Before the
UNITED STATES DEPARTMENT OF JUSTICE
Washington, D.C. 20530

Request for Comment Regarding the 1995 Bank Merger Competitive Review Guidelines	)))))))))

Comment of Federal Trade Commission Chair Lina M. Khan[1]

I commend the Antitrust Division's initiative to consider whether and how to revise the 1995 Bank Merger Competitive Review Guidelines. I support the goals outlined by the Division as part of this effort: ensuring that these guidelines reflect current market realities and empirical learning, ensuring that Americans face choice among financial institutions, and safeguarding against the concentration of market power.[2]

Lawmakers have long recognized that mergers in sectors that play an especially critical role in the economy—like banking—warrant particular scrutiny. The Supreme Court, too, has observed the cascading ramifications that banking consolidation can have, noting that "concentration in banking accelerates concentration generally."[3] In this comment, I identify how banking consolidation can reduce competition in the market for lending to new and small businesses while also reducing consumer access to services. As it considers whether to update the guidelines, I encourage the Division to consider how bank mergers may affect business dynamism and local communities.

A loss of competition in banking can have a significant impact on traditional price metrics of competition, inflating fees for basic services[4] and reducing interest rates for accountholders.[5] The effects, however, are much broader than higher prices for consumers: access to financing is a critical input for virtually every business, making banking a critical sector in which to preserve the benefits of competition to preserve the

[1] The views expressed in this comment are my own and do not necessarily reflect the views of the Commission or any other Commissioner.
[2] Press Release, Dep't of Just., Antitrust Division Seeks Additional Public Comments on Bank Merger Competitive Analysis (Dec. 17, 2021), https://www.justice.gov/opa/pr/antitrust-division-seeks-additional-public-comments-bank-merger-competitive-analysis.
[3] *U.S v. Philadelphia Nat'l Bank*, 374 U.S. 321, 370 (1963).
[4] *See, e.g.*, Vitaly M. Bord, *Bank Consolidation and Financial Inclusion: The Adverse Effects of Bank Mergers on Depositors* 6-9 (Dec. 1, 2018).
[5] *See* Robin A. Prager & Timothy H. Hannan, *Do Substantial Horizontal Mergers Generate Significant Price Effects? Evidence from the Banking Industry*, 46 J. INDUS. ECON. 433, 442-449 (1998).

vitality of many other industries.[6] In this comment, I highlight the impact of increasing concentration in the banking sector on business dynamism and consumers. Small and new businesses drive employment, economic growth, and prosperity, and they depend to a significant degree on local banks to obtain the financing they need to form and thrive. This has been evident during the pandemic, with community banks handling a disproportionate share of lending under the Paycheck Protection Program.[7]

1. **Bank consolidation could make the market for small business lending less competitive, harming business dynamism.**

Congress has protected competition in banking with a robust oversight regime. The Bank Merger Act and Bank Holding Company Act each require prior approval from federal banking regulators before banks can merge.[8] The appropriate regulator must consider whether the merger may substantially lessen competition, tend to create a monopoly, or otherwise restrain trade, in addition to considering a variety of prudential banking considerations.[9] Moreover, the statutory scheme includes an explicit concentration cap, prohibiting a bank from using a merger to grow beyond 10 percent of total insured deposits in the United States.[10]

Despite the tools available to regulators to block concentration, the banking industry has undergone significant consolidation over the past several decades. Between 1980 and 2020, the number of commercial banks declined from 14,400 to 4,600.[11] Mergers and acquisitions have played a key role in this reduction in the number of banks, which decreased, in particular, the number of small banks.[12] Fewer and fewer new banks have been forming since 2010, while banks have been exiting (whether through merger or failure) at the same rate.[13] The net result is that the number of community banks declined 65% from 1988 to 2019.[14]

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[6] 374 U.S. at 370 ("There is no reason to think that concentration is less inimical to the free play of competition in banking than in other service industries. On the contrary, it is in all probability more inimical. For example, banks compete to fill the credit needs of businessmen. Small businessman especially are, as a practical matter, confined to their locality for the satisfaction of their credit needs. If the number of banks in the locality is reduced, the vigor of competition for filling the marginal small business borrower's needs is likely to diminish. At the same time, his concomitantly greater difficulty in obtaining credit is likely to put him at a disadvantage vis-a -vis larger businesses with which he competes.").

[7] Carlos Cordova, *Community Banks Play Outsized Role in PPP Lending*, CSBS (Dec. 11, 2020), https://www.csbs.org/newsroom/community-banks-play-outsized-role-ppp-lending (community banks provided 28% of PPP loans, despite holding only 12% market share by assets or 15% share by loans).

