STATEMENT ON

CROSS-INDUSTRY TAKEOVERS BETWEEN COMMERCIAL BANKS AND THRIFT INSTITUTIONS

PRESENTED TO

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
UNITED STATES SENATE

BY

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9:30 a.m.
Friday, November 21, 1980

Room 5302 Dirksen Senate Office Building

I appreciate this opportunity to give you our views on the matter of cross-industry takeovers between commercial banks and thrift institutions.

Legislation in this area was passed by the Senate September 16. It took the form of an amendment to H. R. 5625, a bill to authorize a gold medal for presentation to the A. Philip Randolph Institute. The amendment, sponsored by Senator Proxmire and Senator Garn, would prohibit banks and bank holding companies from acquiring, merging with or controlling a thrift institution. The amendment would permit exceptions in instances in which the Federal Reserve Board determines that such takeover is necessary "to prevent the insolvency of, or to restore the solvency of," a thrift institution. The Federal Reserve Board could not make such a determination without the concurrence of the appropriate Federal supervisory agency. The prohibition would remain in effect until Congress by concurrent resolution provided for its termination.

I would make the general comment, first, that restrictive legislation such as this amendment would seem to run counter to the spirit of deregulation and freer competition ushered in by the Depository Institutions Deregulation and Monetary Control Act of 1980.

By imposing an artificial ban, the amendment increases restrictive regulation at a time when the financial regulatory agencies are charged by law with reducing regulation and allowing greater freedom for market forces to operate. Instead of promoting the market role, this amendment would establish a new regulatory barrier which would reinforce the functional distinctions among depository institutions. This is inconsistent with the purpose of the new Act which takes important steps to de-emphasize differences between thrift institutions and commercial banks.

We are not certain that there is a need for this legislation. We have had only 10 applications for cross-industry takeovers in the past five years, and in most cases the thrift institution has been the prime mover.

We see some possible detrimental effects from enacting the cross-industry restriction into law.

First, if the amendment is construed as applying to failed banks, it could affect the actions of the FDIC, as receiver, in certain instances. To that extent, it would make our job more difficult in arranging purchase and assumption transactions immediately after mutual savings bank failures in some States.

Second, the amendment eliminates one possible way of resolving the situation of a chronically troubled thrift institution.

Finally, the amendment is a further encroachment on States' rights in defining permissible intrastate mergers.

I will discuss each of these points in detail later in this testimony. Perhaps at this point it would be useful to review current law (statutory, regulatory and decisional) and policy governing the acquisition of thrifts by banks and bank holding companies.

REVIEW OF CURRENT LAW AND POLICY

Under current law, the Federal bank regulator of any bank desiring to acquire an FDIC-insured mutual savings bank is responsible for approving the acquisition. Under Section 18(c)(1) of the Federal Deposit Insurance Act, however, the FDIC is responsible for approving the application of any FDIC-insured bank to acquire a savings and loan association or an uninsured mutual savings bank. The FDIC must also approve any cross-industry merger in which the resultant institution is an insured nonmember bank. As a result of the Bank Holding Company Act of 1956, as amended, Federal Reserve approval is required for any acquisition by a bank holding company.

In the one case in which FDIC approved a commercial bank's acquisition of a nonaffiliated savings and loan, the thrift was not federally insured, it had deposits of only $2.0 million after 75 years of operation, and it had only one full-time employee. In these circumstances, the FDIC determined that approval would benefit the citizens of the community in which the savings and loan was located.

Ten cross-industry merger applications have come before the FDIC since 1976. Seven were approved and three are pending. Two cases in New Hampshire and one in Connecticut in 1976 involved commercial banks and savings banks that were already affiliated and operating in the same quarters. Each merger was, in effect, a consolidation which produced a commercial bank.

In a 1978 case, a commercial bank in Georgia took over a failed credit union.

The remaining six cases involve thrifts acquiring or seeking to acquire commercial banks. These include two approved mergers in New Jersey (in 1977 and 1979) and one in New Hampshire in 1980. In addition, cases are pending in Arizona, Connecticut and Vermont.

Bank Holding Company Acquisition

To be eligible for bank holding company acquisition, under Section 4(c)(8) of the Bank Holding Company Act, the activities of a company must be so "closely related" to the business of banking as to be a "proper incident" to banking. The Federal Reserve held in a 1977 case that while thrifts are "closely related" to banking, their ownership by bank holding companies is not a "proper incident" to banking. In that case, the Federal Reserve denied the application of a multi-bank holding company to keep a savings and loan which it acquired prior to the 1970 amendments to the Bank Holding Company Act.

