ENDNOTES:

[1]*See* https://courts.delaware.gov/Opinions/Download.aspx?id=349650.

[2]Discussed here: https://www.paulweiss.com/media/3325930/26jan16ma.pdf.

[3]The court declined to apply the higher materiality standard in *Magellan* because no Delaware court had done so in a mootness fee context since *Xoom* and the parties had not briefed whether the standard should be changed.

COMPETITION AND FINANCIAL STABILITY: THE EMERGING REGULATORY FRAMEWORK FOR BANK MERGER REVIEWS

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The federal regulatory process for reviewing and approving proposed bank mergers has recently come under close examination from a number of regulatory angles. From the bank regulators,[1] to federal legislators,[2] to the Antitrust Division of the United States Department of Justice ("DOJ"),[3] regulators are focused on the bank merger process. The recent attention strongly suggests the bank merger review process may become more onerous, and that material changes to formal guidance may also be forthcoming.

Bank merger review under the current process requires the general review and approval of the applicable bank regulator or regulators and a specific review of the competitive effects of the proposed merger from the DOJ. Significant bank mergers in recent times have been fraught with hurdles, including, since the passage of the Dodd-Frank Act, a requirement that bank regulators, as part of their review process, consider the "stability of the United States banking or financial system."[4] The difficulties in this aspect of the review process may be compounded going forward by members of the executive and legislative branches, in addition to independent regulatory agencies, seeking to enhance the review process.[5]

Most recently, Jonathan Kanter, Assistant Attorney General of the Antitrust Division of the DOJ, foreshadowed DOJ's widening approach to bank mergers, considering multiple new factors that may be present in a given merger transaction, to account for purported new market realities within the industry.[6] Although not formal, the articulated approach represents a significant departure from past analyses, which limited their focus to deposit concentration and branch location overlaps. Likely more than a coincidence, some of Kanter's comments correspond to the DOJ and Federal Trade Commission's most recent issuance of their Draft Merger Guidelines, published on July 19, 2023, and as of the time of this writing, open to public comment. Neither Kanter's comments, nor the Draft Merger Guidelines have been solidified yet in revised regulatory guidelines or been tested in a court of law, but they do provide insight to future agency approach.

As discussed further below, bank M&A activity may confront additional regulatory hurdles, and longer deal timelines, as DOJ considers ad-

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ditional factors to decide whether a proposed merger will substantially lessen competition. A key question going forward is the extent to which DOJ will examine the complexity and offerings of each financial institution as individual markets, subjecting the transaction to various "veto points" —*i.e.*, reasons to challenge a deal—or if DOJ will consider those offerings collectively, in light of bank stability to ensure economic stability, as a whole.

The DOJ's Position

In a much-anticipated speech at the Brookings Institution, DOJ repositioned its stance on bank merger reviews since it sought public comment on potential revisions to the 1995 Bank Merger Guidelines in 2021.[7] Acknowledging the special role Federal banking agencies have in bank mergers, DOJ reaffirmed it would take a robust approach to its competition review consistent with *U.S. v. Philadelphia National Bank*.[8] The message: DOJ can and will challenge bank mergers it alleges to be anticompetitive even if federal bank regulators otherwise approve the transaction.

This revised approach includes analyzing bank M&A deals in ways that reflect DOJ's view of "market realities:" Analysis of local branch offices no longer suffices as a means to maintain the "benefits of competition." Rather, DOJ will evaluate a broader range of competitive factors including "fees, interest rates, branch locations, product variety, network effects, interoperability, and customer service," in addition to looking at deposit share by geography and branch overlap. It is unclear if each of these facets will be considered separate markets or viewed holistically, and it likely will take time for DOJ to fully evaluate how these factors related to each other. These developments also likely will lead to more investigations, greater deal time, and the production of additional data, and documents.

The DOJ did not indicate if it would conduct any review of the financial stability impact of a proposed merger. Financial stability is a specific statutory factor that the Federal banking agencies must consider under the Bank Merger Act. Banks have been concerned DOJ might insert itself into that issue. Enhanced DOJ scrutiny of bank M&A activity could complicate efforts by banks to achieve greater operational efficiencies and to shore up capital levels through acquisition. Bank M&A is a common strategy for addressing capital deficiencies or enhancing performance, particularly among smaller banks. For midsize and regional banks facing new regulatory requirements akin to the requirements imposed on the largest banks, such limitations and frictions on bank M&A could prevent them from achieving the economies of scale needed to afford such regulation and compete with larger banks. Antitrust agencies may be less likely to credit scale-and-scope arguments, *e.g.*, the transaction enhances the merging parties' ability to compete. However, there is a possibility that DOJ consider those arguments in light of the banking industry and the impact on the global economy, before determining how to analyze potential anticompetitive effects.

This industry has experienced recent turmoil. DOJ has yet to show its hand and formalize revised banking guidelines to assist with planning and preparation of potential regulatory investigations following a merger filings. The recently issued Draft Merger Guidelines speak in generalities and are not meant to highlight how the banking industry (or any industry) may be differ-

ent from other sectors. However, DOJ may provide additional transparency through advisory opinions and updating the bank merger guidelines. In the meantime, banks with DOJ merger investigations should expect DOJ to issue expanded data and document requests consistent with its expanded competitive factors review.

