Statement for the Record

On Behalf of

American Bankers Association

Before the

Subcommittee on Financial Institutions & Monetary Policy

Of the

House Committee on Financial Services

May 1, 2024

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The American Bankers Association (ABA) appreciates the opportunity to provide a Statement for the Record for this hearing entitled "Merger Policies of the Federal Banking Agencies." The ABA is the voice of the nation's $23.7 trillion banking industry, which is composed of small, regional and large banks that together employ approximately 2.1 million people, safeguard $18.8 trillion in deposits and extend $12.5 trillion in loans.

Summary

ABA strongly supports the Subcommittee's examination of the current regulatory landscape surrounding bank mergers. The current standards for assessing the competitive impact of mergers, which date from 1995, are significantly outdated and do not accurately reflect competitive conditions in today's financial services markets. By failing to capture the impacts of competition from online financial institutions and nonbank financial services providers, decisions on merger applications by the bank regulatory agencies and the Department of Justice (DOJ) may unjustifiably constrain mergers involving banks across the industry spectrum. One result is that community banks may be unable to consolidate with neighboring institutions, impairing their ability to continue serving their communities and meet the burdens of increasing regulatory and compliance costs.

The bank regulatory agencies are signaling new approaches to assessing merger impacts on the "convenience and needs" of affected communities and implications of merger transactions for financial stability. Though these matters have been part of regulators' merger review for some years, [1] current agency leadership appears poised to adopt dramatically new standards, which warrant scrutiny from Congress and the public.

[1] The requirement to consider a merger's potential impact on financial stability was added to other statutory requirements by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.

Introduction

The laws governing bank mergers[2] require the appropriate Federal regulatory agency to consider specific factors concerning the institutions, their markets, and the impacts of the merger:

- The potential impact on competition; [3]
- The financial and managerial resources and future prospects of the companies and banks concerned, including the competence, experience, and integrity of the officers, directors, and principal shareholders of the company or bank;
- The convenience and needs of the community(ies) to be served;
- The applicant's record of meeting the credit needs of its entire community, including low- and moderate-income neighborhoods, consistent with the safe and sound operation of the institution;
- The effectiveness of the company or companies in combatting money laundering activities, including in overseas branches; and
- The extent to which the transaction would result in greater risks to the stability of the United States banking or financial system.

The broad statutory language and the substantial room for interpretation it allows the Federal banking agencies call for detailed, ongoing Congressional oversight to assure both the soundness of the financial system and feasibility of institutions' strategic planning and goals, as set by banks' boards and management for their long-term success.

Key Policy Considerations

A. Competitive Analysis

Under existing standards for evaluating a merger's competitive impact, geographic market definitions are based primarily on bank physical branch networks. This analysis omits consideration of critical features of markets in which banks operate and customer groups they serve. Any market definition should allow these additional factors to be considered in assessing the relevant competitive environment:

- Online delivery of financial services by banks without a branch presence, including online mortgage companies, nonbank commercial real estate lenders, and other online lending services;

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[2] Depending on the structure of the proposed transaction, either the Bank Merger Act, 12 USC 1828(c), the Bank Holding Company Act, 12 USC 1842(c), or both may apply. Under the Bank Merger Act, the primary Federal regulator of the resulting institution must approve a transaction in which depository institutions merge – the Office of the Comptroller of the Currency for national banks and Federal savings association, the Board of Governors of the Federal Reserve System for state-charted banks that are Federal Reserve members, or the Federal Deposit Insurance Corporation for other state-chartered banks. If a holding company is acquiring a depository institution (whether or not a merger will occur at the depository level), the Federal Reserve must approve the transactions under the Bank Holding Company Act. The agencies must consider essentially the same factors in all cases.

[3] Specifically, the regulator must consider whether the transaction would result in a monopoly, or (unless it finds that the anticompetitive effects of the proposed transaction are clearly outweighed in the public interest) would have the effect of substantially lessening competition, or would tend to create a monopoly, or in any other manner would be in restraint of trade.

- Money-market funds (which are direct competitors for bank deposits);
- Farm Credit System institutions, thrift institutions, and credit unions; and
- Fintechs and other nonbank firms, which frequently unbundle financial services traditionally provided by banks through physical branches.

