



# HAPPY STATE BANK

## MEMORANDUM

**TO:** Antitrust Division, Department of Justice

**FROM:** David Jones, Brandon Wing, and Linda Crank on behalf of Happy State Bank

**DATE:** October 15, 2020

**RE:** Happy State Bank Public Comments Regarding Banking Merger Guidelines Review

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Happy State Bank (“HSB”) welcomes the opportunity to provide public comments relevant to the Antitrust Division’s (the “Division”) consideration of whether to revise the 1995 Banking Merger Guidelines (the “1995 BMG”) and its approach to competitive analysis of bank mergers.

HSB is an approximately \$5.5 billion bank headquartered in Amarillo, Texas. In the last three acquisitions in which HSB has engaged, it has become very familiar with competitive effects analysis issues, especially with respect to rural banking markets. In each transaction, HSB was allowed to consummate the acquisition without a divestiture. However, the delay and additional expense required to show that there would be no adverse competitive effects in each transaction was substantial and largely caused by a dated approach to evaluating competitive effects in banking markets under the 1995 BMG and a dated approach to defining banking markets.<sup>1</sup>

### OVERVIEW

HSB believes that the 1995 BMG have become outdated given changes in market forces over the last 25 years. The focus of the 1995 BMG is on the Herfindahl-Hirschman Index (“HHI”) screening tool. The 1995 BMG as applied currently is not meaningful when applied to rural markets where the defined banking markets are simply too small. In 2017, 88.8% of rural markets were considered highly concentrated as measured by the HHI threshold in the 1995 BMG (an HHI over 1,800) and the HHI mean for all US banking markets was 3,468.<sup>2</sup> It seems safe to say the 90% of rural markets are not generally suffering from highly concentrated monopolistic activity – or that would be a different crisis demanding attention. The relevant economic banking markets in rural markets are almost universally defined too narrowly.

HSB believes that the 2010 Horizontal Merger Guidelines (“2010 HMG”) should be applied to the banking industry, but should be supplemented with banking-specific guidelines that are written from

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<sup>1</sup> HSB notes that the Division has access to materials provided by HSB relating to the investigation opened relative to the Plainview banking market, which may also be instructive in the exercise of updating the bank merger guidelines.

<sup>2</sup> See “Market Concentration and Its Impact on Community Banks”, Andrew P. Meyer, published in the Regional Economist, First Quarter 2018, St. Louis Federal Reserve. (“Meyer”)

scratch to be consistent with the 2010 HMG. The 1995 BMG should be retired. The HHI screen under the 2010 HMG (rather than the thresholds under the 1995 BMG) should be used for the sake of consistency among industries. ***The bank specific guidance most needed is with respect to properly defining geographic and product banking markets.***

In 1974, the Supreme Court affirmed a 1963 decision that concluded that banking markets are local. The Court stated “the relevant geographic market of the acquired bank is the localized area in which that bank is in significant, direct competition with other banks...”<sup>3</sup> In the last 45 years, the financial services industry has undergone significant competitive and technological innovations which must be considered when defining the relevant geographic products and markets for antitrust purposes.

In 1974, the Supreme Court also anticipated in a prophetic way that the day might come when non-banks would need to be factored into determining banking markets: “We do not say ... that, in a case involving a merger of commercial banks, a court may never consider savings banks [i.e. nonbank competitors] and commercial banks as operating in the same line of commerce... At some stage in the development of savings banks [i.e. non-bank competitors], it will be unrealistic to distinguish them from commercial banks...”<sup>4</sup> The Court also affirmed it “must recognize meaningful competition where it is found to exist” and not “blind itself to economic realities.”<sup>5</sup>

Abandoning the notion that all banking is “local” is entirely consistent with the writings above of the Supreme Court in 1974. The Supreme Court anticipated that changes were occurring that could make the concept of banking being local the exception, rather than the rule.

***That anticipated day has arrived. Banking merger guidelines should be developed that incorporate a realistic identification of meaningful non-bank and non-local competitors and provide for defining banking markets that do not blindly ignore the economic reality of such competitors.***

### SUMMARY RECOMMENDATIONS

HSB’s opinions are based on its experience and are informed by the work of Dr. Michael Noel, whose expert report will be referenced in the specific comments below. HSB understands that its assertion that the guidelines are out of date must be accompanied by a practical proposal for fixing the problem. HSB asserts three propositions are true: (1) currently, banking markets, in particular rural markets, are often defined in a way that does not reflect the way markets for other industries would be defined under the 2010 HMG; (2) rural markets should be defined in the same way urban markets are, based on customer behavior and access to services; and (3) utilizing deposits as the metric for analyzing HHI thresholds is flawed in many respects; however, there is no readily available, feasible substitute that can be used as a screening tool.

***Based on the propositions above, HSB makes the following general recommendations to the Division:***

***The Division should adopt banking-specific guidelines that appropriately define banking markets consistent with true economic market forces and customer behavior. This will result in larger but more realistic rural markets that are consistent with the 2010 HMG. Realistically, such markets should be entire states or regions of larger states.***

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<sup>3</sup> *United States v. Connecticut Nat’l Bank*, 418 U.S. 656 at 667.

<sup>4</sup> *Id.* at 666.

<sup>5</sup> *Id.* at 662.

***If banking markets are appropriately defined, then the number of market participants will be sufficient to ensure that HHI thresholds, with some revisions, based on deposits will remain an adequate and practical screening tool.<sup>6</sup>***

In support of its position, HSB will provide several exhibits, as well as references to an Expert Report dated October 9, 2020, prepared by Michael D. Noel, Ph.D. at the request of HSB, which specifically addresses the comments solicited by the Division on September 1, 2020. It is referenced here as “Noel.” The expert report was independently submitted to the Division by Dr. Noel as a public comment on October 13, 2020. It will be provided with these comments for convenience.

