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U. S. Department of Justice
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SENT BY EMAIL TO: ATR.BankMergers@usdoj.gov

RESPONSE TO INVITATION TO COMMENT

Dear Mr. Delrahim:

Please accept this response to the Department of Justice's ("DOJ") Invitation to Comment ("Invitation") regarding DOJ's existing 1995 Bank Merger Guidelines ("1995 Guidelines").

I am a retired banker with extensive experience in bank merger and asset purchase transactions. The geographies included both metro areas and rural markets.

DOJ is to be commended for inviting comments and giving attention to the appropriateness of the bank merger review guidelines in light of, as the Invitation states, "…emerging trends in the banking and financial services sector…" The banking industry has undergone significant changes as to types of competitors and relative size of competitors. Examples include the growth of money market mutual funds that compete directly with bank deposits and non-bank lending both to consumers and business. While competition will continue to evolve which offers consumers and business more choices, all significant sources of competition rightfully should be taken into account when considering bank mergers under anti-trust laws.

The process of assessing the impact on competition in any industry is an exercise in both art and science, or often referred to as qualitative and quantitative, and cannot easily be put in a checkbox analysis. Definition of markets is a foundational element of the assessment so that pre- and post-merger concentration can be measured but the measurement itself is also of utmost importance. Availability of relevant and reasonably accurate data can be expected to always be an issue but can also improve over time. Still, qualitative factors will long be with us as market definitions are by nature usually imprecise even while seemingly precise.

My comments are organized in relation to the questions posed in the Invitation, as follows:

Guidance Generally

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

Comment: The 2010 Horizontal Guidelines ("2010 Guidelines") provide a useful description of the approach used by DOJ as well as informative insights into the logic to be applied. However, the guidelines acknowledge on page 1 of the "Overview" certain limitations, as follows:

> "These Guidelines should be read with the awareness that merger analysis does not consist of uniform application of a single methodology. Rather, it is a fact-specific process through which the Agencies, guided by their extensive experience, apply a range of analytical tools to the reasonably available and reliable evidence to evaluate competitive concerns in a limited period of time. Where these Guidelines provide examples, they are illustrative and do not exhaust the applications of the relevant principle."

While banking is not monolithic, there are similarities among banks, especially among community and midsized banks, as to customer segments and types of competition. Larger banks tend to be active not only in a wider range of geographies but also in lines of business not generally found in smaller banks. Given the number of banks to which the anti-trust laws, rules and guidelines are applied, reducing the potential disparity of analysis between agencies which could lead to different outcomes in the same situation should be an important policy objective. In addition, a generally standardized approach, such as is attempted in the 1995 Guidelines, should benefit both the efficiency of the agencies and the understanding of potential buyers and sellers as to the rules to be applied. Not understanding the "rules of the road" retards the interest of buyers in seeking beneficial acquisitions which can lessen the willingness of sellers to open locations that may not be saleable in the future. This is of particular importance in smaller markets, including rural markets.

The bank merger guidelines should not contradict the principles in the 2010 Guidelines and some degree of repetition is useful. However, the focus of industry level guidelines should address how the general principles are applied in the industry, what factors are relied on to successfully mitigate potential adverse effects on competition, including the logic employed, and sources of data that have been determined to be pertinent and acceptable. DOJ should allow the bank regulatory agencies ample and direct opportunity to inform the bank merger guidelines reflecting those agencies' high degree of specialized knowledge of the industry, especially with respect to definitions of markets and competition in the industry.

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

Comment: The Clayton Act seemingly has a straightforward authority to prohibit business combinations where "…the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly…" yet the Act does not directly define either "competition" or "monopoly", the foundation of the authority granted. Trying to translate economic concepts such as competition, monopoly, markets and market power often runs into hurdles when applied to actual real-life transactions and situations. Narrative and examples help to explain how those type concepts are used in applying the law.

The 2010 Guidelines work to add clarity to the language in the Act, communicates how DOJ and the Federal Trade Commission have agreed to interpret the Act's language and lays out how analysis is to be applied. Continuing that waterfall, guidelines that clarify how the 2010 Guidelines are to be applied to proposed bank mergers is a logical next step.

In that sense, the guidelines for banking should neither contradict the 2010 Guidelines nor fail to address the principles provided. *Rather, the bank merger guidelines should go further in explanation and add further clarity in context of the banking industry and identify any specific measures and quantification that will be used. Narrative explanations and descriptions of the logic employed greatly help in understanding which promotes both compliance and pursuing beneficial transactions.*

- 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)?

<u>Comment:</u> As just described, having DOJ bank merger guidelines that clarify further the 2010 Guidelines should be helpful to furthering compliance and approving beneficial transactions. In that structure, the bank merger guidelines serve to aid the bank regulatory agencies in carrying out their duties under various banking acts. These agencies not only have extensive specialized knowledge of banks and banking but through their supervision function also have extensive knowledge of markets (both geographies and products) in which their supervised banks operate. This is especially the case when defining markets, competitors and assessing the impact of mergers on competition in those markets.

