

Bank Deregulation And Concentration— What Policy for Mergers?

By Wilbur T. Billington

Nebraska and Oklahoma joined a long list of states this year allowing banking organizations to expand beyond a single location. Not only do both states allow limited branching, they also allow multibank holding companies. Kansas is the only state in the Tenth District still adhering strictly to unit banking.¹

The changes in Nebraska and Oklahoma are notable, given the conservative positions they have always taken on banking structure. The changes reflect a national trend toward product and geographic deregulation in banking.

While many look on deregulation with favor, it brings to center stage issues vital to the Federal Reserve System's role of central banker. For example, there is some concern that deregulation will make the financial system more fragile as fewer but larger organizations

¹ States of the Tenth Federal Reserve District are Colorado, Kansas, Missouri, Nebraska, New Mexico, Oklahoma, and Wyoming.

Wilbur T. Billington is a senior vice president in charge of the Bank Supervision and Structure Division of the Federal Reserve Bank of Kansas City. This article is based on his presentation to a joint meeting of the boards of directors of the bank and its branches held at Denver on September 15, 1983.

form its base. And as these fewer institutions develop national payments links, the change may affect how monetary policy actions are transmitted to the economy. Certainly, the impact of deregulation raises the importance of the System's need to be involved in both supervisory and monetary policy. While some may advocate that the Federal Reserve confine itself to monetary policy, such a change seems very ill advised, especially now during these rapidly changing and uncertain times.

Deregulation also has brought questions about the concentration of financial resources to the national policy agenda. As the country moves toward interstate banking, concern over concentration in banking being raised to unacceptable levels will no doubt be accentuated.

The following discussion of bank merger policy in an environment of deregulation and concentration highlights four elements: first, some of today's events bearing on tomorrow's banking structure; second, current levels of banking concentration related to political and geographic boundaries; third, traditional antitrust tools used to influence banking competition and concentration and their effectiveness in dealing with the emerging banking structure;

and, fourth, some suggestions on steps to be taken in preparing for a likely increase in national merger activity.

Events affecting deregulation of banking structure

Bankers have always wanted to compete and to see their organizations grow and flourish. Recent legislative, judicial, and regulatory events are now more encouraging to them in their expansion objectives.

On the legislative front, the changes in Nebraska and Oklahoma are only two of the most recent illustrations of a more liberal attitude toward bank expansion. Over the past two years, multibank legislation has passed in Pennsylvania, West Virginia, Arkansas, and Illinois. States such as Connecticut, Massachusetts, Maine, Alaska, South Dakota, and Delaware have recently allowed, within bounds, out-of-state banks to acquire banks within their borders. Several states are discussing how they might allow interstate banking within regional zones, such as the Southeast, the Northeast, and maybe the Northwest. There is also a mood on Capitol Hill that, while not yet clear, tends toward easing geographic restrictions.

On the judicial front, recent decisions also have made it easier for banking organizations to expand. Most notable has been the 1981 *Mercantile Texas Corporation* decision by the Fifth Circuit Court of Appeals, which limits the ability of regulators to block market extension proposals by increasing the evidentiary requirements on them.

On the regulatory front, federal banking agencies themselves, acting under the influence of recent court decisions or the need to meet financial emergencies, have taken a more liberal stance on bank consolidation. Early this year, for instance, Mellon National Corporation, Pennsylvania's largest banking organiza-

tion, was allowed to acquire the state's seventh largest banking organization, the Girard Company. Shortly afterward, Interfirst Corporation, the largest banking organization in Texas, acquired First United Bancorporation, the state's tenth largest banking organization. Completing the picture of large bank consolidations is the approval given to BankAmerica to acquire the financially troubled SeaFirst Corporation.

These events have increased the concentration of financial resources. They also call into question how well traditional antitrust standards can be applied to influence events on a regional or national basis as emerging trends develop into a merger movement. Before going into these matters, however, it might be well to put the current level of concentration into perspective. After all, it is the level of concentration that dictates the speed at which answers are sought to deal with growing regional and national concentration.

