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Remarks of J. L. Robertson

Member of the Board of Governors
of the
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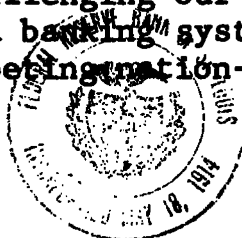
Bank Mergers in Perspective

Let me begin by speaking as if I were one who is unalterably opposed to bank mergers: Since I was born - a half-century ago, give or take a few years - the population of the United States has about doubled. Economic growth has been even greater. Gross national product has increased fivefold. The amount of money in circulation today is more than ten times what it was. And the total resources of the American banking system have risen from $22 billion to almost $300 billion. But what has happened to our banking system, structurally? In 1920 our country had over 30,000 banks; today we have less than half that number. Every year hundreds of sound and serviceable independent banks disappear, having been absorbed by bigger institutions. Can anyone doubt, in the face of these facts, that the American banker is moving away from the free and open competitive system that has helped the country achieve its miracles of production, distribution, and general prosperity?

Now I must change the pitch - in both voice and substance - and talk like somebody else, one of those who seem to think that bank mergers are our only salvation. The question now becomes: How did our country ever achieve so much with such an antiquated banking system, and how much longer can we afford to pay the high price for this outmoded arrangement? When the National Banking System was established a century ago, perhaps a banking structure composed of thousands of small institutions was necessary. Since that time the population of our country has changed from overwhelmingly rural to overwhelmingly urban. When we cut the pattern of our banking system, there were no such things as the telephone, the automobile, or paved roads. Developments such as these should have obliterated the individual small-town bank, just as they did the local independent telephone system that served my home town, Broken Bow, Nebraska, when I was a boy.

Germany, France, Canada, Japan, England, Italy - countries that are now challenging our economic pre-eminence - each has a streamlined banking system in which from three to eleven vigorously competing nation-wide banks control the



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bulk of the commercial banking resources of the country and are geared to serve nation-wide industry both at home and abroad. A country as rich as ours perhaps could afford the luxury of having several times as many banks as the rest of the world combined, were it not that the iron law of relative efficiency is making the small unit bank more and more of an anachronism. The constantly increasing complexity of banking problems, the greater scope that larger organizations can offer promising young men, the advantages of electronic accounting that can be afforded only by institutions with tens of thousands of customers - all make it increasingly clear that the small local unit bank has outlived its place in our economy.

There you are! I have tried to speak the part, successively, of those who feel that the bank merger movement, unless arrested right now, will spell the doom of the free enterprise system, and those who contend that people who oppose bank mergers and cling to unit banking today are like those who opposed the internal combustion engine in 1911 and stood firmly behind the horse.

But let me warn you, the impressive generalities on both sides must be analyzed with plenty of skepticism. For example, a few minutes ago, without speaking a word of untruth, I gave you a completely false impression by failing to mention certain additional facts and by juxtaposing facts that had no valid relationship to each other. It is true that we had 30,000 banks and now have less than 15,000; it is also literally true that hundreds of independent banks disappear through merger every year. But the overwhelming majority of the thousands of banks that are no more, disappeared not as a part of the modern merger movement but simply because they became insolvent during the banking trouble of thirty years ago.

And look at some of the arguments I made <u>in favor</u> of mergers. I attempted to wring your hearts by conjuring up a picture of thousands of small, inefficient banks in which feeble octogenarians were making shaky entries in handwritten ledgers, trying to put off for a few more years the inevitable liquidation. But such banks are figments, as we all

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know. I made no mention of the real problem of mergers among large banks fully able to afford and utilize electronic accounting and with no management succession problems. And most important, I carefully avoided any reference to the conviction of many economists that by reducing the number of competing banks in a market area we inevitably reduce also the vigor of banking competition and the general benefits to the economy that result from competition.

Well, so much for the need for skepticism; I may have spent too long on a point that preoccupies me more from year to year - the fact that truth is a most elusive commodity. What I hope to do this morning is to marshal, in perspective, a few relevant truths, so that when we do reach conclusions on the bank merger problem, they will be realistic evaluations rather than a hodgepodge of emotional generalities.

