Statement of

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I am pleased to appear before this Committee on behalf of the Federal Reserve Board to discuss antitrust issues related to mergers and acquisitions between U.S. banks and between banking organizations and other financial services firms. Under U.S. law, when considering the competitive effects of a proposed bank merger or acquisition, the Board is required to apply the competitive standards contained in the Sherman and Clayton Antitrust Acts. Under these standards, the Board may not approve a proposal that would result in a monopoly or that may substantially lessen competition or tend to create a monopoly in a particular market. In the case of proposals that involve the acquisition of a nonbanking company by a bank holding company, the Board must consider whether the acquisition can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency that outweigh possible adverse effects. My statement today will discuss how the Federal Reserve implements these requirements. I will also try to provide some broad perspective on the ongoing consolidation of the U.S. banking system and the potential effects of bank mergers.

It is important to understand that the Bank Holding Company Act does not give the Board unfettered discretion in acting on merger and acquisition proposals, and that competition is not the only criterion that the Board must consider when assessing such a proposal. Other factors that the Bank Holding Company Act requires that the Board consider include the financial and managerial resources and future prospect of the companies and banks involved in the proposal, and the effects of the proposal on the convenience and needs of the community to be served, including the performance record of the depository institutions involved under the Community Reinvestment Act. The Bank Holding Company Act also establishes nationwide and individual state deposit limits for interstate bank acquisitions and consolidated home country supervision standards for foreign banks. In my testimony before the Committee on Banking and Financial Services on April 29, I discussed each of these topics in some detail. Lastly, if a bank holding company proposes to acquire a firm that is engaging in an activity not previously approved for bank holding companies, the Board must determine whether such activities are so closely related to banking or to managing or controlling banks as to be a "proper incident" to banking.

I. Trends in Mergers and Banking Structure

It is useful to begin a discussion of the Board's antitrust policy toward bank mergers with a brief description of recent trends in merger activity and overall U.S. banking structure. The statistical tables at the end of my statement provide some detail that may be of interest to the Committee.

Bank Mergers: There have been over 7,000 bank mergers since 1980 (table 1). The pace accelerated from 190 mergers with $10.2 billion in acquired assets in 1980, to 649 with $123.3 billion in acquired assets in 1987. In the 1990s, the pace of both the number and dollar volume of bank mergers has remained high. So far this year, the rapid rate of merger activity has continued. For example, if only the five largest mergers or acquisitions approved or announced since December are completed, a total of over $500 billion in banking assets will have been acquired.

The incidence of "megamergers," or mergers among very large banking organizations, is a truly remarkable aspect of current bank merger activity. But, it is useful to recall that very large mergers began to occur with growing frequency after 1980. In 1980, there were no mergers or acquisitions of commercial banking organizations where both parties had over $1.0 billion in total assets (table 2). The years 1987 through 1997 brought growing numbers of such acquisitions and, reflecting changes in state and federal laws, an increasing number of these involved interstate acquisitions by bank holding companies. The largest mergers in U.S. banking history took place or were approved during the 1990s--including Chase-Chemical, Wells Fargo-First Interstate, NationsBank-Barnett, and First Union-CoreStates. And while these mergers set size precedents, the recently proposed mergers of Citicorp and Travelers, and NationsBank and BankAmerica, if consummated, would set a new standard for sheer size in U.S. banking organizations.

National Banking Structure: The high level of merger activity since 1980, along with a large number of bank failures, is reflected in a steady decline in the number of U.S. banking organizations from 1980 through 1997 (table 3). In 1980, there were over 12,000 banking organizations, defined as bank holding companies plus independent banks; banks (independent banks plus banks owned by holding companies) in total numbered nearly 14,500. By 1997, the number of organizations had fallen to about 7,100 and the number of banks to just over 9,000. The number of organizations had declined over 40 percent and the number of banks by over one-third.

The trends I have just described must be placed in perspective, because taken by themselves they hide some of the key dynamics of the banking industry. Table 4 shows some other important characteristics of U.S. banking. While there were about 1,450 commercial bank failures and over 7,000 bank acquisitions between 1980 and 1997, some 3,600 new banks were formed. Similarly, while over 18,000 bank branches were closed, the same period saw the opening of nearly 35,000 new branches. Perhaps even more importantly, the total number of banking offices, shown in table 3, increased sharply from about 53,000 in 1980 to over 71,000 in 1997, a 35 percent rise, and the population per banking office declined. This includes former thrift offices that were acquired by banking organizations. Fewer banking organizations clearly has not meant fewer banking offices serving the public.

These trends have been accompanied by a substantial increase in the share of total banking assets controlled by the largest banking organizations. For example, the proportion of domestic banking assets accounted for by the 100 largest banking organizations went from just over one-half in 1980, to nearly three-quarters in 1997 (table 5). The increase in nationwide concentration reflects, to a large degree, a response by the larger banking organizations to the removal of state and federal restrictions on geographic expansion both within and across states. The industry is moving from many separate state banking structures toward a nationwide banking structure that would have existed already had legal restrictions not stood in the way. The increased opportunities for interstate banking are allowing many banking organizations to reach for the twin goals of geographic risk diversification and new sources of "core" deposits.

As I will discuss shortly, it may well be that the retail banking industry is moving toward a structure more like that of some other local market industries such as clothing and department store retailing. As in retail banking, clothing and department store customers tend to rely on stores located near their home or workplace. These stores may be entirely local or may be part of regional or national organizations. Thus, it should perhaps not be surprising that banks, now freed of barriers to geographic expansion, are taking advantage of the opportunity to operate in local markets throughout the country as have firms in other retail industries.

But, it would be a mistake to think that adjustment to a new statutory environment--and the increased opportunities for geographic diversification--were the only reasons for the current volume of bank merger activity. Each merger is somewhat unique, and likely reflects more than one motivation. For example, a recent study of scale economies in banking suggests that efficiencies associated with larger size may be achieved up to a bank size of about \$10-\$25 billion in assets. In addition, some lines of business, such as securities underwriting and market-making, require quite large levels of activity to be viable.

Increased competitive pressures caused by rapid technological change and the resulting blurring of distinctions between banks and other types of financial firms, lower barriers to entry due to deregulation, and increased globalization also contribute to merger activity. Global competition appears to be especially important for banks that specialize in corporate customers and wholesale services, especially among the very largest institutions. Today, for example, almost 40 percent of the U.S. domestic commercial and industrial bank loan market is accounted for by foreign-owned banks.

More generally, greater competition has forced inefficient banks to become more efficient, accept lower profits, close up shop, or--in order to exit a market in which they cannot survive--merge with another bank. Other possible motives for mergers include the simple desire to achieve market power, or the desire by management to build empires and enhance compensation. Some mergers probably occur as an effort to prevent the acquiring bank from itself being acquired, or, alternatively, to enhance a bank's attractiveness to other buyers.

Many of these factors are also motivating mergers between bank and nonbank financial firms. However, in these cases, a key causal factor is the on-going blurring of distinctions between what were, not very long ago, quite different financial services. Today, as the Board has testified on many occasions, and despite the fact that banks continue to offer a unique bundle of services for retail customers, it is increasingly difficult to differentiate between many products and services offered by commercial banks, investment banks, and insurance companies. Thus, we should not find it surprising that firms in each of these industries should seek partners in the others.

Local Market Banking Structure: Given the Board's statutory responsibility to apply the antitrust laws so as to ensure competitive banking markets, it is critical to understand that nationwide concentration statistics are generally not the appropriate metric for assessing the competitive effects of mergers. Moreover, the extent to which mergers can increase national concentration is limited by the provisions in the Riegle-Neal Act of 1994 that amended the Bank Holding Company Act and established national (10 percent) and state-by-state (30 percent) deposit concentration limits for interstate bank acquisitions. States may establish a higher or lower limit, and initial entry into a state by acquisition is not subject to the Riegle-Neal statewide 30 percent limit.

Beyond this, the Board has a statutory responsibility to apply the antitrust laws so as to ensure competitive local banking markets. Evidence indicates that in the vast majority of cases the relevant concern for competition analysis is competition in local banking markets. This is based partly on survey findings that indicate that households and small businesses obtain most of their financial services in a very local area. In addition, it is based on empirical research that shows deposit rates tend to be lower and some loan rates, particularly those on loans to small businesses, are higher in local markets with relatively high levels of concentration.

While concentration has increased in some local markets, it has decreased in others, from 1980 through 1997, in both urban and rural markets, so that the average percentage of bank deposits accounted for by the three largest firms has remained steady or actually declined slightly, even as nationwide concentration has increased substantially (table 6). Essentially similar trends are apparent when local market bank concentration is measured by the Herfindahl-Hirschman Index (HHI), defined as the sum of the squares of the market shares. Because of the importance of local banking markets, I would like to provide somewhat more detail on the implications of bank mergers for local market concentration.

Metropolitan Statistical Areas (MSAs) and non-MSA counties are often used as proxies for urban and rural banking markets. The average three-firm deposit concentration ratio for urban markets decreased by three percentage points between 1980 and 1997 (table 6). Average concentration in rural counties declined by 1.7 percentage points. Similarly, the average bank deposit-based HHI for both urban and rural markets fell between 1980 and 1997 (table 7). When thrift deposits are given a 50 percent weight in these calculations, average HHIs are sharply lower than the bank-only HHIs in a given year, but the HHIs trend slightly upward since 1984. On balance, the three-firm concentration ratios and the HHI data indicate that, despite the fact that there were over 7,000 bank mergers between 1980 and 1997, local banking market concentration has remained about the same.

Why haven't all of these mergers increased average local market concentration? There are a number of reasons. First, many mergers are between firms operating primarily in different local banking markets. While these mergers may increase national or state concentration, they do not tend to increase concentration in local banking markets and thus do not reduce competition.

Second, as I have already pointed out, there is new entry into banking markets. In most markets, new banks can be formed fairly easily, and some key regulatory barriers, such as restrictions on interstate banking, have been all but eliminated.

Third, the evidence overwhelmingly shows that banks from outside a market usually do not increase their market share after entering a new market by acquisition. Studies indicate that when a local bank is acquired by a large out-of-market bank, there is normally some loss of market share. The new owners are not able to retain all of the customers of the acquired bank. Anecdotal evidence suggests that some other banks in the market mount aggressive campaigns to lure away customers of the bank being acquired.

Fourth, it is important to emphasize that small banks have been and continue to be able to retain their market share and profitability in competition with larger banks. Our staff has done repeated studies of small banks; all of these studies indicate that small banks continue to perform as well as, or better than, their large counterparts, even in the banking markets dominated by the major banks. This may be due, in part, to more personalized service. But whatever the reason, based on this experience, we expect that there will continue to be a large number of banks remaining in the future.

Despite a continued high level of merger activity, studies based on historical experience suggest that in about a decade there may still be about 3,000 to 4,000 banking organizations, down from about 7,000 today. Although the top 10 or so banking organizations will almost certainly account for a larger share of banking assets than they do today, the basic size distribution of the industry will probably remain about the same. That is, there will be a few very large organizations and an increasing number of smaller organizations as we move down the size scale. It seems reasonable to expect that a large number of small, locally oriented banking organizations will remain. Moreover, size does not appear to be an important determining factor even for international competition. Only very recently have U.S. banks begun to appear, once again, among the world's twenty largest in terms of assets. Yet those U.S. banks that compete in world markets are consistently among the most profitable and best capitalized in the world, as well as being ranked as the most innovative.

Finally, administration of the antitrust laws has almost surely played a role in restricting local market concentration. At a minimum, banking organizations have been deterred from proposing seriously anticompetitive mergers. And in some cases, to obtain merger approval, applicants have divested banking offices with their assets and deposits in certain local markets where the merger would have otherwise resulted in excessive concentration.

Overall, then, the picture that emerges is that of a dynamic U.S. banking structure adjusting to the removal of longstanding legal restrictions on geographic expansion, technological change, and greatly increased domestic and international competition. Even as the number of banking organizations has declined, the number of banking offices has continued to increase in response to the demands of consumers, and measures of local banking concentration have remained quite stable. In such an environment, it is potentially very misleading to make broad generalizations without looking more deeply into what lies below the surface. In part for the same reasons that make generalizations difficult, the Federal Reserve devotes considerable care and substantial resources to analyzing individual merger applications.

II. Federal Reserve's Application of Antitrust Standards

The Federal Reserve Board is required by the Bank Holding Company Act (1956) and the Bank Merger Act (1960) to review specific statutory factors arising from a transaction when (1) a holding company acquires a bank or a nonbank firm, or merges with another holding company, or (2) the bank resulting from a merger of two banks is a state-chartered member bank. The Board must evaluate, among other things, the likely effects of such mergers on competition. This section of my statement discusses in some detail the methodology the Board uses in assessing the competitive effects of a proposed merger.

Competitive Criteria: In considering the competitive effects of a proposed bank acquisition, the Board is required to apply the same competitive standards contained in the Sherman and Clayton Antitrust Acts. The Bank Holding Company (BHC) Act and the Bank Merger Act do contain a special provision, used primarily in troubled-bank cases, that permits the Board to balance public benefits from proposed mergers against potential adverse competitive effects. The law also requires that the Board consider the potential effects on competition in the relevant market when bank holding companies acquire nonbank firms, as will be discussed later.

The Board's analysis of competition begins with defining the geographic areas that are likely to be affected by a merger. Under procedures established by the Board, these areas are defined by staff at the local Reserve Bank in whose District the merger would occur, with oversight by staff in Washington. In mergers where one or both parties are in two Federal Reserve Districts, the Reserve Banks cooperate, as necessary. To ensure that market definition criteria remain current, and in an effort to better understand the dynamics of the banking industry, the Board has recently sponsored several surveys, including national Surveys of Small Business Finances, a triennial national Survey of Consumer Finances, and telephone surveys in specific merger cases, to assist it in defining geographic markets in banking. These surveys are particularly useful because electronic technology and banks with widespread branch networks are becoming more prevalent. The surveys and other evidence continue to suggest that small businesses and households most often obtain their banking services in their local area. This implies using a local geographic market definition for analyzing competition. Local markets would, of course, be less important for the financial services obtained by large businesses.

With this basic local market orientation of households and small businesses in mind, the staff constructs a local market index of concentration, the HHI, which is widely accepted as a useful measure of market concentration, in order to conduct a preliminary screen of a proposed merger. The HHI is calculated based on local bank and thrift deposits. The merger would generally not be regarded as anticompetitive if the resulting market share, the HHI, and the change in that index do not exceed the criteria in the Justice Department's merger guidelines for banking. However, while the HHI is an important indicator of competition, it is not a comprehensive one. In addition to statistics on market share and bank concentration, economic theory and evidence suggest that other factors, such as potential competition, the strength of the target firm, and the market environment may have important influences on bank behavior. These other factors have become increasingly important as a result of many recent procompetitive changes in the financial sector. Thus, if the resulting market share and the level and change in the HHI are within Justice Department guidelines, there is a presumption that the merger is acceptable, but if they are not, a more thorough economic analysis is required.

To conduct such an analysis of competition, the Board uses information from its own major national surveys noted above, from telephone surveys of households and small businesses in the market being studied, from on-site investigations by staff, and from various standard databases with information on market income, population, deposits, and other variables. These data, along with results of general empirical research by Federal Reserve System staff, academics, and others, are used to assess the importance of various factors that may affect competition. To provide the Committee with an indication of the range of other factors the Board may consider in evaluating competition in local markets, I shall outline these factors.

Potential competition, or the possibility that other firms may enter the market, may be regarded as a significant procompetitive factor. It is most relevant in markets that are attractive for entry and where barriers to entry, legal or otherwise, are low. Thus, for example, potential competition is of relatively little importance in markets where entry is unlikely for economic reasons.

Thrift institution deposits are now typically accorded 50 percent weight in calculating statistical measures of the impact of a merger on market structure for the Board's analysis of competition. In some instances, however, a higher percentage may be included if thrifts in the relevant market look very much like banks, as indicated by the substantial exercise of their transactions account, commercial lending, and consumer lending powers.

While the merger guidelines provide a significant allowance for nonbank competition, competition from other depository and nonbank financial institutions may be given some additional consideration if such entities clearly provide substitutes for the basic banking services used by most households and small businesses. In this context, credit unions and finance companies may be particularly important.

The competitive significance of the target firm can be a factor in some cases. For example, if the bank being acquired is not a reasonably active competitor in a market, the loss of competition would not be considered to be as severe as would otherwise be the case.

Adverse structural effects may be offset somewhat if the firm to be acquired is located in a declining market. This factor would apply where a weak or declining market is clearly a fundamental and long-term trend, and there are indications that exit by merger would be appropriate because exit by closing offices is not desirable and shrinkage would lead to diseconomies of scale. This factor is most likely to be relevant in rural markets.

Competitive issues may be reduced in importance if the bank to be acquired has failed or is about to fail. In such a case, it may be desirable to allow some adverse competitive effects if this means that banking services will continue to be made available to local customers rather than be severely restricted or perhaps eliminated.

A very high level of the HHI could raise questions about the competitive effects of a merger even if the change in the HHI is less than the Justice Department criteria. This factor would be given additional weight if there has been a clear trend toward increasing concentration in the market. The possibility of efficiency gains, especially via scale economies, is considered when appropriate, although this has generally not been a significant factor.

Finally, other factors unique to a market or firm would be considered if they are relevant to the analysis of competition. These factors might include evidence on the nature and degree of competition in a market, information on pricing behavior, and the quality of services provided.

Some merger applications are approved only after the applicant proposes the divestiture of offices in local markets, and where the merger cannot be justified using any of the criteria I have just discussed. We believe that such divestitures have provided a useful vehicle for eliminating the potentially anticompetitive effects of a merger in specific local markets while allowing the bulk of the merger to proceed.

Remedies: Divestitures and Denials: The Board makes a concerted effort to provide the industry and other market participants with clear competition standards in order to make the regulatory process as efficient as possible. This is accomplished especially through published Board Orders on individual merger decisions. Furthermore, staff at the Reserve Banks and the Board often provide guidance to banks and bank holding companies that are considering a merger even prior to the filing of a formal application as well as after an application is filed. In this way, applicants learn very early in the process whether their application is likely to raise antitrust concerns. In fact, because this information regarding the principles applied by the Board in its competitive analysis is so readily available, applicants are able to structure proposals so that few merger applications are denied on competitive grounds.

Some potential applicants choose not to file an application after being advised of the Board's policy and standards. Other potential applicants, who recognize that their application raises serious concerns about competition, choose to make divestitures of offices to remedy the competition problem. As I indicated above, divestitures have proven to be an effective way for applicants to resolve a competition problem without jeopardizing the entire deal. Indeed, the Board has approved 48 merger applications involving divestitures during the 1990s.

Board denials of applications on competitive grounds are rare. Nevertheless, despite the Board's efforts to inform the industry of its antitrust policy and standards, the Board has denied four applications because of adverse competitive effects during the 1990s.

Reviews of Policies and Procedures: Given the rapid pace of change in the U.S. banking and financial system, the Board and its staff review policies and procedures for assessing competition on a nearly continuous basis. Periodically, more formal reviews are conducted, the most recent of which was completed by Board staff early last year. This review essentially confirmed the continued appropriateness of our existing methodology. I would like to highlight five aspects of that review that might be of particular interest to the Committee.

