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Debevoise In Depth

Biden's Bank Merger Competition Order: FinTech Disrupts Its Presumptions by Disrupting the Marketplace

July 19, 2021

On July 9, 2021, President Biden issued a sweeping Executive Order (the "Order")[1] on competition. While the Order is directed to agencies across the federal government and will have wide-ranging implications for various business sectors, this Client In Depth focuses specifically on the provisions of relevance to evaluating the potential impact on bank mergers and acquisitions.

The Order "encourages" the Department of Justice (the "DOJ"), in consultation with the Board of Governors of the Federal Reserve System (the "FRB"), the Federal Deposit Insurance Corporation (the "FDIC") and the Office of the Comptroller of the Currency (the "OCC", and, together with the FDIC and FRB, the "Banking Agencies"), to review current merger practices and adopt a plan within 180 days of the date of the Order for the "revitalization of merger oversight" to provide more extensive scrutiny of bank mergers. On that same day the Order was issued, the Federal Trade Commission (the "FTC") issued the following press statement (the "FTC Press Release"):

> The following statement can be attributed to Federal Trade Commission Chair Lina Khan and Acting Assistant Attorney General of the Justice Department Antitrust Division Richard A. Powers: "We must ensure that the merger guidelines reflect current economic realities and empirical learning and that they guide enforcers to review mergers with the skepticism the law demands. The current guidelines deserve a hard look to determine whether they are overly permissive. We plan soon to jointly launch a review of our merger guidelines with the goal of updating them to reflect a rigorous analytical approach consistent with applicable law."

As to the view of the Banking Agencies, in an address to Congress on July 14, 2021, when asked by Representative Gregory Meeks how the FRB plans to coordinate with the DOJ in reviewing the bank merger process, FRB Chair Jerome Powell responded

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[1] The White House, Executive Order on Promoting Competition in the American Economy (July 9, 2021), *available* here.

that while no decisions have been made, the FRB will work closely with the DOJ to address the Order's directive. On July 15, 2021, Representative Maxine Waters, Chairwoman of the House Committee on Financial Services, expressed her support of the Order in a press release, in which she encouraged the FRB to "review its outdated bank merger guidelines and carefully scrutinize concentration among large regional banks, especially in light of recent deregulation among that same group of banks[.]"[2]

While the FTC Press Release states that there will be an analysis of the current marketplace in connection with ongoing merger review guidelines, it also appears to follow the overall tone of the Order and preordain that more "skepticism" of the competitive impact of bank mergers is warranted. The banking industry view of the implications of the Order and FTC Press Release, even at this early stage, is highlighted by a July 14, 2021 earnings call statement by PNC that its acquisition of BBVA would raise much more scrutiny today, which will weigh on PNC as it considers transactions going forward.[3]

However, ensuring that bank merger guidelines reflect the "current economic realities and empirical learning" of the marketplace, as the FTC Press Release states it would, would not appear to support the more punitive DOJ merger review suggested by the Order and the FTC Press Release. Section I of this Client In Depth discusses how the rise of Fintech necessitates a move away from the branch-oriented analysis espoused by the Order—indeed, following a branch-based model threatens to further exacerbate the asset-size barbell that is currently developing among financial services providers. Section II then highlights how the restrictive view of competition indicated by the Order and the FTC Press Release may impede the Biden Administration's policy goal of enhancing an inclusionary banking system that improves access to financial services for the unbanked and underbanked. Finally, Section III suggests actions that banks may wish to take to mitigate the potential impacts of the Order and FTC Press Release, both generally and as to their own merger activity.

Fintech Has Fundamentally Changed the Banking Marketplace

A core tenet of any competitive analysis is defining the market in which the deal participants compete. The Fact Sheet accompanying the Order focuses on branch

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[2] Congresswoman Maxine Waters, Press Release: Waters Applauds President Biden's Executive Order to Examine Bank Merger Practices, Urges Federal Reserve to Strengthen Merger Reviews, U.S. House Committee on Financial Services (July 15, 2021), *available* here.

