# Guidelines for M&A Are Evolving

regulatory Mergers and Acquisitions competition

**Summary:** The regulatory environment for banking M&A is evolving. Regulatory agencies are assessing the current competitive environment with an eye toward improving measures of competitiveness. While much remains uncertain, the recent merger of U.S. Bank and Union Bank offers some insights that may benefit banking institutions.

The Knickerbocker Rules of 1845 formalized the game of baseball. Over time, though, the rules changed. Until 1884, balls had to be pitched underhand, not thrown overhand. A walk required nine balls from 1874 to 1889, and foul balls weren't counted as strikes until 1901 in the National League and 1903 in the American League. The strike zone was modified in 1950 and again in 1963, and the rules continued to evolve with 1975's controversial designated hitter rule.

Financial industry rules also evolve and change as time goes on. Currently, the rules for mergers and acquisitions (M&A) among financial institutions (FIs) are undergoing a change. In July 2021, the federal government issued the Executive Order on Promoting Competition in the American Economy. The executive order encouraged the Department of Justice and other agencies responsible for financial regulations to ensure competitiveness in the financial industry by providing more robust scrutiny of M&A.

### Understanding the Changing Competitive Landscape

In recent years, the strategic goals of M&A have shifted for many FIs. While consolidation and scaling remain priorities, expanding digital services and product capabilities have become key strategic objectives for many deals. Amid current economic headwinds, falling valuations (especially for financial technology firms), and tighter credit conditions, well-capitalized FIs may find opportunities to add significant value through M&A. However, uncertainty in the evolving regulatory environment may create challenges.

For example, in September, Federal Reserve (Fed) Governor Michelle W. Bowman discussed the evolving competitive landscape in banking services. This included the need to develop a framework for evaluating bank mergers that recognizes the growing diversity and complexity of the market. Some of the competitive factors that Bowman mentioned were:

- **Rapid growth of online deposits.** From 2020 to 2021, online deposits increased by 42%, while deposits made at bank branches grew by 10%. As a result, the geographic criteria used in initial screens to evaluate the impact of mergers is less relevant than it once was.
- **Competition from credit unions.** Credit union deposits were not included in early screening under 1995 bank merger guidelines. As membership requirements have changed, however, and deposit and loan assets have grown, credit unions have become significant competition for banks. From 2017 to 2019, 29 credit unions acquired community banks. As a result, Bowman noted competition from credit unions should be weighted more heavily in merger analysis.
- **Competition from non-bank entities.** Financial technology companies pursue many types of loan products, especially consumer, small business, and student loans. Since these companies do not have the same reporting requirements, it is challenging to measure market competitiveness. To capture the impact of

non-bank competition across products and geographies, Herfindahl-Hirschman Index (HHI) thresholds may need to be relaxed.

Understanding the competitive environment in banking services and modernizing M&A competitive analysis may lead to new standards for assessing proposed deals. In the best case, evolving standards could make it possible for financial institutions (CFIs) to achieve the scale needed to compete effectively.

**A Slow Evolution**

The evolution of M&A guidelines is likely to take significant time. While much uncertainty remains, the approval of U.S. Bank's acquisition of Union Bank offered some insights to regulators' analysis of financial industry mergers. Here are a few key points for CFIs considering M&A deals:

- **Community Reinvestment Act (CRA) performance is important.** The Office of the Comptroller of the Currency's (OCC's) approval order assessed the probable impact of the merger on the communities served. The OCC considered CRA ratings and evaluated prospective performance through a convenience and needs analysis. The latter led to U.S. Bank establishing a 5Y $100B Community Benefits Plan.
- **The Consumer Financial Protection Bureau (CFPB) has influence.** The CFPB issued a consent order against U.S. Bank in 2022 for engaging in practices that violated consumer laws and caused accounts to be opened without consumers' consent. The CFPB reviewed U.S. Bank's progress under the consent order and commented on both the institutions' consumer compliance and fair lending records. The role of the CFPB in M&A analysis is similarly expected to expand.
- **Size and financial stability remain top of mind.** The OCC approval letter indicated concern that post-merger, the size of the financial institution would be the fifth-largest commercial bank headquartered in the US. The merger would increase potential risk in financial systems. However, this concern was offset by recovery and resolution planning requirements for the new institution and its holding company.
- **The merger analysis framework continues to evolve.** While regulatory agencies have made it clear that there is a need for a new competitive analysis framework, this merger appears to have relied primarily on established standards. It's likely the framework will continue to evolve over time.

Financial regulators are reevaluating the competitive environment in financial services, along with the regulatory framework and competitive guidelines for M&A activity. Their analysis is likely to result in modified requirements for M&A deals and may slow consolidation within the industry. Approved mergers are likely to yield valuable information about the approach regulators are taking to ensure the industry remains competitive. CFIs would do well to monitor how these mergers continue to shape M&A guidelines in the future.

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## ECONOMY & RATES

Rates As Of: 01/27/2023 07:35AM (GMT-0700)

| Treasury | Yields | MTD Chg | YTD Chg |
|---|---|---|---|
| 3M | 4.71 | 0.29 | 0.29 |
| 6M | 4.79 | 0.03 | 0.03 |

| | | | |
|---|---|---|---|
| 1Y | 4.67 | -0.03 | -0.03 |
| 2Y | 4.22 | -0.21 | -0.21 |
| 5Y | 3.64 | -0.36 | -0.36 |
| 10Y | 3.55 | -0.33 | -0.33 |
| 30Y | 3.67 | -0.29 | -0.29 |

| **FF Market** | **FF Disc** | **IORB** |
|---|---|---|
| 4.33 | 4.50 | 4.40 |
| **SOFR** | **Prime** | **OBFR** |
| 4.30 | 7.50 | 4.32 |