October 16, 2020

Time to Revise the Department of Justice's Bank Merger Guidelines

In September, the Antitrust Division for the Department of Justice requested public comment as to whether its 1995 Bank Merger Guidelines ("Banking Guidelines") should be revised.

As detailed in the appended comment letter we submitted to the DOJ and the federal banking agencies yesterday, we make several recommendations, including:

- Increasing the concentration screening thresholds to reflect non-bank competition and deposit data issues;
- Incorporating and clarifying informal analyses adopted since 1995 affecting retail and small business banking markets;
- Clarifying the DOJ's analysis of middle market banking;
- Reducing uncertainty in local geographic market definition;
- Offering more guidance to address recurring issues related to centrally booked deposits; and
- Expanding and clarifying the weakened competitor defense applicable to financially impaired banks.

We applaud the DOJ's willingness to re-examine the Banking Guidelines given developments in the industry over the intervening decades since they were issued and strongly encourage the federal banking agencies to follow suit as they did in 1995.

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SUBMISSION

OF

WACHTELL, LIPTON, ROSEN & KATZ

TO THE

ANTITRUST DIVISION OF THE DEPARTMENT OF JUSTICE

AS TO

REVISIONS TO THE 1995 BANKING GUIDELINES

October 15, 2020

**COMMENTS TO THE
ANTITRUST DIVISION OF THE DEPARTMENT OF JUSTICE
ON WHETHER TO REVISE
THE 1995 BANKING GUIDELINES**

On behalf of Wachtell, Lipton, Rosen & Katz,[1] we submit the following comments in response to the Department of Justice Antitrust Division's (the "Division") September 1, 2020 request for public comment as to whether the Division should revise its 1995 Banking Guidelines (the "Banking Guidelines").[2]

Background

The banking industry has a unique function in our economy and a history of intensive regulation. In fact, prior to the Riegle-Neal Act of 1994, restrictive state and federal laws prohibited many bank holding companies from operating in multiple states unless those states had entered into reciprocity arrangements permitting such operations. The result was an inefficient and byzantine market structure with upwards of 14,000 banks. When these restrictions were gradually lifted through proliferating state reciprocity agreements, and ultimately abolished by Riegle-Neal, it sparked not only a massive amount of entry by newly unshackled interstate holding companies but also a wave of much-needed consolidation exactly as intended by the statute. Despite such consolidation, bank concentration at the local level has not increased overall;[3] today, over 5,000 banks and thrifts operate nationwide. Moreover, layers of state and national deposit caps as well as a national liability cap restrict bank acquisitions by the nation's largest banking institutions. *No other industry is subject to such mandates*.

After the financial crisis of the late 2000s, banks found themselves subject to substantially increased regulatory reporting requirements directed at safety and soundness and

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[1] Wachtell, Lipton, Rosen & Katz is a full-service law firm with extensive experience handling mergers and acquisitions, corporate and securities law, and complex litigation. It has represented the buyer or seller in numerous bank and bank holding company mergers, including most of the largest such transactions in U.S. history.

[2] *See* U.S. DEP'T OF JUSTICE, BANK MERGER COMPETITIVE REVIEW – INTRODUCTION AND OVERVIEW (1995), https://www.justice.gov/sites/default/files/atr/legacy/2007/08/14/6472.pdf (hereinafter the "BANKING GUIDELINES").

[3] *See* Robert M. Adams, *Consolidation and Merger Activity in the United States Banking Industry from 2000 through 2010*, at 14-15 (Fed. Rsrv. Bd. of Governors, Working Paper No. 2012-5, 1 2012), https://www.federalreserve.gov/pubs/feds/2012/201251/201251pap.pdf (noting that MSA, micropolitan and rural banking market concentration levels fell despite several years of consolidation in the U.S. banking industry); David C. Wheelock, *Banking Industry Consolidation and Market Structure: Impact of the Financial Crisis*, FED. RSRV. BANK OF ST. LOUIS REV., Nov.-Dec. 2011, at 420-24, https://files.stlouisfed.org/files/htdocs/publications/review/11/11/419-438Wheelock.pdf ("Despite an increase in the share of total U.S. deposits held by the very largest banks, the concentration of deposits among banks in local markets changed little, on average, from the mid-1980s through the 1990s . . . . Furthermore, the advent of interstate bank branching in 1997 had little immediate impact on either local banking market concentration or state-level measures of banking market competition . . . . [M]ean and median HHI values declined by more than 100 points between 1999 and 2006 for commercial banks, whereas . . . median HHI values declined by 93 points and mean HHI values declined by 4 points for commercial banks and savings institutions.").

systemic risk. The compliance infrastructure mandated by these regulations has incentivized regional and mid-sized institutions to combine and achieve the requisite economies of scale to compete against much larger institutions. Simultaneously, technological innovations in service delivery require significant and ongoing investment that further exacerbate the need for scale economies. The efficiencies achieved through mergers and acquisitions are thus procompetitive[4] and should not be discouraged as they enable smaller and regional competitors to more effectively compete with the large national players in this highly regulated industry.

In this context, we applaud the Division for undertaking the effort to revise its guidance and wholeheartedly encourage modernization of the Banking Guidelines, and we fervently hope the banking agencies implement at least some of the revisions. When adopted, the Banking Guidelines established Herfindahl-Hirschman Index ("HHI") concentration thresholds that were more relaxed than those in the merger guidelines applied to other industries (which we refer to as the "Industrial Guidelines"),[5] an acknowledgment that the branch deposit data used for determining concentration levels did not account for non-bank and out-of-market competitors and of the challenges in defining product markets where banks competed to varying degrees against hybrid institutions such as thrifts and credit unions.[6] Since then, the 2010 revisions to the Industrial Guidelines leapfrogged the Banking Guidelines (which remained unchanged) in the relaxation of concentration thresholds – an anomalous circumstance that has persisted for 10 years.[7] At the same time, issues of product and geographic market definition in banking have blurred even further; not only have thrifts and credit unions become more "bank-like," but technological developments such as online banking, remote deposit capture and the growth of electronic payments have introduced new competitors, strengthened smaller competitors,

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4 *See* Anne K. Bingaman, Assistant Att'y Gen., Antitrust Div., U.S. Dep't of Justice, Address before the Comptroller of the Currency's Conference on Antitrust and Banking (Nov. 16, 1995), https://www.justice.gov/atr/speech/antitrust-and-banking ("To the extent that a bank merger allows the merging firms to achieve significant economies of scale or scope, consumers may benefit from lower costs and/or improved services . . . ."); *see also* Press Release, U.S. Dep't of Justice, *Justice Department Requires Divestiture in Order for BB&T and SunTrust to Proceed with Merger* (Nov. 8, 2019), https://www.justice.gov/opa/pr/justice-department-requires-divestitures-order-bbt-and-suntrust-proceed-merger ("[C]ustomers will continue to have access to competitively priced banking products, including loans to small businesses, while preserving the investments in innovation and technology this merger is expected to generate.").

5 *Compare* U.S. DEP'T OF JUSTICE AND THE FED. TRADE COMM'N, 1992 MERGER GUIDELINES § 1.5 (1992) (hereinafter "1992 HMG"), https://www.justice.gov/archives/atr/1992-merger-guidelines, *with* the BANKING GUIDELINES, *supra* note 2, § 1. The HHI is a means of estimating market concentration levels by summing the squares of market participants' shares.

6 *See* Robert E. Litan, Deputy Assistant Att'y Gen., Antitrust Div., U.S. Dep't of Justice, Antitrust Assessment of Bank Mergers before the Antitrust Section of the ABA (Apr. 6, 1994), https://www.justice.gov/atr/speech/antitrust-assessment-bank-mergers ("In addition, I should explain why at the screening stage we use a looser HHI test (1800/200) than is suggested by the Guidelines (1800/50) as a threshold indicating a likely challenge. The basic reason is that banks face competition in virtually all of their services from non-banks, as well as from out-of-state banks, that often cannot be captured by computing HHIs based solely on deposits. We have recognized the strength of that competition generally by screening out mergers causing changes in the HHI up to 200 even where the post-merger HHI in the market is 1800 or higher.").

7 *See* U.S. DEP'T OF JUSTICE AND THE FED. TRADE COMM'N, HORIZONTAL MERGER GUIDELINES, § 5.3 (2010) (hereinafter "2010 HMG"), https://www.justice.gov/sites/default/files/atr/legacy/2010/08/19/hmg-2010.pdf (adopting higher 2500/100 HHI threshold for transactions that potentially raise competitive concerns).

broadened geographic markets and accentuated the challenges of using branch deposits as a proxy for market share calculations.[8]

In view of these developments, we believe the deposit-based concentration thresholds should be raised significantly from the 1800/200 HHI level established 25 years ago.[9] Notably, only two years after these HHI levels were mutually agreed to by the Division and the Board of Governors of the Federal Reserve System ("FRB"), an FRB economist proposed that they be raised to 2200/250 to reflect economic developments and the reality of enforcement practice.[10] That proposal was withdrawn, but the reality persisted. We see no reason not to raise the screening threshold to at least 2200/250 in view of current and expected competitive dynamics in the industry. Inasmuch as the FRB economist's proposal originated 23 years ago, and numerous mergers exceeding the 2200/250 threshold have been approved by the FRB and the Division in the last 25 years, even higher thresholds – possibly 2500/250 – are likely justified by subsequent developments.[11]

In addition to raising the HHI thresholds,[12] as discussed in detail below, we respectfully submit that the revised Banking Guidelines should:

- Incorporate and update many of the long-standing Division practices that are articulated in the 2014 FAQs and other sources,[13] including:

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8 Further complicating the use of branch deposits as a competitive yardstick is the dramatic increase in the percentage of deposits booked at very large bank branches over the last 25 years. In 1994, the top 100 bank branches in the United States held 9% of the country's total deposits. As of the second quarter of this year, the top 100 branches held 37.5% of total deposits, even as the total number of U.S. bank and thrift branches increased during that period. As of June 30, 1994, there were 81,297 branches in the Federal Deposit Insurance Corporation ("FDIC") Summary of Deposits database (76,323 of them reporting deposits) while as of June 30, 2020, there were 85,395 branches (82,361 reporting deposits). *See generally* FDIC, SUMMARY OF DEPOSITS (SOD) – ANNUAL SURVEY OF BRANCH OFFICE DEPOSITS, https://www.fdic.gov/regulations/resources/call/sod.html. This trend toward the centralized booking of deposits demonstrates the geographic fungibility of bank deposits. *See* discussion *infra* notes 43–44

9 *See* BANKING GUIDELINES, *supra* note 2, § 1 (transactions in which the resulting HHI is less than 1800 or result in a change in HHI of less than 200 "clearly do not have significant adverse effects on competition," and do not meet the test for further scrutiny).

10 *See* David S. Neill, *New Safe Harbor or Not? Fed Clarifies Antitrust Thresholds for Bank Deals*, 16 BANKING POLICY REPORT NO. 13, 1997, at 1 (reporting that the then Assistant Director of the FRB's Division of Research and Statistics announced plans to relax the concentration thresholds to 2200/250 during remarks made at an American Bar Association panel), https://www.wlrk.com/webdocs/wlrknew/WLRKMemos/WLRK/WLRK.18597.97.pdf.

11 A 2500/250 threshold would align with the historical difference between the 1992 Industrial Guidelines and the Banking Guidelines and thus account for the now-relaxed thresholds in the 2010 Industrial Guidelines. *See infra* notes 35–44. We note that even greater latitude should be given to mergers of financially impaired institutions given the exigencies of those situations. *See infra* notes 132–137.

12 *See* discussion *infra* notes 35–44.

13 *See* discussion *infra* notes 25–34.

