Fact Sheet: The Review Process for Bank Mergers and Acquisitions Is Seriously Deficient, Allows Too-Big-to-Fail to Proliferate, and Fails to Protect Consumers

February 10, 2023

Introduction

The dramatic increase in the largest, too-big-to-fail ("TBTF") banks over the last two decades should be a concern to everyone given the catastrophic threat they pose to the financial system and economy as well as to the livelihoods and standard of living of every American. That threat became a reality in the 2008 financial crisis ("2008 Crash"), causing a $20 trillion impact to the economy through the massive number of lost jobs and homes and in far too many cases the evaporation of a lifetime of personal savings.

That continuing threat is why TBTF banks on the brink of collapse and catastrophe are bailed out by policymakers, rather than allowed to fail and go bankrupt like nearly every other company in America. This special carve out from the most basic rules of capitalism not only creates indefensible moral hazard but allows those banks to shift the costs of their unwise, negligent, reckless, or illegal conduct to the public. It is the worst example of privatizing gains and socializing losses.

Additionally, the creation of ever-bigger banks can lead to a reduction in the availability of consumer banking products and services, increased costs associated with products and services,[1] or even a lack of access altogether when bank branches are closed. For those with insufficient access to banking services, there is increased use of alternative and costly financial services such as check cashing or payday loans. Additionally, the size of[2] and access to small business loans decline with a greater share of banking system assets held by larger banks, making it more difficult to open or sustain successful small businesses that can lead to increased employment and higher incomes for community residents.

The current process utilized by the banking regulatory agencies ("Agencies")—Federal Reserve ("Fed"), Office of the Comptroller of the Currency ("OCC"), and Federal Deposit Insurance Corporation ("FDIC")— to review applications by banks that want to acquire or merge with another bank ("merger review process") is grossly insufficient. It has allowed the TBTF problem to proliferate and become larger and harder to solve. The Agencies must update their merger review process to more fully account for the risks to financial stability and the potential harm to consumers. Otherwise, this trend of increasing and basically unchecked consolidation within the banking system will continue, increasing the threat to our financial system and further harming consumers.

A Long History of Bank Mergers and Acquisitions Supported by An Insufficient Merger Review Process Has Led to Immense Consolidation and Increasing Risks within Our Banking System

An insufficient merger review process, combined with other factors such as changes in laws and economic events, has contributed to massive consolidation in the banking industry over the last three-and-a-half decades. Since the mid-1980s, the number of commercial banks has declined by roughly 70 percent. The pace of mergers increased substantially after Congress passed a law in 1994 that codified the right to interstate banking at a national level.[3]

---

[1] *See* Vitaly M. Bord (2018). Working Paper. "Bank Consolidation and Financial Inclusion: The Adverse Effects of Bank Mergers on Depositors [Job Market Paper]". Harvard University. https://scholar.harvard.edu/files/vbord/files/vbord_-_bank_consolidation_and_financial_inclusion_full.pdf.