HSB is located in Amarillo, Texas in the northern part of Texas and is most familiar with competitive effects issues in its markets. HSB will use that experience to discuss concrete examples in this response. The most common regional definition for the “Texas Panhandle” is the upper 26 counties of Texas surrounding Amarillo. The most common definition for the “South Plains” is the next lower 18 counties surrounding “Lubbock.” **Exhibit 1** is a map of the Texas Panhandle and South Plains that will be referred to in the responses below to the comments. The map shows the Fed predefined banking markets and the undefined counties as of the date of this response.

### **COMMENTS**

The remainder of this Memorandum provides HSB’s response to each of the specific requests for public comments issued by the Division on Tuesday, September 1, 2020.

#### **1. Guidance Generally.**

##### ***a. To what extent, if at all, is it useful to have banking-specific merger review guidance, beyond the 2010 Horizontal Merger Guidelines?***

It is extremely important to have banking-specific merger review guidance. The banking industry is undergoing a continuing consolidation as the number of banks over the last 36 years has steadily declined from 14,400 commercial banks in Q1 1984 to 4,404 banks in Q2 2020.<sup>7</sup> This consolidation is happening primarily with the disappearance of smaller banks, which tend to be located in more rural areas. As such decline continues through mergers, updated guidance is essential.

Banking is perhaps unique in that there are multiple regulators involved in banking matters and such regulators may have differing opinions, which creates uncertainty with respect to acquisitions. There are three primary bank regulators: the Federal Reserve Bank (the “Fed”), the Federal Deposit Insurance Corporation (“FDIC”), and the Office of the Comptroller of Currency (“OCC”). The Fed is tasked with initially defining banking markets, which may or may not be followed by the other regulators or the Division. Banks are also subject to state regulators which could have 50 different opinions about banking markets.

It is also extremely important that banking-specific guidelines complement the 2010 HMG. The current 1995 BMG is inconsistent with, and even contradicts, rather than complements, the 2010 HMG. Per Dr. Noel, the 1995 BMG leads to “systemic and known errors in merger analysis” and should “be

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<sup>6</sup> HSB notes that emphasis must be placed on the fact that the initial HHI screen is just a screening tool, that uses an imperfect metric – deposits – and the screening results should not prejudice any subsequent Division or bank regulatory agency investigation.

<sup>7</sup> Federal Reserve Bank of St. Louis and Federal Financial Institutions Examination Council (US), Commercial Banks in the U.S. [USNUM], retrieved from FRED, Federal Reserve Bank of St. Louis; <https://fred.stlouisfed.org/series/USNUM>, October 13, 2020.

retired in its entirety.” See Noel, Para. 9-10. Dr. Noel discusses at length the deficiencies in the 1995 BMG. The document is 25 years old and has not kept up with changes in banking. See Noel, Para. 5-11. Also, the 1995 BMG has no discussion of how banking markets should be defined and instead defers to the Fed predefined banking markets, which is problematic. See Noel, Para. 1-14. Dr. Noel also notes the 1995 BMG focuses almost entirely on the use of the HHI screening tool which is based on deposits, a metric which has flaws as discussed below. See Noel, Para. 15-23.

b. ***To what extent, if any, does the industry need greater clarity on how the Division applies the 2010 Horizontal Merger Guidelines in its investigations?***

Greater clarity is always welcomed to reduce uncertainty. However, that clarity is best provided by a document specific to the banking industry, in place of the current 1995 BMG, rather than changing the 2010 HMG.

c. ***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)?***

Joint guidance is always helpful to create consistency and thereby reduce uncertainty. To the extent the Division has the final say by opening an investigation, it is more important to understand the Division’s guidance than to have joint guidance.

More specifically, joint guidance on how banking markets should be defined is most needed. If the Division would predefine banking markets according to the 2010 HMG, it would provide immense help to the industry, especially if the banking regulators would then adopt the Division definitions. Further, proper definition of banking markets would alleviate some of the shortcomings of the HHI screening tool based on deposits.

It is not efficient to define banking markets on a case-by-case basis as needed for proposed transactions. It is problematic that the Division relies on the Fed predefined markets. Per the Dallas Federal Reserve Bank, it has defined some but not all markets and urges banks anticipating a merger to consider:

*“Banking market determination is conducted on a case-by-case basis, and **previous determinations may not be regarded as precedents for future decisions.** Where a potential anticompetitive situation is perceived, the Reserve Bank will undertake a thorough investigation to determine if a previously defined market should be redefined or to define a market not previously examined. (emphasis added)<sup>8</sup>”*

This approach is problematic in two ways. First, not all markets are defined.<sup>9</sup> Second, those that are defined cannot be relied upon – they have no precedential value. Therefore, the Division’s reliance on these Fed predefined markets is misplaced. See further the discussion in response to Questions 3.b. and 3.c.

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<sup>8</sup> Federal Reserve Bank of Dallas, <https://www.dallasfed.org/banking/applications/mkdef#tab1>

<sup>9</sup> See **Exhibit 1** showing that 40% of the counties in northern Texas are undefined.

2. **Herfindahl-Hirschman Index (HHI) Threshold.**

- a. ***Should the screening thresholds in the 1995 Banking Guidelines be updated to reflect the HHI thresholds in the 2010 Horizontal Merger Guidelines? If so, please explain why with evidence, if available.***

The simple answer is yes, especially based on the proposition that generally banking markets are predefined as being too small, especially in rural areas. Increasing the threshold based on the 2010 HMG will provide minimal relief, but does not solve the problem.

Obviously, the smaller the number of market participants, the higher the HHI concentration will be. In 2017, the mean HHI concentration in rural markets was over 3,450.<sup>10</sup> Consider the following: (1) under the 2010 HMG threshold of 2,500, if there are four or less participants, a market will be highly concentrated; and (2) under the 1995 BMG threshold of 1,800, if there are six or less participants in a market, the market will almost certainly be highly concentrated.

