Department of Justice

STATEMENT OF

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BEFORE THE
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
HOUSE OF REPRESENTATIVES

CONCERNING

THE ROLE OF THE DEPARTMENT OF JUSTICE
IN ANALYZING BANK MERGERS
UNDER THE ANTITRUST LAWS

ON

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Mr. Chairman and Members of the Committee:

I am pleased to have this opportunity to appear here today to discuss competition in the banking industry, and to describe for the Committee the role that the Department of Justice plays in preserving that competition. As I am sure you are aware, there has been a trend in recent years towards consolidation in the banking industry that we expect to continue.

That trend includes mergers of banks who are direct head-to-head competitors. Bank mergers among competitors may raise issues under the antitrust laws, and merit examination by the Department. The Department recently challenged two of those mergers, in Hawaii and Maine, and obtained adequate relief--divestitures that ensured that competition would not be in peril in certain markets.

The Department believes that a competitive banking system is crucial to the health of the banking system itself and to the health of our economy as a whole. The Department has long taken an active and aggressive role in promoting and preserving competition in banking. The antitrust laws will be enforced vigorously in the banking industry, as in all other industries.

Existing antitrust laws are fully adequate to guard against anticompetitive mergers or acquisitions, or other

anticompetitive activity, in the banking industry. The Antitrust Division reviews virtually every proposed bank, thrift or bank holding company merger, consolidation, or acquisition--including acquisitions involving the deposits of a failed or troubled bank or thrift from the FDIC or RTC--in all, between 1,500 and 2,000 transactions each year. So far in 1991, we have processed 1,253 applications.

Most bank mergers do not pose anticompetitive threats. They may in fact be procompetitive, for example, where they bring new and aggressive competitors into a market. The Division does not generally oppose mergers of banks that operate in different geographic markets, or mergers of relatively small banks operating in the same market where that market is not already concentrated. These mergers may provide efficiencies that will reduce the merging bank's operating costs by permitting the merged bank to consolidate back-office operations, or by permitting a bank to diversify and thereby be less at risk from economic downturns in a particular community. Mergers that lead to lower costs should lead to lower prices and better service for consumers.

Mergers between banks with competing operations and substantial market shares in the same communities require careful scrutiny, and may be (and have been) opposed by the Department. When we believe that a bank merger threatens

competition, we investigate that merger thoroughly and advise the regulators of our concerns. If those concerns are not resolved, we challenge the proposed merger in court.

The antitrust laws--including Section 7 of the Clayton Act, which prohibits mergers or consolidations which would tend to reduce competition significantly or tend to create a monopoly--apply with full force to the banking industry, and the Department of Justice has the power to enforce those laws on behalf of the United States. We, of course, are not the only agency committed to preserving competition in the banking industry. The banking laws require bank and thrift regulators to consider competitive effects and to refuse to allow consolidations that present threats to competition unless "the anticompetitive effects are clearly outweighed in the public interest by the probable effect of the transaction in meeting the convenience and needs of the community to be served." (12 U.S.C. § 1828(c)(5)(B)). The Department believes that the "convenience and needs of the community" generally are served by the existence of competition. We therefore consider whether a merger that might appear anticompetitive offers procompetitive efficiencies that clearly outweigh its likely anticompetitive effects.

Both the Division and the regulators approach the analysis of banking mergers through the framework of the Department's

Merger Guidelines. The Division and the banking agencies work closely together in reviewing and investigating bank mergers. It may be helpful if I describe the framework we use to analyze mergers. Our investigations seek to determine whether, after the proposed merger, the firms remaining in the industry will be able to raise the prices paid by customers who cannot or are not likely to find close substitutes for important banking products. We start by identifying the relevant markets--both product and geographic--in which the merging firms compete. Firms may, and in banking often do, compete in many product markets--different types of banking services, including a variety of loans and deposit services for different types of customers--in many communities. Our analysis of relevant banking markets begins by focusing on individual products or services, or combinations of products or services, that the merging banks provide, and determining what other products are available as alternatives to banking products.

Our experience in bank mergers generally, and our recent investigations in several specific cases, have led us to the conclusion that many business customers, especially small- and medium-sized businesses, have a narrower range of product options and suppliers than do individual consumers for many important banking products. We generally refer to these products as business banking products. Where this has been the case, we have focused our primary enforcement attention on

business banking services, including loans and transaction accounts--big-ticket items that involve very substantial amounts of commerce.

