ALABAMA BANKERS ASSOCIATION

BOARDBRIEFS

A NEWSLETTER FOR ALABAMA'S BANK DIRECTORS

SEPTEMBER 2021 • VOLUME 6 • NUMBER 3

IN THIS ISSUE

Difficult Math: Why Current Antitrust Guidelines Are Stifling Bank Mergers in Rural Communities
by Michael S. Murphey, *Porter White & Company* and Richard Hills*, Waller*

What Bankers Need to Know About Pulling Credit Reports
by Frank J. Catalano*, McGlinchey Stafford*

The Reform and Modernization of BSA/AML
by Julia A. Gutierrez, *Compliance Alliance*

BOARD BRIEFS
is published by the Alabama Bankers Association.

QUESTIONS? Call us at (334) 244-9456.
Visit ABA online at www.alabama.bank

ALABAMA BANKERS ASSOCIATION
445 Dexter Ave., Suite 10025
Montgomery, AL 36104
Phone (334) 244-9456

Difficult Math: Why Current Antitrust Guidelines Are Stifling Bank Mergers in Rural Communities

by Mike Murphey and Richard Hills

The Antitrust Guidelines for Banks

All bank merger and acquisition ("M&A"), regardless of size, are reviewed by banking agencies and the Department of Justice ("DOJ") to ascertain competitive ramifications on the impacted market area. The process is governed by banking guidelines developed in 1995 and has resulted in 90% of rural markets currently being defined as uncompetitive, effectively eliminating the ability of small banks within those markets from using M&A to better serve their markets. The Alabama State Banking Department described the current disadvantage faced by rural banks as follows:

> The current competitive factors framework unnecessarily restricts common-sense, community-benefitting combinations of small banks that operate in close proximity to one another. Particularly in rural areas, the existing framework can force a selling bank to disregard the potential buyers operating closest to it, even though a nearby buyer usually is more likely than a distant bank to focus on the selling bank's community, customers and employees. In the classic case, which we have observed often, a distant buyer acquires a small bank for the seller's stable base of low-cost core deposits. The distant bank then uses these deposits to fund loan growth in other areas. Over time, the distant bank pays less and less attention to the selling bank's constituents, including the lending needs of the selling bank's local community.

This article will discuss how the guidelines work, how they impact Alabama's banking markets, and potential remedies.

How the Guidelines Work

The guidelines process is relatively straightforward and defines market competition by participants, geography, and level of competitiveness:

- **Participants:** Banks and thrifts are the only entities covered by the guidelines. Credit unions, fintechs and non-bank entities are excluded. Alabama currently has 103 banks and thrifts whose main office is located in the state.
- **Geography:** A market area is defined by the Federal Reserve and is typically based on county boundaries or the Ranally Metropolitan Area. Alabama has 49 market areas, 27 defined by county, 22 defined by RMA.
- **Level:** Competition is quantified by the Herfindahl-Hirshman Index, which is calculated by summing the squares of banks' shares of deposits in each market. As a rule of thumb, the more banks in a market, the lower the HHI. Guidance permits M&A activity if the transaction does not increase a market' s HHI by 200, and if the

postmerger HHI does not exceed 1,800. Otherwise, the DOJ will require additional analysis which typically will delay the final decision and may portend non approval of the proposed transaction. Alabama has 17 markets below 1807 HHI and 32 markets greater than 1807. The low HHI markets average 19 banks, the high HHI markets average 5.

The Federal Reserve maintains a public database reflecting banks, deposits, HHI score and proforma HHI impact on M&A within a given market area through the Competitive Analysis and Structure Source Instrument for Depository Institutions database, whose link is: https://cassidi.stlouisfed.org/index.

Impact on Alabama

Alabama has 67 counties and 49 market areas. The mismatch results from larger city market areas incorporating several counties (ie; Birmingham market area has seven counites, Montgomery market area has five). The following analysis reflects the impact of deposits and HHI scores on intra-county M&A activity within any given county in the state.

