Understanding Antitrust Considerations in Banking Proposals

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Introduction

Banking consolidation is important trend in U.S banking. News accounts report mergers and acquisitions among community banks, super-regional organizations, and money center companies. Indeed, since the mid-1980s, the number of banking organizations in the United States fell by around 45 percent. Many believe this decline will continue.

As consolidation continues, it is more likely that transactions will occur that raise issues under the nation's antitrust laws. Typically, these issues will be raised during supervisory review of merger and acquisition transactions.

This resource helps those contemplating banking transactions understand antitrust analysis of those transactions. To accomplish this, it reviews the tools, methods, and factors taken into consideration in evaluating the competitive effects of banking proposals.

If you have questions about this resource, we encourage you to contact the Banking Studies and Structure Department.

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The Federal Deposit Insurance Act ("FDIA"), the Bank Holding Company Act ("BHCA"), and the Change in Bank Control Act ("CIBCA") provide for the antitrust review of bank and bank holding company transactions and change in control notifications. The wording of the antitrust sections in these acts is similar and incorporates the standards set out in the Sherman Antitrust Act and the Clayton Act. For example, Section 3(c) of the BHCA precludes the Board of Governors of the Federal Reserve ("Board") from approving any transaction which would create a monopoly or would lessen competition in any section of the country. However, such a transaction may be permitted if it results in substantial public benefits. For example, a transaction that preserves banking services in a community or that reduces the cost and inconvenience of bank failure may provide significant public benefits and permit approval.

The FDIA, BHCA, and CIBCA assign the responsibility for antitrust review of banking transactions to the Federal banking agencies and the Department of Justice ("DOJ"). The Comptroller of the Currency ("OCC") reviews transactions where the resulting bank is a national or a District of Columbia bank. The Federal Reserve reviews transactions involving bank holding companies and where the resulting bank is a state member.[1] The Federal Deposit Insurance Corporation ("FDIC") reviews transactions where the resulting bank is a state nonmember. In instances where the FDIC is not the reviewing agency, the other banking agencies provide a copy of applications they receive to the FDIC. Additionally, the OCC, Federal Reserve, and FDIC circulate their applications to the DOJ for its review and comment. Besides this review opportunity, the DOJ has 30 days to re-examine the competitive aspects of transactions after their approval by the federal banking agencies and enjoin the transactions if it feels there are antitrust violations.[2] It is important to note DOJ review is not done in instances of mergers between depository institutions and their affiliates. Furthermore, the review period is reduced to 10 days in emergency situations and done away with completely in failing bank situations.

In their competitive review of banking proposals, the three banking agencies use the DOJ merger guidelines.[3] The DOJ, in conjunction with the Federal Trade Commission ("FTC"), issued its latest guidelines on April 8, 1997.[4] The DOJ merger guidelines specify matters considered in competitive analyses and offer direction to American business on the types of transactions that may be subject to greater scrutiny under the antitrust laws. DOJ's and FTC's intent in publishing the merger guidelines

is to aid business planning, reduce business cost, and lessen the chance of firms entering into arrangements that may face antitrust challenge.

Basic Concepts Used in Competitive Analysis

The nation's antitrust laws, as incorporated into banking law, make it illegal for anyone to engage in any transaction that would create or further a monopoly in the business of banking in any part of the United States. This statement of national policy seems relatively straightforward. However, the terms, “business of banking” **(product market)**, “part of the United States” **(geographic market)**, and **“create or further monopoly,”** are subject to interpretation and it has been left to the banking agencies, the DOJ, FTC, and the courts to define them.

The product market

Product market in antitrust analysis refers to the individual goods and services supplied by firms that are party to a merger or acquisition. It defines the goods and services that are purchased by consumers whose quantity, quality, and price may be influenced by combining firms. For banks, these goods and services include such things as transaction accounts (checking accounts, NOW accounts, and Money Market Accounts), time and savings accounts, loans (agriculture, business, consumer, and real estate), safety deposit boxes, trust services, and other products and services normally provided by full service banks.

However, because other firms provide many of the same products and services offered by banks, defining the product market for banks presents practical difficulties, e.g., how do deposit and loan services offered by thrifts or credit unions differ from those provided by a bank? Thus, it is not too surprising that the definition of product market has been a source of debate and an issue addressed by courts.

