

# How do the Federal Reserve and the U.S. Department of Justice, Antitrust Division, analyze the competitive effects of mergers and acquisitions under the Bank Holding Company Act, the Bank Merger Act and the Home Owners' Loan Act?

## FAQs

This document offers information about how the Federal Reserve and the U.S. Department of Justice, Antitrust Division (Division) conduct their statutory responsibilities to evaluate the competitive effects of mergers, acquisitions, and other transactions when determining whether to approve these applications. Given the increase in applications to acquire or merge following the recent recession and changes to the application process resulting from passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, this document should be especially useful for banking organizations that are contemplating acquisitions.

The discussion begins by focusing on the Federal Reserve's application review process and the factors considered by the Federal Reserve in its competitive review. The discussion then explains the role of the Division. The reviews by the Federal Reserve and the Division, while independent, are for the most part very similar. However, there are minor aspects of the review that differ, and the document concludes with questions covering these potential differences. The discussion focuses on applications filed under the Bank Holding Company (BHC) Act, the Bank Merger Act and the Home Owners' Loan Act. These types of applications include mergers and acquisitions that can affect the competitive environment in retail banking markets and that in some cases may raise competitive concerns. Analysis of competitive effects in wholesale and nonbanking markets – which may be local, regional, or national in scope – is undertaken on a case-by-case basis and should be discussed with Reserve Bank or Board staff, and the Division.

The FAQs below provide a basic outline of the application review process. Each application, however, is unique and is evaluated based on the circumstances of the specific transaction involved. If you have questions that are not addressed below, please contact your **Federal Reserve Bank** or the **Board of Governors** and the **Division**.

### **1. Where do I submit an application under the Bank Holding Company Act or Bank Merger Act?**

Applications should be sent to the Reserve Bank in the district in which the applicant's headquarters office is located.

## 2. Under what circumstances should an application be submitted?

The primary types of applications received by the Federal Reserve under the Bank Holding Company Act, Bank Merger Act and the Home Owners' Loan Act include<sup>1</sup>:

Statute and Section	Type of application*
Bank Holding Company Act 3(a)(1)	Formation of a Bank Holding Company (BHC)
3(a)(2)	Bank to become a subsidiary of a BHC
3(a)(3)**	BHC to acquire a bank
3(a)(4)	BHC to acquire the assets of a bank
3(a)(5)**	BHC to acquire or merge with another BHC
4(c)(8)	BHC to engage in nonbanking activities (including acquiring a savings association)
Federal Deposit Insurance Act (Bank Merger Act) 18(c)**	State member bank to acquire another insured depository institution
Home Owners' Loan Act 10(e)**	Savings and Loan Holding Company (SLHC) to acquire a federal savings association  SLHC to acquire or merge with another SLHC
Change in Bank Control Act	Change in ownership of a bank
Depository Institution Management Interlocks Act	Overlap of management between BHCs or SLHCs
* Other types of applications or notices may require an analysis of competition	
** Applications of these types are most likely to raise competitive issues	

<sup>1</sup> Applications by savings and loan holding companies to acquire a nonbank depository institution are filed under the Home Owners' Loan Act, 12 U.S.C. § 1467a.

### **3. What is the initial step in evaluating competitive effects of an application?**

The competitive analysis of banking acquisitions begins with an initial screen based on market shares and market concentration for the local banking markets in which the parties to a transaction have overlapping operations. Market shares for a local banking market are based on the deposits of the depository institutions in the market, as discussed in question 4, below. The Herfindahl-Hirschman index (HHI) is the usual measure of market concentration and is calculated as the sum of squared market shares in a local banking market. The definition of local banking markets is discussed in questions 10-13.

### **4. When can an application be approved by the Reserve Bank and when is an application reviewed by the Board of Governors?**

To expedite the review and approval process, the Board of Governors delegates approval authority to the relevant Reserve Bank for applications that pass certain initial screens. These screens include those that indicate the likely competitive effects of the transaction. Once an application is received, the Reserve Bank determines whether the application can be approved under delegated authority.