Since at least the mid-1960s, the cluster of products and services that constitutes commercial banking has been used, and reaffirmed by the courts, as the relevant product line for bank merger analysis. The cluster is meant to encompass the set of products and services that is purchased primarily from banks, a set that technological and other market developments have clearly changed over time. However, extensive review of available data, including our practical experience in analyzing cases, indicated that there still exists a core of such activities for both households and small businesses. Such activities certainly include federally insured deposits and, for small businesses, likely encompass certain credit products and services as well. Thus, the cluster continues to be the product line used by the Board for bank merger analysis.

The staff's review also indicated very strong support for the continued use of local geographic markets for the cluster of bank services as the primary concern of competition analysis. Survey data indicate, for example, that 98 percent of households, and 92 percent of small businesses use a local depository institution. In addition, it is estimated that almost 90 percent of services consumed at depositories by households, and 95 percent of services consumed by small business, are provided by local depositories. On a closely related issue, our staff considered whether it might be appropriate to use somewhat different competition standards in urban and rural markets. This question was motivated by the fact that, since rural markets tend to be more concentrated than urban markets, it is frequently more difficult for banks in a given rural market to merge with each other than it is for banks in an urban market. However, no objective basis was discovered for treating urban and rural markets fundamentally differently in the analysis of potential competitive effects of a merger. Thus, all proposals continue to be evaluated on a case-by-case basis using common standards.

Our staff also reviewed whether continued use of the Department of Justice's merger guidelines was appropriate or whether, in light of institutional and technological changes, a more liberal initial screen should be applied. While the market for banking services certainly has become more competitive since the existing guidelines were established in 1984, the current guidelines continue to provide a useful initial screen for deciding whether a proposed merger is likely to have anticompetitive effects. In particular, the more generous allowance in the guidelines for the effects of nonbank competition were deemed to remain sufficient for the vast majority of cases. Exceptions can be dealt with on an individual basis. Moreover, there is considerable virtue in having both the Federal Reserve and the Department of Justice use the same initial screen. In the end, there appears to be no substitute for a careful case-by-case analysis, of the type that I discussed above, of proposals that violate the Board's and the Department of Justice's initial guidelines.

Lastly, in light of a substantial body of evidence accumulated over the 1980s, economies of scale are considered as a potential mitigating factor in our analysis of merger proposals. Many studies using data from the 1970s and 1980s indicated only small economies of scale in banking, economies that were exhausted at about $100 million in total assets. However, recent research using data from the 1990s suggests that significant scale economies may exist for much larger firms, perhaps for banks as large as $10 to $25 billion in assets. If these results hold up to additional scrutiny, we will clearly need to evaluate once again the weight given to economies of scale in competition analysis.

Coordination with Department of Justice: The Federal Reserve and the Department of Justice (DOJ) coordinate their antitrust analysis of banking consolidations through a combination of formal and informal procedures. These procedures have two objectives. First, they ensure that the two agencies share information that is relevant to the competition analysis of all bank merger proposals which raise a serious competitive issue. Second, they ensure that the analysis of each agency is known to the other.

A number of procedures have been developed at various stages of the application process. Largely, they entail the exchange or sharing of documents. The Department of Justice, for example, is provided a copy of all bank applications made to the Federal Reserve. The geographic markets used to conduct the competitive analysis are provided by the Federal Reserve to the DOJ. Also, the Department of Justice regularly (about every two weeks) sends the Federal Reserve and other banking agencies a document listing those mergers that the DOJ believes are not likely to have significantly adverse competitive effects. Finally, in cases involving Justice Department-required divestitures, the Department typically sends the Federal Reserve a copy of the "letter of agreement" that identifies the terms of the required divestitures.

A significant amount of information is also shared on an ad hoc basis. Direct staff-to-staff communications, including conversations and meetings, play an important role in the resolution of difficult competitive issues. Communications between the staffs of the Justice Department and the Federal Reserve can be frequent and may occur without limit at any stage of the application process, including pre-application and post-approval. In the past, a range of issues has been discussed and resolved informally, including both geographic and product market definitions and divestiture requirements. Such informal interactions occur routinely in both banking and nonbanking cases and are probably the single most important means by which the Federal Reserve and the Department of Justice coordinate their competitive analyses.

The Department of Justice places substantial weight on the potential effect of a merger on lending to small businesses. The Board also considers small business lending but in the context of the more general analysis of the cluster of banking services. Because of these differences in emphasis, the Board and Department may, in occasional cases, reach different conclusions regarding the competitive effects of a merger.

Recent Cases: As I noted earlier, the Board has always believed that it is important to make its antitrust policy clear to the industry and other members of the public. One way it attempts to accomplish this is by providing a detailed analysis of competitive issues in its public Order on each case. In a number of recent large and complex cases, the Board has reinforced its policy and methodology for analyzing competition, and reminded applicants of the need for noticeable, and possibly increasing, "mitigators" in cases that exceed the Department of Justice screening guidelines. This was done because during the past couple of years an increasing number of applicants came very close to the Board's limits, in terms of structural effects and strength of mitigating factors, for approving bank mergers. It appeared as though some applicants had concluded that the Board had relaxed its competition standards. That conclusion is incorrect.

For example, in one recent Order the Board noted,

As the Board has indicated in previous cases, in a market in which the competitive effects of a proposal as measured by market indexes and market share exceed the DOJ guidelines, the Board will consider whether other factors tend to mitigate the effects of the proposal. The number and strength of factors necessary to mitigate the competitive effects of a proposal depend on the level of market concentration and size of the increase in market concentration.(1)

The Board has recently also considered cases in which Department of Justice guidelines were exceeded in a large number of local markets. In those cases as well, the Board indicated that mitigating factors should exist in each local market being affected. There, the Board stated that:

In these cases, the Board believes that it is important to give increased attention to the size of the change in market concentration as measured by the HHI in highly concentrated markets, the resulting market share of the acquiror and the pro forma HHIs in these markets, the strength and nature of competitors that remain in the market, and the strength of additional positive and negative factors that may affect competition for financial services in each market.(2)

In summary, at a time when the banking industry is undergoing an unprecedented merger movement that is likely to continue for a considerable period, it is particularly important to have a public policy that will maintain a competitive banking marketplace and that is well understood by all market participants. The Board seeks to accomplish these public policy objectives in an efficient and effective manner by maintaining a relevant and up-to-date policy, cooperating closely with the Department of Justice, keeping the industry and other members of the public well informed, and providing information and guidance through staff at the Board and Reserve Banks.

Nonbank Acquisitions: The ability of bank holding companies to engage in a wide range of nonbanking activities was made possible by the 1970 amendments to the Bank Holding Company Act. Permissible nonbanking activities are those that satisfy a two-part test delineated in section 4(c)(8) of the Bank Holding Act. This test first requires the Board to find that a nonbanking activity is "closely related to banking." Second, the Board must determine that the performance of the activity "can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interest, or unsound banking practices."

The Board has determined that nonbanking activities are closely related to banking if they meet any one of three criteria: (1) banks generally have in fact provided the proposed services; (2) banks generally provide services that are operationally or functionally so similar to the proposed services as to equip them particularly well to provide the proposed services; or, (3) banks generally provide services that are so integrally related to the proposed services as to require their provision in a specialized form.

The competitive effects of a proposal must be reviewed as part of the "net public benefits" test that governs nonbanking acquisitions. Unlike the case in banking acquisitions, however, in every nonbanking acquisition, the Board must also weigh other possible effects--such as undue concentration of resources and the existence of unfair competition--against public benefits and find that public benefits are predominant in order to approve the proposal.

Generally, the Board's competitive analysis of nonbanking acquisitions is very similar to that used in banking mergers. In particular, the economic analysis begins with determining the product market in question, and then the relevant geographic area for assessing competition. The relevant market area may be local, regional, national, or international, depending on the product under review and the exact nature of the marketplace. Then, proposed changes in market structure are examined along with other factors, such as potential competition, to determine the extent to which competition may be reduced. Over the years, nonbanking acquisitions generally have raised fewer competitive concerns than banking mergers. This is because nonbanking activities have generally been conducted in markets where industry concentration was low or moderate and where numerous competitors existed (e.g., consumer finance and mortgage banking).

III. Conclusion

The Federal Reserve is required by law to assess the competitive implications of proposed bank mergers and acquisitions. In order to fulfill its statutory responsibilities, the Federal Reserve devotes considerable resources to the case-by-case evaluation of merger proposals. The Board normally focuses its analysis on a proposed merger's potential impact on competitive conditions in local markets for banking services. In some cases, particularly those involving the acquisition of nonbank firms, broader geographic areas are used. The Federal Reserve's (along with the Department of Justice's) administration of the antitrust laws in banking has helped to maintain competitive banking markets in the midst of the most significant consolidation of the banking industry in U.S. history. It is the Board's intention and expectation that this will continue to be the case in the future.

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Table 1

Bank Mergers and Acquisitions, 1980-1997

Year	Number of bank mergers	Bank assets acquired*
1980	190	$10.18
1981	359	34.07
1982	420	40.87
1983	428	50.05
1984	441	69.82
1985	475	67.12
1986	573	94.41
1987	649	123.29
1988	468	87.71
1989	350	43.39
1990	366	43.74
1991	345	150.29
1992	401	165.42
1993	436	103.05
1994	446	111.76
1995	345	184.44
1996	312	286.07
1997**	207	140.51
Total	7,211	$1,806.19

* Asset values in billions of dollars. ** 1997 numbers are estimated.

Source: Stephen A. Rhoades, "Mergers and Acquisitions by Commercial Banks, 1980-1994," Staff Study, Federal Reserve Board (January 1996). Updates supplied by the author.

Table 2

Number of Large Mergers, 1980-1997*

Year	Number of large mergers	Number of large interstate mergers
1980	0	0
1981	1	0
1982	2	0
1983	5	0
1984	6	0
1985	9	4
1986	9	6
1987	18	11
1988	14	7
1989	3	2
1990	6	2
1991	16	12
1992	23	15
1993	15	10
1994	15	11
1995	20	16
1996	26	14
1997**	15	11
Total	203	121

*Where the acquiring firm and target bank are over $1 billion in assets. ** 1997 numbers are preliminary.

Source: Stephen A. Rhoades, "Bank Mergers and Industrywide Structures, 1980-1994," Staff Study, Federal Reserve Board, 1996. Updated by author.

Table 3

Number of Banks, Banking Organizations, and Offices, 1980-1997[1]

Year	Banks[2]	Banking organizations[2]	Number of banking offices[3]	Population per banking office[4]
1980	14,407	12,342	52,710	4,307
1985	14,268	11,021	57,417	4,145
1990	12,194	9,221	63,392	3,928
1991	11,790	9,007	64,681	3,896
1992	11,349	8,730	65,122	3,916
1993	10,867	8,318	63,658	4,053
1994	10,359	7,896	65,183	3,999
1995	9,855	7,571	68,228	3,861
1996	9,446	7,313	68,694	3,860
1997	9,064	7,122	71,080	3,765

1. Banks are defined as insured commercial banks; banking organizations are defined as bank holding companies and independent commercial banks; and banking offices are defined as insured U.S. commercial banks plus branches owned by insured commercial banks.

2. Source: NIC Database, Reports of Condition and Income.

3. Number of banking offices=number of insured U.S. commercial banks+number of branches owned by insured U.S. commercial banks. The sources of the branch figures are the Annual Statistical Digest and Annual Report published by the Board of Governors of the Federal Reserve System.

4. Population data for 1980-1997 are from the U.S. Department of Commerce (Bureau of Economic Analysis).

Table 4

Entry and Exit in Banking, 1980-1997

Number

Year	New insured commercial banks	Failure of insured commercial banks	Mergers and acquisitions	Bank branches (insured commercial banks) Openings	Closings
1980	206	10	190	2,099	267
1981	199	7	359	2,175	332
1982	316	32	420	1,575	393
1983	366	45	428	1,281	547
1984	400	78	441	1,363	869
1985	318	116	475	1,407	596
1986	248	141	573	1,250	748
1987	212	186	649	960	942
1988	228	209	468	1,509	1,042
1989	201	206	350	1,730	687
1990	175	158	366	2,722	884
1991	107	105	345	2,273	1,428
1992	73	98	401	1,644	1,675
1993	59	40	436	1,944	1,733
1994	48	11	446	2,713	1,151
1995	110	6	345	2,526	1,489
1996	148	5	313	2,487	1,870
1997	207	1	n.a.	3,122	1,636
Total	3,621	1,454	7,005	34,780	18,289

Sources: Failure data are from Federal Deposit Insurance Corporation, Statistics on Banking 1934-1996, vol. 1. Mergers and acquisitions data are from Stephen A. Rhoades, "Bank Mergers and Industrywide Structure, 1980-1994," Staff Study, Federal Reserve Board, 1996. Updated by author. New bank and branch openings and closings are from the Federal Reserve Board, Annual Statistical Digest, relevant years.

Table 5

Shares of Domestic Commercial Banking Assets Held

by Largest Banking Organizations, 1980-1997

Year	Top 5	Top 10	Top 25	Top 50	Top 100
1980	13.5	21.6	33.1	41.6	51.4
1981	13.2	21.1	33.2	41.6	51.6
1982	13.4	21.8	34.2	43.0	53.6
1983	13.2	21.0	34.0	43.3	54.3
1984	13.0	20.4	33.3	43.7	55.4
1985	12.8	20.4	33.2	45.8	57.9
1986	12.7	20.2	34.1	47.3	60.4
1987	12.6	19.9	34.8	48.5	61.9
1988	12.8	20.4	35.7	51.1	64.0
1989	13.3	21.7	36.9	51.8	64.7
1990	13.1	21.8	37.8	52.7	65.4
1991	16.0	24.4	40.3	53.4	65.5
1992	17.3	25.6	41.8	55.6	67.1
1993	17.6	26.9	43.8	58.0	69.2
1994	18.2	27.9	45.7	59.9	71.3
1995	17.8	28.8	47.5	61.4	72.2
1996	21.1	32.9	51.0	64.3	73.5
1997	22.5	33.8	52.7	66.1	74.6

Sources: NIC Database, Reports of Condition and Income.

Table 6

Average Three-firm Deposit Concentration Ratio (in percent) based on Insured Commercial Banking Organizations, 1976-1997

Year	Metropolitan statistical areas	Non-metropolitan counties
1976	68.4%	90.0%
1977	67.8	89.9
1978	67.2	89.9
1979	66.7	89.7
1980	66.4	89.6
1981	66.0	89.4
1982	65.8	89.3
1983	65.9	89.4
1984	66.3	89.4
1985	66.7	89.4
1986	67.5	89.5
1987	67.7	89.5
1988	67.8	89.7
1989	67.5	89.7
1990	67.5	89.6
1991	66.7	89.3
1992	67.5	89.2
1993	66.8	89.2
1994	66.6	89.0
1995	66.3	88.8
1996	66.9	88.7
1997	65.4	88.3

Source: Summary of Deposits, 1976-1997.

Table 7

Average Herfindahl-Hirschman Indexes (HHI) of Metropolitan Statistical Areas and Rural (Non-MSA) Counties, 1976-1997

	Insured commercial banks only		Insured commercial banks plus 50% of savings banks and savings and loan deposits	
Year	MSAs	Non-MSA counties	MSAs	Non-MSA counties
1976	2,087	4,520	N.A.	N.A.
1977	2,043	4,493	N.A.	N.A.
1978	2,021	4,471	N.A.	N.A.
1979	1,986	4,438	N.A.	N.A.
1980	1,973	4,417	N.A.	N.A.
1981	1,958	4,372	N.A.	N.A.
1982	1,961	4,360	N.A.	N.A.
1983	1,948	4,350	N.A.	N.A.
1984	1,958	4,358	1,366	3,781
1985	1,990	4,357	1,373	3,766
1986	2,022	4,345	1,388	3,744
1987	2,014	4,334	1,402	3,754
1988	2,020	4,316	1,400	3,726
1989	2,010	4,317	1,423	3,761
1990	2,010	4,291	1,468	3,788
1991	1,977	4,257	1,511	3,831
1992	2,023	4,222	1,563	3,832
1993	1,994	4,234	1,588	3,887
1994	1,976	4,208	1,606	3,880
1995	1,963	4,171	1,619	3,858
1996	1,991	4,145	1,639	3,844
1997	1,949	4,114	1,611	3,826

Sources: Summary of Deposits data for banks and Survey of Savings data for thrifts. Pre-1985 HHIs calculated using 1985 MSA definitions. 1997 HHIs use 1996 MSA definitions. Other years HHIs based on the year's MSA definitions.

Judiciary Homepage

1. First Union Corporation, Board Order dated April 13, 1998, pp. 17 and 18.

2. NationsBank Corporation, 84 Federal Reserve Bulletin 129 (1998), p. 134.

DEPARTMENT OF JUSTICE

STATEMENT

of

JOHN M. NANNES

Deputy Assistant Attorney General

Antitrust Division

U.S. Department of Justice

Before the

Committee on the Judiciary

United States House of Representatives

Concerning

Mergers in the Financial Services Industry

Washington, D.C.

June 3, 1998

Mr. Chairman, and members of the Committee, it is a pleasure for me to appear before you today on behalf of the Antitrust Division of the Department of Justice to discuss our enforcement program with respect to mergers involving the banking industry.

Free-market competition is the engine that has made the American economy the envy of the world. In particular, our nation's economic vitality depends upon the financial soundness and competitive structure of the banking industry, for it is the credit provided by that industry to American consumers and businesses that helps the free-market engine run smoothly. Experience has shown that where there are competing sources of credit, the price of credit is lower and its availability is greater. That rivalry also brings consumers the benefits of greater innovation and better quality financial services.

Today's hearing is most certainly timely, as this is a time when significant changes are occurring in the banking and financial services industries. While we have seen a large number of bank mergers over the past decade as bank regulatory strictures on the geographic area in which a bank may operate have loosened, I think it is apparent to all that we are now beginning to see banks involved in mergers of a different size and scope than we have seen in the recent past.

With respect to size, transactions such as the recently announced proposed merger between NationsBank and Bank of America dwarf the size of previous bank mergers. I think it is entirely possible that we will see other large bank mergers proposed in the future as well. Not only are we likely to see transactions between large banks in the future, but we are also likely to see more and more of an entirely new type of merger transaction, the merger between a large bank and a large financial services company. A current example of this type of transaction is the proposed merger between Citicorp and Travelers Group.

Congress, banking regulators and antitrust authorities all must ask what are the implications of this changing landscape. From an antitrust perspective, will these transactions require a change in focus of bank merger review? How should these transactions be analyzed from an antitrust perspective? Are transactions of these types likely to limit consumer options such that prices will rise and quality of products and services will decline? All of these questions, and many others, need to be considered with an eye to ensuring that the changing landscape will not result in large institutions with market power that would enable them to force customers to pay higher fees and lending rates, receive lower rates for deposits, and receive lower service quality.

Today I would like to describe how the Antitrust Division analyzes bank mergers generally, briefly outlining both the regulatory structure under which we conduct our review and the analytical approach that we take. I will also briefly describe some recent instances where we have required divestitures that are designed to remedy the competitive concerns that exist with the merger, while allowing the merged firm to realize efficiencies associated with the parts of the transaction that do not raise competitive concerns. The analytical approach that we use, applied to the facts presented in particular mergers, will, I believe, continue to preserve competition as the banking and financial services industries head into the 21st century.

