119210

BY THE COMPTROLLER GENERAL

Report To The Congress

OF THE UNITED STATES

Bank Merger Process Should Be Modernized And Simplified

Federal agencies do not have uniform criteria for evaluating proposed mergers and, as a result, make conflicting assessments of mergers.

Unlike nonbanking commerce, Federal banking laws do not provide for shell corporations to facilitate the takeover of total ownership of an entity. Bank holding companies or stockholders are using a complex merger process to obtain total ownership of a bank. This process, which could be simplified, is expensive, time consuming, and burdensome.

This report contains recommendations to the Congress and the three Federal banking agencies to modernize and simplify the laws and procedures used by the agencies to assess and approve bank merger applications.

UNITED STATES GENERAL ACCOUNTING OFFICE

119210

GAO/GGD-82-53

AUGUST 16, 1982

119210

Request for copies of GAO reports should be sent to:

U.S. General Accounting Office
Document Handling and Information
Services Facility
P.O. Box 6015
Gaithersburg, Md. 20760

Telephone (202) 275-6241

The first five copies of individual reports are free of charge. Additional copies of bound audit reports are $3.25 each. Additional copies of unbound report (i.e., letter reports) and most other publications are $1.00 each. There will be a 25% discount on all orders for 100 or more copies mailed to a single address. Sales orders must be prepaid on a cash, check, or money order basis. Check should be made out to the "Superintendent of Documents".

COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON D.C. 20548

B-202669

To the President of the Senate and the
Speaker of the House of Representatives

This report discusses the Federal laws and the regulatory supervision for approving bank mergers. We conducted this review because merging has been and will continue to be a very important means of bank expansion, and its regulation presented us with an opportunity to recommend ways of reducing the regulatory burden unnecessarily being placed on banks and the bank regulators. Our review was conducted pursuant to the Federal Banking Agency Audit Act (31 U.S.C. 67).

Copies of this report are being sent to the Director, Office of Management and Budget; the Attorney General; the Secretary of the Treasury; the Comptroller of the Currency; the Chairman, Federal Deposit Insurance Corporation; the Chairman, Board of Governors of the Federal Reserve System; and the Chairman, Federal Financial Institutions Examination Council.

Charles A. Bowsher
Comptroller General
of the United States

COMPTROLLER GENERAL'S
REPORT TO THE CONGRESS

BANK MERGER PROCESS
SHOULD BE MODERNIZED
AND SIMPLIFIED

DIGEST

As the number of bank mergers grows and the uses for the merger process change, shortcomings have surfaced both in the law governing the process as well as in the process itself. While GAO takes no position on whether mergers are "good or bad" for the banking industry, it believes that the merger laws could be updated to relieve needless administrative burdens placed on merger applicants and the Federal bank regulatory agencies who must process merger applications.

GAO undertook this review because of recent increases in the number of bank mergers and the potential for further increases. These increases could result from changes in State banking laws to remove limitations on branching or changes in Federal laws to permit banks and bank holding companies to acquire other types of financial institutions or to acquire banks or branches outside of their home States. Also, increases could be precipitated by a significant deterioration in the financial condition of banks. (See pp. 5 to 7.)

UNIFORM STANDARDS NEEDED FOR EVALUATING MERGERS

Broadly speaking, in acting on merger applications, the Federal and State agencies consider (1) the financial condition of the applicant banks; (2) the character and experience of the management of the surviving bank; (3) whether the convenience and needs of the community will be served; and (4) the effects of the merger on competition.

Although Federal bank regulators' assessments of the competitive effects of proposed mergers received the most consideration and involved the most controversy, the agencies' evaluations were not uniform, and specific criteria had not been developed for making the evaluations. The regulators defined the relevant market to be used in evaluating competitive effects of proposed mergers in different ways and lacked uniform criteria in applying the line of commerce and potential competition concepts. (See p. 13.)

This has resulted in conflicting decisions by Federal regulators and encourages "agency shopping" whereby parties to a merger seek out the Federal bank regulator possessing the most lenient standards for assessing mergers. (See p. 15.)

