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THE BANK MERGER ACT REVISITED

Address of

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in the Regulation of Banking

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We have now completed ten years of experience under the Bank Merger Act of 1960 -- a decade which has frequently been exasperating for banks, supervisory authorities, the Antitrust Division and the Courts.

We are, of course, dealing with difficult, and still evolving, concepts of competition. Beyond that, we must take into account the economics of banking service in a given community, the banking needs and convenience of the public, and, occasionally, the operational problems of a bank which seeks to merge. Advice must be given, and decisions made, within the framework of differing state laws that have a clear bearing on the alternatives to merger that are available and within the framework of a complex regulatory structure in which a multiplicity of agencies at both Federal and State levels can influence the final result. I think it hardly a surprise, under these circumstances, that proposed mergers which appear on their face to present similar facts may ultimately have quite different fates.

An explanation of why these differences occur is not an endorsement of the present system. I believe, in fact, that the present division of administrative authority over bank mergers has had several unfortunate consequences: it has obstructed the development of a rational and consistent public policy on bank mergers; it has encouraged disrespect for the standards of competition set forth in the Act and in Supreme Court decisions; and it has aggravated problems of competitive imbalance within the nation's dual banking system.

But if the past ten years have exposed the deficiencies inherent in a tripartite administration of bank merger policy among the three Federal bank agencies, they have also seen a number of substantive bank merger issues settled, particularly in the years since 1966. The standards of Section 7 of the Clayton Act <u>are</u> applicable in determining whether the effect of a proposed bank merger "may be substantially to lessen competition" in any section of the country within the meaning of the Bank Merger Act. A proposed merger found to "have anticompetitive effects as judged by the standards normally applied in antitrust actions" <u>may</u> nevertheless be approved if the deciding agency finds that these anticompetitive effects "are clearly outweighed in the public interest by the probable effect of the transaction in meeting the convenience and needs of the community to be served." 1/ On this issue, the burden of proof has been placed by the Supreme Court on the banks involved, with the requirement that they show that the expected benefits in terms of convenience and needs of the community to be served cannot reasonably be achieved through other, less anticompetitive, means. 2/ Whereas prior to 1966, it was unclear what weight the deciding agency was to place on its analysis of the various competitive factors, as distinct from banking factors and convenience and needs, it now appears that the competitive factors are to be assigned a primary weight, although the other

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1/ <u>United States v. First National City Bank of Houston</u>, 386 U.S. 361 (1967).

2/ <u>United States v. Third National Bank in Nashville</u>, 390 U.S. 171 (1968).

factors must still be considered. The only difficulty with that is that some competitive effects of a merger may be pro competitive while other competitive effects of the same merger may be anti competitive.

In the Phillipsburg case decided last June, the Supreme Court for the first time considered the proposed merger of small banks in a banking market of limited population.[3/] But the Court's opinion, in some respects unanimous and in other respects divided 5-2 (with two justices abstaining), is likely to affect all bank merger activity in the years ahead. The fact that one bank was $25 million and the other $17 million in asset size may actually be the least important aspect of the case, except as a reminder that almost 85% of all banks in the United States are below $25 million in asset size. That the Court was unwilling to write into the Bank Merger Act or the Clayton Act a loophole of that magnitude is not surprising when both acts seem to require a competitive analysis based on relative size and influence within a given market.

Of greater importance, it seems to me, was the Court's treatment of the relevant product market or "line of commerce" issue, its determination of the relevant geographic markets for assessing competitive impact and community convenience and needs, and its views as to the share of a market which constitutes a violation of Section 7 of the Clayton Act for purposes of the Bank Merger Act.

3/ United States v. Phillipsburg National Bank, __ U.S. ___ (decided June 29, 1970).