[3] Jon Prior, "Bank M&A Will Get Tougher after Biden Order," American Banker (July 14, 2021) *available* here.

closures,[4] which indicates a physical bank presence-based analysis that harkens back to the banking landscape of several decades ago. In this regard, the DOJ published the currently applicable Bank Merger Act guidelines in 1995 (the "1995 Guidelines"). As their initial screen, the 1995 Guidelines use bank deposits, based on the branches to which the deposits are attributed, as a proxy for bank competition in particular geographic markets.

However, the U.S. banking landscape has profoundly changed in the almost three decades since the 1995 Guidelines. The Internet has spawned the Fintech industry, which has disintermediated banks from many of their historical services and generated competitors with higher valuations due, in part, to their freedom from bank regulation. For example, nonbank mortgage lenders now provide a greater volume of mortgages than banks.[5] On April 7, 2021 Jamie Dimon, CEO of JPMorgan Chase, warned of the "enormous threats" facing banking, noting that "Fintech's ability to merge social media, use data smartly and integrate with other platforms rapidly (often without the disadvantages of being an actual bank) will help these companies win significant market share."[6] Mr. Dimon also commented that banks need to be "scared" of Fintech, naming Fintech companies like Paypal and Square as well as "BigTech" companies like Apple and Amazon as direct competitors.[7]

These Fintech and BigTech service providers succeed, in part, because they offer the digital access that is increasingly expected by consumers, particularly in the wake of the COVID-19 pandemic. A focus on branch closures ignores the reality that, for most consumers, their "branch" now exists in their pocket. For example, at Bank of America, digital channels accounted for 44% of its combined account openings and loan originations in the past quarter, slightly down from the 47% high in the same quarter last year at the height of the COVID-19 pandemic but still significantly above the 29% of all openings and originations in the same period in 2019.[8]

The DOJ recognized this transformation in 2020 and then in September sought public comment on updating the 1995 Guidelines to "reflect emerging trends in the banking and financial services sector and modernize its approach to bank merger review under

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4 The White House, FACT SHEET: Executive Order on Promoting Competition in the American Economy (July 9, 2021), *available* here.

5 Orla McCaffrey, "Nonbank Lenders are Dominating the Mortgage Market," *The Wall Street Journal* (June 22, 2021), *available* here.

6 Jamie Dimon, Chairman & CEO Letter to Shareholders, JPMorgan Chase & Co. 2020 Annual Report (April 7, 2021), *available* here.

7 Hugh Son, "Jamie Dimon says JPMorgan Chase should be absolutely 'scared s---less' about Fintech Threat," *CNBC* (January 15, 2021), *available* here.

8 Imani Moise, "US Banks Close More than 250 Branches in Bet on Digital Future," *Financial Times* (July 15, 2021), *available* here.

the antitrust laws[.]"[9] The DOJ has not published a response to that request for comment. Similarly, FRB Governor Michelle Bowman recognized in a February 2021 speech that the FRB's approach to "analyzing the competitive effects of mergers and acquisitions needs to keep pace" with the "technological developments and financial market evolution [that] are quickly escalating competition in the banking industry."[10] With the release of the Order, the question now is whether the modernization of the 1995 Guidelines sought by the DOJ in 2020 will continue to be part of the process to update merger guidelines and practices, or whether the result of the FTC's analysis principally will be a location-based analysis that does not recognize the implications of Fintech or the digital (rather than physical) services-driven transformation of the banking industry.

