September 24, 2021

Memorandum

To: Members, Committee on Financial Services
From: FSC Majority Staff
Subject: Wednesday, September 29, 2021, Subcommittee on Consumer Protection and Financial Institutions hearing entitled, "The Future of Banking: How Consolidation, Nonbank Competition, and Technology are Reshaping the Banking System."

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The Subcommittee on Consumer Protection and Financial Institutions will hold a hybrid hearing entitled, "The Future of Banking: How Consolidation, Nonbank Competition, and Technology are Reshaping the Banking System" on Wednesday, September 29, 2021, at 10:00 a.m. ET in room 2128 of the Rayburn House Office Building and on the virtual meeting platform Cisco Webex. This single-panel hearing will have the following witnesses:

- **Paulina Gonzalez-Brito**, Executive Director, California Reinvestment Coalition
- **Makada Henry-Nickie**, Robert and Virginia Hartley Fellow - Governance Studies, Brookings
- **Sarah Jane Hughes**, University Scholar and Fellow in Commercial Law, Indiana University School of Law
- **Desiree Jackson**, Assistant Vice President for Treasury Management, Beneficial State Bank
- **Jim Reuter**, Chief Executive Officer, FirstBank on behalf of American Bankers Association

Overview

The U.S. financial system has changed significantly over the decades. Through mergers, acquisitions, and organic growth, banks have become larger in size and fewer in number while serving a greater number of people, thereby limiting competition.[1] Additionally, the rate of *de novo* (newly chartered) depository institutions has slowed.[2] Moreover, nonbank and financial companies are increasingly playing a larger role in lending, payments, and offering other financial products and services to consumers and small businesses.[3] In some cases, nonbank and fintech companies represent competition to traditional financial institutions, while in other cases, these companies partner with depository institutions to help them expand into other markets.[4] These changes have impacted the availability and manner in which consumers can access financial products and services.[5] The hearing will examine these evolving trends and their impact on consumers, small businesses, communities of color, bank employees, and other industry participants, and evaluate policy options to ensure there are robust safeguards in the

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[1] *See* FDIC, BankFind Suite: Find Annual Historical Bank Data, (Accessed Sept. 12, 2021); *See also* Federal Reserve Bank of St. Louis, Total Assets, All Commercial Banks, (Accessed Sept 14, 2021); *See also* S&P Global, Ten Years Later, World's Biggest Banks Keep Getting Bigger, (Nov. 27, 2021).
[2] *See* FDIC, Supervisory Insights: Vol. 13, Issue 1 - Summer 2016, (2016), p. 3-8.; *See also* FDIC, BankFind Suite: Find Annual Historical Bank Data, (Accessed Sept. 12, 2021);
[3] *See* Federal Reserve Bank of Cleveland, The Rise of Fintech Lending to Small Businesses: Businesses' Perspectives on Borrowing, (Apr. 3, 2020); *See also* CRS, Marketplace Lending: Fintech in Consumer and Small-Business Lending, R44614, (Updated Sept. 4, 2021), p.5.
[4] *See* Board of Governors of the Federal Reserve System, Community Bank Access to Innovation through Partnerships (Sept. 2021), p.7
[5] *See CRS,* Fintech: Overview of Innovative Financial Technology and Selected Policy Issues, R46332, (Apr. 28, 2020).

public's interest that improve competitiveness, promote innovation, and provide broad access to affordable financial products and services.

Executive Order on Promoting Competition in the American Economy

On July 9, 2021, President Biden signed Executive Order 14036, "Promoting Competition in the American Economy,"[6] which initiated a government-wide effort, establishing dozens of initiatives that promote competition across the entire economy, including the financial services sector. It calls on the Department of Justice, in consultation with the Board of Governors of the Federal Reserve System (Fed), the Federal Deposit Insurance Corporation (FDIC), and the Office of the Comptroller of the Currency (OCC), to strengthen merger oversight under the Bank Merger Act and the Bank Holding Company Act of 1956 (BHCA).[7] Those statutes specifically direct those agencies to consider factors such as the depository institution's "financial and managerial resources" and "the convenience and needs of the community to be served" in the merger review process and discourages regulators from approving mergers that would result in monopolies or substantially less competition and present risks to financial stability or bank failure.[8] In addition, the Executive Order calls for the Consumer Financial Protection Bureau (CFPB) to issue rules under Section 1033 of the Dodd–Frank Wall Street Reform and Consumer Protection Act, that would provide guidance on how consumers have access to their financial data and "can more easily switch financial institutions and use new, innovative financial products."[9]

