FDIC
FEDERAL DEPOSIT INSURANCE CORPORATION

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FDIC MERGER POLICY 1970-1972

Presentation

of

Frank Wille, Chairman
Federal Deposit Insurance Corporation

at the

Practicing Law Institute Seminars
on
Bank Acquisitions and Mergers and Other Antitrust Problems

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Under the Bank Merger Act, the Federal Deposit Insurance Corporation is the deciding agency with respect to merger applications in which the resulting bank is either a state-chartered commercial bank which is not a member of the Federal Reserve System or an FDIC-insured mutual savings bank. In addition, the FDIC is required to pass on all merger applications involving the acquisition of a noninsured institution even if the resulting bank may be a national bank or a state member bank. These two provisions have required FDIC review and decision of 173 merger applications since I became Chairman on April 1, 1970. Forty-eight of these applications involved either "phantom bank" mergers or internal reorganizations, and three more involved the purchase of assets of a bank that had already failed by a newly organized state non-member bank. As to the 122 remaining applications, 109 (or 89 percent) were approved and 13 (or 11 percent) were denied.

Except in two or three cases where an emergency merger was approved on traditional banking factors, every one of these 122 applications resulted in a public statement issued at the same time the FDIC's decision was announced, detailing the Corporation's analysis, its view of the material facts, and the reasons for its ultimate disposition of the application. I urge you to review these statements--on the 109 approvals as well as the 13 denials--to get an accurate view of how the FDIC approaches the wide variety of factual circumstances presented by particular applications. * There are similar facts, as you know, in many applications, and the public record of FDIC reaction should prove invaluable to you in counseling your clients and presenting their applications in the most effective way. I intend to generalize some of our reactions at these PLI seminars, but the decisions themselves are clearly the most reliable guides to prediction.

The FDIC's 109 approvals during this period are as important to you as the 13 denials, but since public attention has been focused on the denials, a few words of comment about the denials may be in order. Of the 13 denials, 7 involved banks competing in the same local banking market and, in my view, presented factual circumstances indicating clear or probable violations of Section 7 of the Clayton Act based on

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* Copies of these merger statements may be obtained as they are issued from the FDIC's Information Office, 550 17th Street, N. W., Washington, D. C. 20429. They are subsequently reprinted on a calendar year basis in the FDIC's Annual Report, copies of which may also be obtained from the Corporation's Information Office.

past bank merger decisions of the United States Supreme Court. None of these denials was appealed to the courts. 1/ The remaining 6 applications were denied because of our conclusion that significant potential competition between the two banks would be eliminated or that the proposed merger would have significant adverse consequences to the future competitive structure of a given state or a given banking market, without overriding public benefits based either on banking factors or considerations of public needs and convenience. 2/ The FDIC, as you know, is being

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1/ Proposed mergers of Valley Fidelity Bank and Trust Company and Bank of Knoxville, 1970 FDIC Annual Report 130; United Mutual Savings Bank and State Mutual Savings Bank, 1970 FDIC Annual Report 134; First-Citizens Bank & Trust Company and The Lucama-Kenly Bank, 1971 FDIC Annual Report 159; Westminster Trust Company and The Union National Bank of Westminster, 1971 FDIC Annual Report 147; Anderson Banking Company and The State Bank of Lapel, 1971 FDIC Annual Report 150; First-Citizens Bank and Trust Company of South Carolina and Bank of Chesterfield, FDIC opinion B-11, May 1, 1972; and American Bank and Trust Co. of Pa. and Lebanon County Trust Company, FDIC opinion B-15, May 31, 1972.

2/ Proposed mergers of Bank of Hawaii and Hawaiian Trust Company, Limited, 1970 FDIC Annual Report 137; Washington Mutual Savings Bank and Grays Harbor Savings and Loan Association, 1970 FDIC Annual Report 141, aff'd on reconsideration, 1971 FDIC Annual Report 164; The Citizens and Southern Emory Bank and The Citizens and Southern Bank of Tucker, 1971 FDIC Annual Report 152; Continental Bank and Bank of Pennsylvania, 1971 FDIC Annual Report 155, aff'd on reconsideration (August 18, 1972); Chittenden Trust Company and Lamoille County Bank, FDIC opinion B-19, June 13, 1972; and The Pennsylvania Bank and Trust Company and Union Bank & Trust Co., FDIC opinion B-24, July 14, 1972.

challenged in the courts on two of these six denials, and we are fully prepared to defend our actions in each of them. [3/] It remains to be seen whether Section 7 of the Clayton Act will be interpreted by the Supreme Court to extend to the factual situations presented by some of these cases. Even if Section 7 is not so extended, the Court will ultimately have to decide whether the banking agencies nevertheless have discretionary authority to deny proposed merger transactions under similar circumstances.

It has been said that when it comes to mergers and bank structure, the FDIC has an institutional bias in favor of small banks, but the facts do not support the charge. Most of the 8,000 nonmember commercial banks regularly examined by the Corporation are indeed small (the median size at year-end 1971 being $7.2 million in deposits), but the largest had $1 billion in deposits and 118 all told had deposits in excess of $100 million. An additional 195 had total deposits of between $50 million and $100 million. In the case of FDIC-insured mutual savings banks, the median deposit size was significantly greater

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3/ Washington Mutual Savings Bank v. FDIC, S.D. Washington, Civil No. 45-71C3; Continental Bank v. FDIC, E.D. Pennsylvania, Civil No. 72-1827.

