Is the Bank Merger Regulatory Review Process Ripe for Change?

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While a more streamlined process may be desirable, many competing interests mean that the road to change will likely be long.

In this renewed era of megamergers, including the recent mergers of Bank of America Corporation/FleetBoston Financial Corporation and JPMorgan Chase & Co./Bank One Corporation, we again revisit the extensive burden of the regulatory approval process. The existing process is complex with differing competitive analysis by banking agencies and the Department of Justice (DOJ). The Gramm-Leach-Bliley Act of 1999 (GLBA) and its amendments to the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (HSRA) add the Federal Trade Commission (FTC) to the competitive review process when certain merging companies have competing nonbank subsidiaries. In addition, more often than not, in megamergers there are attempts by states, community groups and public officials to stall or at least extract concessions from parties in order to meet their own agendas. Further, some of the larger institutions are now facing nationwide and state deposit cap restrictions. Lawmakers on both sides are calling for change. Is the process ripe for change?

This article will describe the more controversial elements of the merger approval process—the competitive review, the convenience and needs review and the interstate banking review. Each description will be followed by a short discussion of the controversy each review invokes and its effect on the regulatory review process. This article concludes that the process is ripe for change but that such a change will be viewed as controversial and likely be a long time in the making.

Summary of Regulatory Requirements

The federal banking agency approval process, even for a routine or friendly bank merger, may take up to six to nine months under the Bank Holding Company Act (BHCA), if the transaction involves the merger of financial and bank holding companies, or the Bank Merger Act, if the transaction involves the merger of the banks themselves. Because most transactions involve the merger of holding companies under the BHCA, the Federal Reserve Board ("Fed") usually will review the merger application.

In its review of the proposed bank merger, the BHCA requires the Fed to consider the effect of the merger on competition in the markets affected by the proposed transaction. The Fed also must consider the financial and managerial resources and future prospects of the merging banks and the convenience and needs of the communities to be served. In addition, the Fed must consider the merging companies’ anti-money-laundering...
records. Finally, the Fed must ensure compliance with interstate banking laws, including nationwide and state deposit share limitations.

Competitive Review

The most complex and time-consuming part of the regulatory review process is the competitive review. If the Fed concludes that the merger will substantially lessen competition, tend to create a monopoly or be in restraint of trade, it is required to deny the application unless it finds that the anticompetitive effects are “clearly outweighed” in the public interest by the convenience and needs of the community. If consummation of the transaction would result in a monopoly, the BHCA requires the Fed to deny the application, regardless of other considerations.

Though the bank merger laws were drafted with language identical to the federal antitrust law for nonbank mergers, Congress did not intend for the bank merger laws to supplant the federal antitrust laws. As a result, the DOJ has the responsibility to conduct an independent competitive review of a bank merger proposal under the federal antitrust laws.

Fed Antitrust Review

The Fed’s analysis of competitive effects focuses on the market concentration levels found in the defined product and geographic markets of the merging institutions. Drawing its support from established U.S. Supreme Court precedent, the Fed defines the product market as a cluster of products and services denoted by the term “commercial banking.” Also drawing from Supreme Court precedent, the Fed recognizes that the geographic market for this cluster is local in nature. Considering a number of factors, including, among others, population density, worker commuting patterns and advertising patterns of financial institutions, the Fed has predefined banking markets. Using deposits as a proxy, market concentration is measured by the Hirfindahl-Hirschman Index (HHI), which assigns a numerical rating ranging from 1 (least concentration) to 10,000 (monopoly) to rate the postmerger level of competition present in the relevant predefined markets.

The federal banking agencies and the DOJ have jointly developed merger guidelines to facilitate the competitive review. These guidelines are used to identify proposed mergers that clearly do not have significant adverse effects on competition. Using these guidelines, the Fed generally will conclude that there will be no excess market concentration if the HHI is less than 1,800 and the concentration level does not change by more than 200 points. If the excess market concentration exceeds this threshold, the Fed will determine if there are factors present that mitigate or lessen the anticompetitive effects of the transaction. Such factors might include the quality and quantity of the competitors remaining in the market, the presence of large full-service thrift institutions or credit unions, the existence of actual competition by nonbank or out-of-market institutions, the attractiveness of the market for entry and ease of market entry. Where mitigating factors are insufficient to alleviate competitive concerns, divestiture may remedy such concerns. Divestitures typically involve the sale of branches with their attendant deposits and lending portfolios. While expressing a preference for divestiture to out-of-market buyers, the Fed typically leaves the branch selection and terms and conditions of divestiture agreements up to the applicants.

