021–0017) (Dec. 10, 2021), *available at* https://bpi.com/wp-content/uploads/2021/12/BPI-CommentCFPBBigTechInquiry-12-10-21final.forsubmission-CFPB-2021%E2%80%930017.pdf.

severely stressed conditions, were $52 billion. At the end of 2020—the jump-off date of the 2021 stress tests—those banks held $432 billion in loss absorbing resources (the sum of common equity, preferred stock and allowances for credit losses). Therefore, the combined net losses of non-GSIBs in the stress tests accounted for only about 12% of the total loss absorbing capacity of those banks. In addition, those institutions have more than doubled their highest quality capital relative to the onset of the 2008 financial crisis.

Figure 4: Loss Absorbing Resources of Non-GSIB DFAST Participants



Notes:[1]Includes 15 BHCs subject to DFAST 2021 that are not GSIBs.

[2]Includes the top 15 BHCs as of 2007, excluding those that are currently GSIBs.

In addition to these high levels of capital and liquidity, the multitude of other post-crisis reforms and enhanced prudential standards further reduce the risk that any large IDI would fail. Generally speaking, intensive regulatory examination and supervision, as well as the stress tests mentioned above, function to discourage banks from accumulating unsafe levels of risk. Single-counterparty credit limits reduce the risk that failure of a major counterparty would trigger failure or any related harms to financial stability. Clearing requirements and swaps margin requirements for uncleared swaps reduce the possibility that contagion and spillover effects of failed derivatives trades would cause bank failure by requiring that collateral be available to offset losses caused by the default of a derivatives counterparty and that parties regularly exchange collateral based on market developments in order to prevent the build-up of uncollateralized exposure. Furthermore, many firms engage in recovery planning, in addition to resolution planning, as part of their business-as-usual risk management processes, which further reduces the risk that a firm would fail, even if it were to incur heightened losses.[199]

Taken together, the capital, liquidity, and other prudential standards applicable to IDIs, as well as the high level of supervisory scrutiny regulators provide to these institutions, make it extremely unlikely that a large IDI would fail. In light of this low probability, the benefits, if any, of imposing any GSIB-like resolvability requirements are unlikely to ever be realized, making their expected value fleetingly small and largely uncertain. Any such value is more than offset by the significant, broadly felt and certain costs that would be associated with imposing such requirements.

(iv) Although Question 9 is framed as creating additional options for improved resolvability, imposing GSIB-like resolvability requirements on large IDIs and their affiliates would de facto move them to an SPOE resolution strategy and would contradict the resolution optionality statutorily granted to these institutions and recognized in the FDIC's own IDI resolution planning rule.

Imposing an SPOE resolution strategy and a GSIB TLAC requirement on large IDIs and their affiliates would reject the past decade of resolution planning undertaken by these institutions under both the Dodd-Frank Title I resolution planning requirement and the FDIC's IDI resolution planning rule. Under Title I, bank holding companies with $250 billion in assets or that are otherwise in Categories I, II or III are required to submit plans for their orderly resolution under the U.S. Bankruptcy Code. The FDIC and the FRB have responsibility for reviewing these plans, identifying any deficiencies and ultimately deciding whether a determination of "not credible" is to be made. To date, the plans of BHCs with large IDIs have not been deemed "not credible" by the Federal Bank Regulators. Thus, imposing an SPOE framework and TLAC requirement on these firms to improve resolvability would run directly counter to the judgments made by the FDIC and FRB after detailed analysis of the resolution plans of organizations with large IDIs. Imposing a specific resolution strategy and a GSIB-like TLAC requirement on these entities would, without any notice, comment or even public justification, effectively upend a framework that the Federal Bank Regulators themselves developed and that has been operating smoothly for the past decade whereby institutions have continually improved their resolution planning capabilities.

Similarly, IDIs with $100 billion or more in total assets have to submit resolution plans to the FDIC separate and apart from the Dodd-Frank Title I resolution plans. The plans submitted to the FDIC are for the resolution of the IDI under the FDIA. In the FDIC's Statement on Resolution Plans for Insured Depository Institutions issued on June 25, 2021, the FDIC explicitly acknowledged that, since issuing the IDI resolution plan rule in 2012, "the FDIC and [covered IDIs] have been through multiple resolution plan submission cycles [and] [t]hrough this experience, the FDIC has learned what aspects of the resolution planning process are most valuable."[200] Furthermore, the FDIC notes that the Corporation itself has gained additional resolution capabilities through separate rulemakings subsequent to the issuance of the IDI resolution planning rule.[201]

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199 OCC regulations specifically require national banks with $250 billion or more in total assets to engage in recovery planning. To an extent a firm meets these criteria, it must engage in recovery planning that complies with these regulatory standards.

200 FDIC, *Statement on Resolution plans for Insured Depository Institutions* (Jun. 25, 2021), *available at* https://www.fdic.gov/resources/resolutions/resolution-authority/idi-statement-06-25-2021.pdf.

201 *See, e.g.,* 12 C.F.R. Parts 370 & 371.

The FDIC's 2021 statement further acknowledges that "the appropriate overall resolution strategy for an IDI depends on the facts and circumstances when the FDIC is appointed receiver." This is a key reason why resolution planning requirements have focused on a firm's ability to provide critical information in a timely manner to help inform strategic options, which may include a sale to one or more third-party acquirers or the establishment of a bridge depository institution to continue the operations of the failed institution pending its sale, either as a whole to a single acquirer or in pieces to multiple acquirers. The resolution planning process is not designed to presuppose a specific reason for failure or a specific outcome, but rather to give the resolution authority all the information it needs to execute on a variety of situations.[202] Notably, and as discussed further above, the plans themselves provide: information on how an IDI could be separated from its parent company organization; information on interconnectedness; strategies for the sale or disposition of the deposit franchise, business lines and assets; information on critical services, key personnel, management information systems, and critical valuation and balance sheet information.

Under the IDI Rule, the FDIC reviews the plans in consultation with the appropriate Federal Banking Regulator for the covered IDI and its parent company. If, after consultation with the appropriate Federal Banking Regulator, the FDIC determines that the resolution plan is not credible, the FDIC must notify the IDI of the deficiencies and the institution must then submit a revised plan addressing such deficiencies. The FDIC resolution planning rule does not mandate enhanced prudential standards beyond the statutory requirements under Title I of Dodd-Frank; therefore, it would be wholly inappropriate to impose prudential resolvability requirements through the IDI resolution planning review process, particularly when doing so would represent a dramatic and unjustified departure from the FDIC's longstanding approach to evaluating such plans.

Furthermore, the FDIC's statutory obligations in a resolution are to protect insured depositors and to resolve the institution in the least costly manner to the DIF.[203] Sale to one or more other large financial institution(s) would, in many instances, protect a failing IDI's insured depositors and be the least costly resolution strategy and could be structured to avoid any material adverse competitive effect and minimize any additional future resolvability costs; therefore, requiring large IDIs to take actions that go beyond these goals is beyond the FDIC's authority under the FDIA.[204] If this strategy is deemed to be no longer sufficient from a public policy perspective, Congress should reflect this in the applicable statutory framework.

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202 Unlike the case for GSIBs, where activities are not as highly concentrated in the IDI and resolution of the parent is therefore not necessarily as tightly linked to resolution of the IDI, imposing a *de facto* SPOE requirement on institutions with large IDIs effectively dictates the resolution strategy for the IDI regardless of the specific failure scenario.

203 *See* 12 U.S.C. § 1823.

204 FDIC Acting Chairman Gruenberg has previously suggested that one goal of TLAC for large IDIs is the protection of uninsured depositors because of a concern that haircutting uninsured depositors at one large bank might cause runs at other large banks. But, as is the case with the general issue of failure of a large IDI, that risk is extremely low, and the risk is reduced even further because one or more purchasers is likely to want to assume all deposits. Moreover, that objective is not one of the FDIC's statutory objectives in resolution and the resultant loss of uninsured deposit discipline may offset any gain.

(d) *Policymakers should clearly articulate, provide reasonable support for and engage in a deliberative process with respect to any perceived weaknesses in the resolvability framework currently applicable to large IDIs before modifying the framework.*

To the extent regulators harbor concerns regarding the resolvability of large IDIs and their parent companies beyond those set forth in the FDIC RFI, they have not clearly articulated these concerns or provided specific analysis that would allow for appropriate public scrutiny, consideration and deliberation. If policymakers hold concerns, they should clearly articulate and explain them through either the legislative process or a separate RFI so that all appropriate stakeholders can appropriately consider their merits and, if necessary, assist in crafting solutions specifically and narrowly designed to address any issues in a balanced and cost-efficient manner. As demonstrated in this response, merely transferring requirements designed for a completely different type of institution and to address a different set of policy challenges would be a costly and inefficient—if not entirely ineffective—way to address any concerns.

Irrespective of the merits of imposing TLAC and SPOE on large IDIs (and, as discussed above, we think that any merits are limited and outweighed by the adverse results of such requirements), there is a basic question of whether this issue is properly considered in the context of an FDIC RFI on bank mergers. The question of the appropriate resolution framework for banks has, at most, tangible relevance to the question of bank mergers. Rather, to the extent that this issue requires renewed debate, it should be the subject of a separate RFI that directly addresses the issue. If the Federal Bank Regulators then determine that any adjustments to the resolvability framework are merited, they should make such changes through an Administrative Procedure Act-compliant notice and comment process.

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?*

The existing regulatory framework already provides the flexibility needed to analyze transactions involving large and smaller banking organizations.

The record of congressional action in the context of bank regulation makes clear that, where Congress feels it is appropriate to differentiate between small and large banking organizations, it will take steps to impose varying regimes and requirements to banks of different sizes.[205] In addition,

[205] *See*, *e.g.*, 12 U.S.C. § 5365 (2010) (Section 165 of the Dodd-Frank Act, which required the FRB to establish enhanced prudential standards for certain bank holding companies, foreign banking organizations and nonbank financial companies and led to the current asset- and risk-based categorization of banking organizations for purposes of heightened standards applicability); Pub. L. 115-174, The Economic Growth, Regulatory Relief, and Consumer Protection Act, S. 2155, 115th Cong. (2017) ((i) revising the threshold for systemically important financial institutions under the Dodd-Frank Act, which raised the floor for the applicability of heightened prudential standards from $50 billion to $250 billion in total consolidated assets and (ii) exempting banks with less than $10 billion in assets from the Volcker Rule and existing risk-

the legislative history of the BMA and bank merger provisions of the BHCA, and the associated amendments since enactment, do not appear to indicate that Congress intended that there be differing requirements or processes applied to the evaluation of proposed transactions involving smaller banking organizations as compared to large organizations beyond what the Federal Bank Regulators felt necessary in their supervisory capacities to consider in order to resolve the enumerated banking factors. Years of industry experience with the Federal Bank Regulators' bank merger review practices support the view that the Federal Bank Regulators appropriately use the discretion Congress provided under the current statutory framework to examine proposed transactions of different sizes and involving institutions of all types without needing to implement a novel regulatory dichotomy between mergers involving smaller and large banks. At the same time, however, we support further efforts to reduce the regulatory burden on smaller banks.

* * *

based capital and leverage ratio requirements provided they exceed the community bank leverage ratio established by the Federal Bank Regulators).

We appreciate the opportunity to comment on the FDIC's RFI. If you have any questions, please contact the undersigned by email at gregg.rozansky@bpi.com, dpommerehn@consumerbankers.com and brent.tjarks@midsizebanks.com.