Guidance provided by the courts outlines the basic methodology for defining a product market in banking transactions. In this regard, the Supreme Court, through a series of decisions between 1963 and 1974, defined the product market for banking.

… It is the cluster of products and services that full service banks offer that as a matter of trade reality makes commercial banking a distinct line of commerce. Commercial banks are the only financial institutions in which a wide variety of financial products - some unique to commercial banking and others not - are gathered together in one place ... Thus,

banking constitutes a single line of *commerce for purposes of antitrust analysis.*[5]

Thus, in the Court's eyes, banks are unique and apart from other financial service providers. The Court, however, realized that other financial service providers could become full competitors of banks. In its 1974 decision, the Court noted "At some stage in the development of savings banks it will be unrealistic to distinguish them from commercial banks for purposes of the Clayton Act."[6]

During the 1980s and 1990s, deregulation and financial and technological innovations blurred distinctions among financial service firms. As a consequence, the influence of nonbank firms has been increasingly taken into consideration in analyzing the competitive effects of banking proposals.

The geographic market

The geographic market in antitrust analysis refers to the area or section of the country in which firms produce or sell their goods and services. It is the area where customers feel the competitive impact of a merger or acquisition. In DOJ merger guidelines terms, it is the smallest geographic space where a firm can institute a small product price increase and enhance profits.[7]

Just as it has with the definition of product market, the Supreme Court has offered guidance on the practical problem of setting geographic limits on the area directly affected by a transaction.[8] In U.S. v. Philadelphia National Bank, the Court noted that the "section of the country" affected by a proposal is not defined by "where the parties to the merger do business or even where they compete, but where within the area of competitive overlap, the effect of the merger will be direct and immediate."[9] The Court further commented that banking markets must, due to the service nature of banking, be limited in their geographic scope. "The factor of inconvenience localizes banking competition as effectively as high transportation costs in other industries." Therefore, in defining a banking market, care must be taken to identify the "market area in which the seller operates, and to which the purchaser can practically turn for supplies." In addition, because transaction size is an important determinant of the practical alternatives available to bank customers, the Court noted it was most appropriate to evaluate a transaction in terms of its meaning for customers that were "neither very large or very small." In light of these considerations, the Court concluded that banking markets are local in nature and limited in their geographic scope.[10]

Since 1974, the U.S. financial system has undergone significant deregulation and experienced financial and technological innovations. For example, the advent of such things as, online banking, online bill pay, and remote deposit capture permit banking organizations to inexpensively reach and serve customers over greater geographic distances. This has caused some to argue that the market for banking services is less local than it once was and that geographic markets are larger than they were decades ago.

In the past, the high cost of conducting banking over long distances effectively kept the geographic market for banking services local. Low cost personal computers and high speed, low cost communications let customers inexpensively find, compare, and utilize banking services beyond their immediate locale. The same technological advances make it easier for banks and other financial service providers to manage geographically dispersed operations and make it less expensive to serve more distantly removed customers. Thus, local markets, counties or metropolitan areas, may no longer adequately represent the geographic market for banking services. Some suggest based on anecdotal information that the market for many banking service may have expanded, leading them to advocate abandoning local markets in antitrust analyses.[11] Others have studied the question more rigorously coming to a variety of conclusion regarding geographic market size. In some instances, they find that states rather than counties or metropolitan areas may be a better approximation of the geographic markets for some banking products.[12] Others agree that broader concentration measures (statewide) are useful for analyzing the competitive impact of proposed bank mergers but argue local banking market remain useful predictors of bank pricing power.[13] Along this line some find that households obtain to a substantial degree certain key asset services, notably checking accounts, at local depository institutions.[14] Another finds that distance still remains a deterrent to making commercial loans, especially as lending institution size shrinks, implying local banking markets.[15] Still others argue that it is costly in time and effort to change institutions, and as a result consumers seldom change banks except when their bank is merged into another or customers move to a new location, once again implying local market.[16]

Thus on the face of it, there may be some evidence to support erosion in the local nature of some banking products. Despite this, the markets for a good number of banking products still appears to be local in nature, limiting the geographic scope of market for these products.