($71.2 million), the largest had about $3 billion in deposits, 129 exceeded $100 million in deposits and 59 more were in the $50-100 million range. Not only do banks with more than $50 million in deposits hold 59 percent of all bank deposits under FDIC's immediate supervision, they account for a majority of the merger applications filed with FDIC, just as banks of similar large size account for most of the merger applications filed with the Comptroller of the Currency and the Federal Reserve Board. Thus, of the 109 merger applications approved by the Corporation since April 1, 1970, 68 involved one or more banks with more than $50 million in deposits, as did 11 of the 13 denials.

The FDIC recognizes that bank mergers can stimulate competition, strengthen one or both participating banks and bring substantial benefits to the public by way of improved service and convenience. The Corporation is unlikely to approve a merger, however, which in our view is significantly anticompetitive, unless there are compelling banking factors or a demonstrated deficiency in banking services for the general public that cannot be corrected except by the proposed merger. Conclusions on each of these items are matters of judgment, of course, but I would say that if the FDIC has an institutional bias, it has very little to do with the absolute size of banks but a great deal to do with the number of meaningful competitors available to bank customers in particular states and in local banking markets throughout the country. [4/] These discussions, I hope, will make that concern clear and how it affects FDIC's merger decisions.

I. MERGERS OF BANKS IN THE SAME LOCAL MARKET

In assessing the merits of a typical bank merger application, the FDIC first seeks to determine whether the facts presented indicate a violation of Section 7 of the Clayton Act, as interpreted by the United States Supreme Court in past bank merger decisions. These decisions indicate that if a merger between existing banks in the same local banking market produces "a firm controlling an undue percentage share of the relevant market, and results in a significant concentration of firms in that market," a violation of Section 7 is likely to be found. United States v. Philadelphia National Bank, 374 U.S. 321, 363 (1963), quoted with approval in United States v. Phillipsburg National Bank, 399 U.S. 350, 366 (1970). In Phillipsburg, the resulting bank would have controlled 19.2 percent of the demand deposits and 23.4 percent of the total deposits held at all

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4/ The Corporation has, for example, approved the mergers of the $728 million Greater New York Savings Bank and the $250 million Flatbush Savings Bank (1970 FDIC Annual Report 111), the $608 million Franklin Savings Bank in the City of New York and the $423 million Kings Highway Savings Bank (1971 FDIC Annual Report 60), and the $362 million Prudential Savings Bank and the $178 million Broadway Savings Bank (FDIC opinion B-32) (October 2, 1972). It was relevant to each approval that the New York SMSA has over 100 mutual thrift institutions, including at least 28 with more than $500 million in savings accounts.

commercial bank offices in the local market used by the Court, and its citation of the Von's Grocery and the Pabst Brewing cases[5] suggest that even lower percentages may constitute an "undue percentage share" in bank merger cases. It also appears that the Court's reference to a "significant concentration of firms in that market" is related not to the total number of banks which would remain to serve the market if the proposed merger were approved, but to any significant increase caused by the merger in the percentage share of the market's commercial bank business and offices thereafter controlled by the two or three most prominent banks in the market.

In applying these antitrust standards, the geographic definition of the local banking market becomes critical. This definition may well determine whether two banks should be considered present competitors and what the consequences of their proposed merger may be on the concentration of local banking resources. The Supreme Court has recognized that a delineation of the relevant geographic market for these purposes can seldom be precise, and it remains in many cases one of the most difficult of agency determinations. The Court has said it is important to consider the places from which a bank draws its business, the location of its offices and where it seeks business, but the key factor in its opinions

5/ United States v. Von's Grocery Co., 384 U.S. 270 (1966); United States v. Pabst Brewing Co., 384 U.S. 546 (1966).

seems to be the area within which a bank customer who is neither very large nor very small can, as a practical matter, turn to do his banking business. In Philadelphia, for example, the Court stated that a "workable compromise must be found" and urged a "fair intermediate delineation which avoids the indefensible extremes of drawing the market either so expansively as to make the effect of the merger upon competition seem insignificant, because only the very largest bank customers are taken into account in defining the market, or so narrowly as to place [the banks in question] in different markets, because only the smallest customers are considered." United States v. Philadelphia National Bank, 374 U.S. 321, 361 (1963). The discussion in Phillipsburg on this point was also oriented to customer convenience. United States v. Phillipsburg National Bank, 399 U.S. 350, 361-364 (1970).