Although it considers all views and recommendations from other banking agencies and interested third parties, the Fed makes its own decision on the antitrust and other issues raised in the application. The Fed may decide to approve the application even if a third party has announced its intention to block the merger in court on anticompetitive or other grounds. If the Fed gives approval, however, the merger may not be consummated before the 30th day after approval. This 30-day period gives the DOJ, among others, the opportunity to review and object to the transaction. If a suit to block the merger under the federal antitrust laws is to be commenced (by the DOJ or a third party), it must be done during this 30-day period.

DOJ Antitrust Review

Like the Fed, the DOJ analyzes the effect a bank merger (particularly a merger between institutions in the same market) would have on competition in the relevant product and geographic markets. The DOJ analysis of the proposed merger ordinar-
ily begins within the time period of the banking agency’s review but can carry over into the 30-day period after banking agency approval. The DOJ also uses the HHI to measure market concentration in the relevant markets. The DOJ has advised the banking agencies that it generally will refrain from challenging bank mergers unless the HHI exceeds the 1,800/200 threshold. However, even though the DOJ performs its analysis using the same statutory language and merger guidelines, the DOJ’s analysis of a bank merger’s competitive effects differs markedly from the analysis employed by the Fed. In addition, the DOJ’s treatment of the divestiture remedy is inconsistent with that of the Fed.

The major difference in analysis lies with the definition of the relevant product market. As noted above, the Fed defines the market as the cluster of products and services denoted by the term commercial banking. In contrast, the DOJ divides the product market into two separate and independent markets: the consumer market providing bank services aimed at the individual customer and the business market focusing on services to business customers. Breaking the cluster down even further within the business product market, the DOJ closely scrutinizes the effect the proposed merger would have upon small and medium-sized business customers and their ability to reasonably obtain banking services.

The DOJ product market distinction is important for several reasons. First, more limited market definition raises the market concentration level by eliminating or largely discounting noncommercial bank competitors from the HHI calculation. For example, the Fed, believing that savings associations have become, or have the potential to become, significant competitors of commercial banks, routinely weights the deposit of all thrifts as a group at 50 percent or higher in its calculation of the competitive effect of other banks in the relevant market. The Fed also will factor into its analysis any nonbank institution that it believes exerts a competitive influence in the relevant market. In contrast, the DOJ asserts that few thrifts compete in the business product market, although they compete with commercial banks in the consumer product market. Moreover, the DOJ holds to the long-standing belief that federal law greatly restricts the degree and scope to which thrifts can engage in commercial lending. As a result, the DOJ accords little or no weight to thrift deposits in its calculation of the competitive effects in a relevant market. This approach also leads the DOJ to conclude that other financial institutions, such as credit unions and finance companies, should not be included in the calculation of market concentration because they do not offer the full range of services provided by commercial banks.

Second, the DOJ’s focus on the effect a merger will have on small- and medium-sized businesses (as opposed to the business market as a whole) further narrows the list of banking competitors in a market. In other words, the DOJ could discount from its competitive impact analysis other area banks that the DOJ believes do not provide adequate or convenient banking services to small- and medium-sized businesses. This approach gives the DOJ the latitude to object to an in-market merger even in areas in which the HHI calculation would suggest relatively low market concentration.

Third, these differences affect the DOJ’s definition of geographic market. Limiting the product market to small- and middle-market business lending often leads to a smaller geographic market and, as a result, a more concentrated market than that analyzed by the Fed. Another notable difference in analysis, unrelated to market definition, is the DOJ approach to divestitures. While the DOJ does accept divestiture as a potentially sufficient antitrust remedy, the DOJ is involved in all aspects of the divestiture process. In order to ensure that viable competitors emerge from the divested branches, particularly competitive in the business loan market, the DOJ may select the assets and branches to be divested, select a “competitively suitable buyer” and dictate the terms and conditions of divestiture.

The result of these largely incompatible analyses has, in the past, led to an inevitable clash—the Fed approving bank mergers only to have them challenged by the DOJ on antitrust grounds.

**FTC Review**

Traditionally, bank mergers themselves have been entirely exempt from the premerger notification and waiting period requirement of the HSRA. Because Fed approval also was required for the nonbank portion of such mergers, the HSRA
only required a contemporaneous filing with the FTC and DOJ for that portion of the transaction. The GLBA amended the BHCA to permit certain “financial activities” without prior Fed approval. The GLBA then amended the HSRA to require premerger notification filings and waiting periods for transactions involving financial activities that meet certain thresholds yet do not require Fed approval. The filing requirements can be burdensome and the fee for filing the notification is substantial. In addition, if the FTC or DOJ requests additional information, the statutory 30-day waiting period can be extended for an additional 30 days after the date in which all the requested information has been received. It is not clear at this time what additional burdens an FTC review will bring because the market for these nonbank activities currently is unconcentrated. This will be an area to watch as consolidation continues and these markets become more concentrated.