A 1963 Supreme Court decision establishing commercial banking as a single line of commerce caused Federal bank regulators to generally consider only banks when making competitive analyses of mergers. The distinction between banks and other competing institutions has eroded significantly since 1963. GAO believes that the Congress should specifically provide that the Federal bank regulators, to the extent practicable, consider competing nonbank financial institutions in assessing the competitive effects of mergers. (See pp. 22 and 23.)

The effect that a merger is likely to have upon the future concentration of banking resources in the relevant market has long been a subject of controversy. The potential competition doctrine asserts that the merging of two banks not now in competition with each other may nevertheless have an anticompetitive effect because the merger eliminates the probability that the two banking organizations might become competitors in the future. This doctrine by its very nature is ambiguous and difficult to apply. As a result, Federal bank regulators do not consider this issue uniformly in assessing mergers. (See p. 17.)

THE PHANTOM BANK MERGER PROCESS COULD BE ELIMINATED

Despite its frequent use, the phantom bank merger process is expensive, time consuming, and burdensome to banks, bank holding companies, and Federal regulators. This process involves the chartering of a phantom bank for the sole purpose of facilitating the conversion of a target bank into a wholly owned subsidiary of a bank holding company. Generally, it never emerges as an operating bank and the resulting bank in the merger transaction is, in most cases, indistinguishable in name, location, and services offered from the target bank.

A typical use of the phantom bank merger process would be as follows. The stockholders who control at least two-thirds of the voting stock of a bank want to gain total control of the bank. These stockholders request approval from the Federal Reserve Board to establish a bank holding company. The bank holding company then obtains a charter for a phantom bank from either the Office of the Comptroller of the Currency or a State regulatory agency. The newly chartered bank is referred to as a phantom bank because it never exists as an operating entity. The existing bank is merged with the phantom bank which is wholly owned by the bank holding company. Shareholders of the targeted bank receive bank holding company stock for their shares at a specified ratio; however, shareholders who oppose the merger may receive cash for their shares in lieu of holding company stock. The bank holding company thus will own 100 percent of the surviving bank's stock.

GAO was advised that the complicated phantom bank merger process is used because banking laws do not provide for shell corporations which serve similar purposes for nonbank corporations. (See p. 32.)

GAO is proposing to eliminate the requirement to charter a phantom bank and merge it with the bank targeted for acquisition. Instead, GAO recommends that the bank holding company submit a plan to the Federal Reserve Board outlining its acquisition intents and methods. This plan would be filed in conjunction with the bank holding company application. (See p. 37.)

GAO believes that this proposal would reduce costs and expedite the acquisition process while having no adverse effect on the parties to the transaction or the public. The GAO change could reduce costs to national banks by an estimated $8,000 to $54,000 for each merger. The estimated savings for State-chartered banks would be somewhat less with estimates ranging from $500 to $8,400 per merger. In addition, Federal regulators could reduce their costs associated with reviewing and processing these applications. (See pp. 40 to 42.)

THE MERGER PROCESS SHOULD BE STREAMLINED

It currently takes months to process a merger application--a delay which can cause some problems for applicants. While the bank regulators have made some efforts to streamline the application process, GAO recommends additional changes to agency practices and merger law which would reduce administrative costs and, more importantly, reduce processing times for merger applications. For example, the publication and comment periods for merger applications are spread out for longer periods than for other types of organization changes and should be shortened. (See p. 45.)

RECOMMENDATIONS TO THE CONGRESS

The Congress should amend the Bank Merger Act and the Bank Holding Company Act to

--provide that, to the extent practicable, the Federal bank regulatory agencies consider competing nonbank financial institutions in evaluating the competitive effects of a bank merger (see p. 31);

--provide an alternative to the phantom merger process (see p. 43);

--exempt phantom mergers and corporate reorganizations from competitive effects assessments (see p. 61);

--exempt phantom mergers and corporate reorganizations from the Attorney General review (see p. 61); and

--delete the publication and comment period for certain mergers and shorten the period for others (see p. 61).

Suggested draft language to implement these recommendations is included in appendix II of this report.

RECOMMENDATIONS TO BANKING AGENCIES

GAO made several recommendations to the banking agencies which provide for evaluating the competitive effects of a merger, the timely furnishing of competitive reports, improving coordination with State bank regulators, and delegating more approval authority to their field offices. (See pp. 31 and 61.)

