

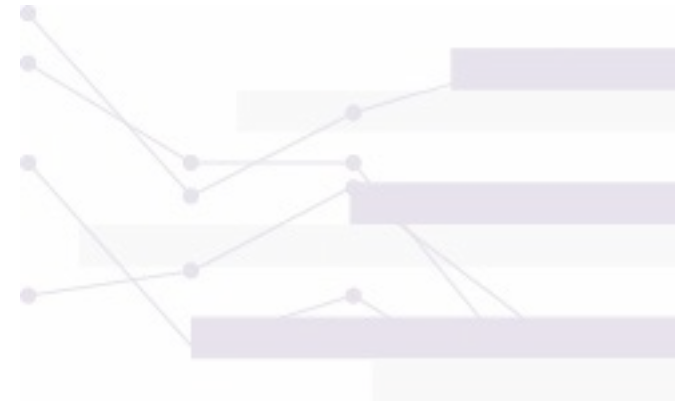
In Response to the FDIC's RFI on Bank M&A Transactions

August 10, 2022

Overview

- These slides have been prepared for presentation purposes only. Please refer to the BPI/CBA/MBCA comment letter to the FDIC (dated May 31, 2022), for a more complete and detailed explanation of the points addressed herein as well as other key considerations.

- Topics to be addressed:
 - Introduction/Overview
 - Empirical Analysis (slides 3-10)
 - Systemic Risk Considerations (slides 11-15)
 - Role of the CFPB
 - SPOE/TLAC for Non-GSIB Banks (slides 16-22)



Comments on the Empirical Analysis Included in the FDIC RFI

The number of large banks has been stable since the mid-2000s

- The empirical analysis in the FDIC RFI 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.

Table 1. Number of Insured Depository Institutions by Asset Size

Asset Size (2020 dollars)	Year		
	1990	2005	2020
<\$10B	14819	8724	4899
\$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.

Notes: The size of banks is measured using total assets, expressed in 2020 dollars.

The share of assets and deposits of large regional banks has also been about the same over the past 15 years

- 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.
- After adjusting for economic growth and inflation, the percentage of assets and deposits held by large regional banks remained roughly unchanged between 2005 and 2020.
- Table 2 shows an increase in the share of assets and deposits held by banks above \$100 billion in assets driven by banks owned by the eight U.S. GSIBs (e.g., GS and MS became holdings companies in 2009).

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.

Note: The size of banks is measured using total assets, expressed in 2020 dollars.

Resiliency of large regional banks increased significantly since 2005

- In the aftermath of the 2008 financial crisis, the U.S. regulatory agencies introduced more stringent capital and liquidity standards on large banks which has reduced the probability of failure of large regional banks by a significant amount.
- As shown in Table 4, the common equity tier 1 capital ratio of large regional banks rose nearly 4½ percentage points between 2005 and 2020.
- As shown in Table 5, the ratio of high-quality liquid assets to assets for large regional banks more than doubled from 10 percent in 2005 to 23.3 percent in 2020.

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.

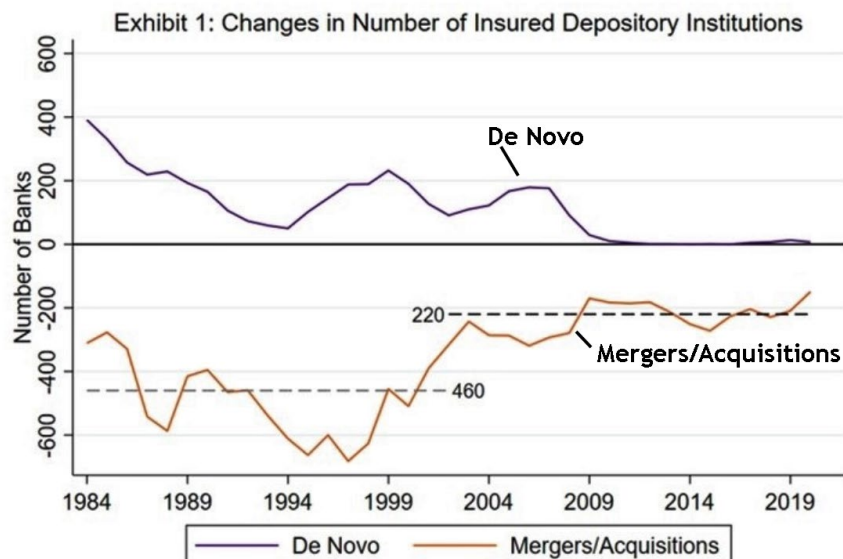
Table 5. Ratio of Liquid Assets to Total Assets of Insured Depository Institutions by Asset Size

