
FRBSF WEEKLY LETTER

November 28, 1986

The Wells Fargo-Crocker Acquisition

On May 30, 1986, the largest banking acquisition in history was consummated. Wells Fargo & Company acquired Crocker National Corporation from its parent holding company, Midland, plc. This acquisition combined the third and fifth largest banking organizations in California, and made Wells Fargo the second largest bank holding company in the state. The acquisition involved over 700 branches and \$31 billion in domestic deposits. Nationally, the combination lifted Wells Fargo from eighth to fourth largest in terms of consolidated domestic deposits.

In the past, concern over possible anti-competitive effects probably would have made such a union very difficult, if not impossible. Yet the acquisition gained approval with few complications from bank regulatory agencies and the Department of Justice. Prior to receiving the approval to buy Crocker, Wells Fargo committed to sell only seven small offices with combined deposits of approximately \$225 million, or less than 1 percent of the combined deposits of the two banking organizations.

Why was Wells Fargo able to secure regulatory approval for an acquisition that probably would have been unthinkable only a few years ago? The main reason is the increased acceptance in antitrust analysis of savings and loan associations and savings banks as capable competitors with commercial banks. Indeed, competition from savings and loans in California is probably the single most important factor that made the approval of the acquisition of Crocker by Wells Fargo possible with only minimal divestitures. A secondary reason is that more liberal antitrust standards are being applied to mergers and acquisitions in banking because of greater competition from nondepository financial firms.

Regulators

Wells Fargo's proposal to acquire Crocker was evaluated by three agencies. The Federal Reserve had a central role because Wells Fargo & Company and Crocker National Corporation are bank holding companies. The Office of the Comptroller of the Currency (OCC) reviewed the

application because it is the primary regulator of the nationally chartered Wells Fargo Bank, N.A. — the bank subsidiary of the holding company. The Department of Justice (DOJ) was involved because it has oversight responsibility in anti-trust matters for all types of firms.

Considering competitive effects

Competitive analysis for the Wells Fargo-Crocker proposal centered on the effects of the acquisition in the 36 local banking markets in which the two organizations were represented. These markets comprised all the major metropolitan areas in California as well as smaller rural markets consisting of counties or parts of counties. Before the acquisition could be approved, the regulatory agencies had to determine that the combination of the two banking organizations would not substantially lessen competition or, if it did, that the anti-competitive effects were outweighed by the "convenience and needs" considerations in the communities involved. Convenience and needs factors would be positive if the combination were to improve or expand banking services within the communities in question.

Market concentration

The usual starting point in determining whether a merger or an acquisition in banking might be anti-competitive is the concentration of banking activity in the relevant markets. The traditional belief is that the smaller the number of firms dominating a market, the more likely those firms will be able to raise prices. In other words, when one or a few banks account for most of the activity in a market, they will find it easier to "conspire" (either overtly or covertly) to fix interest rates on loans and deposits. Bank regulators therefore are concerned that increased market concentration will lead to higher interest rates on loans and lower yields on deposits.

Many in economics and the legal profession question the connection between market concentration and anti-competitive behavior. Vigorous competition can exist with only a handful of competitors, or even less. Moreover, attempts

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by private firms to limit competition among themselves tend to be undermined by incentives to cheat on formal or informal agreements to "fix" prices (interest rates) and by the potential or actual entry of new competitors. As a result, regulators now take a more flexible view of the relation between concentration and anti-competitive behavior for antitrust purposes.

Nevertheless, evidence regarding market concentration continues to play a key role in the approval of merger or acquisition applications. In fact, the Department of Justice has established guidelines indicating when a merger or acquisition likely would be challenged based on the impact on market concentration. In its guidelines, the DOJ uses the Herfindahl-Hirschman Index (HHI) for measuring concentration. The HHI is the sum of the squares of the percentage point shares of the firms in a market. With one firm in a market, this index would equal its maximum value of 10,000 ($100\%^2$). If there were three firms in a market with market shares of say, 50%, 25% and 25%, respectively, the HHI would fall to 3750 points ($50\%^2 + 25\%^2 + 25\%^2$). As the number of firms increases and the market shares of individual firms shrink, the HHI approaches its theoretical minimum of zero. Thus, a higher HHI indicates greater market concentration.

New antitrust standards

Under DOJ guidelines, only markets with HHIs of greater than 1800 points are considered highly concentrated. In February 1985, the DOJ indicated that it is not likely to challenge bank mergers and acquisitions unless the HHI after the merger is 1800 or higher and the combination of the banking organizations increases the HHI by at least 200 points.

This standard represented an appreciable relaxation of previous guidelines in recognition of competition from nondepository financial institutions. While these institutions are not included directly in the calculation of market shares used to determine market concentrations, the DOJ reasons that the provision of financial services by nonbanks should lessen the potential for adverse competitive effects that may result from concentration in banking alone.

The more liberal DOJ guidelines made it somewhat easier for the Wells Fargo-Crocker acquisition to meet approval. Using the new DOJ guidelines and considering only deposits for commercial banks as measures of market shares, potential adverse effects on competition were not issues in 21 of the 36 markets in which the two organizations competed. In contrast, only 15 of the markets involved in the acquisition would have satisfied the pre-1985 standards.

Thriffs as competitors

Along with the new DOJ "yardstick" that accounts for *indirect* nonbank competition, the competitive realities in financial markets caused the DOJ and bank regulatory agencies in antitrust analysis to treat thrifts as *direct* competitors with commercial banks. In the past, antitrust analysis viewed commercial banking as consisting of an integrated, and inseparable, set of activities. Since thrifts (particularly savings and loans) could not offer a full array of bank-like services, they were not treated as *direct* competitors with banks.