Because of this focus the FDIC pays particular attention to the ease of transportation to and from the bank sought to be acquired. Thus, in suburban communities, the adjacent city might be included if commutation to and from the city is relatively convenient for a significant number of potential bank customers. The availability of inter-area bus, railroad and subway transportation, and their use by significant numbers of potential bank customers would be material factors in reaching such a conclusion. In many areas of the country, however, such transportation facilities are not available and FDIC's examination is limited to the ease of automobile travel to and from offices of the bank to be acquired. In sparsely populated areas, where the use of one's automobile to drive significant distances is a normal routine, the FDIC begins its efforts to delineate the local banking market by examining the area within about 15 miles from each office of the bank to be acquired. The resulting approximation of the area within which a potential bank customer might be expected to turn for alternatives might then be cut back by such natural barriers as mountains, rivers, parks or forests or by an interstate highway or incorporated area that serves, similarly, as an outer boundary. In some cases, where the bank to be acquired is in a small community and people are regularly drawn to the nearest population centers for employment, shopping or entertainment, the initial area might be expanded to include such population centers if they are near the perimeter of the 15-mile zone. In no event, however, is the Corporation likely to expect a dissatisfied bank customer to travel more than 25 miles to seek out a banking alternative. On the other hand, in areas of relatively high population density which do not have mass transit facilities, a reasonable distance within which to expect a bank customer to seek alternatives might be significantly less than 15 miles. The FDIC is attempting, in short, to delineate a realistic geographic area within which a potential bank customer might turn for banking service if he becomes dissatisfied with the bank being acquired.

Standard Metropolitan Statistical Areas, some of which cover very large geographic areas, may or may not be used by the FDIC to delineate the relevant local market depending on whether or not the SMSA in question approximates the geographic area we would derive from our own process. If it does, we are likely to use the SMSA as a matter of convenience. If it does not, the FDIC uses the geographic area derived by the process previously described. Moreover, if the area from which a bank, particularly a small country bank, draws the bulk of its business is significantly smaller than the relevant geographic market area derived by the FDIC process, the Corporation will use the latter as more consistent with the Supreme Court's comments on the subject.

Assuming two banks are competing within a local banking market so defined, what are their chances of success in consummating a proposed merger? Obviously, the closer their facts are to those presented in Phillipsburg, the more unlikely FDIC approval becomes. On the other hand, the Corporation has approved a substantial number of bank mergers between two banks in the same local market during the past two and a half years. These approvals tend to fall into two categories, depending on the economic characteristics of the market involved.

In the first category, the local banking markets have been of substantial population and normal economic activity. Proposed mergers of banks within such markets have been approved with relative ease where the two banks together controlled 10 percent or less of the market's total banking resources, where the resulting bank would continue to face significant competition from one or more banks with larger shares of the local market, and where a significant number of banking alternatives relative to the market's total population would remain for a dissatisfied bank customer. 6/ The Corporation has also approved two applications where these same conditions prevailed, except that the resulting bank held more than 10 percent but less than 15 percent of the total commercial bank IPC deposits in the market. In each case, the merging bank was a relatively small bank and held such a small percentage share of the market's

6/ See, e.g. First State Bank of Oregon and The Multnomah Bank, 1970 FDIC Annual Report 91; The Warwick Savings Bank and Orange County Savings and Loan Association, 1970 FDIC Annual Report 107; Flatbush Savings Bank and The Greater New York Savings Bank, 1970 FDIC Annual Report 111; The Farmers and Merchants Savings Bank and The Lone Tree Savings Bank, 1970 FDIC Annual Report 117; Westchester County Savings Bank and The Bank for Savings of Westchester, 1971 FDIC Annual Report 41; Kings Highway Savings Bank and The Franklin Savings Bank in the City of New York, 1971 FDIC Annual Report 60; Civic Center Bank and Trust Co. and The South East National Bank of Chicago, 1971 FDIC Annual Report 83; Barclay Bank and Trust Company of Boston and United States Trust Company, 1971 Annual Report 126; First Bank of Savannah and Industrial Bank of Savannah, FDIC opinion B-7, April 17, 1972; Tracy-Collins Bank and Trust Company and American National Bank, FDIC opinion B-13, May 23, 1972; Caddo Trust and Savings Bank and The Oil City Bank, FDIC opinion B-31, August 31, 1972; Broadway Savings Bank and Prudential Savings Bank, FDIC opinion B-32, October 2, 1972; and Commercial Security Bank and Murray State Bank, FDIC opinion B-34, October 10, 1972.

total deposits that the degree of actual competition likely to be eliminated by the merger proposed could be characterized as insubstantial. 7/

In the second category, the local banking markets have all been under 40,000 in population, economic activity has been sluggish at best and in a number of cases substantially depressed because of unemployment, a declining population, or income levels well below national or statewide averages. In such markets, the FDIC has permitted the merger of several very small banks, most of them under $5 million in size, into somewhat larger banks even though the resulting bank would have a percentage share of the market's total banking resources substantially higher than those enjoined by the Supreme Court in more populous and affluent markets. 8/ In each such case, however, the FDIC has

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7/ South Side Bank and Trust Company and East Scranton Bank, 1971 FDIC Annual Report 34; Johnstown Bank and Trust Company and Community National Bank of Pennsylvania, FDIC opinion B-26, August 4, 1972.

8/ See, e.g. Lincoln County Bank and Gleason State Bank, 1971 FDIC Annual Report 36; Millersburg Trust Company and Farmers' State Bank of Dalmatia, 1971 FDIC Annual Report 109; The First State Savings Bank of Gladwin and The State Savings Bank of Harrison, FDIC opinion B-6, March 31, 1972; The Kentucky Bank & Trust Company and Planters Bank, FDIC opinion B-17, June 13, 1972; Citizens State Bank and Trust Company and The Farmers Bank of Leona, FDIC opinion B-20, June 29, 1972; Merchants and Farmers Bank and Peoples Bank of Durant, FDIC opinion B-25, July 14, 1972; and Citizens Bank and Trust Company and The H. Y. Davis State Bank, FDIC opinion B-30, August 31, 1972. CF. Citizens Bank and Bank of Simpsonville, 1970 FDIC Annual Report 71; and Magnolia Bank and Citizens Savings Bank, Magnolia, Mississippi, 1971 FDIC Annual Report 103.

satisfied itself that a reasonable number of banking alternatives, relative to the population served, would remain for dissatisfied customers and that few, if any, less anticompetitive merger alternatives were available to the bank being acquired.

