Too many bank mergers can hurt small businesses

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Banks in the United States have been merging at a rapid pace in recent years, with regulators speeding up the approval process and making few or no denials.

In a forthcoming study in the *Yale Journal on Regulation*, Jeremy Kress of the University of Michigan Ross School of Business argues that bank mergers deserve much more scrutiny than they're currently getting. Kress, an assistant professor of business law, details several innovative ways that could happen.

Why are we seeing so many bank mergers lately?

There are a few reasons mergers are spiking. Banks say they need to achieve scale in order to invest in information technology and cybersecurity. Many banks are just now escaping enforcement actions from the financial crisis, which frees them up to merge. And a bank deregulation law from last year incentivized firms to grow.

Why is this a problem?

There is significant evidence that bank mergers lead to higher prices for consumers, lower availability of credit and lower rates on deposit accounts. The most significant effects are felt by small businesses because the smaller banks that tend to be gobbled up in these mergers are the ones doing the bulk of small business lending.

Then, there are additional negative effects on economic development when small businesses can't get access to the loans they need to grow.

You explain that regulators are legally bound to consider factors beyond competition, including whether a merger is in the public interest. What are you proposing in that regard?

First, I think regulators should start from the presumption that a bank merger will not benefit the public, given that mergers often lead to higher prices and less availability of credit. Regulators should insist on verifiable and quantifiable public benefits in order to approve a merger.

Second, regulators should look more closely at banks' performance under the Community Reinvestment Act, which requires banks to serve low- and moderate-income areas. Regulators have traditionally been deferential to banks that barely scrape by on this requirement. They could substantially increase their expectations.

Third, I strongly believe that the Consumer Financial Protection Bureau should have a say in bank mergers. The bureau is legally responsible for overseeing consumer compliance at large banks, but it doesn't have a voice in bank merger applications.

Are there other factors regulators are failing to consider?

Since 2010, regulators have been required to consider a merger's potential risk to the financial stability of the United States. But thus far, the financial stability analysis has been pretty rudimentary. There are useful quantitative metrics available to gauge threats to financial stability, but regulators aren't using them when considering bank mergers.

The one that I highlight in the paper is a numerical metric developed by the Basel Committee on Bank Supervision. It is essentially a financial stability score. Regulators use that score for other purposes, like setting capital requirements. So I urge the regulators to establish cutoffs for financial stability risk in bank mergers using empirical metrics like the Basel Committee score.

More information: Kress, Jeremy C., Modernizing Bank Merger Review (August 21, 2019). 37 *Yale Journal on Regulation* (2020). Available at SSRN: ssrn.com/abstract=3440914

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