Concentration of resources

The traditional way of looking at concentration has been to measure the share of resources controlled by the four largest firms in a geographical area. A possible caveat for banking is that this measure may overstate the true level of concentration in product markets. Today, there are reasonable, though not perfect, substitutes for the services supplied by commercial banks. Savings and loans come first to mind. Nevertheless, commercial banks are a dominant feature of the financial system, and there remains concern with the level of concentration in banking.

Nationwide, the four largest banking organizations control about a tenth of total bank deposits. In contrast, concentration in other key industries, like petroleum refining, steel, and automobiles, ranges from 30 to 90 percent. If

the Tenth District states are considered a region, the four largest organizations controlled 30 percent of total bank deposits in 1982. Of district states, Colorado is the most highly concentrated, with the four largest banking organizations controlling 53 percent of state bank deposits. Of the ten major metropolitan banking markets in the district, four-firm concentration ratios in 1982 ranged from 39 percent in Kansas City to 87 percent in Albuquerque.

These figures demonstrate a simple, but important, feature of the current banking environment. As the view of concentration moves from national boundaries, where banking restrictions are more stringent, to state and local boundaries, where mergers are more frequently allowed, concentration increases. These figures suggest, therefore, that as the laws continue to be liberalized, allowing more state and interstate mergers, concentration of financial resources also will increase.

This does not imply that the tendency is necessarily harmful. Removing barriers to entry across state lines could facilitate competition as firms seek new market opportunities. Nevertheless, when such entries are made through acquisition, banking concentration will tend to increase. And this tendency raises the question of whether present antitrust standards are adequate for dealing with the developing merger movement in a way that is consistent with a strong, competitive national banking system.

Current antitrust tools and banking

The current approach to reviewing bank mergers and acquisitions focuses on the effects on either existing competition or probable future competition. If a proposed merger or acquisition would combine two or more banks or companies competing in a market, existing competition would be affected. If the elimination of an existing competitor results in ex-

cessive local market concentration without offsetting public benefits, the proposal is denied.

In the event of banking organizations expanding statewide, the Federal Reserve System has analyzed the effect of such expansions on future competition. Where a banking organization tries to enter an already highly concentrated market through the acquisition of a leading bank, the Federal Reserve has denied the proposal if there was evidence that the acquiring firm would enter the market with a new bank or through acquisition of smaller banks. In this way, the System has been able to inhibit large market extension mergers where it concluded that competition could be better served by encouraging procompetitive entry. This policy also has tended to constrain increases in statewide concentration. Because of the evidentiary requirements imposed by the *Mercantile* decision, however, many believe that probable future competition will be less useful as a tool for analyzing interstate bank mergers.

Developing alternatives for dealing with national merger issues

The discussion so far has outlined the events prompting change in the structure of banking and focused on the sufficiency of current antitrust tools in meeting potential increases in banking industry concentration. From this review, it can be concluded that the analysis of bank mergers works well in some areas and not so well in others. For example, the analysis used in reviewing horizontal mergers will continue to be effective in controlling local banking concentration. There is no consensus, however, on the attitude that should be taken toward market extension proposals. Although there is currently no reason for alarm about concentration in banking, a sound and consistent policy must emerge soon to deal with prospective developments in banking structure.

Certain steps could be taken to develop such a policy. First, antitrust decisions could be reviewed again, especially those dealing with the national issue in other industries, to see what elements in those cases might apply to the emerging national trends in banking. Second, definitions of the geographic and product markets could be reexamined. It could be that the right tool is being applied to the wrong situation. Recent changes in national and state laws, services, and technology have clearly expanded the product and geographic scope of banking. A broader definition might show some smaller local mergers desirable while allowing better control of trends toward large regional or national concentrations of banking resources. Third, the use of probable future competition needs to be reevaluated to determine whether it remains a valid economic concept that can be effectively applied. It has been pointed out that for the concept to be effective, it must be simple, uniform, easily applied, and capable of resolving adversarial difference. If the evolution of merger policy reflects these criteria, it will be effective in providing a sound basis for dealing with the potential for increased concentration in banking.

Conclusion

Banking is not now highly concentrated, so there is time to explore alternatives for policies governing mergers. Any viable approach, however, must be formulated to be consistent with national goals to control concentration, with the national need to facilitate financial and economic growth, and with sound economic theory that will withstand market and legal review. Such a policy can and should be developed in view of the emerging trends in banking structure.