- The Division's "2% test" for determining inclusion of thrift and credit union deposits in the Division's analysis of small business banking;[14] and

- The Division's historical practice of using Community Reinvestment Act ("CRA") small business loan origination data for evaluating competition for small business lending;[15]

- Describe how the revised Banking Guidelines mirror or diverge from the FRB, Office of the Comptroller of the Currency ("OCC") or Federal Deposit Insurance Corporation ("FDIC") approaches or methodologies;[16]

- Eliminate Ranally Metro Area ("RMA") and county geographic markets as part of its initial screen and instead evaluate concentration in geographic markets no narrower than the FRB market for all markets, or at the very least, adopt this practice for rural markets;[17]

- Adopt higher concentration screening thresholds for rural markets than for non-rural markets, or, if the Division is disinclined to have different thresholds, specifically outline the mitigating factors that may be relevant to the Division's analysis of competition in a rural market;[18]

- Explicitly recognize the distortions caused by headquarters branches and provide more guidance to parties as to the type of accounts the Division and the banking agencies will consider excluding;[19] and

- Include a clear description of (1) middle-market banking products and services; (2) middle-market banking customers; and (3) the geographic market in which middle-market banking will be evaluated or, at the very least, the factors the Division will consider or evaluate in determining the geographic scope of such a market:[20]

    - Identify the general framework in which the Division will evaluate middle-market competition (*i.e.*, shares versus bidding market). To the extent the Division continues to believe share data are useful in evaluating middle-market banking, the revised Banking Guidelines should describe the type of data and information that the Division would find persuasive in demonstrating share or competitive presence in the absence of publicly reported data.

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14 *See* discussion *infra* note 83.

15 *See* discussion *infra* notes 83–85.

16 *See* discussion *infra* notes 30–34

17 *See* discussion *infra* notes 48–80, 110–115.

18 *See* discussion *infra* notes 110–115.

19 *See* discussion *infra* notes 43–44, 81.

20 *See* discussion *infra* notes 89–109.

- Reflect existing Division policies and recognize the increased and growing competitive significance of thrifts and credit unions by:[21]

    - Crediting at 100% of deposits thrift and credit union deposits in an analysis of retail banking markets;

    - Crediting at 100% of deposits any thrift or credit union that holds 2% of more of its assets in Commercial & Industrial loans ("C&I") in evaluating small business banking concentration; and

    - Crediting at 50% of deposits any thrift or credit union in an analysis of small business banking and lending where the institution has at least 1% of assets in C&I loans.

- Include a broadened acknowledgement of the weakened competitor defense, provide additional guidance as to the Division's framework for evaluating such a transaction, and contemplate a more relaxed screening threshold, or an explicit discounting of an impaired bank's deposit and loan share in transactions involving a weakened competitor.[22]

Guidance Generally

To what extent, if at all, is it useful to have banking-specific merger review guidance, beyond the 2010 Horizontal Merger Guidelines? To what extent, if any, does the industry need greater clarity on how the Division applies the 2010 Horizontal Merger Guidelines in its investigations?

Banking-specific merger review guidance is critical for efficient merger review both for the banking industry and for the Division and regulators conducting the review. One measure of the success of the Banking Guidelines is the limited number of investigations opened by the Division and the rarity of a denial of a merger by a bank regulator.[23] This is achieved because practitioners in the area generally understand how mergers will be reviewed, allowing them to avoid transactions that are unlikely to be approved, to anticipate, plan for and more promptly offer remedies in areas that are very likely to raise competitive issues, and to prepare analyses for those areas that might raise competitive issues.

The Banking Guidelines specifically address (1) the HHI screen applied (which was higher than that of the Industrial Guidelines); (2) the product markets to be reviewed (retail (implied), commercial and possibly other specialized products); (3) the geographic markets to be reviewed (FRB-defined markets, Ranally Metro Areas, counties); (4) the calculation

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21 *See* discussion *infra* notes 116–128.

22 *See* discussion *infra* notes 132–137.

23 The FRB has issued only two Orders denying acquisitions since 1995. The Division has issued only 37 press releases regarding bank mergers since 1995 despite reviewing thousands of transactions.

methodology, including identifying the data used and any adjustments needed (as applied differently to each product market); and (5) acceptable mitigating factors (like demographic or economic market changes and recent entry).[24]

The Division's approach to each of these points has evolved with the industry and changes in data sources since 1995 – except the HHI screen (discussed below). This evolution has been documented in presentations by Division officials, in the 2014 FAQs, and through the experience of industry professionals. These scattered sources do not present cohesive or comprehensive guidance and can be easily misinterpreted both by Division staff and the private bar.[25] Additional detail on calculations and methodology is now possible. The data available for the preliminary screen are the same in every transaction,[26] and specific guidance on calculations and adjustments should be explicit.

The sheer number of consolidations[27] in this still fragmented industry[28] has enabled the Division and the other agencies to build a level of in-house expertise and established practices that simply do not exist with most other industrial mergers. Unique issues faced by banks that are impaired or potentially failing – as occurred during the financial crisis and may reoccur as a result of the current low-interest rate economy, especially during the pandemic – also require guidance beyond the generalities of the Industrial Guidelines.

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[24] *See generally* BANKING GUIDELINES, *supra* note 2.

[25] *See*, *e.g.*, Bd. of Governors of the Fed. Rsrv. Bd., *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 Golding Company Act, the Bank Merger Act and the Home Owners' Loan Act?* (2014) (hereinafter the "2014 FAQs"), https://www.justice.gov/atr/page/file/1232171/download; Org. for Econ. Cooperation and Dev., *Roundtable on Competition and Regulation in Banking* (Working Paper No. 2, 2006) (hereinafter "OECD 2006"), https://www.ftc.gov/sites/default/files/attachments/us-submissions-oecd-and-other-international-competition-fora/Banking_US.pdf; Robert Kramer, *Antitrust Review in Banking and Defense*, 11 GEO. MASON L. REV. 111 (2002); Robert Kramer, Chief, Litigation II Section, Antitrust Div., U.S. Dep't of Justice, "Mega-Mergers" in the Banking Industry before the American Bar Association Antitrust Section (Apr. 14, 1999), https://www.justice.gov/atr/speech/mega-mergers-banking-industry; Constance K. Robinson, Director of Ops., Antitrust Div., U.S. Dep't of Justice, Bank Mergers and Antitrust Trends before the Association of the Bar of the City of New York (Sept. 30, 1996) (hereinafter "Robinson Sept. 1996"), https://www.justice.gov/atr/speech/bank-mergers-and-antitrust-trends; Constance K. Robinson, Director of Ops., Antitrust Div., U.S. Dep't of Justice, Bank Mergers and Antitrust, Bank Mergers and Antitrust before the 31st Annual Banking Law Institute (May 30, 1996) (hereinafter "Robinson May 1996"), https://www.justice.gov/atr/speech/bank-mergers-and-antitrust; Bingaman, supra note 4.

[26] These data include the FDIC Summary of Deposit data, *see supra* note 8; FDIC Call Reports, https://www.fdic.gov/regulations/resources/call/; and CRA loan origination data, https://www.ffiec.gov/cra/craproducts.htm.

[27] *See* OECD 2006, *supra* note 25, at 5 ("[T]he basic similarity of the factual issues across the range of banking mergers, and the very large numbers of these mergers that occur every year, have both permitted and necessitated the establishment of certain procedural "shortcuts," without which the efficient review of banking mergers in the United States would be much more difficult."). The Division has performed 23,763 screenings and 16,832 competitive analyses from 1995 to 2018 according to the Division's Workload Statistics, https://www.justice.gov/atr/division-operations (last accessed 10/5/2020).

[28] There remain more than 5,000 FDIC-insured banking institutions in the United States. *See* FDIC, 14 QUARTERLY BANKING PROFILE – SECOND QUARTER 2020 at 3 (2020), https://www.fdic.gov/bank/analytical/qbp/2020jun/qbp.pdf#page=1. *See also supra* note 3 (demonstrating a lack of bank concentration generally at the local level).

Accordingly, we believe it would be counterproductive and impractical to place bank mergers under the general Industrial Guidelines.[29]

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 (FRB), the Office of Comptroller of the Currency (OCC), and the Federal Deposit Insurance Corporation (FDIC)?

The banking industry inhabits a unique statutory and regulatory regime. The regulatory framework in which the competitive ramifications of every merger is reviewed by the Division and at least one bank regulator requires specialized guidance.[30] One of the great achievements of the Banking Guidelines was that the Division, the FRB and the OCC[31] agreed on a common screen of 1800/200, and we strongly encourage all the agencies charged with reviewing bank mergers to join in lifting the thresholds (preferably to at least the level we propose). In the absence of such an interagency agreement, the impact of only the Division lifting the threshold would amount to little.

Even today, while the Division and other bank regulators have achieved a laudable amount of procedural coordination and ostensibly operate under the same concentration thresholds using the same data sources, their substantive methodologies diverge significantly, especially as to the treatment of thrifts, credit unions and headquarters deposits.[32] These differences can significantly affect the agencies' respective HHI calculations, resulting *de facto* in two different HHI screens for any given merger despite the apparent harmony achieved by the Banking Guidelines. Parties are thus often required to make multiple arguments to different regulatory audiences and ultimately to divest branches and deposits to reach the "highest common denominator" required by the different reviewing agencies. In these circumstances, parties trying to gauge antitrust risk before embarking on a merger face considerable uncertainty. Accordingly, we strongly encourage that the agencies, at a minimum, jointly adopt higher screening thresholds. Further harmonization of their methods for calculating those thresholds

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[29] Where, however, more specific guidance simply does not make sense either because the issue is too nuanced or involves a non-core banking product, the Industrial Guidelines may serve as a helpful guidance tool for the Division and parties. For example, in addition to the traditional deposit and lending services offered by banks – which are the principal markets of interest in the Division's review of bank mergers – other products such as credit card services or ATM networks may be better evaluated under the lens of the Industrial Guidelines.

[30] *See* OECD 2006, *supra* note 25, at 5 ("The Antitrust Division is tasked with reviewing all bank merger transactions that are proposed throughout the United States. Banking is unique in many respects, one of which is the regulatory scheme through which banks operate. In addition to the Division, bank agencies are tasked with evaluating the competitive effects of the transaction. Because of this dual review, there is a significant level of interagency staff cooperation."); *id*. at 7 ("Both bank and non-bank mergers are subject to competitive review under the Division's Merger Guidelines, but they differ because (i) bank merger transactions receive antitrust immunity after the post-approval waiting period expires, (ii) if the Department files suit, there is an automatic stay and a federal district court would conduct a de novo review of the transaction, and (iii) the timetable for bank merger review is defined in the banking statutes.").

[31] The FDIC did not officially adopt the guidelines (though it did adopt the 1800/200 screen), but in our experience has largely followed them in practice.

[32] *See*, *e.g.*, 2014 FAQs, *supra* note 25, Q.17-19, 23, 31-32 (describing how the FRB and Division treat thrift and credit union deposits and how the FRB treats centrally booked and government deposits).

would go a long way toward mitigating the uncertainty and confusion surrounding the antitrust review of bank mergers.

In the absence of total harmonization, which we acknowledge is unrealistic, joint guidelines that clearly explain the divergent approaches of the agencies is also helpful. In 2014, the FRB (with the Division's cooperation) published a FAQ describing how the FRB and the Division analyze the competitive effects of mergers and acquisitions. It was intended, in part, to provide parties with additional clarity on the FRB's review process and the ways in which the Division's review process, while similar, diverged from the FRB review process.[33] This guidance has helped to streamline applications, minimize surprises to the merging parties and, thus, expedite processing by the Division.[34] It is imperative that applicants, at the very least, continue to receive such guidance as to how the agencies' approaches diverge.

We thus respectfully submit that the revised Banking Guidelines should:

- *Incorporate and update many of the long-standing Division practices that are articulated in the 2014 FAQs and other sources; and*

- *Describe how the new Banking Guidelines mirror or diverge from the FRB, OCC or FDIC approaches or methodologies.*

Herfindahl-Hirschman Index (HHI) Threshold

Should the screening thresholds in the 1995 Banking Guidelines be updated to reflect the HHI thresholds in the 2010 Horizontal Merger Guidelines?

As noted, we believe the deposit-based thresholds should be raised to 2200/250 at a minimum, and possibly to 2500/250. Presently, as a "screening test" for competitive considerations under the Banking Guidelines, the Division and FRB traditionally conclude that a merger presents no competitive concerns and warrants no further investigation if either (a) the post-merger HHI (computed by summing the squares of deposit-based market shares of all FDIC-reporting firms in affected geographic markets) is less than 1800 or (b) the increase in the HHI as a result of the merger is less than 200 points. If a proposed transaction does not exceed this 1800/200 screen, "the banking agencies are unlikely to further review the competitive effects of the merger."[35]

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33 *See generally id*.

