Implications of Warren Bank M&A Proposal

Related Industries

Financial Institutions

AUTHORED ARTICLE | Winter 2020

By Jeffery E. Smith and Scott A. Herkamp
(Published in the Winter 2020 issue of *The Bankers' Statement*)

In December of 2019, Senator Elizabeth Warren and Representative Jesús García announced the introduction of the Bank Merger Review Modernization Act (the act), which would "...restrict harmful consolidation in the banking industry and protect consumers and the financial system from 'Too Big To Fail' institutions." It blames much of the 2008 financial crisis on institutions that would ostensibly be categorized as "too big to fail," and specifically references the SunTrust/BB&T merger, alleging that it would create the "...first new Too Big To Fail bank since the financial crisis."

Without clear reasoning, the proposed legislation would increase consumer participation in regulatory review of proposed mergers and include mandatory participation in the review process by the Consumer Financial Protection Bureau.

While the act ignores the fact that every bank merger includes comprehensive review of the Community Reinvestment Act (CRA) record of both parties, provides opportunities for community input, and takes into consideration the results of CRA and consumer compliance ratings, it would impose additional standards which, if enacted, would certainly have a chilling effect on bank combinations and potentially impact bank values.

The act would impose required regulatory approval standards, including: (1) guaranteeing that the merger is in the "public interest;" (2) determining that the merger would act to safeguard the stability of the financial system; (3) requiring that regulators examine the anticompetitive effects on individual banking products; and (4) ensuring that the merged institution has adequate financial and managerial resources.

Releases issued by the act's sponsors highlight that the Federal Reserve received some 3,819 bank merger applications between 2006 and 2017, yet failed to decline any of these applications. However, these

releases fail to note that 503 of these applications were withdrawn. In addition, these releases fail to distinguish between different types of mergers, such as those that were effectuated to address troubled institutions, affiliate mergers, or other mergers either in the public interest or unrelated to the elimination of competition. These releases also appear to criticize the fact that potential merger partners often meet confidentially with regulators in advance of public announcements of proposed transactions. These meetings, of course, are an important step to understand how the agencies might view a proposed transaction in order to avoid market and customer chaos and manipulation by announcing a transaction without knowing of any potential regulatory hurdles. Confidentiality in the bank regulatory system is and always has been a critical part of the oversight of banking institutions, yet the sponsors' releases paint this process in a suspicious and negative light.

In addition, given the importance of certainty in banking and other markets, including equity markets, knowing the position of the regulatory agencies in advance would avoid the chaos that would ensue from simply filing for a merger without knowing the likely regulatory outcome. Shareholders and community groups still have their say in the process. Many potential transactions are reviewed with regulatory agencies and not pursued, which may well add credence to the confidential process currently in place and the fact that the applications that were filed were approved.

Community groups and consumers impacted by a proposed combination already have significant opportunities to comment on merger proposals and to seek and obtain public hearings as to the impact of the proposals on the affected communities and the availability of financial products and services in those communities. As a result of these opportunities, bankers already face the potential for significant delay and additional expense that accompanies such CRA-related activities. Historically, CRA-related merger protests resulted in expensive and time-consuming delays, and sometimes questionable payments to community groups which were subject to little to no "after the fact" oversight as to whether these payments were used as promised.

Banks are already subject to extensive consumer and consumer-related examination. In fact, institutions with less than satisfactory CRA, fair lending and other consumer-related examination ratings are not eligible to participate in mergers or a variety of other corporate activities in most instances.

The releases also allege that there are antitrust considerations that are not being adequately addressed under the current merger review process. Existing merger reviews already include a review of antitrust considerations. Additionally, the fact that the definition of bank markets changes from time to time is one reason why confidential bank reviews of potential combinations with regulatory agencies prior to any public announcement of a proposal are necessary. In fact, the recent SunTrust/BB&T transaction approval included required divestitures of 30 branches and $2.4B in deposits – not an insignificant requirement.

Proposed public disclosure of discussions with regulators prior to submission of an application would not only cause havoc with trading in bank shares, but would, in fact, shut down the merger process.

Further, the act ignores the impact of fintech players in the markets and how insured depository institutions need to have the flexibility to react to changes in the financial services markets to avoid potential expense, liquidity and other concerns that may arise in this rapidly-changing industry. Closing unproductive branches in areas where fintech and other changes in customer banking habits have occurred is one of the expense saving mechanisms that can help an institution be – and remain – an

important part of its community.

The act would certainly reverse many of the bank regulatory rollbacks that have been put in place by the Trump administration. Interestingly, however, those rollbacks have not had an adverse impact on consumer protections.

Anyone who has been involved in a bank merger understands and respects the intricacies and intensity of the existing regulatory review process, the obligations of the agencies that review these proposals, and how it and they protect against bad deals and adverse consequences for consumers. While unlikely to pass in the Republican-controlled Senate, the Act is certainly indicative of what the banking environment would look like if Senator Warren, a longtime critic of the financial services industry and Democratic presidential contender, were to be elected.