The Board's delegation criteria for competition state that an application cannot be approved by a Reserve Bank under delegated authority and must be reviewed by the Board if (i) the merger or acquisition would raise the HHI by 200 points or more to a level of 1800 or higher in any local banking market in which the parties to a transaction have overlapping operations, or (ii) the merger or acquisition would increase the post-transaction market share for the acquiring firm to more than 35 percent in any overlapping market. Other factors unrelated to competition also can preclude Reserve Bank approval under delegated authority.

The initial HHI calculations are based upon deposit shares of the depository institutions in a local banking market. For these *initial* calculations, the deposits of all institutions with a commercial bank charter receive 100 percent weight and the deposits of all institutions with a thrift charter (i.e., savings banks and savings and loan institutions) receive 50 percent weight in computing market shares.

### **5. Why do thrift deposits receive 50 percent weight in the preliminary HHI/market share screen?**

Because thrifts typically have not provided a full range of retail banking products and services provided by commercial banks, their deposits are given 50 percent weight. In addition, thrifts have not been active in commercial lending, as legal restrictions historically have limited commercial lending by thrifts. Although these legal restrictions have been relaxed to some extent, many thrifts remain less active competitors than commercial banks in commercial lending markets.

The one exception to the partial weighting of thrifts in the initial screen is when a thrift is a subsidiary of a BHC. In such situations, the thrift is assumed to operate as an integral part of its parent and receives 100 percent weight, as do all commercial banks.

**6. What happens if my application exceeds the delegation criteria in one or more local banking markets?**

If an application exceeds delegation criteria in one or more local banking markets, then the application cannot be delegated to the Reserve Bank for approval, and it must be acted upon by the Board of Governors. Board and Reserve Bank staff provide an analysis of the competitive effects of the transaction to the Board members, who vote to approve or deny the application. A simple majority vote is required for Board Action.

**7. Where can I find information about Federal Reserve banking markets and calculate market shares and HHIs for a possible transaction?**

The Federal Reserve Bank of St. Louis maintains a website called CASSIDI™ (<http://cassidi.stlouisfed.org/>) that includes up-to-date information about Federal Reserve banking markets for all 12 districts. CASSIDI™ also allows calculation of preliminary market shares and HHI changes for potential transactions.

Note that for an application that does not meet the initial delegation screen for competition, the market shares ultimately considered by the Board in its analysis may differ from the preliminary data presented by CASSIDI™ because they will reflect adjustments made to account for the facts and circumstances of the particular case (see discussion below).

**8. How does the Federal Reserve define antitrust markets?**

An antitrust market is the particular market in which a product or service is sold. There are two aspects to any antitrust market. First, the market includes all products that are considered to be close substitutes by consumers of the product. Second, the market covers the geographic area within which consumers consider providers of the product or service to be close substitutes for each other.

**9. What product markets does the Federal Reserve typically consider for bank merger applications?**

As a result of judicial precedent, the regulatory agencies have adopted a product market limited to the “cluster” of commercial banking products and services.<sup>2</sup> This definition applies to those bank products and services that are provided to most households and small businesses, rather than to those products that are provided to wealthy individuals or major corporations. In certain applications, the Board will investigate the competitive effects in other, more specific product markets, such as credit card issuance or mortgage lending. These distinct product markets have been determined to include products that may be obtained separately from other commercial banking products or services, and whose geographic markets may be regional or national in scope.

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<sup>2</sup> *United States v. Philadelphia National Bank*, 374 U.S. 321, 356 (1963). See also *United States v. Connecticut National Bank*, 418 U.S. 656 (1974); *United States v. Phillipsburg National Bank & Trust Co.*, 399 U.S. 350 (1970).

## **10. How does the Federal Reserve define geographic antitrust markets?**

Consistent with the Horizontal Merger Guidelines issued by the Department of Justice and Federal Trade Commission, the Federal Reserve defines geographic *antitrust markets* based solely on factors related to demand and substitution – i.e., possible consumer responses to changes in the rates, fees, or other characteristics of banking services.<sup>3</sup> As such, consumer substitution behavior, broadly defined, is central to the definition of antitrust markets. The characteristics of the depository institutions matter only insofar as they affect consumer choice.