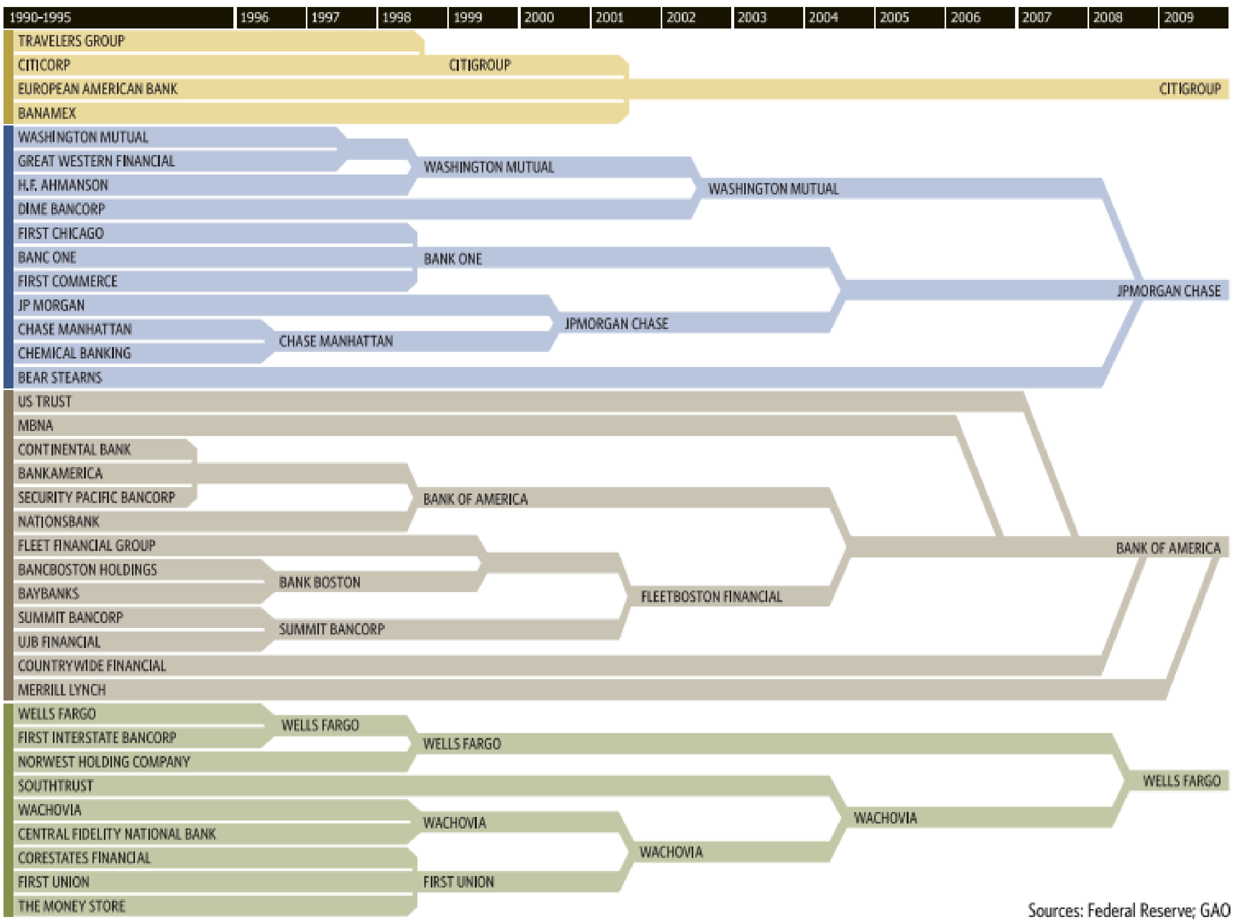
[2] An examination of national data from the Federal Financial Institutions Examination Council on assessments related to the Community Reinvestment Act shows that the average small business loan size decreases significantly across bank groupings of increasing size.

[3] The Riegle-Neal Interstate Banking and Branching Efficiency Act, 12 USC § 1811.

For example, about 30 banks had consolidated into just four gigantic, too-big-to-fail banks by the time of the 2008 Crash. The 2008 Crash then resulted in government-brokered takeovers of large, failing Wall Street banks by already TBTF banks.[4]

There has also been a consolidation of banking and other financial activities. In 1999, the Gramm-Leach-Bliley Act repealed the portion of the Glass-Steagall Act of 1933 that required the separation of commercial banking, investment banking, and insurance, setting off mega-mergers between these three types of companies, greatly exacerbating the TBTF problem, and creating a too-big-and-too-complex-to-manage problem.[5]

1990- 2009 HISTORY OF CONSOLIDATION FOR CITIGROUP, JP MORGAN CHASE, BANK OF AMERICA, AND WELLS FARGO



The consolidation both in number of banks and in products and services has dramatically changed the landscape of the U.S. banking industry, reducing competition, concentrating risks, and increasing financial stability concerns. Currently, the very largest banks control the U.S. banking system:

[4] Bank of America acquired Merrill Lynch and Countrywide Financial; JPMorgan Chase acquired Bear Stearns and Washington Mutual; Wells Fargo acquired Wachovia.

[5] *See* Better Markets Fact Sheet, *Glass-Steagall Financial Reform Law and Efforts to Reinstate It* (July 29, 2015), https://bettermarkets.com/sites/default/files/Better%20Markets%20Fact%20Sheet%20on%20Glass-Steagall%20_0.pdf.

