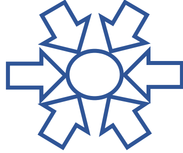

Financial Services Management

U.S. Merger Policy

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Impact Assessment

- U.S. merger policy now formally reverses longstanding statements that mergers are likely to benefit consumer welfare and increase economic efficiency.
- There is instead a pronounced presumption that organic growth is preferable to M&A, with mergers now facing numerous hurdles based on direct and indirect effects as well as those deemed potential concentration based on DOJ/FTC analytics.
- PE roll-ups face new approval challenges many will find difficult to traverse.
- Information concentrations (e.g., re patents, payees/payors, counterparties) will be considered concentrations and likely pose M&A obstacles for larger entities.
- Vertical mergers face new obstacles likely to be a particular challenge to larger banks for which horizontal M&A is even more problematic not only now with the DOJ and FTC, but also the banking agencies.
- Even minority stakes face approval challenges, hindering the ability of banks to engage in fintech “partnerships” and cross-shareholding with nonbanks below Fed “control” thresholds. It will also be more challenging for tech-platform companies and PEs to circumvent BHC requirements and acquire strategic banking positions.

Overview

Building on a request for comment,[1] the Department of Justice (DOJ) and Federal Trade Commission (FTC) have now proposed specific revisions to U.S. merger policy that significantly redirect the manner in which M&A transactions – even if only for minority positions – will be considered. Although this is only a draft statement, it tracks much of what President Biden laid out in his 2021 executive order on U.S. competition policy[2] and actions since then by the DOJ

[1] See **MERGER10**, *Financial Services Management,* December 21, 2021.

[2] See *Client Report*, **MERGER6**, July 9, 2021.

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and the FTC. As a result, the guidelines are more of a roadmap providing clarity than a new approach unless the final version differs substantively in any major way or future Administrations adopt a different policy. Near-term U.S. merger policy makes it considerably more difficult to finalize horizontal, vertical, and even minority holdings, a challenge likely to be particularly acute in U.S. financial services where government agencies believe there is undue concentration in banking, payment, private-equity, and other sectors. The clarity and specifics of the guidelines will give firms a clearer understanding of obstacles to possible transactions as well as risks to those that have been previously consummated. However, the guidelines are statements of agency policy based on their read of law, not a binding legal action. As a result, merger participants who believe that their transactions were unduly denied and companies ordered to shed certain operations may still seek legal redress in the courts.

Impact

The 2010 standards under which these agencies long operated put the burden of proof on entities opposing mergers based on the view that these transactions generally improved market efficiency and enhanced innovation. The new policy would – and indeed the agencies already are – altering the merger-approval presumption to favor protests raised either by competing entities or by the results of DOJ or FTC staff assessments that would now consider many factors – e.g., worker impact – overlooked in previous reviews.

A fundamental premise of the new policy is that firms seek to maximize their own profit and valuation rather than that of any individual business unit. Thus, many of the defenses – e.g., recognition of reputational risk – against assertions that a merger will not make use of market power will be disregarded if staff find the firm has a record of, the ability to, and/or incentives that encourage anti-competitive behavior. DOJ and FTC decisions may appear or even be subjective because much will depend on how the agencies think a firm's incentives are likely to lead it to behave. It may also be difficult to judge when a firm is increasing likely concentration simply by understanding the market in which it plans to operate because knowing how a competitor prices or otherwise behaves could be deemed "coordination" that leads to disapproval. Workers' rights are also a new, high-priority concern, with transactions likely to employ people in the same area or with a certain expertise subject to disapproval on grounds that reduced competition could adversely affect the ability of employees to bargain for wages, benefits, working conditions, and other key concerns.

As discussed below, these new guidelines focus in several areas on technology platform companies and intermediaries. However, the criteria to be applied to them apply to all firms, not just technology-based ones, and thus directly affect the financial-services sector. For example, the new policy will scrutinize transactions that do not result in a controlling interest, judging this not only by traditional measures of minority investments, but also by the potential for direct or indirect control. In its 2020 standards defining control and thus when FRB approval is required,[3] the Fed made it significantly easier for banks to take positions in other financial companies or even commercial ventures without triggering the need for prior approval. Conversely, nonbank financial companies

3 See **TAKEOVER10**, *Financial Services Management,* February 14, 2020.

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and even commercial entities are able to take small positions, enter into "partnerships," or otherwise engage with banks without triggering FRB review that might require BHC status. Now, even transactions that escape Fed notice could be reviewed before or after acquisition by the DOJ or FTC, creating both an additional impediment to transaction consummation as well as post-acquisition business risk. It will also be considerably more difficult for nonbanks and especially tech platforms to acquire small stakes in banks or nonbank small entrants in ways that further blur the barriers between banking and commerce in these companies. It is likely that PE efforts to acquire direct or indirect stakes in failing banks will not only face continuing banking-agency obstacles, but also significant challenges from DOJ.