Create or further monopoly

To “create or further a monopoly” in antitrust analysis means the ability to exert control over product output and price. In terms of the DOJ

merger guidelines, it is the ability to profitably institute a "small but significant and nontransitory [product] price" increase.[17] Whether or not parties to a merger or acquisition can accomplish this is assumed to be closely tied to market concentration and change in concentration.[18]

To aid business planning and to avoid antitrust problems, the DOJ and FTC set out concentration standards which, if exceeded, may trigger a more intense review of a merger or acquisition transaction for possible antitrust violation. These standards are included in the DOJ merger guidelines and are phrased in terms concentration change and post-merger market concentration.

The concentration measure used in the standards is the Herfindahl-Hirschman Index (HHI). The HHI is calculated by squaring the percentage share of a product, such as deposits, held by each competitor in a market. The squared shares are then summed to generate the HHI for the market. For example, a market with three firms with market shares of 10, 30, and 60 percent respectively would have a HHI value of 4600 ($10^2+30^2+60^2$).

The advantage of the HHI over other concentration measures is that it captures both the number and relative size of institutions competing in a market. Using the three firm example from before, if the market shares of the firms were 5, 15, and 80 percent instead, the HHI value would have been 6650. The greater size disparity among the firms raises the HHI, bringing the market HHI closer to the theoretical high of 10,000 (the ratio value for monopoly).

Depending upon its HHI, a geographic market is considered unconcentrated, moderately concentrated, or highly concentrated. The higher the level of concentration or HHI, the smaller is the change in concentration permitted to avoid likely antitrust challenge by the DOJ or FTC.[19]

The banking agencies use a set of criteria, including the DOJ merger guidelines, to screen applications and notifications brought before them for possible antitrust issues. In the case of the Federal Reserve, transactions that result in a *pro forma* product market share of less than 35 percent and that meet benchmarks in the DOJ merger guidelines (see Table 1) normally aren't viewed as presenting antitrust issues.[20]

Table 1. U.S. Department of Justice Merger Guidelines

	Moderately Concentrated Market	Highly Concentrated Market

Post merger HHI	Below 1800		Above 1800	
HHI change	Under 200	Over 200	Under 200	Over 200
Chance of DOJ challenge	Unlikely	Depends upon situation	Unlikely	Likely

For transactions involving very small depository institutions, the Federal Reserve has special criteria. These criteria are employed in instances where the target bank or bank holding company has total deposits less than $50 million and the *pro forma* market share of the acquirer is less that 40 percent.

Table 2. Federal Reserve Small Depository Institution Merger Criteria

Post merger HHI	Below 2000	Below 2500
HHI change	Under 400	Under 300

It is important to point out that banking transactions that fall outside these safe harbor guidelines aren't necessarily precluded from passing antitrust muster. There may be extenuating or mitigating circumstances that lessen or override the effect of the transaction on market competition. Some of these circumstances are discuss later.

Antitrust Analysis of Banking Proposals

The HHI calculation and determining if a particular banking transaction meets the safe harbor criteria is the end point of antitrust analysis. Many quantitative and qualitative matters are taken into consideration to reach this point. These matters focus on making operational the concepts set out by the Supreme Court that must be considered in antitrust review. This involves answering questions such as what is the identifiable product affected by the transaction and who are the sellers of the product (product market), including the locations at which they are located (geographic market).

The product market

There are two questions addressed regarding product market in antitrust analysis. What is the product or line of commerce affected by the transaction and who are the sellers of the product? Regarding the answer

to the first question, the Federal Reserve follows Court guidance and views the cluster or bundle of financial services provided by banks as the relevant product line for antitrust analysis.

Because no single measure exists for these services, total deposits is often used as a proxy for total banking output. On occasion, this measure is adjusted to more accurately reflect business with smaller customers. For example, deposits by other banks, unusual deposits by large business customers, and deposits by governmental units may be deducted prior to calculating market share percentages.

Answering the second question regarding sellers requires identifying firms that offer similar or product substitutes that meet the demands of the same customers served by parties to a merger or acquisition. For banks, these alternative service providers traditionally have been other banks located in close geographic proximity. Depending upon circumstances, thrift institutions, credit unions, and other financial institutions have been factored into competitive analyses of banking proposals.[21] The inclusion of these other depositor institutions in the analysis "shades down" or reduces the market share of banks, lessening the competitive effects of a banking transaction. This shading is done by applying a percentage weight to output, often deposits, of these other depository institutions.

