Acquiring Failed Banks*

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Abstract

I study the effects of acquisitions of failed banks over the last decade. During that period, the vast majority of distressed banks were sold through a competitive bidding process. My empirical strategy relies on comparing outcomes for the acquiring bank to those for the bank that came second in the auction. The acquisitions generate positive abnormal returns on announcement. I test whether this reflects access to new lending opportunities or access to the deposit franchise, and find evidence that it is the latter. After the takeover, the lending of the combined entity in areas where the failed bank operated collapses. Deposit outflow from the acquired bank is far more muted. The lending decline holds for loan categories that were not responsible for the bank's failure, and is not driven by local demand shocks. It is not explained by the acquirer using the acquired deposits to fund loans in markets not directly affected. However, the acquirer's deposit rates in these unaffected markets do go down, reflecting increased deposit market power. Confirming that a loss of relationship capital drives the lending decline, the effect is much stronger in markets where the acquirer was already present and thus, is more likely to shut down the failed bank's branches. Surprisingly, this consolidation does not affect deposit retention. Overall, my results suggest that on failure the deposit franchise is transferred seamlessly to the acquiring bank but the loan production technology is not.

Keywords: Bank failure; acquisitions; bank regulation; competition
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