

Issue Update

Regulatory guidelines for reviewing bank merger applications date from 1995 and do not reflect profound changes in the financial services landscape since then. In the intervening years, the market for financial products and services has seen the rise of availability and use of online banking, the interstate expansion of bank branch networks, the enhanced market access made possible by advertising and communication innovations, and the growing market presence of nonbank financial firms, including “fintechs,” credit unions, and Farm Credit System institutions. The Federal banking agencies and the Department of Justice have opened a public discussion about updating the guidelines, but much advocacy still lies ahead.

The competitive analysis required for approval of a bank merger looks at whether the proposed transaction (1) would result in a monopoly in any U.S. market, or (2) would substantially lessen competition, unless those anticompetitive effects are clearly outweighed by benefits to community convenience and needs. Yet, despite the increased competition since 1995, government agencies usually assess competition very narrowly: competition in geographic banking markets (pre-defined by the Federal Reserve) is normally measured primarily by comparing deposit market shares (treating deposits as a proxy for all banking services). Moreover, deposit market shares are generally determined by reference to physical branches located in that geographic market. If the projected combined branch deposit market shares of two banks that intend to merge would exceed certain mathematical thresholds, the merger will likely be rejected as damaging overall competition or approved only if the banks make major changes to their footprints. Although banks sometimes are able to present limited evidence of broader competition, the regulatory review normally takes no account of nonbank competition or of competition from other banks reaching customers online, without a branch presence in the relevant market. The agencies have sometimes shown more flexibility in recent applications, but there has been no systematic, transparent update.

In reviewing merger applications, the Federal banking agencies must also consider other factors. Though such things as managerial resources, capital, liquidity, supervisory track records, and anti-money-laundering compliance will vary significantly among institutions, two required factors have particular policy implications: the institutions’ record of Community Reinvestment Act compliance and the effect of the proposed transaction on U.S. financial stability. The agencies’ approach to assessing these factors is also evolving.

Why It Matters

An update of the bank merger guidelines is important to the health of the U.S. financial system and economy. Banks in all markets face increased pressure to maintain investments in technology (for improved customer service and cybersecurity) and in compliance infrastructure. Some banks may find a merger and related economies of scale to be the most efficient way to meet these needs. Moreover, a narrow, outdated view of competition is both unreasonably restrictive and likely to produce irrational outcomes. For example, if two community banks between them have all the branches in their geographic market (as pre-defined by the Federal Reserve), they likely cannot merge because, under current standards, the merger would cause excessive market concentration. This result becomes more likely when the regulators fail to consider additional competition from credit unions and other nonbank competitors or from online service delivery by firms that have no local branches. If instead one of them

is willing to combine with a larger multistate institution that has no presence in that market yet, that transaction could be approved (other things being equal) because it would be viewed as leaving two viable competitors in the local market. If one of the banks wants to merge because, for example, it needs greater critical mass to invest in cybersecurity, under the current guidelines that bank may have only the second choice.

Recommended Action Items

- **Banks should encourage the agencies to pursue the update process to take account of all actual financial services competition in their markets.** Data to capture innovative competition can sometimes be elusive, but the competition clearly exists. Banks should emphasize that the agencies will lack an accurate picture of competition otherwise, and their merger decisions will be based on distorted information.

As a way of background, the Department of Justice has published Requests for Information in connection with a merger guidelines update. Meanwhile, in 2024 the Comptroller of the Currency and the Federal Deposit Insurance Corporation adopted statements of policy updating their approaches to such assessments, which increase the processing burden for transactions they review and suggest that they are more likely to disapprove many transactions. The FDIC subsequently withdrew its 2024 statement and may propose an updated one in the future. OCC's policy statement has been addressed by a joint resolution of Congress under the Congressional Review Act and has also since been withdrawn.

- **Banks should also support updating the regulatory framework that implements the Community Reinvestment Act.** Updates to these regulations are necessary to reflect product and delivery channels in the Digital Age. In addition, modernized CRA regulations may also lead to improved "convenience and needs" analysis for bank mergers.