So, the relief granted by updating the threshold as a practical matter gives markets with five or six participants a small chance of passing the threshold. The overarching problem is that most rural markets already appear to be highly concentrated because of the way the HHI is calculated, with few participants being included in the initial screen. The HHI screen, as designed, excludes a vast assortment of participants in the market such as: credit unions, thrifts, national online deposit gatherers, online lenders, farm credit lenders, and others.<sup>11</sup>

The Texas Panhandle and the South Plains presently each have one defined banking market that consists of a single county. The Matador market, which has one bank location, and the Wellington banking market, which has two bank locations. The problem is not the HHI threshold, it is the market definition.

***The problem is less one of utilizing and determining the HHI threshold than it is of properly defining the market based on recognizing the competitors in the market that do not have a physical presence.***

The question raises several issues that must be addressed over and above the specific question asked about the HHI thresholds. In theory, the use of HHI as a screening tool to determine competitive effects in the banking industry is consistent with the 2010 HMG and the use of HHI as a tool in other industries. Unfortunately, the use of HHI as applied in the banking industry is inconsistent with the 2019 HMG and creates challenges in applying the results, especially in rural markets. Dr. Noel discusses the limitations of the HHI metric in the 1995 BMG extensively in the context of limiting the product market to deposits. See Noel, Para 16-23.

The challenges identified with using deposits as the HHI metric include the following:

- i. Deposits are a measure of an expense for a bank, rather than a measure of revenue.
- ii. Deposits are a default metric, because the data is readily accessible from the FDIC on an annual basis.
- iii. Deposits are only a single aspect of what banks do. Deposits do NOT:

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<sup>10</sup> See “Market Concentration and Its Impact on Community Banks”, Figure 1, Andrew P. Meyer, Regional Economist - First Quarter 2018, Federal Reserve Bank of St. Louis.

<sup>11</sup> See Noel, Para. 32-34.

- 1) Accurately measure the competition, given advances in technology.
  - 2) Take into account the size and sophistication of competitors.
  - 3) Distinguish between commercial, public, brokered, and consumer accounts.
  - 4) Account for competition from non-bank and non-depository institutions.
- iv. Deposits of a bank (or its competitors) with multiple branches are subject to manipulation based on the bank's internal mechanism for allocation of deposits among branches. National deposit gatherers may report all deposits to a single location.<sup>12</sup>

Because deposits have issues, the Division should evaluate alternative measures. The question becomes: Is there a practical, feasible, alternative to deposits? Some alternatives:

- i. Loans in the market (all sources, not just banks) - possible sources:
  - 1) HMDA data – which is annually reported by census tracts to the Consumer Financial Protection Bureau (CFPB) and can be aggregated by census tracts, counties, etc.
  - 2) Small business/small farm data, which is also reported by census tract to the government by larger banks.<sup>13</sup>
  - 3) Competition from farm credit lenders, which could be problematic to collect.
- ii. Total size and sophistication of the competitors in the market.

Acknowledging that banking markets are regional, or even statewide or national, would alleviate the need to change the HHI screening tool. Dr. Noel asserts “Markets are now regional in nature (and nationalizing over time) ...”. See Noel, Para. 33.

### 3. Relevant Product and Geographic Markets.

- a. ***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 global issue is: whichever product markets are utilized, the challenge is to include all market participants. This necessarily involves recognizing the economic reality of the additional competition due to the changing landscape of online, electronic, and out-of-market competitors. See Noel, Para. 41.

The one large retail market that affects most consumers in a significant way is the mortgage market. For banks that offer a mortgage product, the competition is extensive and generally not captured for competitive effects analysis in rural markets. HMDA data is reported by geography with respect to

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<sup>12</sup> For example, Ally Bank, along with other industrial banks (Morgan Stanley, American Express, etc.), is located in Salt Lake City, Utah, and reports all of its deposits in that county. Ally Bank reported \$117.9 billion in deposits all located in Sandy, Utah. Morgan Stanley reported \$112.6 billion in deposits in Sandy, Utah. Clearly, some of those deposits originated in the Panhandle and South Plains of Texas. It appears that those institutions are operating in a “national” market. Source: FDIC Summary of Deposits, 6/30/2020.

<sup>13</sup> Banks under approximately \$1.3 billion in assets are not required to report. The actual number was \$1.284 billion as of 12/31 for the last two years.

both applications taken and funded loans.<sup>14</sup> For example, the Fed-defined Lubbock Banking Market in Texas (4½ counties) has 28 local bank institutions.<sup>15</sup> **Exhibit 2** shows 2019 HMDA data for the defined Lubbock market. Based on HMDA data, there were 375 institutions that took mortgage applications totaling \$2.635 billion. The market share of the local institutions was only \$848.9 million, or a 32.21% market share. The market share of the top 15 non-local participants was 40.43%. The remaining 337 participants accounted for 27.36% of the market share. In the Lubbock defined market, which is actually more urban than rural, the local banks only had one-third of the mortgage market.

Similarly, small farm and small business activity is reported by census tracts to the regulators by larger banks (over approximately \$1.3 billion in size) and shows the non-local competition for this business line in rural markets. It does not, however, pick up the significant competition from Farm Credit participants.

- b. ***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?***

Markets should be defined with regard to the 2010 HMG. As stated before, the 1995 BMG needs to be retired and new guidance written to reflect advances in the banking industry and to provide consistency with the 2010 HMG. The Division should screen based on true economic markets. In fact, it would be extremely helpful if the Division predefined markets on a regional or statewide (or national) basis.

As noted in response to question 1.c., there are a number of issues with the predefined Fed markets. The main problem is consistency of definitions. Most presumed markets have been defined – or get redefined – in response to a proposed transaction. This is the explicit approach taken by the Fed.<sup>16</sup> The process for defining the appropriate market is tailored to the transaction and does not seek to provide definitions beyond what is necessary for the transaction. If an undefined county next-door is not involved in a transaction, it is unlikely to be included in whatever new market definition is presented as a result of the transaction.<sup>17</sup> So, the market definition process admittedly ends before the true market is defined, which results in the Fed noting that prior definitions “may not be regarded as precedents” in a future transaction. In other words, a bank cannot rely on the predefined market definitions.