34 *See* OECD 2006, *supra* note 25, at 5 ("The analysis of banking mergers is different primarily in the amount and type of information available and the tools we use in evaluating this information . . . ."); *id*. at 7 ("[T]here is a significant amount of public information available for banks that is not available for other industries, such as FDIC Summary of Deposit data, bank call reports, and Community Reinvestment Act ('CRA') data. Because of this access to information, the bank merger review process typically is more transparent and predictable.").

35 *See* BANKING GUIDELINES, *supra* note 2, § 1.

When the 1800/200 standards in the Banking Guidelines were adopted, they were more relaxed than the HHI thresholds applied to industrial mergers (1800/50), residing at the upper limit of the Industrial Guidelines' category of moderate concentration with a greater permissible HHI change.[36] This was an acknowledgement by the Division that "banks face competition in virtually all of their services from non-banks, as well as from out-of-state banks, that often cannot be captured by computing HHIs based solely on deposits."[37] In 2010, however, when the Industrial Guidelines were revised to relax HHIs for industrial mergers,[38] the Banking Guidelines were not similarly revised.[39] As a result, the Banking Guidelines became more restrictive than the Industrial Guidelines, inverting the relationship of the previous 15 years, even though the circumstances justifying the original relaxation had become more compelling. In recognition of the distinct characteristics of the banking industry, the Division should again, not simply apply the Industrial Guidelines HHI thresholds to bank mergers, but adopt levels that *exceed* those of the current Industrial Guidelines, restoring the prior relationship between those standards for reasons that are even stronger in today's competitive environment than they were in 1995. A shift in the Banking Guidelines threshold to 2500/250 would restore the balance that previously existed prior to issuance of the 2010 Industrial Guidelines. Short of that aspiration, an inter-agency threshold of 2200/250 would be a significant move in the right direction.

In practice, the DOJ and banking regulators have often cleared transactions with concentration levels that significantly exceed the current thresholds, indicating that the screens are set too low to provide much utility.[40] This result is unsurprising given that the local branch

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36 Under the 1992 Industrial Guidelines, markets with post-merger HHIs of 1000 or less were deemed unconcentrated; those with HHIs between 1000 and 1800 (with a transaction-related increase of more than 100 points) were deemed "moderately concentrated"; and those with post-merger HHI above 1800 are "highly concentrated" and a change in HHI over 100 points was presumed likely to create or enhance market power while those with a change in HHI over 50 points may potentially raise significant competitive concerns. *See* 1992 HMG, *supra* note 5, § 1.5.

37 Litan, *supra* note 6; *see also* Neill, *supra* note 10.

38 Under the 2010 Industrial Guidelines, markets with post-merger HHIs of 1500 or less, or with a change in HHI of less than 100 points, are deemed to be unconcentrated, those with HHIs between 1500 and 2500 (with a transaction-related increase of more than 100 points) are deemed to be "moderately concentrated" and those with resulting HHIs over 2500 and a change in HHI over 200 points are "highly concentrated" and presumed likely to enhance market power. *See* 2010 HMG, *supra* note 7, § 5.3.

39 This relaxation was intended to be more consistent with Federal Trade Commission ("FTC") and Division practice. Investigation and enforcement data for 1996 through 2007 showed clearly that the FTC did not adhere to the thresholds articulated in the 1992 Guidelines. *See* Timothy J. Muris and Bilal Sayyed, Comment Letter to the Horizontal Merger Guidelines Review Project #545095-00053, entitled *Three Key Principles for Revising the Horizontal Merger Guidelines* 6-11 (Dec. 7, 2009), https://www.ftc.gov/sites/default/files/documents/public_comments/horizontal-merger-guidelines-review-project-545095-00053/545095-00053.pdf.

40 Since the Division does not release the results of its HHI analyses, a review of published FRB Orders provides insight into the levels of HHIs approved. We reviewed a sample of 77 FRB markets approved since 2010 where a merger's HHI exceeded 1800/200 in the initial screening or where initial screening HHIs were not reported, but there was a divestiture and post-divestiture HHI reported (excluding acquisitions of noncontrolling interest or where no HHI information was released). Of these, 32 or 42% of the markets had HHIs that still exceeded 1800/200 after accounting for all quantifiable mitigating factors *and* divestitures. We would argue some of those divestitures to below 1800/200 were arbitrarily high as the 1800/200 guidelines reflected out-of-date standards.

A few recent examples of approved HHIs exceeding 2200/250 after adjustments include *First Citizens BancShares, Inc.*, FRB Order No. 2019-18 (Dec. 16, 2019) (Cherokee, North Carolina: 2237/304), *Banner* deposit data upon which initial screens are calculated presents a variety of challenges that have been addressed *ad hoc* on a transaction-by-transaction basis for many years. These data are collected by the FDIC annually from all of its insured institutions. The FDIC data necessarily provide a point-in-time snapshot of deposits and are reported independent, and without consideration, of the characteristics of those deposits from a competitive perspective. For instance, the trends in deposit movements reflecting changes in a bank's condition are lost; the data are not geocoded by customer location and do not account for different methods that banks use for booking deposits to branches or how related deposit accounts have been householded within a bank's information systems. Most importantly, corporate accounts, brokered deposits, collateralized government deposits and other highly volatile deposit accounts typically booked in regional or national headquarters branches are not segregated from true retail deposits.

These data also exclude entirely local financial institutions, such as credit unions, that are not insured by the FDIC and certain online institutions that also provide financial services.[41] While the agencies have long acknowledged the need to give some weight to local thrifts and credit unions, the agencies use different standards in evaluating when and how much to credit these deposits and how to allocate them among different geographic markets, resulting in differing views as to which geographic markets are likely to raise competitive concerns.[42] The data are thus under-inclusive because they limit market participants to those reporting deposits to the FDIC in a relevant geographic market. Importantly, this fails to account for the rise of internet banking and decreased reliance on bank branches in general as a means of attracting and retaining customers and deposits, as discussed below in detail.

The data also ignore the supply-side ramifications of the largest nationwide banks with hundreds of billions of dollars of deposits in a small number of branches. As depicted in the chart below, the top 100 branches in the U.S. held 9% of total deposits in 1994, but now account

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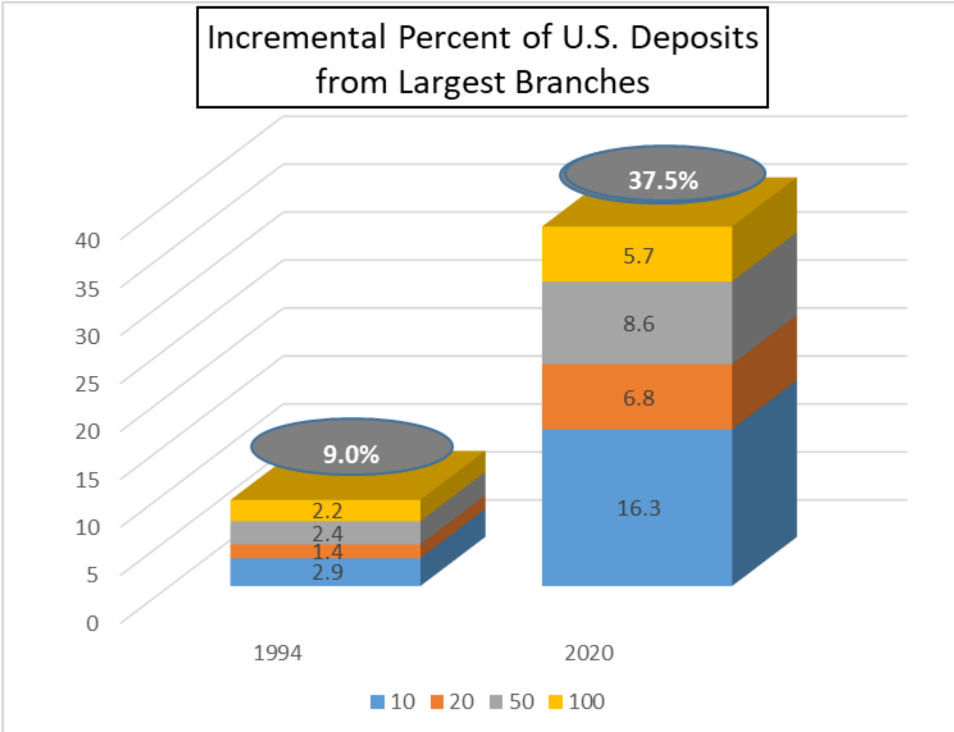
Corporation, FRB Order No. 2015-23 (Sept. 3, 2015) (Walla Walla, Washington: 2367/327), *Chemical Financial Corporation*, FRB Order No. 2014-16 (Sept. 30, 2014) (Cadillac, Michigan: 2339/329), and *Regions Financial Corporation*, 93 Fed. Res. Bull. C16 (Oct. 20, 2006) (Mobile Area, Alabama: 2410/339).

41 In our experience, online banks report their deposits in one or a few "branches" for FDIC-reporting purposes. As such, these institutions are excluded entirely where the "branch" is not located in a local market, even if the bank is servicing a local market. On the other hand, the online bank's deposits are *overstated* in local markets where those "branches" are located. In our experience, the Division has heavily discounted these online "branch" deposits in the local markets in which they are booked.

42 The Division uses a "2% test" to determine how much competitive weight to give institutions (banks, thrifts and credit unions) when evaluating the small business banking product market. It includes those institutions that hold 2% or more of their assets in Commercial and Industrial (C&I) loans at 100% of their deposits in the market share analysis and excludes all institutions failing the test. *See* 2014 FAQs, *supra* note 25, Q.31-32. We believe that the use of the 2% test originated during the acquisition of BayBanks by Bank of Boston in 1996, but it was only discussed verbally and was not then published. *See* David S. Neill, *New Antitrust Policies Add Complexity and Uncertainty to Bank Mergers*, 17 BANK AND CORP. GOVERNANCE L. REV. 196, 196 (1996). The 2% test effectively supplanted Screen B of the Banking Guidelines a year after they were issued. *See* BANKING GUIDELINES, *supra* note 2, § 2. The FRB typically include thrifts and some credit unions at 50% of deposits as the FRB uses deposits as a proxy for a market of all retail and business banking products and services (aka the "cluster of banking products"). If the FRB finds thrifts or credit unions to be bank-like in product offerings, they will include 100% of their deposits. Both the Division and banking regulators require credit unions to be accessible to the majority of the residents of the market in order for them to be included. *See generally* 2014 FAQs, *supra* note 25.

for 37.5%. Additionally, the 10 largest branches hold 16.3% of national deposits, or $2.5 trillion, up from 2.9% in 1994.[43]



This trend toward the centralized booking of deposits creates a two-fold problem: it overstates the market shares of banks with mammoth branches in the markets where these branches are located and understates their shares in all the other markets from which these deposits actually originated. These centralized branch deposits of the nation's largest banks also represent a huge source of supply-side lending capacity that could be deployed to any local market where pricing incentives beckon. For example, the nation's largest branch, JPMC's New York headquarters, currently holds $541 billion – up from $392.9 billion two years ago (an increase of ~38%).[44] It is likely that the half-trillion dollars in deposits booked at that New York branch have no bearing on JPMC's competitive significance in the local New York City retail deposit or small business lending markets, but were moved there from other locations for administrative reasons. Nor is the lending capacity represented by those deposits constrained to be used in New York; it can be deployed anywhere. Thus, while much of the classic headquarters issues (discussed below), such as volatility, collateralization or other contractual restrictions may render a significant portion of these mega-branch deposits unsuitable for lending, it is likely that a majority of them in fact represent an enormous reserve of lending capacity that could be deployed quickly to any market in the nation; put simply, a lack of locally booked deposits by these institutions is neither indicative of their geographic reach nor their

43 Table was created using FDIC Summary of Deposits data, *supra* note 8.

44 The 2018 deposits combine two "branches" reporting the same physical address while, in 2020, only one branch remains. *See* FDIC Summary of Deposits data, *supra* note 8.

enormous lending power. The supply-side ramifications of the mega-branches of large, nationwide banks is further reason to raise the HHI thresholds when examining local markets.