Mergers, Acquisitions, and Consolidation

The total number of federally-insured banks in the U.S. has fallen from 17,811 in 1984 to 4,951 as of June 30, 2021.[10] Similarly, the number of federally-insured credit unions has declined from about 15,000 in 2004 to 5,029 as of June 30, 2021.[11] While the banking industry had been consolidating prior to the 1980s, some experts point to various laws passed in the 1980s and 1990s, such as the Riegle-Neal Act, that allowed for interstate banking where banks could open branches across state and even county lines, resulting in a decline in the number of community banks.[12] The 2008 global financial crisis may also have been a catalyst for further mergers and acquisitions. According to the FDIC, the rate of voluntary mergers, among community banks in particular, "increased sharply following the financial crisis as a wave of post-crisis failures receded."[13] Additionally, since the 2008 financial crisis, several of the largest banks have increased in their asset size, by 30 to 44 percent according to one estimate.[14]

Financial institutions look for merger and acquisition opportunities for many reasons. According to a 2020 survey of bank leaders, the top reasons financial institutions reported for pursuing mergers or acquisitions were to (1) "acquire an attractive deposit base," (2) "increase earnings per share," (3) "supplement or replace organic growth," (4) "rationalize operating costs over a wider base," and (4) "expand into new markets."[15] Additionally, when asked about their growth strategy, 25 percent of bank

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[6] Executive Order 14036, *Promoting Competition in the American Economy* (Jul. 9, 2021).

[7] *Id.*

[8] 12 U.S. Code § 1828

[9] Executive Order 14036, *Promoting Competition in the American Economy* (Jul. 9, 2021).

[10] FDIC, *BankFind Suite: Find Annual Historical Bank Data*, (Accessed Sept. 14, 2021); FDIC, *Quarterly Banking Profile* (Q2, 2021). *See also* Figure 1.

[11] NCUA, *Annual Report 1984*, NCUA, Quarterly Credit Union Data Summary 2021 Q2, (2021); Federal Reserve Bank of St. Louis, *Geographical Outreach: Number of Credit Unions and Financial Cooperatives for United States* (accessed Sept. 15, 2020); *See* Figure 3.

[12] Roosevelt Institute, *Community Banking is Alive, Well: The Three Myths about Dodd-Frank and Community Banks,* (Jun. 8, 2017) and White House Council of Economic Advisors, *The Performance of Community Banks Over Time*, (Aug. 2016).

[13] FDIC, *Community Bank Mergers Since the Financial Crisis: How Acquired Community Banks Compared with their Peers*, (2017). Also see the Testimony of Sarah Edelman before the Committee (March 21, 2017).

[14] CRS, *Systemically Important or "Too Big to Fail" Financial Institutions* (Sept. 24, 2018).

[15] Bank Director, *2020 Bank M&A Survey*, (Nov. 2019).

leaders responded they "want to be active acquirers" and 60 percent were "open to acquisitions, but will focus on organic growth."[16]

In recent years, bank consolidation has also led to a reduction in bank branches throughout many communities. U.S. bank branches fell from a peak of 85,566 in 2009 to 74,935 in 2020.[17] The four largest banks alone have seen a decline of over 3,600 branches during that time.[18] The number of credit union branches has risen slightly from 19,247 in 2004 to 21,566 in 2020.[19] One study suggests that following the financial crisis, bank mergers have had "a negative impact on branch density in all counties, with a stronger effect in micropolitan and rural counties."[20] The same study found "the share of unbanked and underbanked households at the county level was positively associated with branch closures and negatively related with the presence of community banks."[21] Other research found that "merger-induced branch closings have large effects on credit supply to local small businesses."[22] Continued consolidation and branch closures may also reduce economic opportunity and access to credit in low-income and underserved areas. A 2016 investigation by the Federal Reserve Bank of New York found low-income census tracts were more than twice as likely to be located in banking deserts than higher income tracts.[23]