In practice, when an acquisition transaction is submitted, the defined banking markets are then often changed in response to the proposed transaction. For example, the Fed-defined Amarillo market has been redefined multiple times in response to various transactions.

As an example of how the Division should approach defining rural banking markets, HSB uses the example of the top 44 counties in Texas. *See Exhibit 1.* These counties are defined as two markets by many organizations, governmental and otherwise, which are the Texas Panhandle, the upper 26 counties surrounding the hub of Amarillo, and the South Plains, the lower 18 counties surrounding the

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<sup>14</sup> Reporting entities also report decisions made on non-funded applications.

<sup>15</sup> Per the CASSIDI tool provided by the Federal Reserve Bank of St. Louis, *see* <https://cassidi.stlouisfed.org/index>.

<sup>16</sup> Federal Reserve Bank of Dallas, <https://www.dallasfed.org/banking/applications/mkdef#tab1> (*see* “Banking Market Determination” as quoted in response to Question 1.c.)

<sup>17</sup> For example, in 2019, HSB was involved in a transaction to acquire four existing rural branches from another institution. The transaction resulted in the Fed defining for the first time defining or redefining three banking markets, including the Matador banking market, which is a square one-county market consisting of 990 square miles, 1200 people, and one bank location.

hub of Lubbock. *See Exhibit 3.* As can be seen in **Exhibit 1**, the predefined banking markets are a patchwork of markets covering only about 60% of the counties.

**Exhibit 1** shows that presently, out of 44 counties, 18 counties – over 40% – are either fully or partially *undefined* as part of a banking market. HSB believes this problem exists for large portions of rural markets throughout the country. The uncolored parts of the **Exhibit 1** map are undefined for banking market purposes. This is problematic for any entity wishing to enter into one of these 18 counties. The HHI screening tool becomes irrelevant as currently set up in the CASSIDI website because an undefined county is not part of the CASSIDI website. A request must be made to the Fed to include the county in a defined banking market and then wait to see the result.

Given the changes in the competitive environment for banks (online banking, non-bank competitors, etc.), HSB proposes that larger regions should be defined as the relevant banking markets. In support of that proposal, as an example, HSB incorporates by reference **Noel**, Para. 75-76, and **Noel**, Exhibit B, which makes the case for defining the Texas Panhandle and South Plains as the two relevant economic banking markets in northern Texas. This is consistent with how other entities view the region. *See Exhibit 3.*

An example of the inconsistency of defining markets is evident when you compare the Matador banking market, which consists of Motley County, to the Houston banking market, which consists of 10 counties. *See Exhibit 4.* One market has 1,200 people and one bank location. The other has over 7 million people and 1,426 locations. The definition of the Matador banking market simply does not make sense in today's world, or according to the 2010 HMG. Dr Noel discusses a number of additional examples that do not make sense. *See Noel*, Para. 65-71.

Generally, for the reasons stated in these comments, rural markets are defined too narrowly and, given advances in technology and changes in the banking market, even urban markets may be defined too narrowly. Dr. Noel observes that rural banking markets are “egregiously narrowly defined ... in many rural areas.” *See Noel*, Para. 64.

In rural areas, often the starting place of definition of the assumed market is the “county.” This harkens back to the 1963 Supreme Court ruling that banking markets are local. That simply is not the case today. **Noel**, Para. 13, 45-50, 60. This is especially true in the Texas Panhandle and South Plains, where county lines were drawn up arbitrarily in the late 1800s based on the Texas constitutional requirements that counties be a minimum of 900 square miles in size and as square as possible. County lines were not drawn for economic reasons. Observe in **Exhibit 1** the consistent shape of the counties.

A much more reasonable starting place is the closest hub city that is the center of economic activity within a region or sub-region of a state. *See Noel*, Para 62. ***Geographic market definitions used in the screening process should be markets as would be defined in other industries under the 2010 HMG.***

c. ***Should the geographic markets for consumer and small business products and services still be considered local?***

**No.** A lesson learned from COVID-19 is that the only true “local” product is a safety deposit box. Every other product and service offered by most banks can be delivered without entering into a branch or can be done electronically. Banking is no longer local. And, as noted, that concept is not contrary to the Supreme Court guidance from 1974.

As Dr. Noel explains, the transformation of banks, from brick-and-mortar locations to electronic providers of services, changes which approach in the 2010 HMG should be used to define geographic markets:

“The 2010 HMG presents two different approaches to defining markets – markets based on the location of firms (“firm-centric”) and markets based on location of customers (“customer-centric”). The 2010 HMG states that the former applies when “customers receive goods or services at suppliers’ locations” and the latter applies when “suppliers deliver their products or services at customers’ locations”. The banking industry was clearly the former in the 60s, but has since shifted mostly into the latter. Banks now travel to you. Banking is increasingly customer-centric and the distance to a branch is less and less important.” See Noel, Para. 55.

#### 4. **Rural versus Urban Markets.**

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

According to Meyer, a market is “stuck” when it exceeds the relevant HHI threshold because its within-market merger activity is severely limited.<sup>18</sup> In other words, when the market exceeds the 1,800 HHI threshold established under the 1995 BMG, it is stuck. Meyer observes only 29% of urban markets are stuck, but almost 90% of rural markets as of 2017 are “stuck.” The issue is not that monopolistic activity is occurring in rural markets, it is that rural markets are defined too narrowly.

Rural and urban defined banking markets differ considerably in size because of the outdated perception that all banking is “local.” See Noel, Para 60-61, 64. The relevant market for the consumer should be determined by the consumer’s willingness to travel or access non-traditional means to satisfy the consumer’s banking needs.