It is important to note that financial institution “service areas” are not equivalent to antitrust markets. For example, a bank’s branch network may span several local banking markets or cover only a small fraction of a local banking market.

## **11. What data does the Federal Reserve use to measure overall banking activity in a market?**

The primary data used to construct market shares and HHIs for local banking markets are deposits obtained from the Federal Deposit Insurance Corporation’s Summary of Deposits (SOD, available at <http://www2.fdic.gov/sod/>). These data include the location of each branch of all FDIC-insured banking institutions and the dollar value of deposits at each branch. These branch-level deposits allow the calculation of total deposits for each institution in a local banking market. Deposits are considered a reasonable indicator of the level of activity or output of a depository institution, because deposit accounts are widely held by consumers and small businesses and are held in combination with other commercial banking products. In addition, for smaller institutions, deposits may be considered a measure of a bank’s lending capacity.

## **12. How are local geographic banking markets initially defined for a specific transaction?**

The Federal Reserve has divided the United States and U.S. territories into more than 1,500 local banking markets. The Federal Reserve does not define geographic markets that are specific to each application for a number of reasons, including the large number of applications that must be processed; the need for timely processing of applications; and a desire to allow industry participants to reasonably anticipate how the Board will view the competitive effects of a potential application before the application is filed. However, for any transaction, the geographic markets are examined carefully to ensure that the market definitions are appropriate.

## **13. What geographic markets does the Federal Reserve typically consider for bank merger and bank acquisition applications?**

Many geographic markets follow Metropolitan Statistical Area (MSA) definitions or rural county lines, but some markets comprise multiple MSAs/counties or parts of MSAs/counties, reflecting that economic activity does not always track political boundaries. Up-to-date geographic market definitions are available on CASSIDI™ or from staff at the relevant Reserve Bank.

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<sup>3</sup> The Horizontal Merger Guidelines are available at <http://www.justice.gov/atr/public/guidelines/hmg-2010.html>.

#### **14. What information is used to define geographic markets?**

The Federal Reserve uses various information sources to determine the scope of geographic markets. These data focus on economic integration of different regions as it pertains to consumer price sensitivity and willingness to switch banks. The information used most frequently to define geographic banking markets includes commuting patterns, shopping patterns, interviews with local government and business leaders, and surveys of local households or small businesses. These data provide information on where the consumer can practicably turn to for services.

#### **15. Can I dispute the geographic market definition?**

As a matter of course, the Federal Reserve Board and Reserve Banks review market definitions for markets where competitive thresholds for delegation are exceeded to ensure that those definitions are still appropriate. Applicants also may dispute the definition of a geographic market relevant to their application by proposing an alternative market definition and providing evidence supporting the alternative. Such evidence should focus on retail banking customers' substitution behavior or on the economic integration of the relevant economic areas for the proposed geographic market definition.

#### **16. What types of institutions are included in the HHI calculations?**

The preliminary market structure calculations made by the Reserve Bank to determine whether an application meets the delegation criteria for competition include the deposits of commercial banks weighted at 100 percent and the deposits of thrifts (i.e., savings banks and savings and loan institutions) weighted at 50 percent.

For cases that may not be delegated, the Board may choose to give the deposits of *some* thrifts a weight of 100 percent and/or include the deposits of *some* credit unions, generally weighted at 50 percent, as discussed below in questions 17 through 19.

#### **17. When do thrift deposits get 100 percent weight?**

Thrifts that are active commercial lenders with full-time commercial lending staff may receive 100 percent weighting in HHI/market share calculations. Among other factors, Board staff consider the amount of commercial and industrial (C&I) loans made by a thrift, relative to its other lending activities or overall assets, as well as its C&I lending relative to the C&I lending activity of local commercial banks.