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

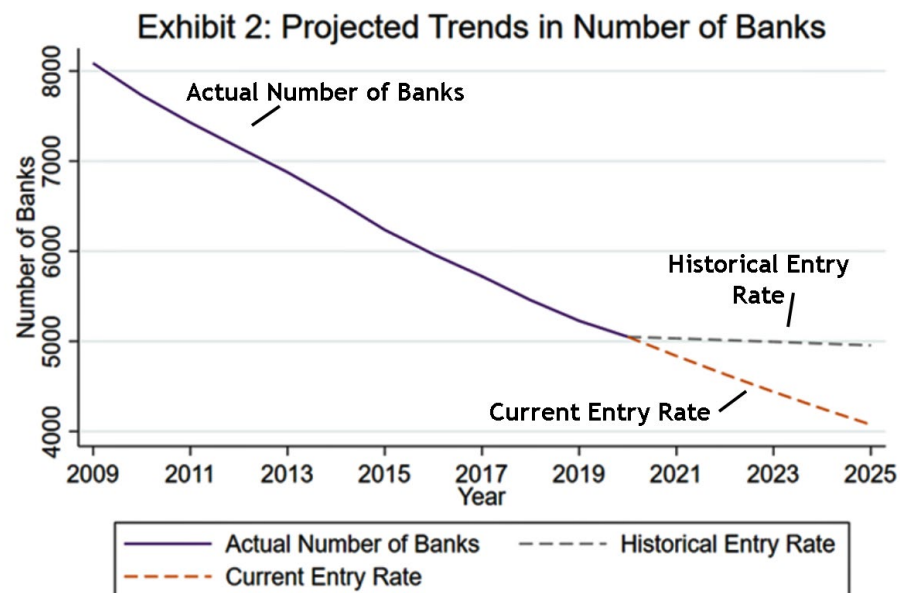
Source: S&P Global Market Intelligence.

The role of bank mergers in explaining the decline in the number of small banks has diminished over time

- The empirical analysis in the RFI assumes that a decrease in the number of small banks is attributable to mergers.
- The empirical analysis in BPI's research note shows that the collapse of entry into commercial banking explains approximately 60 percent of the decline in the number of banks post-2010 (Exhibit 1).
- 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 the 2012-2020 averages (Exhibit 2)



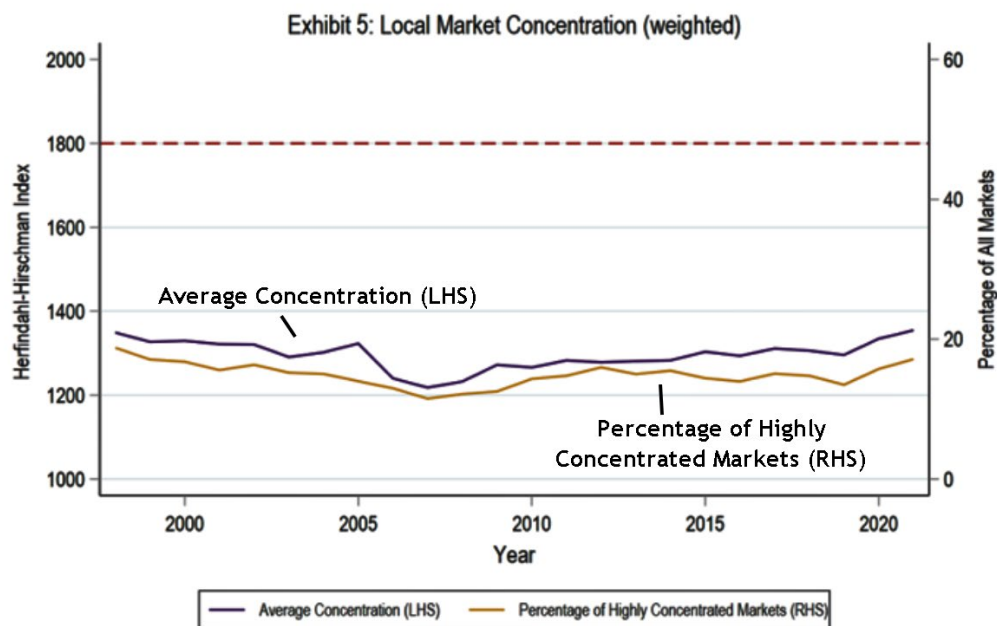
Source: Federal Deposit Insurance Corporation.



Source: S&P Global Market Intelligence, BPI Staff Calculations.

