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Banking Mergers: The Case to Replace the 1995 Banking Merger Guidelines—Part I: A Changed Industry

Michael D. Noel*

Significant changes on the horizon in how the Department of Justice Antitrust Division evaluates mergers in the banking industry will materially affect the types of mergers that will be challenged and the advice attorneys give to their banking clients. The current set of banking-specific merger guidelines, published in 1995, have long fallen out of date, and are no longer consistent with economics best principles contained in the 2010 Horizontal Merger Guidelines. After recent merger reviews highlighted problems with the banking guidelines, the Division requested public comments on how it might revise its current approach to banking merger review analysis.

In this first part of a two-part article, the author introduces the topic and comments on the guidance generally. The second part of this article, which will appear in an upcoming issue of The Banking Law Journal, *will comment on the Herfindahl-Hirschman Index Threshold, relevant product and geographic markets, rural versus urban markets, non-traditional banks, the de minimis exception, and offers conclusions.*

The purpose of merger review is to determine whether a given proposed merger is likely or unlikely to harm competition. Each merger is different and so it is necessary to review each on its own merits. If a merger is expected to produce positive or neutral net benefits, it can be allowed to proceed and, if not, it can be challenged or allowed to proceed with conditions.

BACKGROUND

In most industries, there is a single layer of merger review, conducted by either the Federal Trade Commission ("FTC") or the Department of Justice Antitrust Division (the "Division"), under the authority of the Sherman Act of 1890 and the Clayton Act of 1914, as amended. The Division, rather than the FTC, typically handles merger reviews in the banking industry. In banking,

* Dr. Michael D. Noel is a competition economist and professor of economics at Texas Tech University in Lubbock, Texas. His primary field of research is competition and antitrust policy, which includes the analysis of mergers and acquisitions, market definition, Herfindahl-Hirschman Index analyses, unilateral and coordinated effects, and related issues.

there is a second layer of merger review as well. Depending on the charter and structure of the bank, a second review is conducted either by the Federal Reserve Board (the "Fed"), the Federal Deposit Insurance Corporation ("FDIC") or the Office of the Comptroller of the Currency ("OCC"), under the authority of the Bank Holding Company Act ("BHC") of 1956 and the Bank Merger Act ("BMA") of 1960.[1] Any proposed merger amongst bank and bank holding companies must be approved both the Division and by the relevant regulator to proceed.

With respect to reviews conducted by the Division, the Division relies in large part on a set of merger guidelines in 1995 specific to the banking industry, known as the 1995 Banking Merger Guidelines ("BMG"). The 1995 BMG is intended to provide guidance to banks prior to any application as to how the Division evaluates mergers, and what factors make a proposed merger more or less likely to be challenged. But there is a problem. The 1995 BMG was written 25 years ago at a very different time in the industry and no reflects the realities of the modern banking industry. It also no longer follows currently accepted economic best practices as laid out in the most recent general merger guidelines document, the 2010 Horizontal Merger Guidelines ("HMG"), which is jointly issued by the FTC and the Division. The 1995 BMG are in serious need of a thorough revision and that time appears to be now.

Over the past 25 years, competition in the banking industry has undergone a transformation change. Banking competition is no longer local like it was back in the 1980s and 1990s, when accessing almost any kind of banking service required visiting a brick-and-mortar branch. Today, banks not only compete with other banks in the immediate local area, but almost any bank that can reach customers online and electronically, which is almost any bank, investment house, credit card issuer, and so on. Fewer and fewer people need regular access to a branch anymore and many never step foot inside a branch anymore. In fact, many banking services today (direct deposit, credit card use, bill pay) occur automatically in the background without any thought or intervention by the customer at all, let alone a branch visit.

Banking competition is also much more diverse today than in the past. Banks compete not only with other banks but with a wide variety of non-bank entities, such as online lenders (e.g. mortgages, business loans), money transfer apps (e.g. Paypal, Venmo), closed-loop credit card companies (e.g. American

[1] *See, for example*, Darwish, N. "Keeping Banking Competitive: Evaluating Proposed Bank Mergers and Acquisitions," *Chicago Fed Letter*, Federal Reserve Bank of Chicago, May 2014. Hereafter, *Chicago Fed Letter*. There are separate regulators for credit unions and for thrift banks and for bank-like entities such as investment banks or mortgage lenders as well.