#### **18. When are credit unions included in the HHI calculations?**

If an application exceeds the delegation criteria in a given market in the initial screen, Board and Reserve Bank staff will consider whether any credit unions should be included in the structural concentration calculations, because they exert competitive pressure on banks in the market. Credit unions are typically included in these calculations if two conditions are met: (1) the field of membership includes all, or almost all, of the market population, and (2) the credit union's branches are easily accessible to the general public. In such instances, a credit union's deposits will be given 50 percent weight.

## **19. Under what circumstances would a credit union get 100 percent weight in the HHI calculation?**

If a credit union has significant commercial lending and has staff available for small business services (special tellers, lending officers, business-only teller windows, etc.), then its deposits may be eligible for 100 percent weighting. To date, it has been very rare for a credit union's deposits to receive more than 50 percent weight.

Total C&I lending as a percentage of assets is an important factor in this consideration. The C&I lending of a credit union includes C&I loans, unsecured business loans, and unsecured revolving lines of credit for business purposes.<sup>4</sup>

## **20. What happens when a bank acquires a thrift?**

If a bank or a BHC acquires a thrift institution, the thrift's deposits are given 100 percent weight in calculating post-merger market shares and HHIs, even if that thrift's deposits were weighted at 50 percent prior to the acquisition. This reflects the Board's expectation that the thrift will be operated like a typical commercial bank after the acquisition and will be an active commercial lender.

## **21. What is a mitigating factor?**

A mitigating factor is a characteristic of a particular market that suggests that the market is more competitive than traditional structural measures would indicate. A transaction with greater structural effects (i.e., a high resulting market share and level of and change in the HHI), would require stronger mitigating factors to allow approval of the application. For example, an application that would result in a change in the HHI of 500 to a level of 2500 in a given market would require stronger mitigating factors for approval than would an application that would result in a change of 210 to a level of 1900.

## **22. What general mitigating factors are considered by the Board?**

In the past, the Board has considered mitigating factors such as (1) the attractiveness of a market for entry or the ease of entry into the market, especially actual de novo entry into the market; (2) the number of competitors; (3) the number of competitors with significant market shares; (4) the effects of a shrinking market; and (5) whether the target bank is failing or experiencing severe financial difficulties. In addition, applications can present unique facts that are deemed to mitigate the structural effects of a transaction.

## **23. What are centrally booked deposits and how does the Board account for them?**

Central booking occurs when a bank records deposits at a central office and does not book the deposits to a branch that is connected to the location of the depositor. As a result, centrally booked deposits of an applicant can overstate the presence of an institution in the local banking market. The applicant should alert Reserve Bank or Board staff about centrally booked deposits when they trigger antitrust concerns. The Board has made adjustments for centrally booked deposits in market share calculations in certain cases where the applicant has provided

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<sup>4</sup> Business loans secured by real estate and construction loans are not counted as C&I loans.

supporting evidence and where similar adjustments can be made to the deposits of other competitors in the market.

#### **24. How does the Board treat government deposits?**

Significant government deposits held at branches in a local market are handled in much the same way as centrally booked deposits. The applicant should indicate that it has significant government deposits in a particular market, and Reserve Bank or Board staff will determine what, if any, adjustments should be made.

#### **25. How does the Board treat specialty banks?**

Depository institutions that provide only specialized services are generally not included in local market share calculations. Such institutions include credit card banks and trust companies. In certain types of applications, the Board may consider these types of institutions when examining competition in product markets.

#### **26. How does the Board treat Internet banks?**

Deposits of Internet banks are generally not included in local market share calculations, because it is not possible, given current data, to determine where the depositors of such banks are located.