Even if appproval were granted in one instance, a bank holding company under present law could not acquire a second savings and loan association and remain a banking organization. Such a bank holding company would then have become a multiple savings and loan holding company, and under the National Housing Act would be prohibited from engaging directly or indirectly in commercial banking activity.

We are aware of only two kinds of situations in which the Federal Reserve has approved a bank holding company acquisition of a thrift or a thrift-like institution. First, the Federal Reserve this year approved the acquisition of a savings and loan by a bank. This approval was unique, however, because it represented a rescue operation to save the thrift.

Second, the Federal Reserve in 1975 and 1980 approved acquisitions of New Hampshire guaranty savings banks by bank holding companies. The functions of guaranty savings banks are similar to those of savings and loan institutions, and such banks have the differential. However, guaranty savings banks are stock corporations and the FDIC classifies them as commercial banks for statistical purposes. There are six guaranty savings banks in New Hampshire, including the two that are held by bank holding companies.

Mutual Savings Banks

Mutual savings banks, by their form of organization, already are insulated to a significant extent from takeover by commercial banks and bank holding companies. Many States impose restrictions on conversions of mutuals to stock institutions which could be readily acquired by banks or bank holding companies. Additionally, such conversion is typically time-consuming and expensive. These factors serve as deterrents to takeovers of mutuals by commercial banks and bank holding companies.

State Law

State law is not clear cut, but in general States seem to inhibit cross-industry takeover. Twelve of the 17 States with mutual savings banks permit their merger only with other mutual savings banks. These States are Alaska, Connecticut, Delaware, Massachusetts, New Jersey, New York, Pennsylvania, Rhode Island, Vermont, Wisconsin and Washington.

Four States expressly permit mutual savings banks to merge with commercial banks or bank holding companies. These States are Maine, Maryland, New Hampshire and Oregon.

The remaining two States are silent on the matter. They are Indiana and Minnesota.

Law in most States is silent on the matter of mergers between savings and loan associations and commercial banks. Arizona, Maine and Ohio have permitted acquisition of a savings and loan by a commercial bank or bank holding company, either *de facto* or by express statute.

AMENDMENT ON CROSS-INDUSTRY TAKEOVER

I would like to discuss in detail our comments on the amendment to H. R. 5625 that would bar cross-industry takeovers except for emergency situations.

The amendment would take away options that now exist in certain troubled bank situations. These would occur in States which now or in the future permit mergers between commercial banks and mutual savings banks. If the amendment is construed to apply to a failed bank, then the amendment would also complicate certain failed mutual savings bank cases.

The amendment represents a loss of flexibility. In difficult situations involving troubled and failed banks, the FDIC wants more options, not fewer. I would like to elaborate on that point later in this testimony.

It is true that the amendment would permit emergency exceptions to its ban on cross-industry takeovers. But these exceptions involve a complex procedure. When we are dealing with a bank failure, we are always under time pressure. We must comply with statutory requirements to coordinate with State banking authorities, the appropriate courts and often the Comptroller of the Currency. Nevertheless, operating within this framework, we invariably have been able either to arrange for continued banking service to a community without a break or to pay off depositors within a few days of a closing.

This amendment could require us to deal with an additional factor in specific failed mutual savings bank situations -- those in which we may seek to arrange a merger with a commercial bank. In that circumstance, the amendment would give the Federal Reserve Board the right to make a determination of insolvency. Traditionally, this function has been left to the State as the chartering agency. The new authority conferred by this amendment opens the possibility that the Federal Reserve Board could make a finding contrary to that of the chartering agency; even if it did not, precious time could be lost if the Federal Reserve Board chose to make its own examination to assess the solvency of an institution. If the Federal Reserve Board simply accepts the finding of the chartering agency and does not make its own examination, then the Board would have no purposeful role in failed bank proceedings. If the Board made no finding, its failure to act could cast doubt on the legality of whatever course of action ensues.

The present system of dealing with failed banks has thus far worked well. I will later describe revisions which we believe are in order. But we see no need for introducing the kind of changes represented by this amendment.

EFFECTS ON MERGERS

In the case of mergers involving functioning institutions, the amendment would eliminate a choice that traditionally has been left to the financial institution acting in conjunction with the forces of the marketplace, State law and the Bank Merger Act.

The proposed ban on certain cross-industry mergers would prohibit even a beneficial merger, one which in a given instance may be the most appropriate and desirable way of restoring a troubled mutual savings bank to a sound, competitive status. As drafted, the amendment would permit cross-industry mergers only "to prevent insolvency of, or to restore the solvency of" a thrift institution.