Financial Stability Considerations Within the Broader Bank Regulators' Review

Following the 2008 financial crisis, Congress charged the Federal banking agencies with considering financial stability risks in the context of bank M&A.[9] Therefore, as a statutory matter, the requirement to review the effects of a proposed bank merger on financial stability rests with the bank regulator.[10] However, the DOJ speech hints at the possibility that the DOJ may also consider factors related to, if not exactly overlapping with, the banking agencies' mandate to consider financial stability. Although DOJ's speech did not expressly state that the DOJ would conduct a review of the financial stability impact of a proposed merger, the DOJ may find a way to indirectly address this issue or at least weigh in on it under the cover of its expanded competitive factors review. "[C]ompetition [may] manifest[] itself" through "network effects" and "interoperability," among other things. DOJ may argue those factors are relevant to financial stability.

Even if review of financial stability effects of a proposed merger stays entirely with the bank regulators, critics of past bank M&A policy have argued that the Federal banking agencies have failed to develop a robust approach to financial stability and are reaching outcomes (*i.e.*, approving mergers) inconsistent with financial stability considerations. More specifically, those critics argue that consolidation creates more "too-big-to-fail" institutions, allegedly posing additional risks to financial stability. They also argue the Federal banking agencies' current approach to assessing financial stability risks of a proposed merger lacks analytical rigor.[11]

But critics of bank M&A activity misread the Federal banking agencies' statutory financial stability mandate. Congress charged the Federal banking agencies with considering risks to the stability of the U.S. banking or financial *system*. It did not charge them with merely reviewing the systemic risk profile of the resulting bank and denying the proposed merger if the systemic risk profile increases or exceeds some arbitrary measure of systemic risk in a vacuum. Although that analysis is part of the financial stability mandate, it is not sufficient given the system's dynamism and the interplay between and among banks. The resulting bank's systemic risk profile does not necessarily reflect, and is not the same as, the system's risk profile as a whole. Federal banking agencies need to be mindful of the overall structure of the banking system, including the distribution of banks within it, and banks' role within the larger financial system over which the Federal banking agencies have limited to no control but with which banks may compete.[12]

Prohibiting bank mergers merely preserves the status quo structure of the banking system and any of its existing structural shortcomings while failing to acknowledge the dynamic relationship between the banking system and the larger financial system of which it is part. Implicitly a *de facto,* categorical, "no merger" rule assumes the status quo is optimal or is at least preferable to alternatives. There is insufficient empirical evidence in favor of the status quo to make that assumption.

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Critics also fail to consider the circumstances in which M&A activity reduces financial stability risks. To the extent the Federal banking agencies have concerns about the resolvability of U.S. global systemically important banks ("G-SIBs"), they may not want to impede the growth of more regional and super-regional banks that could credibly assume portions of the businesses of a G-SIB or other large bank in the event of its failure or other need to divest portions of it businesses.[13] Likewise, allowing the growth of G-SIB alternatives also helps address substitutability concerns by increasing the likelihood that specific financial services and products (*e.g.*, tri-party repo, certain debt underwriting, etc.) will not be solely available through G-SIBs—or worse, solely through one or two G-SIBs. A U.S. banking system with more regional banks and some fluidity among the heretofore frozen G-SIB ranks may increase financial stability of the system as a whole, regardless of changes in the systemic risk profiles of any individual bank. This is something Federal banking regulators may consider.

Nor are the positive impacts of bank M&A on financial stability limited to larger banks. Bank M&A is a useful and necessary option for the Federal banking agencies in dealing with undercapitalized or otherwise troubled banks of all sizes, as recent bank failures have demonstrated.[14] Federal banking agencies may prefer allowing healthy banks voluntarily to acquire troubled banks (and optimizing available regulatory capital in the system) before those troubled banks reach the point of failure, requiring the FDIC to engage in emergency bank M&A, to invoking extraordinary government action (like guaranteeing uninsured deposits) or precipitating widespread bank failures.[15] While it's unclear how the DOJ will approach bank merger reviews, Federal banking agencies should avoid any semblance of a *de facto* moratorium on bank M&A, as it does nothing to reduce the financial stability risks that some commenters have alleged exist and it could preclude the Federal banking agencies from utilizing a key option in times of financial stress.

Conclusion

From here, how DOJ implements its expanded review, and what deference it will provide, if any, to the Federal banking agencies charged with reviewing financial stability under the Bank Merger Act will matter most. It is not clear whether the critics of the current bank merger process will succeed in making bank mergers more difficult within the existing portion of the merger review process that takes place within the Federal banking agencies. But whatever changes do come that make bank mergers more difficult, they may have unintended and negative consequences for financial stability and the structure of the financial services industry. Critics would do well to consider those consequences.