AGENCY COMMENTS AND GAO'S EVALUATION

The Department of Justice, the Comptroller of the Currency, the Federal Reserve Board, and the Federal Deposit Insurance Corporation generally agreed with the problems identified by GAO. The principal disagreement expressed by the agencies concerned GAO's recommendation that the Congress amend the law to provide that the Federal agencies consider competing non-bank financial institutions when evaluating the competitive effects of a bank merger.

Basically, the agencies interpreted our recommendation as requiring the Congress to specify a list of competing institutions that the agencies should consider when evaluating proposed mergers. The agencies were concerned that any statutory list would soon become outdated and that the agencies should have flexibility to make decisions on which competitors to include without added statutory restrictions. This was not the intent of the GAO recommendation, and the language in the final report has been revised to clearly provide the agencies with needed flexibility in this area.

Specific agency comments and GAO's evaluation are included on pages 27 to 30, 44, and 62. The full texts of all comments received appear in appendixes III through VII.

Contents

		Page
DIGEST		i
CHAPTER		
1	INTRODUCTION	1
	Mergers take various forms	1
	Laws governing the merger process	3
	Processing merger applications	4
	Increase in bank mergers	5
	Bank mergers and bank holding companies subject to similar review criteria	6
	Objectives, scope, and methodology	7
2	UNIFORM STANDARDS NEEDED FOR EVALUATING COMPETITIVE ASPECTS OF PROPOSED MERGERS	10
	Legislative efforts to promote uniformity in merger decisions	11
	Federal regulators delineate relevant market differently	13
	Bank regulators differ in considering potential competitive effects	17
	Need for new definition of line of commerce	20
	Agency shopping exists in the banking industry	24
	Competitive factor reports are not timely and are not always used	25
	Conclusions	26
	Agency comments and our evaluation	27
	Recommendation to the Congress	31
	Recommendations to the Comptroller of the Currency; Chairman, Board of Directors, FDIC; and Chairman, Board of Governors, FRS	31
3	A MORE DIRECT APPROACH TO THE PHANTOM BANK MERGER PROCESS WILL RESULT IN SAVINGS TO BANKS AND FEDERAL REGULATORS	32
	The phantom bank merger process	33
	Objective of phantom bank merger	36
	Opportunities exist for improving the process	36
	An increase in phantom bank mergers seems likely	42

Chapter		Page
	Conclusions	43
	Recommendation to the Congress	43
	Agency comments and our evaluation	44
4	THE MERGER APPLICATION PROCESS SHOULD BE STREAMLINED	45
	Cost savings and benefits to be gained in reducing processing time	45
	More approval authority should be delegated to OCC and FDIC regional directors	46
	Revisions needed in FDIC procedures for accepting and evaluating merger applications	51
	Need to reassess publication and comment requirements for merger applications	52
	Competitive reports are not needed from other agencies on phantom mergers and corporate reorganizations	55
	Period for Attorney General to bring action may not be needed for phantom mergers and corporate reorganizations	57
	FDIC and FRS could coordinate more effectively with State banking agencies	58
	Conclusions	60
	Recommendations to the Congress	61
	Recommendations to the Comptroller of the Currency; Chairman, Board of Directors, FDIC; and Chairman, Board of Governors, FRS	61
	Agency comments and our evaluation	62
APPENDIX		
I	Preparatory actions and supporting documentation required by OCC when issuing a charter for a phantom bank	63
II	Proposed legislation	65
III	Letter dated March 29, 1982, from the Department of Justice's Assistant Attorney General for Administration	71

		Page
IV	Letter dated March 29, 1982, from the Comptroller of the Currency	75
V	Letter dated March 26, 1982, from the Federal Deposit Insurance Corporation	79
VI	Letter dated April 2, 1982, from the Federal Financial Institutions Examination Council	82
VII	Letter dated April 1, 1982, from the Federal Reserve System	84