In 1963, as you know, the Court had determined that the appropriate line of commerce for judging the proposed merger of two large, full-service commercial banks in the metropolitan Philadelphia area was "commercial banking", without regard to the competition which such banks were conceded to face from a variety of non-bank sources in one or more of the loan, deposit or trust services which they offered their customers.[4/] In Phillipsburg, the Court reaffirmed that determination, although the banks involved depended much more heavily on time and savings deposits from retail customers and made many more mortgage loans to individuals than the big city banks in the Philadelphia case. Despite the greater similarity of the banks in Phillipsburg with mutual thrift institutions, the Court found that the "cluster of products and services termed commercial banking" had an economic significance well beyond the individual products and services involved, so that it was not appropriate to consider the extent to which savings banks, savings and loan associations or other financial institutions provided services in the same geographic market similar to the services offered by the merging banks.

Whatever views bankers, economists, lawyers or the agencies themselves may have as to the merits of the Court's view, I regard it as settled that in the typical commercial bank merger case, the decisive line of commerce for assessing competitive impact within the meaning of the Bank Merger Act is limited to the products and services provided only by commercial banks in the relevant geographic market. A similar analysis would

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4/ United States v. Philadelphia National Bank, 374 U.S. 321 (1963).

seem to require that in a merger of mutual thrift institutions they also be treated separately from other financial institutions where the "cluster of products and services" they can offer includes deposit accounts at interest rates higher than the rates commercial banks and certain other types of financial institutions can offer on the same accounts. On the other hand, where special local circumstances prevail (as, for example, in a state where mutual savings banks generally control commercial bank affiliates), a combined line of commerce may be appropriate. Or, if mutual savings banks or savings and loan associations obtain unlimited checking account powers in the future, the Court's "line of commerce" analysis may have to be reexamined because of its past emphasis on the economic importance of the demand deposit function and its uniqueness to commercial banking. A similar reexamination might follow the elimination of differences in rates authorized and paid on savings accounts in mutual thrift institutions. Absent such local circumstances or changes in the powers of financial institutions, the separation of commercial banks from other institutions that compete with them only in part appears to be required "by the standards normally applied in antitrust actions" which now are incorporated in the Bank Merger Act.

The Court in Phillipsburg also reaffirmed its 1963 approach to the definition of the relevant geographic market within which competitive impact should be assessed. This stressed the "market area in which the seller operates and to which the purchaser can practicably turn for supplies."

The "market area in which the seller operates" is located by reference to the places from which it draws its business, the places where its offices are situated, and the places where it seeks its banking business. At least two, and possibly a larger number of geographic markets, may be relevant under a reasonable application of this standard. The obvious ones are the geographic areas from which the two banks derive the bulk of their banking business. Frequently these are the same for both banks, as in Phillipsburg, or they may overlap in part. If the offices of the two banks are located at some distance from each other, and one bank is significantly larger than the other, the trade area of the smaller bank will undoubtedly be examined more closely than the trade area of the larger bank, since it is in that area that such a merger will usually be found to have its greatest competitive impact.

This discussion would not be complete without noting further that the Court found a merger proposal anticompetitive within the meaning of the Clayton Act, and hence within the meaning of the Bank Merger Act, where one bank controlled only 11.3% of the total demand deposits within a relevant geographic market and the other bank controlled only 7.9% of such deposits in the same market, for a combined total of 19.2%. This was a share of the market substantially below that found anticompetitive in prior bank merger cases, but completely consistent with Clayton Act precedents in nonbank merger cases, some of which involved much lower percentages than those in Phillipsburg.

Given the view that these figures establish a prima facie case of anticompetitiveness, and given the heavy burden banks have of proving community convenience and needs to justify an anticompetitive merger, it is unlikely that many mergers of viable banks already competing in the same market can be justified. In this connection, it is worth noting that the Court in Phillipsburg further held that "convenience and needs" may not be evaluated in an area smaller than the geographic market used in assessing competitive impact. Furthermore, it is not enough to show that the proposed merger would benefit members of the public interested, for example, only in large loan and trust services; the merging banks must also show that all seekers of banking services in the relevant area would benefit. The final hurdle is that the banks must also establish that these benefits cannot reasonably be achieved by some other, less anticompetitive, means.