The first map reflects deposits per county. Typically, the fewer deposits, the less competitive a market. The second map reflects HHI per county. The higher the HHI, the less competitive the market. Note the high correlation between the gray counties in map one (low deposit) and the gray counties in map two (high HHI). Map Three represents proforma HHI outcomes of intra-county Community Bank M&A in each Alabama market area and indicates that these transactions would likely not be permitted in 33 counties, all in rural Alabama. Please note the high correlation of the dark gray counties in map three to the low deposit gray counties in map one and the high HHI gray and orange counties in map two.

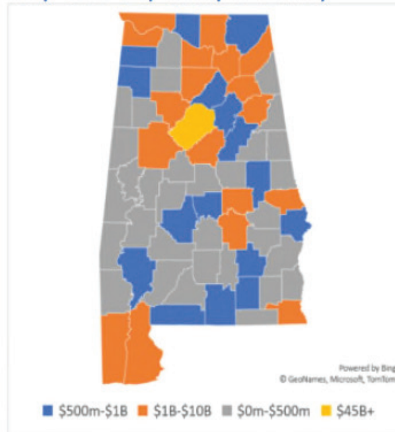
Potential Remedies

As a result of these shortcomings, the DOJ issued a request for public comment in September 20203 regarding updating the DOJ's approach to bank M&A, specifically in rural markets.

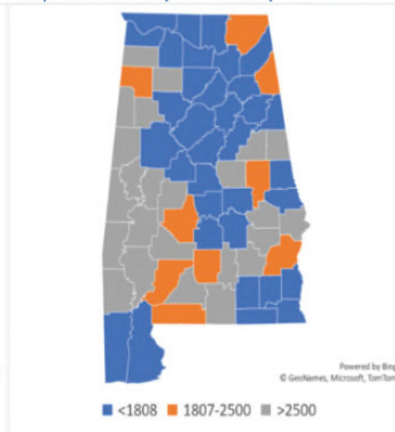
Currently it is unclear whether the guidelines will be revised and what impact any revisions will have on M&A in rural markets. However, the following suggestions submitted to the DOJ from numerous community bank advocates (including the Alabama State Banking Department) would significantly improve the ability of rural banks to engage in M&A activity:

- Focus on community benefits from intra-county bank M&A
- Expand market competition to include non-depository financial institutions, credit unions and savings institutions.
- Consider competition from outside a market area should be considered, especially online providers.

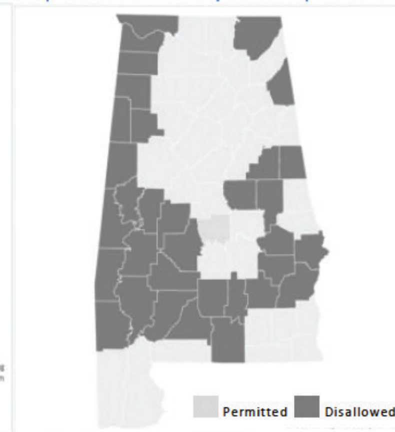
Map One: Deposits per county



Map Two: HHI per county



Map Three: HHI acquisition per county



Porter White & Company

Investment Banking Since 1975

M&A Advisory | Valuations | Strategic Planning
Capital Advisory | Fairness Opinions | Workout Consulting

(We do not sell bonds)

PW&Co

Michael Murphey | | murphey@pwco.com

15 Richard Arrington, Jr. Boulevard North
Birmingham, AL 35203 | 205.252.3681

Find out more by visiting **pwco.com**

- Use a higher HHI threshold for rural markets in recognition of the fewer
- number of bank/credit union participants in smaller dollar rural economies.
- Utilize a de minimis exception for M&A transactions in rural markets.