ABBREVIATIONS

ATS	automatic transfer service
BHC	bank holding company
FDIC	Federal Deposit Insurance Corporation
FRS	Federal Reserve System
GAO	General Accounting Office
IPC	individual, partnership, and corporate
NOW	negotiable order of withdrawal
OCC	Office of the Comptroller of the Currency
RMA	Ranally Metropolitan Area
S&L	savings and loan association
SEC	Securities and Exchange Commission

CHAPTER 1

INTRODUCTION

A merger in the banking industry is the combining of two or more financial institutions into one. A merger can be arranged to "save" a failing institution, or it can be initiated by the institutions in order to increase size, enter a new market, consolidate management functions, or expand business options. The merger also plays an important role in the formation of new bank holding companies (BHCs) and in the acquisition of banks by existing BHCs.

Two of the principal objectives of the Federal bank regulatory agencies are to preserve the soundness of the banking system and to promote market structures conducive to competition. Bank mergers and their effects on the public and the financial system have been of concern to the Federal bank regulatory agencies for many years. To assist the agencies in promoting a freely competitive and financially sound bank system, the Bank Merger Act, as amended (12 U.S.C. 1828(c)), provides that no bank subject to Federal supervision can merge with another bank without first obtaining approval of the appropriate Federal regulator.

Responsibility to regulate mergers when the resulting bank is a national or District of Columbia bank belongs to the Office of the Comptroller of the Currency (OCC). The Federal Reserve System (FRS) regulates mergers when the resultant bank is State-chartered and a member of the Federal Reserve, and the Federal Deposit Insurance Corporation (FDIC) is responsible for mergers when the resultant bank is State-chartered and insured by FDIC but is not a member of the Federal Reserve. The Department of Justice considers the antitrust implications of all bank mergers. All mergers of State-chartered banks are also approved by their State regulatory authorities.

MERGERS TAKE VARIOUS FORMS

The term merger can be used to describe a variety of corporate changes. The merger process itself can vary in complexity depending on the objectives of the merger being formulated. For use in this report we have placed bank mergers into six categories:

--Forced or emergency merger - A merger necessitated in the case of a failing bank. A stronger bank absorbs the troubled bank to prevent its failure.

--Regular merger - The routine combination of two banks where one or the other is the surviving institution.

--Phantom or interim bank merger - Through a three step process of (1) the creation of a BHC, (2) the chartering of a "phantom" bank which will not come into existence as an operating bank, and (3) the merging of this phantom bank with an existing targeted bank whereby the major stockholders controlling at least two-thirds of the stock of the existing bank or BHC can take total control of the targeted bank.

--Corporate reorganization - The merging of two or more banks which are already under the control of a BHC.

--Consolidation - The merging of two or more banks resulting in the creation of a new bank.

--Purchase and assumption - A transaction where a bank purchases certain or all of the assets and assumes certain or all of the liabilities of another bank.

Mergers in 1980

	FDIC	FRS	OCC	Total
Regular	61	8	24	93
Phantom	63	11	52	126
Corporate reorganizations	18	4	12	34
All other	-	-	17	17
Total	142	23	105	270

LAWS GOVERNING THE MERGER PROCESS

Statutory authority for bank merger transactions comes primarily from 12 U.S.C. §§ 214a, 215, and 215a and the Bank Merger Act. This act provides that, in evaluating a merger application, Federal regulators consider several factors when granting or withholding consent on a bank merger application. These factors are the financial and managerial resources and future prospects of the existing and proposed institutions, the convenience and needs of the community to be served, and the effect of the merger on competition.

Agency policies provide little indication of exact criteria or specific weight to be given to any of the above factors, and judgment necessarily plays a large role. This makes it difficult to determine how much consistency exists among the agencies.

The Bank Merger Act also imposes several procedural requirements on the Federal banking agencies and the applicants. These procedures provide that:

- Appropriate notice of the proposed merger be published by the applicants in a newspaper of general circulation for a prescribed period of time.

- The deciding agency must request and be provided, within specified time limits, reports on the competitive effects of the proposed merger from the other two Federal regulators and the Department of Justice.

- The merger cannot be consummated before the expiration of a 30-day time period following notice of approval to the Department of Justice. If the agency has advised the Attorney General of the existence of an emergency action requiring expeditious action, the 30-day period can be reduced to 5 days. This time period permits Justice or other interested parties to commence any desired court action against the proposed merger.