Regulatory Structure

The Antitrust Division is the antitrust enforcement agency that reviews acquisitions and mergers among depository institutions.(1) The Department typically receives notice of approximately 1,000 mergers per year that propose to combine assets of depository institutions. We have established a special unit within the Antitrust Division that focuses entirely on bank mergers. Of those 1,000 merger notifications, approximately 100 each year initially present issues that require an in-depth competitive analysis. Thus far in FY 1998, we have required remedies to preserve competition in ten instances, already equaling the number of matters in which remedies were required to preserve competition in FY 1997.

Generally speaking, the Division's review of mergers involving depository institutions does not take place under the Hart-Scott-Rodino premerger notification regime but instead under the bank regulatory statutes. Under these statutes, authority to approve or disapprove mergers rests with one of four bank regulatory agencies.(2) The bank merger statutes require that the bank regulatory agencies consider competitive effects of a transaction along with other factors such as convenience and needs in their decision process. Bank-bank mergers require a competitive factors report from DOJ. For both bank-bank mergers and transactions involving the merger of bank holding companies, DOJ is afforded a 30-day post approval waiting period in which to file suit before the transaction receives antitrust immunity. Filing of a suit by DOJ triggers an automatic stay. One overall effect of this regulatory structure is that the Division's competitive concerns are usually addressed by the Division reaching an agreement with the parties for some type of remedy, and litigation is rare.(3)

Screening Guidelines

A significant advance in the bank merger competitive review process was achieved in 1994 with the development by the Division, the FRB and the OCC of the Bank Merger Screening Guidelines, which clarify each agency's processes and, in a single document, set out the ground rules for each agency's review of mergers.

In practice, the Screening Guidelines have ensured that bank merger applications come to the Division with the information necessary for us to review them and reach an initial assessment of a merger's likely competitive effects. The Guidelines have allowed us and the other agencies to begin an examination and analysis of the competition issues and possible resolutions at an early stage.

The screening guidelines indicate that we will look first at market concentration and the change in that concentration as a result of the merger to make a first cut with respect to potential competitive concerns. If either the market concentration is low or the resulting increase in concentration in the market is low, that will end our inquiry. If the proposed merger fails the market concentration tests in the screens, it does not necessarily mean that a competitive problem exists. Instead, if the proposed bank merger fails the screens, then the Department does an in-depth factual analysis to determine the likely competitive effects of the merger on consumers in the affected markets.

Analytical Approach of the Antitrust Division

The Antitrust Division's review of proposed bank mergers applies the same methodology that we use in other industries--that of the Horizontal Merger Guidelines[(4)]--to analyze the likely effect of the merger on competition to supply each product sold by each merging firm in each geographic area in which the product is sold. The objective of the analysis, of course, is to assess whether the merger could create or facilitate the exercise of market power, where market power is defined as the ability of firms to increase price or reduce quality from competitive levels. The Division will thus analyze the merger's impact on the range of products and services provided by banks in particular geographic areas. These include deposit, loan, and investment and trust services sold to retail consumers; deposit, loan, and various other services, including cash management services, sold to businesses; and correspondent services, such as check clearing and foreign exchange services, sold to other banks.

In each investigation we conduct, we look for the choices consumers will have if, after a merger, there are price increases. If you are getting a small business loan from a commercial bank, for instance for working capital, and if the merged bank tries to raise its prices, what choices do you have? If the small business has sufficient reasonable alternatives available to it besides the merged bank, we would not be concerned from an antitrust perspective. On the other hand, if there were not sufficient reasonable alternatives available, we would be concerned about the merger.

Historically, we have generally found that bank mergers are less likely to threaten to reduce competition in products and services provided to retail consumers, as opposed to business consumers, because retail consumers typically have local banking alternatives available to them, such as other banks, thrifts and credit unions, sufficient to prevent the creation or exercise of market power. However, where we have found such competitive concerns, targeted divestitures have protected retail consumers. Of course, we will continue to screen and investigate during our bank merger reviews for any significant loss of competition in the retail area.

To the extent that our investigations have resulted in a determination that competitive concerns exist, it has most often been with respect to the availability of banking services, including loans and credit, to small and medium-sized businesses. Such small and medium-sized businesses may have few alternatives available to them for some of their credit needs.

For example, small businesses tend to have some types of credit needs--such as lines of credit for business startup and working capital purposes--that may attract neither in-region thrifts or credit unions nor banks located in other regions. These businesses tend to have to rely on local commercial bankers for such credit needs. Thus, a merger between two of only a few local commercial banks in a particular market could raise competitive concerns.

Recent DOJ Enforcement Efforts

Our law enforcement objective with respect to bank mergers--like that of all mergers--is to prevent the anticompetitive effects of a particular merger, thereby ensuring that competition is preserved. With respect to bank mergers, we are typically able to accomplish this objective through targeted divestitures while at the same time permitting those parts of the merger that do not have anticompetitive effects (and indeed may generate efficiencies) to go forward. In some instances, particularly in urban areas, requiring a network of branches to be divested (along with associated deposits and loans) helps ensure that a viable, long-term competitor can replace the competition lost via the merger of competitors.

In December 1997, we secured a major divestiture in the proposed acquisition of Barnett Banks by NationsBank. NationsBank agreed to divest approximately 124 branches in fifteen areas of Florida with total deposits of approximately $4.1 billion. That is the largest bank divestiture ever in a single state and overall is second only to the divestitures required in the 1992 BankAmerica/Security Pacific transaction. The Division's investigation was conducted jointly with the Florida Attorney General's Office, which provided us with important information about local market conditions and effective relief alternatives.

Similarly, working closely with the Pennsylvania Attorney General's Office, the Division announced on April 10 that First Union and CoreStates Financial would be required to divest 32 CoreStates branch offices with total deposits of approximately $1.1 billion before they could go forward with their proposed merger. The branch offices required to be divested are located in the city of Philadelphia and in the contiguous counties of Delaware and Montgomery and in the Lehigh Valley. The divestiture that we required is already producing benefits to competition in the Philadelphia area. Those 32 branches were sold to Sovereign Bancorp, a Pennsylvania based bank. Sovereign Bancorp simultaneously purchased an additional 63 branches from First Union/CoreStates, thereby greatly enhancing its competitive stature in the city of Philadelphia and throughout the entire eastern Pennsylvania region.

Most recently, on May 4, we announced that Banc One had agreed to the divestiture of 25 branch offices with total deposits of $614 million in four Louisiana banking markets in order for its acquisition of First Commerce to go forward.

I think it is helpful to note that according to the Federal Reserve Board, which keeps such data, while banking consolidation has led to higher nationwide shares, as measured by assets, of the largest institutions in the past fifteen years, concentration in local geographic markets has remained roughly constant. This is due to a variety of factors, including antitrust enforcement by the banking agencies and the Antitrust Division, new entry into banking markets, and the fact that a number of these bank mergers did not involve competitors serving the same market and thus did not affect local market concentration.

I should emphasize that, as in other industries, we will take whatever action is necessary--and insist on whatever remedy is necessary--to prevent anticompetitive mergers. The bank mergers that have in recent years presented competitive problems, though, have been susceptible to the type of targeted divestitures that I have described, and I believe the relief we have obtained has successfully preserved competition in affected markets.

Looking to the future, the fact that some future bank-bank mergers may involve significantly larger banks is not likely to require a change to the analytical approach used by the Department to review bank mergers. We will continue to analyze the merger's impact on competition to supply each product and service provided by the merging banks in the relevant geographic areas. To the extent that there are not likely to be sufficient alternatives to the merging banks available to consumers (whether retail or business), we will not hesitate to seek necessary remedies to preserve competition. I will note, of course, on a purely factual basis that, other things being equal, the larger the shares of the merging parties with respect to certain products or services in relevant geographic areas, the more competitive concerns the merger may present.

With respect to bank-nonbank mergers, the mergers that we have reviewed to date generally have not raised serious competitive issues. However, as the financial services field continues to undergo rapid change, we will examine each market involved in such mergers closely to see if any mergers of this type may adversely affect competition and consumers.

Conclusion

I would like to conclude my remarks by emphasizing that the Antitrust Division's focus in reviewing a bank merger--and, indeed, any merger--is on whether the merger will hurt consumers by raising prices, reducing quality, or limiting innovation. Our job is to see that businesses and individuals, as consumers of credit and other banking products and services, are not harmed by consolidation within the banking industry. While we will not stand in the way of mergers that are competitively neutral or even beneficial for competition and consumers, we will continue to ensure that the competition that benefits us all is not sacrificed by mergers in the banking industry. As financial service modernization goes forward and we see mergers of larger size and scope, the Antitrust Division will continue to apply forward-looking competitive analysis to each and every merger.

Judiciary Homepage

1. The term "depository institution" refers generally to commercial banks, bank holding companies, savings banks, savings and loan associations, savings and loan holding companies, and credit unions.

2. The responsible agency is determined by the type of resulting institution, with the Federal Reserve Board and the Comptroller of the Currency most often involved in the larger banking transactions.

3. Acquisitions by bank holding companies of non-banking activities, while requiring FRB approval, are not subject to the antitrust immunity and automatic stay provisions. Under current law, these non-banking activities are defined by the FRB but must be closely related to banking. Further, acquisitions of financial services companies through a bank's operating subsidiary ("op sub"), instead of through the holding company, do not require OCC approval under the Bank Merger Act and accordingly are subject to HSR filing requirements.

4. U.S. Department of Justice and Federal Trade Commission, Horizontal Merger Guidelines, 4 Trade Reg. Rep. (CCH) ¶13,104 (April 2, 1992), *as amended*, April 8, 1997.

Testimony of the

Federal Trade Commission

Concerning

The Effects of Consolidation on the State of Competition

in the Financial Services Industry

Before the

Committee on the Judiciary

United States House of Representatives

June 3, 1998

I. Introduction

The Federal Trade Commission ("Commission" or "FTC") is pleased to have this opportunity to testify before the Committee concerning mergers and acquisitions in financial services industries.(1) Mergers of firms engaged in some aspect of financial services are increasing, caused in large part by the erosion of traditional barriers that separate industries that provide financial services. As a result, there is an accelerating transformation of financial services markets and the growth of product-based competition (e.g., several types of firms offering similar financial products), rather than competition within traditional industry segments (e.g., banking and insurance). Indeed, H.R. 10, as passed by the House of Representatives, would eliminate regulatory barriers and allow federal regulators to engage in product-based rather than industry-based regulation.

One of the implications of product-based competition is that, while there is a trend toward greater consolidation within the traditional financial services industry, there has been growth in the number of firms outside that industry that provide financial services and products. Opening up markets to new firms has the potential to result in increased competition, but it may also lead to competitive scenarios that are unfamiliar to traditional regulators. It is here that the Commission can provide significant assistance to the deregulatory effort. The Commission has a long history of examining product-based competition and ensuring that consumers are protected in the purchase of all products.

Competition in the banking and financial services industries is vital to the stability and growth of the American economy. Accordingly, any change in regulatory policy should be carefully considered, not only in light of safety and soundness, but also with regard to competition and consumer protection.

II. Background on the FTC

The Commission welcomes the opportunity to provide its perspective on how the evolution of these markets will affect consumers and the need for government enforcement in the areas of competition and consumer protection. The FTC is the sole general jurisdiction federal agency committed to both competition and consumer protection law enforcement.

In this testimony, we first discuss some important competition and consumer protection issues in financial services, followed by a discussion of how increased deregulation will affect the need for government enforcement with respect to both consumer protection and competition. Finally, we comment on the provisions of H.R. 10 which clarify the FTC's jurisdiction. We believe this clarification is important to assure that consumers receive the full benefits of the efforts to deregulate these markets.

As the financial services environment changes, there will be heightened need for vigilant review and enforcement by the FTC of both the antitrust and consumer protection laws. While the Federal Trade Commission Act does not apply directly to banks or savings and loan institutions,(2) today's financial services transactions most often involve new combinations of holding companies (bank or otherwise), nonbank companies, or nonbank subsidiaries. In such cases, the Commission has previously played an important role in eliminating unlawful restrictions on competition and in protecting consumers from fraud and deceptive practices in financial services industries. The Commission enforces the Clayton Act and the FTC Act against anticompetitive conduct, both merger and nonmerger. Furthermore, the Commission's Credit Practices Division is almost exclusively devoted to policing unlawful credit practices in the financial services industry. It also enforces a number of federal statutes relating to consumer credit practices of nonbank financial service providers. Finally, the Commission assists the banking agencies in developing consumer protection regulations and addresses issues related to electronic commerce.

III. Competition and Consumer Protection in the Financial Services Industry

The Commission believes that consumer protection and competition enforcement should work together to help ensure that consumers receive the benefits of effectively functioning markets. In the financial services area -- as in all other areas -- consumers are best served when they are able to make free choices in a free market. There are two functional requirements for a market to be free -- that competitors be able to provide a range of options for consumers, and that consumers have the ability to make informed decisions from among those options.

Those two ingredients of a free market define the roles of the Commission's competition and consumer protection functions. The antitrust laws protect the range of options in the market, barring firms from engaging in illegal price fixing, restricting entry, or otherwise limiting the choices available to consumers. The credit statutes enforced by the Commission, as well as Section 5 of the FTC Act, protect consumers' ability to select among those options, so that their choice is not distorted by deception or by incomplete or inaccurate information. Both sets of laws will play a vital role in the financial services industry.

As in many other markets, there has been a tremendous increase in mergers, acquisitions and strategic alliances in the financial services industry. Although in the past, bank to bank acquisitions were common,(3) a vast number of recent acquisitions and alliances in the financial services market involve holding companies or nonbank firms, including nonbank affiliates of banks.(4) One recent example of FTC merger enforcement in the financial services industry was the Commission's 1995 challenge to First Data Corp.'s acquisition of First Financial Management Corp., which would have combined the only two competitors in the consumer money wire transfer market, Western Union and MoneyGram.(5) This case was significant because it involved important product-based analysis of a financial services product. Millions of consumers use wire transfers, often in emergency situations, such as when a person loses a wallet or when a traveler runs out of money. They are also extensively used by consumers without banking relationships, who constitute about 20-25 percent of the total population. By requiring divestiture of MoneyGram, the Commission's enforcement action prohibited First Data from creating a monopoly in this market. We estimate that our enforcement action saved consumers $15 million to $30 million per year.(6)

Similarly, in the consumer protection area, the FTC has played a significant role in enforcement in the financial services market. Indeed, in the credit area alone, the Bureau of Consumer Protection enforces twelve federal credit laws that cover almost every aspect of consumer credit.(7) Under these statutes, the FTC engages in enforcement efforts that include, but are not limited to, preventing discrimination in credit, abusive debt collection tactics, inaccurate data reporting to credit reporting bureaus, failure to provide credit information disclosures, and deception and unfair practices in consumer credit transactions.

The Commission has extensive experience in addressing consumer protection issues that arise in the financial services industry. This experience is invaluable in considering financial industry consolidation and market realignment to reflect product-based competition. For instance, in 1992, Citicorp Credit Services, Inc., a subsidiary of Citicorp, agreed to settle charges that it aided and abetted a merchant engaged in unfair and deceptive activities.(8) In 1993, the Shawmut Mortgage Company, an affiliate of Shawmut Bank Connecticut, N.A., and Shawmut Bank, agreed to pay almost one million dollars in consumer redress to settle allegations that it had discriminated based on race and national origin in mortgage lending.(9) In 1996, the J.C. Penney Company entered into a consent decree and paid a civil penalty to resolve allegations that the company failed to provide required notices of adverse actions to credit applicants.(10) In 1998, in conjunction with the law enforcement efforts of several state attorneys general, the Commission finalized a settlement agreement with Sears, Roebuck and Company, which safeguards $100 million in consumer redress based on allegations that the company engaged in unfair and deceptive practices in its collection of credit card debts after the filing of consumer bankruptcy.(11)

In addition to these enforcement actions, the FTC provides consultation to Congress and to the federal banking agencies about consumer protection issues involving financial services. For example, the Commission has recently reported to or testified in Congress regarding the Fair Credit Reporting Act, the Fair Debt Collection Practices Act, and electronic commerce. In addition, the Commission periodically provides comments to the Federal Reserve Board regarding the Fair Credit Reporting Act, and the implementing regulations for the Truth in Lending Act, the Consumer Leasing Act, the Electronic Funds Transfer Act, and the Equal Credit Opportunity Act.(12)

IV. The Evolving Financial Services Industry

As the financial services industry joins other industries in which competition has replaced extensive regulation due to technological changes and improved understanding of markets, it is important that deregulation should be accompanied by effective antitrust and consumer protection law enforcement, to prevent the anticompetitive accumulation and abuse of private market power and to prevent fraud or deceptive practices.(13)

A. Rethinking How We View Financial Services

Where regulatory barriers are eliminated, competition has the potential to benefit consumers through lower prices, more efficient allocation of resources, and greater innovation. However, these potential savings and innovations will not appear automatically once regulation is reduced. Ensuring the benefits of competition requires vigilant enforcement of antitrust and consumer protection laws with a focus on the products and financial services delivered to consumers -- particularly where banks are permitted to join firms in other markets and industries. As the federal banking agencies have relaxed regulations on nonbank activities by banks and their affiliates, for example, banks have acquired securities firms and formed joint ventures with nonbanks. The proposed merger between Citicorp and the Travelers Group brings together a bank holding company and an insurance and securities company. Joint ventures have been created between banks and nonbanks to provide new products in emerging markets of electronic commerce. If some form of financial reorganization legislation is enacted, firms that include both banks and other entities will proliferate. While many mergers and joint ventures represent a sound response to such deregulation, others may be likely to preserve or create anticompetitive power. Accordingly, enforcers must undertake careful and sophisticated analyses to ensure that consumer benefits will not be dissipated by the accumulation of private market power or markets that fail to provide adequate consumer protection.

B. Effective Enforcement of Competition Policies

The antitrust laws were designed by Congress to apply to all industries. However, when the FTC Act was enacted in 1914, Congress excluded banks from FTC jurisdiction, apparently because they already were extensively regulated.(14) In banking, jurisdiction over competition issues, including mergers, was given to the federal bank regulatory agencies.(15) Competitive review by specialized regulatory agencies may be efficient when the regulatory structure as a whole limits mergers to intraindustry consolidations. In the new environment, however, the antitrust agencies should conduct the appropriate antitrust review.

As one of the two federal agencies responsible for merger enforcement, the FTC has a broad base of experience related to the antitrust analysis of mergers generally. Especially in a period of rapid consolidation and market expansion, it is important that the Commission consider several principles of merger enforcement that apply across all industries.

Effective merger enforcement is necessary to preserve the procompetitive effects of deregulation. In several cases in recent years, the Antitrust Division or the FTC challenged a proposed merger or acquisition to ensure that the competitive benefits of regulatory reform were not frustrated. For example, shortly after the substantially deregulatory Telecommunications Act of 1996 was enacted, the Commission challenged the acquisition of Turner Broadcasting by Time Warner, alleging that the merger would restrict other distributors' access to video programming, as well as program producers' access to distribution outlets.(16) The Commission entered a settlement with Time Warner to preserve the opportunity for telephone companies to compete against cable television companies, for cable companies to compete against telephone companies, and for wireless communications companies to compete against both telephone and cable companies -- all objectives of the Telecommunications Act.