#### **27. What remedies are there for a transaction that could be potentially denied for antitrust reasons?**

When staff's analysis suggests that a proposed merger is likely to have significant anticompetitive effects in one or more local banking markets, divestiture of branches in those markets is a potential remedy. A divestiture typically involves the sale of one or more branches, including the assets and deposits associated with those branches, to a third party. An application for a transaction that includes a proposed divestiture that would cause the structural effects of the transaction to meet the delegation criteria for competition (i.e., a change in the HHI of less than 200 points or a post-merger HHI of less than 1800, and a post-merger market share below 35 percent) is unlikely to be denied for competitive reasons. An application accompanied by a divestiture proposal which, after taking into account the effects of the divestiture, does not meet the delegation criteria may be approved based on the presence of adequate mitigating factors. However, there are no general guidelines for determining the level of divestiture that would be necessary to allow the Board to approve a potentially anticompetitive application.

#### **28. What is the role of the Division in reviewing applications filed under the Bank Holding Company Act, the Bank Merger Act, or the Home Owners' Loan Act?**

The Division conducts a concurrent competitive review of the applications and provides comments to the responsible banking agency, such as the Federal Reserve, concerning the competitive factors involved in the proposed transactions. For transactions that are subject to a 30-day, post-approval waiting period, the waiting period may be shortened to 15 days only with the concurrence of the Division.<sup>5</sup> If the Division concludes that a transaction raises competitive concerns, the Division may bring a court action under the antitrust laws to challenge the

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<sup>5</sup> Applications approved under Section 3 of the Bank Holding Company Act and Section 18(c) of the Federal Deposit Insurance Act are subject to a 30-day waiting period. See 12 U.S.C. §1849(b) (1); 12 U.S.C. §1828(c) (6).

transaction. For most cases, the commencement of a court action will stay the effectiveness of the banking agency's approval of the application.<sup>6</sup>

### **29. How does the Division's review of the competitive effects of a transaction differ from the review by the Federal Reserve?**

In the initial screening of the bank applications, similar to the Federal Reserve, the Division performs HHI analysis using SOD data. However, unlike the Federal Reserve, the Division does not have pre-defined geographic markets for screening bank applications, and it reviews the competitive effects of each transaction on a case-by-case basis. The Division may use the Federal Reserve's pre-defined banking markets in its initial review, but it is not bound by those banking markets.

The Division generally reviews the competitive effects of a proposed transaction in each of two product markets: (i) retail banking products and services, and (ii) small business banking products and services.<sup>7</sup> The geographic area in which a retail banking customer is willing to travel for banking services may differ from that of a small business customer. The Division has found that retail banking customers generally prefer to bank where they live or where they work, but small business customers may be geographically more limited. Unlike the geographic market for retail banking customers, the geographic market for small business banking may be smaller than the Federal Reserve's pre-defined banking markets. Accordingly, a transaction that meets the Federal Reserve's HHI delegation threshold still may raise concerns in the Division's review.

### **30. What additional information should be provided in an application to assist in the Division's competitive review?**

In addition to performing HHI analysis for the Federal Reserve's pre-defined banking markets, applicants may wish to perform HHI analysis for each county of overlap. If a transaction would result in a concentration level that exceeds the Federal Reserve's HHI delegation threshold in either a Federal Reserve pre-defined banking market or a county, the parties may wish to provide additional information in the application. Information that would assist in the Division's review includes:

- (i) the amount of business loans, such as C&I loans, booked to the branches of the applicant and the target in the market(s) that exceed(s) the Federal Reserve's HHI delegation threshold;
- (ii) discussion of small business banking competition, including competition from thrifts and/or credit unions;
- (iii) small business loan originations reported under the Community Reinvestment Act ("CRA"), market surveys conducted by the parties, or other data used for measuring market shares of competitors in small business banking.

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<sup>6</sup> See 12 U.S.C. §1849(b) (1); 12 U.S.C. §1828(c) (7) (A).

<sup>7</sup> On a case-by-case basis, the Division also evaluates the competitive effects in other product markets, such as middle-market business banking.

Applicants are encouraged to contact the Division at [antitrust.bank@usdoj.gov](mailto:antitrust.bank@usdoj.gov) to discuss any proposed transaction that may trigger further review by the Division.