For the foregoing reasons, we respectfully submit that the revised Banking Guidelines should:

- *Raise the deposit-based HHI thresholds used to screen potentially problematic transactions to at least 2200/250, or preferably to 2500/250, with respect to retail and small business market segments, in recognition of the endemic problems associated with deposit data and in keeping with the 2010 revisions to the Industrial Guidelines and the original intent that the Banking Guidelines should justifiably be looser than those applied to industrial mergers. Ideally, the higher threshold would be adopted in cooperation with the banking agencies.*

Relevant Product and Geographic Markets

Depending on the transaction, the Division generally reviews three separate product markets in banking matters: (1) retail banking products and services, (2) small business banking products and services, and (3) middle market banking products and services. Are there additional product markets that the Division should include in its analysis?

The 1995 Banking Guidelines specify that the Division screens bank merger applications using the FRB-defined geographic markets and/or at a county-level. Should there be other geographic market definitions used in the screening process? If so, what should they be and why? Should the geographic markets for consumer and small business products and services still be considered local?

We consider the product and geographic market questions in tandem since they are inter-related.

Retail, small business and middle-market banking remain the core product markets of competitive concern in bank mergers and are the appropriate product markets to be addressed by the revised Banking Guidelines.[45] The Banking Guidelines notably do not presently identify retail banking as a relevant product market. However, the screens described in those guidelines which focus on FRB-defined markets, RMAs[46] and county geographic markets were clearly drafted with both retail and small business banking markets in mind.[47]

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45 Other markets, such as syndicated lending, custody, credit cards and payment systems, occasionally raise issues in bank mergers, but not frequently enough (in our opinion) to warrant addressing in the revised Banking Guidelines. Many of those products are nationwide and could be analyzed under the Industrial Guidelines. *See also* note 29.

46 Rand McNally discontinued defining RMAs in 2010. RMAs purported to describe commercially-centered metropolitan areas and were based on U.S. Census data from 2000. Thus, RMAs are no longer a valid representation of current metropolitan areas.

47 The Banking Guidelines do not mention middle-market banking specifically, though it uses the example of "working capital loans to medium-sized commercial customers" as a specialized product that may require separate

Retail and Small Business

All of the product-market analyses and geographic market definitions relating to banking need to account for the transformational technological and other industry developments in recent years (*e.g.*, fintech lending, remote deposit capture, internet banking, and private lenders) that have blurred both product and geographic market lines throughout the financial services industry. Historically, the Division justified its application of local geographic markets to retail product markets based on branch usage by consumers where they work and live. Thus, local branch deposits were the appropriate measurement. Meanwhile, the Division has at times evaluated even narrower geographic markets for small business lending based on distance-related information costs relative to average loan size.[48] Local branch deposits and locally originated (based on CRA data) small business loans were the prescribed measurement. It is hard to imagine an area where technology has reduced costs and rendered geographic distance less relevant than with respect to information and data collection. As detailed below, online lenders with no branch networks – and, correspondingly, no attributable share of local market deposits – now account for 20% of small business loans.[49] And, while branches remain a significant source of deposit-taking, remote deposit capture, online account opening and the growth of cashless payments has diminished their significance for all customer classes. Accordingly, using branch-based deposits as the sole proxy for defining and evaluating product and geographic market definition feels antiquated in the face of such rapid and dynamic change.

Beginning with retail consumers, banking online through pure-play internet banks has grown and will continue to grow: "Banking is a rapidly changing industry, and the biggest paradigm shift that has occurred is the move to digital-only banks. Millennials, in particular, are moving more frequently toward digital banking."[50] In response to demand for online-only

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analysis. BANKING GUIDELINES, *supra* note 2, § 1. Other Division sources discuss middle-market banking more directly. The Division has acknowledged that "medium-sized businesses may be able to access lenders and providers from larger areas" and that "the effective area of competition by banks for such loans and services tends to be larger for small businesses because of the greater ability of banks to secure and service those loans over greater distances." Robinson Sept. 1996, *supra* note 25.

48 Am. Bar Ass'n, *Bank Merger and Acquisition Handbook* 232 (2006) ("Successful commercial lending requires a substantial amount of information – both before and after a loan is authorized – about the business operations and plans of the borrower and the business conditions and environment in which that borrower operates. The need for this information and the cost of obtaining it have important ramifications for the geographic scope of commercial lending activities. Lenders can monitor local businesses and business conditions at lower cost than they can monitor distant ones. Therefore, they are willing to lend to distant customers only if the size of the loan is large enough to justify the additional expense of acquiring and maintaining the necessary information from a distance.").

49 *See*, *e.g.*, Fed. Rsrv. Bank, *2020 Report on Employer Firms Small Business Credit Survey* at 8-9 (2020) (hereinafter "2020 Credit Survey"), https://www.fedsmallbusiness.org/medialibrary/FedSmallBusiness/files/2020/2020-sbcs-employer-firms-report (reporting on percent of funding sources used by small business employer firms in the last five years).

50 Andrew Meola, *How fintechs and digital-only banks are innovating the banking sector*, BUSINESS INSIDER (Jan. 28, 2020), https://www.businessinsider.com/innovative-banking. *See also* Sara Berger, *Survey: 3 in 4 Americans Believe Physical Banks are Becoming Obsolete*, LENDING TREE: MAGNIFY MONEY (Jan. 15, 2020), https://www.magnifymoney.com/blog/news/bank-branch-survey/ (finding that 84% of Millennials and Gen Zers think physical bank branches are becoming obsolete).

banking, institutions are creating and expanding their online-only banks. Smaller regional banks are also creating internet-only brands, and online-only institutions are striving to "make branch banking obsolete."[51]

Separate and apart from the existence of pure-play internet banks is the fact that the financial industry is moving transactions online because customers want to transact their banking activities online. Traditional banks have had to respond to the rapid innovation in mobile banking being driven by these digital startups and others. Checks can be deposited from a mobile device. Payments and billing can be done at home or on mobile devices and almost every bank now offers such services. A 2019 survey conducted by the Federal Reserve Banks found that at least 96% of responding banks with over $100 million in assets offer mobile banking, 48% of online adults use a smartphone for banking at least once a month, and 83% of bank respondents and 71% of credit union respondents offer or plan to offer mobile banking services to their business customers.[52] That same survey recognized that "FinTechs potentially provide disruptive technology, products and agility."[53] A recent survey conducted by the Bank Administration Institute found that 61% of Gen Z and 62% of Millennial consumers would be willing to switch their primary bank account for a better digital experience.[54] Thus, "[f]or many retail banks, online and mobile channels have become as important – if not more important – than branches and ATMS."[55] Consistent with these trends, "[b]anks are expected to become more active in the fintech space, either by launching stand-alone digital banks or through partnerships" with nonbanks.[56]

The newest evolution in online banking are neobanks – branchless fintechs partnering with chartered banks to offer deposits, credit cards, loans and even brokerage services.[57] In the first nine months of 2019, venture capitalists invested $2.9 billion into neobanks of the $24.6

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[51] Nick Clements, *Online banks lead the way in high-rate savings accounts*, CBS NEWS (July 17, 2018), https://www.cbsnews.com/news/online-banks-lead-the-way-in-high-rate-savings-accounts/.

[52] *See* Marianne Crowe, Breffni McGuire, and Elisa Tavilla, Fed. Rsrv. Bank of Boston, *Financial Institutions across the U.S. Participate in the Mobile Landscape Transformation* at 16, 5, 72 (Dec. 23, 2019), https://www.bostonfed.org/publications/mobile-banking-and-payment-surveys/financial-institutions-across-the-us-participate-in-the-mobile-landscape-transformation.aspx.

[53] *Id*. at 5.

[54] Banking Admin. Inst., *BAI Banking Outlook: Digital Banking and the Customer of Today* (2020), https://www.bai.org/research/bai-banking-outlook/digital-banking/.

[55] Val Srinivas and Angus Ross, *Accelerating digital transformation in banking* at 9, 24 DELOITTE REVIEW (Jan. 2019), https://www2.deloitte.com/content/dam/insights/us/articles/DeloitteReview24/DI_DeloitteReview24.pdf.

[56] Deloitte Center for Financial Services, *2019 Banking and Capital Markets Outlook* at 15 (2018), https://www2.deloitte.com/content/dam/Deloitte/us/Documents/financial-services/us-fsi-dcfs-2019-banking-cap-markets-outlook.pdf.

[57] *See* Jeff Kauflin, *Dawn of the Newbank: The Fintechs Trying to Kill the Corner Bank*, FORBES.COM (Nov. 4, 2019), https://www.forbes.com/sites/jeffkauflin/2019/11/04/dawn-of-the-neobank-the-fintechs-trying-to-kill-the-corner-bank/#2b5e8b7fb0f6 ("Globally, a vast army of neobanks are targeting all sorts of consumer and small-business niches – from Millennial investors to dentists and franchise owners. McKinsey estimates there are 5,000 startups worldwide offering new and traditional financial services, up from 2,000 just three years ago.").

billion invested in global fintech business.[58] Fintechs are now receiving banking charters.[59] Banking as a Service is the latest technological and marketing advancement. This allows "licensed banks [to] integrate their digital banking services directly into the products of other non-bank businesses."[60] BBVA was the first bank to offer these services in the United States,[61] and Google is one of the largest companies to enter the collaborative banking service market.[62]

The COVID-19 pandemic has only accelerated the use of digital banking and these practices are likely to continue well beyond the exigencies of the pandemic. In April 2020, 72% of customers at the four largest U.S. banks used mobile banking apps.[63] Mobile deposits at Wells Fargo were 81% higher in April 2020 compared to April 2019,[64] and Fidelity National Information Services reported a 200% jump in new mobile banking registrations and an 85% increase in mobile banking traffic.[65] And as a recent Novantas survey reported, only 40% of respondents intend to return to branches post-COVID.[66]

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[58] *See id*. (reporting $2.9 billion in neobank investment based on a recent CB Insight report); *Global Fintech Report Q3 2019* at 8, CBInsights, https://www.cbinsights.com/reports/CB-Insights_Fintech-Report-Q3-2019.pdf (last accessed 10/7/2020).

[59] *See, e.g.*, Bryan Moore, Bob Warnock, and Michael Jiwani, *From Fintech to Full Service: How Fintechs Can Enter Everyday Banking*, NOVANTAS.COM (Aug. 15, 2020), https://www.novantas.com/industry-insight/novantas-review/2020-summer-fintechs-enter-banking ("Varo Money just became the first fintech to receive a national bank charter.").

[60] James Bessenbach, *What the hell is Banking as a Service and what is it not*, Solarisbank Blog (Oct. 11, 2019), https://www.solarisbank.com/blog/what-the-hell-is-banking-as-a-service-and-what-is-it-not/.

[61] Igor Tomych, *Top Six Banking as a Service Providers to Lead the Next Banking Revolution*, FINEXTRA (Jan. 28, 2020), https://www.finextra.com/blogposting/18379/top-six-banking-as-a-service-providers-to-lead-the-next-banking-revolution ("BBVA is the first bank in the United States to release a holistic suite of BaaS products and so provide third parties with an opportunity to implement their bold financial ideas, supported by the agile and scalable infrastructure of BBVA.").

[62] Sarah Perez, *Google signs up six more partners for its digital banking platform coming to Google Pay*, TECHCRUNCH (Aug. 3, 2020), https://techcrunch.com/2020/08/03/google-signs-up-six-more-partners-for-its-digital-banking-platform-coming-to-google-pay/ ("Much like the mobile banking services offered today by a number of startups, Google will provide the consumer-facing front-end to the digital banking services it makes available, while the accounts themselves will be held by the FDIC-backed partner institutions.").

[63] *See Digital banking soars in the COVID-19 pandemic*, Wells Fargo Stories (May 27, 2020), https://stories.wf.com/digital-banking-soars-in-the-covid-19-pandemic/.

[64] *See id*.

[65] *See* Ellen Sheng, *Coronavirus crisis mobile banking surge is a shift that's likely to stick*, CNBC.COM (May 27, 2020), https://www.cnbc.com/2020/05/27/coronavirus-crisis-mobile-banking-surge-is-a-shift-likely-to-stick.html.