Additionally, mergers can also result in job losses and other negative consequences for workers when financial institutions decide to close branches in the restructuring process.[24] Bank workers are working with community and consumer groups, along with labor organizations, to improve working conditions for bank workers in the future.[25] This includes the right to unionize, ensuring a living wage, and ending unreasonable sales goals, especially in the face of bank consolidation.[26]

De Novo Charters

In the dozen years following the 2008 financial crisis, new bank charters have hit record lows, and in 2014 and 2016, there were no *de novo* charters at all.[27] According to a report from the FDIC, new charter activity is typically cyclical, following trends in the economy.[28] The report points out that "[a] drop in *de novo* activity also occurred after the last financial crisis in the 1980s and early 1990s, when *de novo* bank formation declined to historically low levels before recovering as economic conditions improved."[29] Research from the Fed also suggests 75 to 80 percent of the decline in new charter activity from 2009 to 2013 was a result of a recovering economy and the low interest rate environment, making it

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[16] *Id.*
[17] FDIC, *BankFind Suite: Find Annual Historical Bank Data*, (Accessed Sept. 14, 2021); *See also* Figure 2.
[18] Memo for Committee hearing entitled, *Holding Megabanks Accountable: An Update on Banking Practices, Programs, and Policies* (May 27, 2021).
[19] Credit Union National Association, The Future of Branches, (May 25, 2021).
[20] "All counties" refers to the 3,090 counties analyzed in the study; Calzada, Joan, Xavier Fageda, and Fernando Martínez-Santos, Mergers, branch consolidation and financial exclusion in the US bank market, UB Economics Working Papers, (2019), p. 5-6.
[21] *Id*, p. 6.
[22] Nguyen, Hoai-Luu Q. Are Credit Markets Still Local? Evidence from Bank Branch Closings, American Economic Journal: Applied Economics, (Jan. 2019).
[23] Federal Reserve Bank of New York, Banking Deserts, Branch Closings, and Soft Information, (Mar. 7, 2016).
[24] *See* Banking Dive, Truist reports Q4 profit, continues merger-related job cuts, branch closures, (Jan. 21, 2021).
[25] *See* Committee for Better Banks.
[26] *See* Georgetown University Kalmanovitz Initiative for Labor and the Working Poor, The Case for a Bank Workers' Bill of Rights (Feb. 19, 2020); Committee Press Release, *In Advance of Wells Fargo Hearings, Waters and Green Release Investigative Report Exposing Failures of Megabank's Management, Board, and Regulators* (March 4, 2020); and Committee hearing entitled, *Holding Megabanks Accountable: An Update on Banking Practices, Programs, and Policies* (May 27, 2021).
[27] FDIC, BankFind Suite: Find Annual Historical Bank Data, (Accessed Sept. 12, 2021).
[28] FDIC, Supervisory Insights: Vol. 13, Issue 1 - Summer 2016, (2016), p. 3-8; *See also* Figure 4.
[29] *Id.*

difficult for banks to profit on interest rate spreads.[30] The length and severity of the current *de novo* drought exceeds the slow downs from the 1980s and 1990s.[31] However, while the Fed began to raise interest rates following the Great Recession, the negative economic impact from the COVID-19 pandemic caused the Fed to reduce interest rates again to the zero lower bound where it remains today.