II. QUESTIONS OF DE NOVO ENTRY

An increasing number of the applications filed with the FDIC these days propose mergers between banks which are not currently operating in the same banking market--a reflection, no doubt, of the relatively clear restraints on proposed mergers of significant competitors which are operating in the same local market. In dealing with these "market extension" applications, there is not yet any definitive guidance from the United States Supreme Court, and the bank regulatory agencies have been developing rules of their own which may or may not pass muster when challenged either by the Department of Justice or by applicant banks.

In most such applications, a relatively large branch bank seeks to acquire a smaller bank operating in a local banking market separate and distinct from the local markets served by the larger bank. In such cases, the FDIC is likely to confine its competitive analysis to the impact of the proposed merger in the local banking market served by the smaller bank, since the merger is unlikely to have any perceptible effect in markets already served by the larger bank. In the occasional case where an application of this type involves two banks of relatively equal size which operate in separate markets, the FDIC makes a similar examination as to the competitive impact of their proposed merger in each of the local banking markets served by the two banks. 9/

If the banking market so examined appears to be highly concentrated--that is, because the bulk of the market's commercial bank deposit and loan business is held by two, three or four banks--and if the bank sought to be acquired is one of these leading local banks, the FDIC will attempt to evaluate the reasonableness of requiring the outside bank to enter the market by the establishment of a de novo branch, rather than by means of the merger proposed. The rationale behind such a requirement would be to gain for the public the competitive advantages of having an additional bank of significant size in the market from which to choose its banking services. When the number of meaningful options to the banking public is as limited as I have hypothesized (and the resources of most local

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9/ See, e.g. Lock Haven Trust Company and The First National Bank of State College, 1971 FDIC Annual Report 50; and Elk County Bank and Trust Company and The Bradford National Bank, FDIC opinion B-4, March 7, 1972.

banking markets are typically concentrated in two, three or four banks), the FDIC has no difficulty in subscribing to the view that "one more is better". This view is reflected not only in our merger decisions, but also in our decisions on de novo branch applications.

The FDIC inquiry into the reasonableness of requiring de novo entry begins with the relevant statutory authority for de novo branching in a particular state, but it by no means ends with the discovery that such branching is legally possible. State law, for example, frequently grants existing banks with a home office or even a branch office in a given community protection against outside entry except by merger. If virtually all the desirable communities in a particular banking market are closed to de novo entry by such protective laws, thereby limiting outside banks to unattractive locations in sparsely populated sections of the market, the FDIC would not consider it reasonable to require or expect de novo entry by the outside bank. [10/] Assuming no significant statutory barriers, the FDIC would next examine the economic feasibility of de novo branching within the market. Is there, in other words, sufficient deposit potential within a reasonable period of time to make the establishment of a de novo branch attractive and profitable to an outside bank?

10/ Questions of precedent and structure over a broader area might still result, however, in the denial of the proposed merger. See the discussion below at pages 23 et seq.

Obviously, the general affluence of the area, its economic health and the competition an outside bank can expect to encounter in the market are relevant to this determination. Most de novo branches operate at a loss for the first year or two after they open, and the profit to be derived from the branch in subsequent years must be large enough to offset these initial losses and also earn a reasonable return on the bank's investment. Taking these factors into account, the FDIC would not consider it reasonable to require de novo entry into a market of average income levels where the population for each existing office was 4,000 persons or less and only limited population growth was projected over the years ahead. On the other hand, in a fast growing market where the income levels are substantially above the nationwide average, the fact that the population served by each existing office is 4,000 persons or less would not be controlling. A significant new industrial park or an unusual concentration of industrial, commercial or service activity would obviously affect our views of the deposit potential available for a de novo office. Similarly, a projected growth in the market's population of 10,000 persons per year would probably result in a different conclusion as to the feasibility of de novo branching than a population growth of only 1,000 persons per year or less, even if the population per office existing at the time of the application approximated 4,000 persons of average income.

If the outside bank seeking to enter a market were significantly smaller than the largest institutions already established in that market, the FDIC would generally not consider it reasonable to require that bank to enter de novo, since it could easily find itself at a substantial disadvantage, vis-a-vis the established banks, as it seeks to penetrate the market. Similarly, the Corporation would not consider it reasonable to require de novo entry by a bank without branches or without the managerial or financial resources necessary to make a successful entry starting from scratch.

Once satisfied that de novo entry is legally possible, economically feasible and competitively within the capabilities of the outside bank, the FDIC attempts to assess whether the absence of de novo entry by the bank in question would have any significant anticompetitive consequences over the long term within the market. If, for example, the outside bank which seeks to merge a leading local bank is one of a significant number of potential de novo entrants, many of whom are of larger size than the applicant and all of whom have had successful de novo branching experience, particularly in neighboring markets, the FDIC would tend to downgrade the competitive importance of having the applicant, as distinct from these other potential entrants, enter de novo. Our reasoning would be that even if additional competitors of significant size were desirable in the market, other banks are even more likely potential entrants through de novo branching than the applicant. Similarly, if the market in question, although highly concentrated in two, three or four banks in terms of the market shares of local deposits and loans they hold, also contained a significant number of other large banks or of affiliates of large multibank holding companies, the FDIC would consider it less important that the applicant make its entry de novo rather than by merger.