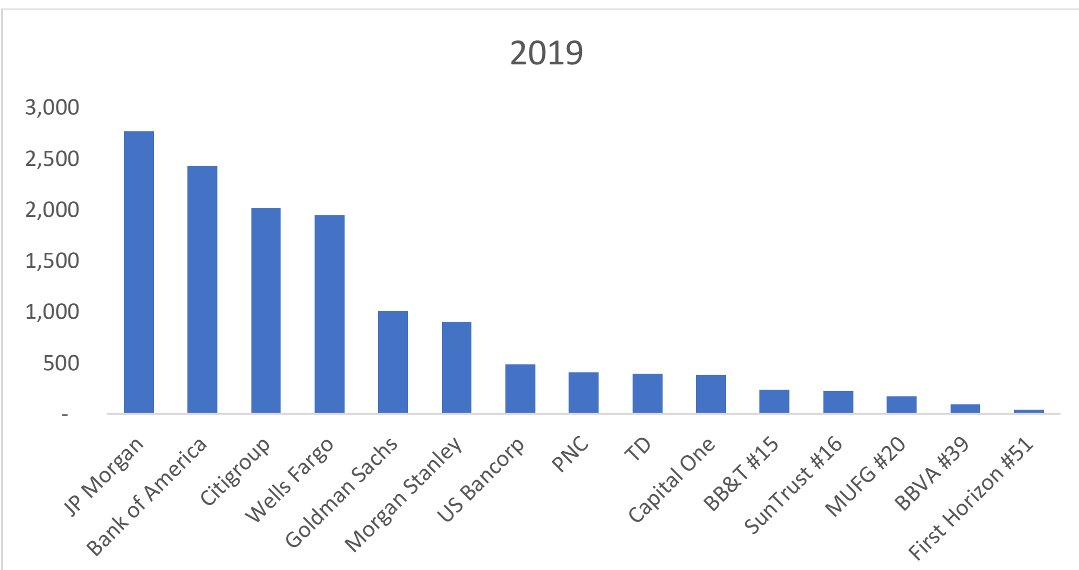
- The top four banks hold about half of all assets in the banking system.
- The top ten banks hold almost half of all deposits and loans.
- JPMorgan Chase, Goldman Sachs, Bank of America, and Citigroup hold about 90% of the total notional amount of all derivatives contracts held by U.S. banks.

And the pace of mergers has not slowed. In fact, there is an ongoing race to create ever-bigger banks. Indeed, in just the last three years the three largest resulting bank mergers since the 2008 global financial crisis were approved by the Federal Reserve and the Office of the Comptroller of the Currency ("OCC"). BB&T and SunTrust banks merged in 2019 to become what is now the tenth largest BHC, creating "Truist Financial", with $548 billion in assets. PNC Bank closed its acquisition of the US operations of BBVA in 2021 and is now the ninth largest BHC with $560 billion in assets. And this past October (2022), the acquisition of MUFG Union Bank by U.S. Bancorp was approved to make U.S. Bancorp the seventh largest BHC with $600 billion in assets.