The competitive effect or the amount of shading attributed to alternative depository institutions in the market depends upon a number of factors. Probably the most important of these is whether or not the institution makes commercial loans. For example, thrifts are routinely included in competitive analyses. The amount of competitive effect given to them depends heavily upon their commercial lending. If a thrift has a commercial loan department or a significant portion of its assets in commercial loans, it may be given full weight in the competitive analysis. This is also the case if the thrift is a subsidiary of bank holding company.[22] Otherwise, thrifts are given half weight in the calculation of market concentration.

Credit unions typically aren't included in competitive analyses banking transaction because of restrictions that are often placed on their membership and asset powers. Occasionally, they may be given half weight in market concentration calculations if they have a wide field of membership, have a "street" presence (for example a free standing building or a direct entrance to the street), and make commercial loans.

Beside thrifts and credit unions, there may be other financial institutions that may be considered as a shading factor in competitive analyses. These institutions include industrial banks, credit card banks,

and nonbank banks. The shading effect of these institutions is done on firm-by-firm basis.

The geographic market

Defining the geographic market requires identifying the area of the country affected by the transaction. For the vast majority of individuals and businesses, the market for banking products is geographically limited. Many, because of convenience, bank close to where they live or work. Thus, market boundaries are set by business interactions caused by the ebb and flow of people within a geographic area. Because of this, such things as the willingness of people to travel, geographic impediments, employment opportunities, shopping alternatives, historic rivalries among towns, and aggressiveness of competitors may all influence a market's geographic dimensions. Consequently, the appropriate market for judging the competitive effects of a banking proposal may not be readily apparent and may be open to question and debate.

Because views can differ on the appropriate market definition, the Federal Reserve asks banking organizations and others (applicants), prior to filing, to contact the appropriate Reserve Bank for a preliminary definition of the banking market. In many instances, the preliminary market definition for transactions in rural areas is the county. For metropolitan areas, the preliminary definition may be a Ranally Metropolitan Area ("RMA") or Metropolitan Statistical Area.[23] These definitions delineate markets by tying economic activity in a geographic area to an important city or central place. In rural areas, the central place is often the county seat. This seat of government is often the largest city in the county, offering the widest array of shopping services and the greatest employment opportunities. In metropolitan areas, it is a large city that serves as a focus of economic activity.

The Federal Reserve recognizes that a county or RMA/MSA may not accurately describe the market affected by a banking transaction. As a result, applicants may offer alternative market definitions and describe the competitive effects of their proposals in the delineated market.

If an alternative market definition is offered, applicants need to provide support for any proposed market. Examples of support include such things as check cashing survey data, highway traffic counts, commuting data, regional trade area studies conducted by governmental bodies and others, media coverage and circulation statistics, employer and shopping service locations, and any other data that may demonstrate the economic integration of a specified geographic area.

In addition to data supplied by the applicant, the Federal Reserve may gather other information. For example, Federal Reserve staff may conduct interviews with bankers and ask them to name their competitors. Staff members may also survey households and small businesses, asking them where they bank or what they believe are reasonable alternative sources for banking services. Additionally, staff members may make on-site visits, discussing commuting patterns and economic interaction with local employers, retailers, chambers of commerce, bankers and others.

On occasion, the data supplied by applicants and the information gathered by the Federal Reserve may result in modifying the initial county or RMA/MSA definition used to approximate a market. For example, a rural county banking market may be altered by including a city or cities in adjacent counties or adjusted by excluding certain cities on the county's periphery. Similar type adjustments may be made to urban RMA or MSA banking markets. When market definitions are altered, the Federal Reserve notifies the applicant of the changes.

Special Factors in Competitive Analysis

If the HHI and its change fall within the merger criteria, little additional analytical work is done. However, if HHI figures fall outside these criteria, more extensive analysis is done to see if there may be special factors or circumstances that lessen the adverse competitive effects of the transaction. These factors relate to such matters as market vitality, competitor quality, public benefits, applicant commitments, and other considerations. Each of these is discussed below.

Market vitality

Market vitality relates to long-run demographic and economic trends in a banking market. Market trends, either up or down, may lessen the competitive effects of banking transactions. As a result, competitive loss may not be as great as indicated by concentration measures.