Express), foreign exchange houses, secure storage, and so on. The online reach of these companies means that banks now face diverse and significant competition along their many lines of business from a wide range of non-bank entities that specialize in one or more of those lines. In short, banking competition is no longer limited to banks.

But the 1995 BMG has not caught up. Even though banking competition is no longer local, calculations under the 1995 BMG are generally restricted to "local" banks. And even though banks compete with a diverse set of non-bank entities along a wide range of business lines, calculations under the 1995 BMG exclude all but a few non-bank entities. As a result, the methodology outlined in the BMG misses much, if not most, of the competition going on.

By way of introduction, there are three major issues. First, the 1995 BMG is built around a specific product and geographic market definition exercise that, while arguably sensible 50 years ago when the Federal Reserve Board established the methodology, is no longer meaningful in the modern banking industry today. Second, the 1995 BMG is focused almost entirely on an Herfindahl–Hirschman Index ("HHI") screen, which due to its outdated notions of product and geographic markets and its routine exclusion of real and known competition, is systematically biased and not meaningful. Third, the 1995 BMG gives almost no attention to countervailing effects, such as efficiencies and failing firm considerations, which is the primary motivation behind many modern banking mergers in the industry today. Taken together, these biases systematically and substantially overstate the potential for harm for many banking mergers and, if continued to be relied upon, lead to repeated policy error.

The problem is especially severe for mergers involving smaller regional banks in rural areas, where the HHIs, calculated in the manner instructed by the 1995 BMG, are often egregiously overstated. In fact, almost any rural area merger with any degree of overlap will fail the HHI screen as calculated, even for obviously pro-competitive mergers. This, combined with the failure to consider efficiencies, means that the 1995 BMG will have opposite of the intended effect in many cases—actually harming competition in the long run instead of protecting it.

These problems were raised in a number of recently proposed mergers among small and medium-sized regional banks in Texas, and led the Division to reconsider the 1995 BMG in its entirely. On September 1, 2020, the Division issued a request for public comments on its current approach to banking merger review analysis under the 1995 BMG. If and when the 1995 BMG is rewritten, it will significantly impact the way banking mergers are handled by the Division, and significantly impact the advice that attorneys handling banking

mergers will provide their clients. Pro-competitive mergers that appeared to have no reasonable chance at success under the old BMG may again become viable.

It is instructive to examine the way banking mergers are currently evaluated by the Division (and the federal agencies) and the ways the BMG has fallen out of date. The following are responses and recommendations submitted by this author in response to the Division's request for public comments on its banking merger guidelines document. It is presented herein in a Q&A format, as it was presented to the Division, using questions provided by the Division.

COMMENTS ON THE GUIDANCE GENERALLY

To What Extent, If at All, Is It Useful to Have Banking-Specific Merger Review Guidance, Beyond the 2010 Horizontal Merger Guidelines?

It is useful to provide banking-specific merger guidance that highlights and clarifies the Division's general approach as it applies to the banking industry. It helps banks understand the Division's views on issues that frequently arise in banking mergers while at the same time not cluttering the main non-industry-specific document, the 2010 HMG. It helps banks avoid the expenses that can result from unexpected challenges and the risk of missed opportunities that can result from unclear guidance. Any new banking-specific guidance must be complementary to, and not contradictory with, the 2010 HMG.

The most recent banking-specific merger guidelines released by the Division, the 1995 BMG, fails in this regard. The 1995 BMG is now 25 years out of date and was written at a time when the banking industry was very different than today. It is largely focused on a mechanical HHI screen calculation that is no longer being performed correctly, given the nature of banking competition today, and contains no meaningful discussion of countervailing or offsetting effects. It does not take into account the competitive constraints modern banks face and is not reliable for use in merger analysis. The product and geographic market definitions adopted in the 1995 BMG are at the center of much of the problem.

The banking industry has undergone a significant transformation over the past 25 years. Long gone are the days of long lines at the bank at lunch hour to do such routine banking tasks as withdrawing some spending cash or depositing a paycheck. Credit cards, debit cards, direct deposit, electronic money transfer, nationwide ATM networks, remote commercial services and online banking and lending have all revolutionized the way consumers and businesses interact with the industry. Fewer and fewer individuals step inside a physical branch anymore, and those that do, do so less and less often. Even

significant tasks like opening an account, investing, or applying for a mortgage or small business loan, can easily be done online. Customers do not "travel" to banks anymore as much as banks travel to customers. Banking is as convenient as a computer in one's office or a smartphone or credit card in one's pocket. Direct deposit, auto bill pay, and other automatic services take place quietly in the background without customer intervention.