Congress has taken steps to spur *de novo* charters, in a manner that would improve access to financial services, especially for consumers in banking deserts, while promoting safety and soundness, consumer protection, and community reinvestment. In July 2021, the House Financial Services Committee reported favorably on H.R. 4590, the Promoting New and Diverse Depository Institutions Act, which would require Federal banking regulators to study the challenges prospective *de novo* depository institutions face and develop a strategic plan based on the study to promote the creation of newly chartered depository institutions.[32]

Competition and Partnerships with Fintechs

In recent years, nonbank financial technology companies, referred to as fintechs, have captured a larger share of consumer, mortgage, and small business lending markets.[33] These firms often use alternative data, algorithmic decision making, and other new technologies to offer financial products online and through mobile apps, and they often do not have physical retail locations.[34] The total market share of consumer loans originated by non-depository fintech companies grew from 22 percent in 2015 to about 49 percent by 2019.[35] Fintechs are also competitive in small business lending with 32 percent of small business borrowers applying for fintech financing in 2019.[36] In the housing market, nonbank mortgage lenders have also increased market share, accounting for more than 68 percent of mortgage originations in 2020.[37] Some fintechs have pursued bank charters including Industrial Loan Company (ILC), Special Purpose National Bank, and National Trust charters to enhance their ability to offer financial services and compete with traditional financial institutions.[38] Advocates have raised concerns that fintechs are not as closely regulated as traditional banks. For instance, some ILC-chartered institutions are not subject to supervision by the Fed under the BHCA.[39]

Depository institutions also often partner with fintech companies. Banks and credit unions that do not have the technical expertise or desire to manage fintech platforms themselves often rely on technology service providers (TSPs).[40] Federal banking regulators (except the National Credit Union Administration (NCUA))[41] have the authority to supervise and examine depository institution-TSP partnerships, and banks are required to ensure actions taken by the TSP on behalf of the bank follow all banking laws and

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[30] Divisions of Research & Statistics and Monetary Affairs, Federal Reserve Board, Where Are All the New Banks? The Role of Regulatory Burden in New Charter Creation, (2014).
[31] FDIC, BankFind Suite: Find Annual Historical Bank Data, (Accessed Sept. 12, 2021).
[32] Committee, Committee Passes Legislation to Advance Investor Protections, Support Manufactured Housing Communities, and Promote De Novo Depository Institutions, Press Release, (July 30, 2021).
[33] *See* Experian, Fintech vs. Traditional FIs: The Latest Trends in Personal Loans, (September 17, 2019); *See also* Federal Reserve Bank of Cleveland, The Rise of Fintech Lending to Small Businesses: Businesses' Perspectives on Borrowing, (Apr. 3, 2020).
[34] *See CRS,* Fintech: Overview of Innovative Financial Technology and Selected Policy Issues, R46332, (Apr. 28, 2020).
[35] Experian, Fintech vs. Traditional FIs: The Latest Trends in Personal Loans, (September 17, 2019).
[36] Federal Reserve Bank of Cleveland, The Rise of Fintech Lending to Small Businesses: Businesses' Perspectives on Borrowing, (Apr. 3, 2020).
[37] Wall Street Journal, Nonbank Lenders Are Dominating the Mortgage Market, (Jun. 22, 2021).
[38] *See* House Financial Services Committee, Hearing entitled "Banking Innovation or Regulation Evasion? Exploring Modern Trends in Financial Institution Charters," (Apr. 15, 2021).
[39] See FDIC, The FDIC's Supervision of Industrial Loan Companies: A Historical Perspective (2004).
[40] *See CRS,* Fintech: Overview of Innovative Financial Technology and Selected Policy Issues, R46332, (Apr. 28, 2020).
[41] Testimony of The Honorable Todd Harper, Chairman, National Credit Union Administration, before the Committee (May 19, 2021).

regulations.[42] In some cases, TSPs may not have experience with bank regulation compliance, which could introduce more risk for a depositoryinstitution.[43] This has prompted some banks to offer compliance toolkits, trainings, or other resources to TSP partners.[44]

Innovation and Technology

Evolving technology is changing banking to drive more business digitally. Depository institutions are increasingly adopting enhanced mobile banking services, and in some cases, expanding into new markets solely through web presence.[45] With an ever-increasing digital footprint, cyber security is of critical importance to financial institutions to protect customers' deposits and financial data.[46] The coronavirus pandemic accelerated a trend of declining cash transactions in favor of debit, credit, and digital transactions.[47] Similarly, some banks are experimenting with cashless bank branches in which tellers do not have access to physical currency.[48] Additionally, with the rapid growth of digital assets, fintechs and traditional financial institutions are looking to offer more options to buy, sell, and provide custody services for cryptocurrencies.[49]