With sufficient clarity in the bank merger guidelines, joint guidance between DOJ and the bank regulatory agencies is not necessary to carry out the duties of the various agencies and provide compliance with federal anti-trust laws. DOJ should give deference to the bank regulatory agencies in market definition and assessment of competition, particularly when rural markets are involved.

Herfindahl-Hirschman Index (HHI) Threshold

- 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.

Comment: The 1995 Guidelines express the HHI thresholds differently than the 2010 Guidelines although similar in concept. As the 2010 Guidelines are broader and not industry specific, a perfect correlation is not necessary.

The 2010 Guidelines establishes three ranges of HHI scores as follows:

- Unconcentrated: <1500
- Moderately concentrated: 1500-2500
- Highly concentrated: >2500

These ranges are then viewed through the level of change when HHI's are >1500 such that changes of >100 are markers that additional scrutiny may be warranted and when HHI's are >2500 and the change is >200, a rebuttable presumption exists that it is "…likely to enhance market power".

The 1995 Guidelines takes a more straightforward approach by setting a marker at an HHI of >1800 with a change of >200 for a proposed transaction that likely will warrant additional scrutiny. Footnote 1 on page 1 states that the Federal Reserve is likely to perform additional review if the post-merger market share is >35%.

The practical effect of this difference in the definition of thresholds is that the 2010 Guidelines may capture some additional transactions for analysis albeit on the end of the range that is unlikely to lead to denial or divestiture. The 1995 Guidelines threshold has the benefit of giving a measure of recognition that many bank mergers are between smaller banks in smaller markets that naturally can lead to higher HHIs and higher changes simply due to the small number of banks in a given market.

For the sake of consistency of logic and simplicity, it would seem the threshold definitions in the 2010 Guidelines could be incorporated into the bank merger guidelines with it being made clear that the HHIs levels and changes now used in Screen A is still the starting point for the bank regulatory agency reviews.

Note that in small markets the Fed's 35% market share threshold tends to discourage or prohibit mergers even where a market leader has a very substantial share (say 50% or more) and a merger could make for a stronger competitor better able to compete with the market leader.

Relevant Product and Geographic Markets

- 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?

Comment: The stated product markets remain relevant, especially for community and midsize banks. For larger banks in other lines of business, a facts and circumstances analysis is still needed.

- 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?

Comment: Geographic market definition is most particularly a challenge when addressing rural markets. *As long as the agency performing the merger review understands the nature of rural areas, takes into account relevant factors in making adjustments to the standardized definition and are open to consider recommendations from the applicant (along with supporting data) as to modifications, the current FRB definitions are workable, particularly where consideration is given to non-traditional competitors.* Relevant factors often include travel routes and times to work, education, health care, governmental needs and shopping in addition to trade inflows and outflows in the area. The CASSIDI system maintained by the St. Louis Fed is extremely helpful in preliminary analysis as a starting point.

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

Comment: *In effect, a geographic market definition is, at best, a starting point for analysis.* All significant sources of competition should be included in the analysis, even if only as mitigating factors. As remote or non-local service providers (e.g., "online") continue to grow, exclusion from bank merger review analysis will only lead to less accurate and less reliable merger application decisions. For example, rural markets have access to a wide range of banking and financial services from sources without physical locations in the geographic market. Rural market consumers and businesses not only travel well outside the local market for many services, including banking, but also take advantage of online and other remote providers.

In addition to "online" providers that clearly compete with banks, there are what may be described as indirect competitors as well. For example, brokerage firms have local offices throughout the nation, including rural markets, and provide ready access to money market mutual funds and bank CDs, none of which are captured in the HHI measurement. Likewise, at least one insurance company uses its wide network of local agents to provide bank products from its affiliated bank. That bank is shown in FDIC data solely in one branch. A similar situation exists with vehicle financing and farm equipment financing available through local dealerships and increasingly with online home loan lenders. Note that considerable information is now known as to origination volumes at local levels by home loan lenders.

Rural versus Urban Markets

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

Comment: Rural markets typically have a limited number of banks such that a concentrated market often exists with one competitor having a large share. As a result, the HHI measure can lead to computed higher post-merger concentration levels even for mergers among the banks with lesser market shares. Also, the banks in such markets are often disproportionately affected by government lending programs such as federal agricultural loan programs and small business loan programs.

Rural markets may also be located where many residents commute considerable distance to the nearest urban area for employment, shopping, health care, education and other purposes. Driving 50 miles for someone living in an urban area may be unnecessary and not acceptable, while in many rural markets it may be common and necessary. While bank regulatory agencies may attempt to take into account broader data in their reviews, the methodology is not clear as to how analysis is performed and what "lines in the sand" are used.