The following are examples of significant technological developments, many now taken for granted, that have greatly reduced the need for physical bank branch access:

Credit Cards. One of the first technologies that significantly reduced branch use since 1963 was the widespread adoption of credit cards. VISA and MasterCard, ubiquitous names today, did not exist in 1963 when the Court published its guidance. According to the Federal Reserve, 74 percent of transactions in 2018 were non-cash transactions and 31 percent of those were by credit card.[2] Credit cards are generally issued by mail, carried around by the consumer in a purse or wallet, used online or at the point-of-purchase, and paid either online or by mail. They have significantly reduced cash needs and the need to visit a branch.

Automated Teller Machines ("ATMs"). ATMs revolutionized the banking industry in the 1980s by making physical cash available 24 hours a day and making it available without having to go into, or near, a branch. ATMs can be found in convenience stores, pharmacies, supermarkets, retail stores, stand-alone kiosks, and at a wide variety of retail establishments. The proliferation of ATMs means that bank branches are no longer necessary to access cash. At the same time, cash use is declining—only 26 percent of transactions in 2018 were cash transactions, accounting for only about nine percent of total transaction value.[3]

Debit Cards. Debit cards have quickly become the most popular payment method, accounting for 28 percent of all transactions and 38 percent of all non-cash transactions in 2018.[4] The widespread use of

[2] Federal Reserve Board. "2019 Findings from the Diary of Consumer Payment Choice," June 2019.

[3] Federal Reserve Board. "2019 Findings from the Diary of Consumer Payment Choice," June 2019; Federal Reserve Board. "2015 Findings from the Diary of Consumer Payment Choice," November 2016.

[4] Federal Reserve Board. "2019 Findings from the Diary of Consumer Payment Choice," June 2019.

debit cards and credit cards, the ubiquity of ATM networks, and the declining need for cash all combine to substantially reduce the need to go into a physical bank branch for routine tasks today.

Checks. Checks were once the dominant method of non-cash money transfer, but have been largely replaced with direct deposit services, debit cards and credit cards, and other forms of electronic money transfer. Whereas checks once required a trip to the bank, today they can be deposited in ATMs or by uploading pictures of them online, in addition to mail. Retailers that accept checks can now deposit them into their accounts simply by scanning them.

Direct Deposit. Direct deposit is a form of electronic money transfer which substantially reduced the use of paper checks, and the need for bank visits. The vast majority of U.S. employees today use direct deposit to deposit their paychecks. More generally, electronic money transfers through the Automated Clearing House ("ACH") network have substantially reduced the need for cash and checks and, thus, the need for branch visits.

Consumer Bill Pay Services. Utility bills and other household bills were historically paid by mail (via check), in person at the provider, or by going to a bank which offered this service. Today, bills are more often paid by credit card, debit card, or through the ACH network without the need for a branch visit. Credit card bills themselves can be paid the same way.

Online Banking. One of the most transformative changes in the banking industry over the past 20 years is the rise of online banking. Just as credit cards, debit cards, electronic money transfer, ATM networks, and other technologies greatly reduced branch visits for everyday transactions, online banking took care of much of the rest. Consumers can now go online and perform almost any task that required a branch visit 20 years ago (except getting physical cash which is easily done by ATM). The transformation is especially important for geographic market definition because, for many people, it eliminates the "inconvenience of travel" that the Court discussed in 1963. Today, online customers need not travel to banks—the bank travels to them. Regardless of where a customer lives and regardless of where a bank has its physical branches, if it has any branches at all, online banking reaches them.

Investments. Setting up and managing investments, such as Certificates of Deposits, Money Market accounts, or even brokerage accounts

through a bank's brokerage arm, used to require a branch visit. Today, consumers can shop, buy, renew, close, and essentially do anything else relating to their investments online.

Loans and Mortgages. A visit to a branch was once necessary to apply for a personal or business loan or a mortgage. Some people still prefer to do this, but it is not necessary at most banks. One can apply for loans and mortgages online and pay them online. The largest mortgage lender in the United States, Rocket Mortgage (by Quicken Loans), is an online lender. Kabbage is one of the largest small business lenders. Some lenders do not self-finance but act as intermediaries between businesses and banks regardless of where either is located, entirely eliminating the element of distance between lender and borrower.

