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FDIC moves to modernize bank merger competition analysis, though gaps remain

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Market Intelligence

The Federal Deposit Insurance Corp.'s bank M&A overhaul would make it easier for banks to get deals done, even though advisers say the framework still fails to fully capture the competitive landscape.

A proposed rule from the FDIC would recognize credit unions and thrifts as competitors in competitive analyses, a change the banking industry has sought for decades. It would also establish clearer processing expectations, expand access to expedited treatment for banks with lower regulatory ratings and reduce procedural hurdles for smaller transactions. Those changes could enlarge the pool of potential buyers and sellers and make it easier for banks to complete multiple acquisitions in relatively quick succession, advisers told S&P Global Market Intelligence.

However, advisers said the competitive analysis would remain too closely tied to physical branches and geographic markets to measure competition, leaving out the growing role of online banks, fintechs and other nonbank providers.

"The amount of competition outside the market, especially in rural markets, dwarfs the competition from within the market," Peter Weinstock, partner at Hunton Andrews Kurth LLP, said in an interview. "If you're dealing with First National Bank of a rural market and First State Bank of a rural market, and they're going to get together and there'll be $300 million of deposits in the market, they're just getting to a level where they can afford a little more technology where they're competing with the big banks … and all of those nonbank competitors."

In the rule itself, the FDIC acknowledged the industry's desire for fintech inclusion and said the proposal "may not optimally reflect the competitive landscape." It asked the industry to provide comment on how it can incorporate fintechs.

"Fintechs aren't necessarily holding those deposits, but they are drawing them away from banks. So they are a competitor," said Douglas Weissinger, a member of the business services group advising financial institutions at law firm Butler Snow LLP.

If the agency does not include them in the final rule, banks would still need to advocate for nonbank inclusion in their specific deals, advisers said.

"In most rural markets today, an M&A transaction, even if there are three banks located in the market and two of them are combining, is not anticompetitive," Weinstock said. "Community banks and community credit unions are losing market share, real market share, to players that don't have anything in the geography."

Measuring credit union and fintech deposit competition is difficult because those entities do not report branch level deposit data like banks do. The FDIC proposed allocating credit union deposits among markets based on the number of branches they operate, but that discretion could either understate or overstate a credit union's influence in a market, Weissinger said.

Weinstock said the difficulty of evaluating competition from outside a deal's geography contributes to regulators' unwillingness to include fintechs.

One potential solution would be to make the framework less geographic-centric, he said. Regulators could create broader exemptions for very small communities, similar to the Office of the Comptroller of the Currency's historical treatment of bank deals in communities with populations below 10,000 as "not economically significant," making anticompetitive effects "negligible."

"The notion that the geography is really a border, it's just not sensible," Weinstock said.

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Modernizing competitive analyses

Despite its limitations, advisers said the proposal presents a meaningful improvement over the current framework.

Credit union and thrift inclusion would be particularly helpful in rural markets, where calculating the metric used to determine whether competition is reduced too much can get "sticky" because there are a limited number of banks, Weissinger said.

Automatic credit union and thrift inclusion would also remove the onus on banks and their advisers to make the case for those competitors to be considered.

Currently, applicants have to make their case by identifying credit unions, consumer-finance companies, commuting patterns and other competitive factors not captured by traditional deposit data, advisers said. In a recent example, Fifth Third Bancorp was able to avoid divestitures related to its acquisition of Comerica Inc. after the Federal Reserve included nine credit unions in the competitive analysis for one market in Michigan at a 50% weight.

Easing the review process

The proposal offers other M&A impacts, including establishing processing time guidelines for bank transactions of various sizes, which would give institutions more clarity on what to expect during the review process.

The proposal also signals a potentially significant shift in how the FDIC approaches growth by banks with weaker regulatory ratings by allowing banks with CAMELS composite ratings of 3 or better to qualify for expedited processing. Historically, the FDIC only allowed banks with stronger 1 or 2 ratings to engage in growth initiatives, advisers said.

M&A could present solutions for some banks with weaker 3 ratings, Weinstock said. For example, a bank with technology deficiencies could potentially address them by combining with an institution that has stronger systems.

The proposal also seeks to remove the public comment period for the smallest category of deals, labeled de minimis transactions. For all other transactions, the FDIC would use its discretion to evaluate the validity of public comment letter concerns rather than automatically removing a deal that receives adverse letters from expedited processing.

Advisers called this another positive change, especially given the uptick in bank merger protests. In some cases, serial protestors send in the exact same letters and just change the bank names, Weinstock said.

"Trying to move analysis away from 'All protests have to be treated the same' to 'We're only going to recognize protests if they set a credible basis, and we're going to analyze it in the same time frame so that the protester doesn't get the benefit of an automatic delay or multiple delays' — that's a real positive," Weinstock said.

All of the changes together could bring more institutions into the buyer and seller pool and permit banks to pursue transactions closer together, rather than waiting through long reviews, advisers said. The full effect, however, will depend on whether the OCC, the Federal Reserve and Department of Justice adopt compatible approaches.

"If the other agencies and the DOJ do follow the FDIC's lead, bank merger activity could be meaningfully encouraged," lawyers from Sullivan & Cromwell wrote in a Sept. 22 post.

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