In the process of determining the attractiveness of the market for de novo entry, the capacity of an applicant to enter by that route rather than by merger, and the structual importance that it be required to do so, the FDIC is also likely to form a judgment as to the probability of such entry if the merger is denied. We would base our conclusion in this regard on such factors as recent de novo branching activity on the applicant's part, the proximity of its existing offices to the market in question, the attractiveness of that market for an expansion-minded bank relative to other areas also open to it for de novo branching, and any past demonstrations of interest by the applicant in entering the same market.

In some applications, the management of a significant potential entrant vehemently denies any intention to enter the market de novo if its proposed merger is denied. And usually, quite plausible business reasons can be offered to support this representation. The FDIC listens to such representations--with I think understandable skepticism--and weighs them against the more objective criteria I have mentioned. We recognize, for example, that acquiring an established and viable bank already operating in the desired market may be less expensive and more immediately profitable to the outside bank than entry by de novo branching. But the initial operating losses and the investment in physical facilities required for de novo entry can be quite modest and well within the applicant's financial capability. Moreover, the priorities established by a bank's management under one set of circumstances can well change as important circumstances change. Unforeseen business developments may improve significantly the desirability, as far as the bank's management is concerned, of one possible market for de novo branching as against others. The activities of competitors may force a change in previous priorities of the bank's management for de novo branching, while an improvement in the bank's profit margins may permit a more aggressive expansion program than was originally thought possible by its management. And, of course, an agency denial of its proposed merger may require a reconsideration of the bank's previously expressed intention not to enter de novo.

In my view, a public agency reviewing a bank merger application should reach an independent judgment on the relative attractiveness of a particular market for de novo entry and the likelihood of an applicant's entry by that means if the merger is denied, even if that judgment differs with the express intentions of a bank's management. Neither the agency nor the applicant bank can be certain of what the future holds, but if the entry of additional competitors of meaningful size is important for greater public choice and for the deconcentration of banking resources in a particular local market, there is good reason to weight the scales against approval of a proposed merger which would significantly limit the opportunities for such entry: a merger once consummated is irreversible whereas a denial is not. A future change in a State's banking laws, for example, might permit Statewide branching or merging or the operation of multibank holding companies on a Statewide basis, where bank expansion previously was limited to a single county or multicounty region of the State. The effect of this change would be to increase dramatically the number of potential entrants of meaningful size into many local banking markets previously restricted to banks in the same county or some adjacent area. A merger could be quite properly denied prior to the change in State law, but approved subsequently. Even without a change in State law, competitive developments within the local banking market or within the branching area which includes it, subsequent to denial, might dictate a reversal of the agency's prior decision. The luxury of reexamination, however, is not available if the proposed merger is initially approved.

As this implies, the agency must make its judgments on the basis of State law and the competitive situation in a given area as it finds them at the time of decision. You may be surprised to learn that after completing the many facets of its analysis into the reasonableness of requiring *de novo* entry rather than permitting entry by means of the merger proposed, the FDIC found a *significant* loss of potential competition between the two banks involved in only four applications for "market extension" mergers during the last two and one-half years. Three of these applications resulted in an FDIC denial,[11/] while the fourth resulted in an FDIC approval--solely because the potentially anticompetitive effects in one local banking market were outweighed in our judgment by the potentially procompetitive effects in a much more populous and economically vigorous market.[12/] The FDIC, in addition,

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11/ *The Citizens and Southern Emory Bank* and *The Citizens and Southern Bank of Tucker*, 1971 FDIC Annual Report 152 (finding related to original acquisition in 1965); *Continental Bank* and *Bank of Pennsylvania*, 1971 FDIC Annual Report 155, affirmed on reconsideration, August 18, 1972; and *The Pennsylvania Bank and Trust Company* and *Union Bank & Trust Co.*, FDIC opinion B-24, July 14, 1972.

12/ *First Seneca Bank and Trust Company* and *Lawrence Savings and Trust Company*, 1971 FDIC Annual Report 116.

approved three other "market extension" mergers even though acquisitions by the "most likely" potential entrant were involved because the agency concluded that the relatively small size of the acquired bank in its market made the acquisition tantamount to de novo entry.[13/] One explanation for the relatively few cases in which FDIC has insisted on de novo entry rather than entry by means of the merger proposed may lie in the fact that the "most likely" potential entrants into a highly concentrated local market are not usually State nonmember banks at all, but national banks whose applications must be decided by the Comptroller of the Currency. I prefer to think the statistics are some indication of the common sense and caution FDIC brings to its analysis of the "potential competition" doctrine.