The banking agencies and the DOJ should encourage the inclusion of this and similar relevant information in merger applications when appropriate to provide a more accurate picture of current market conditions. Under the current competitive guidelines, two community banks may be prevented from merging if the government assumes they are the only competitors in their geographic markets, as the bank regulatory agencies and the DOJ define those markets. This outdated concept fails to reflect the competitive impact of online channels and other means of delivering financial services that do not depend on physical branch networks and are not captured by current competitive analyses. A more comprehensive analysis of these competitive factors will provide an accurate picture of products and services available to customers and promote a healthy market and economy.

At the same time, however, the agencies and the DOJ must be clear and transparent about what factors are relevant and how they will be applied – merger transactions are important events in the operations and strategic positions of the institutions concerned, [4] and their customers, employees, and owners deserve clarity.

B. Convenience and Needs of the Community

Although the statutory factor for assessment of the merger's impact on the convenience and needs of the community is separate from the need to assess the institutions' performance under the Community Reinvestment Act (CRA), ABA nevertheless believes that the two standards should be consistent. The CRA record, along with the *pro forma* business plan of the resulting institution, should be the primary evidence that this merger standard will be satisfied.

The CRA requires the federal banking agencies to assess a financial institution's record of meeting the credit needs of its entire community, including low-and moderate-income neighborhoods, consistent with the safe and sound operation of that institution. To implement this requirement, the banking agencies have adopted a regulatory framework that evaluates a bank's lending performance across income stratifications and geographies. CRA examinations also assess a bank's branch distribution and other delivery channels, its community development investments, and its community development services. Together, these assessments provide examiners with a comprehensive picture of how a bank is serving the communities in which it is doing business.

The banking agencies are revising the CRA regulatory framework to reflect the digitization of banking. While ABA has expressed concerns with the revised regulation, we agree that the

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[4] ABA acknowledges that these considerations would apply much less powerfully in transactions that are simply reorganizations of an existing entity with no combination with another, independent entity, though those reorganizations still require regulatory approval under the applicable statutes. Even regarding these less complicated transactions, however, regulatory officials should still apply clear, transparent standards and act in a timely fashion.

emphasis in CRA analysis on brick-and-mortar physical presence is outdated and should be revised. In addition to providing a more comprehensive view of a bank's CRA performance, expanding CRA examinations beyond a bank's physical location would help regulators have a more comprehensive view of how a bank is meeting the convenience and needs of its communities when evaluating merger applications. As such, CRA performance will continue to be a significant factor in merger determinations.

The convenience-and-needs assessment should consider future plans, such as planned branch closings and consolidations, only to the extent that they would materially affect an already "satisfactory" CRA assessment (as defined under current standards). Therefore, unless material changes in activities that CRA measures are contemplated post-merger that would suggest material negative changes in future performance, the CRA performance rating should be taken as sufficient to address the convenience and needs factor in merger assessments.

C. Impact on Financial Stability

The assessment of financial stability concerns in connection with merger applications has been less than fully transparent, and it cannot (and should not) be reduced to a simple set of binary questions and answers, or simple bright-line tests based on asset size. Though we believe that much additional research and public debate on this topic (as well as on broader considerations of financial stability) are necessary, in the near term ABA supports the use of factors already used in practice and that have previously been the subject of public notice and comment. The most sophisticated source of financial stability risk measurement is the list of systemic risk factors used to calculate the Global Systemically Important Bank (G-SIB) Surcharge, set forth in Federal Reserve regulations[5]

These factors are scored on a continuum. Using that approach, a transaction that exhibited aspects of some (or even all of) these factors would not be *per se* disapproved; its potential risks to financial stability would be scored and assessed against a standard. The scoring methodology used in the merger context and any cut-offs would themselves require public notice and opportunity for comment. This approach would, however, avoid the need for bright-line tests that fail to measure actual risks.

In addition, institutions that may present systemic risks are, to the extent Congress determined it to be necessary, subject to numerous "enhanced prudential standards." These standards will apply following any merger transaction when the resulting institution's systemic risk profile makes them subject to those requirements. For example, increased capital requirements (including both risk-based standards and leverage limits), liquidity requirements, exposure limitations, capital planning and stress testing, and enhanced risk governance requirements are all designed to reduce the probability of institution insolvency.

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[5] *See* 12 CFR, Part 217, Subpart H. The factors, which are defined in detail in the regulation, include: (1) total exposures; (2) intra-financial system assets; (3) intra-financial system liabilities; (4) securities outstanding; (5) payments activity; (6) assets under custody; (7) underwritten transactions in debt and equity markets; (8) notional amount of over-the-counter (OTC) derivatives; (9) trading and available-for-sale (AFS) securities; (10) Level 3 assets; (11) cross-jurisdictional claims; and (12) cross-jurisdictional liabilities.