The views and opinions set forth herein are the personal views or opinions of the authors; they do not necessarily reflect views or opinions of the law firm with which they are associated.

ENDNOTES:

[1]Acting Comptroller of the Currency Michael J. Hsu, Opening Remarks for the OCC Bank Merger Symposium (Feb. 10, 2023), *available at* https://www.occ.gov/news-issuances/speeches/2023/pub-speech-2023-15.pdf.

[2]*See, e.g.,* Letter from Sen. Elizabeth Warren to J. Kanter, M. Gruenberg, M. Hsu, M. Barr and J. Yellen (June 27, 2023) (the "Warren Letter"), *available at* https://www.warren.senate.gov/imo/media/doc/2023.06.27%20Letter%20to%20Regu

lators%20re%20Bank%20Merger%20Reviews.pdf.

[3]*See, e.g.,* Assistant Attorney General Jonathan Kanter, Merger Enforcement Sixty Years After *Philadelphia National Bank* (Jun. 20, 2023), *available at* https://www.justice.gov/opa/speech/assistant-attorney-general-jonathan-kanter-delivers-keynote-address-brookings-institution; *see* also Rohit Chopra & Jeremy C. Kress, Comments in Response to the Department of Justice Antitrust Division Request for Public Comments on Updated Bank Merger Review Analysis 1 (Oct. 16, 2020), *available at* https://www.justice.gov/atr/page/file/1330326/download.

[4]*See, e.g.*, BB&T Corp., Application to the Board of Governors of the Federal Reserve System for Prior Approval to Acquire by Merger SunTrust Banks, Inc. and SunTrust Bank Holding Co. (Mar. 8, 2019), *available at* https://www.federalreserve.gov/foia/files/Application-by-BBT-Corporation-to-Acquire- SunTrust%20Banks-Inc-Pursuant-to%20Sections-3(a)(3)-and-(a)(5)-of-BHC-20190308.pdf; *Capital One Fin. Corp.,* 98 Fed. Res. Bull. 7 (2012); *PNC Bancorp., Inc.*, 98 Fed. Res. Bull. 16 (2012).

[5]The exception is in cases of emergency acquisitions that take place in the case of bank failures or near-failures of the type that have roiled the banking system in 2023.

[6]*See* Assistant Attorney General Jonathan Kanter, *supra* n. 3. During the speech, DOJ leadership said that a competitive factors report should evaluate multiple elements, including "fees, interest rates, branch locations, product variety, network effects, interoperability, and customer service."

[7]*See* Assistant Attorney General Jonathan Kanter, *su*pra n. 3.

[8]*U.S. v. Philadelphia Nat. Bank*, 374 U.S. 321, 83 S. Ct. 1715, 10 L. Ed. 2d 915 (1963).

[9]*See* 12 U.S.C.A. § 1842(c)(7) (requiring the Federal Reserve Board to "take into consideration the extent to which a proposed acquisition, merger, or consolidation would result in greater or more concentrated risks to the stability of the United States banking or financial system"); 12 U.S.C.A. § 1828(c)(5) (requiring the Federal banking agencies to "take into consideration . . . the risk to the stability of the United States banking or financial system").

[10]Nonetheless, some commentators have urged the DOJ to consider financial stability, notwithstanding its more limited statutory mandate. *See, e.g.,* Jeremy C. Kress, "Reviving Bank Antitrust," *Duke Law Journal* (Dec. 2022), Vol. 72:519, at 596.

[11]*See, e.g.,* Warren Letter, *supra* n. 2; Jeremy C. Kress, "Modernizing Bank Merger Review," *Yale Journal on Regulation* (2020), Vol. 37:435.

[12]Notably, post-2008 financial crisis statutory and regulatory changes have contributed to the migration of certain activities, such as mortgage servicing, out of the banking system.

[13]*See, e.g.*, Acting Comptroller of the Currency Michael Hsu, "Detecting, Preventing, and Addressing Too Big To Manage" (Jan. 17, 2023), *available at* https://www.occ.gov/news-issuances/speeches/2023/pub-speech-2023-7.pdf (noting that the "most effective and efficient way to successfully fix issues at a [too-big-to-manage] bank is to simplify it—by divesting businesses, curtailing operations, and reducing complexity").

[14]*See, e.g.*, FDIC Press Release, "First-Citizens Bank & Trust Company, Raleigh, NC, to Assume All Deposits and Loans of Silicon Valley Bridge Bank, N.A., From the FDIC," (March 26, 2023), available at https://www.fdic.gov/news/press-releases/2023/pr23023.html; FDIC Press Release, "JPMorgan Chase Bank, National Association, Columbus, Ohio Assumes All the Deposits of First Republic Bank, San Francisco, California," (May 1, 2023), *available at* https://www.fdic.gov/news/press-releases/2023/pr23034.html.

[15]*See* "Banc of California Agrees to Buy PacWest as Regional Lenders Seek Strength Together," *WSJ* (July 25, 2023), *available at* https://www.wsj.com/articles/banc-of-california-pacwest-in-advanced-talks-to-combine-d9e48a1f.

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