The importance of the results of the FTC's evaluation cannot be overstated. In most cases, banks pursue mergers, at least in part, to achieve economies of scale. During the past few years, the leaders of many of the largest mergers, such as BB&T Corporation and SunTrust Bank, Inc.'s merger to form Truist Financial Corporation, Huntington Bank's acquisition of TCF Financial Corporation, and Citizens Financial Group's deal to acquire 80 east coast branches of HSBC U.S.A., N.A., all have cited as a major deal driver the need to create economies of scale, at least in part, to invest in enhanced digital services. Huntington noted that its merger with TCF allowed both institutions to "get scale" to "do things that neither one of us could do independently,"[11] including the ability to "additionally invest in technology, particularly digital, and innovation[.]"[12] Truist cited that the "tremendous increase in the need for technological investment to be able to provide the digital capabilities that our clients now demand" requires a level of investment that neither institution could provide on its own due to economies of scale.[13] Chairman and CEO of Citizens Financial Group, Inc., Bruce Van Saun, whose bank recently was acclaimed by Euromoney as the U.S.'s best bank in 2021,[14] has predicted additional future merger opportunities "because smaller banks are stressed with the move to digital business models and all the technology capex that is required."[15] These banks recognize the need to achieve economies of scale to respond to

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9 Department of Justice, Antitrust Division Seeks Public Comments on Updating Bank Merger Review Analysis, *available* here.

10 Governor Michelle Bowman, "My Perspective on Bank Regulation and Supervision," American Bankers Association Conference for Community Bankers (February 16, 2021), *available* here.

11 Hannah Levitt, "Huntington Bancshares to Buy TCF Financial for $6 Billion," *Bloomberg* (December 13, 2020), *available* here.

12 CNBC Closing Bell, "Huntington Bancshares CEO Discusses $22B All-stock Deal with TCF Financial," *CNBC* (December 14, 2020), *available* here.

13 Squawk on the Street, "BB&T CEO: This Merger Helps Us Deal with Rapid Change," *CNBC* (February 7, 2019), *available* here.

14 The US's Best Bank 2021: Citizens, Euromoney (July 14, 2021), *available* here.

15 Joshua Frank, "Citizens Financial Chief: 'We've Earned the Rights to Do More Deals,'" *Financial Times* (June 30, 2021), *available* here.

customer demand for digital access to compete in the modern financial marketplace against both nonbank Fintechs and bank players able to heavily invest in Fintech.

Stated differently, if these types of bank mergers are not permitted in the future, most banks will not be able to achieve the economies of scale necessary to compete most effectively against Fintech and larger financial institutions. Analysts, including Mike Mayo of Wells Fargo Securities, recognize that data demonstrates that the "largest banks are better able to deploy their scale for technology and efficiency benefits."[16] The sheer scale of this investment by the largest U.S. banks is demonstrated by their expenses in the most recent quarter. Expenses at five of these banks totaled $6.6 billion in the second quarter of 2021, 21% higher than the second quarter of 2019. The increase was due in part to wage increases, but also because "[a]lthough technology spending has been on the rise for years, accelerated digitisation during the pandemic has forced executives to stump up even more" to address "the growing threat from new fintech rivals."[17]

Perversely, this could result in the increased dominance of the current largest bank players as well as the unimpeded expansion of BigTech outside of financial regulation altogether—results that many in government leadership have stated that they wish to prevent. A realistic competitive analysis, recognizing the increasing impact of Fintech competition on both physical locations and online, as well as the impediments already imposed by the Dodd-Frank Act to the continued growth of large banks,[18] would mitigate any concern that these mergers could result in a bank that represented a threat to the marketplace or the U.S. economy. To the contrary, allowing banks below the largest tier to grow with via merger and acquisition should enable them to more effectively challenge the largest institutions, thereby increasing competition in the marketplace.

The Order's Ramifications Could Be Contrary to Its Inclusionary Policy Goal

Ironically, one result of restrictive merger policies also could be to substantially diminish the ability of many banks to achieve one of the underlying policy objectives of the Biden Administration and the Order—providing the underbanked better access to the banking system. As noted, a primary reason for many of the larger bank mergers

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16 Lauren Seay and Nathaniel Melican, "Digital Revolution Forces Efficiency Push, Jobs Cuts at US banks," *S&P Global* (July 14, 2021), *available* here.

17 Imani Moise and Joshua Franklin, "US banks ramp up spending on pay and technology," *Financial Times* (July 17, 2021), *available* here.

