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Statement of

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Chairman, Board of Governors of the Federal Reserve System,

before the

Subcommittee on Domestic Finance

of the

Committee on Banking and Currency

of the

House of Representatives

on

S. 1698

and related bills

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Mr. Chairman, I appear this morning to support the amendment to the Bank Merger Act of May 13, 1960, proposed by S. 1698, as passed by the Senate June 11. The same amendment also is proposed by H.R. 9457 and several companion bills in the House.

These bills--as well as the other, but different, bills understood to be the subject of this hearing--owe their introduction to recent antitrust decisions of the courts and the resultant uncertainties and other problems now existing in the area of bank mergers.

Under the law as declared by these decisions, bank mergers and similar transactions (whether proposed or consummated) are subject to suits to enforce the antitrust statutes. This is true notwithstanding prior approval of the merger application by the appropriate Federal bank supervisory agency pursuant to the Bank Merger Act.

This was the lesson of the much-discussed Philadelphia National Bank decision in 1963 in which the United States Supreme Court outlawed the proposed merger under section 7 of the Clayton Act. (374 U.S. 321) A bank consolidation was held by the Supreme Court in 1964 to violate the Sherman Act in the First National Bank and Trust Company of Lexington case. (376 U.S. 665) Then last March section 7 of the Clayton Act and the Sherman Act were held by the Federal District Court in New York to have been violated by the merger in 1961 of the Manufacturers Trust Company and The Hanover Bank. (240 F. Supp. 867) The merger application in each of these cases had the

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prior approval of the appropriate Federal banking agency under the Bank Merger Act. Other similar cases are pending in the courts.

These decisions under the antitrust laws have made it clear that banks and their customers now face protracted litigation attacking bank mergers that have been approved by a Federal bank supervisory agency under the Bank Merger Act of 1960. In these antitrust suits mergers apparently will be tested on the basis of adverse competitive factors alone, even though the legislative history of the Bank Merger Act shows that, in 1960, the Congress decided that bank mergers should not be judged so narrowly by the supervisory agencies. Instead, the 1960 legislation directed that the effect on competition should be considered along with other factors in determining whether a proposed merger is in the public interest.

The task of harmonizing decisions under the Bank Merger Act with those under the conflicting standards of the antitrust laws will be extremely difficult--if, indeed, it is possible at all. The resulting uncertainties are compounded by the fact that there is no statute of limitations on actions to enforce the antitrust laws. In consequence, bank mergers that took place as long ago as 1950 are now subject to challenge in antitrust suits. If the conflicting standards cannot be reconciled, at least the time within which the Federal Government may take two contradictory positions on the same facts should not extend beyond that reasonably necessary for the banking agencies, on the one hand, and the Department of Justice and the courts, on the other, to discharge their statutory responsibilities.

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As originally introduced, S. 1698 would have amended the Bank Merger Act so as, in effect, to exempt from the antitrust laws all bank mergers hereto or hereafter approved under that Act. Antitrust exemption would have been given also to all bank mergers consummated before enactment of the Bank Merger Act. H.R. 7563 and several companion bills in the House are identical with S. 1698 in its original form.

Correction of the situation along these broad lines was the thrust of my testimony on S. 1698 last May before Senator Robertson's Subcommittee. However, both the Board's report on the bill and my testimony offered an alternative approach for consideration with respect to future mergers in the event the original version of S. 1698 proved unacceptable.

S. 1698 in its present form (and the identical House bills) treats future mergers along the lines of the alternative offered by the Board. While not providing a complete antitrust exemption for future mergers, the bill would eliminate any need to unscramble them. The bill would do this by staying the consummation of a proposed merger for 30 days following approval of the application by the appropriate Federal banking agency under the Bank Merger Act. If the proposal were not challenged by the filing of a suit under the antitrust laws during the 30-day period, it could then be consummated and would thereafter be exempt from the Clayton Act and the Sherman Act. If a suit were instituted during that period, the proposal could not be consummated until conclusion of the litigation, and then only to the extent consistent with the final judgment in the case.

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Except in an emergency situation, the Attorney General (as well as the other two banking agencies) has 30 days under the Bank Merger Act to supply the agency responsible for acting on the merger application an advisory report on the competitive factors involved. Accordingly, the Attorney General would be assured in virtually all cases a minimum of 60 days in which to review a merger proposal if S. 1698 were adopted. In practice, the period in almost all cases would be even longer.

The Bank Merger Act dispenses with the need for the action agency to request advisory reports on competitive factors if the case involves a probable bank failure, and reduces to 10 days the period for supplying such reports if an emergency requiring expeditious action is involved. In such cases, the 30-day stay in the bill for consummation of a merger is subject to similar exceptions.