Why do banks merge? In the early 30's, which is as far back as my banking memory extends, most mergers were rescue operations. A relatively strong bank absorbed a weak bank to save it from receivership or liquidation. But since the Second World War most mergers have taken place for quite different reasons. A small family-owned bank may merge with another because the president is old and has no sons willing or able to carry on. Or he may wish to obtain the more marketable stock of a larger bank. Promising young bankers may prefer the supposedly greater opportunities of an assistant vice presidency in a metropolitan bank to the presidency of a small-town bank, or a large bank may want to obtain the services of the president of another large bank through the merger route - this is what is meant by the mouth-filling phrase "problems of management succession".

Often the initiative comes from the larger bank, the one that is absorbing the other (to judge by the size of premiums being paid for banks these days). Sometimes, I suspect, the motive is unadulterated megalomania or foolish rivalry - the driving desire to be the largest bank in the city or state, not the second largest; or even a thirst for power for the sake of power.

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When two relatively large banks in the same city wish to merge, they sometimes emphasize the growing importance of nation-wide banking competition - the need to be able to compete with banks in New York, Chicago, and San Francisco, for example, for the deposits and loans of enormous national corporations that cannot be adequately served, we are told, by banks with only a half billion dollars of resources.

We are all acquainted with the "flight to the suburbs" in metropolitan areas, a flight residential, mercantile, and industrial. Banks stress the need to "follow their customers" away from the business district of the city; and often, we are told, it is safer and cheaper to "branch" an independent suburban or small-town bank than to create what we supervisors barbarously call a "de novo branch".

In very recent years electronic accounting is mentioned more and more frequently as a reason for merging. We are sometimes told that a $20 million bank, for example, cannot efficiently utilize any but the smallest of the marvelous devices we see advertised in "Banking", but that if two or three such banks merge, they can afford to buy and fully utilize full-scale equipment, to the benefit of the banks' stockholders, their customers, and the American economy.

These are some of the reasons - but only some - that are advanced to justify the hundreds of merger proposals we see every year. It would be fruitless to evaluate them generally, for they must be related to the facts of specific cases. Each of these reasons can be very appealing - especially to the superficial observer. Why should an elderly banker, who has spent a lifetime building a successful institution, be forbidden to reap the benefits of hard work and good judgment by "selling" the bank in such a way as to promote the welfare of his family? Who would oppose an arrangement under which several small banks can give superior service to customers and better returns to stockholders, while releasing manpower for other productive use? What

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valid objection is there to a city bank expanding geographically in order to continue to serve its entire growing metropolitan area?

The chief objection, of course, is the characteristically American notion embodied in such hackneyed but meaningful expressions as "the free enterprise system", "freedom of competition", and the like. Unlike most other countries, the United States has adopted as national policy the principle, to put it broadly and without a great many necessary qualifications, that our people will be better off, in the long run, if most areas of our economy are cultivated by a relatively large number of vigorously competing enterprises. Some observers consider this policy especially important in banking; they regard financial concentration as singularly evil because, in addition to its immediate ill effects, it tends to spawn concentration and monopoly throughout the economy.

The American banking system of thousands of independent unit banks, in cities, towns, and villages, developed from the special conditions that existed here during the nineteenth century. There was an enormous country, a constantly advancing frontier, a vigorous pioneering spirit; and the technological revolution exemplified by the assembly line lay in the future. Nineteenth-century America needed banks, not only to serve, as now, to lubricate a massive economic machine - but, more important at that time, to provide the capital that was absolutely essential for the nation's development. I think it was Preston Delano, an outstanding Comptroller of the Currency, and long my revered mentor, who remarked to me years ago that the west was built on the bones of broken banks.

But different epochs have different needs. It is unreasonable to regard the development of branch banking and group banking in the twentieth century as an accident. Besides being a nation on wheels, rolling over an incomparable network of good roads, the American people are uniquely a banking people. With far less than a tenth of the world's population, we probably have more checking accounts than the rest of the world put together. And this simple fact is one

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of the many reasons for the growth of multiple-office banking: the bulk of bank customers are no longer business enterprises, located downtown.

Unless we wish to impede seriously our economic progress, we must bow to change and reality, exemplified in such developments as these. And, to a great extent, we have acknowledged the force of changed circumstances. The unprecedented growth of branch banking attests to this. In 1951 our country had less than 20,000 banking offices; today we have nearly 25,000.

The crucial question is where we should strike the balance between the sometimes opposing forces of convenience, efficiency, and economy on the one side, and the less tangible long-term values of "free enterprise", "individual initiative", and "vigorous competition" on the other.