Sincerely,

[redacted]

Gregg Rozansky
Senior Vice President, Senior Associate General Counsel
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[redacted]

David Pommerehn
Senior Vice President and General Counsel
Consumer Bankers Association

[redacted]

Brent Tjarks
Executive Director
Mid-Size Bank Coalition of America

cc: Jonathan Kanter
(U.S. Department of Justice)

Mark Van der Weide
(Board of Governors of the Federal Reserve System)

Benjamin W. McDonough
(Office of the Comptroller of the Currency)

Appendix 1

How Has the Size Distribution of Banks Evolved Over the Last 30 Years?

The FDIC issued a request for information (FDIC RFI) on March 25, 2022, seeking feedback about the effectiveness of existing policies governing the merger of insured depository institutions. The background section of the FDIC RFI presents an empirical analysis on the dynamics of the size distribution of banks over more than 30 years. The analysis purports to demonstrate a significant shift in the size distribution toward larger banks and suggests that bank mergers have been the dominant force driving this change.

In this note, we show that the FDIC analysis contains an important methodological flaw that results in a material overstatement in the increase in the number of large banks over the past 30 years. In addition, it demonstrates that the collapse of entry into banking has been an important driver of the decline in the number of smaller banks, a development that the FDIC RFI does not mention.

The FDIC RFI's analysis relies on fixed bank size thresholds based on current dollars to compare bank size groups across time. This assumption exaggerates the increase in the number of large banks, because aggregate assets in the commercial banking sector rose fivefold during the 1990–2020 period. (Consolidation in the banking sector cannot be a driver of the increase in aggregate assets, because a merger does not cause assets in the banking sector to go up.) We show that controlling for economic growth and inflation, the number of *large* banks has been stable since the mid-2000s. In addition, the share of assets and deposits of large regional banks has also been about the same over the past 15 years.

Although the FDIC RFI assumes that a decrease in the number of small banks is attributable to mergers, our analysis in this note shows that the collapse of entry into commercial banking explains approximately 60 percent of the decline in the number of banks post-2010. Because new banks start small, the lack of entry into commercial banking is a key driver of the decline in the number of smaller banks. Increased regulatory costs are one common explanation for the collapse of entry into commercial banking in the aftermath of the 2008 financial crisis.[1] Moreover, our simulations show that the number of smaller banks would stabilize if entry into commercial banking returned to the level that prevailed before the financial crisis.

Finally, our analysis also shows that the role of bank mergers in explaining the decline in the number of small banks has diminished over time. Indeed, we find that the number of bank exits due to a bank merger *fell* significantly starting around 2005 and thereafter largely stabilized, perhaps reflecting a more efficient and less fragmented banking sector relative to the earlier period.

Number of Large Banks Essentially Unchanged Since 2005

The empirical analysis in the FDIC's RFI calculates the size distribution of commercial banks (the data also include thrifts and savings and loan banks) and corresponding change in the number of large banking organizations in 1990, 2005, and 2020. The results show that there was one bank with assets greater than $100 billion in 1990, 11 such banks in 2005, and 33 in 2020. The analysis asserts that

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1 *See* McCord and Prescott (2014).

consolidation in the banking industry was the main driver behind an increase in the number of large and systemically important banking organizations.

The main shortcoming of the empirical analysis in the FDIC RFI is that bank size is significantly influenced by factors unrelated to consolidation and systemic risk, such as general economic growth and inflation. Adjusting for economic growth and inflation shows a much less dramatic increase in bank size over time. For instance, we can show that the number of large banks has not materially increased since 2005. Earlier, regulatory changes were clearly a factor in the growth of large banks. Before the Riegle-Neal Act of 1994, banks were subject to substantial restrictions on interstate and in some cases intrastate branching. For example, out-of-state bank holding companies could not acquire in-state banks.[2] The lifting of those geographic restrictions in 1994, led to an increase in the number of large banks. According to several academic papers, including the work by Jayaratne & Strahan (1997), the increase in bank size led to significant efficiency gains through lower loan losses and operating costs, and geographic limits acted as a "ceiling on the size of well-managed banks."

To facilitate the comparison of bank size over time, we adjust the size of banks in 1990 and 2005 relative to 2020 dollars. We follow McCord and Prescott (2014) and use the change in aggregate commercial banking sector assets between those years and 2020.[3] Aggregate commercial bank assets in 1990 were approximately 20 percent of aggregate bank assets in 2020, so each bank's total assets in 1990 is five times larger relative to 2020 dollars. For example, a bank with $20 billion assets in 1990 would have $100 billion in assets expressed in 2020 dollars. Similarly, applying the same approach, we find bank assets in 2005 are roughly 50 percent of bank assets in 2020, so we double the size of bank total assets in 2005 to make it comparable to total bank assets in 2020.

After adjusting bank size in this way for economic growth and inflation, we find that the number of banks above $100 billion in assets rose between 1990 and 2005 but remained relatively unchanged after that. More precisely, Table 1 shows that there were 21 banks with assets above $100 billion in 1990, 32 such banks in 2005, and 33 in 2020. The increase in the number of large banks between 1990 and 2005 most likely resulted from the passage of the Riegle-Neal Act of 1994, which allowed bank holding companies to acquire banks in different states, and also permitted interstate bank mergers, thereby reducing what were in effect legal and regulatory restrictions on bank size. Those restrictions had existed for most of the history of U.S. banking and led to a highly fragmented and less efficient industry.[4]

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2 For example, Calomiris (2009) showed that those restrictions destabilized the banking sector and subsidized small, poorly diversified banks that were more vulnerable to runs.

3 The analysis is done at the bank level. Also, as noted by McCord and Prescott (2014), adjusting bank size using the CPI would not be ideal, because the analysis is focused on measuring changes in the size of banks over time, not how much banks are charging for their services. An adjustment to bank size using the CPI adjustment would also not account for the increase in aggregate bank assets due to economic growth.

4 *See* Jayaratne and Strahan (1997).

Table 1. Number of Insured Depository Institutions by Asset Size

Asset Size (2020 dollars)	Year 1990	2005	2020
<$10B	14,819	8,724	4,899
$10B–$50B	300	132	102
$50B–$100B	28	28	16
>$100B	21	32	33
Large Regional Banks	17	23	24
GSIBs	4	9	9

Source: S&P Global Market Intelligence.

After 2005, the number of large banks remained essentially unchanged, suggesting that factors other than merger activity have been at play during this next period. Above all, the 2007–2010 recession paused merger activity other than acquisitions of troubled banks, and important regulatory reforms (e.g., Basel III, stress tests, GSIB surcharge, liquidity regulation, resolution planning) implemented during that time act as an effective tax on bank size. Relatedly, the stability in the aggregate number of large banks after 2005 is also observed in banks owned by GSIBs and large regional banks. Namely, of the 33 banks with more than $100 billion in total assets in 2020, nine were owned by the eight U.S. GSIBs, while the remaining 24 were owned by large regional banks (some of which were subsidiaries of a foreign GSIB). In 2005, the eight U.S. GSIBs owned nine banks with assets greater than $100 billion in assets, while the remaining 23 were owned by large regional banks.[5]

Most of the empirical analysis in the FDIC's RFI is focused on changes in the number of banks, but there is also a brief discussion on the percentage of assets and deposits held by banks across different size categories. The use of nominal asset thresholds to define large banks also exaggerates the increase in the percentage of assets and deposits held by those banks over the 30-year period. Focusing on the percentage of assets and deposits across banks also shows the importance of separating large regional banks from GSIBs to understand those trends.

Table 2. Percentage of Industry Assets and Deposits Held by Insured Depository Institutions

Asset Size (2020 Dollars)	Assets			Deposits		
	Year			Year		
	1990	2005	2020	1990	2005	2020
<$10B	39.2	21.3	16.4	46.6	28.6	16.4
$10B–$50B	29.9	12.8	11.4	29.6	14.1	11.4
$50B–$100B	9.0	8.8	5.9	8.9	8.0	5.9
> $100B	21.8	57.1	69.4	14.8	49.3	66.2
Large Regional Banks	15.4	23.7	23.9	10.9	24.9	25.6
GSIBs	6.4	33.4	45.5	3.9	24.4	40.7

Source: S&P Global Market Intelligence.

5 The analysis assumes that Wachovia Corporation and Washington Mutual would not be considered GSIBs had the framework been in place in 2005.

Although Table 2 shows an increase in the share of assets and deposits held by banks above $100 billion in assets, the rise is less pronounced using size thresholds adjusted for economic growth. Moreover, the percentage of assets and deposits held by large regional banks remained roughly unchanged between 2005 and 2020. The increase in percentage of assets and deposits of banks above $100 billion in assets is driven by banks owned by the eight U.S. GSIBs. The changes in composition of the GSIB sample are more complex, because GS and MS became bank holding companies in 2009 and therefore did not exist in our sample in 2005. Moreover, several GSIBs acquired large banks during the financial crisis but their percentage of assets declined slightly after the 2008 financial crisis.[6]

To illustrate the lack of changes in the size distribution of large regional banks since 2005, Table 3 lists the 10 largest regional banks in 2005 and 2020. Several of the banks are the same in both lists, such as U.S. Bank, PNC, and HSBC, while SunTrust merged with BB&T in 2018 to form Truist. The top two banks in 2005, Wachovia and Washington Mutual, were bought by Wells Fargo and JPMorgan, respectively, in 2008. As we point out in the next section, it is highly unlikely that the largest regional banks will be acquired by GSIBs in a future financial crisis. Large regional banks are significantly more resilient in times of economic stress, because capital and liquidity levels are multiples of the levels held in 2005 and because interstate branching and mergers have allowed them to diversify geographically.

Table 3. Ten Largest Regional Banks, 2005 and 2020

Bank Name	2005 ($B)	Bank Name	2020 ($B)
Wachovia Bank, National Association	949	U.S. Bank National Association	545
Washington Mutual Bank	665	Truist Bank	499
U.S. Bank National Association	420	PNC Bank, National Association	463
SunTrust Bank	356	TD Bank, N.A.	402
HSBC Bank USA, National Association	303	Capital One, National Association	364
Wachovia Mortgage, FSB	250	Charles Schwab Bank, SSB	342
KeyBank National Association	179	Fifth Third Bank, National Association	203
PNC Bank, National Association	167	HSBC Bank USA, National Association	198
Regions Bank	163	Citizens Bank, National Association	183
BB&T	161	Ally Bank	172

Notes: The size of the 10 largest regional banks is measured by total assets, expressed in 2020 dollars (see text for details).
Source: S&P Global Market Intelligence.

Resiliency of All Banks Increased Significantly Since 2005

As noted in the previous paragraph, failures of large regional banks may have contributed to an increase in consolidation among the banks owned by the U.S. GSIBs. In the aftermath of the 2008 financial crisis, the U.S. regulatory agencies introduced more stringent capital and liquidity standards on large banks, which have reduced the probability of failure of large regional banks by a significant amount. For example, Basel III increased regulatory capital minimums and buffers, including a capital surcharge for systemically important banks. The Federal Reserve also started conducting annual stress tests for bank holding companies with more than $100 billion in assets. As shown in Table 4, the common equity tier 1

[6] *See* FRB of New York, *Quarterly Trends for Consolidated U.S. Banking Organizations Fourth Quarter 2021*, at 37, quarterlytrends2021q4.pdf (newyorkfed.org).

ratio of large regional banks rose nearly 4½ percentage points between 2005 and 2020. The common equity tier 1 capital ratio of banks owned by GSIBs increased 6 percentage points, because the bank holding company that owns the bank is subject to an additional capital surcharge.

Table 4. Common Equity Tier 1 Capital Ratio of Insured Depository Institutions by Asset Size

Asset Size (2020 Dollars)	Year (Percentage) 2005	2020
<$10B	13.3	15.0
$10B–$50B	10.9	13.7
$50B–$100B	10.7	13.4
> $100B	8.3	13.7
Large Regional Banks	8.3	12.7
GSIBs	8.3	14.4

Source: S&P Global Market Intelligence.