Conclusion

Nearly one third of Alabama's $2.3 trillion economy is defined as a rural market area. The ability to pursue intra-bank M&A in these markets would allow bankers who know these markets to deploy capital and enhance economic development in rural Alabama. While bank regulators have generally supported some revisions of the guidelines to benefit rural banks, with the DOJ led by Attorney General Merrick Garland, progressives are now urging the DOJ to institute a tougher review process to address branch closures and other potential economic harms for lower-income consumers posed by M&A transactions. As a result, whether the guidelines will be revised and the specifics of such revisions are currently unknown.

***Michael S. Murphey** is a vice president who supports Porter White's Community Banking practice. He has spent 40 years in the southeastern US banking industry in various capacities related to commercial lending, including relationship management, underwriting, credit, and portfolio management. Mike's background includes working with companies of all sizes, from small business to large corporate clients. **Richard Hills** is also a partner at Waller. Helping financial institutions reach their goals is the singular focus of Hills' legal practice. Whether representing a de novo community bank or a well-established bank holding company with regional operations, he has earned a reputation for his ability to solve problems for financial services clients with unique needs and specific strategic objectives.*

What Bankers Need to Know About Pulling Credit Reports

by Frank J. Catalano

The recent success of lawsuits alleging that financial institutions impermissibly accessed a consumer's credit report have encouraged filings of additional suits, some of which have resulted in six-figure payments. Consequently, implementing a best-practice policy related to pulling credit reports for extensions of credit can go a long way in mitigating litigation risks for banking institutions.

Permissible Purpose

Under the Fair Credit Reporting Act (FCRA), financial institutions may access a consumer's credit report only for a permissible purpose. A permissible purpose exists when there is a credit transaction involving the consumer and the extension of credit to, or review or collection of, the consumer's account. One way to be certain that no violation of the FCRA exists is requiring the consumer to complete and sign a credit application acknowledging that the information provided is true and correct before any credit reports are pulled. In addition, the application should contain an acknowledgment by the consumer that credit reports will be pulled in order to evaluate the application. In the absence of a signed acknowledgment, it could be argued that a consumer ratified the credit pull by creating a duty to pay, but it is better to avoid the issue altogether with signed documents.

Accessing credit reports is also allowed where there is a legitimate business need for the information in connection with a consumer-initiated transaction. This includes transactions where credit is granted, or the consumer creates a debt obligation. For instance, a permissible need arises related to the collection of a debt owed by the consumer, or to review an account to determine whether the consumer continues to meet the terms of the account.

An experienced legal team

YOU CAN BANK ON

Driving business, practicing law.

waller

AUSTIN BIRMINGHAM CHATTANOOGA NASHVILLE MEMPHIS

No representation is made that the quality of the legal services to be performed is greater than the quality of legal services performed by other lawyers. Contact: Larry Childs 205-226-5701.

wallerlaw.com

Pre-screening consumers in conjunction with offers of credit has also caused litigation risks to banks relative to permissible credit pulls. In these situations, to properly access a consumer's credit report, the financial institution must make sure that a "firm offer of credit" is being communicated to the consumer. This includes confirming that the offer of credit specifies the banks' pre-selection and eligibility criteria, and setting forth any additional conditions (or requesting that the consumer contact the lender to discuss additional conditions). The lender is not, however, required to include specific loan terms such as interest rate, repayment period, method by which interest would be compounded, or whether penalties would be incurred for late payment. Lenders should be certain, however, that the offer conveys sufficient value to distinguish it from a sales pitch.

A permissible purpose to access consumers' credit reports also exists when required for a response to an order of a court with jurisdiction, or a federal grand jury subpoena. This includes not only court orders, but also attorney-issued subpoenas.

Mitigating Risk

Although it is impossible to avoid all potential liability, there are certain practices that can be implemented to minimize the risk of a FCRA violation. Banks should have a written policy in place to ensure that the consumer actually signs the loan application, which contains an acknowledgment that credit reports will be pulled. While this sounds elementary, given modern technology available to companies and individuals, it can be easy to miss required signatures on electronically transmitted documents. In addition, under no circumstances should a lender or third-party (i.e. dealership) sign the customer's name or submit an unsigned application. For electronic submissions, it is also a good idea to include a check box that the consumer actively checks to acknowledge that the information submitted is true and correct, and also that the consumer consents to the credit report being pulled. Finally, if there are joint applicants, lenders should confirm that all parties applying for credit have signed the loan/credit application.