- A description of each approved merger transaction shall be published in each agency's annual report to the Congress.

Some of the laws governing mergers and the related processes date back many years. For example, certain sections of the National Bank Act of 1864 (13 Stat. 99) are still utilized in the phantom bank merger process. The chartering section applicable to this process comes from that act, and the merger provisions were added in 1918.

PROCESSING MERGER APPLICATIONS

The merger application process within the Federal regulatory agencies is fairly uniform. Except for emergency mergers, parties interested in merging generally meet with agency officials before filing a formal application and obtain their comments on the proposed merger. At this time, among the most important issues discussed will be the merger's competitive factors. We were told that at these meetings agency officials provide guidance to potential merger applicants concerning their proposals and express views on the anticompetitive aspects of the proposed merger.

After any preliminary discussion, the applicant may file a merger application with the appropriate Federal regulator. If the resulting institution will be State-chartered, an application will also be filed with the appropriate State regulator. All three Federal banking regulators will notify the State authority upon receipt of a merger application involving a State-chartered bank. The FRS and FDIC will generally not take final action on a merger until the State authority has approved the application. However, State and Federal authorities do little to coordinate their efforts when evaluating a merger application.

After the application is received, the field staff begin their reviews, and any required onsite investigation will be scheduled to analyze factors on which a final decision will be based. This review may include a general canvass of businesses in the area to ascertain the services offered by the existing banks and interviews with the public to determine the adequacy of existing bank services.

Included in an investigation will be specific questions concerning the competitive climate in which the proposed merger will take place. These questions will cover such topics as participation of existing banks in supporting the economic growth of the local community, makeup of competing banks' loan portfolios, nature of the services and facilities provided by the existing banks, and the quality of the management of the competing banks. This information becomes an integral part of the conclusions forwarded to Washington.

Potential competitors in the area are given the opportunity to state their opinions as the applicants must publish a notice of the proposed merger in a newspaper of general circulation in the community in which the main offices of the banks involved are located. In addition, the regulator's region will generally notify all banks in the market area of the filing of the application. If requested, a hearing will be conducted at which the applicants and protestants will have an opportunity to make oral presentations as well as file written comments.

FDIC and FRS have delegated authority to their field offices to issue decisions on certain proposed mergers. The application, along with any other information gathered by the region, will be evaluated for compliance with the Bank Merger Act. In addition, officials will evaluate the comments requested from the other two regulatory agencies and the Department of Justice on the competitive aspects of the proposed merger.

A report of information elicited at the regional level is forwarded to Washington for all OCC mergers and the more difficult FDIC and FRS mergers. Headquarters staff reviews the regional office's recommendation and the comments of the other two regulatory agencies and the Department of Justice. Upon completion of this review, a recommendation and the merger file are forwarded to the appropriate official(s) for review before making a final decision. After the final decision is made, and if the merger is approved, notification is given to both the applicant and the Justice Department. Except for mergers requiring emergency action, the Justice Department has 30 days to consider filing any antitrust action before the merger is finally consummated.

INCREASE IN BANK MERGERS

In recent years there has been not only a significant increase in the number of bank mergers, but also a considerable shift in the makeup of the mergers taking place. As the number of mergers has increased, the most visible increases have been in phantom mergers used to facilitate BHC acquisitions and formations and corporate reorganizations. The increases in these categories have come as a direct result of changes in State banking laws and a general trend toward BHC formations and expansions into new markets followed by the consolidation of the BHC's holdings.

The primary vehicle for this expansion has been the phantom bank merger. As can be seen in the following chart, there has been a significant increase in this type of merger.

Approved Mergers by Category
for OCC, FDIC, and FRS

	1979	1980
Phantoms	61	126
Corporate reorganizations	56	34
Other mergers	90	110
Total	207	270

The interest in phantom mergers has continued into 1981. For the first 9 months of 1981, FDIC had received 142 phantom merger applications as compared to 75 for all of 1980. At OCC, 49 phantom merger applications were received during the first 9 months of 1981 compared to 43 for the same period in 1980. The potential for the continued increase in the number of phantom mergers is discussed in chapter 3 of this report.