The transformation has significant implications for market definition, which has not always been well recognized. First, it makes geographic banking markets much larger. Banks face competition not just from other local banks, but from regional and national banks that reach customers online (as they generally do), fully online banks (e.g. Ally Bank), and a wide range of non-bank entities including online and specialty lenders (e.g. Rocket Mortgage, Kabbage, the Farm Credit System associations), investment houses (e.g. Fidelity, Vanguard), closed-loop credit card companies (e.g. American Express, Discover), money transfer and payment systems (e.g. Paypal, Google Pay), and a wide variety of other types of service entities. Competition is not just limited to local banks anymore.

It also makes product markets more complex. While the 1995 BMG focuses on metrics that are mainly restricted to traditional banks (e.g. deposits), banks face competition from a multitude of non-bank entities including all those mentioned above. Even if one competitor only offers some of the services that banks provide, collectively they compete with banks on all the services that banks provide. Banking competition is not just limited to traditional banks anymore. Product markets are too complex to be summarized by a single metric, like deposits, and reliance on any single measure can miss important dimensions of competition taking place.

The 25-year-old BMG fails to take into account these changes in banking competition today. It predates the transformation and relies on procedures and calculations that are now out of date and inconsistent with the economic principles laid out in the 2010 HMG. It leads to systematic and known errors in banking merger analysis.

The 1995 BMG should be retired in its entirety and a new guidance document written from the top down, with two goals in mind: (1) to provide specific guidance on the types of issues that frequently arise in banking merger

reviews, taking into account the competitive realities of the modern banking industry, and (2) to provide guidance in a way that complements, and not contradicts, the economic principles and best practices laid out in the 2010 HMG.

Recommendations for change follow, but five significant deficiencies in the 1995 BMG are worth summarizing up front.

First, the 1995 BMG does not include an independent discussion of geographic banking markets but simply adopts the geographic banking markets predefined by the Federal Reserve Board (the "Fed"). Over the years, the Fed has predefined a number of geographic banking markets for use in its merger analyses, mainly for metropolitan areas and some rural areas, and fills in the gaps with new markets on an as-needed basis over time. The reliance on these definitions is one of the greatest sources of bias in banking merger analysis today. The methodology is based on long out-of-date notions of strictly local banking and results in markets that are much too narrowly defined, often egregiously so in rural areas. They are too narrowly defined because they fail to take into account consumer substitution patterns and the set of competitive constraints banks actually face in modern banking today.

The Fed's current definitions should be retired in their entirely and a new set of geographic banking markets, with complete coverage of the nation, be rethought from the ground up. It is a significant task, but one that would provide the most meaningful guidance, and would replace the increasingly arbitrary patchwork that makes up the geographic banking markets currently in use. The new definitions would be rooted in economic principles laid out in the 2010 HMG and take into account the modern nature of banking competition.

Second, the 1995 BMG does not contain a meaningful discussion of product markets. It is largely focused on calculating HHI screens using banking deposits as a metric (even though the word "deposits" is not mentioned until the last page), and only briefly mentions that banks can calculate HHI screens using small and medium business loans if needed. It suggests three aggregate product markets, though it is less than clear. A meaningful discussion of product markets and the metrics used to measure market shares in each market must be a central part of the new banking guidelines. The Division should discuss the data sources it uses, what adjustments it makes to its metrics and why, and how it deals with data availability issues. Data limitations can be significant in practice and are not always well addressed.

Consider limitations in the use of bank deposits as a metric for market shares. The Division's preferred metric (according to the 2010 HMG) is revenues, but deposits are not revenues, nor are they the revenues of any product that a bank sells. Nor are they assets. They are a proxy for a bank's capacity to make loans,

but loans are only one part of a bank's business, and deposits in any one area are not exclusively reserved for loans in that same area, so there is an inherent mismatch between them. Also, deposits cross into all three of the Division's proposed product markets and thus cannot be a direct measure of any one of them.