The HHI measure is at best an imperfect baseline starting point which typically requires adjustment and expansion to arrive at an estimated measure of market concentration. This is especially the case for rural markets. Until a better measure of market concentration is devised and implemented, the process of starting with a standard baseline then adjusting for identified factors and then a fair consideration of qualitative information will be necessary. To improve this approach, greater clarity as to what types of data regulators commonly rely on, acceptable mitigating factors and what the "thresholds" for approval are used would be beneficial to all parties.

It should also be possible to establish a simplified rule based on the number of post-merger competitors and market share of deposits. For purposes of illustration, a transaction might be approved with no additional data or analysis as long as two or more local competitors remain and the post-merger bank has less than a 40% market share irrespective of HHI and HHI changes. This simplified rule seems most applicable for reviews of transactions involving smaller rural markets.

However, even such a simplified rule as described would not cover those small rural markets where only two banks are present. These markets due to small size and resulting limited growth potential are rarely attractive banking markets for a new competitor to enter. In these cases, an in-bank merger may be the only opportunity. The inability for the selling bank to have a viable buyer leads to a great reluctance by existing in-market banks as well as new entrants to invest in small rural markets. This lack of investment is particularly detrimental to local government, consumers, business, farmers and ranchers. One way to address this is to allow the seller to show that a good faith attempt to find an out-of-market buyer was not successful. Caution must be exercised in such an approach as the regulatory process itself places the seller at a great disadvantage as potential buyers gain power to make only the lowest of offers. Of course, broadening the definition of market to include non-traditional service providers (“online”, et al) would partially address this situation by recognizing the reality of competition from sources other than local banks. *Likewise, any rule or measure must reflect that rural markets are by nature rural and consumers and businesses routinely travel long distances for all sorts of services, including banking services.*

- 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?

  <u>Comment:</u> Modification of the screening criteria and/or HHI thresholds is worth study as to how such modifications would have impacted past merger review decisions or even how analysis would be impacted using current market data. *In the context of the HHI measure, the more information on competitors that can be quantified and directly included, the better to improve the assessment of market concentration irrespective of urban or rural markets.* A study could include an identification of banking competition not now specifically included (e.g., money market mutual funds, brokered deposits, credit unions, “online” banks and the like) then assess what data can be reasonably obtained or reasonably estimated. Each criterion that can be added would expand the market and lead to greater accuracy. *The study should also directly address whether thrift and savings banks deposits should now be included at 100% as a matter of course and, if not, define the circumstances and factors to be considered as to when 100% inclusion would be allowed and/or required.*

- 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?

  <u>Comment:</u> To change from ad hoc consideration of “farm credit agency” lending would require a workable definition of “rural markets” as well as data from the lending agencies at the “rural market” level. If that data becomes available, as with any significant source of competition, that could serve to enhance the analysis even if only in a mitigating factor analysis. *However, it should be practical to have those federal agencies report lending at the county level. Also, with data tools now available it may be practical to search county records for mortgage and lien filings to estimate the levels of lending by such government agencies.*

Non-Traditional Banks

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

  <u>Comment:</u> Yes. The failure to include significant sources of competition in an analysis undermines both legal compliance with applicable laws as well as discouraging parties from spending time and treasure on possible transactions that may well be beneficial to competition but unlikely to be approved. Banks compete with other banks who have no location in the identified geographic markets including "online" banks, brokered deposits and listing service time deposits not to mention the competition from credit unions and both non-local bank and non-bank lenders.

  The determination of whether and how to consider non-traditional competitors is a complex question. The importance of market definition cannot be overstated.

  Whether the impact on market competition of such non-traditional competitors is best built into the HHI calculation or taken into account as additional data is complicated by the ready availability of needed data. To include directly into the HHI calculations as an ordinary component would require development of the needed data or at least reasonable estimates based on economic studies. *To include in an ad hoc analysis clearer definition of the allowable types of data that agencies would accept and how such data would be used in the analysis would be helpful.* Even in the latter case, it is helpful to specify that the buyer may incorporate additional data into a pro forma HHI calculation for the agencies to consider.

- Does the Division give appropriate weight to online deposits?

  <u>Comment:</u> No. It is not clear from the 2010 Guidelines as to how DOJ would specifically consider "online" deposits in a bank merger review analysis. This is understandable as the 2010 Guidelines are broad and not industry specific. Similarly, the 1995 Guidelines do not specifically address how "online" competitors are considered other than being open to the applicant providing additional data if the analysis in Screen A and Screen B are thought to "…not accurately reflect market concentration and competitive realities in a particular area…" Greater clarity, such as examples, would be helpful.

- Does the Division give appropriate weight to credit unions and thrifts?