While urban and rural markets differ significantly in size; they do not differ with respect to consumer behavior as it relates to seeking products and services. Banking markets need to be defined in those terms. As an example familiar to HSB, in the Texas Panhandle consumers will be drawn to the hub of Amarillo (at the center of a 26-county market) for a whole host of products and services. Their maximum drive times may be similar to the time it takes to cross the defined Houston banking market during rush hour, even though the miles are longer. Many of the services offered in the Amarillo hub are not available elsewhere in the Texas Panhandle. See also Noel, Para. 61.

The concept that all banking services are “local” is no longer true given the technological advances in the provision of banking services. See Noel, Para. 13, 45-50, 60. The Division’s approach for all markets can remain the same if the markets are properly defined.

##### b. ***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?***

Different screening criteria are not necessary if markets are properly defined based on consumer behavior. See Noel, Para. 81. Properly defined markets will be larger and contain more participants, and HHI thresholds will be more relevant and reflective of possible anticompetitive concentrations.

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<sup>18</sup> “Market Concentration and Its Impact on Community Banks”, Andrew P. Meyer, Regional Economist - First Quarter 2018, Federal Reserve Bank of St. Louis.

However, accommodations must be made to the screening process if the approach to defining rural markets is not changed. Presently, such predefined markets are generally very small geographic areas with few brick-and-mortar banking participants. Such defined markets are too narrowly defined, egregiously so according to Dr. Noel. *See Noel*, Para. 43, 60, 61. The screening criteria must take into account that a large majority of such predefined markets have a calculated HHI in excess of the existing thresholds and, since these HHIs vastly overstate concentration, would necessitate raising the thresholds accordingly to compensate. In addition to correcting for overly small geographic definitions, the screening tools need to be modified to take into account non-local competition and non-bank competitors impacting the predefined market.

It is also worth noting that there should be a renewed emphasis on the fact that setting a threshold is simply a “screening” tool and acknowledging that the metric of “deposits” as the underlying criteria for the screening is a flawed/incomplete metric. *See the prior response to Question 2.a.* Deposits are a proxy for an expense category of the bank, or generally for a branch, and at most might correlate with the revenue of the bank/branch by applying a hypothetical net interest margin. *See also Noel*, Para. 16.

Upon failing to meet the screen, there should be no presumption against the bank and a bank should be allowed a fresh start to show the transaction will not be anti-competitive. In other words, the screen should not be considered determinative.<sup>19</sup>

c. ***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?***

This question should be applicable to a broader base than just non-depository farm credit lending institutions. It should also apply to non-local banks, credit unions, mortgage companies, online lenders, and fin-tech companies.

The question seems to imply that anecdotal evidence of the activity of farm credit lenders is the only approach to measuring the competition from those lenders. However, there are other potential measures:

- i. To the extent the lending entities report lending activity in annual reports by county or region, such reports are useful in measuring actual lending activity.
- ii. If the regulators of such entities could be convinced to require reporting by region or county, it would provide a consistent measure which could be relied upon.
- iii. HSB, in two recent transactions, performed a legal search of the real estate records in the relevant counties to determine actual real estate filings. Deed of trust (security interest) filings give both the number and often the dollar volume

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<sup>19</sup> The decision of regulators, as reported in at least one case, to apparently base divestiture on strict adherence to thresholds is an exercise in form over substance without regard to engaging in true analysis of the competitive effects in conformance with the 2010 HMG. Basically, the HHI screen was considered determinative of the result and divestiture was ordered in markets if the guidelines (or the arbitrary FRB 35% deposit market share) were exceeded. In other markets exceeding the guidelines, weight was given to credit unions and thrift deposits in a sufficient amount to squeeze in under the guidelines. In the Atlanta banking market (Georgia), an initial 1,831 screen, was reduced to 1,743 by including 100% of the deposits of two thrift institutions. Likewise, in the Lexington banking market (Virginia), an initial 1,879 screen, was reduced to 1,771 by including 100% of the deposits of two credit unions. For markets in which divestiture was ordered, it was strictly a matter of the fact the deposits of thrifts and credit unions were not enough to get below the HHI or 35% market share thresholds. *See*, FRB Order No. 2019-16, November 19, 2019, BB&T Corporation.

of transactions done within a certain time for farm credit lending institutions, as well as all other institutions making loans secured by real estate. This data supplements HMDA data in verifying the actual number and volume of originations secured by real property collateral within the relevant market. This process is feasible, although relatively expensive, in rural markets where the number of transactions perhaps are less than 500 or so in a reasonably defined period (say one year). It is probably not very reasonable or feasible for a large urban market with thousands of transactions.

- iv. An examination of UCC records could also provide evidence of the number of competitors within a market, although such records will not provide evidence of the dollar volume of such transactions.

## 5. Non-Traditional Banks.

- a. ***Should the Division include non-traditional banks (e.g., online) in its competitive effects?***

**Yes.** Banking markets should be defined based on consumer behavior. For example, one of the most universal financial products consumers seek is a home mortgage. Many consumers seeking a mortgage in today's market would explore options from both online lenders (e.g. Quicken Loans, and Rocket Mortgage) and brick-and-mortar financial institutions. See Noel, Para. 7, 8, and 87.

The analysis should also include competition from traditional banks that do not have a physical location in the market. As discussed in the previous question, HSB analyzed competition by evaluating deeds of trust filed in the real estate records of the market being examined. The real estate records reflected that traditional bank financial institutions only held 52% of the market share of loans. And of that 52%, local banks had 36% of the market share and banks located outside of the defined market area had 16% of the market share.<sup>20</sup> This also provides evidence that, based on actual consumer behavior, the market was defined too narrowly in the first place.

Further, in addition to missing online deposits, there is currently no mechanism for accounting for deposits of financial institutions which leave a market. Deposits are "sticky" and when an institution leaves a specific banking market, experience shows that it will retain the deposits from that market on a decreasing basis over time. The year after the institution leaves, it likely retains a majority of the deposits in that banking market that it reported in the prior year. Those deposits are simply lost in the HHI analysis. This is perhaps becoming more common and problematic as very large institutions exit smaller rural markets – and consolidate into locations in the hub of the regional market. HSB has observed this directly as Wells Fargo, Bank of America, and others leave small towns in the Panhandle and South Plains and presumably consolidate in the hub cities of Amarillo and Lubbock.