As cross-industry expansion occurs, antitrust enforcers should protect against the loss of potential competition. When regulations limited the scope of activity of financial services firms, practically all mergers were horizontal, i.e., between existing competitors. However, recent regulatory changes enable firms to expand their products and services across traditional industry lines so that, for example, bank holding companies may own insurance or securities companies. We have already begun to see proposed mergers among firms engaged in banking, securities, and insurance. When these acquisitions occur, it is important to consider whether potential competition is eliminated. The FTC has expertise in this issue and has challenged several mergers because of the loss of potential competition. For example, competition in the delivery of natural gas has been substantially deregulated. In one recent case involving Questar and Kern River, two western natural gas pipelines, the Commission blocked an acquisition by the only transporter of natural gas into Salt Lake City of a 50 percent interest in the only potential competitive pipeline.(17) The acquisition would have eliminated potential competition from a new entrant in the natural gas transportation market.

Merger analysis should focus on whether any group of consumers may be subject to the exercise of market power. When there is a significant trend toward consolidation and the size of mergers increases, the immediate focus of attention may be at a macro level. Such a focus, however, may miss important competitive problems. In merger analysis we look to determine if there is any group of consumers who may end up paying higher prices as a result of the merger. This focus on competitive harm derives directly from Section 7 of the Clayton Act, which prohibits anticompetitive mergers "in any line of commerce," and it allows otherwise procompetitive mergers to proceed once their anticompetitive aspects have been addressed. For instance, in the FTC's First Data case, one could have argued that many consumers had other alternatives to wire transfers, such as credit or ATM cards. However, our investigation found that for those consumers without banking relationships, who were significant users of these services, credit or ATM cards were not a viable alternative.

Competitive problems can exist in markets even where prices are falling. In new or expanding markets, prices often decrease. When firms in those markets merge, they may claim that antitrust scrutiny is unnecessary because prices are falling. Although such mergers typically do not raise competitive concerns, that does not suggest that antitrust scrutiny is unnecessary. In our challenge to the Staples-Office Depot merger last year, the defendants made that argument without success. In enjoining the merger, the court held that, although prices had decreased over time, eliminating competition between Office Depot and Staples would slow that trend, which would result in a price increase to consumers. Consumers deserve the benefit of all economic and competitive forces that are moving in the direction of lower prices and higher quality goods, and competition enforcement can insure that they get these benefits.

Where enforcement action is necessary, settlements should restore the competition that existed before the merger. Our obligation as antitrust enforcers is not only to bring cases but also to ensure that, where settlement is appropriate, sufficient assets are divested to restore competition to the premerger level.

Over the past three years, the Commission has given renewed attention to assuring that divestitures required by our consent agreements effectively restored competition. The Commission implemented a number of reforms to improve the divestiture process. These changes include imposing shorter divestiture periods, identifying up-front buyers, requiring broader asset divestiture packages, appointing interim trustees, and imposing "crown jewel" provisions.(18) The Commission now insists that divestitures be accomplished in a shorter time so that competition is restored more quickly and it is less likely that assets will deteriorate in the interim. These reforms have begun to show progress in the divestiture process: the average time to divestiture has fallen by more than a third. Currently, many consent agreements have up-front buyers.

The Bureau of Competition is also engaged in a long-term review of past divestitures to determine whether they are effective in restoring competition. Based on the interim results of that review, we are trying to improve our analysis of how to structure effective consent agreements. Designing divestitures in retail markets can be particularly difficult. It is often critical to require a divestiture of a sufficient set of retail locations to a single buyer. Divestiture to a single buyer is often preferable so that a firm can acquire the full range of distributional and advertising efficiencies.

C. The Importance of Consumer Protection Law Enforcement

Expanding markets, deregulating markets, and markets undergoing rapid technological change attract those who prey on the vulnerable. Consumer protection plays an important role in the development of these markets, especially in financial service markets, where safety and security are crucial to consumers.

One example of how the Commission has addressed the challenges of an evolving environment for financial services is in the area of subprime lending. Subprime loans, the extension of credit to higher-risk borrowers, have typically been made by nonbank lenders and are increasingly being made by large corporations that operate nationwide. Although subprime lenders provide loans to consumers who previously have been underserved by banks and other creditors, questions are increasingly being raised about the abusive practices that are reportedly occurring in the industry and about the effects of these practices on the most vulnerable consumers. These abusive lending practices often involve lower-income, elderly, and minority borrowers who may not have easy access to competing sources of credit. The effects of this type of "predatory lending" are severe -- consumers can lose their homes and all the equity that they have spent years building. The Commission has begun to address reported abuses in the subprime home equity market. In recent testimony before the Senate Select Committee on Aging,(19) the Commission outlined its approach consisting of individual law enforcement actions,(20) coordinated enforcement with states,(21) and consumer education.(22)

Another consumer protection concern relates to the privacy of consumers' commercial transactions. Over the last several years, the Commission has been particularly active on privacy issues and has held workshops, convened public meetings, conducted studies, issued reports, and testified before Congress regarding privacy issues.(23)

Cross-industry mergers, such as the Citicorp/Travelers Group transaction, may raise important privacy concerns, in particular over the treatment of consumer information by affiliated companies. Such mergers may allow detailed and sometimes sensitive information about consumers, including medical and financial data, to be shared with relatively few restrictions among newly related corporate entities.(24) Consumers might not anticipate that providing information to one entity for insurance underwriting purposes, for example, might later be used for different purposes by a financial institution that is or becomes an affiliate. The Commission is examining a number of issues relating to consumer privacy issues and tomorrow will present Congress with a report and recommendations.(25)

V. The Importance of FTC Jurisdiction

As set forth above, the Commission will continue to protect consumers and competition as restrictions applicable to the financial services industries are reduced. We believe the clarification in H.R. 10 will provide greater comfort to consumers as the financial services industry undergoes rapid transformation. As banks or their affiliates are authorized to enter nonbanking arenas in which both competition and consumers have traditionally been protected by the FTC, it is important that the Commission's ability to continue to protect competition and consumers in these nonbank businesses not be restricted. If market forces are to succeed in delivering the benefits of competition and nondeceptive information for consumers, the FTC must continue to bring its expertise to bear in markets in which it is now active. H.R. 10 clarifies the FTC's jurisdiction to ensure that the Commission continues to have the ability to enforce the competition and consumer protection laws with respect to nonbank companies.[26]

VI. Conclusion

As the financial services industry undergoes great change, it is important that consumers share in the benefits of consolidation. Technological innovations in electronic commerce, along with service innovations that combine banking, securities, and insurance elements have increased the potential for competition among industries that were once rigidly separated. Many of the legal and regulatory structures erected over the last fifty years are being streamlined or removed. These changes have the potential to increase consumer welfare far into the future.

Our competition enforcement action in First Data and our consumer protection enforcement action in Capital City Mortgage reflect important parallels. The markets in both of these cases were developed by nonbank financial service providers and serve the increasingly expanding population of consumers without banking relationships. Although the general expansion of the financial services industry may suggest more competition and choices for the majority of consumers, there are still a large number of underserved consumers who may not receive the benefits of this expansion. These consumers may have very limited choices in the market and may be particularly vulnerable to the exercise of market power or fraudulent or abusive activities. For these consumers, diligent enforcement of competition and consumer protection laws is particularly important.

These enforcement actions also suggest the value of lodging both competition and consumer protection responsibilities in a single agency. Having a single agency address both issues enables the consumer protection and competition missions to exchange information with each other and develop a unified approach to rapidly evolving markets. This enables the FTC to perform the fundamental function of protecting the basic conditions to effective consumer choice -- options in the marketplace, and an ability to choose freely and knowledgeably among them.

This potential must be protected and nurtured through, among other policies, strong antitrust and consumer protection law enforcement. Commission antitrust enforcement has been effective in the broader financial services market in preventing the anticompetitive accumulation and abuse of private market power. The Commission has developed significant expertise in addressing both competition and consumer protection issues regarding financial services and nonfinancial commercial enterprises. For these reasons, the Commission believes that it should continue to have all the tools necessary to fulfill this vital role into the future.

Judiciary Homepage

1. The written testimony represents the views of the Federal Trade Commission. My oral presentation of the testimony and responses to any questions are my own and do not necessarily represent the views of the Commission or any individual Commissioner.

2. 15 U.S.C. §§ 45(a)(2), 46(a).

3. When one bank merges with another bank, jurisdiction is shared by the Antitrust Division of the

Justice Department and the federal banking agencies.

4. The FTC retains its general jurisdiction over consolidations involving nonbank firms.

5. First Data Corp., C-3635 (April 8, 1996). First Data and First Financial were also two of the largest participants in the credit card merchant processing business. The Commission conducted an extensive investigation of that market but took no enforcement action respecting it.

6. In addition, the Commission and its staff have examined competition issues in both merger and nonmerger investigations in many other financial services markets and related fields -- industries that may well merge or collaborate with banks under the proposed financial services modernization bill, H.R. 10. *See, e.g.*, LandAmerica Financial Group, Inc., C-3808 (May 20, 1998) (real estate title plants); Ticor Title Ins. Co., 112 F.T.C. 344 (1989), *aff'd sub nom.* Ticor Title Ins. Co. v. FTC, 504 U.S. 621 (1992) (title search and examination services); American General Ins. Co., 97 F.T.C. 339 (1981) (merger of insurance companies); Remarks of Chairman Pitofsky on Competition and Consumer Protection Concerns in the Brave New World of Electronic Money, Department of Treasury Conference on Electronic Money & Banking (Sept. 19, 1996); Comments of Staff of the Bureau of Economics, jointly with the Antitrust Division, to the Commonwealth of Virginia regarding limitations on who may handle closings of real estate purchases and financing, home equity loans, and refinancings (Sept. 20, 1996, and Jan. 3, 1997).

7. These are the Equal Credit Opportunity Act, Fair Credit Reporting Act, Fair Debt Collection Practices Act, Truth in Lending Act, Consumer Leasing Act, Fair Credit Billing Act, Electronic Fund Transfer Act, Women's Business Ownership Act, Fair Credit and Charge Card Disclosure Act, Home Equity Loan Consumer Protection Act, Competitive Equality Banking Act, and Home Ownership and Equity Protection Act.

8. Citicorp Credit Services, Inc., 116 F.T.C. 87 (1993).

9. United States v. Shawmut Mortgage Co., 3:93CV-2453AVC (D. Conn. Dec. 13, 1993).

10. United States v. J.C. Penney Co., CV964696 (E.D.N.Y. Oct. 8, 1996).

11. Sears, Roebuck and Co., C-3786 (Feb. 27, 1998).

12. Commission staff participates in numerous task forces and groups concerned with, for example, fair lending, leasing, subprime lending, electronic commerce, and commerce on the Internet, all of which have an impact on the financial services industry.

13. The Commission and its staff have provided comments and studies about financial services industries, as well as telecommunications, trucking, electric utilities and other industries undergoing deregulation. Regarding financial services, *see, e.g.*, Testimony of the Commission concerning H.R. 10, before the Subcommittee on Finance and Hazardous Materials, House Commerce Committee, July 17, 1997; Comments of the Staff of the Bureau of Economics to the SEC on Regulations Governing Registration and Reporting Disclosures of Small Business Issuers (1992); Bureau of Economics Staff Report, Minimum Quality Versus Disclosure Regulations: State Regulation of Interstate Open-ended Investment Company and Common Stock Issues (1987).

14. *See* United States v. Philadelphia National Bank, 374 U.S. 321, 336 n.11 (1963) ("the exclusion of banks from the FTC's jurisdiction appears to have been motivated by the fact that banks were already subject to extensive federal administrative controls").

15. *See* Bank Merger Act of 1996, 12 U.S.C. § 1828(c); Bank Holding Company Act, 12 U.S.C. § § 1842-43; and Home Owners' Loan Act, 12 U.S.C. § 1467a(e).

16. Time Warner Inc., C- 3709 (Mar. 11, 1997).

17. Questar Corp., 2:95CV-1127S (C.D. Utah Dec. 27, 1995) (transaction abandoned).

18. A settlement package includes a crown jewel provision when it requires divestiture of a more valuable asset if the agreed-upon divestiture is not accomplished within a set time period.

19. *See* Prepared Statement of the FTC on Home Equity Lending Abuses in the Subprime Mortgage Industry, before the Senate Special Committee on Aging (Mar. 16, 1998).

20. For example, in January 1998, the Commission filed a complaint in the United States District Court for the District of Columbia against Capital City Mortgage Corporation, a Washington, DC-area mortgage lender, and its owner, alleging numerous violations of federal laws resulting in serious injury to borrowers, including the loss of their homes. FTC v. Capital City Mortgage Corp., No. 1:98-CV-00237 (D.D.C. filed Jan. 29, 1998).

21. In 1997, the FTC conducted joint law enforcement sessions on home equity fraud with state regulators and law enforcers in six different cities.

22. *See, e.g.*, FTC Facts for Consumers brochures such as "Home Equity Scams: Borrowers Beware!"; "Home Equity Loans: The Three Day Cancellation Rule"; "Reverse Mortgages-Cashing In On Home Ownership."

23. For example, the Commission and its staff have issued reports describing various consumer privacy concerns in the electronic marketplace. These include FTC Report to Congress: *Individual Reference Services*, December 1997; FTC Staff Report: *Public Workshop on Consumer Privacy on the Global Information Infrastructure*, December 1996; FTC Staff Report: *Anticipating the 21st Century: Consumer Protection Policy in the New High-Tech, Global Marketplace*, May 1996. In addition, the Commission presented testimony on September 18, 1997, on the Implications of Emerging Electronic Payment Systems on Individual Privacy before the Subcommittee on Financial Institutions and Consumer Credit, House Committee on Banking and Financial Services; on March 26, 1998, on Internet Privacy before the Subcommittee on Courts and Intellectual Property, House Committee on the Judiciary; and on May 20, 1998, on Identity Theft before the Subcommittee on Technology, Terrorism and Government Information, Senate Committee on the Judiciary.

24. Under the FCRA, the transactions or experiences between a consumer and a company may be communicated among affiliated companies without restriction. The communication of other information to an affiliate may be made if a disclosure is made to the consumer and the consumer is given the opportunity to direct that the information not be communicated.

25. This report focuses on the effectiveness of self-regulation as a means of protecting consumer privacy online. The Commission summarizes and assesses the findings from its March 1998 comprehensive survey of commercial Web sites. The report also includes the Commission's analysis of existing industry guidelines and principles on the online collection and use of consumers' personal information.

26. The House-passed bill recognizes that continued Commission oversight of mergers and acquisitions in the financial services industries would help to insure that the policies behind the antitrust laws will be effectively applied as those industries undergo sweeping restructuring. Title I, Subtitle E of H.R. 10, titled "Preservation of FTC Authority," is designed to confirm that nonbank companies, even if affiliated with banks, continue to be subject to the FTC's jurisdiction. In particular, Title I, Subtitle E ensures that, in financial holding company mergers, those portions not subject to federal banking agency approval are subject to standard premerger review under the Hart-Scott-Rodino provisions of the Clayton Act. This will assure review by the federal antitrust agencies of the new affiliations permitted under H.R. 10. These provisions will enable the Commission to receive notice of mergers and acquisitions in financial services industries, so that it can take timely enforcement action to protect consumers and competition.

JOINT STATEMENT

of

CITICORP AND TRAVELERS GROUP

to the

HOUSE JUDICIARY COMMITTEE

Wednesday, June 3, 1998

Witness: John J. Roche, General Counsel (Citicorp)

Good morning, Mr. Chairman, I am John Roche, General Counsel of Citicorp. I are pleased to be here this afternoon to talk about the new company we propose to create -- Citigroup -- and to answer any questions you may have -- regarding anti-trust issues or otherwise -- about the merger.

There are three basic objectives in the creation of Citigroup: increasing customer value and convenience; enhancing our financial strength and stability; and meeting the rapidly growing competitive challenge. I will briefly discuss each in turn.

Customer Value and Convenience

Mr. Chairman, our merger involves a combination of separate businesses: banking, insurance and securities. The ultimate test for our new company will be simple: Will we provide a high level of value and convenience to our customers? We believe we will because of the quality and breadth of our products and services and because of the new company's greatly expanded and innovative distribution channels. Financial products "manufactured" in various parts of our company will be distributed through a broad range of facilities and methods, from the Internet and other technology-based methods to branch office locations in one hundred countries around the world to fully individualized in-home service.

Citigroup also will have the resources to rapidly design new products and services in response to changing customer needs and to invest the funds necessary to keep up with the technology revolution sweeping across our industry.

The scope of our efforts will be key: starting immediately we hope to provide more kinds of financial products and services, in more kinds of ways, to more customers than any other company in the world. Of course, the test of whether or not we succeed will be in the hands of those customers, who will decide whether the products and services we provide, at the prices charged, ultimately satisfy their needs and preferences.

Strength and Stability

The size, resources and diversity of operations of the new company will provide the financial strength and stability necessary to survive and grow in today's rapidly changing world. Whether it is a country crisis, a real estate crisis, or any other crisis, it is clear that the financial services company of tomorrow must have the ability to withstand financial shocks. As companies become larger and more diverse, they are better able to withstand those shocks. Providing major financial services in 100 countries around the world will provide Citigroup a stable and predictable platform of revenues and profits. That stability is essential if we are to continue to serve our one hundred million customers.

Competitive Challenge

There is perhaps no other industry in the world as competitive as the financial services industry. Whether it is intra-industry competition among various commercial banks or among various insurance companies or among securities firms; or whether it is inter-industry competition between banks, mutual funds and securities companies; whether it is between domestic companies or the increasingly active foreign companies; or whether it is between traditional branch office networks or the latest Internet web site, the competition for the customer and his or her business is fierce.

In the new family of companies known as Citigroup, we will combine individual business units in a way that will enhance their competitive position. These individual units are strong companies, but not dominant or even the leading company in their respective industries -- Citibank is not the largest bank in the United States; Salomon Smith Barney is not the largest securities firm in the United States; Travelers Insurance is not the largest insurance company in the United States.

The effect of foreign competition on the financial services industry is particularly striking. While we in the U.S. grapple with modernizing the legislation governing our financial services system, massive consolidation of financial services firms is rapidly taking place overseas. Having long since put those arguments behind and unhampered by outdated and inefficient financial services laws, these new mega-competitors will have a competitive advantage over U.S.-based companies in the next century (now less than two years away) if we are not prepared to compete on a global basis. We must not squander a leading market position through inattention and neglect. It is in the national interest of the United States to provide the environment for its financial services firms to be well prepared for this challenge.

Other Issues

In addition to customer value and convenience, strength and stability, and meeting competition, there are a few other matters I would like to mention briefly. The first is the Citigroup's status under present law. The creation of Citigroup is expressly permitted by current law and regulations; no change in the law is necessary. We will be in full compliance with the law on the day we close our merger and will remain so. We do not seek -- and do not require -- any special legislative or regulatory accommodation to create Citigroup.