In addition to these standards, bank mergers come under DOJ policy enunciated by way of a June 2023 speech by Assistant Attorney General Kanter. Much in the way DOJ will now evaluate bank transactions anticipated the new DOJ/FTC over-arching guidelines. However, Mr. Kanter also indicated that "broader" questions remain under the purview of the banking agencies. Despite much discussion about the need to update considerations in areas such as financial stability and resolvability, the draft merger policy outlined in a 2022 request for views from the FDIC remains the only expression of banking-agency policy.

What's Next

The draft guidelines were released on July 19; comments are due sixty days after *Federal Register* publication.

Analysis

These guidelines are not mutually exclusive nor do they preclude the agencies from objecting to transactions on other grounds. The guidelines stipulate that:

- Mergers in highly-concentrated markets should not eliminate even a relatively small competitor. Concentration is "high" when there are only "a few significant" competitors either by merger or a leveraged buy-out that heightens the likelihood of a firm's failure. The agencies generally use the Herfindahl-Hirschman Index (HHI) to judge concentration, with an index increase of more than 100 showing significantly heightened concentration; this reduces HHI calculations to the methodology in effect prior to 2010. Firms with market shares over thirty percent are also problematic.

- Mergers should not substantially reduce competition even in non-concentrated markets or when market shares are difficult to measure, e.g., via joint control, common strategic deliberations showing that one firm alters pricing or otherwise responds to the other firm's practices, and other factors detailed in the guidelines along with measurement

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techniques outlined in an appendix.

- Mergers should not increase the risk of active or passive "coordination" among remaining firms. The three factors measured to assess coordination address prices, wages, or product features even where these are algorithmically determined. It is unclear where monitoring another firm's prices or wages to ensure effective competition ceases and coordination may be found, especially in transparent markets. However, it is clear that acquisition of a "maverick" would be viewed as problematic.

- Mergers should not block potential entrants in concentrated markets. Acquisition of low-probability entrants in highly-concentrated markets is also problematic. In general, policy has a preference for organic growth, not acquisition. The guidelines detail how the agencies judge possible entrants and relevant probability. Entrants need not have commercialized products yet in the market or be active in the same region. Conversely, the determination of a possible entrant will not lessen the potential anti-competitive effect of two merged firms that do not involve an entrant.

- Mergers should not permit firms to control products, services, or customers (regardless of whether these are vertical supply and distribution relationships) that are essential to its rivals' competitiveness or may impair new entrants. The guidelines detail which times of related products, services, or customers would trigger concerns (e.g., access to confidential information about its rivals). Key to this analysis is the extent to which related products are easily substituted by other providers.

- Vertical mergers should not foreclose competition, with the agencies determining this via market-structure review of factors detailed in the guidelines. It is sufficient to reject the transaction if the merger would permit the acquirer to control fifty percent of market share, although this may be rebutted as detailed in one of the guideline's appendices.

- Mergers should not entrench or expand dominant market positions, regardless of resulting efficiencies. Market shares of at least thirty percent will trigger inquiry, but dominance may be judged by other factors (e.g., patents, likely switching costs, undue network effects and/or scale). Determinations of additional dominance may be based on potential effects over time even if no near-term additional control is evident. The ability of firms to tie, bundle or otherwise limit access to competing providers is also a key concern.

- Mergers should also not entrench trends towards greater concentration.

- The agencies may evaluate a merger in the context of any others (i.e., in roll-ups). Here, the agencies would capture what they consider could be anti-competitive intent executed by a series of small mergers, looking either at the market or the acquirer and taking incentives as

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well as actual circumstances into account.

- The agencies will review transactions involving multi-sided platforms based on competition between platforms, on a platform, or that could displace a platform. These transactions will not only be considered under the guidelines detailed above, but also platform "market realities." Transactions need to involve competitors only in their "infancy" to prove problematic, with possible conflicts of interest a major concern related to multi-sided platforms. The agencies will seek to deter even "small accretions of power."

- Mergers involving competing buyers will be scrutinized for effects on workers or other sellers. Thus, firms that do not compete in any of the ways detailed above might still not be allowed to merge if they seek to hire the same kind of workers or do so in the same area. Mergers that benefit sellers may still be denied if there is harm to buyers.

- The agencies will also look at acquisitions of partial ownership or minority interests, determining if the acquisition of less than full ownership still endows control or even just influence or access in areas such as competitively-sensitive information. Incentives in such scenarios will be carefully reviewed, looking principally at whether partial ownership affords the ability to influence the target firm, incentives for reduced competition (e.g., by lowering the return from the target acquisition, the acquirer's decision not to compete with the target), or access to non-public information. These concerns exist even in the absence of coordination.

- Mergers should not otherwise substantially lessen competition or tend to create a monopoly – i.e., none of the considerations above is exhaustive.

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