Implementing policies to mandate that consumers complete and sign the credit application with the proper acknowledgments will go a long way to reduce future litigation risks. In addition, having a strong policy in place regarding submission of credit applications, and communicating that policy in clear and certain terms to employees who directly work with customers, will also help minimize exposure.

Frank Catalano is of counsel in McGlinchey's Dallas office, and part of the Consumer Financial Services Litigation team. He can be contacted at fcatalano@mcglinchey.com or (214) 445-2411.

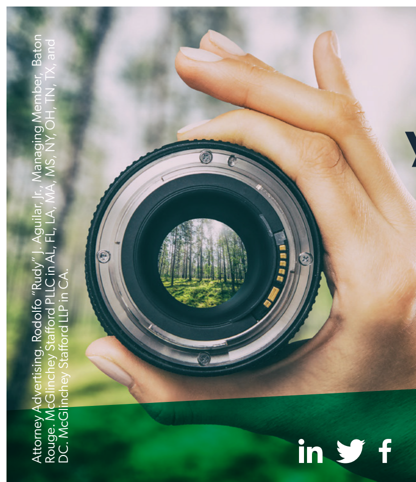
The Reform and Modernization of BSA/AML

by Julia A. Gutierrez

With technology changing and growing at what seems like the speed of light, banking laws and regulations can struggle to keep up. All too often we skim across various regulations that revolve around paper transactions or technology that barely exists. One area of banking that can be especially impacted by an inability to keep up with the ever-changing world of technology or modernization is the Bank Secrecy Act. The Bank Secrecy Act has been around since 1970 when it was passed by Congress as the first set of laws to combat money laundering in the United States. With the exception of the amendment to incorporate the provisions of the USA PATRIOT Act, there haven't been many significant changes to the Act until recent years. In order to fulfill its purpose of fighting money laundering and financial crimes as effectively today as it did 50 years ago, the Act must be revised and revamped to meet the challenges and technological advances of the time.

Background

Over the past several years, the Financial Crimes Enforcement Network (FinCEN) has placed a great deal of focus on reforming and modernizing the BSA. The objective really began years earlier when



your business. our focus.

We help banks and holding companies navigate the complex landscape within which they operate. It's our business, and it's why banks hire us as outside counsel to handle commercial and consumer legal matters. Always on call, we aim to help you respond to what you're facing right now and stay ahead of the curve to anticipate what's next. **We give you more.**

mcglinchey.com

Albany Baton Rouge Birmingham Boston Cleveland Dallas Fort Lauderdale Houston Irvine Jackson Jacksonville Nashville New Orleans New York City Washington, DC

the Bank Secrecy Act Information Technology (IT) Modernization Program was developed in 2010 to provide a modernized IT foundation to collect, store, safeguard, analyze, and share data collected pursuant to the expectation of the BSA. Modernization remains a critical component of government efforts to ensure transparency among U.S. financial systems to detect and deter crime, to strengthen national security, and to achieve economic stability and growth. More recently, the call for modernization returns to the forefront as FinCEN sets out to "re-examine the BSA regulatory framework and the broader AML regime."

In 2019, the House Financial Services Committed issued proposed bills related the Bank Secrecy Act and Anti-Money Laundering and Combating the Financing of Terrorism (CFT) laws. One of the proposed bills set to reform the BSA/AML in an effort to strengthen and modernize the program by focusing on information sharing, resource sharing, and technological innovation. Congress has also considered various proposals which could restructure and modernize the BSA/AML. The U.S. Department of Treasury issued its 2020 National Strategy for Combating Terrorist and Other Illicit Financing which called for AML modernization by leveraging new technologies coupled with innovative compliance approaches.