The discussion of de novo entry up to this point has assumed that the two banks seeking to merge operate in different banking markets. I would note, however, that significant potential competition between two banks may be eliminated by their merger even if they operate in the same market, since de novo branching by both banks in the future within that same market may bring them into increasing competition in the future. In assessing the probability of such de novo branching, the FDIC goes through an analysis

13/ Suburban Trust Company and National City Bank of Baltimore, 1970 FDIC Annual Report 63; The Connecticut Bank and Trust Company and The Columbus Industrial Bank, 1971 FDIC Annual Report 100; and Union Trust Company and The Winthrop Bank and Trust Company, FDIC opinion B-22, July 14, 1972.

similar to the one I have outlined in "market extension" cases. Thus, in three of the seven mergers denied by FDIC because substantial existing competition would have been eliminated, the elimination of significant potential competition between the two banks in the future through *de novo* branching in the same market was also cited, thereby providing a subsidiary reason for FDIC's action.[14/]

III. FUTURE STRUCTURE AND THE ALTERNATIVE MERGER

When an agency denies a bank merger because it eliminates a substantial amount of existing competition within a local banking market, it acts to preserve the number of meaningful competitors in that market and to prevent a significant increase in the market resources held by the acquiring bank. Its decision must of necessity reflect the view that the market structure proposed by the merger is undesirable --either because it is illegal or because it may adversely affect customers in the market. When an agency denies a bank merger because it believes *de novo* entry by one bank into the market where the other operates should be required instead, its decision must of necessity reflect the view that the existing structure of that market is not as desirable as one in which a greater

14/ *United Mutual Savings Bank* and *State Mutual Savings Bank*, 1970 FDIC Annual Report 134; *Westminster Trust Company* and *The Union National Bank of Westminster*, 1971 FDIC Annual Report 147; and *American Bank and Trust Co. of Pa.* and *Lebanon County Trust Company* (FDIC opinion B-15) (May 31, 1972).

number of meaningful competitors are offering banking services to the public. It acts, not to prevent a reduction in the number of options available to bank customers, as in the first case, but to encourage an increase in such options. In both cases, however, the agency is expressing its concern for the structure of competition in a local banking market and for the number of meaningful options available to the public.

This concern for structure is inherent in any effort to apply antitrust principles to proposed bank mergers. Indeed, judgments about market structure have been assumed, if not expressly stated, in the merger decisions of the Supreme Court for a long time--first as to industrial mergers and more recently as to bank mergers. This being the case, agency efforts to maintain or even improve the number of meaningful options available to the public within a local banking market have been generally applauded as proper objectives of public policy even if the wisdom of specific decisions are debated. What is more controversial today is whether the agencies have any obligation under Section 7 or, barring that, any discretion under the Bank Merger Act, to consider the likely impact of a proposed merger on competition in the future within a geographic area broader than the local markets currently being served by one or more of the applicant banks.

The FDIC believes it has that obligation and that the competitive impact of a given merger has not been fully analyzed until its likely effect in that broader area has also been assessed. What area is it that we consider relevant for this purpose, and why?

In the 34 States which permit some form of Statewide banking, i. e., Statewide branching or merging or Statewide operation of multibank holding companies, the FDIC considers the entire State to be this broader geographic area. In States like Pennsylvania, Indiana and Kentucky which permit only more limited forms of branching, the FDIC considers the county or multi-county region within which branching or merging is permitted as the area in addition to the local banking market which should be examined. In unit banking States, no further inquiry is necessary so long as multibank holding companies are not permitted. Thus, the broader area examined by FDIC is the widest geographic area under State law within which the banks involved in a proposed merger may merge, branch de novo or have bank holding company affiliates.

Why do we consider this broader area relevant and important, even if economists would say it is not technically a "banking market"? There are several reasons. First, the statutory language of both Section 7 and the Bank Merger Act places restraints on proposed acquisitions the effect of which "in any section of the country may be substantially to lessen competition". It is not at all clear to us how the mandate given the agencies and the courts under this formula can be given effect unless the competitive impact of the proposal is examined not merely in the local banking markets where the two parties have their existing offices but also in that section of the country where they can, under State law, have offices or affiliates in the future.

Secondly, the Supreme Court has recognized that the branching area open to two banks under State law may help to define the relevant geographic market for purposes of assessing the competitive impact of their merger[15/] -- without apparently realizing that in many States this area can differ markedly from the area in which two merging banks actually operate offices. Thirdly, it is the area from which any list of potential entrants into a particular local banking market must be drawn. The identification of the "most likely" potential entrants, as we have seen, may have a critical bearing on the significance to be attached to any loss of potential competition between two parties to a proposed merger, one of which might reasonably be expected to enter the other's market by de novo branching if the merger is denied. And finally, since the broader area is the only area from which new competitors can arise in the future to challenge those banks or bank holding companies with significant competitive advantages already in terms of financial strength and management diversity, the failure to place restraints on the acquisition of significant local banks by the largest banks or holding companies presently operating in the broader area can prevent smaller and intermediate size banks from ever mounting a serious challenge to these larger organizations and can even serve to widen the existing gap in resources between these larger organizations and their

15/ United States v. The Philadelphia National Bank, 374 U.S. 321, 361 (1963).

nearest competitors. Let me illustrate with the following not-so-hypothetical example.

State X has one major banking market and 10 smaller ones, all economically separate. Five banks hold about 75% of the commercial bank deposits and loans in each market, although individual market shares may range from 10% to 25%. The five banks in the State's largest banking market are significantly larger than any of the other banks, but none has more than 10% of the State's total commercial bank deposits or loans. Each is considering major expansion moves now that the State Legislature has changed State law so as to permit multibank holding companies, Statewide merging and/or Statewide de novo branching.