Many factors may be considered in evaluating the economic state of a market. Among these are population growth, population per banking office, deposit growth, deposits per office, and per capita income. Changes in market employment, retail sales, and loans may also be considered. A particularly important mitigating factor is the entry and exit by banking organizations in or out of a market.

Invariably, these factors are compared with a state average or some other comparable average. Unfavorable comparisons are generally taken as an indication of the market's inability to support the existing number of competitors. Banking organizations close down offices or leave

the market completely. Moreover, it is unlikely that a banking organization outside the market would purchase a bank or make a permanent commitment of resources to the market. As a consequence, consolidation represents one of the few alternatives available to preserve banking services in the market. This, combined with the number of remaining banking alternatives in the market, lessens possible antitrust concerns.

Alternatively, favorable growth trends such as rising personal income, high population and deposits per banking office relative to state averages or similar type of banking market, and substantial deposit growth may also mitigate competitive effects. In rapidly growing markets, those operating outside the market may find it profitable to supply banking services. New banks may be chartered, providing consumers with additional banking alternatives. Existing banks may be purchased by banking companies not represented in the market, providing customers with access to previously unavailable banking services. These considerations and the number of competitors remaining in the market after consummation of the transaction may help alleviate antitrust concerns.

Competitor quality

Competitor quality relates to special characteristics of parties to the transaction and those of other depository institutions in the market. In some instances, these characteristics may limit the effectiveness of individual market competitors. As a consequence, market share may overstate their competitive importance. For example, small absolute size, low loan share, modest deposit growth, and a low loans-to-deposits ratio may be viewed as indicating that the applicant and/or the target are ineffective competitors and competitive loss may not be as severe as HHI numbers show.

Public benefits

Public benefits relate to a host of factors that may improve customers' welfare if a merger or acquisition proposal were approved. Examples of such benefits are new banking services, expanded operating hours, increased efficiency, cost savings, management succession, and preserving a banking office that otherwise might be closed.

When a banking organization falters or fails, there are considerable public benefits associated with preserving the organization as a source of banking service. In such situations, public benefits may outweigh adverse effects on competition.[24]

A number of factors may indicate that the prospects of an organization to be acquired are uncertain. Examples of these are downward trends in performance, asset problems, and operating losses. Further, an institution may not appear to have the necessary internal financial and managerial resources to reverse its poor performance and its viability is questioned. In some instances, the institution's primary supervisor may indicate that the institution is in danger of failing.

In situations involving a failing or near-failing institution, the Federal Reserve looks for the alternative with the least adverse effects on market competition. Often, only in-market organizations are interested in the troubled institution and the Federal Reserve has few, if any, alternatives to approving a transaction. However, where alternatives exist, the applicant may be expected to do more to overcome adverse competitive effects. In such instances, the acquiring company may have to make certain branch office divestitures if its proposal is to move forward. [25]

In addition to preserving banking services, merger and acquisition transactions may result in operating efficiencies that benefit the public. For example, in one transaction an early estimate placed merger cost savings at nearly $1 billion.[26] Despite these savings, the acquiring organization was required to make certain divestitures before the transaction could move ahead. Thus, in situations where a transaction has significantly adverse effects on competition, benefits associated with cost savings may not outweigh anticompetitive effects.[27]

Applicant response

Applicant response relates to actions an applicant may take to lessen the anticompetitive effects of a proposal. Examples of such actions include commitments not to control and divestitures.

In some situations, commitments not to control may be used to lessen competitive concerns of a merger or acquisition transaction. These situations usually involve cases where a bank holding company acquires between 5 and 25 percent of any class of outstanding voting shares of another bank or bank holding company.[28] In such circumstances, the applicant commits not to take actions that would allow it to exercise control or exert a controlling influence over the acquired institution.

Divestitures are another way to reduce or eliminate the adverse competitive effects of merger or acquisition transactions. Applicants may commit to branch divestitures to lessen the competitive effects of their proposals. In such cases, the applicant often agrees to submit definitive

sales agreements to the Board prior to consummation of its proposed merger or acquisition. Further, applicants often commit that if events preclude consummation of the divestitures within a specified period of time, e.g., 180 days, they would transfer the relevant offices to an independent trustee. The trustee would immediately sell the branches.