[66] *See id*. In addition, the COVID-19 crisis has caused a sharp increase in domestic deposits in the United States from $2.7 billion as of June 30, 2019, to $15.5 billion as of June 30, 2020. *See generally* FDIC Call Reports, *supra* note 26. This presumably temporary shift in depositor behavior has the potential to distort a bank's competitive presence when based on these distorted deposit data. *See* Hugh Son, *U.S. banks are 'swimming in money' as deposits increase by $2 trillion amid the coronavirus*, CNBC.COM (Jun. 21, 2020), https://www.cnbc.com/2020/06/21/banks-have-grown-by-2-trillion-in-deposits-since-coronavirus-first-hit.html ("A record $2 trillion surge in cash has hit the deposit accounts of U.S. banks since the coronavirus first struck . . . . The wall of money flowing into banks has no precedent in history: In April alone, deposits grew by $865 billion, more than the previous record for an entire year.").

Similarly, one of the most dynamic trends in banking that is particularly relevant for small businesses is online lending. Online lenders (who have no physical branch presence in most local markets) "deliver speed, ease of use, and convenience," have lower fixed operating costs because "the Internet obviates the need for brick-and-mortar retail spaces," and encourage digital transactions that "enjoy a near-zero marginal cost and start with a high degree of returns to scale." This, in turn, enables lenders to "offer smaller loans than traditional lenders, as the per loan average processing cost falls rapidly with the higher origination volume."[67] Online lenders "have shown that they can reduce delays and inefficiencies in the lending process, without sacrificing credit affordability, rigorous risk assessment, or compliance and controls,"[68] and "are unencumbered by legacy systems and structures that slow down decision[mak]ing. They can automate most of the credit risk evaluation process, and use models that become stronger and more predictive over time."[69] Research from the Federal Reserve Banks of Cleveland and Minneapolis shows that "[t]hrough reaching borrowers less likely to be served by traditional lenders fintech lenders have substantially expanded the small business finance market."[70]

Online lending is an increasingly attractive and accepted option for consumers and small businesses alike. TransUnion, a consumer credit reporting agency, reported that, in 2018, fintechs' share of personal loan balances reached 38%, up 3% year-over-year, whereas banks' share declined to 28%, down 2% year-over-year.[71] One leading peer-to-peer online lender, Lending Club, for example, which started in 2007, reports having lent over $55 billion in personal and small business loans, serving three million customers.[72] And one leading online small business lender, Kabbage, extended over $9 billion to 220,000 small businesses, including $3 billion in 2019 alone.[73] Traditional financial institutions have also entered into the fray.

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67 Christina Wang, *Technology, the Nature of Information, and Fintech Marketplace Lending* at 16-17 (Fed. Rsrv. Bank of Boston Research Paper Series, No. 18-3, Oct. 2018), https://www.bostonfed.org/-/media/Documents/Workingpapers/PDF/2018/cpp1803.pdf.

68 Bernardo Martinez, *Fintechs Could Make Life Easier for Overtaxed SBA*, AM. BANKER (Feb. 15, 2019), https://www.americanbanker.com/opinion/fintechs-could-make-life-easier-for-overtaxed-sba.

69 *Id*.

70 Brett Barkley and Mark E. Schweitzer, *The Rise of Fintech Lending to Small Businesses: Businesses' Perspectives on Borrowing* at 1 (Fed. Rsrv. Bank of Minneapolis System Working Paper No. 20-03, June 2020), https://www.minneapolisfed.org/institute/working-papers/wp20-03.pdf.

71 Andy Peters, *Banks fall further behind fintechs in personal lending*, AM. BANKER (Feb. 21, 2019), https://www.americanbanker.com/news/banks-fall-further-behind-fintechs-in-personal-lending.

72 *See* Press Release, *LendingClub Studies Reveal Customers Prioritize Personal Loan Payments Over Credit Cards, Helping Them Progress Toward Financial Health*, LENDING CLUB (Sept. 22, 2020), https://ir.lendingclub.com/news/news-details/2020/LendingClub-Studies-Reveal-Customers-Prioritize-Personal-Loan-Payments-Over-Credit-Cards-Helping-Them-Progress-Towards-Financial-Health/default.aspx.

73 *See* Hank Tucker, *The Future of Small Business Lending: Fintech 50 2020*, FORBES.COM (Feb. 12, 2020), https://www.forbes.com/sites/hanktucker/2020/02/12/the-future-of-small-business-lending-fintech-50-2020/#666893d44f9b. Kabbage is also the "third-largest PPP lender by application volume," having approved over $5.8 billion in small business loans in a three-month period. *See* Press Release, *Kabbage Soars to Over 209,000 Approved Paycheck Protection Program Applications for $5.8 Billion*, KABBAGE (July 1, 2020), https://newsroom.kabbage.com/news/kabbage-soars-to-over-209000-approved-paycheck-protection-program-applications-for-5-8-billion/.

Marcus, for example, a recent fintech entrant that is owned by Goldman Sachs, reached $1 billion in origination volume within eight months of launch.[74]

Surveys conducted by the Board acknowledged this growing trend as "business owners increasingly turn to online lenders for funding. In 2016, some one-in-five credit applicants (21%) sought financing at an online lender, rising to nearly one-in-four (24%) in 2017."[75] The FRB's 2020 Small Business Credit Survey found that while banks were still the most common source of external financing (44%), online lenders ranked second, at 20%[76] – about one-half the volume provided by banks.[77]

The potential reach and scale of these online lenders should not be discounted and yet, today, these alternative sources of funding are neither taken into account in the traditional small business loan data sources nor considered under the traditional approach of using deposits as a proxy for competition in retail or small business lending.[78] If the impact of these competitors cannot be easily quantified at a local market level, they should be accounted for by raising the concentration thresholds, as we have argued above.

In terms of geographic market definition, to the extent the foregoing technological advances in lending and deposit capture have reduced retail and small business customers' reliance on branches and the need for proximity to loan offices, relevant geographic markets would presumably expand, not contract. As a result, there should be less reason for the Division to investigate market alternatives any narrower than the FRB banking markets.[79] In our

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[74] *See* Peter Renton, *The Fastest Consumer Lenders to $1 Billion in Originations*, LendAcademy (June 26, 2017), https://www.lendacademy.com/consumer-lenders-1-billion-originations/.

[75] *See* Barbara J. Lipman and Ann Marie Wiersch, *Browsing to Borrow: 'Mom & Pop' Small Business Perspectives on Online Lenders* at 3, Bd. of Governors of the Fed. Rsrv. Sys. (June 2018), https://www.federalreserve.gov/publications/files/2018-small-business-lending.pdf/.

[76] 2020 Credit Survey, *supra* note 49, at 8-9; *see also id*. (six percent of small business employer firms used a credit union as a funding source in the last five years and among some business demographics, up to 41% used an online lender).

[77] As with deposits, business lending has been transformed due to the COVID-19 pandemic. Small- and medium-sized businesses have become more willing to switch banks in search of Paycheck Protection Program loans. This may have a long-term effect on the willingness of businesses to split their relationships across multiple institutions, and in the short run could skew small business lending competitive data for the next few years. *See, e.g.*, Jon Prior, *Frustrated by PPP, Many Small Businesses are Ditching Their Banks*, AM. BANKER (June 21, 2020), https://www.americanbanker.com/news/frustrated-by-ppp-many-small-businesses-are-ditching-their-banks.

[78] The competitive analysis has, to date, been limited by the available FDIC and CRA data, which do not incorporate these alternative competitors. However, the growing presence and acceptance of online lenders should be considered a material mitigating factor in the Division's analysis and evaluation of what concentration levels raise competitive concerns.

[79] The individual Federal Reserve Banks define the banking markets within their regions. Each Bank uses its own methodology. A database of the most recently established definitions (CASSIDI) is maintained at the Federal Reserve Bank of Saint Louis. Generally, the definitions are reviewed whenever a merger is proposed in a market and are intended to reflect "an economically integrated area . . . within which banking customers can practicably turn for alternative banking services when faced with unfavorable prices." They are evaluated based on commuting data; highway traffic volume statistics; travel times; geographic features; access to retail, commercial, governmental, educational, or health services; and common media coverage. *See, e.g., Banking Markets in the Twelfth Federal*

experience, in most instances when the Division has investigated concentration in a more narrow geographic market, the parties have been able to persuade the Division – after expending both the parties' and Division's time and resources – that the original market definition is adequate or there are other mitigating factors that would negate the effects of narrowing the market.[80] We believe that technology that has so clearly reduced branch reliance and distance-related information costs should, at a minimum, obviate the Division's need to investigate narrower geographic markets.

As mentioned above, issues of product and geographic market definition are also raised when a regional or mid-sized bank applicant's headquarters branch is present in an overlap market. The deposit data relied upon by the Division are *over-inclusive* in these circumstances to the extent they are intended to reflect a bank's local competitive presence or a bank's its capacity to lend to local small businesses. These branches typically hold large amounts of out-of-market deposits and deposits that are not suitable for lending, including mortgage escrows, corporate accounts, brokered deposits, collateralized government deposits and other highly volatile deposit accounts. Such non-retail, non-local and/or encumbered deposit accounts do not reflect the marketing prowess of a bank in attracting the deposits of retail or small business customers in a local market; nor do they add appreciably to a bank's local lending capacity. Distorting both the product and geographic dimensions of market definition, these deposits necessarily distort the market share analysis under the current Division screens.

In our recent experience, appropriate accounting for the distortive effects of non-local headquarters deposits has been a critical element in demonstrating no or lesser competitive concerns in particular markets. Despite the Division's consideration of these issues in practice, there is little publicly available guidance as to the types of headquarters or large branch deposit accounts it is willing to exclude or the circumstances under which it will do so. In view of the frequent occurrence of these concerns, we would recommend that the Division's revised Banking Guidelines provide more detailed guidance as to what evidence the parties should bring forward on headquarters or large branch deposits and how the Division will treat that evidence in particular circumstances. We would also encourage the banking agencies to join in this effort, as there is considerable divergence in their treatment of this issue.[81]

Reserve District at 1 (May 2019), https://www.frbsf.org/banking/files/marketdef-May-2019.pdf. FRB markets do not follow the arbitrary political boundaries of counties as Metropolitan Statistical Areas do.

[80] One of the most compelling arguments *against* narrower markets is that local competition extends radially and is impacted by a chaining effect whereby distant consumers can affect banking markets elsewhere. *See, e.g.*, Robert Tannenwald, *The Geographic Boundaries of New England's Middle-Lending Markets* at 47, NEW ENGLAND ECONOMIC REVIEW (July–Aug. 1994), https://www.bostonfed.org/publications/new-england-economic-review/1994-issues/issue-july-august-1994/the-geographic-boundaries-of-new-englands-middlelending-markets.aspx ("Because of the economic ties linking the municipalities in [disparate locations], depositors and banks located in any one community can directly or indirectly influence the prices of banking services in all other communities within the market . . . . [T]hey can exert this influence by initiating a chain reaction of responses to price changes, by both depositors and banks, that ultimately spreads throughout the market. This occurs even if the depositors in one community do not consider all banks within the market to be viable alternatives. Thus, depositors . . . living on the northern border of [a] market can indirectly influence the price of banking services offered by banks [on the southern border of the market], more than 60 miles away.").

[81] *See* 2014 FAQs, *supra* note 25, Q. 23 (describing how the FRB treats centrally-booked deposits). On a related issue, the revised Banking Guidelines should explain when the Division and/or the banking agencies will

In this regard, the use of small business loan origination data collected for CRA purposes often serves as an important check in confirming the distortions caused by headquarters deposits, and should be addressed in the revised Banking Guidelines.[82] Geocoded CRA data avoid a variety of problems plaguing the use of deposit-based market shares (including the 2% test)[83] and can, at minimum, confirm that a party's headquarters branch deposits do not translate into an outsized share of small business loan originations. It can also show whether out-of-market banks are lending into the market[84] and whether one or both of the merging parties has only a small or *de minimis* lending presence in a given market. While the CRA data also pose certain issues in that smaller institutions (which may be very active in their respective local markets) are exempted from reporting,[85] applicants have methods of estimating shares for non-reporters, to which the Division has been amenable.[86] In any event, CRA loan origination data provide a more direct measure of local lending competition than deposit-based proxies, especially in markets containing headquarters offices.[87]

In view of the immense changes to the banking and financial services sector over the last two decades, we respectfully submit that the Division's revised Banking Guidelines acknowledge the presence of these new competitors for all banking services discussed above, the impact of these institutions and related changing consumer and business banking practices on the

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exclude the deposits of large competitors in a market – such as a credit card bank, online bank, or trust company – that would cause the overall market to appear more concentrated than the deposit data would otherwise indicate. *See supra* notes 41–44.