Finally, the Senate-passed bill (like the original version) would exempt from the antitrust laws all bank mergers consummated prior to its enactment. But, the exemption would not apply where the bank resulting from the merger has been dissolved or unscrambled pursuant to a final judgment in an antitrust suit.

Another bill before you (H. R. 8388), differs from S. 1698 in certain respects. Under H. R. 8388, antitrust exemption would not be given to any merger--past or future--approved under the Bank Merger Act as to which the Attorney General either brought, or published his intention to bring, an antitrust suit within 7 days following

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approval of the application. If the Attorney General only published his intention to sue, then the 7-day period would be lengthened to 30 days during which suit could be filed.

Since November 1961, the Board has had a published rule staying consummation of mergers for 7 days following Board approval, except in special situations. (12 CFR 262.2(f)(5)) I would doubt, however, that--as to future mergers--the above procedure of H. R. 8388 would be an acceptable alternative to the 30-day-stay provision of the Senate bill. No objection has been raised to the 7-day rule in any cases considered by the Board thus far, but freezing it into the statute seems inadvisable. Cases might arise where a longer time is needed.

With respect to past mergers under the Bank Merger Act, the above provisions of H. R. 8388 differ very materially from the Senate bill. As already noted, the exemption in the Senate bill for past mergers as to which antitrust litigation is pending would free the banks involved from further proceedings under the antitrust laws, regardless of when suit was filed. This would not be true, of course, under H. R. 8388. As stated above, I support the Senate bill.

The Bank Merger Act prohibits the merger, consolidation, acquisition of assets, or assumption of liabilities of one Federally insured bank with or by another such bank without the prior approval of the Comptroller of the Currency, the Board, or the Federal Deposit Insurance Corporation, depending on whether the resulting, acquiring, or assuming bank is to be a national bank, a State member bank, or a nonmember insured bank.

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The Act requires the appropriate agency to take into account several specific factors in determining whether to approve or to disapprove a merger application. Thus, in every case the agency must consider, as to each of the banks involved, its financial history and condition, the adequacy of its capital structure, its future earnings prospects, the general character of its management, and whether its corporate powers are consistent with the purposes of the Federal Deposit Insurance Act. In addition to these so-called "banking factors", the appropriate agency must also consider, as to each of the banks involved, the convenience and needs of the community to be served, and the effect of the transaction on competition, including any tendency toward monopoly. The agency may approve the transaction only if, after considering all 7 statutory factors, it finds the transaction to be in the public interest.

I have already referred to the advisory reports on the competitive factors involved in merger cases that the action agency is required by the Act to request from the other two banking agencies and the Attorney General before granting or denying merger applications. The Board, of course, gives careful consideration to these reports in determining whether to approve or disapprove applications under the statute. However, the legislative history of the Act stresses that the reports are limited to the competitive factors only, that they are purely advisory, and that they are not recommendations as to what actions should be taken by the banking agencies on merger applications.

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As I testified before the Senate Subcommittee last May, the original version of S. 1698, in a very real sense, would have merely restored to the bank merger situation the rules that were generally understood to apply at the time of adoption of the Bank Merger Act and until the court decisions already mentioned. The history of the Act leaves no doubt as to this in my view, and there surely can be no doubt as to the authority of Congress to do so.

S. 1698, as passed by the Senate, essentially, would restore those rules as to past mergers. It would not do so as to future mergers. But, as to future mergers, the bill would avoid any necessity for unscrambling. Certainly, the same history that supported the Senate bill, as introduced, also supports the present bill.

The competitive effects and implications of bank mergers obviously were the major reasons prompting enactment of the statute. A main emphasis of the entire legislative history--and rightly so--is that competition is an indispensable element to a strong and progressive banking system. This and the important gaps that existed prior to 1960 in the Federal law governing bank mergers were stressed as the reasons why legislation was necessary.

The most troublesome issue in formulating the Bank Merger Act was the standards by which the legality of bank mergers was to be tested. As the Committee reports explain, sections 1 and 2 of the Sherman Antitrust Act prohibit unreasonable restraints of trade in interstate commerce and monopolies and attempts to monopolize in

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any parts of such commerce, while corporate acquisitions in the circumstances described in section 7 of the Clayton Act are prohibited where the effect may be substantially to lessen competition, or to tend to create a monopoly. However--and to re-emphasize--it is abundantly clear from the legislative history that Congress did not want the legality of bank mergers to be tested by adverse competitive factors alone, to the exclusion of banking factors and offsetting benefits to the public. Indeed, the Congress understood specifically that there would be situations in which "approval of the merger would be in the public interest, even though this would result in a substantial lessening of competition." (S. Rpt. No. 186, April 17, 1959, pp. 19-24; H. Rpt. No. 1416, March 23, 1960, pp. 10-13)

Nevertheless, the recent court decisions involving bank mergers have underlined the fact that, in the antitrust field, such matters as banking factors and offsetting benefits to the public are virtually ignored. This, of course, marks the basic difference between the responsibility of the Federal banking agencies under the Bank Merger Act and the antitrust functions of the Attorney General and the courts. In deciding a case under the Bank Merger Act, the action agency must arrive at a balanced decision of approval or disapproval based upon a consideration of all of the factors specified in the Act. Sound banking and the needs and convenience of the public, as well as effect on competition, must be taken into account. To process merger cases in a way which, essentially, would give consideration only to adverse

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competitive effects, to the exclusion of other proper considerations under the statute, would be contrary to the responsibility vested in the action agency by the Act.