Many individuals, on the other hand, have a broader range of product options and suppliers. They can obtain deposit accounts from thrift institutions, credit unions or other financial services providers, and may be able to obtain personal credit or home mortgages from a wide array of lenders or in a large number of forms. Thus, in the recent cases we have not believed that the proposed acquisition would be likely to harm substantially these individual consumers. In an appropriate case, however, we would consider the impact of a bank merger on markets for consumer loans or services.

Our rationale for beginning and focusing our investigation and analysis in these important product areas is that, where important groups of bank customers have few alternatives to bank products and few competing suppliers of such products, the likelihood of anticompetitive price increases is the greatest. Recent research by Timothy Hannan, of the Federal Reserve Board's staff, provides strong confirmation that commercial loan rates to small businesses are indeed substantially higher in cases where such businesses have only a small number of local

commercial banks to which they can turn for their important credit needs 1/

In recent bank merger challenges, the Department was concerned about the competitive effects of the mergers on prices for a range of business banking products. We evaluated the merger in the context of individual services, such as the market for commercial loans to small and medium-sized businesses and the market for business transaction accounts. In addition, we considered whether the assessment would vary if the relevant market were a package or cluster of commercial banking services. We also considered various ways of measuring market share. In the First Hawaiian and Fleet/Norstar cases, it apparently did not matter: No matter which product market we looked at, no matter which measurement we used, there would have been a significant increase in bank concentration in several local geographic markets. We found in our First Hawaiian case, for example, that only the very largest businesses in Hawaii could obtain credit from mainland banks, and then only when they were seeking to borrow $5 million or more. And we found in Fleet/Norstar that small and medium-sized businesses in Maine did not, and basically could not, turn to banks in cities such as New York for their credit needs.

1/ Hannan, "Bank commercial loan markets and the role of market structure: Evidence from surveys of commercial lending," 15 J. Banking & Finance 133 (1991).

Having identified the relevant market or markets, we then identify the suppliers in the market and evaluate the market shares of those firms, to assess whether the merger will cause the market to be concentrated among only a few banks. Where a merger leaves few significant remaining banks, those remaining firms may be able to charge prices (interest rates, fees, and the like) above competitive levels.

The next phase of our analysis involves a detailed assessment of market conditions to determine whether the market is conducive to anticompetitive behavior in light of post-merger structural conditions. The proposed transaction is evaluated in light of all the relevant circumstances presented by the specific factual context of the affected markets.

Perhaps the most significant factor we consider is the likelihood that firms not currently competing in the market will be able to enter the market at a level at which they become effective competitors of the few firms remaining after the proposed merger. Expansion by smaller incumbents is another important means by which additional supply can be brought into the market, thereby making anticompetitive price increases unprofitable and unlikely. We look at both the ease or difficulty of entry and expansion and the history of entry into the specific markets and other markets in the industry. If timely, likely and sufficient entry is easy and attractive, the

firms in the market that attempt to raise prices or otherwise exercise market power will face new competition, and enough new competition should drive prices back down to competitive levels. It is not enough that entry is theoretically possible: The Department will only conclude that anticompetitive consequences are unlikely if we are persuaded that entry sufficient to defeat a supracompetitive price rise would be likely to occur within a short time frame.

There are some regulatory impediments to entry in the banking industry. Under current federal law, states have the power to prevent out-of-state bank holding companies from entering, to allow entry only under specific circumstances, and to restrict or prohibit branch banking. States vary widely in their restrictions on branch banking and interstate bank holding companies. Hawaii, for example, prohibits out-of-state bank holding companies from acquiring or opening banks, and that entry restriction was one of the reasons the Department concluded, in last year's <u>First Hawaiian</u> case, that there was not a sufficient likelihood of entry to prevent the potential anticompetitive effects of a merger between the second and fourth largest banks in that State. These artificial restrictions on entry create and exacerbate competitive problems within local banking markets.

Economic conditions prevailing in specific markets may discourage potential competitors from making the investments necessary to enter the market. Specifically, we examine whether a firm would find it profitable to enter in light of a host of factors, including the scope of required operations, the costs and risks associated with the investment, and the market opportunities likely to be available to the entrant in the post-merger environment.

The foregoing analysis is designed to determine whether market conditions are conducive to a lessening of competition in the market following the proposed merger. A merger can, however, result in a net gain in efficiency, and hence can lead to lower costs for the merging parties and lower prices to consumers. Thus, in evaluating the overall effects of a merger that poses substantial competitive risks, the Department will consider as an element of its analysis the assessment of true cost savings that will result directly from the merger.

In many cases, the financial health of the acquired firm is relevant to the competitive analysis. A firm is failing when it has no hope of successful reorganization and its assets will exit from the market absent the merger. The "failing company" doctrine has been recognized under the antitrust laws for several decades.