A limitation of bank deposits that is especially troubling is that many bank competitors are entirely disregarded. Specialty lenders that compete directly with banks for loans but do not take deposits, such as online lenders (e.g., Rocket Mortgage, the largest mortgage lender in the nation) or Farm Credit System associations (which rival commercial banks in combined loan value in agricultural areas), are entirely disregarded. Large online banks (e.g. Ally Bank) whose deposit data is not available on a market-level basis are also entirely disregarded. The default assumption that the market shares of these competitors is exactly zero is not defensible. Credit unions and thrifts that compete directly with banks for loans and other services are arbitrarily downweighted to 50 percent of actual deposits, which is also not defensible unless these entities are doing nothing with the other 50 percent, which is unlikely. Exclusions and downweights such as these cause significant, systematic, and known biases in deposit-based HHI screens in virtually every market share calculation in virtually every merger analysis. As a result, the deposit-based HHI screens as they are currently used by the agencies are not reliable for use in merger analysis.

Loan values are a useful revenue metric that measures outputs instead of inputs, but have similar data limitations. The most troubling limitation is that many bank competitors are again disregarded. Bank and market level loan data is generally unavailable for banks that do not meet a sufficient size threshold and such banks are generally disregarded. The commonly-used Community Reinvestment Act ("CRA") data on commercial loans, for example, excludes all but the larger banks with at least 1.3 billion dollars in assets. The omission is significant and especially severe in rural areas where many banks are small and do not meet the required threshold. Market-level loan data is also generally unavailable from Farm Credit System ("FCS") associations, which rival commercial banks in combined loan value in agricultural areas, and they are disregarded as well.[5] Exclusions such as these cause significant, systematic and known biases in loan-based HHI screens in virtually every market share

[5] Morris, C., Wilkinson, J, and Hogue, E. (2015). "Competition in Local Agricultural Lending Markets: The Effect of the Farm Credit System," *Economic Review*, Federal Reserve Bank of Kansas City.

calculation in virtually every merger analysis. As a result, the loan-based HHI screens as they are currently used by the agencies are not reliable for use in merger analysis.

The 1995 BMG contains no discussion of the biases in the HHI calculations. While the HHI screen is only intended to be a screen, with banking agency reviews in particular, it is often taken to be determinative, and it can be difficult for applicants to successfully point out the inherent biases in the HHI as it is calculated.

Problems with product and geographic banking markets and the metrics used to evaluate them need to be rectified in a new set of banking guidelines. Product markets need to be carefully discussed, geographic markets based on current competitive constraints thoughtfully constructed, the choice of metrics and the limitations of those metrics carefully considered, and market shares estimated or imputed (even imperfectly) using the best available information. The resulting HHIs should be free of systematic and known biases. The additional effort can be substantial, but is necessary for estimating a meaningful HHI.

If traditional merging banks already pass the HHI screen, in spite of biased and inflated market shares, and before the disregarded competitors are included, then the additional data collection effort will generally not be necessary.

Third, and putting aside the biases in the market definition exercise, the 1995 BMG is inconsistent with the 2010 HMG simply because it relies on different HHI thresholds. Thresholds are inevitably arbitrary to a degree, but there is no economic basis for applying a different set of thresholds to the banking industry than to other industries, provided the market definition exercise is carried out properly.

The reason for the discrepancy is simply that the 1995 BMG thresholds are out of date. They are based on thresholds that were first introduced almost 40 years ago in the 1982 HMG and were still a part of the then-current guidelines from 1992. It is easily fixed.

Fourth, the 1995 BMG contains no meaningful discussion of offsetting or countervailing effects, as those terms are used today. It makes no allowance for efficiency effects in particular, which is surprising because cost and innovation efficiencies are important motivations driving banking mergers today. The minimum efficient scale in the industry is increasing. Electronic and online technologies have broken down the location barrier to entry, and large and efficient competitors can now reach out to customers outside the areas where they have a physical presence, if they have a physical presence at all. Low-cost online banks and lenders have become very popular, and most large traditional

banks now offer an efficient and expansive set of electronic and online services that consumers and businesses across the country have increasingly come to expect.

Efficiencies are important in a technologically-advanced industry but especially important for smaller local and regional banks who face increasingly aggressive competition from their larger counterparts. Smaller, less efficient or less technologically advanced banks will have a more difficult time competing and are at higher risk for long term failure (the vast majority of bank failures are exactly these kinds of banks). Mergers are an important tool for emerging banks to achieve the economies of scale needed to effectively compete in today's industry.

An unfortunate irony is that many of the mergers likely to generate the greatest efficiencies are among smaller local and regional banks in rural areas, but this is also where biases in product and geographic market definition inflate HHIs the most, and the potential for policy error is the greatest. In other words, the biases embedded in the merger review analysis, disproportionately affecting rural areas, results in an unintentional inversion of the goals of merger policy—preventing some of the smallest, least harmful, and most efficient mergers from taking place.