Similarly, the Basel III reforms also introduced several liquidity requirements (the liquidity coverage ratio and the net stable funding ratio) for large banks. Those require banks to hold a larger percentage of their balance shares in assets easily liquidated in a stress period, such as deposits at Federal Reserve Banks, U.S. Treasury securities, and Agency MBS (subject to a haircut). The introduction of liquidity requirements should also make default of large banks less likely and avoid the need of fire sales. As shown in Table 5, the ratio of high-quality liquid assets to assets for large regional banks and GSIBs was 10 percent and 8.9 percent, respectively, in 2005, and 23.3 percent and 31 percent, respectively, in 2020.[7]

Table 5. Ratio of Liquid Assets to Total Assets of Insured Depository Institutions by Asset Size

Asset Size (2020 Dollars)	Year (Percentage) 2005	2020
<$10B	14.1	10.3
$10B–$50B	12.8	17.0
$50B–$100B	8.7	20.9
> $100B	9.3	28.4
Large Regional Banks	10.0	23.3
GSIBs	8.9	31.0

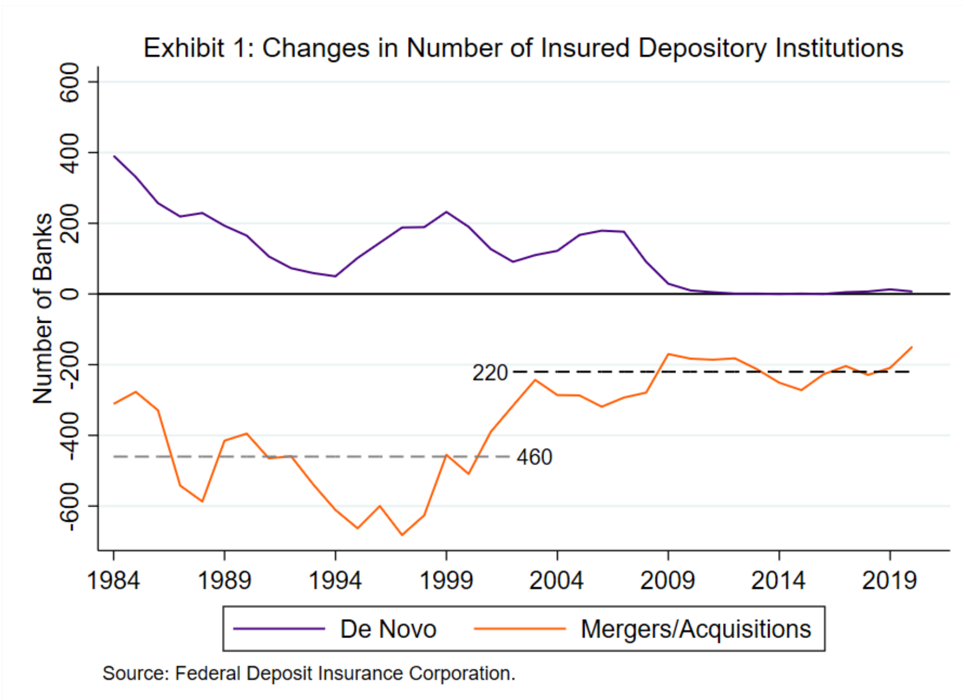
Source: S&P Global Market Intelligence.

Collapse of Entry into Commercial Banking and Decline in Number of Banks

7 Interestingly, the share of liquid assets at banks with less than $10 billion in assets fell between 2005 and 2020. This could be a symptom of the community bank leverage ratio, which disincentivizes banks to hold safer assets.

The empirical analysis in the FDIC's RFI overstates the impact of mergers on the decline in the number of small banks, a total that has declined significantly over time starting around 1978 and shows no sign of abating.[8] As we discuss in more detail, the main driver of the decline in the number of small banks over the past decade is explained by the lack of entry into commercial banking, a phenomenon first noted by McCord and Prescott (2014) and Adams and Gramlich (2014).

The analysis in the FDIC RFI defines bank entry as including both new charters (or *de novo* banks) and the conversion of an existing institution to a commercial bank that has applied and received FDIC insurance.[9] Bank exits include bank failures (both assisted mergers and those paid off by the FDIC), unassisted mergers and acquisitions, and withdrawals from FDIC insurance for other reasons (e.g., voluntary liquidations, conversion to nonbanks). Exhibit 1 plots the time series of the main drivers of changes in the number of banks: entry of *de novo* institutions (purple line) and unassisted mergers (orange line) between 1984 and 2020. *De novo* banks are non-negative, because their entry results in more banks. Mergers and acquisitions are represented by negative values for the opposite reason.



The most notable observation in Exhibit 1 is the collapse in the number of *de novo* banks after the 2008 financial crisis. Between 1984 and 2007, new entrants averaged close to 200 banks per year, a number that declined during the financial crisis. After 2011, the number of newly licensed banks collapsed to five banks each year on average. Moreover, the number of exits due to a bank merger fell significantly since

8 *See* https://banks.data.fdic.gov/explore/historical.

9 The FDIC's definition for *de novo* banks includes newly licensed institutions or those chartered by the Office of the Comptroller of the Currency or by state banking authorities (in which case the primary federal regulator is the Federal Reserve Board for "member" banks or the FDIC for "nonmember" banks). These include banking authorities in the U.S. territories or possessions. In addition, it also includes charters issued to take over a failing institution.

the early 2000s. Before 2002, on average, about 460 banks exited because of mergers each year. After 2002, the number of deletions due to mergers dropped to about 220 banks per year. Moreover, in the last 10 years, only one smaller bank has been acquired by a large bank.

Next, we quantify the importance of the collapse of entry into commercial banking in explaining the decline in the number of banks between 2012 and 2020. We ran a simple counterfactual analysis by computing the evolution in the number of banks, assuming entry in the post-crisis period reverted to the levels seen before the financial crisis. The difference between the number of banks obtained using the counterfactual and the actual number of banks allows us to infer the importance of bank entry in explaining the decline in the number of banks.

To conduct the counterfactual analysis, we need the distribution of banks by size categories at the end of 2011, the probability of moving across size buckets (*i.e.*, a transition matrix), the number of new entrants, and their corresponding size categories. Following McCord and Prescott, we split the number of banks at the end of 2011 into seven size categories. The transition matrix tallies how many banks in a given size category each year stayed in the same size category in the succeeding year, how many increased or decreased in size, and finally how many exited the sample. We calculate the transition probabilities for each year between 2012 and 2020, and the analysis uses the average transition probabilities across that time.

Table 6. Annual Transition Probabilities Between Size Categories (Average Percentage, 2012–2020)

Size Class	Exit	<$100m	$100m–$500m	$500m–$1B	$1B–$5B	$5B–$10B	$10B–$50B	> $50B
< $100m	5.5	91.0	3.5	0.0	0.0	0.0	0.0	0.0
$100m–$500m	4.1	1.8	92.0	2.1	0.0	0.0	0.0	0.0
$500m–$1B	4.0	0.0	4.4	86.4	5.2	0.0	0.0	0.0
$1B–$5B	4.2	0.0	0.0	2.4	91.4	2.0	0.0	0.0
$5B–$10B	4.0	0.0	0.1	0.0	3.1	84.7	8.1	0.0
$10B–$50B	3.1	0.0	0.0	0.1	0.2	3.0	91.6	2.0
> $50B	1.6	0.0	0.0	0.0	0.0	0.0	2.1	96.3

Table 6 reports the average transition probabilities across bank size categories between 2012 and 2020. Each row represents the asset size in the current year, and each column the asset size in the following year. For example, for banks with less than $100 million in assets in the current year, 5.5 percent left the sample in that year, 91 percent stayed in the same asset category, and 3.5 percent moved to the next highest size category. By construction, the probabilities in each row sum to 1.

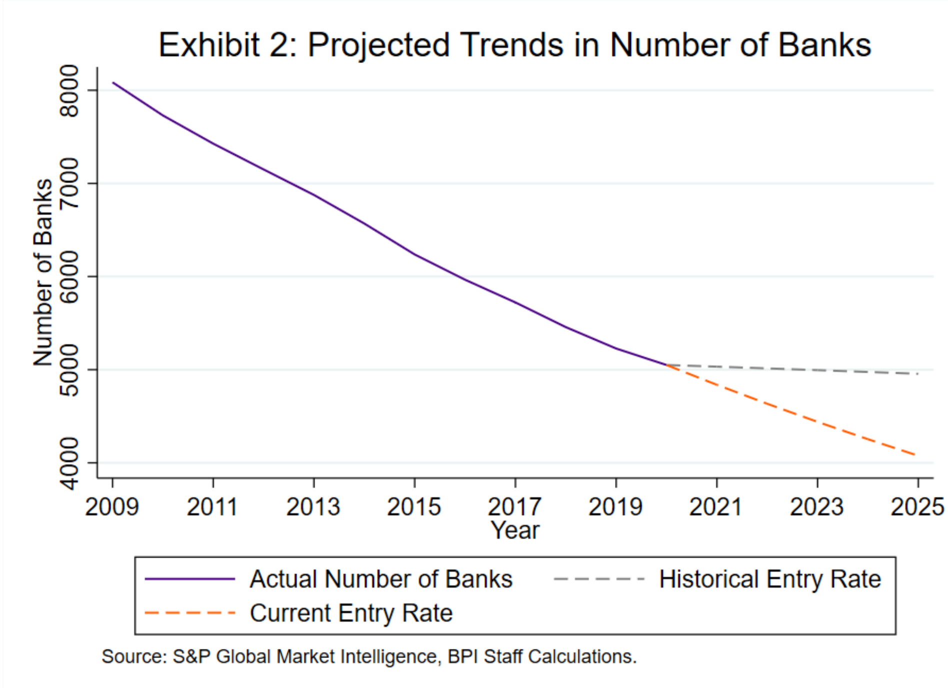
In terms of new bank formation, the counterfactual analysis assumes 200 new banks were chartered each year on average. This number corresponds to the average number of *de novo* banks between 1984 and 2007 in the FDIC data, excluding the years when the U.S. economy was in a recession. Finally, we use data from the entire sample to estimate the size distribution of new entrants. Newly chartered banks are small in terms of assets. Based on our sample, 73 percent of new banks had assets of less than \$100 million at the time of their founding, and the remaining 27 percent were in the \$100 million–\$500 million range.

Table 7. Results of Counterfactual Analysis on Number of Banks

Size Class	Actual 2020	Counterfactual 2020	Difference	% Difference
< \$100m	894	1,856	962	107.6%
\$100m–\$500m	2,391	2,830	439	18.3%
\$500m–\$1B	771	767	–4	–0.5%
\$1B–\$5B	725	728	3	0.4%
\$5B–\$10B	107	120	13	12.1%
\$10B–\$50B	110	116	6	5.5%
> \$50B	52	50	–2	–3.6%
Total	5,050	6,467	1417	28.1%

Table 7 compares the actual number of banks in each size category against the number of banks based on our counterfactual exercise at the end of 2020. With an entry of 200 banks each year between 2012 and 2020, we estimate that there would be 6,467 banks in existence instead of 5,050 banks at the end of 2020. Because we had 7,427 banks at the end of 2011, the number of banks would have dropped by 960 (*i.e.*, 7,427 – 6,467) instead of the actual 2,377. In percentage terms, the collapse of entry into commercial banking accounts for 60 percent (*i.e.*, (2,377 – 960)/2,377) of the decline in the number of banks between 2012 and 2020.