  <u>Comment:</u> No. See similar comment to prior question. It should be noted that credit unions include what may be described as "non-traditional" credit unions that have very

broad “common bonds” and pursue broad strategies including small business and other commercial loans that go well beyond the traditional credit union. Where such “non-traditional” credit unions are present in the market, their activity should also be included in the market definition and analysis to more accurately perform the merger review. Even where credit unions are of the traditional type, there should be specific consideration given as those compete directly for consumer deposits and loans.

The bank merger guidelines would be improved if the guidelines incorporated directly information from the bank regulatory agencies as to how they consider and measure credit union and thrift deposits and other data elements into their analysis. *There are credit unions and thrifts that behave very much like banks in both consumer and business banking and should be included 100% in the HHI analysis, even if only in a pro forma calculation.* Credit unions and thrifts each should have the account level data to identify deposits at the county level.

- 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.

  <u>Comment:</u> Measurement of the activity of “online” banks (including as previously mentioned herein both brokered deposits and listing service CDs) is certainly an impediment to inclusion in the HHI analysis and even in the consideration as additional data without reporting at the county level. However, given current technology and geocoding methods, where the “online” banks are insured financial institutions it should be practical for them to report deposits and loans at the county level. That is not to say there would not be definitional issues to resolve. A practical expedient could be to report only annually. The data collection could be limited to only the largest banks to simplify the process (about 120 banks account for about 80% of US bank industry assets). However, the bank regulatory agencies could perform an economic research study of the larger banks to assess the extent to which these types of remote deposits exist before requiring data collection.

  Note that such deposit reporting can also be applied to larger credit unions and thrifts including an economic study to assess extent of existence in significant levels. Likewise, money market mutual funds can be similarly addressed.

De Minimis Exception

- 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?

Comment: The concept of a *de minimis* exception is not only desirable but likely necessary to address rural markets, most notably where there are few bank locations in the market as defined. The banking industry has many small banks to which the agencies apply the HHI analysis merger review process. As noted previously, where the markets are also small, the HHI methodology will likely lead to measured high levels of concentration simply due to the small number of market participants. The 1995 Guidelines appear to allow the bank regulatory agencies considerable leeway in how they consider additional data and discretion in its use. It would seem that the use of a 200-point HHI change is a more specific way the agencies attempt to reflect the anomalies of the HHI formula in markets with few participants.

Nonetheless, if, based on a study and analysis of past merger reviews, it can be reasonably determined that a threshold for transaction size in relation to the defined market could avoid the expenditure of time and treasure of the parties and the agencies without sacrificing the consideration of material competitive effects, that could be productive.

The definition of a *de minimis* exception measure should be based on study and analysis of past bank merger reviews. For the sake of illustration, a measure might be expressed as the post-merger market would still have at least two competitors and the merged bank would not have more than 40% market share.

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In summary, several themes arise in responding to the DOJ Invitation for Comment, summarized as follows:

- The ability to assess bank mergers solely on a quantitative basis is often limited due to vagaries of market definitions and availability of reliable data is limited. Qualitative analysis remains important in conducting the analysis;

- Better information in the guidelines as to what types of qualitative data has been found acceptable in supporting mitigating factors would be most helpful. For example, a compendium of factors accepted by the agencies could add much clarity;

- All significant sources of competition should be included in the HHI or mitigating factor analysis. These would include competition from non-local banks, thrifts, credit unions, money market mutual funds and the many online bank lenders and non-bank lenders (including major government loan programs). Measurement will be a challenge in doing so but economic research can be conducted to identify which sources may likely be significant and then develop approaches to collect the needed data periodically;

- Adjusting the basic HHI analysis (such as included in the CASSIDI system) is not as important to a proper and fair analysis as a (a) willingness of DOJ and the bank regulatory agencies to being open to applicant proposals for market definition and considering pro forma adjustments, (b) consistent application of the guidelines and (c) DOJ giving deference to the bank regulatory agencies due to their specialized knowledge in defining markets, identifying competitors and assessing concentration and changes; and

- Consideration of definitions of rural markets is in need of attention due to the nature of a great variety of rural markets. The current FRB definitions makes for a useful starting point but calls for consideration of unique market characteristics which likely are more important in smaller markets than large markets. A simplified *de minimis* rule would be helpful in screening out transactions that have a high likelihood of approvals without divestiture.

Finally, competition arises from the presence of a service provider irrespective of how successful they may be. The mere presence in a market, even if only "online" or other remote or indirect means, places pressures on market players to compete to protect their share. Knowing that customers can obtain an insured deposit product through their investment broker or online guides banks to compete. A wider view of competitors is required to fairly assess concentrations. The primary question is the measurement of that competition.

Thank you for the opportunity to comment. Please do not hesitate to contact me should you have questions.

Sincerely,

/s/
J. Robert Kelly
Rogers, Arkansas