[82] In certain instances, the Division has excluded loan origination data for certain competitors (*e.g.*, credit card companies) and entertained estimates for non-reporters. The Division should use this as an opportunity to clarify and provide guidance as to when and why it will make such adjustments to the CRA data.

[83] *See supra* note 42 (describing the 2% test).

[84] OECD 2006, *supra* note 25, at 9 ("CRA data is a great tool to get a 'quick look' at the small business lending in a particular county. The CRA data also provides valuable information about out-of-market banks' lending activities in a particular county.").

[85] The CRA data also include collateralized loans in addition to the non-collateralized C&I loans that have historically been the Division's primary concern.

[86] As suggested, *supra* note 82, the Division should include in the revised Banking Guidelines best practices for providing such estimates.

[87] CRA data also suggests the size of the geographic market for small business lending should be broader than a county. Forty-eight percent of all counties reporting CRA loans between $100,000 and $1 million showed fewer than 20 loans originated in 2018, with a median of 21 loans. In contrast, some metropolitan counties show significant lending – for example, Los Angeles County reported nearly 13,000 such loans. *See generally* Community Reinvestment Act, CRA Data Products, https://www.ffiec.gov/cra/craproducts.htm.

The banking regulators are presently evaluating what data to gather from market participants, which may ultimately affect what data are available for the antitrust analysis. The OCC's recent CRA rule requires OCC-supervised banks to "collect and maintain data on the value of each retail domestic deposit account and the physical address of each depositor." OCC, Dep't of the Treasury, 12 C.F.R. pt. 12, 195 at 204 (May 20, 2020), https://www.occ.gov/news-issuances/federal-register/2020/nr-occ-2020-63a.pdf. These deposits will be geocoded quarterly at the county level. The FRB is also evaluating its CRA regulations and has asked for comments on a requirement that large banks collect and report retail deposit data. The FDIC has not yet made a proposal, but we hope the agencies will ultimately reconcile their CRA revisions. Until the first data are available, it will be unclear how it may affect competitive analyses for retail or small business markets.

Division's analysis of banking product and geographic markets, and the degree to which these changes further challenge the use of deposit-based market shares to reliably capture competition. In particular, the revised Banking Guidelines should:

- *Raise the concentration thresholds, as we have argued, to the extent that online banks and other out-of-market lenders have non-quantifiable impacts in local markets;*
- *Eliminate RMA and county geographic markets as part of its initial screen and instead evaluate concentration in geographic markets no narrower than the FRB markets to account for the growth of non-branch competitors and decreased reliance by consumers on physical branches. This would also better align the Division's practice with that of the other banking agencies;*
- *Explicitly recognize the distortions caused by headquarters branches and provide more guidance to parties as to the type of accounts the Division and the banking agencies will consider excluding;*
- *Include explicitly the Division's historical practice of using CRA data for evaluating competition for small business lending. Moreover, where more direct alternative data sources exist – such as CRA small business loan originations – those sources should be favored over problem-prone, deposit-based measures (a) in markets presenting headquarter issues; and (b) where they show that one or both parties' small business loan originations are* de minimis *despite the shares implied by deposit-based measures;*
- *Specifically describe any common adjustments made to CRA data (such as eliminating credit card banks) or estimations made by the Division of lending by those not required to report CRA data. This would not preclude applicants from presenting alternative analytics, where appropriate, but would inform the applicants of the Division's expectations prior to announcing a transaction; and*
- *Identify and prioritize acceptable mitigating factors in the retail and small business markets.*

<u>Middle-Market</u>

Middle-market banking presents somewhat different analytical challenges for both product and geographic market definition, and the Division has provided little official guidance. The Banking Guidelines do not discuss it, nor do the 2014 FAQs, aside from a footnote acknowledging that such a product market exists.[88] Parties generally have had to rely on prior Division enforcement practice and a handful of speeches by Division officials for policy.[89]

88 *See* 2014 FAQs, *supra* note 25, fn.7.

89 *See*, *e.g.*, Robinson Sept. 1996, *supra* note 25; Bingaman, *supra* note 4; Kramer, *supra* note 25; and OECD 2006, *supra* note 25.

From these sources, it appears (subject to change in any given transaction) that the Division roughly defines the middle-market to consist of businesses that have sophisticated cash management needs, annual revenues of $10 million to $250 million and credit needs of $1 million to $10 million.[90] The historic concern was that small banks had neither the in-house lending limits nor service offerings to accommodate the middle-market, and that national capital markets were not accessible to middle-market businesses. Because the average loan size to the middle-market was larger than to small businesses, the Division acknowledged that middle-market loan customers could attract "more distant" lenders and that the relevant geographic markets were "larger" than the local FRB markets used for retail and small business.[91] How much larger has, in our experience, varied by transaction. The Division and FRB have provided little guidance. In some transactions, public commentary suggested statewide[92] or regional, such as New England,[93] markets. At other times, the middle market seemed no larger than a metro area.[94]

In truth, the FRB's research economists have shed more light on middle-market competition than the Division even though the FRB does not formally evaluate the middle-market in its merger review. Dating back to the 1990s, research by FRB and Federal Reserve Bank economists showed that geographic markets for middle-market businesses were no less than statewide and likely regional.[95] An FRB study released in August of this year – analyzing borrowers with annual revenues of $10 million to $250 million – definitively concludes that local FRB markets are not relevant for middle-market firms, and that markets are at least statewide and maybe larger.[96] Assuming markets are statewide, the authors of the August study note that

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90 As noted, this definition is presently subject to change in any given transaction, and there have been exceptions. *See* Robinson Sept. 1996, *supra* note 25 ("In the Comerica/Manufacturer (unchallenged) merger in Detroit, 'middle market' customers had sales of $5 million to $50 million.").

91 *See* OECD 2006, *supra* note 25, at 8 ("The geographic market for middle market customers is generally larger than that for small businesses."); Robinson Sept. 1996, *supra* note 25 ("Medium-sized businesses may be able to access lenders and providers from larger areas, but still tend not to have the access to national capital markets that may be available to larger corporations."); Robinson May 1996, *supra* note 25 ("Although we use the same methodology for our analysis of lending to medium-sized businesses, the effective area of competition by banks for such loans and services tends to be larger than for small businesses because of the greater ability of banks to secure and service those loans over greater distances.").

92 *See* Kramer, *supra* note 25 ("We found that there was a very limited number of middle market players in New Mexico.").

93 *See* OECD 2006, *supra* note 25, n.30 ("In the Fleet/Bank of Boston (1999) transaction, DOJ staff had significant concerns over middle market lending in New England. Staff conducted interviews with competitors and customers that strongly suggested that middle market lending was a regional market.").

94 *See* Kramer, *supra* note 25 ("[W]e believed there could be a middle-market problem particularly at the lower-end, involving loans ranging up to $3-$5 million. In Indianapolis, there are about 40 or so banks and thrifts, although few were engaged in middle-market lending.").

95 *See*, *e.g.*, Tannenwald, *supra* note 80, at 61 (concluding that for firms with more than $50 million in revenues, "Connecticut apparently belongs in the same market as New York City," and that New Hampshire might also be in that market).

96 David Benson and Ken Onishi, *Are There Competitive Concerns in "Middle Market" Lending?*, FEDS Notes (August 10, 2020) (hereinafter "Benson & Onishi"), https://doi.org/10.17016/2380-7172.2618. Cash management and other deposit services do not constrain geographic markets in this arena. As in retail and small business banking, technology has shifted most of these formerly branch-based services to online portals. For

"the median state has about 30 percent of committed credit supplied by out-of-market banks."[97] Without even accounting for this out-of-state leakage, "middle market concentration is overall low. The average state HHI is 1456," or two standard deviations below the Industrial Guidelines' 2500 HHI standard for highly concentrated markets.[98]

Importantly, the authors "believe our HHI measure overstates actual market concentration, because non-bank lenders are known to be a significant substitute to traditional banks in the middle market."[99] An earlier study conducted by the National Bureau of Economic Research evaluated "the prevalence of direct nonbank lending," finding that it "is widespread: about *one-third* of all loans in our data were extended by nonbanks."[100] Among the nonbank entities engaged in this lending are finance companies, private equity/venture capital firms, hedge funds, investment banks, insurance companies, business development companies and investment managers.[101] Such nonbank lending expanded rapidly in the wake of the financial crisis and stricter regulations (especially those imposed on OCC-regulated banks) that increased the costs for banks to lend to middle-market firms with low or negative EBITDA.[102] Other sources have similarly noted that "[i]n the decade since the financial crisis, buyout firms have aggressively moved into the business of lending to midsize companies."[103]

In addition to the foregoing market definition concerns, we believe the Division should acknowledge other characteristics of middle-market banking that bear significantly on the

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examples of these online options, *see*, *e.g.*, Wells Fargo, Analyzed Business Checking Account, https://www.wellsfargo.com/biz/checking/analyzed (last accessed 10/6/2020); CFBank, Business Cash Management Services, https://www.cfbankonline.com/business-banking/business-cash-management-services/ (last accessed 10/6/2020); Truist, Business Checking Accounts, https://www.bbt.com/small-business/banking/checking.html (last accessed 10/6/2020); PNC, Business Checking, https://www.pnc.com/en/small-business/banking/business-checking-overview/business-checking.html (last accessed 10/6/2020).

97 Benson & Onishi, *supra* note 96.

98 *Id*. As discussed below, other aspects of the middle-market indicate that it is better characterized as a bidding market, such that traditional HHI concentration measures are probably less relevant.

99 *Id*. (citing Sergey Chernenko, Erel Isil, and Robert Prilmeier, *Why do Firms Borrow Directly from Nonbanks* (Nat'l Bur. of Econ. Research Working Paper #26458, 2019) (hereinafter "NBER 2019"), https://www.nber.org/papers/w26458).

100 NBER 2019, *supra* note 99, at 3.

101 *See id*.

102 *See id*. *See also* Deron Weston, Val Srinivas, Philip Jacob, et al., *Winning in middle-market banking* at 8, DELOITTE UNIV. PRESS (2016), https://www2.deloitte.com/content/dam/Deloitte/nl/Documents/financial-services/deloitte-nl-fsi-banking-winning-in-middle-market-banking-new-strategies-and-new-tools-report.pdf ("[B]anks have been scaling back their presence in the riskier subgroup of the middle-market segment, in part prompted by federal regulators' leverage lending guidelines. This has opened a window of opportunity to nonbanks, including private equity firms, hedge funds, business development companies and marketplace lenders.").

103 Miriam Gottfried and Rachel Louise Ensign, *The New Business Banking: A Private-Equity Firm*, WSJ.com (Aug. 12, 2018), https://www.wsj.com/articles/the-new-business-banker-a-private-equity-firm-1534075200. *See also id*. ("Non-banks – many private equity firms – held more than half a trillion dollars of loans to midsize companies at the end of 2017 . . . .").

competitive analysis, namely the bidding market nature of competition for these customers.[104] Our interviews with clients over the years have consistently shown that middle-market businesses are sophisticated purchasers of banking services that solicit multiple bids for credit and other services. These customers typically have substantial experience with purchases of commercial lending and treasury management services, and many have full-time executives devoted to administration and decision-making for the firms' financial service needs. These companies are aware of their plentiful financial service options and are able to switch financial institutions, shop their credit needs around to obtain the best rates, terms and structure, and to reallocate purchases of certain banking products among their multiple current providers in response to changing capital needs or market forces.