Other factors

Other factors may serve to reduce the competitive effects of a bank merger or acquisition proposal. These factors include such matters as long-standing affiliations and remaining market competitors. In many cases, they are mentioned with other points that the Board may have considered in its deliberations on a case. Together, these other and other considerations tend to alleviate competitive concerns over the proposal.

Long-standing affiliations relate to the length of time institutions may have been affiliated. This factor takes on importance in proposals where the Board must evaluate a transaction from the perspective of an earlier transaction that brought institutions under common control. In some instances, the earlier transactions may have occurred when the institutions were very small. They may have pre-dated the U.S. antitrust laws or occurred when antitrust laws weren't applied to ownership transactions involving individuals. As a consequence of long-term, common control, little competition would be eliminated by approving the current transaction.

Remaining competitors relate to the number of banking alternatives available in the market. In situations where approval of a transaction still leaves a number of banking alternatives available to consumers, the effects of the transaction on competition may be viewed as less onerous.

Conclusion

Banking consolidation is an ongoing feature of U.S. banking. As consolidation trends continue, it is likely that merger and acquisition transactions will raise market competition questions.

This resource described the concepts and tools used to analyze the competitive effects of banking transactions on market competition. Additionally, it explained the logic behind the concepts and tools and demonstrated their use. Ultimately, the goal was to improve the understanding of antitrust matters and by doing so help organizations contemplating mergers and acquisitions avoid transactions that may not

pass antitrust muster or that present competitive issues that may be costly to resolve.

Endnotes

[1] A state member bank is a state chartered bank that is a member of the Federal Reserve System. A state nonmember bank is an insured state chartered bank that is not a member of the Federal Reserve System.

[2] The period for DOJ review is the reason for the 30 day delay between an agency's approval of a transaction and the time when it can be consummated.

[3] Although the discussion mentions the DOJ guidelines in terms of banking only, they are applied to transactions among firms in other industries.

[4] Department of Justice and Federal Trade Commission, Horizontal Merger Guidelines, Issued April 2, 1992. Revised April 8, 1997. See http://www.usdoj.gov/atr/public/guidelines/hmg.htm

[5] U.S. v. Phillipsburg National Bank & Trust Co., 90 S.Ct. 2035 (1970).

[6] U.S. v. Connecticut National Bank, 94 S.Ct. 2788 (1974).

[7] DOJ Guidelines, pp. 16-18.

[8] For a detailed discussion of the many practical issues in defining a geographic market see John D. Wolken, "Geographic Market Delineation: A Review of the Literature", Staff Economic Studies 140, (Board of Governors of the Federal Reserve System, 1984).

[9] U.S. v. Philadelphia National Bank, 83 S.Ct. 1715 (1963).

[10] The last time the Supreme Court addressed an antitrust case involving banks was in 1974 (U.S. v. Connecticut National, 94 S.Ct. 2788 (1974)). In that case, the Court reaffirmed its view on banking as a separate product market and banking markets being local in nature.

[11] "Rethinking Antitrust," Brian W. Smith and Mark W. Ryan. Banking Strategies, Bank Administration Institute, September/October 1997, Volume LXXII, Number V.

[12] "Local or State? Evidence on Bank Market Size Using Branch Prices," Paul Edelstein and David P. Morgan . Economic Policy Review, Federal Reserve Bank of New York, May 2006, pp. 15-25. "The Expanding Geographic Reach of Retail Banking Markets," Lawrence J. Radecki, Economic Policy Review, Federal Reserve Bank of New York, 1998, no. 2 (June): 15-34.

[13] "The Geographic Scope of Retail Deposit Markets," Erick Heitfield and Robin A. Prager. Finance and Economics

Discussion Series 2002-49, Board of Governors of the Federal Reserve System, October 2002.

[14] "Market Definition in Banking: Recent Evidence," Dean F. Amel and Martha Starr-McCluer. Antitrust Bulletin, 47, p.6389.

[15] "Commercial Lending and Distance: Evidence from Community Reinvestment Act Data," Kenneth P. Brevoort and Timothy H. Hannan . Finance and Economics Discussion Series 2004-24, Board of Governors of the Federal Reserve System, May 2004.
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[16] "Have barriers to entry in retail commercial banking disappeared?" Stephen A Rhoades (Winter 1997). "Household Switching Behavior at Depository Institutions: Evidence from Survey Data," Elizabetha K. Kiser . Finance and Economics Discussion Series 2002-44, Board of Governors of the Federal Reserve System, October 2002.