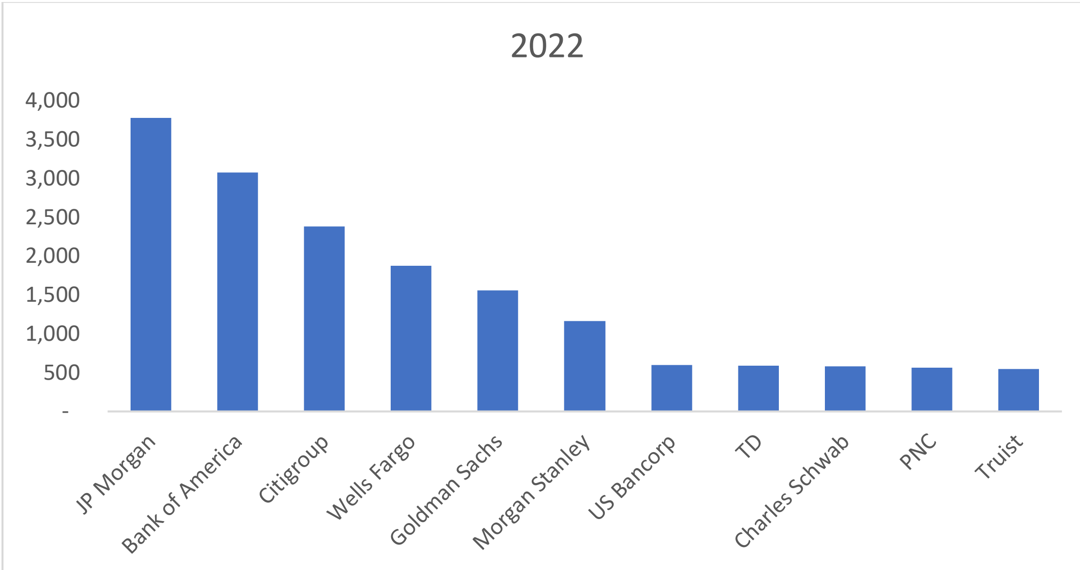
Additionally, TD Group US Holdings ("TD Bank") has applied to acquire First Horizon Corporation, which would create the eighth largest bank with around $610 billion in assets.[6] TD Bank has also announced that it is planning to acquire Cowen Inc., an investment bank, which will increase its asset footprint by about another $9 billion.

The figures below illustrate the scale of the post-merger consolidation for these banks. The first figure shows the ranking of these banks by total assets in 2019, before any of the mergers were completed. The second figure shows the ranking of the banks assuming all mergers have been completed, including TD Bank.

BANK HOLDING COMPANIES AS RANKED BY TOTAL ASSETS ($B)
(2022 RANKING ASSUMES ALL MERGERS COMPLETED)



[6] Financial information for current total assets was obtained from the Federal Financial Institution Examination Council's webpage for the National Information Center, "Large Holding Companies," https://www.ffiec.gov/npw/Institution/TopHoldings.



Assuming the TD Bank acquisition of Cowen closes, it will join the other recent megabanks, Truist, PNC, and U.S. Bancorp, in also having substantial capital markets operations. Clearly, these banks are becoming not only much larger but also significantly more complex and interconnected throughout the financial system while engaging in more potentially high-risk activities.

The figures also show just how much the largest banks have grown over a three-year period. Total cumulative assets of the top ten banks grew by nearly $3.5 trillion over that period. Not shown in the figures is how much asset concentration there has been among the very largest banks. Total assets for the five largest banks has grown to over $12 trillion—nearly 4.5 times larger than the assets of all 4,300+ community banks combined—from about $3 trillion twenty years ago.[7]

The Current Merger Review Process is Grossly Deficient

The merger review process involves the consideration of four main factors:

1. anticompetitive effects,
2. financial stability risks,
3. effect on the public interest/ convenience and needs of communities served, and
4. the financial condition and management effectiveness at the merging companies.[8]

As currently designed and implemented, the merger review process ostensibly prioritizes the factor of anticompetitive effects. This seems to be in-line with the implied—but certainly not required— prioritization within the applicable laws, the Bank Holding Company Act and the Bank Merger Act. These laws are specific that a merger should not be approved if it could lead to a monopoly or if it would substantially lessen competition.

However, the laws also grant the agencies substantial discretion as to how to include the non-competition factors (financial stability, community needs, and financial and managerial resources), directing the agencies to "consider"

[7] *See* Remarks by Acting Comptroller Michael J. Hsu, Office of the Comptroller of the Currency, Detecting, Preventing, and Addressing Too Big To Manage (Jan. 17, 2023), https://occ.gov/news-issuances/speeches/2023/pub-speech-2023-7.pdf.
[8] *See* 12 U.S.C. § 1828(C).

them in the review process. This discretion allows the agencies to elevate the non-competition factors to an appropriate role in the merger review process and apply stricter scrutiny to these factors that is well beyond the current merger assessment process.