At the same time, we strongly support financial modernization and urge the passage of legislation this year. The recent passage of H.R. 10 in the House of Representatives was truly an historic step toward that goal. It is now the turn of the Senate to act, and we are encouraged by the recent statements of Chairman D'Amato and Ranking Member Senator Sarbanes that the Banking Committee will turn to that task.

With regard to H.R. 10, you asked our opinion on the amendment to the Hart-Scott-Rodino Act that was included in Section 143 of H.R. 10. That amendment would require a financial holding company to make a Hart-Scott-Rodino filing to the Federal Trade Commission and the Justice Department whenever it acquires another company engaged in activities that are "financial in nature," such as an insurance company, a securities firm, or an investment company. Currently, when the Federal Reserve Board reviews acquisitions of non-banking firms by bank holding companies it evaluates the impact of the acquisition on competition, including the potential for undue concentration of resources, decreased or unfair competition, and conflicts of interest. This amendment, therefore, would shift the focus of the anti-trust review from the Federal Reserve Board to the Federal Trade Commission and the Justice Department for activities that are "financial in nature." We have no objection to such a change.

The second issue is regulatory oversight. We have long accepted functional regulation; indeed, virtually every aspect of each of our various businesses is, and has been, heavily regulated. Since the new Citigroup will not be engaged in any "commercial" activities, our regulators will all be very familiar to you -- the Federal Reserve Board, FDIC, OCC, OTS and various state banking authorities to the SEC to the fifty state Departments of Insurance. Working with a variety of regulators in the most effective way is one of the challenges -- one of the opportunities -- created by our new company.

The third issue I would like to mention is our commitment to our communities. Citigroup is focused on delivering customer value and convenience. We are just as focused on demonstrating our commitment to the communities in which we are active. As our Fed application clearly shows, we believe both companies have been good corporate citizens and have done an excellent job in meeting our Community

Reinvestment Act obligations. We intend to build on this record and do even more in the future. The combination of our two companies will give us the opportunity to increase the access to credit, deposit, investment and insurance offerings for customers of all income groups, and we intend to do so.

In closing, Mr. Chairman, let me reemphasize the importance of maintaining a leading U.S. position in financial services in the new, global economy. Emerging markets, privatization, and dramatic growth in savings and investments worldwide present a competitive challenge to U.S. financial services companies. We believe the Citicorp Travelers Group merger will create a leading U.S. global competitor.

Thank you for this opportunity. We would be happy to answer any of your questions.

Judiciary Homepage

JOINT STATEMENT

of

NATIONSBANK CORPORATION AND BANKAMERICA CORPORATION

to the

HOUSE COMMITTEE ON THE JUDICIARY

WEDNESDAY, JUNE 3, 1998

Witnesses: Paul J. Polking, General Counsel (NationsBank Corporation)

James N. Roethe, General Counsel (BankAmerica Corporation)

Testimony to the House Committee on the Judiciary

June 3, 1998

Mr. Chairman, members of the committee. I am Paul Polking, General Counsel of NationsBank Corporation. My partner, Jim Roethe, general Counsel of BankAmerica Corporation, and I are pleased to be here this afternoon to discuss the effects of consolidation on the state of competition in the financial services industry.

In assessing the competitive effects of the mergers involving financial institutions, it is important to keep in mind that each of the mergers before the committee today is unique.

For example, the Citicorp/Travelers transaction is based on a product diversification model - a bundling of the broadest possible array of financial services, while the Banc One/First Chicago NBD transaction represents a regional geographic diversification -- the merger of two midwestern banking organizations operating in contiguous markets to create a broad regional franchise.

The merger of NationsBank and BankAmerica is simply the combination of an east coast bank and a west coast bank to create the first truly nationwide banking franchise.

NationsBank holds approximately $311 billion in assets and $174 billion in deposits. NationsBank is geographically diversified with commercial banking operations in sixteen Southeastern, Mid-Atlantic, Mid-Western and Southwestern states and the District of Columbia. This diversification has enabled NationsBank to reduce the credit risk associated with any one region or industry group such that NationsBank has been able not only to weather regional recessions without significant problems, but to prosper and improve its capital and liquidity position in recent years.

BankAmerica holds approximately $265 billion in assets and $174 billion in deposits. Like NationsBank, BankAmerica is geographically diversified with commercial bank subsidiaries operating primarily in eleven Northwestern, Western, and Southwestern states. The merger with NationsBank will bring much greater diversification, with the combined franchise being focused in high growth markets across the nation.

The new BankAmerica will hold approximately $576 billion in assets and $348 billion in deposits. Notwithstanding the overall size of the resulting institution, the proposed merger of equals between NationsBank and BankAmerica raises almost no competitive issues with respect to banking activities.

For the most part, the parties are complementary in geographic scope; the commercial banking operations of our companies overlap locally in only two states -- Texas and New Mexico. The safe harbor thresholds for deposit market concentration established by the Federal Reserve Board and the Department of Justice appear to be exceeded only in the Albuquerque, Clovis and McKinley County markets in New Mexico and in Dallas, Texas. In the other overlap markets in New Mexico and Texas, the deposit concentration levels are within the 1800/200 safe harbor threshold.

In order to minimize competitive concerns, we are discussing with federal authorities the divestiture of branches holding sufficient deposits and associated loans to bring market concentration within safe harbor levels in the New Mexico markets of Albuquerque, Clovis and McKinley County. We believe that deposit market concentration, based on eleven-month old data, is overstated in the Dallas market, and that substantial mitigating factors warrant the conclusion that no divestitures are required in the Dallas market.

Keeping in mind the nature of the NationsBank/BankAmerica transaction -- the creation of the first nationwide banking franchise -- and the fact that there is very little overlap of banking markets served by the two companies, we think it is clear that there are virtually no competitive issues raised by the proposed merger.

The idea that the combination of two large banks, or any other companies, results, solely because of their size, in a situation that is anti-competitive or otherwise bad for our customers, or consumers, businesses, and the economy generally, is simply not true. Following the mergers that you will hear about today, there will still be thousands of banks and other financial services companies serving consumers and businesses in the United States.

In the NationsBank/BankAmerica merger, we believe that consumers are the real winners. We will have the ability to offer our customers a new level of services with coast to coast branches and ATMs. Our presence across the nation will translate into convenience and value.

Scale and efficiency are already translating into lower prices, NationsBank has just recently passed on the advantages of scale to 5 million individual deposit customers by eliminating a number of fees and freezing monthly fees on our two most popular checking accounts through the year 2000. We estimate that these changes alone will result in annual savings in fees of approximately $24 million for our customers in 1998. These changes have also resulted in increased customer retention and new accounts.

Just as importantly, the combined company will have the financial resources to sponsor the development of superior technology to make banking increasingly convenient to our customers through telephones, personal computers and even interactive television. The time for developing alternatives to the branch delivery system is now. Today, NationsBank and BankAmerica customers conduct more transactions outside traditional branches than inside them - over the telephone, at ATMs, through personal computers and at grocery store banking centers.

The merger will also result in an institution that is better able to meet the credit needs of the communities it serves. NationsBank and BankAmerica customers and the communities in which they live will benefit from the most comprehensive community investment program ever to be offered -- NationsBank and BankAmerica have announced a $350 billion/10 year commitment to CRA activities.

The merger is simply a reflection of the marketplace's drive to give customers what they want more efficiently and effectively.

As for the impact of the merger on the overall economy, the combined company will act as a powerful engine by efficiently and effectively providing capital to a wide range of businesses - from the smallest to the largest. At the same time, the combined company will have tremendous stability as a result of its capital position and economic and geographic diversification.

The last point I would like to cover is the impact of our merger on competition both relative to small banks and in the international arena. As I mentioned earlier, despite the consolidation that the banking industry has undergone and the mergers we're discussing today, there are still thousands of banks and other financial services providers, including many small banks, serving consumers and businesses. In addition, more than two hundred new bank charters were granted last year alone. Most of these banks are community banks perceiving an opportunity to provide an alternative to the kind of companies represented here today.

Internationally, as evidenced by the recently announced mergers of UBS and Swiss Bank, Royal Bank of Canada and Bank of Montreal and Canadian Imperial Bank of Commerce and Toronto Dominion, consolidation is happening all around us. U.S. banks must be allowed to keep pace in order to maintain the preeminence of the U.S. financial services industry and to fuel economic growth.

This concludes my remarks. Mr. Chairman and members of the committee, we thank you for the opportunity to appear before you.

Judiciary Homepage

Testimony

of

James L. Foorman

Senior Vice President

Law Department

First Chicago NBD Corporation

Before the

House of Representatives

Committee on the Judiciary

June 3, 1998

Mr. Chairman, I am James L. Foorman, Senior Vice President in the Law Department of First Chicago NBD Corporation, headquartered in Chicago, Illinois. My background includes some 24 years of experience in the banking industry.

I appreciate the opportunity to appear before the Committee today to address the subject of merger activity in the financial services industry and its effect on competition.

What we are seeing today in banking is no different from what is occurring in other industries. Companies combine to achieve economies of scale, foster product innovation, and respond to the changing needs and preferences of their customers.

Just 2 ½ years ago, First Chicago NBD Corporation was created in a merger of equals transaction between NBD Bancorp of Detroit, Michigan, and First Chicago Corporation of Chicago, Illinois. At that time, NBD and First Chicago were then the largest banks headquartered in Michigan and Illinois, respectively. The First Chicago-NBD merger has been, we believe, a success story for our customers, our employees and our communities.

We believe that all of these constituencies benefit from larger, stronger banks, and that ultimately the nation's economy in general will be strengthened. Further, we are confident that this consolidation will be accomplished while maintaining the competitiveness that has characterized the financial services industry.

On this latter point, I would observe that the current process, with reviews both by the Federal Reserve and the Department of Justice, has been more than adequate to address matters of product overlap and geographic concentration. In our pending merger with Banc One Corporation, for example, we have publicly said that we would divest substantial assets in the state of Indiana, where both organizations have a significant presence. All of the competitive aspects of our transaction will be reviewed and approved by both the Department of Justice and the Federal Reserve.

In the final analysis, virtually everything we do as a business must consider the interests of our customers as primary. If they don't find our products and services valuable, we cannot succeed. In the case of bank mergers, it is not the size of the institution *per se* that's important, but rather how that size can more effectively and efficiently serve customers. Indeed, no matter how large a bank may be, it must remain close to its customers to be successful.

The ability to deliver a broader array of banking products and services across a broader geography is at the heart of this issue. Over the years, our customers' needs and preferences have changed dramatically - and we expect they will keep changing in ways we cannot predict. Today's consumers want choices in the products they use and convenience in how they do business with their bank.

Convenience and choice are vital to our business customers as well. Even the smallest businesses are demanding more sophisticated cash management vehicles as well as financing solutions. Small and mid-sized businesses are becoming more global, and look to their banks to help them manage multiple currencies and move money around the world.

What enables us to serve these needs, in large part, is technology. Certainly technology is an important driver in bank mergers. The systems and technological infrastructure needed to serve our customers today and in the next century require enormous economies of scale that can only be achieved by combining the resources and earnings potential of companies like First Chicago NBD and BANC ONE.

The growth of the organization and its enhanced earnings power also benefit the communities we serve, through the financial services we provide as well as our philanthropic and civic involvement.

Finally, there is an additional benefit to the broader geographic presence that results from combinations such as the proposed merger of First Chicago NBD with BANC ONE. Our organization, particularly in its consumer, small-business and middle-market business, has been solidly grounded in the Midwest. We - along with our customers - have learned how to manage through the Midwest's often difficult business cycles. But we believe there is an advantage to the institution, to our customers, and indeed to the banking system, in the greater economic diversity associated with a larger geographic "footprint." In that sense, the same forces that allow customers to access our services over a wider area also serve to help protect the franchise itself.

In summary, we believe that bank mergers are necessary to the continued health of the financial services industry in the United States, and that these combinations serve to benefit bank customers, employees, and communities.

Mr. Chairman, thank you for permitting me to share our views with the Committee. I would be pleased to respond to any questions you or your colleagues might have.

Judiciary Homepage.

U.S. House of Representatives

Committee on the Judiciary

Written Statement

of

Steven A. Bennett, General Counsel

on behalf of

BANC ONE CORPORATION

Mr. Chairman and Members of the Committee:

I am Steve Bennett, General Counsel of BANC ONE CORPORATION, and I am pleased to be representing the company in the critical discussions you've initiated with my industry today.

My remarks will be brief and, I hope, to the point.

The BANC ONE/First Chicago NBD merger appears rather modest compared with the august combinations represented here today. Although our merger is within a single geographical region - the Midwest - the only significant market overlap is in the State of Indiana which we plan to handle with the adroit sensitivity incumbent upon any experienced and enlightened institution which intends to maintain customers and community good will.

It would be a mistake, however, to deem the new BANC ONE a Midwestern bank given our significant assets and growth in Texas, Arizona, Louisiana, Utah, Oklahoma and Colorado.

Although this merger may look like "more of the same" to the regulators and our competitors, it does represent some historic changes for BANC ONE.

First and foremost, it will mean moving our headquarters to Chicago from Columbus which means we'll be a powerhouse in the financial center of the Midwest but saddens some of us who are now and always will remain loyal to Ohio. It will give us a high-profile opportunity to demonstrate our commitment to our non-headquarters marketplaces.

Our Chairman, John B. McCoy, will become the President and CEO while First Chicago NBD's Chairman will become the Chairman of the new BANC ONE.

Since the enactment of the Bank Holding Company Act of 1956, the Federal Reserve Board and the Justice Department have worked together to apply the nation's anti-trust laws to the merger activities of bank holding companies operating in multiple states. There is no reason for this critical oversight role to change as a result of mergers like ours or any financial modernization legislation passed by Congress. Indeed, the combined oversight of the Federal Reserve Board and Department of Justice has been more than adequate to ensure a free, open and competitive market for financial services. This oversight, coupled with the national deposit caps embodied in the Riegle-Neal legislation, prevent the creation of monopolies in the financial services industry.

Our experience in merger activity to date is that the regulators are tough and the competition, especially from the smaller, "community" banks, is tougher. You cannot help but notice that each announcement of a merger is reported in local newspapers along with the attendant article outlining how smaller banks and their people are preparing to cannibalize the merged institution's retail and commercial customer base during and after the transition. And they mean it! And we mean to hold those same customers. We win some and we lose some and that's how the free market works.

But banks and other insured depository institutions are not our only competitive concern. The insured certificate of deposit is no longer America's investment product of choice. Today the customer demands access to higher yields and broader options. Many folks make decisions regarding their financial services over the phone and the choices of products and suppliers are virtually unlimited. If recent history is any indicator, soon most investment and other financial services decisions will be made via personal computers. Currently it is estimated that nearly 5 million investors trade stocks online and that number grew 150% in the last half of 1997 alone.

BANC ONE has sought out merger partners in order to compete with the full spectrum of financial service providers. Others may prefer to specialize in one or several niches customized to their selected customer targets. We hope to develop the economy of scale necessary to support the technological systems and expertise required of a premiere provider of the complete range of financial services products at a very competitive price.

If we restrict the conversation to just the banking industry, 1/3 of all the nations' banks are now offering PC home banking. Three years ago there were less than 1 million customers. Today there are over 7 ½ million. In three years it is anticipated that there will be well over 15 million banking computer customers.

These customers know no geographic limitations. They are not interested if their bank or broker or insurance agent is down the street or around the world. BANC ONE wants to be their bank, broker and agent.

The competition gets fiercer every day and we're dedicated to meeting the challenge in the growing number of communities where the bank branch is our signature as well as the national and international marketplace.

Again, thank you for this opportunity and I look forward to your questions.

Judiciary Homepage

Testimony

of

William L. McQuillan

President

of the

Independent Bankers Association of America

before the

United States House of Representatives

Committee on the Judiciary

on

"The Effects of Consolidation on the State of Competition in the Financial Services Industry"

June 3, 1998

William L. McQuillan

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Good afternoon, Mr. Chairman. I am Bill McQuillan, president of the Independent Bankers Association of America and president of The City National Bank, an $18 million bank located in Greeley, Nebraska. I also serve as an elected director on the board of directors of the Federal Reserve Bank of Kansas City.(1) It is an honor and a pleasure to appear on behalf of the IBAA before the House Judiciary Committee, and to discuss the timely issue of bank mergers and their potential for anticompetitive effect. In particular, Mr. Chairman, the IBAA appreciates the opportunity to set forth on the record a brief summary of our concerns about recent bank mergers and the trends they reflect and augur. We appreciate that this Committee, under your leadership, is taking a hard look at the recent wave of mergers. Although banks and banking have not been a core concern of this Committee, we believe that a number of proposed bank mergers that currently await regulatory approval raise issues of concentration and competition that have long been central to this Committee's work. We appreciate that the Committee is deploying its considerable antitrust background and expertise to look into these developments.

I want to organize my remarks today in terms of two ostensibly separate types of bank mergers: those between existing banks, and those between banks and nonbank entities. Both are, of course, subject to section 7 of the Clayton Act.(2)

BANK-BANK MERGERS

The first of these--mergers between existing banks--falls easily into traditional patterns of antitrust analysis, generally that concerned with so-called "horizontal mergers." The assumption has been that such mergers between competitors present obvious dangers of restraining competition. On the other hand, at least two factors are relied on by the proponents of interbank mergers to dismiss those dangers. First, we are told, many recent and proposed bank mergers have principally affected markets in which competition is and will remain robust, thanks to a large number of competitors; consequently, the argument goes, the loss of a number of competitors to interbank mergers will have no appreciable anticompetitive effects, such as a diminution in accessibility and quality of banking services and an increase in fees.

Second, we will be told, many of the very largest interbank mergers, including that proposed between NationsBank and Bank of America, involve large banks that have not generally competed in the same geographic markets. In fact, we may be told that such transactions are not really horizontal mergers at all, but conglomerate mergers involving non-competing (albeit huge) entities in discrete markets. Consequently, the argument continues, the consolidation of behemoths, whose operations are concentrated on the east and west coasts respectively, can entail few legitimate fears of anticompetitive effect.

We believe this argument to be conveniently myopic. We must look behind such gross generalities advanced to excuse all manner of interbank mergers. For example, it is time to reexamine the relevance geography has to market definition in the modern banking industry. Modern banking is no longer bound by local and isolated markets. We are dealing with a global, 24-hour market in currencies, securities and funds, linked by computers and, as a practical matter, accessible to all. Clearly credit card and debit card marketing and usage know no geographic boundaries. And large bank mergers impact the already limited ownership of the crucial electronic payment networks. Accordingly, the fact that each of two large merger candidates maintains brick-and-mortar retail banking outlets primarily in disparate geographical localities is irrelevant in terms of potential anticompetitive impact. The question is: What is the nationwide effect of truly nationwide banking?

Effect on Prices, Small Business Lending and Economies of Scale

We should examine empirically the economic impacts of recently-consummated interbank mergers. What have been their real effects, on access to banking services by consumers, and on convenience? What have been their observable effects on the level of fees and charges, and related phenomena such as minimum balance requirements? Have fees gone down and services expanded, as the proponents of these mergers would have us believe? Or, have fees to consumers gone up as large banks have become increasingly bureaucratized and oblivious to the needs of their customers?