- b. ***Does the Division give appropriate weight to online deposits?***

**No.** HSB is not aware that the Division gives any weight to online deposits. It would be absolutely appropriate, and is needed, for the Division to develop a quantitative proxy for handling online deposits. But as noted earlier, there is also a need for developing a measure for deposits held by bank institutions located outside of the banking market. In this regard, it is noted that deposits are reported to the FDIC by "branch", rather than the location of the deposit customer. As noted above, HSB has

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<sup>20</sup> The analysis looked at the three full counties in the defined Plainview banking market (Castro, Swisher, and Hale). Of a total of \$90 million in loans: ag lenders held an 18% share, non-traditional lenders held a 30% share, local banks held a 36% share, and non-local banks held a 16% share.

observed large banks located in hub cities that have closed branches in rural markets and it is presumed the deposits from the rural branches are now reported in the branch in the hub city.

As discussed earlier, using deposits as the metric for HHI analysis is flawed, but it does not appear that there is a reasonable/feasible alternative to using deposits as the HHI metric for screening purposes. To the extent a predefined quantitative proxy could be developed by the Division for online deposits, the screening tool would be more valuable and more accurate. Dr. Noel presents some alternative solutions in his work. *See Noel*, Para. 91-92.

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

**No.** It is HSB's understanding that the Division only gives full weight to credit union and thrift deposits upon request by the bank being evaluated. Credit unions and thrifts are active competitors with banks for providing consumer services, and deposits should be weighted 100% in the initial screening. NCUA share data could reasonably be incorporated into the CASSIDI screening tool.

d. ***Given that 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.***

A proxy allocation could be developed in several ways as discussed by Dr. Noel. *See Noel*, Para 91-92. The Division could also do an economic analysis to develop a single nationwide – or by state – proxy percentage that could be utilized in the safe harbor “screening” process. As noted above with credit union and thrift deposits, such a predefined proxy could easily be incorporated into the CASSIDI tool.

6. **De Minimis Exception.**

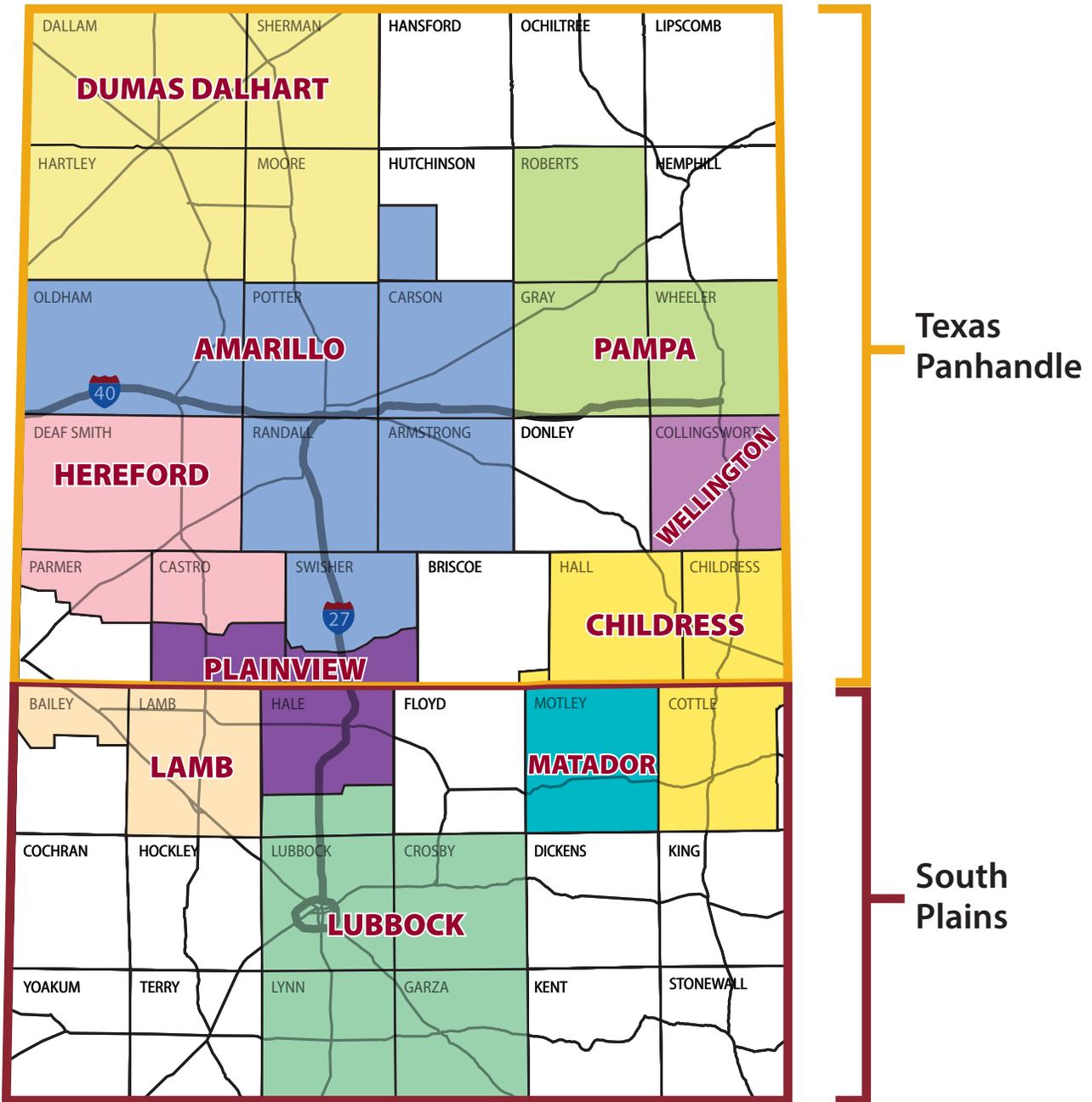
a. ***Should the Division implement an internal de minimis exception for very small transactions whereby the Division would automatically provide a report on the competitive factors of the transaction to the responsible banking agency but would not conduct an independent competitive effects analysis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