Under our governmental system, such conflicts of opposing interests - opposing benefits and detriments - are dealt with, for better or worse, by the people's representatives in government - the legislative, executive, and judicial branches, all three. In our system of government, the complexity of this process is multiplied by the fact that we have both sovereign states and a sovereign federal government, often with responsibilities and powers in the same areas of activity.

Each of the fifty states has banking laws and a bank supervisory system. The federal government has at least three. In addition, Congress has enacted antitrust laws, which apply to banking despite its status as a "regulated industry".

Bank mergers have been permissible for many years under both federal and state laws, but these earlier laws seldom enumerate standards or objectives that should guide supervisors in permitting or prohibiting mergers. In those far-off days the supervisor's main concern was whether the continuing bank would be a sound and serviceable institution. The possible effect on banking competition was a secondary consideration.

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Within the past decade "The Bank Merger Problem", in capital letters, has become a major problem - to legislators, administrators, and the public - for the first time. In 1956 Congress enacted a law to "control the future expansion" of bank holding companies, and in 1960 a law that, broadly speaking, requires the approval of one of the three federal supervisory agencies as a prerequisite to any bank merger. A number of states also have enacted laws that parallel, to a considerable extent, the philosophy embodied in the federal legislation.

The Bank Merger Act of 1960 for the first time enumerated factors that federal supervisors must take into consideration in passing upon proposed mergers. The ultimate test is embodied in the statutory provision that the Comptroller, the Board of Governors, or the Federal Deposit Insurance Corporation, as the case may be, shall not approve a proposed merger "unless, after considering all factors, it finds the transaction to be in the public interest."

Seven "factors" are enumerated in the Bank Merger Act. The first six - often called "the banking factors" - are concerned with the quality of assets, adequacy of capital, competence of management, earnings prospects, and "the convenience and needs of the community to be served". Is one of the banks in a weakened condition; is this a rescue operation? Or has it mediocre and unaggressive management, so that its community is not being adequately served? Or is its only executive officer an elderly man, running a bank that cannot afford to replace him at today's salaries? Or, on the contrary, are both banks well-managed, serviceable, and with promising futures, so that there is no "banking need" for the merger? These are a few of the questions that we ask ourselves.

The seventh factor named in the Bank Merger Act is the sign of the times. It deals with the effect that the merger will have "on competition (including any tendency toward monopoly)". Those are the words of the statute; could anything be simpler and more straightforward? As the Senate Committee that considered the Merger Act pointed out

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in its report, competition is "an indispensable element in a sound banking system".

It is only the application of these seven factors to actual cases - the weighing of the favorable and unfavorable aspects of a merger proposal - that is steadily increasing the consumption of tranquilizers by bank supervisory officials.

Occasionally a situation arises in which there is no practical alternative to merger - where, for one of the reasons I have suggested, a bank must either merge with another or go out of existence and deprive its community of needed services. However, the usual case is quite otherwise. There are, let us say, four banks in a small city. All are doing reasonably well, are well managed, and face no serious problems. The second largest and the smallest wish to merge. If the merger is permitted, it is contended, substantial economies and heightened efficiency will result, additional services will be offered to the banks' customers, and the combined bank will be better able to compete with the city's largest bank.

On the other hand, the banking public of the city, of course, would thereafter have only three alternative competing sources of banking services, both on the deposit and loan sides. That is to say, as a matter of arithmetic, the number of competing banks will drop from four to three. And it is clear from the words of the statute, read in the light of its legislative history, that if the proposed merger would lessen competition, it should not be approved unless the favorable aspects of other factors clearly outweigh the adverse "competitive factor" to the extent that the public interest would be promoted by approval.

Just for exercise, I wish each of you would try to decide whether the amalgamation of a certain pair of banks in some four-bank city with which you are familiar, would actually increase or lessen competition, and to what extent. And after you have resolved that preliminary question - perhaps by deciding, as we often must, that "competition will be lessened, but it is hard to say how much" - then go on

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and weigh this imponderable against the benefits you guess may flow from the merger - to both the public and the banks. (But, for the purposes of this exercise, you need not bother weighing any possible benefits secretly offered to bank officers for persuading unsuspecting stockholders to vote for the merger.)

I hope each of you will run through this process, however briefly, with a real situation (other than your own!) in mind, because it will increase your tolerance toward the apparent shortcomings of supervisory decisions regarding bank mergers. We are acutely aware of these shortcomings, and we can only fervently hope that after a few more years' experience we - or our successors - will see through the merger glass a trifle less darkly.