Some thrift institutions, including some mutual savings banks, may be less than sound for a protracted period without deteriorating to near or actual insolvency. Under the amendment, these chronically troubled institutions could not seek a long-term resolution of their difficulties through a cross-industry merger. As a supervisor which must deal with troubled institutions and which must act on merger applications, we would oppose the loss of flexibility implied by this amendment.

As in the case of failed banks, we believe that the amendment would create an unwarranted complication by expanding the Federal review procedure for proposed cross-industry mergers of functioning institutions.

In brief, we can see little purpose in this departure from the principles of the Bank Merger Act. The slight shift of authority may be considered as a limited restructuring of the bank regulatory agencies, a matter which ought not to be addressed in a piecemeal fashion.

STATES' RIGHTS

Finally, as I indicated, the amendment would further preempt the right of all States to make determinations on intrastate mergers. The amendment does not derive from the anticompetitive or other public interest considerations that form the basis for the Bank Merger Act. The amendment would simply and arbitrarily bar a given class of mergers. This is inconsistent with the precepts of the Bank Merger Act in which specific competitive and other public interest considerations are the justification for Federal involvent in merger transactions that otherwise would be left to the forces of the marketplace. We cannot find sufficient cause for preemption in the case of the cross-industry amendment.

EXTRAORDINARY ASSISTANCE

Earlier, in commenting on the emergency provisions of the amendment, I said that the FDIC wants more options, not fewer, in dealing with troubled and failed bank situations. I would like to discuss changes in existing law which would give us better tools to do our job in the banking environment of the 1980s.

We support enactment of S. 2575, the extraordinary assistance bill introduced by yourself, Mr. Chairman, at our request and co-sponsored in the House by Chairman Reuss and Congressmen St Germain, Stanton and Wylie. This bill would give us the flexibility we need concerning large institutions. The number of commercial banks with total assets exceeding $1.5 billion has increased by almost 70 percent since 1974 -- from 72 banks to 121 at the end of June 1980. The number of mutual savings banks with assets exceeding $1 billion has increased by 60 percent in the same period -- from 25 banks to 41.

Currently, the FDIC can provide assistance to a bank only when it is in danger of failing and its continued operation is essential to provide adequate banking services in the community. The bill would expand FDIC powers so it would be able to act when it finds a bank is in danger of failing, that severe economic conditions exist which threaten the stability of insured banks in a large geographic area and it is probable that assistance to the failing bank will substantially reduce the risk or avert a threatened loss to the FDIC.

Another provision of the legislation would broaden the field of institutions which may purchase the assets and assume the liabilities of a failed bank. In addition to FDIC-insured banks, under the proposal associations or banks insured by the Federal Savings and Loan Insurance Corporation would become eligible bidders.

A third provision would create a new option for handling a mutual savings and loan association or savings bank in receivership by authorizing the Federal Home Loan Bank Board to approve the conversion, acquisition or merger of such a failed institution into a Federal stock savings and loan association or savings bank. Federally chartered stock savings banks, which would be insured by the FSLIC, could be acquired by either savings and loan or bank holding companies and would have the advantage of access to a new source of capital in the form of stockholder equity.

The legislation also contains extraordinary acquisition procedures which would apply only in the event of failure of the leading banks or thrift institutions in a State and only then under certain extraordinary procedures. Specifically, the bill would permit the Federal Reserve Board to allow an out-of-State bank holding company to acquire a bank in receivership or its controlling holding company if the failed bank has total assets in excess of $1.5 billion or if it is one of the three largest banks in a State. Such authority would be available to the Federal Reserve Board only if the Federal Financial Institutions

Examination Council, with at least four members concurring, first notifies the Board that an emergency exists and that an intrastate purchase is not in the public interest because of financial or competitive effects or is otherwise not feasible. The Federal Reserve Board would be given explicit authority to deny any such transaction on grounds of possible adverse effects on competition or the concentration of financial resources in any State, region or the nation.

The same procedure would be available for the interstate purchase of the successor of a failed insured savings bank if the failed bank had assets in excess of $1 billion or was one of the three largest thrift institutions in the State.

The legislation would grant similar authority to the FHLBB to approve an extraordinary acquisition by a savings and loan holding company of a failed institution insured by the FSLIC or to the successor of a failed FDIC-insured savings bank. The relief would be available only for a failed institution with at least $1 billion in assets or which is among the three largest insured thrift institutions in a State. Again, a four-member vote of the Federal Financial Institutions Examination Council would be a prerequisite.

This is narrowly drawn, very specialized legislation. It is authority we hope we never have to use, but it is a necessary contingency. It provides a safety net, and it will enable us to make fuller use of the resources of our nation's financial system.