Also, resolution planning requirements, if applicable under current regulations to the resulting institution following a merger, would mitigate the consequences should a failure occur. These provisions, developed over a decade since the financial crisis and adjusted by legislation, contain all the metrics required to address systemic risks. In adding financial stability considerations to merger assessments, Congress drew no distinction between prudential requirements that become applicable to the resulting institution following a merger based on existing regulatory thresholds and other similarly situation institutions without a pending merger application.

Moreover, part of the potential financial stability impact of a given institution, including the resulting institution following a merger, depends significantly on the options available to the resolution authority in dealing with the institution's potential failure. Also, the orderly resolution of a failing institution of any size, complexity, or degree of interconnectedness depends on how its resolution is handled. The Dodd-Frank Act provided new tools for handling complex resolutions, and FDIC has reorganized its resolution activities significantly in response.

Nevertheless, the options for resolving such institutions require ongoing innovation and adequate public understanding. It is not possible to have a rational approach to assessing the financial stability implications of a proposed merger without considering how it would be resolved. For many large institutions, resolution planning is already required at the level of either the parent company, the depository institution, or both. The existence of a resolution plan, which would be updated for any material corporate change, usually including a merger, would address financial stability concerns for the resulting institution, just as it does for such institutions outside the merger context.

D. Impact of Credit Union Transactions

We would also like to draw the Committee's attention to the troubling and recent phenomenon of credit unions buying banks. ABA strongly believes that the regulatory agencies should review all the competitive aspects described in detail above in assessing the relevant competitive environment for such transactions. More fundamentally, this Committee and Congress as a whole should reexamine credit unions' exemption from most taxes, and in particular the use of this exemption to grow their institutions rather than expanding services to their communities.

Credit union/bank transactions have constituted 27.3% of transactions announced in 2024 as of March 18 – the highest point to date.[6] While the National Credit Union Administration (NCUA) contends that the *Federal Credit Union Act* constrains credit union growth via field of membership and member business loan restrictions,[7] the *Credit Union Membership Access Act* and subsequent regulatory changes from the NCUA have enabled these not-for-profit cooperatives to overcome those hurdles.

Credit union purchases of banks signify the credit union industry's priorities—leveraging their tax-exempt status to dramatically increase their footprint. Indeed, the NCUA cites geographic expansion and loan growth as the primary drivers of these transactions. It also acknowledges that

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[6] https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/credit-union-bank-deals-becoming-bigger-part-of-m-a-landscape-80842307
[7] https://ncua.gov/foia/library/ncua-response-congressman-french-hill-questions-credit-union-bank-transactions

"former bank customers that are now credit union members may have less consumer financial protection oversight after the bank-to-credit union transaction." [8] In addition, credit unions' exemptions from most taxes as well as the *Community Reinvestment Act* could potentially curb investments in communities where these transactions occur. Rather than pay dividends to their members-owners, credit unions leverage their tax exemption spending tens—or even hundreds—of millions of dollars acquiring banks.[9]

Although the NCUA asserts that "a credit union's only source of capital is retained earnings, which limits the number and amount of acquisitions it can make and remain well-capitalized,"[10] capital markets and subordinated debt further facilitate credit union growth.[11]

The phenomenon of credit unions buying banks was not contemplated when Congress last convened a hearing on the credit union industry in 2005. Congress should determine whether credit unions' increasingly complex activities align with their cooperative structure and statutory mission of service to low- and moderate-income individuals connected through some common bond in a local community.[12]

Legislation Noticed For the May 1 Subcommittee Hearing

ABA appreciates the Committee noticing H.R. 7403, the Bank Failure Prevention Act, introduced by Rep. Andy Barr and Rep. Scott Fitzgerald. This legislation, which would require the Federal Reserve to make a determination on merger applications within 90 days, aims to restore transparency and timeliness in the merger application process. ABA thanks Rep. Barr and Rep. Fitzgerald for their efforts to eliminate the high degree of uncertainty inherent in the merger application process. We hope the Committee will consider applying the same merger determination requirements on the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation while also allowing flexibility for the submission of third-party expert submissions at the request of applicant banks.

ABA also appreciates that the Committee's April 26 hearing memo mentions two bills ABA strongly supports that would provide targeted reporting relief for banking industry and help address privacy concerns with the rule prescribed by the Consumer Financial Protection Bureau (CFPB) implementing Section 1071 of the Dodd-Frank Act (DFA).