In fact, the body of evidence shows that increased concentration has not benefitted bank customers, who correctly perceive an across-the-board increase in fees and charges. According to a March 1998 Checking Account Pricing Study of 350 banks nationwide conducted by Bank Rate Monitor, none of the top 50 banks in the U.S. offer the least expensive checking account. The best deals are offered by smaller regional and community banks. Ironically, the banks offering the most expensive checking accounts turned out to be none other than the banks involved in the latest round of proposed megamergers: Citibank, San Francisco; Barnett Bank, Tampa (merging into NationsBank); NationsBank, Tampa; and NationsBank, Orlando.

The Federal Reserve Board's Annual Report to the Congress on Retail Fees and Services of Depository Institutions (June 1997) found that the average fees charged by multistate banks are significantly higher than those charged by single-state banks, even accounting for the role of locational and other factors that might explain differences in the level of fees charged. And a 1997 study by the U.S. Public Interest Research Group, *Big Banks, Bigger Fees*, found a widening fee gap between large and small banks as fees climbed at big banks, while dropping at small ones. In the previous two years, fees at large banks had risen 3 percent, but fell 2 percent at small banks.

A recent paper by two economists (Simons and Stavins) at the Federal Reserve Bank of Boston questions whether antitrust enforcement has been sufficiently vigorous since mergers have an adverse effect on consumer deposit pricing. Their study of 499 bank mergers found the combined banks lowered interest rates paid on deposits regardless of the amount of competition in the market. In short, there is reason to believe that the vaunted "efficiencies" to be realized by interbank mergers are not in fact being passed along to the consumers. If not to consumers, then to whom?

The effect of interbank mergers on small business lending is also of concern, as small business lending receives short shrift in a banking world of ever larger entities. Generally, the percentage of small business lending is inversely proportional to bank size. According to another Federal Reserve Bank of Boston analysis (Peek and Rosengren), banks under $100 million involved in bank mergers on average had 16 to 19 percent of their loan portfolios in small business loans, while banks over $1 billion involved in bank mergers had on average 6 percent of their loan portfolios in small business loans. And interestingly, small bank acquirers tend to increase small business lending while large acquirers tend to reduce it. Peek and Rosengren note that several recent studies have found small business lending is also growing faster at small banks than large, and that large acquirers are less likely to expand in this sector. They found that banks with less than $100 million or more than $3 billion of assets each had asset growth of about 24 percent from June 1993 to June 1996, yet growth in small business lending (loans under $1 million) was 42 percent at the small banks but only 3 percent at the large banks.

Equally important, we question whether interbank mergers really present the opportunities of increased efficiency that their proponents claim. One recent study indicates that, except below a relatively low threshold in terms of combined assets, bank mergers do not in fact result in the realization of increased efficiency through economies of scale--a common economic rationale for horizontal mergers in any industry. Several other studies (including those conducted by the Harvard Business School and the Federal Reserve Bank of Atlanta) found no significant cost savings or profit improvement (measured as return on assets or gross operating income) as a result of mergers. Ironically, in the Harvard Business School study of New England bank mergers, instances of improved operating results (such as improvement in net interest margin) was due primarily to higher repricing rather than economies of scale, which strongly suggests the use of market power to raise prices, and again raises antitrust concerns. Given sufficient market power, large banks could price smaller competitors out of the market with below market rate loans or above market rate deposits.

We suspect that economies of scale may actually become negative once a merged banking entity exceeds some critical mass, because the increased costs of management and bureaucratization will at some point overwhelm any theoretical economies of scale. The evidence suggests that the optimal size for a bank in terms of economies of scale, profitability and efficiency is between $100 million and $1 billion. An analysis of the largest 100 banks in the May 1998 issue of *USBanker* shows that as a general rule the largest banks have poorer asset quality, lower profitability, less efficiency and weaker capitalization than the smaller banks on the list.

In sum, Mr. Chairman, the recent trends favoring consolidation in the banking industry are coupled with widely-held suspicions that (i) realized efficiencies are overstated or non-existent, and/or (ii) the benefits of such efficiencies as may be realized are not being shared with bank customers, and (iii) increased market power is used to raise prices. We believe that the historical expertise and focus of the Judiciary Committee should be engaged to illuminate these issues promptly.

Effect on ATM Network and Credit Card Markets

ATM Network Markets: A key concern in large interbank mergers, and one that does not get the attention it warrants, is the effect on ATM networks. Market concentrations resulting from bank mergers and acquisitions have potential anti-competitive implications for ATM network markets (specifically control of ATM switches).

ATM networks are joint ventures between competing banks. ATM networks are self-regulated, private sector entities, owned and controlled in the majority of cases by large banks, that set their own pricing and related operating rules subject only to the constraints imposed by the antitrust laws. Given the structure of ATM networks, certain anti-competitive aspects are inherent. For community banks, these anti-competitive aspects are more pronounced as they generally have little influence over network fees, bylaws or operating rules. Access at a fair price to ATM and other electronic financial services networks is critical for community banks to insure their customers also have fairly and competitively priced access to these networks to transact their banking business.

Big bank mergers affect ATM networks in two ways. First, ATM network mergers typically follow. For example, NationsBank and First Union acquisitions in the South prompted the merger of the Honor and Most ATM networks (NationsBank owns 30 percent, the largest single share, of the Honor network). NationsBank's purchase of Boatmen's Bancshares of Missouri prompted Honor's acquisition of the BankMate network in St. Louis formerly owned by MasterCard and three smaller networks. Currently, First Chicago owns 30 percent of the Cash Station network and 25 percent of Magic Line. Banc One owns 20 percent of Electronic Payment Systems, Inc. which operates the MAC network. The pending Banc One/First Chicago merger could result in mergers of all of these networks. (Interestingly, EPS/MAC entered into a consent decree with the Department of Justice in 1994 agreeing to cease certain anti-competitive practices that caused over 1,000 banks, particularly small banks, thrifts and credit unions, to pay higher, noncompetitive prices for ATM transaction processing.)

In the short term, the industry's merger mania is rapidly paving the way for an oligopolistic ATM network market owned by a handful of the nation's largest banks. Essentially, these banks control the pricing, policies and functionality of the nation's ATM networks. Given this control, large banks could limit access for community banks and their customers by imposing anti-competitive and discriminatory pricing, membership requirements, operating rules or technological barriers. Since network policies directly affect the ability of community banks and other small financial institutions to offer competitive ATM services for their customers, they must be allowed to participate fairly in the governance of ATM networks in order to protect these interests.

We note that under current law, the Federal Reserve has the authority to approve or veto ATM network mergers or mergers of other payments processing entities owned by banks. In the past, IBAA has urged the Federal Reserve to consider the electronic banking markets when determining whether a proposed bank merger/acquisition passes antitrust tests. We have urged the Federal Reserve to ensure that its competitive impact analysis evaluates: 1) the market power of a network brand, 2) fees, 3) routing rules, 4) third-party processing requirements, and 5) other factors that could be used to disadvantage community banks.

The second way big bank mergers can effect ATM networks is that, over the long term, large banks could transfer their transaction processing from regional ATM networks to their in-house operations. BankAmerica Corp. is currently the largest ATM owner, and its merger partner NationsBank is second. Together they control more than 15,000 machines--a number that is comparable to multibank shared networks such as Pulse or NYCE. The Banc One/First Chicago merger will result in the nation's second largest ATM owner with almost 10,000 machines. (By contrast, all community banks combined own fewer ATMs than NationsBank/Bank of America.) Excess capacity could be created in existing regional electronic networks as large banks pull transactions out of the network as a consequence of mergers. If this excess capacity is not shifted to smaller financial institutions, the consumer of electronic payment services will have less and less choice. And the customers of community banks, savings and loan associations and credit unions could be forced out of electronic commerce by pricing and other decisions of the fewer and fewer network owners.

Our concerns in this regard parallel those faced by the settlers of Nebraska and other Midwest states early in this century. A few railroads essentially controlled the rural economy. A few banks should not be allowed to control the electronic payment system "railroads" to the detriment of consumers of those payment services.

Credit Card Markets: We have a major anti-competitive concern in the credit card area. Large bank mergers could create an oligopoly of credit card issuers led by Citicorp, Banc One and NationsBank. Citibank is currently the largest issuer of credit cards with 65 million cards outstanding. Banc One/First Chicago combined will hold the number two spot with 53 million cards. NationsBank/Bank of America combined will have 24 million cards outstanding. Once the pending mergers are consummated, the top ten credit card issuers will control 72 percent of the credit card market, according to Robert McKinley of RAM Research in Frederick, Md.

Under today's rules of the game, by using the Visa or MasterCard umbrella, thousands of community banks are issuers of credit and debit cards and set their own pricing and terms. Thousands of community banks and their credit and debit card customers can tie into the Visa and MasterCard brands, which confers on the cards the national and worldwide acceptance essential for the cards' viability. Like ATM Networks, the two card associations, Visa and MasterCard are joint ventures and all competing member banks enjoy the strength of two brands that are recognized and accepted around the world.

We have already heard the ad "Don't think Visa, think Citibank Visa" (i.e., it's not just a Visa Card, it's a Citibank Visa Card). It is our concern that down the road the ad you hear from Citibank or Banc One will jettison the Visa or MasterCard brand name in favor of a credit card or debit product that they exclusively own and control. And with the destruction of the Visa or MasterCard brand names, combined with large banks' long-term goal to destroy the FDIC symbol now on every bank door, enormous financial concentration to their benefit and to the detriment of thousands of community financial institutions and their customers will have been achieved. And then the consumer will suffer because we will be back in the brave new world where every credit card issuer charges a $35 annual fee and a 19.6 percent interest rate regardless of market interest rate fluctuations. And the taxpayer will suffer when the inevitable occurs, and a large financial conglomerate Titanic goes down.

At best, the card brands will be systematically weakened to the detriment of smaller issuers forcing them out of the business because they will not have the marketing budgets to compensate. Historically, Visa and MasterCard have offered baseline marketing and enhancement packages that virtually any size member bank could take advantage of. Increasingly the large issuers will not be willing to support such product parity preferring instead to use their considerable influence to assure their own cards stand out. This in turn, will hinder cooperative brand advertising serving to obscure the message to consumers that other Visa and MasterCard offers are available, not just a "Citibank Visa."

Consumers will not only be disadvantaged by choice limits and higher pricing, some will find themselves "de-marketed" from the card product entirely. With increased consolidation and less competition, large issuers will begin to look for other ways to improve profits. For example, some issuers are already "de-marketing" by eliminating value-added enhancements, changing terms, assessing inactive fees and using other disincentives to discourage transactors, those consumers who pay off their balance each month to avoid finance charges. In addition to simply not offering the card product or raising annual fees, the grace period will be reduced or eliminated as the large card issuers focus on the more profitable revolvers, those who maintain a balance from month to month and pay finance charges, in a sort of reverse discrimination. In Canada today, where only a few large banks exist, most cards carry a high annual fee, \$25 to \$39, and reduced grace periods, from no grace period to just over 17 to 21 days (Office of Consumer Affairs of Industry Canada, Feb. 1998). Revolvers on the other hand will be held captive with higher annual percentage rates (APRs) applied using the highest possible compounded calculation methods and no grace periods along with higher late fees, over-limit fees and risk-based pricing.

Small merchants will also be affected. Already, the core interchange rates that form the basis for merchant pricing favor large merchants which are generally contracted with large banks. Just a few years ago, most of the large banks had bailed out of the merchant business leaving it fragmented and primarily in the hands of non-banks and small community banks. Now the big banks are back with a vengeance and have the clout to win market share. In today's electronic world and with linkages to other commercial services, it will become increasingly difficult for smaller players to compete. With large card bases, the mega banks can also offer special, targeted promotions that will further tie merchants and consumers forcing out the smaller players, primarily community banks. Once the competition is eliminated, merchants, especially small businesses, will have little choice but to pay whatever rates are charged.

CROSS INDUSTRY (BANK-NONBANK) MERGERS

The second type of bank merger involves the merger of a commercial bank and securities firm under a bank holding company format and the proposed, and we believe highly questionable and probably illegal, proposed takeover of Citicorp by Travelers Group, Inc. through a newly organized holding company called Citigroup. This application is pending before the Board of Governors of the Federal Reserve System and is intended to create an entity, Citigroup, with combined total assets of \$697.5 billion.

As you know, Mr. Chairman, the House of Representatives after a three year struggle has just passed legislation, H.R. 10, the purpose of which is to permit the common ownership of commercial banks, securities firms and insurance companies. It would be an enormous stretch of the Bank Holding Company Act for the Federal Reserve to give a go-ahead to this merger proposal without the enactment of H.R. 10. We share Chairman Leach's concern, as reported by Reuters on May 7, that "this is not a deal that is contemplated under current law."

In traditional Section 7 analysis, mergers such as the Travelers/Citicorp merger have been referred to as "conglomerate mergers." Some will argue, Mr. Chairman, that the current wave of cross-industry mergers are in substance akin to mergers of horseshoes and potato chips, and are therefore devoid of anticompetitive effect.

At least with respect to such extraordinarily huge and complex transactions, Mr. Chairman, we suggest that a relaxed antitrust posture vis-à-vis conglomerate mergers is inappropriate, for at least two reasons.

In the first place, such conglomerate mergers may in fact be a far cry from what have been called "pure" conglomerate mergers, defined as one in which no similar or related products are involved, and one which would present little opportunity for reciprocal dealing in derogation of competition.(3) To refer specifically to the proposed Travelers/Citicorp merger, one may reasonably ask whether the products involved are so disparate and whether reciprocal dealing is so remote a danger as proponents of these transactions would have one believe.

The proponents have stated their intention to foster "cross-marketing" or "cross-selling" between the merged banks and other lines of business and "bundling" of various financial products and services, including those that would be divested in the absence of passage of legislation; and that such cross-marketing would survive a required divestiture.

Such "cross-selling" or "bundling" will not be entirely benign. If the entity resulting from a proposed bank-non-bank merger is a dominant force in allegedly discrete markets such as, for example, customer banking, stock brokerage and both life and casualty insurance, it is not difficult to imagine "bundles" with alarming anticompetitive effects in the financial services industry. Why, for example, might an auto loan not be "bundled" with automobile insurance? Why might brokerage not be "bundled" with money market management and checking privileges, perhaps through a "bundling" arrangement that discounts fees to customers who purchase related financial services? Such bundling by the gargantuan end-product of a Travelers/Citibank merger, of course, could enable the combined entities to assert overwhelming market impact, and, indeed, control, to the detriment of the consumer and free competition. Such proposed "bundling" may be demonstrably anticompetitive, as we have seen recently in other industries with sound analogies to the banking industry. The "bundling" of personal computer operating systems and Internet browsers comes readily to mind.

Second, Mr. Chairman, and relatedly: cross financial industry mergers may not really be conglomerate mergers in the first place, let alone "pure" conglomerate mergers. I refer to the fact that a national market in financial products and services may be the relevant market for purposes of Section 7 analysis, not a congeries of dissimilar and separate submarkets. It is undoubtedly true that many of the so-called "products" proposed to be marketed by merged bank-nonbank entities are not traditional banking products, and may therefore have been presumed to exist in discrete markets. But, importantly, many of these products are in fact competitive, in that they are all alternative repositories of private assets. This would be true, for example, of (i) savings accounts, (ii) life insurance and (iii) a 401(k) plan. If a bank-nonbank merger results in a financial services Godzilla, active in all such segments of the market, we suspect it could have profound anticompetitive effects.

ANTITRUST ANALYSIS OF COMMUNITY BANK MERGERS

Mr. Chairman, I would also like to take the opportunity to briefly address another aspect of antitrust analysis as applied to bank mergers that concerns us--namely, community bank mergers--even though this topic is not being directly considered by the Committee today.

Ironically, as regulators consider and approve mergers of ever-larger banks that approach the deposit concentration limits of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, mergers of community banks in local markets are being prohibited on antitrust grounds. For example, in 1996, the Federal Reserve Board denied an application by BancSecurity Corp. of Iowa, which controlled $415 million of deposits (1.1 percent of total deposits in the state) to acquire Marshalltown Financial Corp., which controlled $103 million in deposits (less than 1 percent of total deposits in the state). The combined entity would have controlled 1.4 percent of the deposits in the state. And it would have had 13 other depository institution competitors in its local market.

Many other community banks are dissuaded from even applying to make local acquisitions because they are told up front by bank regulators that the deals will not be approved on antitrust grounds. Recently, we were apprised that a bank with $41 million in deposits will be prohibited from acquiring a bank with $15 million of deposits because of antitrust considerations. Yet the merger of two small community banks can often strengthen competition by creating a stronger competitor to a "small" local branch of a large out-of-area bank. The current rules have the perverse effect of encouraging community banks to merge with out-of-area large banks, rather than merge with each other to increase efficiencies and competitiveness. The consequence could be the loss of all community banks in a particular market and the loss of local focus so critical to the ability of communities to survive and thrive.

These results seem absurd and are a clear indication that the framework of antitrust analysis, particularly as applied to mergers of community banks, should be revisited. Specifically, in analyzing the competitive structure of a particular market:

i) All thrift deposits and credit union deposits should be accorded full weighting. Currently, thrift deposits are weighted at 50 percent and credit union deposits are not weighted at all. Thrifts and credit unions are full equal competitors for deposits. In many rural communities, credit unions are often the biggest deposit competitor that community banks have. And today, thrifts and credit unions alike make commercial loans.

ii) Nonbank and out-of-market competition must be taken into account. This includes deposit-like services (e.g., money market mutual funds with checking features, Merrill Lynch cash management account), securities firms brokering deposits to out-of-market banks or thrifts, and nonbank small business and consumer lenders (e.g., finance companies, equipment lenders, mortgage companies). Internet banking also changes the local competitive landscape.

CONCLUSION

In conclusion, Mr. Chairman, the ultimate goal of antitrust policy is to serve the public good. We urge that the Committee view these proposed megamergers in that context as well, and we recommend that the Committee consider lessons to be drawn from developments in other countries. To take one example, Japan's banking industry is in grave crisis--a crisis brought on, according to many, by the very intra- and cross-industry combinations we see occurring in our own country. The German economic system has dominant universal banks (which it is trying to move away from) and has been wrestling with a less than vibrant economy and a very high unemployment rate. We do not believe that the problems of any economy can be divorced from the country's banking system.

In general, we do not believe that the current wave of mergers, planned and proposed, affecting the banking and financial services industry has been examined thoroughly in terms of traditional antitrust theory, specifically that developed under Section 7 of the Clayton Act, and especially by this Committee. We urge you to undertake a more formalized study or investigation of the effects that bank and financial services consolidation has had on competition, and the availability and pricing of services. We suggest that this Committee involve itself with the Citicorp/Travelers merger application now pending before the Federal Reserve Board at the very time that historic legislation permitting such a merger is pending before the Congress. We further urge your attention both to the effect that interbank mergers have on ATM network and credit card competition and to the application of completely outdated antitrust guidelines to deny small bank mergers.

Finally, we do not understand why anyone would want to radically change our current banking system. It is the envy of the world, with good reason. It has fostered the most successful and dynamic economy in the world. We appreciate your consideration of the antitrust implications and uncharted waters of a financial services world characterized by huge conglomerates which are being created as the Japanese model on which they are based is discredited.

Thank you, Mr. Chairman.

Judiciary Homepage

1. I note for the record that I am not the recipient of any federal grant, contract or subcontract funding.

Additionally, neither City National Bank nor the IBAA is the recipient of any federal grant, contract or subcontract funding.