State Review

Even if the DOJ consents to the Federal Reserve’s approval, the merger may still face a challenge at the state level under the federal and/or state antitrust laws. Where federal antitrust law was meant to address the direct and immediate postmerger effect on competition, state antitrust laws are often more broad and may be interpreted by state attorneys general to include the protection of consumers from potential long-term effects on economic growth and employment and may include “net new benefit” requirements for merger “approval.” Even if the antitrust statutes are not so broad, the states often have different incentives and interests, including non–antitrust and nonbanking agendas. Where states are seeing homegrown banks acquired by large, out-of-state banks, there are concerns for job loss and decreases in revenue from the relocation of large business units and corporate headquarters to other states.

State agencies, acting through their banking department, antitrust division or both, have been closely monitoring bank merger activity, especially mergers involving out-of-state acquirers. Some state antitrust divisions (most recently Massachusetts and Connecticut) have criticized the Fed’s application of antitrust laws and have indicated an intent to challenge Fed-approved mergers that the state deems anticompetitive. There are strong arguments that states may stay a federal approval order pending court decision. Recognizing that concessions to the state may be less expensive than an antitrust lawsuit, states have used the threat of an antitrust action to obtain concessions from the merging companies that are beneficial to the state. For example, the Connecticut state attorney general, in the 1999 Fleet/BankBoston merger and in the 1995 Fleet/Shawmut merger, was able to extract community reinvestment programs by threatening antitrust actions.

Some question the legality of this approach, arguing that the states’ agenda is beyond the scope of antitrust law and the bank merger analysis requirements. The states argue that federal antitrust law does not preempt that of the states. Right or wrong, to avoid undue complication or delay, ensuring the states’ interests are met in a bank merger has become a very real and necessary part of the regulatory process.

Convenience and Needs Review

The BHCA also requires the Fed to consider the convenience and needs of the community to be served, as well as the records of the relevant insured depository institutions under the Community Reinvestment Act (CRA). The BHCA provides no criteria or standards for the convenience and needs analysis. In evaluating the convenience and needs of the communities to be served, the Fed considers all substantive written comments as well as concerns raised at Fed-conducted public hearings. While the BHCA and the CRA do not require public notice or an opportunity for public comment in bank merger transactions, the Fed has determined that public participation in the process is important because it provides the Fed with, among other things, useful information regarding the effect of such transactions on the relevant communities. As a result, the Fed will consider all timely and substantive comments. A comment is substantive if it does not involve individual complaints or raise frivolous, previously considered or unsubstantiated claims or irrelevant issues. For a merger that would
otherwise qualify for the 30-day streamlined review process, a substantive public comment will throw the merger into the extended review process. The Fed, in its discretion, may grant a timely written request for a public hearing upon a showing that a written presentation would not suffice in lieu of a hearing, specific identification of any questions of fact that are in dispute and a summary of the evidence that would be presented at the hearing.

The CRA sets no standards for the evaluation of a bank’s contribution to the needs of its community but rather encourages institutions to meet the credit needs of the local communities in which they are chartered—consistent with safe and sound banking practices. The Fed has consistently held that approval is predicated on a satisfactory record of performance under the CRA, and the focus of the analysis is on the applicant’s existing record of helping to meet the credit needs of its CRA assessment areas, including consideration of the CRA performance records of the parties and the programs the parties have in place at the time the Fed reviews a merger proposal.

Community Groups

One or more outside (and usually vocal) parties often seek to be heard and influence the process. Community activist groups, such as the Association of Community Organizations for Reform Now (ACORN), Greenlining Institute and Inner City Press/Community on the Move, may be expected to object to an in-market transaction if they perceive that community lending or local ownership will suffer if the merger goes through or if the acquirer has a less than satisfactory CRA record. Additional concerns include the likelihood of branch closure in low- and moderate-income neighborhoods, reduced community development, any involvement with the subprime lending market and compliance with fair lending laws. These groups have been very successful in extracting community lending commitments and other concessions from bank acquirers in exchange for not challenging a merger. For example, in the most recent Bank of America/Fleet and JP Morgan Chase/Bank One megamergers, in anticipation of such objections, the companies announced community development initiatives ($750 billion and $800 billion, respectively) just prior to Fed-scheduled hearings. In addition to funding for community development initiatives, community groups also have been able to obtain commitments from merging institutions to cease certain activities, including the funding of certain businesses deemed predatory.