BANK MERGERS AND BANK HOLDING COMPANIES SUBJECT TO SIMILAR REVIEW CRITERIA

As discussed earlier, phantom bank mergers are an integral part of the process for the creation and expansion of BHCs. The phantom merger is primarily used by BHCs as a method of ensuring total control when acquiring an additional subsidiary bank. BHC formations are used to obtain certain tax advantages, expand a bank's available market for obtaining capital, and offer a broader range of services to customers. (These issues are discussed in detail in chapter 3.)

The increase in BHCs over the past 10 years attests to the significance of the benefits to be gained by obtaining BHC status. During the past 10 years the number of BHCs has grown from 1,567 in 1971 to 3,057 in 1980.

Bank merger and BHC applications are reviewed under essentially the same criteria: (1) the competitive consequences, (2) the financial condition and prospects, (3) the quality of the proposed management, and (4) the convenience and needs of the public.

Of these factors, the most controversial is the development and application of the competitive standards. When the Bank Holding Company Act, as amended (12 U.S.C. 1841 *et seq.*), was enacted in 1956, wide disagreement existed over how national antitrust policy should be applied to banking. Bank mergers were generally assumed to be exempt from the Clayton Antitrust Act (15 U.S.C.

§§ 12-27), but BHC acquisitions clearly were not. BHCs normally acquired additional banks through an exchange of stock--a kind of transaction the Clayton Act always has covered.

The Bank Holding Company Act emphasized the Federal Reserve Board's role in controlling expansion of BHCs. The act required the Board to consider whether the formation of a new BHC or an acquisition by an existing BHC would create or expand a given organization beyond the limits consistent with adequate and sound banking, the public interest, and the preservation of competition in the field of banking.

In 1963, the U.S. Supreme Court ended the uncertainty about applying the Clayton Act to bank mergers ruling that they indeed are subject to that antitrust law. And, in part because of the 1963 decision, the Congress took action in 1966 to apply uniform competitive standards to both bank mergers and bank acquisitions by BHCs. Consequently, the 1966 amendments to the Bank Merger Act and the Bank Holding Company Act generally prohibit bank mergers or bank acquisitions whose result "may be substantially to lessen competition" unless the anticompetitive effects are "clearly outweighed by the convenience and needs of the community to be served."

OBJECTIVES, SCOPE, AND METHODOLOGY

The objective of this review was to analyze the economy and efficiency of the policies and procedures used by the Federal banking agencies to process merger applications. We also evaluated the banking procedures from the perspective of reducing the regulatory burden on the bank merger applicants. Our goal was to determine what changes could be made to reduce the costs and burdens of the process without adversely affecting the Federal regulators' ability to effectively evaluate merger applications. Our review was performed in accordance with GAO's current "Standards for Audit of Governmental Organizations, Programs, Activities, and Functions."

During our review we found that it was not feasible to compare premerger and postmerger conditions in order to determine whether or not a merger should have been approved. We were concerned that this type of evaluation could be misleading because after a merger (1) there are continuous and unpredictable changes in the economy and competition within a bank's relevant market area, (2) banking legislation has significantly changed the competitive makeup of the financial industry, and (3) the entry of other types of financial organizations such as money market funds has greatly complicated market analysis. Also, we did not review mergers requiring emergency processing to prevent the probable failure of one of the banks because these mergers are processed under unique procedures.

We interviewed FRS, FDIC, and OCC personnel and reviewed agency records and case files at various organizational levels in Washington, D.C., and at the field offices in Atlanta, Georgia; Richmond, Virginia; and San Francisco, California. At these locations we reviewed agency records and interviewed agency officials to determine how the merger review process was conducted from the time an application was filed until the merger was consummated. We reviewed specific case files to determine whether the policies and procedures which had been adopted were actually used in processing a merger application. We reviewed relevant legislation to determine whether agency policies and practices conformed to the governing legislation and also if any benefits could be gained through amendments to the legislation. We also discussed certain aspects of our review with officials of the Federal Home Loan Bank Board.