The Phillipsburg decision has left a number of practical problems in the areas it discussed and a number of basic substantive issues yet to be resolved by the Court. For example:

-- The Court's discussion of the relevant geographic market for purposes of competitive analysis still leaves considerable agency discretion in defining the exact geographic extent of that market, particularly in metropolitan areas where state law limits the right to branch to an area smaller than the draw of the banks involved for deposit and loan business. We have been admonished that the relevant market must be neither so broad as to minimize obvious anticompetitive effects nor so narrow as to ignore, unrealistically, the competitive influences actually at work within the market. Moreover, in many banking markets, the inclusion or exclusion of deposit and loan figures for offices or institutions of the same type on the periphery of the core area of the market, can make a substantial difference in one's view of the probable competitive effect of a given merger, even in analyzing present or direct competition.

-- In actual situations presented to it for decision, the Supreme Court may or may not adhere to its dictum in the Phillipsburg case that cities "with a population exceeding 10,000 and their environs" can be viewed as an "economically significant" section of the country for purposes of applying normal antitrust standards. If the Court follows this dictum, will it go below 10,000 people in an appropriate case?

-- Many banking markets have had historically only three, four, five or six banks. Will the Court adhere to its view that 19.2% of such a market is anticompetitive on its face? Will the Court go lower than 19.2% in other cases by applying the very low concentration ratios of Section 7 cases outside the bank merger field?

-- Where the relevant geographic area of actual, existing competition is not the same as the area of potential competition under State law, must the competitive impact of the proposed merger be separately assessed within both area? In States where branch banking is authorized only on a countywide or regional basis, is the competitive structure of the entire State nevertheless relevant if Statewide holding companies are possible, or if Statewide mergers are permitted, but de novo branching is limited to the smaller area? If such large and populous areas are relevant, should not the concentration ratios for prima facie anticompetitiveness be significantly lower?

-- If the potential for future competition between the two merging institutions, either through de novo branching or through an alternative merger, is conceded to be a relevant competitive factor, what weight should be assigned to an anticompetitive effect in this area when there are procompetitive effects in the area of direct and immediate competition?

-- Should not consideration be given as well to the precedent effect an approval may have on the long range structure of competition in a given market, particularly if it can lead to a large market dominated by only a handful of banks?

-- To what extent must the deciding agency examine the alternatives which may be available, either internally or by outside assistance, to provide the alleged benefits in banking service or to solve an operating problem if the proposed merger appears to be anticompetitive?

It is apparent from reading the decisions and the competitive factors reports of the three Federal agencies that their disagreements on one or more of these items will continue. Individual views, moreover, on the weight to be given each factor in arriving at a final decision to approve or disapprove, even if such factors are considered, will continue to vary, since it is in this area that subjective views and personal experience of the public officials involved can so easily influence the final outcome.

You have been discussing among other things at this conference the Bank Holding Company Act of 1956 and its most recent amendments enacted last year. In the bank holding company area, the division of authority between the three Federal agencies has, of course, not been followed. Instead the final authority has been assigned to the Federal Reserve Board, a solution which I supported both as New York State Superintendent of Banks and as Chairman of the Federal Deposit Insurance Corporation. I believed then, as I do in the bank merger field, that the interests of fairness, predictability and rationality all require a single agency with the power to decide matters so basic to a bank's competitive position. While individual members of the Board of Governors may disagree with a particular decision, I am confident that a consistent trend of decisions will be evident under the Bank Holding Company Act, even though such consistency has so far eluded the banking industry and the supervisory agencies under the Bank Merger Act.

With these two experiences to choose from, I believe the time has come for the Congress and all interested parties to reexamine the division of authority among the three Federal banking agencies which has been required by the Bank Merger Act but not by the Bank Holding Company Act. In my view, the area of bank mergers is just as important, if not more important, to a bank's competitive position in its market than its ability to acquire non-bank affiliates through a holding company parent.