Local banking markets are no less competitive today versus decades ago

- Concentration levels of local banking markets have not materially changed on average over at least the past 24 years—weighted average concentration indicates a highly competitive banking environment overall
- In general, banking mergers and acquisitions have promoted economies of scale, geographic diversification, and other efficiencies while not adversely affecting competition

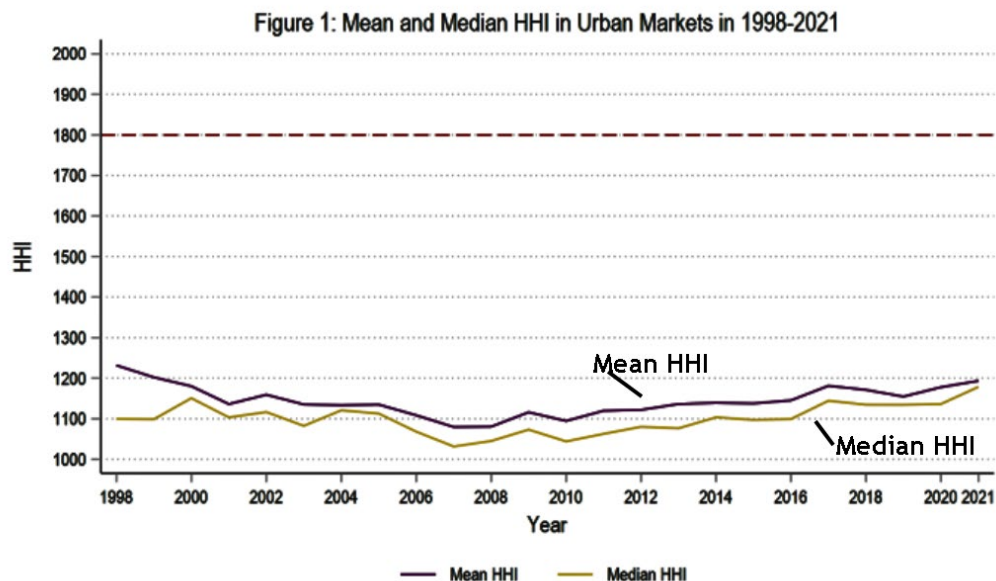


Source: S&P Global Market Intelligence.

Note: Under DOJ guidelines, a banking market with an HHI greater than 1800 is considered highly concentrated.

A deep dive into urban banking markets reveals that mergers have not harmed competition

- Among urban markets with HHI > 1800, we find just three cases where high concentration was attributable to a past merger.
- Assessments of banking market competition by the Department of Justice and the federal banking agencies are conservative, along several dimensions including:
 - Narrow delineation of some geographic banking markets
 - Limited consideration of competition from nonbank financial firms
 - How deposits at local branches are used for quantifying market shares



Bank mergers have not harmed financial inclusion

- Customers retain convenient access to branches.

Table 2: Branch Accessibility – 2013 versus 2020

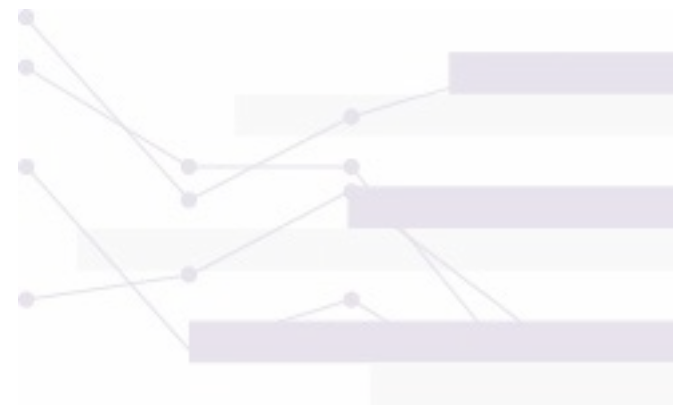
Year	Branches Per 10,000 People		Average Distance to Nearest Branch	
	Urban	Rural	Urban	Rural
Jun-20	2.2	3.2	1.5	4.4
Jun-13	2.5	3.4	1.5	4.5

[For further information please see: Do Bank Mergers Create “Banking Deserts”? The Evidence Indicates No. - Bank Policy Institute \(bpi.com\)](#)

Table 5: Change in Unbanked Share versus Change in Branch Density
Urban areas

Change in branch density	Range across survey CBSAs		Unbanked share		Change in unbanked	Number of survey CBSAs	Number of survey observations		2013 branch density		2020 branch density	
	min	max	2013	2020			2013	2020	median	mean	median	mean
Decrease	-1.34	-0.30	0.076	0.051	-0.025	184	20,992	17,126	2.83	2.88	2.31	2.34
Little change	-0.30	0.23	0.079	0.056	-0.023	67	7,924	6,543	2.34	2.42	2.07	2.23