For community needs, the current merger review process relies heavily on the outcomes of the Community Reinvestment Act ("CRA")-related assessments of the merging entities. This can be seen clearly within the approval documents of recent larger mergers. In the orders approving the SunTrust/ BB&T merger and the PNC/ BBVA merger, the Federal Reserve noted that it "places particular emphasis on the records of the relevant depository institutions under the CRA." This reliance has been shown to be similar for all three federal banking agencies.

Such reliance can be particularly problematic, with one of the largest issues being that CRA assessments are point-in-time and conducted periodically with data from the years prior to the assessment. Therefore, the conclusions from the CRA examination being used in the merger assessment could be out of date. Furthermore, relying on the latest CRA examination conclusions provides no consideration of how performance of the merged institution could be in the future. That is, two separate institutions may indeed be performing well in serving the needs of communities at the time of the merger assessment, but that is no guarantee that they will or plan to continue to do so. Indeed, as a motivation for a merger is often to reduce costs and eliminate so-called "redundancies", a merger may well lead to a net reduction in services across the areas served by the two organizations prior to the merger.

To compensate for this in some merger reviews, especially larger mergers, the review process includes a request for comments from the public as well as a review of and response to those comments. However, soliciting public comments is not a substitute for an up-to-date CRA examination, especially since the review and assessment of comments relies – seemingly, in large part, from the approval orders – on responses from the banks themselves and a thinly-supported, subjective assessment by the agencies. In particular, more must be done with regard to assessing the convenience and needs factor (discussed below).

Similarly, the factor of financial stability does not appear to receive appropriate scrutiny. The recent merger approval documentation from the Fed and the OCC shows that the financial stability/systemic risk review simply involved an "analysis" along the five factors that are used to determine the "score" assigned to Global Systemically Important Banks (the so-called GSIB surcharge score): size, availability of substitute providers, interconnectedness, complexity, and the extent of cross-border activities. While the GSIB surcharge scoring methodology provides a useful, very high-level framework for determining a capital surcharge, it is a crude framework that provides little insight into the many ways risks could be posed to the banking system and greater financial system by the creation of a very large bank.

Additionally, the Fed and OCC provide only subjective assessments about each of the GSIB surcharge score factors that lack any sort of thresholds leading to further consideration and scrutiny of the merger with regard to financial stability concerns. There is also almost no written justification for their conclusions, only providing basic explanations for their conclusions and not the type of robust justification that would be expected for a factor as significant as stability of the U.S. financial system. The agencies must consider the inclusion of a more thorough and deeper analysis of financial stability risks (discussed below).

The Agencies Have Started to Take Some Steps to Assess the Current Process, but They Have Yet To Take Any Action

President Biden's Executive Order from 2021 highlighted the many detrimental impacts of consolidation throughout the economy, including in banking and the financial industry. That order encouraged the Attorney General to engage with the banking regulatory agencies to review guidelines around bank mergers for the "revitalization" of the merger oversight process. The Agencies have started to embrace the opportunity to engage with each other to enhance the merger review processes in a coordinated way.

In late 2021 the Department of Justice issued a request for information from the public on how the merger review process could be improved, focusing on their mandate of assessing competition. Shortly after, the FDIC followed with their own request for information from the public that was broader in scope. In addition to competition, the FDIC also put a lot of emphasis on requesting input on how the merger review process could be improved for the factors of financial stability and convenience and needs.

While the Fed and OCC have not similarly solicited public feedback on how the process can be improved, they have discussed the issues and noted that the process must be enhanced. Fed Vice Chair for Supervision Michael Barr discussed the merger review process in his inaugural speech in that role, noting that convenience and needs and financial stability are important factors to consider. Acting OCC Comptroller Michael Hsu gave a speech focused on improving the merger review process, putting forward his thoughts on how assessments for the factors of competition, convenience and needs, and financial stability can be improved. Additionally, the OCC will be hosting a symposium this month on bank mergers with panels on competition in the sector, convenience and needs of communities, and financial stability implications.

There Are Fundamental Improvements That Must Be Made to the Merger Review Process

Based on their public statements and solicitations, it is clear that the Agencies agree the merger review process needs to be updated and improved, particularly for the factors regarding the convenience and needs of communities as well as financial stability. What is not clear is how they collectively intend to achieve this goal.