As most of you know, during the past year bankers intent on consummating mergers have encountered serious difficulties quite apart from the apparent inability of some supervisors to make up their minds - either expeditiously, or consistently, or clearly. When state banks that are members of the Federal Reserve System, for example, propose to consolidate, it must seem to them that the course is set up like a hurdle race, with the hurdles higher and higher as they approach the finish line. Under state law, the Banking Commissioner must be persuaded to give his approval. After that obstacle has been surmounted, the awesome Federal Reserve System looms ahead. The Reserve Bank of the district investigates the proposal minutely, and then the Federal Reserve Board must decide whether the merger would "be in the public interest".

On occasion, the Reserve Board concludes that a merger would not be "in the public interest", after the State supervisor has reached the contrary conclusion. This is hard to take, I am sure, but most bankers have come to accept this risk as unavoidable, in a federal system like ours. More painful is the recent experience of certain bankers who successfully ran the gauntlet of bank supervisors, only to be challenged by the Department of Justice under the antitrust laws. These people, I am afraid, are certain that this is bureaucratic muddling run riot.

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I was a lawyer before I was so unwise as to become an administrator, and as a lawyer I can say that, under the presently governing federal statutes, there seems to be no escape from this dilemma - the possibility, now an actuality, that a proposed merger is subject to the jurisdiction of coordinate departments of the federal government and that while one says "Go ahead" the other may say "Verboten". In contrast to the situation in other regulated industries, Congress has decided that bank mergers should be subject not only to the jurisdiction of the bank supervisory agencies but also to the jurisdiction of the Department of Justice and the federal courts under the antitrust laws.

To be painfully logical, the fact that the Comptroller of the Currency concludes that the merger of two Philadelphia banks would be "in the public interest" and the Department of Justice wants to enjoin the merger under the Sherman Act does not mean that the two have reached conflicting conclusions. Under the antitrust laws, the only tests are whether a transaction tends to lessen competition or is what the law considers an attempt to monopolize. Even if the transaction admittedly would be in the public interest for other reasons, the antitrust laws may prohibit it, and it is the explicit duty of the Department of Justice to enforce those laws.

On the other hand, it is perfectly clear, under the Bank Merger Act, that the effect of a merger on competition is only one of the several factors that the bank supervisors must consider. If the FDIC, let us say, finds that a proposed merger will contribute so greatly to the convenience of a community as to outweigh the lessening of competition, from the public interest viewpoint, the FDIC is not only authorized, it is obligated to approve - and promptly - even though other federal agencies may have recommended adversely on the competitive factor. In short, the Department of Justice and the FDIC might assure each other: "You are absolutely right!", and yet the one would say "Yes" and the other would try to persuade the courts to say "No" to the same merger proposal.

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To many people, this is an intolerable situation. They believe that if Congress considers the Federal Reserve Board, for example, competent to decide whether a merger is "in the public interest" when all factors are considered, this should settle the matter, and the merger should not be blocked solely on account of competitive considerations that already have been taken into account by the Board and found to be outweighed by the public-interest benefits.

Others are convinced, and not without reason, that so long as we have multiple banking systems and multiple supervisors, with differing philosophies, we will have conflicting, contradictory, and inconsistent administrative decisions. Hence, they believe that applicability of the antitrust laws is essential if we are to avoid chaos or general disintegration of standards in the maintenance of banking competition.

There are some who hope that the courts' decisions in the pending antitrust suits regarding the Philadelphia and Lexington mergers will settle this aspect of the problem. Despite my optimistic temperament, I doubt that it can be settled otherwise than by legislation. But the litigation will have served a worthy purpose if it does no more than give bank supervisors a better concept of the relative importance of competition in deciding whether a proposed merger would promote the public interest.

In the meantime, we must deal with the merger problem as it is, under existing law. The problem, like most problems that amount to anything, is not susceptible of pat solution. It has already been enlarged and distorted, chiefly due to the absence of sufficient skepticism in analyzing the positions of people who claim that all the valid arguments are on their side.

It is my hope that all of us will profit from the sometimes painful experiences of the past year, and that the banking industry, bank supervisors, and Congress will succeed in working out improved procedures that will regulate bank mergers in ways that will be truly "in the public interest". This problem can be solved if we utilize all our resources of information and intelligence, perseverance and

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perspective, to deal with it as one phase of our continuing effort to maintain a progressive and competitive banking system that is able and willing to meet the needs of a dynamic and expanding economy.

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