The Division should develop an internal *de minimis* exception for very small transactions. Small transactions are often motivated by efficiencies. A smaller bank most often needs to sell because of factors that have nothing to do with market share. Such factors include lack of a succession plan, the need for a shareholder liquidity event, regulatory issues, the inability to keep up with the ever more complex compliance requirements, or other issues. In rural areas, there are very few potential entrants into what appears to be a concentrated market, as referenced above in the discussion about HHI. The potential buyers are likely entities that already have a presence within or close to the market in which the selling bank is located.

HSB believes, based on experience, the appropriate *de minimis* size should at least be \$100 million. HSB takes note that the ICBA comment proposal of utilizing the SBA small business designation (\$600 million) could be adopted. (Independent Community Bankers of America, comments dated September 29, 2020.) IBAT also endorsed that approach. (Independent Bankers Association of Texas, comments dated October 15, 2020.)

However, adoption of such *de minimis* exception **must include** a mechanism for a banking institution to request an independent competitive effects analysis from the Division in a situation where the banking agency declines to approve a transaction (or requires divestiture) for competitive effects reasons. The Division works with the 2010 HMG every day and should have the final say if the bank and the banking agency do not reach agreement.

# Exhibit 1 - Northern Texas Banking Markets and Undefined Counties



**Source:** This document was prepared by Happy State Bank. Banking markets were identified using the Federal Reserve Bank's CASSIDI tool (<https://cassidi.stlouisfed.org/index>).

**Undefined (or partially undefined) counties from North to South include:** Hansford, Ochiltree, Lipscomb, Hutchinson, Hemphill, Donley, Parmer, Briscoe, Bailey, Floyd, Cochran, Hockley, Dickens, King, Yoakum, Terry, Kent, and Stonewall.

## EXHIBIT 2

### Mortgage Loan Competition in Lubbock Banking Market ("LBM") Based on HMDA Applications (\$ are thousands)

*Data is from the 2019 HMDA activity submissions to the CFPB*

Institutions Summary	# of Entities	# of Applications	Market Share #	\$ Volume Applications	Market Share \$
Institutions located in the LBM	23*	4,735	33.47%	848,925	32.21%
Top 15 institutions not in the LBM	15	5,953	42.09%	1,065,385	40.43%
Other Institutions in the LBM	337	3,457	24.44%	721,070	27.36%
<b>Total</b>	<b>375</b>	<b>14,145</b>	<b>100%</b>	<b>2,635,380</b>	<b>100%</b>

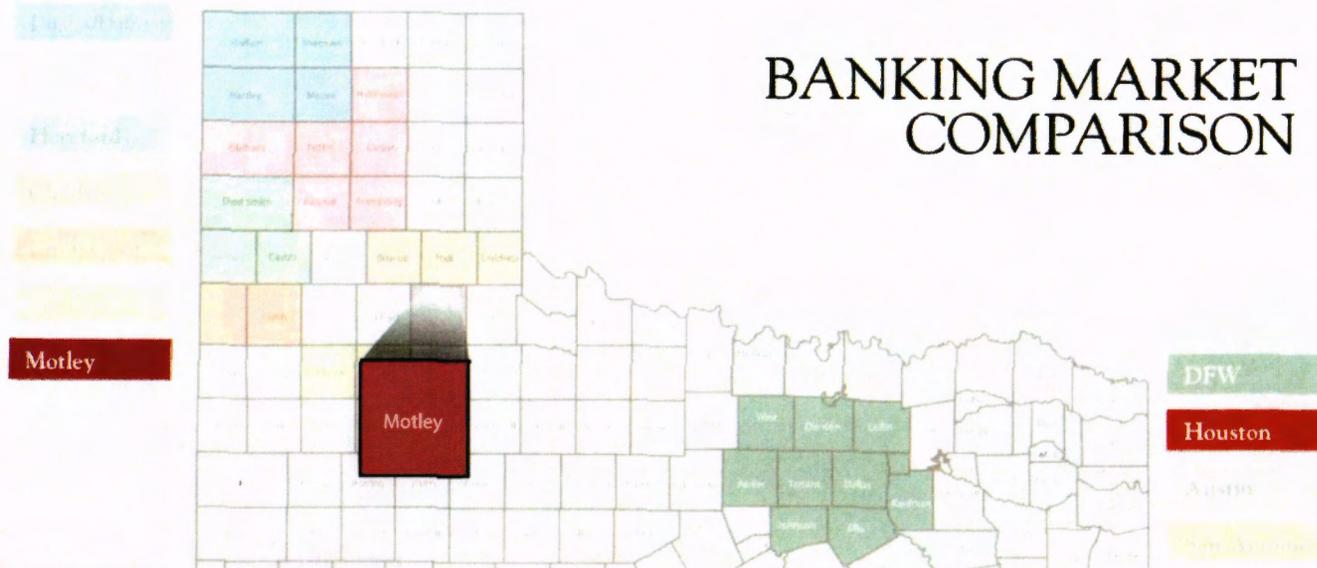
\* There are 28 institutions in the LBM, but 5 did not report any HMDA activity