### **31. Are thrifts included in the Division's HHI analysis?**

In reviewing the competitive effects of a transaction in the retail banking market, deposits of thrifts generally are included in the Division's HHI analysis and are given 100 percent weight. However, for the small business banking market, thrifts are not included in the HHI analysis unless they provide the full array of banking products and services to small business banking customers. To determine whether a thrift is an active competitor in small business banking, the Division will review the outstanding C&I loans, the product offerings, and the commercial lending operations of the institution. In general, if the C&I loans of a thrift constitute less than two percent of its total assets, the thrift will not be considered an active competitor in small business banking.

### **32. Are credit unions included in the Division's HHI analysis?**

The Division may include the deposits of a credit union in the HHI analysis if the credit union meets certain criteria. Similar to the conditions set forth by the Federal Reserve, to be considered an active competitor in retail banking, a credit union must have a community-based field of membership, making it easily accessible to customers looking for banking alternatives in the market. For small business banking, the Division will evaluate factors similar to those considered in the analysis of thrifts to determine whether a credit union is an active competitor. Unlike thrifts, however, credit unions do not provide deposit data to the FDIC. Reliable branch-level data may not be readily available for HHI calculations. Therefore, in such cases, the presence of credit unions that meet these criteria will be considered a mitigating factor in evaluating the competitive effects of a transaction.

### **33. What happens when the Division determines that an application warrants further review?**

When the Division determines that a proposed transaction warrants further review, the Division will open an investigation. The Division will seek additional information and documents from the parties to the transaction and will conduct interviews with third parties to gain a better understanding of banking competition in the local markets. Additional materials sought by the Division in an investigation from the parties may include:

- (i) branch-level information, such as a description of each branch located in the market(s) under investigation and information concerning the branch operation, service area, and deposits and loans booked to the branch;
- (ii) information concerning the lending operations of the banks, such as the number of commercial loan officers and their outstanding loan portfolios;
- (iii) documents relating to competition, such as market studies, pricing surveys, and lost business reports; and
- (iv) documents concerning the transaction, such as presentations to the board of directors.

In most cases, the Division seeks cooperation from the parties by requesting voluntary production of information and documents. The Division, however, may issue Civil Investigative Demands (subpoenas) in an investigation, if warranted.

**34. When the Division concludes that a transaction is likely to have anticompetitive effects, how are the concerns typically addressed?**

The Division often resolves its concerns by seeking a divestiture of branches, including the total customer relationships (deposits and loans), to another bank. The Division believes that branch divestiture is an effective remedy because it provides a banking alternative and helps to replace the competition lost as a result of the proposed transaction. The Division usually requires that the parties divest the branches of the target institution. The divestiture must provide a branch network with locations that would allow a bank to compete effectively in the market. In addition, the Division imposes obligations on the parties to preserve the divestiture assets and to ensure that the conversion process will not result in significant customer run-off. To minimize customer confusion, the divestiture branches should be conveyed directly from the target institution to the divestiture buyer. Furthermore, the purchaser of the divestiture branches must be approved by the Division as competitively suitable. In certain cases, the Division may seek a remedy other than a branch divestiture to resolve antitrust concerns.

**35. How does the Division implement the remedy?**

Usually, the Division and the parties will enter into a Letter of Agreement (LOA) that sets forth the terms and conditions of a divestiture agreement. The parties will include compliance with the LOA as a commitment to the banking agency in connection with their bank application for the proposed transaction. In addition, the LOA will be incorporated in the Division's report to the banking agency as a condition of the Division's concurrence in approving the transaction.

**36. What happens if the Division cannot resolve its antitrust concerns with the parties through a divestiture agreement?**

The Division and the parties usually are able to reach an agreement to resolve the competitive concerns through a divestiture agreement. But if the Division concludes that a transaction raises antitrust concerns and cannot resolve its concerns with the parties, the Division will issue a report to the banking agency opposing the approval of the bank application. If the banking agency nonetheless approves the transaction, the Division generally has 30 days after the agency approval to challenge the proposed transaction in court.<sup>8</sup>

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<sup>8</sup> See 12 U.S.C. §1849(b) (1); 12 U.S.C. §1828(c) (7).