Financial institutions have also begun adopting artificial intelligence (AI), including machine learning, for uses in product marketing, fraud detection and prevention, and other operational uses.[50] Natural Language Processing, a subfield of AI, has also enabled chatbots to help customers through mobile banking, and robo-advisors can advise customers on investment strategies.[51] Many observers have expressed concerns and questions about risks of AI technologies resulting in unpredictable behavior or reinforcing biases.[52] In March 2021, the five federal regulators who are part of the Federal Financial Institutions Examination Council (Fed, FDIC, NCUA, OCC, and CFPB) put out a request for information to financial institutions and stakeholders on the use of AI, including ML, in the financial services space, and how laws and regulations related to housing, credit, and consumer lending are implicated.[53]

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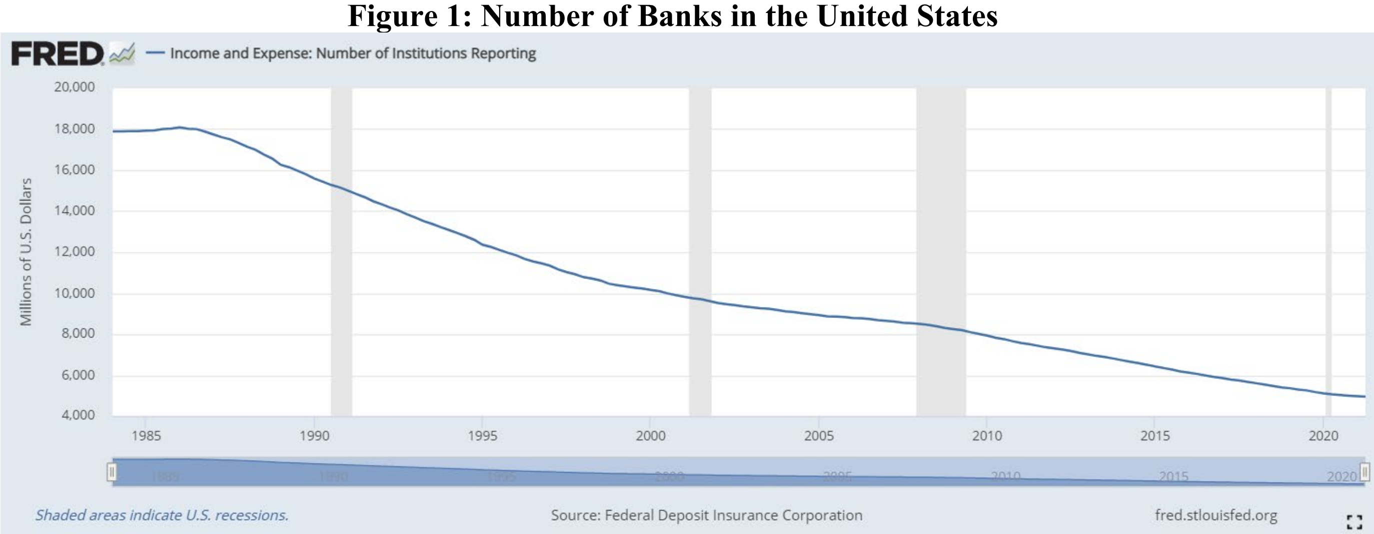
[42] *Id.*
[43] *Id.*
[44] *See* Fed, Community Bank Access to Innovation through Partnerships (Sept. 2021).
[45] California News Times, JPMorgan to open digital retail bank in UK, (Sept. 16, 2021).
[46] *See* American Banker, Cyberattacks draw tech, bank CEOs to White House for brainstorm, (Aug. 25, 2021)
[47] Forbes, The Pandemic Is Fast Forwarding Us To A Cashless Society—And Making Life Harder For The Unbanked, (Oct. 22).
[48] Banking Dive, PNC eyes 'aggressive' consolidation as customer behavior shifts, (Nov. 19, 2021).
[49] CNBC, Bitcoin is coming to hundreds of U.S. banks this year, says crypto custody firm NYDIG (May 5, 2021).
[50] *See* Forbes, Why AI Is Transforming The Banking Industry, (Apr. 5, 2020).
[51] *Id.*; CNBC, JPMorgan is buying UK robo-advisor Nutmeg to boost overseas retail banking expansion, (June 17, 2021).
[52] *See CRS,* Fintech: Overview of Innovative Financial Technology and Selected Policy Issues, R46332, (Apr. 28, 2020).
[53] Federal Reserve, FDIC, CFPB, NCUA, OCC, Request for Information and Comment on Financial Institutions' Use of Artificial Intelligence, Including Machine Learning (Mar. 29, 2021).