As noted above, in his speech on bank mergers Acting Comptroller Hsu put forth some thoughts on how assessments based on each of the factors can be improved. Better Markets has also put forth its own advocacy agenda on this issue that overlaps with points the Acting Comptroller raised but also adds aspects. (See Better Markets comment letters linked above).

Competition Assessment

The assessment for the factor of competition involves computing a standard concentration measure, the Herfindahl-Hirschman Index ("HHI"), and applying pre-determined thresholds to determine if a market is of a sufficient level of competition. The "markets" in this analysis are defined by the Fed based on concentrations of deposits in a geographic area, similar to what is currently being done in the CRA. Additionally, as pointed out by the Department of Justice ("DOJ") in their request for information, the analysis is performed for (1) retail banking products and services, (2) small business banking products and services, and (3) middle market banking products and services. However, nonbank providers of financial products and services are excluded from the analysis, i.e., only banks are included.

The DOJ in its request for information asked whether the analysis should be expanded to include different determinations of "markets" and whether more types of products and services or more granular categories of products and services should be included. The Acting Comptroller stated that both inclusions should be the case, referencing a publication by former Fed Governor Daniel Tarullo who argues for more granular and broader analysis for various types of lending and different geographic market considerations (i.e., local, regional, and national) and for the consideration of broader industry dynamics that includes nonbank lenders.

This would be a much more sensible approach. Banking is a complex and dynamic business that should be providing the products and services to meet the needs of different types of consumers and businesses in different areas. These demands and needs can be very region-specific, even for a particular county. That is, the competition assessment should include:

- Ensuring appropriate sets of products and services are being reviewed for a given geographic market;
- Reviewing geographic markets at multiple levels and perspectives (Fed-defined, county-level, metropolitan area, state, national, etc.);
- Having appropriate distinctions between urban and rural markets as well as along other lines of distinctions (which can be achieved in large part through the first two points); and
- Assessing competition by performing analysis both including and excluding nonbanks.

However, while the competition factor should be improved, it is perhaps more important to improve the assessment of convenience and needs. That is, if a primary goal in assessing the benefits is to assess whether people have and will continue to have the products and services they need for financial wellbeing, then the convenience and needs factor is best suited. The factor of competition only seeks to assess whether there is sufficient competition, not whether that competition actually leads to people having the products and services they need, and so is secondary to the convenience and needs factor in assessing the benefits, if any, of a proposed merger (discussed below).

Convenience and Needs Assessment

As noted above, the assessment of convenience and needs is heavily dependent on CRA-related examinations that likely are out-of-date as well as public comments that receive very little scrutiny. This assessment process all but guarantees the convenience and needs of communities will be poorly assessed at the time of the application review and the convenience and needs going forward are entirely ignored. This must change.

First, the agencies should perform a more up-to-date analysis of CRA review-related data at the time of the merger assessment. At the very least, this analysis should be performed on home lending data, which is reported regularly (annually and, for certain banks, quarterly) and can be analyzed easily without examination teams. Once the Consumer Financial Protection Bureau begins collecting data through its proposed rulemaking amending Regulation B to implement changes to the Equal Credit Opportunity Act made by section 1071 of the Dodd-Frank Act, this analysis could easily be performed for small businesses as well (and some form of such analysis could be performed now with current data sources). Analysis based on more current information at the time of the merger assessment is necessary not only to have a recent picture of the performance of the merging banks but also would allow the agencies to investigate some of the public comments received and provide analytical support for its conclusions.

The analysis should be performed over a robust time period, perhaps for at least a decade prior to the merger application, and use annual data instead of data grouped over several years. Analysis over a more extended time range provides insight into the performance of each of the merging banks and their behavior and business strategy within low-to-moderate income ("LMI") communities and to LMI individuals. Additionally, this insight can provide an indication of how the merged bank may perform in the future. Unlike the analysis performed in CRA examinations which pools multiple years of data, using annual data would more clearly show whether banks are consistent in their behavior year-over-year.