2. 15 U.S.C. Section 18. Section 7 prohibits mergers or combinations where "...the effect of such acquisition may be to substantially lessen competition, or to tend to create a monopoly." Section 7 applies to bank mergers. *United States v. Philadelphia National Bank*, 374 U.S. 321, 83 S.Ct. 1715, 10 LED 2d 915 (1963).

3. *See, e.g.*, 2 Von Kalinoski on Antitrust, Section 32.07[1] at 32-64 (1998).

STATEMENT

of

BILL FLORY

PRESIDENT

of the

NATIONAL ASSOCIATION OF WHEAT GROWERS

before the

UNITED STATES HOUSE OF REPRESENTATIVES

COMMITTEE ON THE JUDICIARY

"THE EFFECTS OF CONSOLIDATION ON THE STATE OF COMPETITION IN THE FINANCIAL SERVICES INDUSTRY"

June 3, 1998

Mr. Chairman, Members of the Judiciary Committee, it is an honor to have this opportunity to appear before this Committee today to discuss the impact of bank consolidations and mergers on wheat producers and other U.S. farmers.

I am Bill Flory, a diversified grain farmer from Culdesac, Idaho. This year, I have the honor of serving as the producer president of the National Association of Wheat Growers (N.A.W.G.), a trade association comprised of 23 member state organizations that represent wheat producers on a wide range of public policy issues, including agricultural credit. Mr. Chairman, before I begin my summary of remarks to the Committee, I would like to note for the record that I am not the recipient of any federal grant, contract, or subcontract funding, except for payments received under federal farm programs that are exempt from disclosure. Additionally, the National Association of Wheat Growers does not participate in any grant, contract, or subcontract programs of the federal government.

While it is unusual for farmers or their organizations to appear before this Committee, the importance of this issue to production agriculture can be easily explained by a brief examination of the magnitude of agricultural borrowing from the various credit sources that lend to farmers.

Prior to the early 1970's total farm business debt for both real estate and operating loans never exceeded $50 billion. The promise of expanded agricultural demand, dramatically improved price expectations, a relatively high level of credit availability, and inflationary pressure on nearly all types of agricultural assets encouraged a dramatic increase in borrowing during the past 25 to 30 years. From its peak of nearly $200 billion in outstanding farm business debt in the early to mid-1980's, to a level of around $150 billion today, farmers, in the aggregate, are now significant consumers of credit. Total interest paid to all credit sources on this indebtedness exceeds $11 billion annually. Production agriculture has a strong vested interest in ensuring that adequate levels of credit remain available to the industry, and in the structure of the financial services industry that will provide financial services in the future.

The N.A.W.G., and farmers in general, are not predisposed to opposing mergers and consolidations in the financial services industry or other economic sectors that impact agriculture. In fact throughout our nation's agriculture history, farms themselves have tended to grow in size as producers have sought new levels of efficiency, lower production costs and enhanced income through economies of scale. That trend continues today, and may in fact accelerate in the future.

For the most part, however, the nation's individual farms and ranches are still "small businesses" compared to those agricultural sectors that provide inputs or are involved in processing and merchandising. While business consolidation appears to be a fact of life, we are concerned that the increased level of concentration within many segments of the industry is not producing either the benefits of scale economies or improved levels of service. In fact, we would suggest that in many instances the opposite is true. It is our belief that many of the consolidations in the last 5-10 year period have served to reduce competition to the point where various sectors can engage in what are effectively monopolistic business practices.

For example, mergers within the rail industry have served to increase the number of captive shippers, failed to provide the improved service levels that were promised, increased the overall cost of transportation to many of their customers, and likely have been able to pass their added costs of the consolidations to customers through higher prices, rather than demonstrating that expanded operating efficiency would allow for customer savings.

Mr. Chairman, we are concerned that a similar impact is manifesting itself within the financial services industry as an increased level of both horizontal and vertical integration occurs. Our fear is that horizontal mergers within the banking sector may not only reduce the availability of credit to farmers and rural America, but will also diminish the level of attention and expertise available to production agriculture. This is particularly true when bank management becomes so removed from its customer base that corporate decisions fail to appreciate the impact of changes to its investment strategy on those customers. At the same time, the cost of mergers to borrowers is likely to increase through higher interest rates, additional service charges, and inconvenience. Although financial institutions may operate 24 hours a day, and exist in a national or even global marketplace, most farms, ranches and other rural businesses are incapable of operating in that environment. While I cannot presume to identify the nationwide impact of further large bank consolidations, experience suggests that the local and regional impact will be negative as competition is reduced in all markets.

In addition to the bank-bank mergers, a number consolidations of banks with other commercial enterprises have been proposed. Again, Mr. Chairman, I am not going to suggest that all such mergers are anti-competitive. In fact, some such arrangements do in fact enhance the availability of services and level of competition in rural America. However, the potential for such merged entities to engage in practices and "effective" requirements that reduce competition and choice are troublesome at best. This is particularly true when both parties already have significant market influence in their respective product markets. We do not believe the so-called product "bundling" that could occur from the creation of large conglomerates with interests in a wide range of financial products is a beneficial proposition for farmers if the result is a further reduction in competition in those product markets. We are concerned that customers may be ultimately "tied" to a basket of financial services dictated by the institution or run the risk of being unable to access any services at all.

Mr. Chairman, I appreciate the opportunity to provide a farmer perspective to your deliberations concerning consolidations in the financial service industry. We believe that this Committee should utilize its expertise and authority to ensure that proposed mergers, prior to their consummation, are subject to a thorough review that addresses company, customer, and public interest needs.

I will be happy to respond to any questions you or other Committee members may have at the appropriate time. Thank you.

Testimony of

Frank Torres

Legislative Counsel

Consumers Union

Before the House of Representatives

Committee on the Judiciary

Hearing on

"The Effects of Consolidation on the State of Compeition

in the Financial Services Industry"

June 3, 1998

Mr. Chairman and members of the Committee, Consumers Union[1] appreciates this opportunity to discuss our views and concerns about the recent wave of mergers in the financial services industry, the effects of those mergers on competition, and the impact on consumers. Given the rapid move by banks to merge over the last few years, and most notably in the last two months, Congressional review of the effects of consolidation in the financial services industry is warranted. This hearing is also timely, as H.R. 10, the Financial Services Modernization bill, passed last month, opens the door to new types of mergers. Even without legislation, the Federal Reserve Board is poised to permit Citicorp and Travelers to join, the largest merger on record..

Since the 1980's the U.S. banking industry has experienced extreme consolidation , with the number of banking organizations nationwide declining by more than 40 percent, from about 13,000 in 1988 to 9,000 in 1997. That number is expected to decline even further in the next decade. The decline in the number of banks has been accompanied by a substantial increase in the share of total banking assets controlled by the largest banking organizations. Nearly seventy-five percent of domestic banking assets are held by the 100 largest banks. The top five banks hold twenty-five percent of the assets, and the top ten banks hold thirty-three percent. The new BankAmerica will control 8 percent of all U.S. bank deposits.

Consolidation May Be Unhealthy for Consumers.

Competition should yield many benefits for consumers: lower prices, increased innovation, better service, quality, and variety. But failure to apply and enforce antitrust laws designed to promote competition would be devastating for consumers' pocketbooks. Consumers are already feeling "bounced" by the merger wave:(2)

- Bigger banks charge higher fees(3), and more of them(4).
- Large banks require higher minimum balances to avoid fees.(5)
- Customers complain about dwindling services.(6)
- The wide array of products and services being offered could lead to confusion for consumers and coercive practices. Consumers' life savings are at risk if they are not informed of the risks of products being sold, misled into believing a product is federally insured, or convinced to buy a product they don't need or can't afford.
- Nationwide consolidation of the banking industry also intensifies the risks borne by deposit insurance and ultimately by U.S. taxpayers, as the merged banks become "too big to fail."(i.e., allowing an enormous bank to fail would "cost" more for the economy than a taxpayer bailout of the bank).

Given consumer concerns about the impact mergers could have on fees, quality of service, and market power, the Federal Reserve Board (which has primary authority over approving mergers involving bank holding companies) should take strong action to ensure the public interest is served by the mergers and the convenience and needs of consumers are met, as required under the Bank Holding Company Act.(7)

Regulatory Interpretation of Antitrust Laws Lenient on Bank Mergers

Application of antitrust laws to bank mergers have been less than effective in addressing competitive and consumer fears. Consumers Union is concerned that overly permissive exceptions to traditional antitrust analysis are leading to a dangerous pattern of banking consolidation that could raise prices for consumers. These exceptions are contained in overly generous merger guidelines, relied on by the Board, and issued by the Justice Department.

The guidelines state that a banking merger resulting in an increase in the market concentration above a certain level (as measured by the Herfindahl-Hirschman Index (HHI)) in a given market may be subject to challenge on antitrust grounds. The levels for banking are more lenient than for other industries to account for competition from nonbank financial service providers, such as finance companies and credit unions. In addition, the Board includes 50 percent of the deposits held by nonbank thrift institutions in a market when making this calculation. Mergers violating these guidelines are frequently approved, often because of the presence of some other factor determined by the regulators, such as potential competition from other types of financial institutions. These tolerances have been criticized as going to far, and thereby potentially underestimating the market power of the merging institutions.(8)

The Bank Holding Company Act sets concentration limits for total amount of deposits of insured depository institutions at ten percent nationwide and thirty percent for a state. States are allowed to set limits on the percentage of the total amount of deposits of institutions in the state.(9)

A study by Board staff concluded that "it does not appear that the antitrust laws are a significant impediment to consolidation in the banking industry" as currently implemented under the Department of Justice Merger Guidelines.(10) In fact, the banking system could theoretically have as few as six banks.(11) Yet, antitrust issues, such as market concentration, exercise of market power, and restrictions on entry, with resulting effects on competition, raise significant concerns.(12) It is not because there are no antitrust concerns, but because of the way the antitrust laws are interpreted under the Merger Guidelines, that antitrust laws may be less effective when it comes to bank mergers as opposed to other industries.(13)

The Merger Guidelines allow predicted efficiencies to be balanced against the anticompetitive effects of a merger. Yet, there is mixed evidence that any efficiencies exist at all.(14) Even where there is risk of monopoly, the Justice Department=s guidelines permit mergers that could have operating efficiencies. If, as the studies show, efficiencies do not exist, allowing a merger between two competitors to move forward may lead to a loss of competition. If efficiencies do not exist, there may be pressure from shareholders to make up for losses, resulting in higher fees charged to consumers. On the other hand, if efficiencies do exist, consumers should receive some significant benefit from the cost savings.(15)

One way to address the concern about inadequate antitrust enforcement is to reassess how mergers are analyzed. For example, perhaps the Board should be exploring why, instead of merging, these already large banks are not competing. Would the marketplace be better served if the merging firm entered by internal expansion or by a "toehold" acquisition of a small existing competitor in that market? An acquisition by the probable entrant of a leading firm in the market would diminish the chance of a future entry that might increase competition in the market. In the current merger climate, analysis of potential competition should be given greater weight in antitrust review.(16)

Consumers Can Be Harmed by Increasing Market Power.

The ability of firms to exercise market power by setting inflated prices harms consumers. Many banking markets are already highly concentrated, including both metropolitan and rural markets.(17)

A recent study examined the price effects of bank mergers that substantially increased local market concentration found that deposit rates declined after the merger by local market rivals.(18) The study concluded that there was evidence that these mergers led to increased market power.

There is also some research which suggests that there are barriers to entry in retail banking markets. That research also found that any possible public benefit from bank mergers in the aggregate may be offset by adverse effects on competition.(19)

Congress has Given the Board a Mandate to Act in the Public Interest and Ensure Mergers Meet the Convenience and Needs of Consumers.

In analyzing the competitive aspect of a merger, the Board is to consider the effect on the public interest. A merger is not to be approved unless the agency "finds that the anti-competitive effects of the proposed transaction 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."(20)

The legislative history of the Act is clear in showing that Congress gave specific and unique authority to the Board "to measure whether each application should be granted or denied in the public interest."(21) Moreover, Congress specifically noted that:

The factors required to be taken into consideration by the Federal Reserve Board under this bill also require contemplation of the prevention of undue concentration of control in the banking field to the detriment of public interest and the encouragement of competition in banking. It is the lack of any effective requirement of this nature in present Federal laws which has led your committee to the conviction that legislation such as that contained in this bill is needed.(22)

The Board should reassert its role in rejecting mergers that are not in the public interest and that fail to meet the convenience and needs of the community. At a minimum, the Board can ensure that merging banks:

- Meet the Financial Needs of Consumers and Communities: The Board must assess how merging banks serve the communities in which they operate or sell products. Greater commitment to communities should be a condition of any approval.
- **Provide Affordable Bank Services:** Despite record profits in the banking industry, nearing $60 billion last year, banks continue to charge higher fees. Banks should be required to provide low-cost basic banking to all their customers throughout the country.
- **Protect against abusive and deceptive sales practices:** While "one-stop shopping" and cross-selling are touted as the answer to consumers' financial needs, consumers may be in danger of being misled and deceived into losing their life savings or pressured into buying overpriced products they do not need or want. To help ensure consumers derive benefit from one-stop shopping, companies should be required to comply with a package of consumer protections, including: protections against confusion over products; privacy protections; suitability standards; protections against high pressure sales tactics; and a redress mechanism for people to recover losses.

- **Pass on Cost Savings to Consumers:** A share of the cost savings generated through any of the touted efficiencies should be passed on to consumers through lower fees or at least a moratorium on increasing fees charged by banks.
- **Investing in Communities:** Merging banks should help meet the financial services needs of communities. The bank affiliates should make Community Reinvestment Act (CRA) commitments involving specific programs and dollar goals to the communities. Just as banks must comply with the CRA, the insurance and securities business should be responsible to the communities in which they operate.

Other Issues:

FTC Jurisdiction: H.R. 10 retained most of the existing structure related to the antitrust review of bank mergers. The bill clarifies that the Federal Trade Commission (FTC) has jurisdiction over bank and nonbank mergers. Bank regulators are required to notify and share data on mergers involving nonbank activities.(23) The FTC should have this authority to assess, investigate and take action when there are unfair and deceptive practices in any affiliate. As banks consolidate with other financial services entities the risk for consumers from anti-competitive practices is great. This is important because the FTC has the authority to address "anti-competitive" practices harmful to consumers that may not otherwise be covered by antitrust laws.

Ensure Competition and Access for All Bank Services: The Department of Justice is investigating certain exclusionary practices that involve the credit card industry. Rules imposed by VISA and MasterCard on financial institutions that limit their ability to issue other cards may create serious barriers to competition and cause harm to consumers.(24) Congress should ensure that mergers involving major banks such as Citicorp, or BancOne, major issuers of VISA and MasterCard, in no way harms the expansion of competition in the credit card business. Concerns have also been raised about the effect of the mergers on the control of the ATM network.

Too Big To Fail: Regulators have indicated that they would take extraordinary steps in response to the failure of a very large bank, including full protection for uninsured depositors, creditors, and suppliers of funds to the bank's holding company, even shareholders, without regard to the cost to the FDIC. This practice became known as "too-big-to-fail." There is a fear that the large institutions created by these mergers will exacerbate the "too big to fail" doctrine, should one of the merged companies fail, prompting a bailout.(25) Additionally, there is concern that too much government protection encourages banks to shift funds into riskier practices.(26)

Banking and Commerce: Permitting banking and industrial firms to merge could lead to a huge concentration of economic power. Rather than promoting increased competition, this would allow consolidation across markets. Such economic consolidation is likely to lead to inflated prices and diminished innovation. Concentration of economic power could have a disastrous impact on the economy if decisions affecting banks were made by a few commercial entities or if the financial condition of those entities weakened. Many argue that the "basket approach" will prevent excessive concentration of economic power.

Mixing banking and commerce also give banks that extend credit an incentive to make credit decisions based on what is good for affiliated businesses rather than what is creditworthy. Banks could deny credit to competitor of their commercial entities, hoping to gain an advantage in the market. For consumers and small businesses, this may make it difficult for them to get loans if they are not part of the bank's overall business strategy. Moreover, consumers may feel the effects when businesses in their areas close and concentration of ownership increases, forcing consumers to pay higher prices or limiting consumer choice in the marketplace.

Conclusion

The rapid changes and ongoing consolidation in the financial services industry gives cause for concern if banking regulators fail to adequately assess the effect that consolidation will have on consumers. Failure to fully assess how a merger impacts competition may allow firms to gain market power. Congress should ensure, in the face of the changing financial marketplace, that consumers are protected.

Judiciary Homepage

1. Consumers Union is a nonprofit membership organization chartered in 1936 under the laws of the State of New York to provide consumers with information, education and counsel about goods, services, health, and personal finance; and to initiate and cooperate with individual and group efforts to maintain and enhance the quality of life for consumers. Consumers Union's income is solely derived form the sale of Consumer Reports, its other publications and form noncommercial contributions, grants and fees. In addition to reports on Consumers Union's own product testing, Consumer Reports, with approximately 4.5 million paid circulation, regularly carries articles on health, product safety, marketplace economics and legislative, judicial and regulatory actions which affect consumer welfare. Consumers Union's publications carry no advertising and receive no commercial support.

2. "Customers Say Bank Mergers Deal Them Out," Washington Post, pg. A 1, April 19, 1998.

3. Big Banks, Bigger Fees: 1997 PIRG Bank Fee Survey, USPIRG, July 1997.

4. "How Good is Your Bank," Consumer Reports, March 1996.

5. "Fees for Checking Accounts Vary Widely," NY Times, December 25, 1997.

6. "Will Deals Deliver Better Services," WSJ, April 14, 1998.

7. Section 3(c)(1)(B)(C) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841 et seq.)

8. Thomas G. Krattenmaker & Robert Pitofsky, *Antitrust Merger Policy and the Reagan Administration*, 33 Antitrust Bull. 211 (1988).

9. Section 3(d)(2) of the Bank Holding Company Act.

10. Stephen. Rhoades, *Consolidation of the Banking Industry and the Merger Guidelines*, 37 Antitrust Bulletin 689 (1992).

11. Rhoades, *Consolidation of the Banking Industry and the Merger Guidelines*, 37 Antitrust Bulletin

689 (1992).

12. Steven Rhoades, *Have Barriers to Entry in Retail Commercial Banking Disappeared?*, 43 Antitrust Bulletin 997 (1997).

13. The Merger Guidelines have been described as "astonishingly cavalier" in their disregard for the legislative purposes underlying Section 7 of the Clayton Act. For example, they fail to consider as a factor working against a merger whether it would occur in a market that has recently experienced a trend toward increased concentration. The legislative history behind Section 7 leaves no doubt that Congress meant to apply harsher merger standards to such industries.Thomas G. Krattenmaker & Robert Pitofsky, *Antitrust Merger Policy and the Reagan Administration*, 33 Antitrust Bull. 211 (1988), citing Derek Bok, *Section 7 of the Clayton Act and the Merging of Law and Economics*, 74 Harv. L. Rev. 226 (1960).