If the lack of entry into commercial banking persists, it will continue to drive a decline in the number of small banks, assuming the transition probabilities stay consistent with those reported in Table 6. Exhibit 2 extends the analysis reported in Table 7 for another 5 years. The projection done using the current entry rate assumes 5 newly chartered banks each year, which corresponds to the average formation of new banks between 2012 and 2020. The historical entry rate sets the number of new entrants equal to 200. Based on the current entry rate, we project the number of banks will reach 4,075 by the end of 2025, representing a further decline of another 1,000 banks. By contrast, using the historical entry rate, we predict the number of banks would be essentially unchanged over the next 5 years.



Some Reasons for Lack of Entry into Commercial Banking

Two common explanations for the collapse of entry into commercial banking are increased regulatory costs and low profitability. The former includes higher capital requirements, more stringent and burdensome regulatory compliance created by the Dodd-Frank Act, and new requirements for *de novo* banks seeking deposit insurance by the FDIC. Newly chartered banks incur three types of costs. First, new banks need to pay for filling fees for a new charter with the OCC or state banking authorities, though these are generally small costs. Second, new banks are subject to capital requirements that may depend on the state in which the new bank is formed and the type of charter. And third, newly chartered banks must apply for participation in the Deposit Insurance Fund (DIF) with the FDIC. To receive deposit insurance, a new bank needs to submit information on its business plan (which typically includes a Tier 1 common capital requirement of at least 15%), and the FDIC requires banks to follow this plan for a certain period.

According to McCord and Prescott, the intensity in the regulatory requirements and supervision of *de novo* banks increased in the aftermath of the 2008 financial crisis. For instance, the FDIC expanded the period during which FDIC-supervised *de novo* entities are subject to higher capital requirements and more frequent examinations from three to seven years. In addition, the FDIC requires those banks to ask for an approval regarding changes in their business plans during the seven-year period.

Another potentially important reason is the level of interest rates. The main source of revenues of newly chartered banks comes from interest income, because these banks are small. For most of the post-crisis period, interest rates were near zero, since the economy was still recovering from the 2008 financial crisis. However, there are a few challenges to this explanation. First, the level of interest rates increased in late 2018, and still there was no meaningful increase in the number of *de novo* banks. Second, in recent years there have been many start-ups offering consumer and small business loans, payments, and other types of services not subject to bank regulatory rules. This suggests that entry into bank-like activities remains attractive, but regulatory costs have become prohibitively expensive.

Other explanations include lack of scale economies for smaller banks. Certain studies have shown that economies of scale are far more extensive for larger banks (e.g., Wheelock and Wilson 2012 and Kovner, Vickery and Zhou 2014). The investment in new technologies necessary to remain competitive with other banks requires large upfront investments that are now much more difficult for smaller banks to absorb. Those elevated fixed costs due to new technologies, combined with increased regulatory compliance costs, have likely resulted in a lack of entry into commercial banking.

Conclusions

Our empirical analysis shows that assertions about the effect of mergers on the size of U.S. banks is overly simplistic and misses two important facts.

First, after adjusting for economic growth and inflation, the number of large banks has not increased since the 2008 financial crisis. In addition, large regional banks hold 3 times more common equity tier 1 capital, the most loss-absorbing capital instrument, and 5 times more high-quality liquid assets relative to the levels that prevailed at the onset of the financial crisis. In practice, this implies that the likelihood that a large regional bank will fail has declined substantially. Also, the size of large regional banks, accounting for economic growth and inflation, remains relatively unchanged.

Second, the FDIC RFI omits a key driver of the decline in small banks over the past decade, namely the collapse of entry into commercial banking. To understand the decline in the number of small banks and its impact on smaller communities, it is important to understand the regulatory factors that account for the lack of bank entry.

Appendix 2

Financial Stability Considerations for Bank Merger Analysis

Greg Baer, Bill Nelson and Paige Paridon

May 16, 2022

Since enactment of the Dodd-Frank Act in 2010, the federal banking agencies have been required by statute to consider risks to financial stability when evaluating proposed bank mergers and acquisitions.[215] The agencies have not issued regulations to define an approach to evaluating financial stability effects but have discussed the financial stability factors in public orders reviewing proposed mergers.[216] This note describes those orders and outlines a more comprehensive approach for conducting a systematic analysis of financial stability effects for future reviews.

I. Statutory requirements to consider financial stability

Historically, federal law has required the federal banking agencies to consider a variety of competitive, managerial, community and other factors in assessing a merger or acquisition.[217] Financial stability became one of these factors in 2010, when the Dodd-Frank Act amended the Bank Holding Company Act to require the Federal Reserve also to consider "the extent to which a proposed acquisition, merger, or consolidation would result in greater or more concentrated risks to the stability of the United States banking or financial system."[218] A similar provision applies to nonbank acquisitions.[219]

Similar to the Bank Holding Company Act, the Bank Merger Act requires the relevant agency to consider "the financial and managerial resources and future prospects of the existing and proposed institutions, the convenience and needs of the community to be served, and *the risk to the stability of the United States banking or financial system*."[220] The Dodd-Frank Act does not define financial stability for purposes of either statute.

II. Past Agency Reviews of the Financial Stability Factor

[215] The Bank Merger Act requires the relevant "responsible" banking agency to give prior written approval for, among other transactions, a merger or consolidation between insured depository institutions or an assumption by an insured depository institution of liability to pay deposits made in an uninsured depository institution. 12 U.S.C. § 1828(c). Section 3 of the Bank Holding Company Act requires the Federal Reserve to approve an acquisition of a bank by any company, and Section 4 requires the Federal Reserve to approve the acquisition of a nonbank company (or a proposal to directly engage in nonbanking activities) by bank holding companies. 12 U.S.C. §§ 1842(a), 1843(j). Section 604(d) of the Dodd-Frank Act amended Section 3(c) of the Bank Holding Company Act to require the Federal Reserve, when evaluating a proposed bank acquisition, merger, or consolidation, to consider "the extent to which [the] proposed acquisition, merger, or consolidation would result in greater or more concentrated risks to the stability of the United States banking or financial system." Section 604(e) of the Dodd-Frank Act similarly amended Section 4(j)(2) of the BHC Act to require the Federal Reserve to consider financial stability concerns when reviewing notices by bank holding companies to engage in nonbanking activities. Section 604(f) of the Dodd-Frank Act amended the Bank Merger Act to require the "responsible" banking agency to consider the risk to the stability of the United States banking or financial system in considering a proposed merger.

[216] For brevity's sake, we will below refer only to mergers and not add "and acquisitions," in part because most acquisitions include a merger of subsidiary banks.

[217] 12 U.S.C. § 1842(c)(2)-(3), (6).

[218] 12 U.S.C. § 1842(c)(7).

[219] 12 U.S.C. § 1843(j)(2) requires the Federal Reserve to consider "whether performance of the activity by a bank holding company or a subsidiary of such company can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interests, unsound banking practices, or *risk to the stability of the United States banking or financial system*." (emphasis added).

[220] 12 U.S.C. § 1828(c)(5) (emphasis added).

To date, each banking agency has assessed financial stability in the merger context on a case-by-case basis without promulgating any governing rules.[221] In approving mergers since the financial stability factor was added, the agencies have generally provided a high-level description of how they assessed that factor.
The Federal Reserve first considered the financial stability factor in 2012 in connection with Capital One's acquisition of ING's U.S. retail banking operations pursuant to Section 4 of the BHC Act.[222] The standard used in that case has generally been followed by the Federal Reserve in all subsequent cases, at least those for which an analysis has been disclosed publicly.[223] The *Capital One* order provides:

> In reviewing applications and notices under sections 3 and 4 of the BHC Act, the Board expects that it will generally find a significant adverse effect if the failure of the resulting firm, or its inability to conduct regular-course-of-business transactions, would likely impair financial intermediation or financial market functioning so as to inflict material damage on the broader economy. This kind of damage could occur in a number of ways, including seriously compromising the ability of other financial institutions to conduct regular-course-of-business transactions or seriously disrupting the provision of credit or other financial services. To assess the likelihood that failure of the resulting firm may inflict material damage on the broader economy, the Board will consider a variety of metrics. These would include measures of the size of the resulting firm; availability of substitute providers for any critical products and services offered by the resulting firm; interconnectedness of the resulting firm with the banking or financial system; extent to which the resulting firm contributes to the complexity of the financial system; and extent of the cross-border activities of the resulting firm. These categories are not exhaustive, and additional categories could inform the Board's decision.[224]

The order also states that the Board "has considered whether the proposed transaction would provide any stability benefits and whether enhanced prudential standards applicable to the combined organization would offset any potential risks,"[225] but contains no analysis of those benefits or offsets – perhaps because such analysis was superfluous in a case where the Board apparently concluded there were no meaningful risks to financial stability to offset.

The Federal Reserve has discussed potential benefits to financial stability in connection with two acquisitions: the acquisition by Goldman Sachs of GE Capital's financial assets pursuant to the Bank Merger Act and the acquisition by Morgan Stanley of E*TRADE under Section 4 of the BHC Act.[226] In the *Goldman* order, the Board found that

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[221] The Federal Reserve has not adopted a regulation relating to its assessment of the financial stability factor, but its rules relating to capital surcharges for global, systemic bank holding companies (GSIBs) provide guidance as to the Federal Reserve's approach to and analysis of financial stability issues related to large banks.

[222] This application was decided under section 4 of the BHCA Act because ING's retail banking operations were conducted in a thrift rather than a bank.

[223] Indeed, subsequent public orders issued by the Federal Reserve under Sections 3 or 4 of the Bank Holding Company Act or the Bank Merger Act typically provide a footnote stating "For further discussion of the financial stability standard, see Capital One Financial Corporation, FRB Order No. 2012-2 (February 14, 2012)."

[224] FRB Order No. 2012-2, Order Approving the Acquisition of a Savings Association and Nonbanking Subsidiaries, Capital One Financial Corporation McLean, Virginia (February 14, 2012), 28-29; available at: Order Approving the Acquisition of a Savings Association and Nonbanking Subsidiaries -- Capital One Financial Corporation (federalreserve.gov)

[225] *Id*. at 36.

[226] The Board also considered the Morgan Stanley acquisition under Section 163(b) of the Dodd-Frank Act, which requires the Federal Reserve to conduct a financial stability analysis when reviewing notices by bank holding

"the transaction would provide GS Bank with approximately $17 billion in deposits, a deposit customer base, and a platform for increasing its deposit funding in the future. As a result, the proposal would immediately improve the stability of GS Bank's funding profile by diversifying sources of funding and increasing stable funding and would allow the bank to maintain and further improve its funding profile in the future. This should enhance financial stability."[227]

In the *Morgan Stanley* order, the Board stated that "while the acquisition would marginally increase Morgan Stanley's systemic footprint, certain financial-stability-enhancing features of the acquisition would operate as mitigating factors" including "[t]he Board's regulatory and supervisory frameworks [that] are tailored to apply the strictest standards to U.S. GSIBs and to increase in stringency with an individual GSIB's systemic footprint" and that "[f]ollowing the acquisition, all of E*TRADE's activities would be subject to the strictest standards [and] the acquisition of E*TRADE also would provide Morgan Stanley with an additional stream of stable revenues for its wealth- and investment-management business and would diversify its funding structure."[228] Thus, the Board has considered potential financial stability risk mitigants and benefits of a merger, but not in a consistent or formally established manner.

