Banks’ Ability to Scale is a Benefit, Not an Inherent Problem

Greg Baer | Oct. 13, 2022

A Sept. 30 Barron’s op-ed by Better Markets CEO Dennis Kelleher claimed that a “spree” of pending bank mergers would create “too big to fail” banks and threaten the financial system. He is wrong.

First, the op-ed doesn’t get basic facts right. The specific pending mergers involving regional banks cited in the op-ed would not come close to forming a “systemically important institution” according to either the global or U.S. systemic-risk frameworks. The op-ed also conflates bank size with too big to fail status, which we agree has no place in our financial system. Fortunately, the perception of too big to fail in the U.S. has been addressed by the Dodd-Frank reforms championed at the time by Mr. Kelleher. And as documented in recent academic papers, markets now expect much larger losses to creditors in the event a global systemically important bank fails.

Second, Mr. Kelleher’s hyperbole about “supersizing” banks ignores the clear benefits bank mergers create for consumers and taxpayers through economies of scale, enhanced competition, and financial stability. Economies of scale enables banks to bolster their defenses against cyber threats, to reach more customers by expanding their networks, and to invest in innovative technologies to produce the kinds of modern-day products and services that today’s tech-savvy customers demand. The banks referenced by Mr. Kelleher would still be trillions of dollars smaller than the largest banks post-merger, but would have greater resources to compete, lowering costs and improving service for all consumers.

Moreover, from a systemic risk perspective, the probability of a bank failure typically will go down – not up – as a result of a merger. Accordingly, large bank mergers do not inherently increase systemic risk. In fact, mergers often enhance financial stability by diversifying banks’ business models, increasing managerial resources and more stringent capital and liquidity requirements tailored to the resulting bank.

Third, Mr. Kelleher’s principal recommendation for reform – approval of a combined post-merger resolution plan on a pre-merger basis as a condition to even file a regulatory application – would be impractical to implement and produce no public benefit. And, fortunately, the existing regulatory framework already accounts for how mergers affect a bank’s resolution planning. Under that framework, a large bank is required to report to regulators within 45 days of any material event that could meaningfully affect its resolution plan. Any significant merger would trigger such a notice and regulators could then require the bank to revise its resolution plan to account for the merger. Moreover, in certain cases, a merger (e.g., one that results in a bona fide systemically important institution) will automatically trigger heightened requirements to enhance resolvability.

While best practices continue to emerge over time, each institution’s resolution plan is intended to be a unique, evolving and dynamic document. Similarly, as U.S. regulators better understand organizational structures, interconnectivity both within firms and the wider market, regulations may require fine tuning. In fact, the Fed and FDIC are already evaluating the resolution planning guidance for large banks to ensure that there is robust analysis related to the potential impact on the Deposit Insurance Fund from any given resolution strategy; a credible strategy for exiting from a bridge bank; and detailed liquidity planning to support any resolution transaction.

In conclusion, the premise that "big is bad" in bank mergers is a false assumption that policymakers should avoid. The reality is that banks that determine to grow through M&A are making such decisions in today's banking landscape – a highly competitive banking marketplace and a stable, resilient banking system fortified by rigorous rules.

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