[8] *See* 12 U.S.C. 1828(c), 12 U.S.C. § 1842(a).

[9] 12 U.S.C. § 1828; *see also* Bank Holding Company Act of 1956, *Id*. § 1841 *et seq*.

[10] 12 U.S.C. § 1828(c)(13)(A) (imposing on the merged entity a limit of 10 percent of total insured deposits nationwide); *Id.* § 1842(d)(2) (imposing a limit of 10 percent of total insured deposits nationwide, and 30 percent of total insured deposits within any state).

[11] Emrehan Aktug et al., EFFECTS OF SMALL LOANS ON BANK AND SMALL BUSINESS GROWTH, U.S. SMALL BUS. ADMIN., at 6 (Mar. 2020), https://cdn.advocacy.sba.gov/wp-content/uploads/2021/03/09094530/De-Novo-Bank-Formation.pdf.

[12] *Id.* ("mergers and acquisitions [] have reshaped the competitive landscape and increasing consolidation naturally has led to a decline in the number of small banks.").

[13] *Id.* at 6-7.

[14] Daniel Brown, SMALL BUSINESS FACTS: SPOTLIGHT ON COMMUNITY BANK LENDING, U.S. SMALL BUS. ADMIN. (Sept. 2019), https: // cdn.advocacy. sba. gov/ wp-content/uploads/2019/09/25164013/Fact-Sheet-Community-Bank-Lending. pdf ("In the fourth quarter of 2018, there were 4,979 FDIC-insured community banks, down significantly from 7,442 at the end of 2008, and 14,323 at the end of 1988.").

Research shows that local banks are a particularly important sources of financing for small businesses.[15] Small banks engage in different lending behavior from large banks, focusing more on individualized analysis of small businesses than on large companies with well-established credit records.[16] Local banks' competitive advantage in collecting "soft" information leads to higher approval rates for small business loan applications.[17] Smaller banks also provide better service to small businesses, resulting in higher satisfaction rates from their customers.[18] Small banks are more likely to be located in rural areas, providing more convenient service to certain businesses in underserved communities.[19] The types of loans these banks make available and accessible to small businesses has been shown to have a significant impact on small business employment growth and small business entry, promoting new business formation and making our economy more dynamic.[20] And by concentrating on small business lending, local banks reinvest in their local communities, rather than shifting fees and lending generated from local deposits to other regions.

Because small and local banks are so important to small businesses and new business formation, competition in the market to serve those businesses can be reduced when a merger changes the mix of small and large banks in a community. Studies have shown that bank mergers have reduced small business credit availability[21] and the size of loans, while increasing the cost of credit.[22] Less credit, smaller loans, and higher costs are strong indicators of reduced competition.

These effects ripple throughout a community. As bank mergers reduce financing to local businesses, fewer such businesses form, harming business dynamism.[23] With fewer businesses forming, bank mergers are associated with decreased construction and lower local property prices.[24] The loss of these businesses also has significant effects on the jobs available in a community, given that small businesses accounted for 48% of private employment and 63.3% of net new job creation from 1992 to 2013.[25] Thus, bank

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[15] Rebel A. Cole, HOW DID BANK LENDING TO SMALL BUSINESS IN THE UNITED STATES FARE AFTER THE FINANCIAL CRISIS?, U.S. SMALL BUS. ADMIN. (Jan. 2018), https://www.sba.gov/sites/default/files/439-How-Did-Bank-Lending-to-Small-Business-Fare.pdf; *see also* Brown, *supra* note 14.

[16] Aktug et al., *supra* note 11, at 7-8. *See* Allen N. Berger et al., *Does Function Follow Organizational Form? Evidence from the Lending Practices of Large and Small Banks*, 76 J. FIN. ECON. 237, 266 (2005).

[17] Aktug et al., *supra* note 11, at 7-8.

[18] Brown, *supra*, note 14.

[19] *Id.*

[20] *Id.*; *see also* Aktug et al., *supra* note 11, at 5 ("small business loans (especially loans less than $100k with stronger effects) have a statistically and economically significant impact on small business employment growth and small business entry.").

[21] *See, e.g.*, Allen N. Berger et al., *The Effects of Bank Mergers and Acquisitions on Small Business Lending*, 50 J. FIN. ECON. 187, 217, 222 (1998); Steven G. Craig & Pauline Hardee, *The Impact of Bank Consolidation on Small Business Credit Availability*, 31 J. BANKING & FIN. 1237, 1248-58 (2007); Paola Sapienza, *The Effects of Banking Mergers on Loan Contracts*, 68 J. FIN. 329, 364 (2002). The impact on small business lending is most significant when a community bank merges with a nonlocal institution. *See* Julapa Jagtiani & Raman Quinn Maingi, *How Important Are Local Community Banks to Small Business Lending? Evidence from Mergers and Acquisitions* 18-20 (Fed. Res. Bank of Phila., Working Paper No. 18-18).