The FDIC's approach has been similar. In approving the merger of SunTrust and BB&T, the FDIC's order stated, "In evaluating the likely impact of the proposed transaction on the stability of the U.S. banking or financial system, the FDIC considered quantitative and qualitative metrics, each of which aims to assess whether Truist Bank's systemic footprint would be such that its failure or financial distress would compromise the overall stability of the U.S. banking or financial system . . . The qualitative metric considered with respect to this Application relates largely to the resolvability of Truist Bank, taking into account the institution's proposed organizational structure and its expected continuity, saleability, and separability in resolution."[229] None of the quantitative metrics was disclosed, however. In terms of mitigation, the FDIC did note that "the resolvability of Truist Bank would not present a risk to the stability of the U.S. banking or financial system that is not otherwise mitigated by regulatory requirements applicable to the institution and its parent holding company, including requirements to regularly submit resolution plans."[230]

For its part, the OCC's approach is set forth in its licensing manual, and focuses exclusively on potential costs of a merger, including any increase in size of the combining institutions; whether there would be a reduction in the availability of substitute providers for the services offered by the combining institutions; whether financial distress at the combined entity would cause significant risks to other institutions; whether the combination would "contribute to the complexity of the financial system" whether the combination "would materially increase the extent of cross-border activities of the combining institutions" and whether the proposed transaction would increase the relative degree of difficulty of resolving or winding up the combined institution's business in the event of failure or insolvency.[231]

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companies with total assets of $50 billion or more, or nonbank financial companies supervised by the Federal Reserve, to acquire voting shares of companies with total assets of $10 billion or more. 12 U.S.C. § 5363(b)(4).

[227] Federal Reserve Board Order No. 2016-03 (March 21, 2016) at 23.

[228] Federal Reserve Board Order no. 2020-05 (September 30, 2020) at 23.

[229] Branch Banking and Trust Company Winston-Salem, North Carolina, Application for Consent to Merge with SunTrust Bank, Atlanta, Georgia, and to Establish Associated Branches Order and Basis for Corporation, Approval (Nov. 19, 2019); available at: pr19111a.pdf (fdic.gov).

[230] *Id*.

[231] Comptroller's Licensing Manual, Business Combinations, Version 1.1 (July 2018), at 8; available at: Comptroller's Licensing Manual, Business Combinations (occ.gov)

Drawing on the agencies' case-by-case precedent and engaging in other analysis, we set out below a framework that the agencies should universally apply when assessing the change in financial stability resulting from a proposed merger and a series of factors that should inform such an analysis. The agencies should issue this framework for notice and comment, after conducting further research to enhance their analysis and identify additional factors that should be considered.

III. Assessing the financial stability consequences of a merger

A comprehensive assessment of the change in financial stability resulting from a proposed merger should consider: (1) any change in the probability of failure of the merged company relative to its predecessors; (2) any change in the systemic cost upon failure of the merged company relative to its predecessor; and (3) any consequences of the merger for other companies. The first two considerations are akin to analyzing the risk of a loan or other asset – probability of default times loss given default – with the additional need to consider that risk *relative* to the risk presented by the existing companies, consistent with the approach in prior orders. We first describe the systemic cost index, a quantitative tool that can be used to measure the systemic risk of a firm, and recommend that, in the merger context in particular, it should incorporate the first two considerations set forth above.

A. THE SYSTEMIC COST INDEX

Federal regulation contains one codified measure of the systemic risk presented by a firm: the Systemic Cost Index used to calculate a GSIB capital surcharge.[232] The Federal Reserve has explicitly adopted this methodology for assessing mergers in certain cases, and, the metrics it has used in assessing financial stability risk in other cases are coincident with the components of the GSIB surcharge, and the GSIB surcharge is the only rule that provides metrics for those risks.[233] In addition, the agencies each state that they consider quantitative and qualitative metrics in reviewing merger proposals, and thus, it seems highly likely that the agencies consider the systemic indicator scores of firms proposing to merge.

The Federal Reserve requires U.S. banks to calculate their systemic indicator scores under two different methods, with the higher of the two resulting surcharges applying. In the Basel methodology, known as Method 1, the systemic indicator score is calculated using an equally weighted average of five measures of systemic importance—complexity, interconnectedness, cross-jurisdictional activity, substitutability, and size. The U.S. score, known as Method 2, replaces the substitutability category with short-term wholesale funding. Consequently, using the systemic scores, the failure of a bigger bank will have more systemic costs than the failure of a smaller bank, if the bigger bank has any systemic costs of failure at all.

The systemic cost index appears to be a reasonable place to start in assessing systemic risk. That said, it significantly overstates systemic risk, and any assessment in the merger context would need to correct for this bias. First, the GSIB methodology, adopted in 2015,[234] has never been adjusted to account for numerous market and regulatory actions that have been adopted subsequently and which, by the Federal Reserve's own account,

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[232] 80 Fed. Reg. 49082 (Aug. 14, 2015), available at: 2015-18702.pdf (govinfo.gov).

[233] For example, the following orders referenced the increase in the GSIB scores that would result from the proposed mergers: BB&T/Suntrust (2019), TD/Schwab (2020), Morgan Stanley/Etrade (2020), PNC/BBVA (2021). *See also* Capital One order at 28 ("the size of the resulting firm; availability of substitute providers for any critical products and services offered by the resulting firm; interconnectedness of the resulting firm with the banking or financial system; extent to which the resulting firm contributes to the complexity of the financial system; and extent of the cross-border activities of the resulting firm").

[234] *See* note 15, *supra*; *see also* Calibrating the GSIB Surcharge, Board of Governors of the Federal Reserve System, (July 20, 2015), available at: https://www.federalreserve.gov/aboutthefed/boardmeetings/gsib-methodology-paper-20150720.pdf.

significantly decrease systemic risk. These include central clearing of derivatives, margin requirements on a wide range of uncleared swaps, and single counterparty credit limits.[235] The systemic cost index takes no account of resolution plans and, for GSIBs, does not consider the existence of a single-point-of-entry resolution strategy designed to keep broker-dealers open and operating during resolution, and which prohibits derivatives counterparties from exercising close-out rights upon resolution. Furthermore, with respect to contagion risk, the GSIB surcharge does not take account of regulation that requires any advanced approaches bank – so, nine in total, and effectively the six largest U.S. banks – to deduct from its regulatory capital any long-term debt issued by a GSIB. This requirement serves as an effective prohibition on any such holding.

Second, four of the measures under Method 2 – complexity, interconnectedness, cross-jurisdictional activity, and size – are calculated as the sum of balance-sheet and off-balance-sheet items for a GSIB at the end of each year, divided by the average over the 2012 and 2013 levels of the aggregate sum across global GSIBs of those same items. Thus, these four measures have increased over time with both inflation and with economic growth, holding risk constant. While the Federal Reserve noted this problem and stated that it would adjust accordingly, it has failed to do so.[236] Lastly, with the incredible growth in the Federal Reserve's balance sheet, banks have significantly increased the holding of reserve balances – riskless assets that nonetheless have inflated their systemic risk scores. Even if corrections are not made to the GSIB methodology for capital purposes, they are essential for purposes of merger review.

Most significantly, the systemic cost index is a static measure of a given firm's systemic risk. It allows for comparison in the case of a merger to only a very limited extent – that is, one can add up the index for the two merging institutions and see if the sum is higher, lower, or (most likely) the same as the *pro forma* index for the combined organization. But that simple math ignores a host of factors that are relevant for assessing whether a given merger increases or decreases financial stability risk, either by changing the probability of failure, the cost of failure, or both, and thus should be considered in any proposed merger. We describe these factors below.

B. EFFECT ON THE PROBABILITY OF FAILURE

[235] *See, e.g.,* 20160510_tch_research_note_gsib_surcharge-1.pdf (bpi.com); 07.12.2016_newell_testimony_newell.pdf (house.gov); 07.17.2018_greg_baer_testimony.pdf (house.gov). Section 723 of the Dodd-Frank Act amended the Commodity Exchange Act (CEA) by adding Section 2(h)(1), which provides that "it shall be unlawful for any person to engage in a swap unless that person submits such swap for clearing to a derivatives clearing organization that is registered under [the CEA] or a derivatives clearing organization that is exempt from registration under [the CEA] if the swap is required to be cleared." Sections 731 and 764 of the Dodd-Frank Act add a new section, section 4s, to [the CEA] and a new section, section 15F, to the Securities Exchange Act of 1934, respectively, which require registration with the [CFTC] of swap dealers and major swap participants and the [SEC] of security-based swap dealers and major security-based swap participants (each a ''swap entity'' and, collectively, ''swap entities''). For swap entities that are prudentially regulated by one of the OCC, Board, FDIC, FCA, or FHFA, sections 731 and 764 of the Dodd-Frank Act require those agencies to adopt rules jointly for swap entities under their respective jurisdictions imposing (i) capital requirements, and (ii) initial and variation margin requirements on all swaps not cleared by a registered derivatives clearing organization or a registered clearing agency. *See also* 83 Fed. Reg. 38460 (Aug. 6, 2018), available at: 2018-16133.pdf (govinfo.gov). The Board established single-counterparty credit limits for bank holding companies and foreign banking organizations with $250 billion or more in total consolidated assets, including any U.S. intermediate holding company of such a foreign banking organization with $50 billion or more in total consolidated assets, and any bank holding company identified as a global systemically important bank holding company under the Board's capital rules.

[236] The fifth measure, "short-term wholesale funding" (STWF) is calculated as the ratio of the GSIB's STWF divided by its average risk-weighted assets over the previous four quarters. Because the STWF measure is divided by a number that also will grow over time, it will not trend up with economic growth and inflation.

Set forth below are factors that can affect the relative probability of failure of a merged firm as compared to its predecessors.

1. Change in the characteristics of the institution

a. Diversification

Mergers generally bring greater diversification in terms of product offering and geographic footprint, which reduces a firm's exposure to any one industry or region and thus lowers the firm's probability of default. Hughes, Mester, and Moon (2001) find that large banks achieve a better risk-profit trade-off than smaller banks because diversification reduces their risk.[237] Goetz, Laevan, and Levin (2016) find that a one-standard-deviation increase in bank diversification across metropolitan statistical areas reduces bank risk by one fourth.[238] Thus, any financial stability analysis should include an estimate of how much diversification benefits reduce the probability of failure. As noted above, the Federal Reserve has recognized such benefits, noting in its *Morgan Stanley* order how the merger "would provide an additional stream of stable revenues for its wealth- and investment-management business and would diversify its funding structure" and in the *Goldman* order, how financial stability would be enhanced because the merger "would immediately improve the stability of GS Bank's funding profile by diversifying sources of funding and increasing stable funding and would allow the bank to maintain and further improve its funding profile in the future." In other words, even though both cases involved a GSIB acquisition, which would create a larger institution, the Board viewed the diversification and stable funding benefits of the resulting entity to be sufficiently great so as to reduce the merged entity's probability of failure such that financial stability would be enhanced.

Thus, any financial analysis in the context of a merger review should include an assessment of any diversification benefits of the merger.

b. Returns to scale

Banks' first line of defense against losses is profits, and there are considerable returns to scale in the banking industry. In other words, larger banks are more profitable than smaller banks, and this increased profitability reduces the resulting institution's probability of failure. Positive returns to scale have been found by Hughes, Lang, Mester, and Moon (1996), Berger and Mester (1997), Hughes and Mester (1998), Hughes, Mester, and Moon (2001), Bossone and Lee (IMF), Wheelock and Wilson (2009), Feng, Guohua and Serletis (2010). Thus, any financial stability assessment should take into consideration the *pro forma* profitability of the combined organization relative to its predecessors and the resulting change in the probability of failure.

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[237] They also find that banks respond to that better risk-return profile by becoming riskier, a shift that examination and regulation is specifically designed to limit.