Second, the merger review process should include some thresholds related to both the CRA examination conclusions and any additional analysis performed that either prevent a merger from proceeding or that require certain actions and commitments. Some "unspoken" thresholds may currently exist that are discussed with the banks prior to the formal merger applications being submitted, but thresholds should be codified as part of the process so that the public has full transparency of the expectations of the agencies. A set of possible examples of remedial actions and commitments should also be published for the public's awareness, such as divesting branches or executing community benefit agreements ("CBAs"), but ultimately the actions or commitments required as part of the approval should be directly related to the identified issues.

Third, more must be done to ensure the convenience and needs of communities are served after merger completion:

- Any area in which competition is shown to be materially reduced, whether across products or for individual significant products such as mortgages, should lead to
  - heightened scrutiny and
  - conditions that require improvement in specific geographical areas that are monitored by regular examinations, at least annually at first, as well as more regular overall CRA-related examinations.
- The agencies should designate underserved assessment areas, which would result in
  - elevated review scrutiny in those areas and
  - remedial supervisory actions or commitments to improve the provision of products and services in those areas with appropriate supervisory consequences for failure to do so.

Acting Comptroller Hsu and others have highlighted the use of so-called community benefit agreements, which have been beneficial in certain cases with large bank mergers. However, the details of these agreements typically are not shared with the public, so it is impossible for the public to assess whether or not the merged banks indeed fulfilled the agreements that were put in place. Additionally, many banks take much longer to fulfill their commitments than stated in the agreement without meaningful consequences. If these are to be used more frequently, then they must be public and come with consequences.

Financial Stability Assessment

The agencies have a duty to assess the financial stability risks resulting from the mergers they review. Systemic and financial stability risks deserve special scrutiny, especially considering the weakening of the regulatory framework implemented during the Trump era. Strengthening the merger review process around financial stability risks is necessary regardless of the regulatory framework, but the dilution of post-crisis reforms provides even more reason to do so.

Governor Lael Brainard recognized this issue in a statement made after her abstention from voting on the PNC acquisition of the U.S. operations of BBVA:

"The increases in banking concentration in the $250 to $700 billion asset size category, where common-sense safeguards have been weakened, raise some concerns, and it might be helpful to undertake a broader review of our framework, since we know from experience even noncomplex banks in this size range can pose risk to the financial system when they encounter financial distress."

Clearly, the agencies must do a better job of identifying and assessing systemic risks and financial stability concerns related to merger plans for large banks. The GSIB surcharge analysis discussed above is insufficient for these purposes. The GSIB surcharge framework was not designed to assess potential risks to the financial system. Rather, it was designed to apply a capital surcharge to the world's largest and most complex banking institutions. As Governor Brainard pointed out, smaller and less complex institutions that are still large by any standard can pose risk to the financial system. Therefore, comparing any potentially merged bank to GSIBs is not sufficient, unless one or more of the merging banks is already a GSIB. Even in that case more factors and information must be considered in the process. Former Governor Daniel Tarullo aptly described the current process as “analytically underdeveloped” in an opinion piece for the Brookings Institution.

First, for mergers that result in an institution with total assets greater than $250 billion, the agencies should require the submission of a combined resolution plan for the merged entity. This should include an assessment of the ways in which the merger increases and reduces resolution challenges or obstacles. Such a plan would provide great insight into the complexity of the merged entity and its operations and allow for a more involved and appropriate assessment of the implications of its failure. After all, that is exactly the purpose of the resolution plan requirements, and so a combined plan should be required to be submitted and utilized for assessment in the merger review process. Making large banks prepare for their possible resolution is critical to addressing the too-big-to-fail problem.

In his speech, Acting Comptroller Hsu suggested that one way to address systemic risk of large mergers would be to “condition approval on credible and verifiable commitments to achieving resolvability, tailored to the resolution risks of the resulting bank.” The best way to ensure this occurs is by having a resolution plan in place for the merged entity at the time of the application process, which is important for banks that are large enough to pose risk to the system, including large banks that are not GSIBs. As the Acting Comptroller also points out in that speech, if the only way to resolve a large regional is that “it would have to be sold to one of the four megabanks, then…we have a financial stability problem.” Resolution preparedness is necessary to have confidence that large banks can be shut down and/or be taken apart and sold off piece-by-piece more easily in the event the bank fails, instead of being sold off in whole to a megabank.