The Bank Merger Act itself indicates that a desire for uniform standards is the reason the two nondeciding agencies, as well as the Department of Justice, have been given an opportunity to submit their views on the competitive factors of a merger proposal to the other agency. It was the Congressional view, as expressed in the Senate report that preceded the enactment of the original Act in 1960, that the Comptroller of the Currency, the Federal Reserve Board and the Federal Deposit Insurance Corporation

> "...must review applications with the same attitude, and must give the same weight to the various banking and competitive factors. The Comptroller must not be more lenient in approving mergers so as to attract merging State banks into the national banking system. The Board and the FDIC likewise must not be more lenient in approving mergers so as to tempt national banks to leave the national banking system. The State banking system and the National banking system must develop and compete with each other on their own merits, without pressure in either direction from the administration of the [Act]."

The Committee Report in the House agreed that every effort "must be made to avoid a situation where one Federal agency is 'tough' about mergers and another is 'easy', where there might be an inducement to arrange mergers so as to result in the kind of bank where approval could be easily obtained." While the House limited the reports of the nondeciding agencies to competitive factors, they further stated the view that "The problem of obtaining uniformity is particularly acute in regard to the competitive factors, and it is expected that this uniformity can be obtained without asking the other two banking agencies for reports on the banking factors..." It recognized the merit in a suggestion made at that time that a single agency be authorized to approve all mergers, but reaffirmed its belief that the consultation provided in the final Act would achieve the purposes of that suggestion.

A review of the nearly 1700 merger proposals brought to a final, public decision by one of the three Federal bank agencies under the Bank Merger Act will show that this Congressional desire for uniformity of result has not been achieved under the Bank Merger Act.

I would therefore suggest that the Congress undertake a reexamination of the administrative provisions and experience under the Bank Merger Act with a view to determining whether the pattern established in the Bank Holding Company Act should be adopted as well in the bank merger field. There are, of course, a number of ways in which greater uniformity of result could be achieved.

A study prepared for, and recently released by, the Conference of State Bank Supervisors recommends that the Bank Merger Act be repealed, on the ground that, as interpreted, it is duplicative of the Clayton Act machinery available to the Antitrust Division. I think this suggestion both premature and unrealistic; premature because the full impact of the Bank Merger Act Amendments of 1966 has not been determined by Supreme Court decision, and unrealistic because the Antitrust Division has so many conflicting demands for an allocation of their limited resources over the full range of merger activity within American business and finance. The Congress, moreover, in both the Bank Merger Act and the Bank Holding Company Act, has expressed a desire for thorough agency review and control of all applications on the part of banks to expand -- by merger with other banks or by holding company affiliation with banks and nonbank businesses closely related to banking or managing or controlling banks.

Another possibility is the assignment of all bank merger authority at the Federal level to the Board of Governors of the Federal Reserve System, pending more complete changes in the present structure of bank regulation at that level. Given the existing responsibilities of the Board, however, and the new ones added by the Bank Holding Company Act Amendments of 1970, the Board itself might consider this proposal not to be administratively feasible at the present time.

I think a more practical interim step might be the assignment to the Federal Reserve Board of all authority over proposed mergers involving a subsidiary bank of a bank holding company, irrespective of the classification of the resulting bank as a national bank, a State member bank or a State nonmember bank insured by the FDIC. This would be consistent with the Board's past authority over direct acquisitions of banks by a holding company and consistent also with its new authority over the expansion of bank holding companies into areas closely related to banking or controlling or managing banks. The assignment of such merger authority should be manageable for the Board and would encompass within its scope, on a consistent basis, the merger activity of the larger, expansion-minded banks in the country, most of which have become subsidiaries of either one-bank or multi-bank holding companies.

I have identified this problem of administration under the Bank Merger Act and proposed a partial but significant remedy, not in the expectation of early Congressional action, but in the hope of starting a serious discussion that may lead in time to more uniform results in actual merger decisions under the Act. I believe this to be required before the public interest in a truly competitive banking structure in this country can be achieved.

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