18 A limitation imposed by section 163(b) of the Dodd-Frank Act (12 U.S.C. § 5363) requires financial holding companies with assets of $250 billion or more to obtain prior FRB approval if the nonbank target engaged in Gramm-Leach-Bliley Act "financial in nature" activities has assets in excess of $10 billion.

over the past few years has been to achieve economies of scale to invest in digital services. Data suggest that these digital services, much more than the retention of redundant branches in low- and moderate-income communities after a merger, are likely to achieve the inclusionary effect desired by all.

Growth in accessibility of digital banking services, such as the ability to send and receive payments and government benefits almost instantaneously, has been of significant assistance in helping the underbanked avoid high-cost credit products as well as payday loans and late fees.[19] The FDIC conducted a qualitative study in 2015 examining the potential for mobile financial services to improve banks' access to underserved (including unbanked) consumers and the potential for mobile financial services to help banks sustain and grow banking relationships with this same group. Some participants in the focus group found that mobile alerts and monitoring tools helped them "reduce fees, track their finances better, and improve on-the-spot decision-making" as well as manage payments efficiently.[20]

The Banking Agencies have taken note that the COVID-19 pandemic highlighted the necessity to increase access to digital banking services to the unbanked and underbanked. While the majority of individuals qualified to receive pandemic stimulus payments by direct deposit, it took weeks to distribute these payments, in the form of checks and prepaid debit cards, to households that did not have updated bank account information with the Internal Revenue Service; the bulk of these households were unbanked and underbanked.[21] If implemented to significantly impede bank mergers, and thus hinder the ability of banks to achieve economies of scale, the Order may in fact limit the ability of banks to increase the digital access that the FDIC and others have deemed critical to promoting inclusionary banking.

Suggested Response by the Banking Industry

Finally, this Client In Depth concludes with some suggestions as to how to respond to the Order and FTC Press Release.

- **Engage in the merger guideline review process**. As the DOJ works with the Banking Agencies to review current merger practices over the coming months, banks

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19 *See, e.g.*, Claire Greene, Fumiko Hayashi and Joanna Stavins, "Delivering Benefits of Faster Payments to the Underserved," FRB (April 15, 2021), *available* here.

20 FDIC, How America Banks: Household Use of Banking and Financial Services, 2019 FDIC Survey (October 2020), *available* here.

21 Governor Lael Brainard, Private Money and Central bank Money as Payments Go Digital: An Update on CBDCs, FRB (May 24, 2021), *available* here.

may wish to consider engaging in the merger guidelines review process, both through trade groups and, if appropriate, individual comment. Hopefully, as occurred in 2020, the FTC will seek public comment before finalizing any changes to the guidelines. Assisting the FTC to understand "current economic realities" may lead to a more favorable update of the merger guidelines.

- **If engaging in a merger or acquisition with competitive issues:**
  - **Highlight the breadth of the competitive marketplace**. As noted throughout this Client In Depth, Fintech has become increasingly prevalent in the banking marketplace. Documenting in merger applications the reality of competition from nonbank Fintechs, as well as from the largest institutions that are able to invest heavily in Fintech, may assist in eliminating or limiting the need for divestitures or more serious actions.
  - **Focus on the consumer access benefits**. Banks also may wish to further document the consumer benefits, particularly with respect to access and inclusivity, that will result from the proposed merger, highlighting how enhanced digital offerings possible from the economies of scale the acquirer can obtain will benefit the underbanked and low- and moderate-income communities in particular.

Conclusion

Much has been written about the possible adverse impact on the banking industry of increased regulation and enforcement by the Banking Agencies. However, given the current market reality of both Fintechs with valuations that often are multiples of banks' valuations and large financial institutions able to deploy capital and resources to an extent not fathomable by regional and smaller banks, the Order and FTC Press Release are no less significant. Attracting bank customers and growth at reasonable efficiency ratios, increasingly possible only with an emphasis on digital channels that require significant investment to develop, remains a prerequisite for long-term success in the banking industry.

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