The new set of banking-specific merger guidelines should include a discussion of efficiencies (and the related issue of failing firms) and their importance in the banking industry. Efficiencies are discussed in some detail in the 2010 HMG but not at all in the 1995 BMG and they are not always afforded the conversation they deserve in banking agency reviews.

Fifth, the 1995 BMG section entitled "Additional Analysis" highlights how very out of date the 1995 guidelines have become. At first, the section appears to be a discussion of countervailing effects—reasons why adverse competitive effects may be unlikely post-merger even if market concentration is high. The 2010 HMG discusses many such reasons, for example, efficiencies, potential entry, the presence of powerful buyers, and failing firms. But upon closer inspection, this is not what the section is. It is largely a list of reasons why the HHI, when calculated as instructed in the worksheets attached to the guidelines, may still be calculated incorrectly and be biased.

There are three significant problems with this section. One, a meaningful discussion of actual countervailing effects is missing. Whereas the discussion of countervailing effects in the 2010 HMG begins with a correctly calculated HHI and focuses on relevant competitive issues that may be important but cannot be captured by a correctly calculated HHI (e.g. efficiencies), the 1995 BMG is focused almost solely on calculating the HHI and discussing reasons why the calculation itself may be wrong. Two, and importantly, the HHIs, when

calculated as instructed, are essentially *always* wrong. The geographic banking markets used in these analyses are narrowly defined, often egregiously so, and a substantial portion of actual competition that merging banks face, local and non-local, bank or non-bank, are either downweighted or entirely disregarded. Three, perhaps not recognizing that the HHI calculations are systematically biased, the 1995 BMG then requires applicants to prove and reprove time and time again that the HHI they calculated, in the manner they were instructed to calculate it, is wrong and not meaningful to their situation. It creates a wasteful exercise in which applicants are instructed to calculate a wrong HHI and then prove each time that it is wrong. More problematically, if the HHI screen is taken to be determinative, as it often is, it can deter pro-competitive mergers and unintentionally harm banking competition in the long run.

Going through some examples of the "additional analyses" is instructive. The idea behind these analyses is that if the calculated HHI exceeds the threshold, merging firms can appeal to one of the listed exceptions to argue that competition is unlikely to be harmed post-merger anyway. But what is immediately obvious is that almost all of the listed exceptions are almost always true. The exceptions are not really exceptions then, but the rule. Some examples:

> *"Evidence that rapid economic change has resulted in an outdated geographic market definition, and that an alternate market is more appropriate"*

The exception is the rule. The 1995 BMG adopts the Fed's geographic market definitions which are based on an out-of-date strictly local model of competition. It does not take into account the technological changes in the industry and how consumers and businesses do their banking today. Fewer and fewer people regularly access physical bank branches anymore and an increasing number rarely if ever enter into a branch. Consumers and businesses have access to much larger set of competitors, irrespective of location, and the old local model of competition is no longer sufficient.

> *"Evidence that market shares are not an adequate indicator of the extent of competition in the market"*

This exception is also the rule. The 1995 BMG focuses largely on deposit shares which, as discussed, systematically exclude a wide range of competitors that either do not take deposits (e.g. lenders such as Rocket Mortgage or Farm Credit System associations) or do not make deposit information publicly available on a market basis (e.g., online banks such as Ally Bank). It arbitrarily downweights credit unions and thrifts to 50 percent (on the idea that they often provide fewer services), but there is no economic justification for downweighting or outright excluding legitimate competitors in a properly defined product

market. The assumption that the market shares of these firms are exactly zero (or 50 percent of deposits in the case of credit unions and thrifts) creates systematic and known biases in the HHI calculations in essentially every situation.

> *"Evidence concerning entry conditions, including evidence of entry by institutions within the last two years and the growth of those institutions that have entered; evidence of likely entry within the next two years; expectations about potential entry by institutions not now in the market area"*

This exception is also the rule, and demonstrates how out of date the guidelines have become. The calculated HHIs systematically exclude a vast assortment of competitors, including:

- Online banks (e.g. Ally Bank);
- Online lenders (e.g. Rocket Mortgage, Kabbage);
- Farm Credit System associations;
- Specialty providers (investment houses, closed loop credit card systems, money transfer services and apps, foreign exchange, and so on); and
- Out-of-area traditional banks that can now easily reach local customers through electronic and online means.