[238] Similarly, in a speech in 2018, the President of the ECB Mario Draghi, when describing the benefits of European integration, said:

> In the United States for example, retail banking integration has led to a significant increase in the number of multi-state banks. That was not always the case. For example, following the oil price collapse in the mid-1980s, almost every bank in Texas failed, creating a state-wide credit crunch. One reason was that banks were not allowed to operate across states, so the balance sheets of local banks were completely concentrated on their home state.
>
> In a more integrated US banking sector, banks have geographically more diversified loan-books and deposit bases. By offsetting losses made in crisis-hit states with gains in other states, US banks are more resilient to local shocks and can keep their lending stable.

c. Technology and operational efficiency

Scale also allows the merged entity to invest in technology and other resources to reduce risks, most notably operational risks, including threats to cybersecurity. In almost every recent merger, management has cited rising technology costs and cyber risk as a rationale, with the merged firm better able to harness the best technology. Indeed, French central bank governor François Villeroy de Galhau recently admonished his EU counterparts for not enacting policies to strengthen the EU banking market by encouraging more mergers of EU banks:

> More than anything else, our banks need economies of scale to have the means to invest properly – including in their digital transformation. Digital is mainly about IT investment, hence fixed costs, hence size. It is high time to start thinking European, instead of national. Let us not fool ourselves: preventing our banks from growing will only make them less profitable and easier prey. We have to avoid a scenario where European G-SIBs would disappear or remain too few, because then we would have partly surrendered our strategic autonomy.[239]

The Agencies regularly note that a combined organization can benefit from the best of each bank on a number of dimensions, including, for example, with respect to managerial resources. Thus, it is logical to conclude that the same should also be true for operational risk management and resilience and technological sophistication in the context of considering the financial stability impact of the merger. Future analysis should consider whether the merged entity will be able to afford and deploy better technology, improving its operational resilience and reducing its probability of failure.

d. Managerial resources

Frequently, acquisitions occur after regulators have determined that the acquired firm has compliance or other problems. In any case, an acquiror may have greater managerial and financial resources, and thus be more capable of not only resolving existing problems but also in identifying strategic opportunities. Therefore, financial stability analysis should include a finding of whether the acquisition would improve managerial resources and thereby reduce the probability of failure.

2. Regulatory consequences of the merger

In banking, larger size comes with a host of more stringent regulations that have the explicit purpose and actual effect of reducing financial stability risk.[240] Those regulations reduce the probability and systemic cost (direct and indirect) of failure. Indeed, in its semiannual financial stability reports, the Federal Reserve has recognized that examination and regulatory efforts by the Federal Reserve and the other agencies have the effect of mitigating "the risks and consequences of financial instability" and explained that "for the largest, most systemically important BHCs, these actions have included requirements for more and higher quality capital, an innovative stress-testing regime, new liquidity regulation, and improvements in the resolvability of such BHCs."

a. *Liquidity requirements*

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[239] "Looking up to achieve a Financing Union," a speech by François Villeroy de Galhau, Governor of the Banque de France, Eurofi – Paris, Feb. 23, 2022, *available at* https://www.banque-france.fr/sites/default/files/medias/documents/looking_up_to_achieve_a_financing_union.pdf.

[240] In issuing its final rules imposing enhanced prudential standards on a tiered basis according to a bank's risk profile, the Board stated that "By establishing categories of standards that increase in stringency based on risk, the framework would ensure that the Board's prudential standards align with the risk profile of large banking organizations, supporting financial stability and promoting safety and soundness," 84 Fed. Reg 59032, 59037 (Nov. 1, 2019), available at: 2019-23662.pdf (govinfo.gov).

Liquidity requirements imposed on larger banks include the liquidity coverage ratio, net stable funding ratio, internal liquidity stress tests, liquidity risk management requirements, liquidity buffers, and resolution liquidity requirements. Those requirements, all adopted since 2010, have dramatically increased the amount of cash and cash equivalents held by large banks and reduced their reliance on short-term and unstable funding. As shown in the Fed's November 2021 Supervision and Regulation Report, liquid assets composed over 27 percent of total assets in the banking sector in the third quarter of 2021.[241]

These large cash holdings come with significant economic costs – namely, reduced loan supply – but substantial financial stability benefits. They reduce the probability of failure, as liquidity is the most frequent cause of failure. They also prevent a bank from having to stop providing liquidity to other financial institutions or liquidate assets at firesale prices if it comes under stress.

The LCR applies to BHCs with at least $250 billion in assets or at least $50 billion in weighted short-term wholesale funding (wSTWF) and becomes more stringent as asset size and wSTWF increase.

Set forth below is a table showing the categories of banks subject to increasingly stringent prudential standards:

Firm Type	Qualifier
Category I	U.S. G-SIBs
Category II	>=$700b total assets or >=$75b in cross-jurisdictional activity
Category III	>=$250b total assets or >=$75b in NBA, wSTWF or off-balance-sheet exposure
Category IV	Other firms with $100b to $250b total assets

The NSFR's requirements apply to BHCs with at least $250 billion in assets or at least $50 billion in weighted short-term wholesale funding and become more stringent as asset size and such funding increase. A modified version of the NSFR rule applies to companies with assets of at least $100 billion, including certain intermediate holding companies formed by foreign banking organizations under FRB's Regulation YY, as well as consolidated subsidiaries that are depository institutions with $10 billion or more in total consolidated assets.

Liquidity stress testing requirements apply to firms with at least $100 billion in assets and become more frequent as asset size or short-term wholesale funding increase. Though the examination process, the Federal Reserve subjects certain firms to its Comprehensive Liquidity Analysis and Review. That program evaluates the liquidity position and liquidity risk-management practices of firms and includes both qualitative and quantitative requirements. Former Fed Chair Janet Yellen testified that "CLAR is designed to ensure that [institutions supervised as part of the Board's Large Institution Supervision Coordinating Committee] have rigorous, forward-looking liquidity stress testing and risk-management practices that account for unique risks, and that the LISCC firms maintain sufficient liquidity to continue to operate through a period of acute stress."[242]

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[241] Federal Reserve Supervision and Regulation Report (Nov. 30, 2022), available at: The Fed - Supervision and Regulation Report - November 2021 (federalreserve.gov).

[242] Statement by Janet L. Yellen, Chair, Board of Governors of the Federal Reserve System, before the Committee on Financial Services, U.S. House of Representatives (November 4, 2015), available at: Statement by Chair Yellen before the Committee on Financial Services, U.S. House of Representatives (federalreserve.gov).

Furthermore, recovery and resolution plans contain triggers, including triggers relating to liquidity, which, when tripped, require the firm's management and board to take specific actions, including the repositioning of resources to improve the liquidity positions of operating subsidiaries. Recovery and resolution plans explicitly impose Resolution Liquidity Adequacy and Positioning and Resolution Liquidity Execution Need requirements designed to equip a firm to measure, monitor and plan for its liquidity needs in a resolution scenario and which, in some instances, may require a firm to increase its liquidity holdings in BAU.

Given the purpose and effect of the LCR, NSFR, CLAR, and liquidity-related resolution requirements, including reporting on form 2052a, the "Complex Institution Liquidity Monitoring Report," which must be provided daily for GSIBs and firms in Categories III and II, any merger that results in greater stringency under any of these regimes results in a lower probability of default. A financial stability assessment in the merger context should note any such changes and their impact.

b. *Capital requirements*

Capital is specifically designed to limit the probability of a bank's failure. Capital requirements grow in stringency along with asset size.[243] Most notably, the capital requirement of banks with over $100 billion in assets includes an additional requirement determined in part through annual stress tests conducted by the Federal Reserve. Banks subject to the tests must have capital sufficient to pass minimum regulatory requirements after a nine-quarter period of severe economic stress. Smaller banks are only subject to the static minimum requirements. In addition, the largest banks are subject to a GSIB surcharge, as noted above.

Furthermore, firms with total assets equal to or greater than $250 billion are subject to capital stress testing requirements annually, whereas firms with total assets equal to or greater than $100 billion and less than $250 billion are only subject to stress tests biennially.[244] Most large banks are also subject to more stringent stress tests that may include a severe global financial market shock.[245] The stringency of the stress tests applied to large banks can increase based on other factors as well.[246]

By the Fed's calculation, an increase in capital alone strongly reduces the probability of failure. For example, the formula used to calculate the GSIB surcharge indicates that a 1.5-percentage-point increase in the effective capital requirement cuts the probability of failure in half.[247]

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[243] *See* Appendix for a detailed description of the GSIB surcharge.

[244] Other factors, including the amount of a firm's nonbank assets, amount of weighted short-term wholesale funding, and off-balance-sheet exposures, could also influence the frequency of supervisory stress testing.

[245] In addition, U.S. GSIBs and banks with more than $700 billion in assets must conduct company-run stress tests annually, whereas firms with total assets equal to or greater than $250 billion and less than $700 billion must conduct company-run stress tests only biennially. The amount of a firm's cross-jurisdictional activity could also cause it to be required to conduct annual company-run stress tests.

[246] In addition to the generally applicable stress test scenarios, the supervisory stress tests applicable to firms with assets equal to or greater than $250 billion that engage in a large amount of trading or custodial activity may include a global market shock add-on component, designed to assess a firm's performance under heightened market distress and uncertainty, or a counterparty default endogenous add-on component, designed to assess a firm's performance in the event of the default of its largest counterparty.

[247] See "Calibrating the GSIB Surcharge," p. 9, https://www.federalreserve.gov/aboutthefed/boardmeetings/gsib-methodology-paper-20150720.pdf.

The GSIB surcharge requirement provides a stark illustration of the extent to which tighter capital requirements can offset increased systemic cost of failure. GSIB surcharges are calibrated so that the probability of failure is lower for GSIBs to offset the increase in the systemic cost of failure.[248] The surcharges are designed so that the expected systemic cost of failure (the probability of failure times the systemic costs of failure) of each GSIB is equal to the expected systemic cost of failure to a reference non-GSIB. As a result, the merger of two GSIBs would cut the expected systemic cost of failure in half.

Thus, any financial stability analysis should include an assessment of the capital requirements imposed on the combined organization in comparison to its predecessors.

c. *Recovery plans*

In addition to *resolution* plans, discussed below, GSIBs are required to prepare *recovery* plans. The Federal Reserve has issued guidance regarding such recovery plans, noting that "the primary goal of such recovery planning is to develop a menu of options that would enable a firm to respond to a wide range of internal and external stresses and maintain the confidence of market participants without extraordinary governmental support."[249] In addition, the OCC generally requires federally chartered banks with more than $250 billion in assets to file recovery plans.[250]

Thus, analysis of any merger that results in the new company qualifying for the first time as a GSIB would need to consider the benefits of recovery plans in reducing probability of failure.

C. EFFECT ON SYSTEMIC COST GIVEN FAILURE

Set forth below are factors that influence the systemic cost given failure, which can change in connection with a merger.

1. Recovery and Resolution Requirements

Title I and Title II of the Dodd-Frank Act are core reforms that ensure that any banking organization can be resolved in an orderly manner. Title I requires any company controlling more than $250 billion in assets to submit a credible resolution plan – also known as a living will, or pre-packaged bankruptcy plan – to ensure that it can be

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[248] *Id*.

[249] The Federal Reserve has issued guidance regarding such recovery plans, noting that "the primary goal of such recovery planning is to develop a menu of options that would enable a firm to respond to a wide range of internal and external stresses and maintain the confidence of market participants without extraordinary governmental support." Federal Reserve Board, SR 14-8: Consolidated Recovery Planning for Certain Large Domestic Bank Holding Companies, Division of Banking Supervision and Regulation SR 14-8 (September 25, 2014), The Fed - Supervisory Letters SR 14-8 on Consolidated Recovery Planning for Certain Large Domestic Bank Holding Companies -- September 25, 2014 (federalreserve.gov). *See also* Federal Reserve Board, SR 14-1: Heightened Supervisory Expectations for Recovery and Resolution Preparedness for Certain Large Bank Holding Companies - Supplemental Guidance on Consolidated Supervision Framework for Large Financial Institutions (January 24, 2014), The Fed - (federalreserve.gov). The Federal Reserve's guidance provides that "a firm is in recovery when it is experiencing or is likely to encounter considerable financial distress but could reasonably return to a position of financial strength if appropriate actions are taken in a timely manner. A firm in recovery has not yet deteriorated to the point where resolution proceedings or bankruptcy are imminent. During this recovery phase, the firm should be working closely with relevant supervisors." SR 14-8.