Second, for mergers that result in an institution above $250 billion, more analysis must be conducted to assess risk to financial stability other than simply utilizing the GSIB surcharge metrics. As noted above, these metrics as compared to the industry as a whole or as compared to GSIBs are insufficient to determine the variety of possible risks an institution could pose to the financial system. The Federal Reserve has a division entirely dedicated to the analysis of financial stability – the Division of Financial Stability. For large mergers, the Division of Financial Stability should conduct and provide a public assessment of the financial stability concerns the merged entity could raise on its own and in the context of the banking system and greater financial system.

At the very least, an assessment should be conducted of the potential impact to funding markets that would be caused by serious distress or failure of the merged bank. It is important to remember that in 2008 Bear Stearns was around $400 billion in assets when it required a Federal Reserve-brokered (and materially supported) fire sale, and Lehman Brothers was around $640 billion at the time it collapsed. These firms distressed financial condition significantly contributed to stress in short-term funding markets, which are critical to the functioning of the financial system.

Managerial Resources and Other Identified Weaknesses Assessment

Consideration of prudential factors should be a major element of any decision making on mergers of large banks, and if there are significant weaknesses in key areas a large bank merger should be rejected. This is critical because any weaknesses identified in either or both of the merging institutions could become even larger concerns once the merger is complete. That is, the increased size, complexity, and interconnectedness of the resulting institution would increase the potential risks resulting from deficiencies among prudential factors. For larger institutions, this increased risk can result in financial stability concerns.

First, the combining of two banks into a larger one that would then not be adequately capitalized, or have insufficient liquidity, should never be allowed. Specifically, the capital and liquidity analysis of a large bank merger should include pro *forma* stress-based measures of capital adequacy and liquidity sufficiency. Just as with an existing large bank, the resulting combined bank must be able to demonstrate it can likely withstand potentially severe stress and still be able to continue to operate and lend to creditworthy borrowers without tax-payer support. If the merged entity cannot demonstrate that it could withstand stress consistent with the Federal Reserve's annual stress test *and* maintain sufficient liquidity in times of stress, there should be no approval of a merger.

Second, demonstrated material weaknesses in key risk management and corporate governance practices or evidence of a failure to comply with applicable laws or rules should form an important element of any merger consideration. Identified weaknesses would provide a strong indication that bank management and the banks' board of directors are not effectively carrying out their responsibilities, and any planned merger should be prohibited. If the problems are at a bank whose operations will be folded into a merging or acquiring institution, then at a minimum the application process should require a written agreement with a detailed accounting of weaknesses at the target bank and a plan that specifically lays out how and when the problems will be addressed by the acquiring bank. The merged bank's operations should be contingent on the commitment to resolve identified weaknesses. If the merger is approved and material problems linger, the merged entity should face meaningful supervisory actions, including having all capital distributions to shareholders suspended until such time as it has addressed the issues detailed in the plan submitted as part of the application.

Should material identified weaknesses be at the acquiring bank, any merger or acquisition should not be allowed until the specific issues have been fully addressed. It should not be the case that an institution with significant identified weaknesses be allowed to acquire another institution, since its issues likely will be continued as part of the larger, merged operation.

Better Banks | Better Businesses
Better Jobs | Better Economic Growth
Better Lives | Better Communities

Better Markets is a public interest 501(c)(3) non-profit based in Washington, DC that advocates for greater transparency, accountability, and oversight in the domestic and global capital and commodity markets, to protect the American Dream of homes, jobs, savings, education, a secure retirement, and a rising standard of living.

Better Markets fights for the economic security, opportunity, and prosperity of the American people by working to enact financial reform, to prevent another financial crash and the diversion of trillions of taxpayer dollars to bailing out the financial system.

By being a counterweight to Wall Street's biggest financial firms through the policymaking and rulemaking process, Better Markets is supporting pragmatic rules and a strong banking and financial system that enables stability, growth, and broad-based prosperity. Better Markets also fights to refocus finance on the real economy, empower the buyside and protect investors and consumers.

For press inquiries, please contact us at press@bettermarkets.com or (202) 618-6430.

1825 K Street, NW | Suite 1080 | Washington, DC 20006 | 202-618-6464 | www.bettermarkets.org