[22] *See* Mark J. Garmaise & Tobias J. Moskowitz, *Bank Mergers and Crime: The Real and Social Effects of Credit Market Competition*, 61 J. Fin. 495, 509-14 (2006); Sapienza, *supra* note 21, at 354.

[23] *Id*.

[24] Garmaise & Moskowitz, *supra* note 22, at 516-18.

[25] *Frequently Asked Questions*, U.S. SMALL BUS. ADMIN. (June 2016), https://www.sba.gov/sites/default/files/advocacy/SB-FAQ-2016_WEB.pdf; Cole, *supra* note 15, at 6-7.

mergers may also be associated with depressed median income, increased unemployment, and greater income inequality.[26]

2. Bank consolidation can reduce consumer access to services.

As banks have consolidated, merged entities have commonly closed branches.[27] Closing a branch reduces competition for banking services in the affected communities.[28] This is particularly true because many consumers strongly prefer banks with locations convenient for them.[29] It is also concerning that post-merger branch closures tend to be concentrated in low and moderate income communities,[30] leaving more vulnerable consumers to face less competitive markets for their financial needs.

This loss of banking competition in local communities can reshape the lives of the people who live there. In low- and moderate-income communities affected by bank consolidation, high-fee check-cashing companies have proliferated[31]—a stark example of consumers turning to a much more costly alternative to a local bank branch. Research has suggested that given the impact of bank mergers on small businesses and associated employment opportunities, households in such communities are more likely to face eviction and have debts sent to collection agencies.[32]

3. The guidelines should be sensitive to how a merger may affect business dynamism and competition to serve small businesses and local communities.

The guidelines should carefully scrutinize how proposed bank mergers will affect competition to serve the financing needs of new and small businesses and local communities. The observed effects on both credit availability and pricing suggest that the current guidelines may understate the competitive effects of bank mergers on these groups of customers and on business dynamism. Accordingly, the following should be considered in updating the guidelines:

a. Small and local banks are particularly strong competitors in serving new and small businesses, and therefore the guidelines may benefit from express consideration of the mix of large and small banks that will remain following a merger, separate from any analysis based on the Herfindahl-Hirschman Index (HHI).

b. In considering competition from non-traditional lending sources, the guidelines should take into account quality considerations that may differentiate those lenders from local community banks.[33]

[26] Garmaise & Moskowitz, *supra* note 22, at 516-18.
[27] Hoai-Luu Q. Nguyen, *Are Credit Markets Still Local? Evidence from Bank Branch Closings*, 11 J. AM. ECON.: APPLIED ECON. 1, 15-17 (2019) (finding evidence of significant branch closures by merging banks).
[28] This can be true even if the reduced competition is not the purpose of the branch closure. For example, if one merging party operated a branch in a town with one other competing bank, closing its branch (perhaps to lower costs) would result in a local monopoly for its competitor.
[29] *See* Mary Wisniewski, *Survey: While Checking Fees Vary Wildly By Race and Age, Americans Stay Loyal to Their Banks*, BANKRATE (Jan. 15, 2020), https://www.bankrate.com/banking/best-banks-consumer-survey-2020/; CONSUMERS AND MOBILE FINANCIAL SERVICES, BOARD OF GOV. FED. RESERVE at 9 (Mar. 2016) (noting that 84 percent of survey respondents use bank branches).
[30] GARY A. DYMSKI, THE BANK MERGER WAVE: THE ECONOMIC CAUSES AND SOCIAL CONSEQUENCES OF FINANCIAL CONSOLIDATION 95 (1999).
[31] *See, e.g.*, Bord, *supra* note 4, at 23-25.
[32] *Id*. at 30-32.
[33] Brown, *supra*, note 14. For example, small businesses report dramatically higher satisfaction with small banks (79%) than with online lenders (49%).

c. Deposit-based HHI calculations may not capture variations in lending behavior toward small businesses, so alternative screens that focus on the small business market should be considered.

d. Some consumers strongly prefer local branches, and the loss of competition in local communities from potential branch closures should be considered.

e. Deposit-based HHI screens at the current thresholds appear to have permitted consolidation that reduced competition in consumer banking. Accordingly, adjustments to those thresholds should be considered to strengthen enforcement.

I commend the DOJ for continuing to evaluate this topic. As a universal input, banking is a critical sector, where declining competition could significantly reduce the dynamism of our economy. Given evidence that consolidation can reduce competition in local consumer banking and weaken competition in small business lending, with concomitant harms to local economies and job markets, this review is timely and important.

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