The mere fact that a firm is failing does not end the analysis under the failing company doctrine as it has been developed under the antitrust laws. Notwithstanding the failure of the acquired firm, a lessening of competition can still occur if the merger forecloses the acquisition of that firm by a less anticompetitive purchaser. Thus, the failing company doctrine only will apply where reasonable efforts to locate a less anticompetitive purchaser for the failed firm have been unsuccessful. In Fleet/Norstar, for example, we found that, because there were less anticompetitive alternatives to the acquisition of the failed Bank of New England, the "failing firm" defense was not appropriate. We therefore required that Fleet/Norstar make appropriate divestitures to resolve the competitive problem in certain local markets raised by their acquisition. I would note that our insistence upon local divestitures in that case in no way slowed or impeded the resolution process, nor did it undermine the efficiencies the parties sought to achieve through the acquisition.

We are mindful of the special problems associated with the sale of failed financial institutions, including the need to minimize costs to depositors and taxpayers. Accordingly, the Division's staff has established an excellent working relationship with the staffs of the bank regulatory agencies to address the special problems associated with competitive analysis in failed bank situations. Among other things, we have

been working with the agencies to structure the bidding process in failed bank auctions to ensure opportunities for procompetitive and competitively neutral bids. We also have been willing to meet with prospective bidders to discuss possible antitrust implications of their bids. In short, we are doing everything in our power to ensure that we perform our proper law enforcement function without unduly complicating or impeding the process of resolving failed financial institutions.

If our analysis leads us to conclude that the transaction will harm competition, we must then look for a remedy. Fortunately, in most bank merger cases, the competitive problems have been localized and could be resolved through partial divestitures. Divestitures are designed to replace the competition lost through the merger, while permitting non-offending aspects of the transaction to proceed. This is usually accomplished by the sale of the relevant assets to small, in-market firms or new entrants. In many instances, we have advised the banking agency that a merger or acquisition should only be permitted on the condition that certain divestitures be made, and the agency has ordered the

exchange and discuss empirical studies and other analyses of recent trends in the banking industry. That working group, which is chaired by one of the Antitrust Division's senior economists, should allow all of the participating agencies to sharpen their analyses of merger transactions.

Recent events--including bank failures and the announcement of several significant mergers among major regional banks--will require careful attention by all concerned. We at the Department are attempting to respond in a number of specific ways. First and foremost, we are employing a sound, rational and well-understood approach for analyzing bank merger transactions under the framework of the Merger Guidelines--an approach designed to identify and resolve real competitive problems based upon the facts of specific cases. Second, we are continuing to maintain good working relationships with the bank regulatory agencies to facilitate the review process and provide sensible guidance to the banking community. Third, we are working very hard to improve an overall understanding of how these markets function and the forces that drive or impede competition within them. Our interagency effort through the bank merger working group should improve our base of knowledge materially.

I believe the process is working well. We have the statutory powers we need to perform our assigned function of

divestitures. 2/ It is often the case that the merging parties, familiar with our merger standards, propose the divestitures as part of their application. In other cases, the parties have come forward with divestiture proposals immediately upon an expression of concern by the regulatory agencies or the Department of Justice. The parties agreed to divest, and we recommended approval on condition of divestiture, in a number of recent transactions. The fact that these divestitures have been accomplished without resort to protracted litigation demonstrates that parties can conform their transactions to the requirements of the antitrust laws, while achieving their overall business goals.

It should be apparent from my remarks thus far that our approach to merger analysis is extremely fact-intensive, relying as it does upon an evaluation of the forces that drive competition in specific product and geographic markets. Like the agencies specifically charged with regulating the financial services industry, we are constantly attempting to improve our understanding of those market forces. For example, in June of this year we established an interagency working group to gather,

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2/ United New Mexico Financial Corp's acquisition of First Interstate Bank of Albuquerque, First Interstate Bank of Lea County, and First Interstate Bank of Roswell (1991; $70 million in assets divested); Society Corp.'s acquisition of Trustcorp, Inc., of Toledo, Ohio (1989; five offices divested); and Integra Financial Corp.'s acquisition of Pennbancorp of Titusville, Pa. (1988; 13 offices divested).

enforcing the antitrust laws with respect to bank merger transactions. The agencies are coordinating their efforts to a greater extent than ever before. Parties to significant transactions understand the rules. As our recent actions attest, we are committed to maintaining a competitive financial services industry. The Department of Justice intends to discharge its law enforcement responsibility in this area aggressively and with a healthy dose of common sense.

I will be pleased to answer any questions you may have.