Our experience has largely been confirmed by FRB research dating back to the 1990s. That research consistently showed that middle-market businesses were likely to shop around for financial services and were less likely to cluster their purchases of banking services at a single institution.[105] And given their tendency to split their business among multiple financial institutions,[106] middle-market firms tend to switch freely among those institutions in response to various market forces. The August 2020 FRB study referenced above estimates that on average "about 32% of borrowers switch lenders at maturity" such that "switching costs and other forms of inertia do not encumber middle-market firms."[107] That study also showed that "the average and median state has approximately ten middle-market lenders" *before* including out-of-state and nonbank alternatives.[108] In a bidding market characterized by sophisticated buyers, low switching costs, at least 10 in-state bank bidders and a number of out-of-state and nonbank alternatives, it is hard to imagine competitive concerns arising in middle-market lending. Indeed, the August 2020 FRB study concludes "that there are unlikely to be competitive concerns in the provision of middle market services . . . . Since state concentration is moderate, at most, we also conclude that antitrust authorities should reserve scrutiny to very large bank merger proposals which significantly increase regional market concentration."[109]

Based on the above evidence, investigations into the middle-market should be *extremely rare*.

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104 In this regard, deposit market shares are not typically relevant when analyzing middle-market competitors. *See, e.g.*, 2010 HMG, *supra* note 7, § 6.2

105 *See* Gregory E. Elliehausen & John D. Wolken, *Banking Markets and the Use of Financial Services by Small and Medium-Sized Businesses*, 76 FED. RES. BULL. 801, 805 (1990) ("[S]mall firms are more likely than large firms to maintain a working relationship with a financial institution rather than seek out different suppliers for different financial products. In other words, small firms are more likely than large firms to depend on their primary institution for credit and to use fewer institutions.").

106 *See id.* at 812 ("When we divide our sample of firms into two employment-size categories . . . we find that the average number of financial institutions and services used is significantly greater for medium-sized firms than for small firms in all but one of seventeen comparisons . . . . Overall, medium-sized firms use nearly twice as many financial institutions on average as do small firms (3.1 versus 1.73).").

107 Benson & Onishi, *supra* note 96.

108 *Id*.

109 *Id*.

To the extent the Division determines that middle-market banking is still a relevant product market, we respectfully submit that the revised Banking Guidelines should:

- *Include a clear description of (1) middle-market banking products and services; (2) middle-market banking customers; and (3) the geographic market in which middle-market banking will be evaluated or, at the very least, the factors the Division will consider or evaluate in determining the geographic scope of such a market; and*

- *Identify the general framework in which the Division will evaluate competition (i.e., shares versus bidding market). To the extent the Division continues to believe share data are useful in evaluating middle-market banking, the revised Banking Guidelines should describe the type of data and information that the Division would find persuasive in demonstrating share or competitive presence in the absence of publicly available reported data.*

Rural Versus Urban Markets

The dynamics of rural and urban markets can differ significantly. In what ways, if at all, should these distinctions affect the Division's review?

Should the Division apply different screening criteria and HHI thresholds for urban vs. rural markets? If so, how should the screening criteria and the thresholds differ?

The Division often considers farm credit lending as a mitigating factor. Is there a more appropriate way to measure the actual lending done by farm credit agencies in rural markets?

Historically, the FRB's rural geographic markets have been larger than FRB's urban markets, appropriately reflecting longer distances to population, educational, healthcare, and retail centers and the willingness of rural residents to drive those distances. These larger geographic markets seem appropriate. In addition, many rural markets are unable to sustain more than two or three banks because of low population, correspondingly low demand for banking services, small deposit bases and the presence of farm credit bureaus, which occupy a significant portion of available lending opportunities.

As these markets are often served by fewer, smaller institutions, a traditional review of small business lending would be misleading. In 2018, 45% of non-metro counties (as defined by the U.S. Department of Agriculture) report fewer than 10 CRA small business loans originated between \$100,000 and \$1 million compared to 13% of metro counties.[110] In addition to thrifts and credit unions, banks compete with the Farm Credit System ("FCS"), as well as equipment

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[110] The difference is greater when looking at fewer than 20 loans per county – 23% of metro and 64% of non-metro counties. And 28% of non-metro counties report fewer than five loans. *See generally* Economic Research Service, USDA, *What is Rural?*, https://www.ers.usda.gov/topics/rural-economy-population/rural-classifications/what-is-rural/ (last accessed 10/7/2020); CRA origination data, *supra* note 26.

lenders (such as Deere[111]) and other finance companies (like LendingTree or Age Spring).[112] The FCS's Agricultural Credit Associations lend across all the same product markets as banks, including agricultural business mortgages, operating finance, agribusiness loans, rural infrastructure financing, home loans and export finance.[113] At the end of 2019, FCS's loan portfolio totaled nearly $287 billion to over 571,000 borrowers.[114] The American Bankers Association, which typically touts the power of banks over alternative lenders, estimates that the banking system only serves half the farm loans in the United States.[115] In some markets, limited lending data may be available from the FCS, but this is not uniform across the country. And there are no local data sources for lending by equipment or other nonbank financers. Without such data, the consideration of such competitors as a mitigating factor should permit mergers where HHI levels would otherwise indicate a highly concentrated market. We are unaware of any situation where an agricultural product market raised distinct competitive issues, although we have successfully had to defend this product market in small geographic markets several times, contributing to, we believe, unnecessary and additional time and resources expended by both the Division and transacting parties.

Given the even more limited data constraints for both deposits and loan data in rural markets, we respectfully submit that the revised Banking Guidelines should:

- *Evaluate market concentration in markets no narrower than FRB markets for all, or at least rural markets; and*

- *Adopt higher concentration screening thresholds for rural markets than for non-rural markets, or, if the Division is disinclined to have different thresholds, specifically outline the mitigating factors that may be relevant to the Division's analysis of competition in a rural market, including the availability and prevalence of agricultural loans, which may ultimately justify clearing transactions involving markets that, based on deposit HHI-levels alone, are highly concentrated.*

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111 *See*, *e.g.*, *Farm Equipment Loans and Leases*, John Deere, https://www.deere.com/en/finance/financing/ag-turf/farm-equipment/ (last accessed 10/7/2020).

112 *See* Lending Tree, https://www.lendingtree.com/ (last accessed 10/7/2020); Age Spring, at https://agespring.com/industry/agricultural-financing (last accessed 10/7/2020).

113 *See* Shawn Williamson, *Do You Understand the Farm Credit System? It Holds 40% of All AG Loans*, Successful Farming (Nov. 13, 2019), https://www.agriculture.com/farm-management/finances-accounting/do-you-understand-the-farm-credit-system ("[FCS's] six lines of business currently break out like this: ag business mortgages, 46%; operating finance, 20%; agribusiness loans, 17%; rural infrastructure, 11%; rural home loans, 4%; and ag export finance, 2%. . . . We hold about 40% of the overall ag loan market.") (internal quotations omitted).

114 *See* Regina Gill, *The Farm Credit System* at 15, Fed. Farm Credit Banks Funding Cor. (Oct. 2020), https://www.farmcreditfunding.com/ffcb_live/current/InvestorPresentation.pdf.

115 *See 2019 Farm Bank Performance Report* at 4, Am. Bankers Ass'n (2019), https://www.aba.com/-/media/documents/reports-and-surveys/2019-farm-bank-performance-report.pdf?rev=2881281f5c7648a7ab89f24711e5da8d ("The U.S. banking industry is a major provider of credit to agriculture with $183 billion in farm loans extended – approximately 50% of the total farm credit outstanding in the U.S. – as of year-end 2019.").

Non-Traditional Banks

Should the Division include non-traditional banks (*e.g., *online) in its competitive effects? Does the Division give appropriate weight to online deposits?

Given the geographic dispersion of deposits from online banks is not publicly available (by market or branch) suggest how these institutions can be incorporated into screening and competitive effects analysis.

As discussed above, online banks have not generally been included in the competitive analysis,[116] but almost certainly should be given that they and other financial institutions such as thrifts, credit unions and fintechs are actively competing for retail banking deposits and services. There is no principled reason to exclude these institutions from a retail competitive analysis to the extent their services are offered to customers in a given market. Similarly, those institutions (of whatever kind) that engage in commercial lending should be appropriately weighted as competitors for those services in markets where they compete but, due to data limitations, are usually not appropriately weighted in the Division's analysis.

In the absence of geocoded deposit data or the collection of nationwide small business loan data from online lenders, we revert to our recommendation that the revised Banking Guidelines adopt higher HHI thresholds used to screen for potentially problematic transactions with respect to retail and small business markets to account for the unquantifiable impact online channels are having on competition.

Does the Division give appropriate weight to credit unions and thrifts?

<u>Thrifts</u>

Our understanding is that the Division currently includes 100% of all thrift deposits in calculation shares in the retail deposit market, although Screen A of the Banking Guidelines includes only 50% of thrift deposits. When analyzing the small business product market, the Division began in 1996 (the year after issuing the Banking Guidelines) to apply a "2% test" to thrifts, whereby it includes 100% of the deposits of any thrift that holds at least 2% of its total assets as C&I loans, but entirely excludes thrifts (and other institutions) not meeting the 2% test. The 2% test is applied at the subsidiary level, regardless of an institution's holding company affiliation.[117]

Putting aside the issues surrounding the use of deposit-based proxies for small business lending recounted above, we believe that the foregoing weights are generally appropriate and easy to apply. We would, however, recommend that instead of the "on-off" criteria for thrift inclusion imposed by the 2% test, the addition of an intermediate step would add more continuity to the analysis: namely, including at 50% of deposits those thrifts holding between 1% and 2% of their assets as C&I loans. This addition would also be consistent with the dynamic trend since

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[116] *See supra* note 41.

[117] *See supra* note 42 (discussing 2% test); *see also* 2014 FAQs, *supra* note 25, at Q.31.

the 1990s of thrifts becoming more active commercial lenders. In 1992, C&I loans accounted for only 1.17% of the total assets held by all U.S. savings institutions. By 2000, that percentage had more than doubled (to 2.79%), and as of this year had reached 4.69%. Moreover, as of June 2020, nearly 60% of all U.S. thrifts met the Division's 2% test.[118]

In view of this dynamic trend toward increasing thrift inclusion – and decreasing market concentration – our proposed intermediate "1% test" would mitigate the seemingly arbitrary discontinuities that might otherwise occur in market concentration measurement from one year to the next.

Credit Unions

Though not set forth in the Banking Guidelines, we understand that the Division appropriately applies the same criteria to credit union inclusion as it does to thrift inclusion, subject to certain caveats. The 2014 FAQs state that "[s]imilar to the conditions set forth by the Federal Reserve" a credit union must have a "community based field of membership" to be included in the Division's analysis.[119] We would recommend more clarity in the revised Banking Guidelines as to what percentage (short of 100%) of a community's population must be eligible for membership for the credit union to qualify.[120] We understand the FRB generally considers a threshold of 85% of the community's population as sufficient for credit union inclusion, but this figure has not been published, and 70% inclusion appears to have been acceptable in certain matters.[121]

The Division, in the 2014 FAQs, notes that credit unions do not report branch deposits to the FDIC, which sometimes precludes them from being included in the quantitative HHI calculation.[122] In such cases, the Division will consider the credit unions more vaguely as qualitative "mitigating factors." In our experience, reasonable estimation methods can be used to allocate deposits among a credit union's branch network, and often the issue is mooted where the entire branch network of a credit union is contained within the local market. Rather than relegating credit unions to the vague qualitative "mitigating factors" analysis, the revised guidelines should suggest deposit allocation methods that the Division has found acceptable in the past.

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118 *See generally* FDIC Call Reports, *supra* note 26.

119 *See* 2014 FAQs, *supra* note 25, Q.32.

120 Less than full coverage can occur, for instance, when a credit union's field of membership lists most, but not all, of the counties or communities in an FRB market. Calculating this percentage depends, of course, upon the definition of the geographic market, which should be the FRB market, as discussed *supra* notes 48–80.

121 *See, e.g., Huntington Bancshares Inc.*, FRB Order No. 2016-13 (July 29, 2016), https://www.federalreserve.gov/newsevents/pressreleases/files/orders20160729a1.pdf (approx. 70% field of membership). In at least one transaction, the FRB provided actual in-market members as a percent of the market's population (12% to 28%) rather than the potential membership. These data are generally not publicly available. *First Citizens BancShares, Inc.*, FRB Order No. 2019-17 (Dec. 16, 2019), https://www.federalreserve.gov/newsevents/pressreleases/files/orders20191216a1.pdf.

122 *See* 2014 FAQs, *supra* note 25, Q.32.