Appendix - Legislation

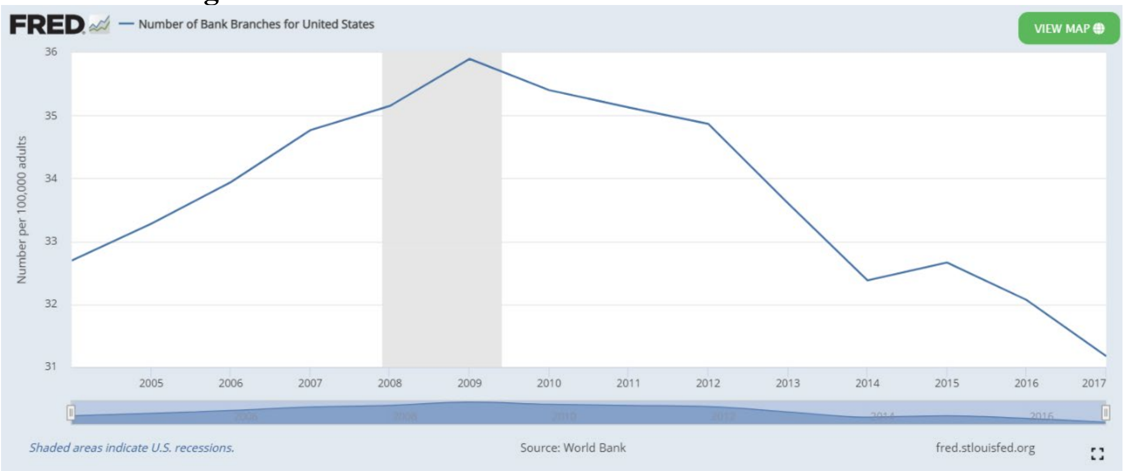
- **H.R. 2311, Credit Union Governance Modernization Act of 2021** (Emmer), which would revise processes regarding the expulsion and reinstatement of credit union members.
- **H.R. 4395, Payment Choice Act of 2021** (Payne), which would prohibit retail businesses from refusing cash payments, prohibit retail businesses from charging higher prices to any customer who pays by cash than customarily is charged to a customer using other forms of payment, and provide a private right of action consumers.
- **H.R. 4590, Promoting New and Diverse Depository Institutions Act** (Auchincloss), which would require Federal regulators to conduct a study examining challenges prospective *de novo* depository institutions face and require Federal banking regulators to develop a strategic plan based on the study to promote the creation of newly chartered institutions, especially minority depository institutions (MDIs) and community development financial institutions (CDFIs).
- **H.R. ____, Bank Merger Review Modernization Act of 2021** (C. Garcia), which would ensure bank mergers are in the public interest by clarifying and strengthening the public interest aspect of the merger review and require regulators to use a quantifiable metric to evaluate systemic risk.
- **H.R. ____, Close the ILC Loophole Act** (C. Garcia), which would eliminate an exemption to the BHCA that permits ILCs and their corporate owners to operate outside of the law's regulatory framework, including ownership restrictions. The discussion draft would grandfather existing ILCs and any pending ILC application that may be approved in the next two years pursuant to an enhanced review, while subjecting parent companies of grandfathered ILCs to Fed supervision.
- **H.R. ____, Financial Services Worker Bill of Rights Act**, which would enhance whistleblower protections, prohibit forced arbitration provisions in employment contracts, impose a fine on financial institutions that have excessive CEO to median pay ratios, and provide other worker protections.
- **H.R. ____, NCUA Oversight of Third Party Vendors Act,** which would reauthorize and make permanent authority NCUA had between 1998 and 2002 over credit union third-party vendors.