As noted above, there are no statutory standards for the convenience and needs analysis. Though not required by statute, the Fed has set up a system for public comment. While the Fed considers all substantive comments, in the final analysis it does not appear that the Fed has rejected a merger proposal based on these comments. However, the effect of the community groups is very real. At a minimum, the community groups can create negative publicity and throw a merger into an extended review process. The desire to avoid this can be great, as evidenced by the substantial community development initiatives unveiled by Bank of America/Fleet and JP Morgan Chase/Bank One in these recent mergers.

Public Officials

Public officials (both state and federal), particularly in high-profile megamergers, may call for hearings or investigations of a merger in order to ensure the merged entity will remain committed to affordable housing and other community development initiatives. Where large CRA commitments are becoming common in megamergers, officials are increasingly demanding state-by-state and project-by-project breakdowns. In addition to CRA commitments, public officials are seeking commitments to maintain premerger employment levels as a community need—a difficult proposition considering efficiency layoffs are an integral part of a merger. Further, the scrutiny may continue postmerger as public officials are increasingly monitoring compliance with premerger commitments. In the case of Bank of America/Fleet, this has led to additional postmerger hearings and a call by some lawmakers for a toughening of the merger approval process.

As previously noted, there are no statutory standards for the convenience and needs analysis, and the CRA analysis requires a review of the existing record rather than forward-looking commitments. Therefore, the focus of the officials is arguably outside the scope of the statutory approval requirements and is not likely to lead to disapproval of the
application under the current law. However, such protests do create negative and potentially damaging publicity. In the case of Bank of America/Fleet, while the stock has not been affected, the negative publicity has been noted by Wall Street analysts.

**Interstate Banking Review**

The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 amendment to the BHCA (Amendment) prohibits the approval of an interstate proposal if the applicant controls, or upon consummation of the merger would control, more than 10 percent of the total amount of deposits of insured depository institutions in the United States. The Amendment also prohibits a bank from controlling 30 percent or more of the deposits in any state and permits the states to adjust this ceiling up or down. The Amendment does not prevent a company from exceeding the nationwide deposit cap through internal growth and effective competition for deposits or through acquisitions entirely within the home state of the company. The intent of the Amendment was to help guard against undue concentration of economic power. Bank of America, in its recent acquisition of Fleet, bumped up against the nationwide cap. J.P. Morgan Chase ran into the state limitation in its recent acquisition of Bank One.

Issues raised in both of these mergers include the proper basis for the calculation of deposit market share and the ability of the acquiring bank to shift around or sell deposits to bring themselves under the cap. There is growing debate as to whether the cap should be raised or even abandoned. Opponents of such a move, including the Independent Community Bankers Association who fought hard to establish the cap, argue that the cap prevents the creation of giant banks that would endanger the deposit insurance fund. Opponents also argue that such a move would limit or diminish the range of meaningful choices available to consumers. Some regulators question the wisdom of curbing consolidation, arguing that market forces should determine the evolution of the banking industry. An additional argument for raising or eliminating the cap is that such a move will allow U.S. banks to continue to be in the world’s top rankings, which some say is in the national interest. The intensity of this debate should rise as consolidation continues and more of the large banks bump up against this cap.

**Conclusion**

The banking agencies and the DOJ, interpreting identical statutory language, can achieve vastly different results. States, community groups and public officials seeking to fulfill their own agendas can stall the process to obtain concessions that arguably are outside the scope of the bank merger and federal antitrust laws. The nationwide and state deposit caps placed 10 years ago may soon be an impediment to expansion. While not currently an issue, as consolidation of certain holding companies continues, the FTC will play an increasingly important role in assessing the nonbank portion of these transactions. A more streamlined process that provides standards and limits for all interested parties and addresses the realities of the marketplace would improve the process. Pursuant to the Economic Growth Recovery and Paperwork Reduction Act, the federal bank agencies continuously review the process looking for ways to make it more streamlined. Some changes may be undertaken pursuant to rule making; others will require action by Congress. Some lawmakers have, in fact, called for a toughening of merger regulations to include more rigid CRA requirements; a review of the full economic effects of the merger, including job losses; and the possibility of binding premerger commitments. Others are questioning the rationale for the deposit cap amid rumors that some of the larger banks are lobbying for its repeal. The process is definitely ripe for change. At a minimum, a review of the regulatory process should ignite some lively debate. However, with so many competing interests, the road to change will likely be long.