[250] 12 C.F.R. Part 30, Appendix E.

resolved under the Bankruptcy Code without taxpayer assistance. Title II provides a backup resolution process administered by the FDIC rather than a bankruptcy court.[251] The relevance is indisputable: as the Federal Reserve has explained, "The goal of the Dodd-Frank Act resolution planning process is to help ensure that a covered company's failure would not have serious adverse effects on financial stability in the United States . . . "[252]

Resolution plans are prepared by bank holding companies and subject to detailed review by the Federal Reserve and the FDIC and include contractual terms and liquidity requirements necessary to conduct an orderly sale of all or part of the company. These resolution plans must include details of the firm's ownership, structure, assets, and obligations; information on how the firm's depository subsidiaries are protected from risks posed by its nonbank subsidiaries; and information on the firm's cross-guarantees, counterparties, and processes for determining to whom collateral has been pledged. Resolution plans generally have liquidity triggers that require the firm's board and management to begin taking actions contemplated by the plan well before the firm reaches capital insolvency. Living will requirements are more stringent for larger bank holding companies than smaller bank holding companies: they are required for bank holding companies with more than $250 billion in total consolidated assets and are to be provided at the discretion of the Federal Reserve for banks with assets between $100 billion and $250 billion.[253]

In addition, banks with over $50 billion in assets are also subject to Dodd-Frank's enhanced early remediation tools, which requires the Federal Reserve to establish early remediation triggers based on liquidity measures and forward-looking indicators, rather than backward-looking indicators.

Recovery and resolution requirements are specifically designed to reduce banks' systemic costs of failure. Thus, any merger that takes the resulting company across one of these thresholds – $50 billion, $100 billion, $250 billion – therefore has a significant benefit for financial stability, as the firm must take considerable, tangible steps to ensure that it can be resolved. A final threshold is for firms that register as GSIBs under the Method 1 systemic indicator score. Given the composition of the GSIB methodology, this effectively means exclusively firms with large broker-dealers.

For GSIBs, resolution would proceed using the single-point-of-entry (SPOE) resolution strategy, whether under Title I or Title II. Under the SPOE strategy, all of the losses across a U.S. GSIB would be absorbed by shareholders and creditors of its parent holding company – which would fail and be put into a Chapter 11 bankruptcy. The principal benefit of the SPOE strategy is that it makes it legally and operationally feasible to impose losses on holding company debt holders, allowing material operating subsidiaries to remain open and operating. SPOE was created as a direct response to financial stability concerns that arose from the failure of Lehman and other broker-dealers that relied heavily on short-term funding. This goal is achieved by maintaining, at the holding company level,

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[251] 12 U.S.C. 5383(b).

[252] 84 Fed. Reg. 59194 (Nov. 1, 2019), *available at*: [2019-23967.pdf (govinfo.gov)].

[253] Pursuant to the joint rule adopted by the Federal Reserve and the FDIC in 2019, the agencies adopted tailored standards for living will requirements for firms with more than $100 billion in total assets related to living wills, establishing four categories of firms: Category I: GSIBs would be required to file resolution plans every two years, alternating between full and targeted plans; Categories II and III: Domestic and foreign firms in this category would be required to file resolution plans every three years, alternating between full and targeted plans. And Category IV: Domestic firms in this category, owing to their limited systemic footprint, would not be required to file resolution plans. Foreign firms with $250 billion or more in global assets, including those in this category, that do not fall in any other category would be required to file a reduced resolution plan every three years, reflecting their limited U.S. systemic footprint. *Id*.

substantial liabilities that cannot run in stress, which is referred to as TLAC, or total loss absorbing capital (basically, equity and long-term debt).[254]

Operational feasibility is achieved by minimizing the types of other holding company creditors, thereby avoiding disputes among creditor classes in bankruptcy. Furthermore, first by an inter-dealer protocol and subsequently by regulation, derivatives counterparties of the broker-dealer are prohibited from treating a holding company bankruptcy or receivership as an event of default and exercising their close-out rights.[255]

The long-term debt issued by a GSIB is referred to as "gone-concern" capital, as it effectively converts to equity upon bankruptcy or the commencement of a resolution proceeding. As of the 4th quarter of 2021, the eight U.S. GSIBs held $2.1 trillion in long-term debt pursuant to Federal Reserve regulation.[256] Any analysis of the financial stability effects of a merger that resulted in first-time GSIB status would need to include a quantification of the *pro forma* TLAC requirement for the new firm, and an analysis of the extent to which that requirement reduces systemic cost given failure relative to the predecessor firms.

As noted, the SPOE strategy is designed to avoid or mitigate impediments to an orderly resolution that could potentially arise in the specific context of a GSIB resolution, which generally would include broker-dealer operations in the United States and other countries. By contrast, banking organizations that hold the great majority of their assets in domestic banks and are not engaged in significant capital markets activity do not present similar complications for purposes of resolution. As a result, in the unlikely event of failure, a single resolution framework—the receivership provisions of the FDIA—would apply to the vast majority of the businesses, assets and liabilities of one of these organizations. This centralized resolution means that many of the practical difficulties that present financial stability risk and necessitate an SPOE strategy —such as coordination of multiple completing insolvency proceedings—are simply not present in this context.

D. CHANGE IN THE RISK TO FINANCIAL STABILITY FOR OTHER REASONS

A proposed merger can change the risks to financial stability for reasons other than those associated with the potential failure of the new institution. The consequences discussed here would change the expected systemic cost of failure of *other* institutions, which should be considered in evaluating a proposed merger.

1. Change in the consequences of the failure of other institutions

One of the contributors to the systemic cost of failure of an institution is the extent to which it provides critical services that few or no other institutions provide. For example, only a large international bank can provide the banking services needed by a large U.S. company engaged in global trade, and there are only a few banks with the scale and scope to provide those services. Indeed, the substitutability component of Method 1 looks at the firm's market share in three systemically significant lines of business: payment activity; assets under custody; and underwriting of debt and equity.[257] The presumption is that as a firm's market share in one of those businesses grows, its presence in those markets becomes harder to replace, and thus its systemic risk grows. While that is

[254] The Federal Reserve established long-term debt requirements for the 8 U.S. GSIBs as the greater of 6% of RWAs, plus GSIB surcharge; or 4.5% of total leverage exposure, and TLAC requirements as the greater of 18% of RWAs, plus a buffer of: 2.5% of RWAs, plus Method 1 GSIB surcharge, plus any countercyclical capital buffer; or 7.5% of total leverage exposure, plus a buffer of 2% of total leverage exposure. 82 Fed. Reg. 8266 (Jan. 24, 2017), available at: [bcreg20161215a1.pdf (federalreserve.gov)]

[255] ISDA 2018 Resolution Stay Protocol (Aug. 22. 2018), available at: [ISDA 2018 U.S. Resolution Stay Protocol – International Swaps and Derivatives Association].

[256] Based on the U.S. GSIBs' 4Q2021 10Qs.

[257] https://www.bis.org/bcbs/publ/d296.pdf.

sufficient for purposes of determining whether a given firm is a GSIB, any complete financial stability analysis for purposes of a merger needs to take account of an additional factor: whether the increased size or other changes to a firm post-merger makes it a better substitute for an existing GSIB – that is, whether its presence in those markets – and there may be other markets – reduces the systemic risk presented by *other* firms. Given that the stated purpose of many regional and mid-size bank mergers is exactly to allow them to better compete with the largest banks, this factor seems significant. If a merger were to create an additional bank capable of providing such services, the systemic consequences of the failure of those other institutions would decline.

Thus, any analysis of financial stability needs to take account not only of the systemic risk of the merged entity relative *to* its legacy firms but also whether the new firm better serves as a substitute for other firms that present systemic risk.[258]

2. Consequences for financial stability of prohibiting the merger

There is an extensive literature showing that because of the significant returns to scale in banking, restricting banks' ability to grow through mergers to efficient size will lead to smaller banks taking on excessive risks to compete with more efficient larger banks. When unprofitable banks are forced to compete with more profitable banks, they may do so by taking on more risk. Marcus (1984) finds that banks with valuable growth opportunities choose lower-risk investment strategies to avoid potential loss of charter. Similarly, Sarin and Summers (2016) argue that banks have gotten riskier because regulations have reduced their franchise value (See also Nelson, Covas, Baer, and Newell (2016)). Conversely, Grossman (1992), Keeley (1990), and Hughes, Lang, Moon, Pagano (1997) find that banks with poorer growth opportunities take on higher-risk investment strategies to exploit safety-net subsidies (gambling on success).

A similar concern arises regarding international competition. In a 2011 speech, then-Governor Daniel Tarullo observed:

> An additional concern would arise if some countries made the trade-off [between systemic risk and efficiency] by limiting the size or configuration of their financial firms for systemic risk reasons at the cost of realizing genuine economies of scope or scale, while other countries did not. In this case, firms from the first group of countries might well be at a competitive disadvantage in the provision of certain cross-border activities.[259]

Further, a policy designed to engender a banking system made up of only smaller or medium-sized banks could increase rather than decrease risks to financial stability. Maudos and de Guevara (2011), in "Bank size, market power and financial stability," looking at cross-country and cross-time evidence including over 30,000 observations, conclude that financial stability increases as banks get larger than about $2½ billion in assets.[260] As

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[258] Acting Comptroller Hsu recognized this benefit of certain mergers in a recent speech: Acting Comptroller of the Currency Michael J. Hsu, Remarks Before the Wharton Financial Regulation Conference 2022, "Financial Stability and Large Bank Resolvability" (April 1, 2022) ("prohibiting . . . [large bank] mergers could shield the GSIBs from competition, potentially helping to solidify their dominance in various markets."); available at: Acting Comptroller of the Currency Michael J. Hsu Remarks before the Wharton Financial Regulation Conference 2022 on Financial Stability and Large Bank Resolvability (occ.gov).

[259] Remarks by Federal Reserve Board Governor Daniel K. Tarullo, "Industrial Organization and Systemic Risk: An Agenda for Further Research," At the Conference on the Regulation of Systemic Risk, Federal Reserve Board, Washington, D.C. (September 15, 2011), available at: Speech by Governor Tarullo on industrial organization and systemic risk: an agenda for further research - Federal Reserve Board.

[260] They find that stability also increases as banks get smaller than $2½ billion in assets, but banks that small are likely not relevant for these considerations.

noted above, Mario Draghi pointed to the financial stability benefits in the United States from allowing interstate banking (and therefore larger, more diversified banks) as a reason why the European Union would benefit by allowing European institutions from expanding their operations across the Union.

Thus, the agencies should consider the possible implications of *not* approving a merger.

IV. Conclusion

An accurate analysis of the financial stability effects of a given merger must include both costs and benefits resulting from that merger. The factors driving such an analysis, described above, seem to suggest that in most cases, market and regulatory benefits of the merger – increased diversification, profitability, and regulatory stringency – will offset the systemic costs associated with creating a larger institution and therefore result in no net increase in financial stability risk, and in many cases a decrease.