14. Governor Laurence Meyer, of the Federal Reserve Board, testified that Board staff recently examined nine bank mergers that seemed most likely to yield efficiency gains, but only found efficiency gains in four. Furthermore, even Governor Meyer admits that evidence on the relative efficiency of mergers is mixed. See, Testimony of Governor Laurence Meyer before the Committee on Banking and Financial Services, U.S. House of Representatives, April 29, 1998.

15. Joseph Brodley, *Proof of Efficiencies in Mergers and Joint Ventures*, 64 Antitrust L.J. 575 (1996).

16. Joseph Brodley, *Limiting Conglomerate Mergers: the Need for Legislation*, 40 Ohio St.L.J. 867 (1979).

17. Steven Rhoades, *Competition and Bank Mergers: Directions for Analysis from Available Evidence*, 41 Antitrust Bulletin 339 (1996).

18. Prager & Hannan, *Do Substantial Horizontal Mergers Generate Significant Price Effects? Evidence from the Banking Industry*, Journal of Industrial Economics (forthcoming).

19. Steven Rhoades, *Have Barriers to Entry in Retail Commercial Banking Disappeared?*, 43 Antitrust Bulletin 997 (1997).

20. Section 3(c)(1) of the Bank Holding Company Act.

21. S.Rep. 1095, 84th Cong. 1st Sess., on the Bank Holding Company Act of 1956 (July 25, 1955).

22. S.Rep. 1095, 84th Cong. 1st Sess., on the Bank Holding Company Act of 1956 (July 25, 1955).

23. Section 141, amending Section 11(b)(1) of the Bank Holding Company Act of 1956, 12 U.S.C. 1849(b)(1).

24. See, March 18, 1997 letter from Consumers Union and Consumer Federation of America to Attorney General Janet Reno.

25. See, Fixing FDICIA: A Plan to Address the Too-Big-To-Fail Problem, Federal Reserve Bank of Minneapolis (1997).

26. This is of particular concern as banks and other institutions target the "subprime" market with offers of easy credit and a multitude of credit card solicitations. At the same time, those same institutions are seeking to keep families facing financial crisis from declaring bankruptcy.

Bank Mergers and Financial Consolidation

Prepared Statement

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Committee on the Judiciary

U.S. House of Representatives

Washington, D.C.

June 3, 1998

Mr. Chairman, Members of the Committee:

I thank you for the privilege of being invited to testify before the Committee, and commend you for scheduling this important series of hearings examining the magnitude and consequences of mergers and concentration in key sectors of the American economy.

My testimony today, on the topic of banking mergers, is drawn from my study of the field, as well as a number of my publications addressing the issues of mergers, market power and antitrust policy more generally, including The Bigness Complex (1986), Dangerous Pursuits: Mergers and Acquisitions in the Age of Wall Street (1989), Antitrust Economics on Trial: A Dialogue on the New Laissez-Faire (1991), and The Structure of American Industry (1995) -- all co-authored with Walter Adams, Distinguished Professor of Economics and Past President, Michigan State University.

The views I express are my own; I represent no person, organization or interest other than myself.

I. Dimensions of Merger-Mania in Banking

As the Committee is well aware, the American economy is ensnarled in an epic merger mania. In 1997, a record $1 trillion of mergers and acquisitions occurred, with 1998 on pace to shatter even that unprecedented total. To put this magnitude in context, there are only seven nations in the world whose gross national product exceeds $1 trillion; it is an amount roughly equal to the GNP of nations like Italy and Great Britain.

Banking is caught up in this merger fever. In fact, financial firms have been in the forefront of the merger and consolidation movement for two decades: In the 1980-1994 period, more than 6,300 bank mergers were recorded, involving nearly 80 percent of all domestic U.S. banking assets.(1)

The bulk of this consolidation has been engineered primarily by the nation's very biggest banks: The twenty-five largest banks accounted for nearly one-half of all bank assets acquired over the 1980-1994 period.(2)

More recently, the magnitude and pace of financial merger-mania has accelerated sharply: The value of mergers and acquisitions involving U.S. banking firms has leaped 166 percent over the past four years, rising from $70 billion in 1995, to $123 billion in 1996, and reaching $186 billion in 1997.(3)

As Table 1 shows, eight of the ten very biggest financial mergers in American history have occurred just in the past year and a half.

The tremendous concentration of power and control over financial

Table 1

Ten Largest U.S. Financial Mergers

Value of Deal Combined Assets

Year (billion) (billion)

Citicorp/Travelers 1998 $83 $ 698

Bank of America/Nationsbank 1998 60 570

Banc One/First Chicago NBD 1998 30 239

First Union/Core States 1997 17 206

Nationsbank/Barnett 1997 16 284

Wells Fargo/First Interstate 1996 12 108

Chase/Chemical 1995 11 297

Dean Witter/Morgan Stanley 1997 11 261

Wash. Mutual/H.F. Ahmanson 1998 10 150

Travelers/Salomon 1997 10 160

Source: Wall Street Journal, various issues.

resources cumulatively resulting from this succession of ever-larger combinations is apparent in Chart 1, which traces the merger-based evolution of this emerging money trust.

At the same time, the number of banks in the country has dropped by more than a third since 1980.[5]

And while some 9,000 banking firms remain in operation, the level of concentration in the field is high and rising: The ten largest banks currently control about one-half of the nation's total commercial banking assets, with the largest 25 together controlling 71 percent. If not interrupted, these concentration levels

Table 2

Banking Concentration by State

(1997)

State	Top Five Banks' Share of Deposits	State	Top Five Banks' Share of Deposits
Alabama	67%	Montana	54%
Alaska	92	Nebraska	46
Arizona	89	Nevada	79
Arkansas	41	New Hampshire	82
California	68	New Jersey	66
Colorado	56	New Mexico	59
Connecticut	73	New York	61
Delaware	73	North Carolina	70
District of Col.	86	North Dakota	45
Florida	71	Ohio	62
Georgia	58	Oklahoma	36
Hawaii	99	Oregon	83
Idaho	87	Pennsylvania	65
Illinois	42	Rhode Island	99
Indiana	44	South Carolina	66
Iowa	29	South Dakota	54
Kansas	29	Tennessee	56
Kentucky	39	Texas	45
Louisiana	63	Utah	79
Maine	79	Vermont	81
Maryland	68	Virginia	61
Massachusetts	85	Washington	77
Michigan	69	West Virginia	56
Minnesota	54	Wisconsin	57
Mississippi	55	Wyoming	64
Missouri	54		

Source: Division of Research and Statistics, Board of Governors of the Federal Reserve System.

will continue to escalate, reaching projected levels of 70 and 85 percent, respectively, over the next two years.(5)

Concentration of banking within individual states is even higher, as Table 2 shows.

II. Dangers of Merger-Mania in Banking

Is this massive financial merger-mania cause for jubilation? Is it the price we must pay to obtain economies, efficiencies, and greater global competitiveness for America in the new millenium -- not only in banking, but throughout an economy dependent on the lifeblood of financial capital? Is it, at worst, merely a benign phenomenon offering the nation the chance for great gains but without any problematic downside risk?

Regrettably, experience and the evidence strongly suggest the contrary, on at least four important grounds:

1. Anticompetitive Consequences. As market concentration rises, and as fewer financial firms collectively control larger shares of markets, the vigor of competition declines and the discipline of the competitive marketplace is subverted. The reason, as one bank analyst candidly confides, is that "Oligopolies are a wonderful form of business for banks .... You can control your deposit prices and leverage your market share."(6)

Another analyst urges that "the key motivation for mergers and acquisitions among banks is, or at least should be, exerting more control over pricing of financial services offerings."(7)

"Fortune 500" firms can, of course, shop the globe for their financial needs. And individual consumers can choose from among thousands of mutual funds in investing their personal funds. But the vast majority of consumers and American businesses are far more dependent on local markets for the bulk of their banking needs, and, thus, they are more easily exploited as financial consolidation constricts the competitive options from which they can choose.

Under these circumstances, the consequences of high -- and rising -- concentration in banking are predictable and observable on a variety of fronts: Higher interest rates for loans;(8)

lower interest rates paid on deposits;(9)

declining interest in serving the financial needs of smaller businesses and individual consumers;(10)

sharply rising fees conventionally charged for various services (such as checking accounts(11)

and the use of automated teller machines(12)

); and the unilateral imposition of a plethora of new fees which, according to industry trade reports, have more than doubled during the current decade.

Beyond this, the giant financial conglomerates that are being merged together can undermine competition in a variety of additional ways that are divorced from competitive merit in any meaningful sense:(13)

By virtue of their "deep pockets" the banking behemoths can outbid, outspend and outlose their smaller, more specialized financial rivals by utilizing profits and resources drawn from less competitive segments and regions to cross-subsidize their expansionary campaigns in other areas. By engaging in various forms of reciprocal dealing, they can exploit the economic leverage of their massive buying power to compel suppliers to patronize their financial services side. In a closely related vein, they can leverage their size in one field in order to enhance their position in other fields by tying the provision of one service to the client's purchase of other services.(14)

And as fewer, larger financial firms stake out dominant positions in particular geographic and service product lines, they become superpowers versed in the art of peaceful coexistence and respect for the status quo.

Mergers between banks with operations located in different geographic regions also undermine the central goal of deregulation efforts to break down artificial barriers to competition. Particularly when the merging banks are large and well-known, these trans-geographic and trans-service consolidations enable merging firms to eliminate their most likely potential competitors. Put differently, it is futile to undertake the enormous effort required to reduce regulatory barriers to competition in financial services if the most important potential competitors merge together in advance.

Finally, it is important to emphasize that these latter, larger anticompetitive problems are not captured by focusing solely on the question of overlaps of merged operations in narrowly-defined "relevant markets". Nor are they addressed by antitrust settlements requiring merging financial giants to spin off relatively inconsequential operations where a few such overlaps might be found.(15)

2. Adverse Impact on Economic Performance. Remarkably, the overwhelming weight of the evidence from a mountain of statistical studies fails to support the grandiose claims concerning the benefits alleged to flow from big bank mergers. There is

no credible evidence that financial mega-mergers are being forced by the dictates of technology or by any autonomous economies of even greater scale.

To the contrary, whether analyzed in terms of various measures of profitability, or in terms of various measures of costs and expense ratios, or in terms of the performance of stock prices before and after merger, the overwhelming weight of the evidence suggests that mega-mergers fail to improve the economic performance of the merged entities. Instead, more often than not, the weight of the evidence strongly suggests that mega-mergers and excessive organizational size tend to undermine good economic performance. As summarized by one of the nation's leading students of the field, "evidence from studies of the economies of scale and scope, the effects of mergers, the relative growth and market share gains of large and small banks, and the adoption of electronic technology does not indicate that there are scale economies or any other operating imperative requiring large size for success in the community banking industry."(16)

In fact, the very biggest banks typically exhibit less efficiency, higher operating cost ratios, and lower profitability.(17)

Of special significance are the results of a recent study of the stock price performance of big bank mergers undertaken by the financial analysis firm Keefe, Bruyette & Woods. Examining the eight largest bank mergers occurring in 1995, this study finds that, three years later, the "Class of '95" performed miserably: Six of the eight largest merged banks underperformed an index of bank stocks generally, with three of them falling short by 40 percent or more; the very best of the "superior" performers turned in stock price gains only 1.3 and 0.1 percent better than the average for all banks.(18)

Obviously, mega-mergers in the financial sector have failed to meet the stock market test of success.

Rather than delivering better services more efficiently, bank mega-mergers seem to generate lower-quality, higher-cost services, as the elephantine organizational structures being created succumb to the inefficiencies of excessive size -- misplaced deposits, good checks mistakenly bounced, funds incorrectly withdrawn from some accounts and put into others, more and longer automated phone messages for customers, Babylonian towers of computers incapable of communicating -- in short, all the hallmarks of the diseconomies of excessive scale.(19)

In fact, the debilities of giantism in financial services are a matter of general recognition, with objective experts suggesting that it may be "Time to Break Up the Banking Behemoths."(20)

Or as Barron's puts it in assessing Citicorp's $80 billion merger with Travelers, "if the history of mergers is any guide, the smart thing for Citicorp shareholders to do may be to sell immediately, or shortly after the Travelers deal is completed"(21)

-- hardly a stirring testimonial to the enduring benefits of mega-mergers.

3. The Opportunity Cost of Merger-Mania. Merger-mania also inflicts an immense opportunity cost on the nation.(22)

The time, energy, attention and multi-billion dollar sums being devoted to mergers and acquisitions are, at the same time, energy, effort and multi-billions of dollars not being invested directly into the nation's economic base. They are scarce resources not being invested directly in the research and development of genuinely new products and services. They are human and financial resources not being invested directly in the construction of new plant and equipment. And they are time, energy and billions of dollars not being invested directly in constructing new state-of-the-art production techniques -- much less addressing the daunting "Year 2000" computer problems faced most prominently by the nation's financial firms.

Put more concretely, the $1 trillion spent on mergers and acquisitions last year is roughly twice the amount spent on research and development by all of American industry ($113 billion) plus the combined net new investment by all American firms ($432 billion) in the 1996-1997 period.(23)

The $123 billion spent on banking and financial mergers in 1996 is four times greater than the total amount spent on all basic research ($30 billion) in the United States by government and business in the same year.(24)

Instead of being invested in the kind of creative capitalism that enhances the real wealth of the nation, these multi-billion dollar sums -- and the energy, attention, effort and talent behind them -- are being devoted to the economically sterile game of reshuffling paper ownership shares of organizations and operations that already exist.

4. Government Bailouts and the "Too Big To Fail" Problem. The financial bigness complexes being created by these mega-mergers subverts the discipline of the private enterprise system in an even more fundamental way, by rendering society increasingly vulnerable to a government bailout problem of growing proportions.

Once any organization is allowed to attain disproportionately large size, its fortunes unavoidably reverberate throughout the economy. Once any organization attains disproportionately large size, its private mistakes and errors become public catastrophes. As Lockheed and Chrysler show, once corporations are allowed to become disportionately large, they are considered too big, too important and too influential to be allowed to fail.

Then, society becomes a hostage to bigness. And when corporate bigness complexes manage their way into trouble, they do not meekly sacrifice themselves on the altar of private enterprise. Instead, they assault Washington and confront a democratic, private enterprise society with an intractable dilemma: (a) Rescue corporate giants from the consequences of their self-inflicted injuries, thereby subverting the essential discipline of a competitive, free enterprise economy; or (b) allow ailing giants to fail, thereby inflicting possibly catastrophic consequences on society while, at the same time, rendering government less accountable to the concerns and fate of the citizenry. The "flunk insurance" accorded giant firms produces "reverse" economic Darwinism -- giant firms survive, not because they're better but because they're bigger -- not because they're fitter, but because they're fatter.[25]

The problem is especially acute in the financial sector, where firms not only control the financial lifeblood of the entire economy, but where they repeatedly have demanded -- and obtained -- multi-billion dollar government bailouts from the consequences of their own decisions: Continental Illinois in the mid-1980s (Continental's assets of $40 billion at the time pale in comparison with the assets of the behemoths being merged together today); bad loans made by the biggest banks to third-world and developing countries, including Mexico; and most recently, the big banks' exhuberance in pouring their funds into risky East Asian ventures. In each of these cases, the American government -- and the American taxpayer -- have been forced to contribute billions to rescue financial giants from the adverse consequences of their own actions.

Mega-mergers, of course, exacerbate the magnitude of this bailout dilemma. In fact, some experts estimate that the number of American banks too big to be allowed to fail has doubled over the past decade[26]

-- a list that grows with each announcement of a new record-breaking merger among banking firms.

In this connection, it is relevant to note that a listing of the world's very biggest banks (Table 3) reveals the majority of them to be

Table 3

Ten Largest Banks Worldwide

(as of Dec. 1997)

Rank	Company	Country
1	Bank of Tokyo-Mitsubishi Ltd.	Japan
2	Deutsche Bank	Germany
3	Crédit Agricole	France
4	Dai-Ichi Kangyo Bank	Japan
5	Fuji Bank	Japan
6	Sanwa Bank	Japan
7	Sumitomo Bank	Japan
8	Sakura Bank	Japan
9	HSBC Holdings	Hong Kong
10	Norinchukin Bank	Japan

Source: N.Y. Times, Dec. 9, 1997.

headquartered in Japan -- which also is the location of the developed world's biggest banking problems and the biggest challenge in bailing out collapsing financial giants.

These facts are not coincidental. Big organizations, like all organizations, make mistakes. None are infallible. The crucial difference is that because of their disproportionate size and impact, the mistakes made by giant firms are also disproportionately large and, as a result, pose equally large problems for an entire society, including its elected representatives in government.

III. Conclusion

In examining mega-mergers in banking, Mr. Chairman, I invite you and your colleagues to recall V.I. Lenin's admiration of financial consolidation and organizational giantism. A century ago, he devoutly believed that consolidation of banking would provide "advantages accruing to the whole people." He declared -- in terms eerily similar to those heard today -- that the benefits of financial bigness "would be enormous. The saving in labour would be gigantic ... making the use of banks universal, increasing the number of their branches, putting their operations within easier reach," and greatly enhancing the "availability of credit on easy terms for the small owners..."(27)

Lenin's faith -- and that of Stalin -- in the virtues of organizational giantism, coupled with their criticism of the competitive market as a duplicative, wasteful and inefficient system, was the foundation on which the centrally planned Soviet economy was built.

It is bizarre, and more than a little incongruous, that that failed delusion has been repudiated by the formerly communist countries, only to be resuscitated in the hallowed halls of Wall Street.

Perhaps it is time to call a halt to the sovietization of the American financial system.

Judiciary Homepage

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For a detailed exposition of the anticompetitive problems posed by large conglomerate mergers, see Walter Adams and James W. Brock, The Bigness Complex (1987), Chap. 14.

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In the case of Nationsbank's $15 billion acquisition of Barnett Bank, for example, the operations required to be divested by the Justice Department in return for its blessing represented less than 4 percent of the total number of offices being combined in the merger. Department of Justice, Press Release, "Justice Department Reaches Accord Agreement with Nationsbank," Dec. 9, 1997.

In the $16.6 billion CoreStates/First Union merger, the number of branch offices ordered divested by Justice represented 1.3 percent of total number of offices being merged. Department of Justice, Press Release, "Justice Department Approves First Union/CoreStates Merger After Parties Agree to $1.1 Billion Divestiture in Pennsylvania," Apr. 10, 1998.

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Banks and financial firms are not unique in this respect. Instead, evidence of the adverse impact of mega-mergers on economic performance is found for American industry generally. See Walter Adams and James W. Brock, Dangerous Pursuits: Mergers and Acquisitions in the Age of Wall Street (1989).

The debacles following the Union Pacific Railroad's acquisition of the Southern Pacific Railroad, and those stemming from Boeing's acquisition of McDonnell Douglas and the defense and aerospace operations of Rockwell, are the latest manifestations of the problem.

In the former case, the firm's president declared at the time of the merger that the Union Pacific/Southern Pacific combination would produce "improvements that truly deserve the term 'unprecedented'." So far, the merger's only "unprecedented" result has been massive congestion tying up rail traffic throughout a large portion of the continental United States. See Peter Coy, "The Antitrust Cops Should Ride the Rails," Business Week, Mar. 2, 1998, p. 48, and Brien O'Reilly, "The Wreck of the Union Pacific," Fortune, Mar. 30, 1998, pp. 102.

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