We interviewed Securities and Exchange Commission (SEC), Department of Justice, and Internal Revenue Service officials. We discussed with these officials their roles in the merger process and how changes in the merger process would impact on their ability to carry out their required responsibilities. Also, we obtained some data from these officials to determine the extent to which they were involved in certain phases of the merger process.

Our review included audit work at eight States where merger activity took place. In these States we interviewed State banking personnel and reviewed State merger laws, policies, and procedures followed in reviewing the merger applications of State-chartered banks. We discussed with these officials their experiences in dealing with Federal regulators as well as with the banks they supervised.

We interviewed banking officials at 24 banks and/or BHCs. We discussed the various types of mergers their institutions had undergone and their experiences with Federal and State regulators. We obtained data from some of these banks on the costs involved in carrying out certain mergers. We also discussed the merger process and obtained cost data from law firms which assist banks in preparing merger applications.

We discussed the merger process with officials from certain special interest groups whose clients are affected by the manner in which mergers are processed and decided. Included in these groups were the American Bankers Association, the Conference of State Bank Supervisors, and the Independent Bankers Association of America.

Our review included the examination of all relevant policies, regulations, and procedures maintained by the banking agencies. We reviewed the laws which impact on the merger process, their tax ramifications, and the requirements of SEC. We reviewed studies done by agency officials in their research departments and by outside consultants and independent research groups.

In order to determine whether or not the agencies were processing merger applications in the most economic and efficient way, we made a detailed review of 55 selected merger cases in the three regions where we conducted our review. Generally, these cases were randomly selected from mergers processed in 1979 and 1980; however, we did select some cases because of the location of the banks involved or the type of merger. We discussed the Federal-State merger approval processes with State banking officials.

We selected 26 mergers to review the uniformity of the standards used by Federal regulatory agencies and the Department of Justice to evaluate the competitive effects of proposed mergers. These mergers included all the merger cases during 1979 and 1980 which were either denied by the deciding agency or on which at least one of the commenting agencies issued a significantly adverse opinion on their competitive effects. We selected these mergers because we felt that they represented the cases in which the more difficult competitive issues would surface.

CHAPTER 2

UNIFORM STANDARDS NEEDED FOR EVALUATING COMPETITIVE ASPECTS OF PROPOSED MERGERS

The area that receives the most consideration by the agencies and involves the most controversy concerns the assessment of the competitive effects of proposed mergers. Our review of the Federal bank regulators' evaluations of the competitive effects of proposed mergers showed there was no uniformity to the evaluations nor had specific criteria been developed for making the evaluations. This lack of uniformity is most evident in the methods used by regulators to define the relevant market to be used in evaluating the competitive effects of proposed bank mergers. In addition, Federal bank regulators lack uniformity in their application of the line of commerce and potential competition concepts. This overall lack of uniformity has resulted in conflicting decisions by Federal regulators and subsequent "agency shopping" by financial institutions. Agency shopping occurs when parties to a merger seek out the Federal banking regulator possessing the most lenient standards for approving mergers.

The agencies' merger practices were influenced largely by the Supreme Court's 1963 decision in the Philadelphia National Bank case. 1/ The court differentiated between the types of services and products offered by (1) banks and (2) other financial institutions. As a result of this case, the regulators are essentially considering only banks in appraising the competitive effects of proposed mergers. The distinctions between banks and other financial institutions have eroded significantly since 1963, and, in our opinion, consideration should be given to amending the Bank Merger Act to provide that agencies, to the extent practicable, consider not only banks but other competing institutions in assessing the competitive effects of mergers.

To promote uniformity among the regulators, the Bank Merger Act requires the responsible agency to request reports on the competitive effects from the Attorney General and the other two banking agencies before reaching a decision on a merger application. The act requires that the commenting agencies furnish these reports within 30 calendar days. Our review showed that, in many cases, the agencies are not providing competitive factor reports to the deciding agency within 30 days as required.

1/United States v. Philadelphia National Bank, 374 U.S. 321 (1963).

Additionally, it did not appear that the requesting agency gave much consideration to adverse opinions furnished by the other agencies.