Modernizing the BSA

Modernization seems to be the frequent theme when it comes to the Bank Secrecy Act. Much of this theme can be credited to the former director of FinCEN, Kenneth Blanco and his focus on the reform and modernization of the BSA/AML. The reform and modernization of the Bank Secrecy Act revolves around a collection of Advanced Notice of Proposed Rulemaking (ANPR), Final Rules, and new or amended laws.

As part of the reform efforts, FinCEN issued a Final Rule on September 14, 2020, which extended BSA/AML requirements to financial institutions lacking a federal functional regulator. The Final Rule required these institutions to develop and implement an Anti-Money Laundering program, to establish a written Customer Identification Program, and to verify the identity of beneficial owners. The final rule closed a regulatory gap between financial institutions and brought about consistency in reporting requirements and decreased the vulnerability of exploitation.

Just a couple days later, on September 16, 2020, FinCEN issued an Advanced Notice of Proposed Rulemaking (ANPR). This was one of the first major efforts in broadening and modernizing the regulatory framework of the BSA and the broader national AML regime. The intent is to provide greater flexibility in the allocation of resources and a greater alignment of priorities across the financial industry and government with a goal of an enhanced effectiveness and efficiency of anti-money launder (AML) programs. It would require financial institutions to have an AML compliance program, including a risk assessment as part of their program. In addition, the ANPR clearly outlines the expectation that financial institutions must meet when developing an "effective and reasonably designed" program. Such programs should: (1) assess and manage risk as informed by a financial institution's own risk assessment process, including consideration of AML priorities to be issued by FinCEN consistent with the proposed amendments; (2) provide for compliance with BSA requirements, and (3) provide for the reporting of information with a high degree of usefulness to government authorities. The overall goal of the 2020 Final Rule is to enhance the effectiveness of anti-money laundering programs as it seeks to modernize the current BSA/AML. As most financial institutions already have risk assessments in place as part of their BSA/AML program, the ANPR may not necessarily add any new expectations, but rather make an industry best practice a regulatory requirement.

BSA/AML Reform continued Jan. 1, when the Senate voted to override President Trump's veto of the National Defense Authorization Act (NDAA) which had been previously overridden by the House on December28, 2020. The NDAA may provide the most significant and comprehensive set of reforms to the BSA/AML since the USA PATRIOT Act of 2001. Some of the most significant reforms include expanding the ability to share Suspicious Activity Report (SAR), streamlined SAR and Currency Transaction Report (CTR), and modifying the BSA/AML program. It also reincorporates an emphasis on risk-based approaches to AML program requirements
The Anti-Money Laundering Act of 2020, part of the NDAA 2021, included the Corporate Transparency Act (CTA) and was effective as law with Congress' override of President Trump's veto of the NDAA on Jan. 1. The CTA has been many years in the making and is intended to be fully implemented by 2023, including the creation of a database of beneficial ownership information with FinCEN. The CTA establishes a new framework for reporting and disclosing beneficial ownership information and really shifts the collection of information from financial institutions to reporting companies, modernizing, and streamlining much of the BSA/AML expectations.

The focus on reform and modernize seems to be ever where we turn as it becomes intertwined in new laws. The efforts and purpose of the Bank Secrecy Act and Anti-Money Laundering remain unchanged. What is changing is the world and technology around us demanding that modernization and reform become priority. It is critical that financial institutions remain knowledgeable of the regulatory and legal changes and embrace the modernization and reform which impacts their programs.

Julia A. Gutierrez currently serves as C/A's Director of Education; developing curriculum and presentations, as well as presenting at various schools and seminars; both live and in a livestream/ hybrid format. She has more than 17 years of financial industry experience to the Compliance Alliance team. She began her career in banking in 2000 while receiving her bachelor's degree from the University of Alabama. Gutierrez served as a risk management and BSA officer and assisted in the development of an enterprise wide risk management and compliance program for a de novo institution.