[For further information please see: Obstacles to Household Financial Inclusion: Do Branch Accessibility and Bank Size Matter? - Bank Policy Institute \(bpi.com\)](#)



Financial Stability Considerations for Bank Merger Analysis

Financial stability considerations for bank merger analysis

- Any review of the change in potential systemic risk consequences of a merger needs to be comprehensive.
- - See Baer, Paridon and Nelson “Financial Stability Considerations for Bank Merger Analysis,” (May 16, 2022) (Appendix 2 of the May 31st comment letter) and Nelson “How to Measure the Change in Financial Stability Risk Resulting from a Merger: Some Technical Considerations” (May 24, 2002) for details.
- In general, there will be consequences that could increase systemic risk and consequences that could decrease it.

Systemic consequences of the potential failure of the merged entity

- Some of the consequences for systemic risk relate to the potential failure of the merged entity.
- The change in systemic risk caused by a potential merger can be estimated in part by comparing the expected systemic costs of the merged entity to the sum of the expected systemic costs of the two merging entities.
 - Just as the expected loss on a loan is the probability of default times the loss given default, the expected systemic costs of the failure is the probability of failure times the systemic costs given failure.
- The systemic cost index is a reasonable starting point for considering the systemic costs given failure. Caveats
 - Scores have risen over time owing simply to economic growth and inflation.
 - Some regulations that may become more stringent for a larger entity can reduce systemic costs given failure, such as more stringent liquidity requirements.
 - Rejecting proposed mergers for which the systemic cost index exceeds a threshold is inappropriate in part because it is blind to change in the probability of default.

Systemic consequences of the potential failure of the merged entity (continued)

- But the systemic cost index tells you nothing about the other half of the calculation – the probability of failure. Typically, the probability of failure will go down as the result of a merger.
 - Increased regulatory and examination stringency. In banking, larger size comes with a host of more stringent regulations, especially but not only capital regulations, designed in large part to reduce the probability of failure.
 - Diversification. Mergers generally bring greater diversification in terms of product offerings and geographic footprint, which reduces a firm's exposure to any one industry or region. See Hughes, Mester, and Moon (2001) and Goetz, Laevan, and Levin (2016).
 - Returns to scale. Banks' first line of defense against losses is profits, and there are considerable returns to scale in the banking industry. 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 and Serletis (2010).
 - Technological 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.

Systemic consequences unrelated to the failure of the merged entity

- There are also consequences for systemic risk unrelated to the failure of the institution, for example
 - The merger may increase the substitutability of other institutions by creating a viable replacement.
 - A policy of preventing banks from benefiting from returns to scale could result in uncompetitive banks that increase risk-taking to boost profitability. See Marcus (1984); Sarin and Summers (2016); Grossman (1992); Keeley (1990); and Hughes, Lang, Moon, and Pagano (1997).



Considerations Relating to SPOE/TLAC for Non- GSIB Banks

The costs of imposing GSIB-like resolvability requirements on large IDIs would not be consistent with Congress’s explicit tailoring regime* and would not be offset by any benefits

The GSIB resolvability framework, in particular the single-point-of-entry (SPOE) resolution strategy supported by a Total Loss-Absorbing Capacity (TLAC) requirement, was **built specifically for GSIBs** to address the unique challenges and risks that would arise if one failed. Imposing GSIB-specific resolvability requirements on large non-GSIB institutions**—which have different structures and do not present the same financial stability issues—is unwarranted and would be unnecessarily costly.

- The GSIB resolution framework, including the international TLAC standard, was **designed to address GSIB-specific resolution challenges**, including multiple large subsidiaries across multiple jurisdictions.
- In the absence of these GSIB-specific challenges, extending SPOE and TLAC requirements to large institutions **would be disproportionate and not meaningfully enhance financial stability**.
- Implementing an SPOE and TLAC requirement for large institutions would impose **significant costs and disadvantages**.