Institutions located in the LBM	# of Applications	Market Share #	\$ Volume Applications	Market Share \$
<b>Institutions</b>				
WELLS FARGO BANK NA	1,132	8.00%	189,230	7.18%
CITY BANK	846	5.98%	148,270	5.63%
JPMORGAN CHASE BANK NA	423	2.99%	85,675	3.25%
PEOPLES BANK	327	2.31%	68,135	2.59%
PROSPERITY BANK	318	2.25%	48,750	1.85%
AMARILLO NATIONAL BANK	251	1.77%	43,325	1.64%
AIMBANK	204	1.44%	45,200	1.72%
FIRST UNITED BANK	166	1.17%	28,640	1.09%
SOUTHWEST BANK	165	1.17%	31,225	1.18%
BANK OF AMERICA NA	158	1.12%	16,430	0.62%
HAPPY STATE BANK	137	0.97%	28,855	1.09%
FIRSTCAPITAL BANK OF TEXAS NA	134	0.95%	25,610	0.97%
FIRST BANK AND TRUST	119	0.84%	38,005	1.44%
CENTENNIAL BANK	73	0.52%	11,735	0.45%
VISTA BANK	66	0.47%	6,460	0.25%
BBVA USA	64	0.45%	8,370	0.32%
PLAINSCAPITAL BANK	52	0.37%	7,020	0.27%
AMERICAN BANK OF COMMERCE	24	0.17%	2,530	0.10%
WELLINGTON STATE BANK	22	0.16%	6,600	0.25%
WESTERN BANK	21	0.15%	4,925	0.19%
LONE STAR STATE BANK	14	0.10%	2,380	0.09%
FIRST NATIONAL BANK TEXAS	12	0.08%	400	0.02%
AMERICAN MOMENTUM BANK	7	0.05%	1,155	0.04%
<b>TOTALS</b>	<b>4,735</b>	<b>33.47%</b>	<b>848,925</b>	<b>32.21%</b>

<b>Top 15 institutions not in the LBM</b>	<b># of</b>	<b>Market</b>	<b>\$ Volume</b>	<b>Market</b>
	<b>Applications</b>	<b>Share #</b>	<b>Applications</b>	<b>Share \$</b>
<b>Institutions</b>				
PRIMEWEST MORTGAGE CORPORATION	1,016	7.18%	203,810	7.73%
TEXAS TECH FEDERAL CREDIT UNION	920	6.50%	178,060	6.76%
AMERIHOMEMORTGAGECOMPANYLL	645	4.56%	126,145	4.79%
ARKLATEX FINANCIAL SERVICES LLC	479	3.39%	94,435	3.58%
21ST MORTGAGE	367	2.59%	27,215	1.03%
QUICKEN LOANS	361	2.55%	63,925	2.43%
CARDINAL FINANCIAL COMPANY LP	339	2.40%	58,965	2.24%
ALLIANCE CREDIT UNION	299	2.11%	43,865	1.66%
GATEWAY FIRST BANK	263	1.86%	39,575	1.50%
PENNYMAC LOAN SERVICES LLC	239	1.69%	39,385	1.49%
NATIONSTAR MORTGAGE	234	1.65%	40,900	1.55%
US BANK NA	208	1.47%	40,750	1.55%
LAKEVIEW LOAN SERVICING LLC	201	1.42%	34,775	1.32%
CBNA	193	1.36%	35,465	1.35%
FREEDOM MORTGAGE CORPORATION	189	1.34%	38,115	1.45%
<b>TOTALS</b>	<b>5,953</b>	<b>42.09%</b>	<b>1,065,385</b>	<b>40.43%</b>



# BANKING MARKET COMPARISON



## Houston Current Defined Market

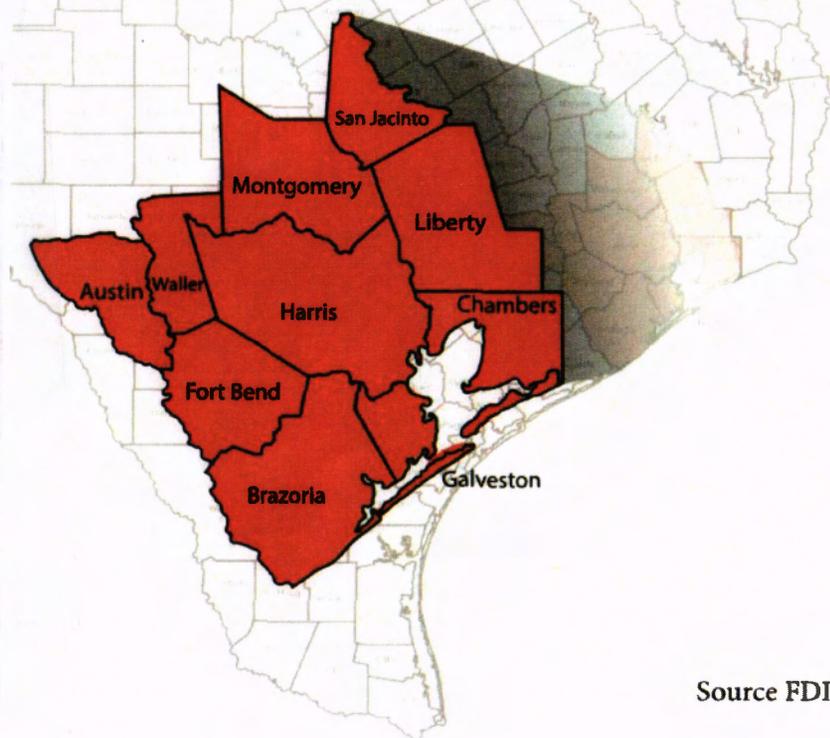
County	Population	Sq. Miles	People/Sq. Mile	Branches
Austin	30,032			13
Brazoria	374,264			73
Chambers	43,837			9
Fort Bend	811,688			144
Galveston	342,139			74
Harris	4,713,325			933
Liberty	88,219			19
Montgomery	607,391			151
San Jacinto	28,859			4
Waller	55,246			6
<b>Total **</b>	<b>7,095,000</b>	<b>9323</b>	<b>761</b>	<b>1426</b>

\*Source: www.FDIC.gov

\*\*Rounding

## Matador Defined Market

County	Population	Sq. Miles	People/Sq. Mile	Branches
Motley	1,200	990	1.21	1



Source FDIC