Obviously, the competitive structure of commercial banking in that State ten years from now will depend in large measure on how the supervisory agencies react to acquisition proposals presented by the State's five major banks. If each sought to acquire a leading local bank in the ten smaller markets, and all such acquisitions were approved, State X could well have only 5 Statewide banks each of which operated in all eleven markets with no significant competition from any smaller bank and no significant potential entrant left that might seriously challenge them in any market in the future. Now some customers in each of the smaller banking markets would probably find the range and quality of their banking services improved, with no change in the number of meaningful options previously available to them. Other customers, however, who might have had 10 or 15 meaningful options available to them previously in two or three adjacent markets would find that their options had been reduced to 5. In addition, instead of holding 75% of the deposits and loans in one market, the State's 5 largest banks might now hold 75% of all commercial bank deposits and loans in the State, and the largest might have 20% or more of the total. A similar hypothetical, on a smaller scale, could be constructed in a State which moved to countywide or regional branch banking.

Fortunately, structural changes in banking rarely occur quite so fast or quite so symmetrically. But the sceptre of Statewide oligopoly is not as far-fetched as some may imagine. The State of Virginia, for example, changed its banking laws in 1962 to permit Statewide merging and Statewide bank holding companies. The <u>amicus curiae</u> brief which Virginia filed with the United States Supreme Court in the <u>Greeley</u> case[16/] points out some of the things that have since occurred. The number of independent banking units in the State, predictably enough, declined significantly--from 303 at year-end 1960 to approximately 180 early in 1971. The number of competitive alternatives in the State's 50 largest cities (which range in population from the 5,300 in Emporia to almost 308,000 in Norfolk) increased from an average of 2.82 to an average of 3.96 over this same period. The deposit share of

16/ <u>United States v. First National Bancorporation et al</u>, Docket No. 71-103.

the largest local bank in six of the State's larger cities (Norfolk, Richmond, Alexandria, Newport News, Lynchburg and Roanoke) declined in a range from 8.6 to 17.5 percentage points as other large organizations entered these cities by acquisition. However, since acquisitions of leading local banks have been repeatedly authorized for the State's five largest banking organizations, their share of total bank deposits in the State also increased, from 27.5% at year-end 1960 to approximately 51.7% in early 1971. The brief expresses the view that despite this increase in Statewide concentration ratios, competition within local banking markets in Virginia has improved significantly since 1962.

The brief fails to mention that in 8 of the State's 15 largest cities three or more of the State's five largest banking organizations represent the majority of banking options available to local residents,[17/] that in 12 of these same 15 cities those banks which are among the State's five largest controlled more than 50%, and in many cases more than 75%, of all local deposits as of June 30, 1970,[18/] and that very few leading banks in any of these cities remain available for

17/ I.e. in Arlington, Chesapeake, Falls Church, Lynchburg, Norfolk, Petersburg, Roanoke and Virginia Beach.

18/ The cities involved and the percentage share of total citywide deposits held as of June 30, 1970 by those banks which are among the State's five largest banking organizations are as follows: Alexandria (55.7%), Charlottesville (53.3%), Chesapeake (85.5%), Danville (53.2%), Hampton (73.0%), Lynchburg (58.7%), Newport News (86.2%), Norfolk (89.7%), Petersburg (89.2%), Richmond (72.0%), Roanoke (60.8%) and Virginia Beach (83.9%).

acquisition by some other banking organization.[19] What is more, it is not at all clear that the acquisition of these remaining lead banks by one or more of the State's five largest organizations will be prohibited.

In North Carolina, to take another example, where the State's largest banks have been authorized numerous acquisitions of leading banks in local markets, Statewide concentration ratios have increased significantly in recent years. In 1960 the State's five largest banks held 56.2% of the State's total commercial bank deposits, a figure which had risen to 66.6% by year-end 1970. Here as in Virginia, the claim has been made that Statewide banking has dramatically improved competition in local banking markets throughout the State, by giving local residents a significantly greater number of alternatives from which to choose their banking services. Yet the fact remains that in 9 of the State's 15 largest cities two or more or these same five banks represent the majority of banking options available to local residents,[20] that in 12 of these same 15 cities those banks which are among the State's five largest controlled more than 50%, and in many cases more than 75%, of all local deposits

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19/ In fact only 10 banks having approximately 15% or more of total city-wide deposits remain independent in these 15 cities: 2 in Charlottesville, 1 in Chesapeake, 1 in Danville, 1 in Hampton, 2 in Portsmouth, 1 in Richmond and 2 in Roanoke.

20/ I. e., in Greensboro, Winston-Salem, High Point, Asheville, Fayetteville, Gastonia, Wilmington, Burlington and Rocky Mount.

as of June 30, 1970,[21/] and that very few leading banks in any of these cities remain available for acquisition by some other banking organization.[22/]

The question remains whether a bank agency which reviews the "market extension" mergers of the largest banks in a State or branching area should be concerned about these longer run structural developments so long as no existing competition between the parties is eliminated and so long as *de novo* entry by the larger bank is not viewed as a reasonable alternative.