Such a conclusion would be fully consistent with the approach Congress adopted with respect to financial stability more generally. In the Dodd-Frank Act, Congress did not prohibit the existence of firms that present systemic risk; rather, Section 121 directed the Federal Reserve to “prevent or mitigate risks to the financial stability of the United States that could arise from the material financial distress or failure, or ongoing activities, of large, interconnected financial institutions” by adopting enhanced prudential standards. Similarly, the Basel Committee and the Federal Reserve did not prohibit the existence of GSIBs but rather implemented post-crisis policies and requirements to “reduce the probability of failure of G-SIBs by increasing their going-concern loss absorbency; and reduce the extent or impact of failure of G-SIBs, by improving global recovery and resolution frameworks.[261]

Lastly, it is worth noting that when Congress adopted the financial stability factor in the Dodd-Frank Act in 2010, it did so years before the Basel Committee on Banking Supervision adopted a framework for a GSIB surcharge, and before such a framework was published in the United States.[262] Similarly, the concept of stress testing to calculate a capital buffer, which is now the core component of the Federal Reserve’s capital regime applicable to the 34 largest banks, was not a consideration in 2010. While Dodd-Frank did include a general requirement for other enhanced prudential standards, those standards took years to develop. Thus, a finding that current regulation and market developments (central clearing of derivatives) are sufficient to offset any financial stability risk arising from a merger would not be a surprise and would reflect adherence to the goals of the statute, not repudiation.

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[261] Basel Committee on Banking Supervision, “Global systemically important banks: assessment methodology and the additional loss absorbency requirement” (Nov. 2011), available at: [Global systemically important banks: assessment methodology and the additional loss absorbency requirement - Rules text (bis.org)](https://www.bis.org).

[262] https://www.bis.org/publ/bcbs207.htm; https://www.govinfo.gov/content/pkg/FR-2015-08-14/pdf/2015-18702.pdf.

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Appendix 3

Estimates of the Effects of the Imposition of TLAC Requirements on Institutions with Large IDIs on Lending Rates

To estimate the costs of TLAC on banks' cost of funding and loan rates, we assume institutions with large IDIs will be subject to the TLAC and LTD requirements as they currently apply to U.S. GSIBs, with two adjustments. First, GSIB-related buffers are set to zero. These include the buffers that sit on top of the requirements based on total leverage exposure. Second, for institutions not subject to the supplementary leverage ratio, total leverage exposure is replaced with total assets. In this instance, we set the requirement at 1 percentage point higher, since total assets do not include off-balance-sheet exposures.

Table 1: Assumed TLAC and Long-Term Debt (LTD) Requirements (%)

		Risk-Weighted Assets (RWA)	Total Leverage Exposure/Total Assets (as applicable) (TLE)
TLAC	Minimum + CCB Buffer	20.5	7.5/8.5
LTD	Minimum	6	4.5/5.5

Table 1 summarizes the TLAC and LTD requirements used in the analysis.[263] There are four requirements, with two ratios calculated with respect to banks' risk-weighted assets, and two other ratios based on banks' total leverage exposure.[264] The TLAC RWA-requirement is set at 20.5 percent, the LTD-RWA requirement equals 6 percent. The TLE-based requirements are 7.5 percent and 4.5 percent for TLAC and LTD, respectively.

The first step of the analysis estimates the TLAC and LTD shortfalls based on the requirements listed on Table 1. Our sample includes all institutions with large IDIs in Categories II through IV for which we were able to find senior unsecured debt outstanding in Bloomberg (17 of 28 banks). The baseline analysis uses senior unsecured debt issued only by the parent company. We also report the results assuming senior unsecured debt amounts issued by its subsidiary bank are also TLAC-eligible. In both cases, the definition of TLAC-eligible liabilities excludes long-term debt amounts maturing in 2022 and 2023.

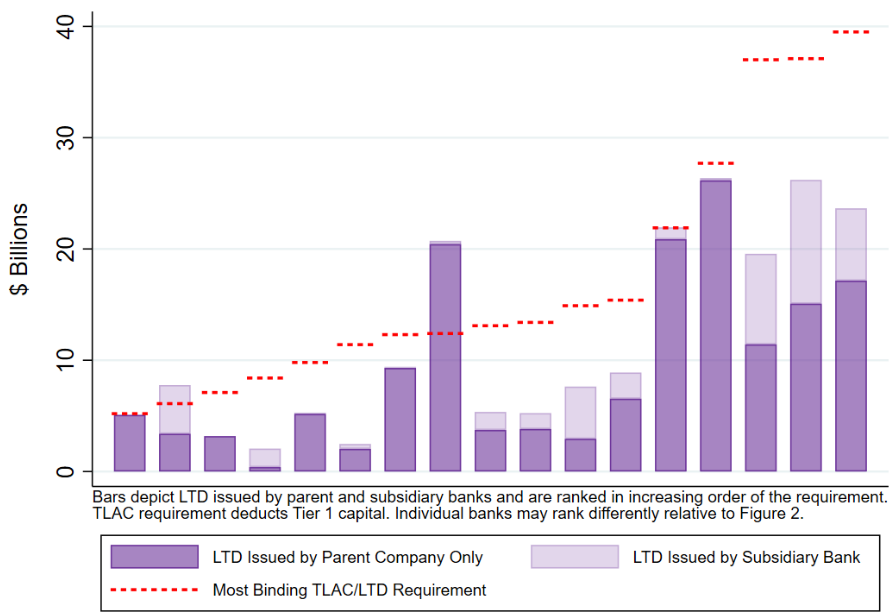
TLAC shortfall amounts are reported in Figure 1. For each institution, we estimate two shortfall amounts, one assuming only the LTD issued by the parent company is TLAC-eligible and the

263 TLAC consists of Tier 1 capital other than minority interests and the unpaid principal of eligible debt securities, adjusted for a 100 percent haircut for amounts due to be paid within 1 year. LTD represents the unpaid principal of eligible debt securities, adjusted for a 100 percent haircut for amounts due to be paid within 1 year and 50 percent haircut for amounts due to be paid between year 1 and year 2.

264 When total leverage exposure amounts are not available because the firm is not subject to the supplementary leverage ratio requirement (i.e., Category IV bank), we use total assets instead and increase the requirement by 1 percentage point.

other including the LTD issued by both the parent company and its subsidiary bank. The shortfalls are calculated as the minimum amount of additional LTD necessary to meet each of the four requirements listed in Table 1. The TLAC-RWA requirement is the most likely to bind across all banks in our sample, followed by the LTD-TLE requirement.

Figure 4: Bank-Specific Shortfalls



Source: Bloomberg, Federal Reserve Board, BPI staff calculations.

The aggregate TLAC shortfall across all banks in our sample is $94.2 billion assuming all TLAC-eligible LTD issued by the parent company and its subsidiaries is available to meet the TLAC and LTD requirements. The average (median) shortfall is $5.5 billion and ranges between a shortfall of 0 and a shortfall of $15.9 billion. The aggregate shortfall increases by 50% to $143.9 billion when only the LTD issued by the parent company is TLAC-eligible. The average (median) shortfall increases to $8.5 billion and ranges from a shortfall of 0 to a shortfall of $25.5 billion.

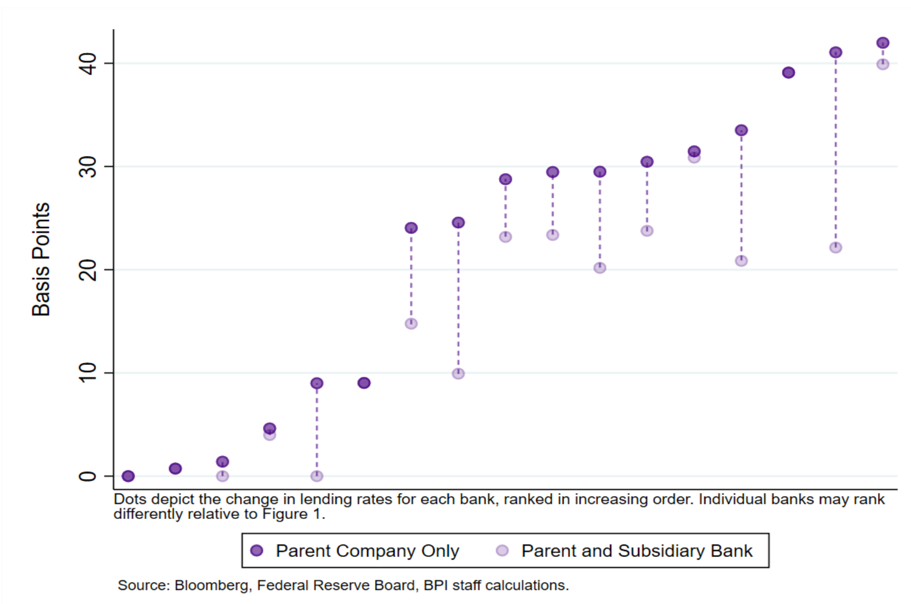
The differences in bank-specific TLAC shortfalls between the two possibilities considered in Figure 1 are significant. In practice, for the LTD issued by a bank subsidiary to be considered TLAC-eligible, the institution would have to convert the bank-level debt to parent-level debt. The costs of the conversion would likely be significant because the parent companies typically have lower credit ratings than their subsidiary banks.

Overcoming these shortfalls to meet TLAC requirements would result in higher funding costs for institutions because, as noted above, they would have to issue more expensive TLAC-eligible liabilities in lieu of cheaper sources of funding like retail deposits. To estimate the cost of meeting the TLAC requirements, the analysis assumes banks would fill their bank-specific shortfalls by issuing unsecured LTD. The additional TLAC-eligible liabilities would replace each bank's current liabilities on a pro-rata basis.

We proxy the cost of TLAC-eligible securities with the weighted average z-spread[265] of each senior unsecured bond plus the yield of government bonds with the same maturity. We set the cost of the liabilities being replaced as equal to each bank's average funding costs as of the fourth quarter of 2021. Under these assumptions, and when the shortfall is measured using LTD held by the parent company only, the cost of complying with the TLAC requirements would average 5 percent of net interest income across all banks in our sample and reach a maximum cost of 11 percent.

We further evaluate the overall costs of TLAC by estimating how the increase in institutions' cost of funding would affect lending rates. The analysis assumes lending rates would increase to offset the rise in interest expenses. This is a similar assumption to the one used in prior studies conducted by the BCBS.[266] The main determinants of the size of the increase in lending rates are the size of the bank-specific TLAC shortfall and the share of interest income on loans in total interest income.

Figure 5: Estimated Impact on Lending Rates



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265 The z-spread measures the difference between the bond yield and the yield of a risk-free bond with the same maturity.

266 *See* Basel Committee on Banking Supervision, *An assessment of the long-term economic impact of stronger capital and liquidity requirements* (Aug. 2010), *available at* https://www.bis.org/publ/bcbs173.pdf; Basel Committee on Banking Supervision, *TLAC Quantitative Impact Study Report* (Nov. 2015), *available at* https://www.bis.org/bcbs/publ/d341.pdf.

Figure 2 shows the estimated effect on lending rates across all banks in our sample. When only the LTD issued by the parent company is TLAC-eligible, our results show a median increase in loan rates of 29 basis points. For a few banks, we estimate the increase in lending rates is at or above 40 basis points. When all LTD issued by the parent company and the subsidiary bank is TLAC-eligible, the median increase in lending rates is still about 20 basis points. Notably, the estimated increase in lending rates is significantly higher than the increase to lending rates estimated by the BCBS as a result of the introduction of TLAC requirements for GSIBs. For instance, in 2015, the BCBS estimated that the median increase in lending rates varied between 5 and 10 basis points, which is significantly lower than the estimates shown in Figure 2. This is because the banks in our sample are mainly deposit-funded, and the cost of replacing deposits with LTD is more costly relative to the replacement costs faced by the GSIBs in the BCBS study that were already more likely to be using wholesale funding when TLAC was adopted.