The BMG discusses past entry (in the last two years) but surprisingly much of this entry is decades old and is still not counted. It is unimaginable that past entry should not already be included in the HHI calculations. In terms of the potential for future entry and future expansion of entrants, which is an actual countervailing effect (and a rare overlap with the 2010 HMG), there is every reason to expect continued entry and expansion of online banks and lenders, specialty providers, and out-of-area traditional banks. Markets are now regional in nature (and nationalizing over time), and mergers of smaller local and regional banks especially are often driven by the need to meet the competitive challenges of their larger and more efficient counterparts, no longer bound by the limits of physical distance.

> *"Evidence of actual competition by out-of-market institutions for commercial customers,* and *evidence of actual competition by non-bank institutions for commercial customers"*

This exception is also the rule. Non-local banks that service commercial customers are systematically excluded from HHI calculations by out-of-date geographic market definitions. Non-bank institutions (including Farm Credit System associations) are systematically excluded from HHI calculations due to data availability issues or out-of-date notions that only true banks matter. Even

competitors that are local and are banks are often excluded from HHI calculations due to data availability issues. The commonly-used Community Reinvestment Act loan data, for example, excludes all banks that have less than 1.3 billion dollars in assets, missing a significant degree of loan competition. The default assumption that the market shares of these banks are exactly zero creates systematic and known biases in the HHI calculations in essentially every situation.

For all the reasons discussed above, the 1995 BMG is in dire need of replacement. The new document would provide meaningful updated guidance on product and geographic banking market definition that takes into account the competition modern banks face today. It would discuss how to calculate the HHI with the best available information and would not rely on assumptions that are known to be biased. It would emphasize that the HHI screen is a first step in the analysis and would discuss the potential for countervailing effects such as efficiencies. It would not be what the 1995 BMG discusses now—a perhaps unintentional listing of the major biases in its product and geographic market definition exercise.[6] The new guidelines would provide meaningful guidance that helps applicants decide whether or not to proceed with a potential merger, and enables agencies to more accurately target those mergers that are likely to have adverse competitive effects.

To What Extent, If Any, Does the Industry Need Greater Clarity on How the Division Applies the 2010 Horizontal Merger Guidelines in Its Investigations?

The 2010 HMG lays out the Division's general approach to merger review applicable across all industries and is best kept as a non-industry-specific document. A separate and new Banking Merger Guidelines document is the best method to provide additional guidance on the Division's approach to issues that frequently arise in banking mergers.

To What Extent, If Any, Is It Helpful to Have Joint Guidance from the Antitrust Division and the Banking Agencies, i.e., the Federal Reserve Board of Governors, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation?

It would be convenient to have a single document from all four agencies in agreement, but the most important and immediate issue is that the new

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[6] Another example, *"Evidence that the merging parties do not significantly compete with one another,"* is reflective of the problem. It is an admission that the product and geographic markets may make no sense at all. A post-merger HHI will not increase if the two parties do not compete with each other, because non-competing parties are by definition not in the same product and geographic market. If the HHI does increase, the product and geographic markets make no sense.

guidance from the Division be economically sound and consistent with the economic principles laid out in the 2010 HMG. There are significant issues in the way banking mergers are currently evaluated (e.g. geographic market definition, exclusion of known competitors, countervailing effects considerations), and ideally there would be agreement on fixing these issues and updating the guidelines in a unified way. In such a case, a four-agency BMG document would be best. But a four-agency document that would compromise on the economic principles laid out in the 2010 HMG is discouraged.

Should there be multiple agency documents, it would be most useful for each agency to produce its document in the form of a stand-alone memorandum document (rather than a list of frequently asked questions only, for example). Each agency would format its document similarly, for easier comparison, and highlight areas of disagreement between itself, the other agencies (including the Division), and the 2010 HMG. It would provide background and justification for any differences in approach. Since the information provided by the agencies comes in piecemeal fashion currently, in the form of FAQs or past publications or bulletins, a more consistent and coordinated approach would be helpful.

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The second part of this article, which will appear in an upcoming issue of *The Banking Law Journal*, will comment on the Herfindahl-Hirschman Index Threshold, relevant product and geographic markets, rural versus urban markets, non-traditional banks, the de minimis exception, and will offer conclusions.