The FDIC believes the answer to this question should be "yes" for a number of reasons. First, it seems incongruous to bar mergers in a local banking market under the antitrust laws that might lead to a concentration of assets approaching 19.2% of the market total and yet permit similar increases in concentration over even broader geographic areas such as a State or a multi county regional branching area.[23/] Is an oligopoly of larger units

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21/ The cities involved and the percentage share of total citywide deposits held by those banks which are among the State's five largest are as follows: Asheville (86.3%), Burlington (89.2%), Charlotte (94.7%), Durham (52.1%), Fayetteville (66.6%), Greensboro (98.9%), Greenville (86.6%), High Point (69.7%), Raleigh (92.2%), Wilmington (84.0%), Wilson (52.3%), and Winston-Salem (99.4%).

22/ In fact, only 8 banks having approximately 15% or more of total citywide deposits remain independent in these 15 cities: 1 in Durham, 1 in Gastonia, 1 in High Point, 2 in Kannapolis, 2 in Rocky Mount and 1 in Wilson (which also has more than 15% of citywide deposits in Fayetteville). Of these 8 banks, three represent the State's seventh, ninth and tenth largest banks.

23/ *A fortiori*, if a large bank in a populous and economically vibrant local market, branching area or State already has 19.2% of the banking resources in its local market or branching area, it would seem even more incongruous to permit it to acquire another bank of *any* size within the same local market or branching area, absent *most* unusual circumstances. The future growth of such a bank might properly be limited to *de novo* expansion and internal growth.

operating over a larger area somehow less offensive under the antitrust laws than an oligopoly of smaller ones operating in a local market? Secondly, it is obvious that every merger of a leading local bank approved for one of the largest banks in a State or branching area prevents some other bank or bank holding company from acquiring the same local bank. Since the largest banks in a given State or branching area are usually the ones best able to make the most attractive offers to smaller banks, such approvals encourage further acquisitions by the same banks of leading banks in other local markets. The effect of a series of such mergers is to deny to intermediate-sized banks and bank holding companies important building blocks they may need to become truly effective and significant competitors as against the largest banks in a given State or regional branching area. At the same time, such mergers may widen the gap in resources and area coverage between the largest banks and their nearest competitors in the intermediate-sized ranks.

By contrast, a different merger policy, which prevents the acquisition of leading local banks by those already well in the competitive lead within the larger Statewide or regional area and encourages their acquisition instead by intermediate-sized organizations, could lead in my hypothetical example to 10 or 15 effective Statewide competitiors, rather than 5, and to local banking markets in which the number of meaningful options available to local residents was substantially larger than the 5 such options presently available to them. It would attempt, in other words, to maximize, rather than minimize, the number of significant competitiors in each of the markets involved.

Such a merger policy proceeds on the basis that potential competition between two banking organizations can become actual competition in the course of time not merely by the entry of one de novo into the markets served by the other, but by one or more alternative mergers as well. Thus, in my hypothetical, if the acquisition of a leading local bank by one of the State's five largest were denied, the applicant might turn to a smaller, less significant bank in the same market, whose acquisition would bring it into actual competition with the lead bank it had previously sought to acquire. The latter might in turn be acquired by a banking organization headquartered in the same city as the State's five largest banks, thereby improving its capabilities in that market as against the five largest. Or it could be acquired by a bank holding company operating outside the major city which was seeking to improve its competitive capabilities before attempting to enter the State's largest market and to compete there with the State's five largest banks. In each of these cases, banks not previously in competition could become actual competitors in the future.

The FDIC recognizes that pursuing such a merger policy may involve a trade-off in many cases between immediate improvements in banking service and competition in a particular local market and the longer-term possibility of even more vigorous competition and a significantly greater number of meaningful options for residents of many local markets. The FDIC also recognizes that a merger policy which seeks to maximize the number of significant competitors in local markets throughout a State or regional branching area assumes that most local markets can profitably absorb a greater number of competitors than they have today -- an assumption the Corporation's research efforts and experience with de novo branching would indicate to be well-founded. Given this choice, between limited improvements in service and competition in a particular local market and the longer-run possibility of much greater competition and public choice in a larger number of local markets, FDIC has opted for the latter, and this policy is reflected in our three remaining denials, each of which was primarily concerned with some aspect of Statewide or regional structure.[24/]

24/ Bank of Hawaii and Hawaii Trust Company, Limited, 1970 FDIC Annual Report 137; Washington Mutual Savings Bank and Grays Harbor Savings and Loan Association, 1970 FDIC Annual Report 141, aff'd on reconsideration, 1971 FDIC Annual Report 164; and Chittenden Trust Company and Lamoille County Bank, FDIC opinion B-19, June 13, 1972.

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Despite this lengthy discussion of the competitive factors considered by FDIC in its action on merger applications that come before it for decision, I would restate in conclusion what the statistics of our merger decisions show -- that in the vast majority of cases, we find no significant anticompetitive effects from proposed mergers, and this is true in both "single-market" and "market extension" cases. When this preliminary conclusion has been reached, FDIC approval is readily given to an application since virtually any improvement in banking service, even for limited numbers of bank customers, will suffice as a demonstration that public needs and convenience will be served. On the other hand, when a contrary conclusion has been reached on the competitive factors, it is unlikely that an applicant will be able to demonstrate sufficient benefits to the community to warrant FDIC approval.