Figure 1: Number of Banks in the United States



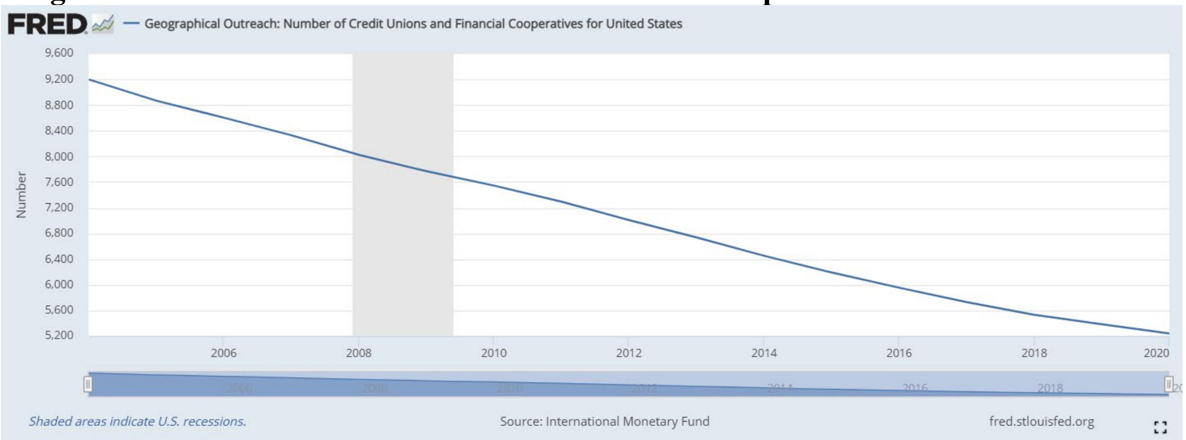
Source: Federal Reserve Bank of St. Louis, Income and Expense: Number of Institutions Reporting, (Accessed Sept. 15, 2020).

Figure 2: Number of Bank Branches in the United States



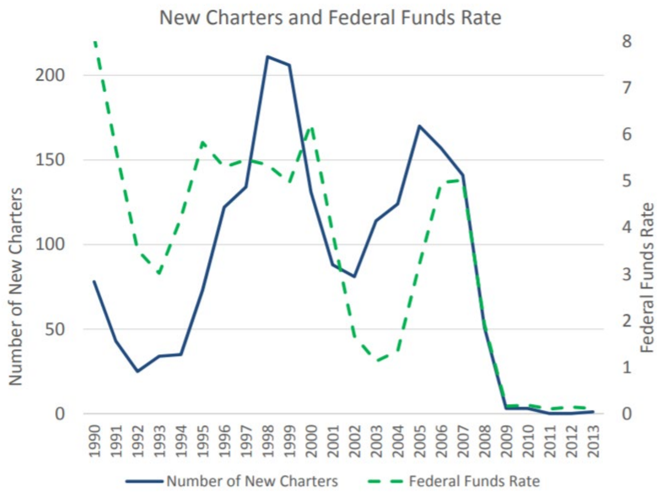
Source: Federal Reserve Bank of St. Louis, Number of Bank Branches for United States, (Accessed Sept. 15, 2020).

Figure 3: Number of Credit Unions and Financial Cooperatives in the United States



Source: Federal Reserve Bank of St. Louis, Geographical Outreach: Number of Credit Unions and Financial Cooperatives for United States, (Accessed Sept. 15, 2020).

Figure 4: New Charters and Federal Funds Rate



Source: FDIC, Supervisory Insights: Vol. 13, Issue 1 - Summer 2016, (2016), p.4.