Section 1071 requires lenders to collect and report to the CFPB information on small business lending for the purposes of enforcing fair lending laws and supporting community development efforts. The CFPB has finalized a rule implementing Section 1071, which directs what data must be collected, but there are still unanswered questions about how that data will be used and how

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[8] Ibid.

[9] https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/credit-unions-kick-off-2024-with-record-breaking-bank-buys-80022076

[10] https://ncua.gov/foia/library/ncua-response-congressman-french-hill-questions-credit-union-bank-transactions

[11] https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/credit-union-subordinated-debt-levels-stall-after-years-of-rapid-growth-77541326

[12] https://www.aba.com/advocacy/policy-analysis/aba-state-association-ltr-credit-unions-tax-exemption

much of it may be public. Banks and other lenders who make at least 100 small business loans in each of the two preceding calendar years will be required to collect the information.

While the banking industry fully supports complying with the nation's fair lending laws, the enormity of the data points to be collected and the 100-loan threshold for determining which lenders must report means compliance with this new ruling will place significant collection and reporting burdens on lenders, especially community banks. The CFPB itself downplays the cost that would be imposed on banks, but data from an ABA survey shows that the CFPB's analysis grossly underestimated the costs associated with implementing and complying annually with the final rule, and failed to adequately assess the proportional impact on smaller banks. For example, while the Bureau said it would only cost entities between \$44,800 to \$77,800 to build the systems and implement processes necessary for compliance with the rule, respondents to the ABA survey said one-time costs would range between \$112,685 and \$7,474,186.[13]

Additionally, the final rule states that the CFPB will not go through a public rulemaking procedure to determine whether and how data will be redacted prior to publication. Publication of the data collected for Section 1071 compliance purposes will create privacy concerns for small businesses across the country.

ABA strongly supports the following bills to meaningfully amend the Section 1071 Small Business Lending Data Collection and Reporting Rule:

- H.R. 1806, the Small LENDER Act, introduced by Rep. French Hill (R-AR) would adjust the final rule to apply to lenders originating at least 500 small business loans in each of the two preceding calendar years rather than those originating at least 100 small business loans; and only cover loans to businesses with gross annual revenues of \$1 million or less, rather than businesses with revenues of \$5 million or less. A 500-loan threshold would still cover 70% of bank lending to small businesses, which would produce a robust data set for enforcement of fair lending and support for community development, without driving small lenders out of the market.

- H.R. 1810, the Bank Loan Privacy Act, introduced by Rep. Blaine Luetkemeyer (R-MO), would direct the CFPB to issue a rulemaking for public comment about how the 1071 information collected will be shared and used. Opening up the privacy considerations to a rule-making procedure would allow small business customers to weigh in with their views and concerns about privacy.

Conclusion

ABA strongly supports the Subcommittee's interest in examining the current regulatory landscape surrounding bank mergers. The current standards for assessing the competitive impact of mergers are significantly outdated and do not accurately reflect competitive conditions in today's financial services markets. By failing to capture the impacts of competition from online financial institutions and nonbank financial services providers, decisions on merger applications

[13] See, ABA Survey at: https://bankingjournal.aba.com/2024/02/the-true-cost-of-too-much-data/

by the bank regulatory agencies and the DOJ may unjustifiably constrain mergers involving banks across the industry spectrum. In particular, community banks may be unable to consolidate with neighboring institutions, impairing their ability to continue serving their communities and meet the burdens of increasing regulatory and compliance costs.

ABA commends the commitments made by the banking agencies and the DOJ to update all aspects of the standards governing financial institution merger transactions. It is very important, however, that the agencies conduct a more comprehensive analysis of competitive factors, beyond just deposit share based on physical branches. This will provide a more accurate picture of products and services available to customers and promote a healthy market and economy. A more granular and risk-sensitive approach to financial stability impact assessment will not only rationalize the merger review process but will also promote a better general understanding of this critical topic.

Finally, ABA appreciates the Committee's interest in advancing legislation that would amend the CFPB's Section 1071 Small Business Lending Data Collection and Reporting Rule by providing targeted reporting relief for lenders and addressing privacy concerns when the Bureau makes applicant data public. We respectfully urge the Committee to favorably report H.R. 1086 and H.R. 1810 during the next markup session.

Thank you for the opportunity to provide our views on this very important hearing.