[17] DOJ Guidelines, p. 12.

[18] In the Philadelphia National Bank case, the Supreme Court held that an "undue percentage share of the relevant market" and "a significant increase in concentration of firms in that market" did not necessarily violate Section 7 of the Clayton Act. Instead, it raised only "an inference" that the transaction would significantly lessen competition. See U.S. v. Philadelphia National Bank, 83 S.Ct. 1715 (1963).

[19] The change in the HHI can be calculated quickly by multiplying the percent market share of the buyer by the market share of the seller and multiplying this product by 2. For example, Bank A acquires Bank B. Before the purchase, Bank A controls 15 percent of the market's deposits. Bank B controls 10 percent. The change in the HHI would be 15x10x2 or 300 points.

[20] The DOJ and FTC guidelines for nonbanking proposals are more stringent than those for banks. For nonbanking proposals, the DOJ and FTC may challenge mergers in some instances where the change in the HHI falls between 50 and 100 points (See table below).

	Unconcentrated market	Moderately concentrated market		Highly concentrated market		
Post-merger HHI	Below 1000	1000 to 1800		Above 1800		
Increase in HHI due to merger	Any change	Less than 100	More than 100	Less than 50	50 to 100	More than 100

Probability of DOJ challenge	Unlikely	Unlikely	More likely than not	Unlikely	Depends upon the post-merger HHI	Likely

[21] Some have argued for using "sub-markets" to measure bank output. For example, in First Hawaiian, Inc., Honolulu, Hawaii, to acquire First Interstate of Hawaii, Inc., 77 Federal Reserve Bulletin 56 (1991), the DOJ argued that the appropriate product market was commercial lending to small and medium-sized businesses. However, the Board of Governors used the traditional "cluster of services" approach, using total deposits as a proxy for banking output.

[22] A slightly different calculation is made when a banking organization acquires a thrift. The thrift is given half-weight (its deposits are divided by two before adding them into the total for the market) before its deposit share is squared and included in the calculation of the Pre-HHI. The thrift's deposits are counted fully in calculating market total and squared deposit share in the Post-HHI calculation.

[23] Rand McNally created RMAs as a tool to identify areas of population concentration (generally 50,000 or more). RMAs tie together developed areas around an important city. The U.S. Office of Management and Budget defines Metropolitan and Micropolitan Statistical Areas, collectively referred to as Core Based Statistical Area Areas (CBSAs). CBSAs tie together adjacent communities having a high degree of economic and social integration to a population core. Metropolitan Statistical Areas have at least one urbanized area with 50,000 or more inhabitant. Micropolitan Statistical Areas have at least one urbanized area of 10,000 inhabitants but with no area having as many as 50,000 inhabitants.

[24] It may be argued that a troubled organization is not an effective competitor and that market share data overstate its competitive posture in the market. Further, it may be argued that market competition is harmed regardless of the decision made on an in-market firm's merger or acquisition of a troubled institution. If the transaction is approved, the market loses the troubled institution as a competitor. However, if the transaction is denied, the troubled institution is closed and is no longer a competitor.

[25] Janusz A. Ordover and Margaret E. Guerin-Calvert, Bank Merger Analysis and the New Merger Guidelines: The View From the Department of Justice, presentation before the Federal Reserve Bank of Chicago, Chicago, Illinois, May 8, 1992, pp. 4-5.

[26] Teresa Carson and Karen Gullo, "400 Branch Cut Called Possible", American Banker, August 14, 1991, p. 3.

[27] The DOJ merger guidelines do not presume that the cost savings are the dominant motive for merger and acquisition transactions. "Mergers that increase concentration...raise the possibility that adverse competitive effects will outweigh efficiencies ... [and] that when concentration thresholds are surpassed efficiencies must be substantial in order for them to be considered as a defense to an otherwise potentially anticompetitive merger." Janusz A. Ordover and Margaret E. Guerin-Calvert, Bank Merger Analysis, p. 20.

[28] Ownership must remain below 25 percent if commitments not to control are to be used to lessen antitrust concerns. Under the BHCA, control occurs when a company owns 25 percent or more of any class of voting stock of a bank or bank holding company.