We also recommend that our proposed "1% test" modification suggested above be applied to credit unions to reflect those institutions' trends toward increasing membership and increasing business lending.[123] In the last 10 years, credit union membership has grown nearly 35%, and total assets and loans held by credit unions has grown by more than 90%.[124] Regulatory changes have expanded the small business lending capacity of credit unions,[125] and they have become regular acquirers of banks and bank branches.[126] As of June 30, 2020, 137 credit unions, holding more than $40 billion in deposits, met the Division's 2% test.[127] The 2020 Small Business Credit Survey found that 6% of employer firms (with 1-499 employees) used a credit union for lending in the last five years.[128] And over 50% of banks reportedly consider credit unions to be frequent competitors for small business lending.

In view of the above, we respectfully submit that the revised Banking Guidelines reflect the Division's current practice and explicitly account for thrifts and credit unions in its competitive analysis by:

- *Crediting at 100% of deposits thrift and credit union deposits in an analysis of retail banking markets. As noted, the revised Banking Guidelines should also indicate what percentage of population coverage is necessary for a credit union to be included;*

- *Crediting at 100% of deposits any thrift or credit union that holds 2% of more of its assets in C&I loans in evaluating small banking concentration; and*

- *Crediting at 50% of deposits any thrift or credit union in an analysis of small business banking and lending where the institution has at least 1% of assets in C&I loans.*

***De Minimis* Exception**

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123 The 2014 FAQs specify which lines from credit unions' financial reports the FRB use to calculate C&I loans. *See id*. at Q.19. The revised Banking Guidelines should clarify whether the Division uses the same approach.

124 *See Credit Union Trends*, CREDIT UNION NAT'L ASS'N (Sept. 2018), https://www.cuna.org/uploadedFiles/Global/About_Credit_Unions/AssetTrends-Sep2018(1).pdf; *CUNA U.S. Membership Benefits Report*, CREDIT UNION NAT'L ASS'N (2020), https://www.cuna.org/uploadedFiles/Global/About_Credit_Unions/National-MembBenefitsJ20.pdf.

125 *See*, *e.g.*, John Reosti, *Credit unions vs. banks: How we got here*, AM. BANKER (Apr. 24, 2018), https://www.americanbanker.com/news/credit-unions-vs-banks-how-we-got-here ("[B]eginning in the mid-1970s, credit unions steadily expanded the menu of products and services they provided, as well as their fields of membership, all with the blessing of their federal regulator, the NCUA. . . . As credit unions have come to look increasingly like banks, bankers and their trade groups have questioned why they remain exempt from paying federal taxes.").

126 *See* Michael Gossie, *Credit unions buying banks becomes exploding trend in financial services sector*, AZ Big Media (Mar. 2020), https://azbigmedia.com/business/banking-industry/credit-unions-buying-banks-becomes-exploding-trend-in-financial-services-sector/ ("Credit unions bought 16 banks in 2019, which more than doubled the seven mergers that took place in 2018, and that 2018 number more than doubled the three deals that were made in 2017.").

127 *See* FDIC Call Reports, *supra* note 26.

128 *See* 2020 Credit Survey, *supra* note 49–50, at 8.

Should the Division implement an internal* de minimis *exception for very small transactions whereby the Division would automatically provide a report on the competitive factors of the transaction to the responsible banking agency but would not conduct an independent competitive effects analysis of these deals? If so, what would be an appropriate* de minimis *size of transaction?

As a matter of conserving the Division's resources otherwise used to analyze very small transactions that are unlikely to raise competitive issues, a *de minimis* exemption would be good in theory along the lines of the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended, which exempts transactions valued at less than $50 million, as adjusted.[129] We recognize, however, that defining a threshold in banking could be problematic in practice.[130] Moreover, the statutory post-closing immunity afforded bank mergers uniquely distinguishes this sector from mergers reviewed pursuant to the HSR Act.[131]

We believe a more relevant question is whether the Division should relax and accelerate its review of acquisitions of financially impaired banks that are not operating under regulatory agreements or at risk of imminent failure.[132] The acquisition of such "weakened competitors" was a recurring and urgent concern during the financial crisis and could arise again in the current low-interest rate, pandemic economy. Distinct from the "failing firm" defense, the "weakened competitor" doctrine is focused on the validity and predictive value of using snapshot market share statistics to evaluate the competitive significance of a firm that is clearly evidencing a dynamic trend toward decline.[133] It has special relevance to banking in that deposit and loan

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[129] 15 U.S.C. § 18a(a).

[130] We note that since sometime after 2006, the Federal Reserve Bank of Kansas City has posted that special criteria for targets under $50 million and *pro forma* shares under 40% should apply; the screening threshold should be 2000/400 or 2500/300. *See Understanding Antitrust Considerations in Banking Proposals* at 7, Fed. Rsrv. Bank of Kansas City, https://www.kansascityfed.org/en/banking/bankerresources/banking-structure (last accessed 10/7/2020).

[131] 12 U.S.C. §§ 1828(c)(7)(C), 1849(b)(1); *see also supra* note 30 (noting bank antitrust immunity); Kramer Antitrust Review, *supra* note 25, at 115-16.

[132] We note that the Bank Merger Act provides that the banking agencies may waive normal application procedures and waiting periods – and forgo a request for "competitive factors" report from the Division – and approve a transaction for immediate consummation "to prevent the probable failure" of an insured depository institution or if "an emergency exists requiring expeditious actions." *See* 12 U.S.C. § 1828(c)(4) & (6). Thus, in true failing bank situations, the Division would typically not review the transaction.

[133] Financial weakness, a declining market position, and an "impaired ability to compete" are all mitigating factors that have been considered by the courts when evaluating market share statistics and the competitive effects of a proposed merger. *United States* v. *Consolidated Foods Corp.*, 455 F. Supp. 108, 135 (E.D. Pa. 1978). In *United States* v. *General Dynamics Corp.*, 415 U.S. 486, 508 (1974), the Supreme Court held that the defendant's demonstration of their "weak . . . position . . . went to the heart of the Government's statistical *prima facie* case based on production figures and substantiated the District Court's conclusion that [the acquired party], even if it remained in the market, did not have sufficient reserves to compete effectively. . . . Thus, [e]vidence of past production does not, as a matter of logic, necessarily give a proper picture of a company's future ability to compete." *Id*. at 501. "Viewed in terms of . . . probable future ability to compete – rather than in terms of past production" – a company may be "far less significant [than] statistics seem to indicate." *Id*. at 503. Lower courts following the *General Dynamics* decision have specifically probed the merging parties' financial conditions and future ability to compete. *See, e.g.*, *United States* v. *Consolidated Foods Corp.*, 455 F. Supp. 108, 135 (E.D. Pa.

data are collected once a year; time-lagged market shares attributed to impaired banks almost invariably overstate their competitive significance when they are being acquired in exigent circumstances.

Prior to issuing the Banking Guidelines, Division officials in 1992 gave explicit recognition to the defense stating that "the financial health of the acquired firm is relevant to the competitive analysis . . . in terms of measuring the competitive significance of a firm . . . . For example, in banking . . . poor financial condition of the bank, *while short of actual failure*, may in some circumstances signal a bank that is a substantially weaker competitive influence in the market. Where this is factually supported, such evidence will be taken into account in the analysis of the possible competitive effects of the merger."[134] In the Banking Guidelines, the Division pared back on this guidance significantly, stating only that it will consider "evidence that a particular institution's market shares overstates . . . its competitive significance (such as evidence that an institution . . . is not competitively viable or is operating under regulatory restrictions on its activities)."[135]

We believe the Division in the revised Banking Guidelines should provide more explicit guidance as to what considerations it will give *not only* in situations involving non-viable institutions or those already operating under banking regulatory agreements/orders, but also financially impaired institutions not facing imminent collapse or regulatory takeover.

In a pattern often replicated during the financial crisis, banks experiencing significant losses, share price declines or credit rating downgrades would take actions and encounter customer reactions that quickly sapped their competitive vitality and that undercut the predictive value of the time-lagged deposit and loan data typically used to evaluate their competitive significance. Briefly summarized, this pattern consisted of the following:

- Anticipating liquidity and capital concerns, the bank would cut back on new lending even before any evident deposit decline. Thus, its deposit levels would immediately begin to overstate its competitive vitality as to lending.

- Customers, especially businesses with deposits exceeding FDIC insurance coverage, would soon engage in a partial run on the bank by moving deposits to other competitors or off-balance sheet money markets. Again, months-old SOD-based deposit market shares would not reflect these developments.

1978) ("the reasoning of [General Dynamics] can provide guidance for a broad range of Section 7 challenges where one party to a merger suffers under an *impaired ability to compete*" (emphasis added)); *Lektro-Vend Corp.* v. *Vendo Co.*, 660 F.2d 255, 275-77 (7th Cir. 1981) (declining market position and profitability taken into consideration in assessing competitive effects of an acquisition); *see also United States* v. *G. Heilman Brewing Co., Inc.*, 1972 Trade Cases (CCH) § 74,080 (E.D. Mich. 1972) (denying the government a preliminary injunction after defendants showed that the acquired company's sales and working capital had declined such that its loan agreements were in danger of being violated, and its operations and advertising were severely restricted).

134 *See* Margaret E. Guerin-Calvert and Janusz A. Ordover, The 1992 Agency Horizontal Merger; Guidelines and the Department of Justice's Approach to Bank Merger Analysis, 37 ANTITRUST BULL. 667 (1992). (hereinafter "Guerin-Calvert & Ordover") (emphasis added).

135 BANKING GUIDELINES, *supra* note 2, § 2.

- Banks not subject to regulatory orders would often seek to replace lost core deposits with short-term, high-priced CDs (so-called "hot money") from the national brokered deposit market. Not only would this change in the bank's deposit mix further misrepresent its share of local market deposits, it would disadvantageously raise the bank's cost of funds and provide a less stable deposit base against which the bank could loan. The change in the bank's deposit *mix* was thus another way in which the bank's deposit share would overstate its future capacity to originate loans on a competitive basis.

- As the bank would cut lending and fail to bid for or win new middle-market relationships, existing customers, uncertain of the bank's longevity and fearful of service disruption, would become more proactive in splitting and spreading their business among other banks. Once again, this competitive disadvantage was not reflected in months-old deposit and loan data.

While the Division may have an institutional resistance to "weakened competitor" defenses, the foregoing patterns during the financial crisis were real and motivated many bank mergers. In the current pandemic-depressed economy with historically low interest rates, banks may once again face unusual challenges.[136]

We thus respectfully submit that the revised Banking Guidelines should:

- *Explicitly acknowledge the weakened competitor defense – more along the lines of the 1992 Ordover/Guerrin-Calvert speech[137] than the clause in the Banking Guidelines;*

- *Provide more guidance as to the kinds of information it would find compelling to substantiate the defense; and*

- *Provide for a more relaxed screening threshold, or an explicit discounting of the impaired bank's deposit and loan shares to account for the data issues identified above.*

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[136] Since the onset of the pandemic, the Federal Reserve has restricted share repurchases, capped dividend payments and modified small business lending rules. *See* Press Release, *Federal Reserve Board announces it will extend for an additional quarter several measures to ensure that large banks maintain a high level of capital resilience*, Bd. of Governors of the Fed. Rsrv. System (Sept. 30, 2020), https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200930b.htm; Press Release, *Federal Reserve Board announces extension of rule change to bolster effectiveness of the Small Business Administration's Paycheck Protection Program*, Bd. of Governors of the Fed. Rsrv. System (July 15, 2020), https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200715a.htm; Press Release, *Federal Reserve Board expands its Main Street Lending Program to allow more small and medium-sized businesses to be able to receive support*, Bd. of Governors of the Fed. Rsrv. System (June 8, 2020), https://www.federalreserve.gov/newsevents/pressreleases/monetary20200608a.htm; Press Release, *Federal Reserve Board releases results of stress tests for 2020 and additional sensitivity analyses conducted in light of the coronavirus event*, Bd. of Governors of the Fed. Rsrv. System (June 25, 2020), https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200625c.htm.

[137] Guerin-Calvert & Ordover, *supra* note 134, at 685.

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We thank the Division for considering these comments. Please do not hesitate to contact David Neill, Damian Didden or Christina Ma at Wachtell, Lipton, Rosen & Katz (212-403-1000) if you have any questions.

Respectfully submitted,

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