Financial deregulation has brought the importance of thrifts as *direct* competitors to the forefront. Savings and loans and savings banks now offer transaction accounts to households and businesses and make consumer, commercial, and industrial loans. The question is no longer whether thrift competition should be weighed when determining the competitive implications of bank mergers and acquisitions, but how heavily.

The Federal Reserve Board generally includes thrift deposits with a 50 percent weight when determining total deposits and market shares. The DOJ separates banking into commercial and consumer activities, and usually assigns thrift deposits a weight of 20 percent for the former and 100 percent for the latter. The Office of the Comptroller of the Currency treats thrifts as full competitors with commercial banks.

Thriffs make the difference

In all the different approaches among the agencies, including thrift deposits in market share calculations radically lowers the measured concentration in most banking markets in California. Using the Federal Reserve's approach, for exam-

ple, the HHI for the banking market in the San Francisco area was about 2000 points before the Wells Fargo-Crocker acquisition, when only commercial banks were considered. The market therefore fit the DOJ's definition of highly concentrated (HHI of 1800 or more). When savings and loans also were included (with a 50 percent weight), the HHI by the Federal Reserve's calculation was around 1200 points.

If thrifts had been excluded, the combination of Wells Fargo and Crocker would have raised the HHI in the San Francisco area by more than 400 points in a highly concentrated market, and therefore would have exceeded the DOJ guidelines mentioned earlier. By considering thrifts, the San Francisco area market remained only moderately concentrated after the combination.

Overall, the explicit inclusion of thrift institutions in the analysis of the Wells Fargo-Crocker acquisition reduced from 15 to 7 the number of markets in which the effects on competition could have been found to be substantially adverse in the absence of any divestitures. The 15 markets would have involved close to \$20 billion in combined Wells Fargo and Crocker deposits, compared to \$1 billion in the 7 markets in which Wells Fargo did make divestitures.

Without the consideration given to thrift institutions in local banking markets in California, approval of the Wells Fargo-Crocker acquisition would have been much more difficult to secure and almost surely would have required the divestiture of substantially more than \$225 million in deposits.

Statewide concentration

The Federal Reserve's analyses of mergers and acquisitions involving large banking organizations often deal with the issue of statewide, and sometimes even national, concentration of financial resources. However, in the Wells Fargo-Crocker case — the largest banking acquisition to date — the concentration of resources was not a major issue in part because banking itself has become less concentrated in California. On a statewide basis, the HHI for banks fell from about 1700 points in 1980 to around 1350 points in 1985. Judged from this lower base, California was moderately concentrated in terms of banking deposits even after the union of Wells Fargo and Crocker, not highly concentrated as would have been true in 1980.

The prominence of thrift institutions in California is another reason that the statewide concentration of resources was not a serious issue in the Wells Fargo-Crocker acquisition. Savings and loan deposits in California are about equal to the total domestic deposits of commercial banks in the state. Moreover, 33 of 49 depository institutions with domestic deposits greater than \$1 billion in California are savings and loans.

As was true for the evaluation of the competitive factors in local markets, the treatment of thrifts as direct competitors with commercial banks helped mute concerns over any concentration of financial resources in California that may have resulted from Wells Fargo & Company's purchase of Crocker National Corporation.

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Opinions expressed in this newsletter do not necessarily reflect the views of the management of the Federal Reserve Bank of San Francisco, or of the Board of Governors of the Federal Reserve System.

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BANKING DATA—TWELFTH FEDERAL RESERVE DISTRICT (Dollar amounts in millions)

Selected Assets and Liabilities Large Commercial Banks	Amount Outstanding	Change from	Change from 11/6/85	
	11/5/86	10/29/86	Dollar	Percent ⁷
Loans, Leases and Investments ^{1 2}	202,548	989	4,935	2.4
Loans and Leases ^{1 6}	182,158	1,130	3,565	1.9
Commercial and Industrial	50,270	958	- 1,054	- 2.0
Real estate	67,000	129	1,416	2.1
Loans to Individuals	39,520	- 91	1,650	4.3
Leases	5,584	- 4	183	3.3
U.S. Treasury and Agency Securities ²	12,520	- 119	699	5.9
Other Securities ²	7,870	- 22	669	9.2
Total Deposits	207,733	4,901	5,960	2.9
Demand Deposits	55,159	4,475	6,155	12.5
Demand Deposits Adjusted ³	37,826	2,351	- 7,264	- 16.1
Other Transaction Balances ⁴	18,398	950	3,669	24.9
Total Non-Transaction Balances ⁶	134,175	- 524	- 3,864	- 2.7
Money Market Deposit Accounts—Total	46,392	48	913	2.0
Time Deposits in Amounts of \$100,000 or more	32,794	- 358	- 5,802	- 15.0
Other Liabilities for Borrowed Money ⁵	24,574	- 1,370	- 246	- 0.9
Two Week Averages of Daily Figures	Period ended 11/3/86	Period ended 10/20/86		
Reserve Position, All Reporting Banks				
Excess Reserves (+)/Deficiency (-)	21	59		
Borrowings	64	12		
Net free reserves (+)/Net borrowed(-)	- 42	48		

¹ Includes loss reserves, unearned income, excludes interbank loans

² Excludes trading account securities

³ Excludes U.S. government and depository institution deposits and cash items

⁴ ATS, NOW, Super NOW and savings accounts with telephone transfers

⁵ Includes borrowing via FRB, TT&L notes, Fed Funds, RPs and other sources

⁶ Includes items not shown separately

⁷ Annualized percent change