**See The Economic Growth, Regulatory Relief, and Consumer Protection Act, S. 2155, 115th Cong. (2017) (revising, among other things, 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)*

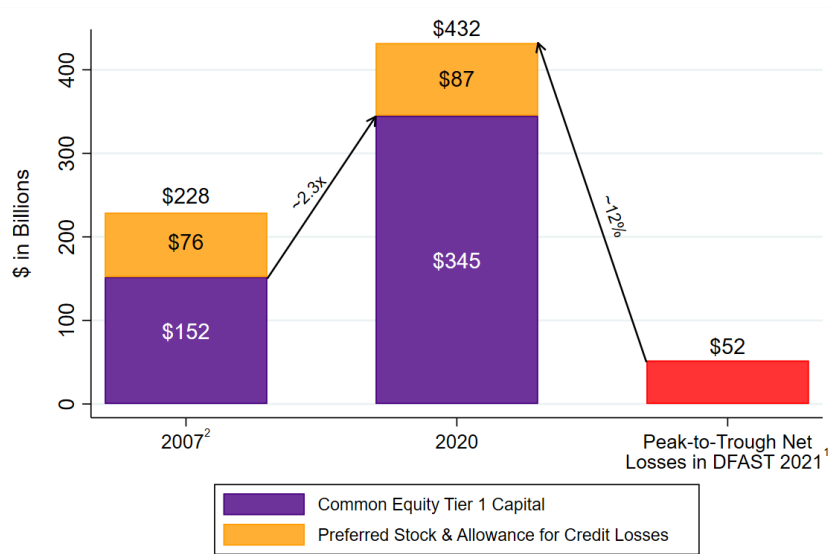
***Note: The term “large” in this presentation generally follows the RFI and refers to all institutions with at least \$100 billion in assets that are not GSIBs.*

SPOE and TLAC address GSIB-specific resolution challenges

GSIB Challenge	GSIB Solution	Basic Large Institution Difference
<p>Coordinate the resolution of the insured bank under the FDIA and the non-bank affiliates under multiple insolvency regimes</p> <ul style="list-style-type: none"> Systemically important nonbank affiliates, like large broker-dealer operations Systemically important operations in multiple jurisdictions, and officials in those jurisdictions may not always cooperate with each other 	<p>SPOE enables only the top tier holding company to enter resolution proceedings</p>	<p>Vast majority (typically over 90%) of activities and assets typically conducted and held in a single U.S. IDI subsidiary</p> <ul style="list-style-type: none"> Primary bank subsidiary accounts for more than 97% of the assets of each of the top three large regional banking institutions (U.S. Bancorp, Truist Financial Corporation, and The PNC Financial Services Group).
<p>Continue multiple critical operations spanning legal entities and jurisdictions without disruption through resolution in order to preserve financial stability and maintain franchise value</p>	<p>TLAC essentially pre-funds the resolution entity to allow critical operations across legal entities and jurisdictions to continue without disruption through resolution</p>	<p>No systemically important nonbank entities or critical operations beyond deposit book, such as securities broker-dealers or systemic payment operations, that would need to continue as going concerns for financial stability purposes</p> <p>More generally, large institutions do not pose systemic risk comparable to that of GSIBs (see next slide)</p>

The probability of large institution failure is low

- Myriad post-crisis reforms have **significantly reduced the risk of failure** in the last decade.
- Graph below 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.



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

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

The assumption that large regional banks could only be resolved through acquisition by a GSIB (or other larger bank) is unfounded

- Resolution plans often contemplate either
 - Sale of the bank to another institution
 - **Separation** of parts of the bank's business and sales of those parts to **multiple buyers**

- Separation option is **viable** because
 - Assets and activities concentrated in the primary IDI, with no significant interconnections across multiple legal entities
 - Given nearly all assets/liabilities concentrated in the IDI, **FDIC receivership powers apply to the overwhelming majority of operations and contractual relationships**
 - There would be **geographies or asset packages** that could be purchased by multiple buyers
 - Existing separability requirements require large banks to **identify discrete "objects of sale" or "franchise components"** as needed to allow the FDIC to dispose of various components in different ways
 - Resolution plans provide FDIC with **information necessary to execute this or any other strategy**

The costs of a GSIB-like resolvability framework are significant and unwarranted

- Would shift a portion of large banks' funding mix from low-cost deposits to higher-cost borrowing, which would **increase borrowing costs** for businesses and customers by as much as 40 basis points.
 - Harm borrowers
 - Drive borrowers to less- or un-regulated lenders.
- Would shift a portion of banks' funding from a stable source to a market-dependent source, which is **inconsistent with safety and soundness considerations**
- Would **increase procyclicality** by forcing institutions to issue debt during financial downturns, at the same time bond spreads are widening
- The SPOE structure imposes higher liquidity requirements, which may make sense when a central source of liquidity is deemed necessary so that it is available if any one of several subsidiaries requires it, but not for large regional banks

An aerial photograph of a city skyline, featuring several tall skyscrapers. A large, semi-transparent purple rectangle is overlaid on the top half of the image, containing contact information for the Bank Policy Institute. The sky is blue with scattered white clouds.

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