No exemption from the antitrust laws is contained in the Bank Merger Act. When the Act was passed in 1960, there seemed to be little reason for such an exemption. Efforts in Congress in 1956 to make section 7 of the Clayton Act applicable to banks were not successful. As the legislative history of the 1960 Act clearly shows, it was generally agreed at that time that section 7 of the Clayton Act, as amended by the Celler-Kefauver Act in 1950, was inapplicable to bank mergers, normally accomplished through asset acquisitions rather than stock acquisitions. For example, testimony for the Department of Justice was that section 7 "is little help" in stopping bank mergers because it "covers bank stock--not bank asset--acquisitions". (Hearings on S. 1062, House Committee on Banking and Currency (1960), p. 162) In addition, there was little or no experience by which to judge the usefulness of the Sherman Act in dealing with bank mergers.

In its deliberations on the legislation that became the Bank Merger Act, the Congress specifically rejected proposals that antitrust standards be adopted as criteria for approvals of bank mergers. Also rejected by the Congress was a proposal that the Attorney General be permitted to intervene and obtain court reviews in bank merger cases pending before the Federal banking agencies. Instead, the Congress decided that the proper role for the Department

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of Justice in bank merger cases would be fulfilled by submitting advisory reports on the competitive factors to the banking agencies for consideration by them in deciding whether to approve or disapprove merger applications.

The special needs and characteristics of banking is the central theme running throughout the legislative history. It was emphasized that banking is a licensed, strictly regulated, and closely supervised industry that offers problems acutely different from other types of business, whether regulated or not. A high degree of public confidence is peculiarly essential to a sound and vigorous banking structure. Because of considerations such as these, the Congress in enacting the Bank Merger Act deliberately chose to place the authority to approve or disapprove bank mergers in the Federal banking agencies. The report of your Committee on the Bank Merger Act stated that the "bill vests the ultimate authority to pass on mergers in the Federal bank supervisory agencies", because of their thorough knowledge of banks and the banking business. (H. Rpt. No. 1416, March 23, 1960, pp. 9-10) It is particularly apropos that the Senate Committee said: "The advance approval factor is important in halting bank acquisitions before they are consummated and in preserving the depositors' confidence in an institution which might otherwise be destroyed by an attempt to unscramble assets after an acquisition has been completed." (S. Rpt. No. 196, April 17, 1959, p. 22)

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In six instances suits are pending under the antitrust laws to unscramble a bank merger. To my mind, the key point in these cases is that it is impossible to restore the situation that existed before the merger took place. One bank has replaced two banks. But a Federal court order cannot recreate the two banks that formerly existed, nor can it compel any bank customer--whether he has become a customer since the merger or was a customer of one of the former banks--to do business with either of the two new banks. Two new banks would require two new charters, which could be issued only by the Comptroller of the Currency or the State bank supervisor. If the two new charters were issued, presumably some of the depositors would leave their accounts in one or the other of the new banks to which they had been allocated in the unscrambling process, but almost certainly some of them would not. Very likely some would switch, instead, to the other newly-created bank or to some different bank. For most depositors, this would be a relatively easy matter, depending on their preference in banking services. But for borrowers it could well pose hardship. For example, a loan commitment from the bank being unscrambled might exceed the loan limit of either of the two newly-chartered banks.

If the bank to be unscrambled were acting as executor of a will, or as trustee for an irrevocable trust, apparently it would require legal proceedings in a State court to substitute a new executor or trustee, which might be neither of the two new banks. The situation is further complicated by operating and personnel

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problems, such as how to retain competent officers who are asked to choose between attractive offers from established competitors and an uncertain future with a smaller, newly-chartered bank. For these reasons, no matter how one may feel about whether the merger should have taken place in the first instance, there is no turning back. To unscramble the resulting bank clearly poses serious problems not only for the bank but for its customers and the community. Considerations such as these clearly support the antitrust exemption in the bill for mergers already consummated, as well as the prospective features of the bill.

I hope, Mr. Chairman, that your Subcommittee will favor the approach to the problem approved by the Senate, and that such a measure will be promptly enacted.

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