LEGISLATIVE EFFORTS TO PROMOTE UNIFORMITY IN MERGER DECISIONS

Several laws have been passed governing bank mergers. Included in these laws is section 18(c) of the Federal Deposit Insurance Act, more commonly known as the Bank Merger Act (12 U.S.C. 1828(c)). This act specifically governs the merger of banks, and one of its primary objectives is to prevent any proposed merger transaction which would substantially lessen competition or tend to create a monopoly.

Differences among the three Federal regulatory agencies in evaluating the competitive effect of proposed bank mergers have long been an area of considerable study and discussion. The intent for uniformity among the three Federal regulatory agencies in evaluating the competitive effects of proposed bank mergers is expressed in the Senate report that preceded the enactment of the original Bank Merger Act of 1960:

> "* * * (each responsible agency) must review applications with the same attitude and must give the same weight to the various banking and competitive factors. The Comptroller must not be more lenient in approving mergers so as to attract merging state banks into the National banking system. The Board and the FDIC likewise must not be more lenient in approving mergers so as to tempt national banks to leave the National banking system. The State banking system and the National banking system must develop and compete with each other on their own merits, without pressure in either direction from the administration of (the Act)." 1/

The act was passed in response to congressional concern over the increasing concentration of banking resources and the absence of standards for the bank regulatory agencies to assess proposed mergers. The act was intended to effect greater control over bank mergers by requiring premerger approval by one of the three banking agencies and competitive factor reports from the other two regulators and the Department of Justice. Although the act required these competitive

---

1/U.S. Cong., Senate, "Regulation of Bank Mergers," 86th Cong., 2d sess., S. Rept. 196 (Washington, D.C.; GPO, 1959), p. 23.

factor reports in the interests of uniformity, it was passed on the assumption that the Clayton Antitrust Act was not applicable to banks. This lack of antitrust guidance with regard to bank mergers led to inconsistent decisions being rendered by the Federal regulators when evaluating the competitive aspects of proposed bank mergers.

In 1963, however, the Supreme Court ruled that section 7 of the Clayton Act did apply to banks. As a result, in 1966, the Congress amended the Bank Merger Act to reconcile the goals of the act with the antitrust laws by providing that the Sherman Antitrust Act (15 U.S.C. §§ 1 and 2) and section 7 of the Clayton Antitrust Act be uniformly applied by the banking agencies, the Department of Justice, and the courts as a set of standards for assessing the competitive aspects of proposed bank mergers.

The Bank Merger Act states that, "in the interests of uniform standards" the responsible agency, before acting on any application for approval of a merger transaction, shall request reports on the competitive factors from the Attorney General and the other two banking agencies. The congressional intent was to promote uniform decisions by the Federal bank regulators when evaluating the competitive aspects of proposed bank mergers thus avoiding the situation of any particular agency being too lenient or too strict. The Congress thereby hoped to prevent agency shopping. The courts have affirmed this congressional intent in seeking uniformity in assessing competitive factors:

> "The principal aim of the 1966 Act was to curtail the discretion of the banking agencies. There had been significant variances in the application by the agencies of the seven factors in the 1960 Act and agency shopping was feared. Congress sought the uniform application of a single set of standards by both agencies and the courts. Reports from the Attorney General and the other two banking agencies on the competitive factors involved in a merger were to insure uniformity. * * *" 1/

The Department of Justice has since developed guidelines for assessing the competitive ramifications of proposed corporate mergers which, although they do not specifically mention banks, are applied to bank mergers. These guidelines require the definition of the relevant market in both product and geographic

---

1/Washington Mutual Saving Bank v. Federal Deposit Insurance Corporation, 482 F. 2d 459, 464 (9th Cir., 1973).

dimensions and that the market share be measured by indicators such as total deposits. However, these guidelines are not specific as to how the relevant market should be delineated. As of January 1, 1982, these guidelines were being revised.

FEDERAL REGULATORS DELINEATE RELEVANT MARKET DIFFERENTLY

In applying antitrust standards to proposed bank merger transactions, the geographic delineation of the local banking market(s) in which to assess the competitive effects of a proposed bank merger is critical. It will form the basis for determining the effect of the proposed merger on the concentration of banking resources in the local banking market. The agencies generally begin by determining the service area of each bank proposing to merge. They then establish the geographic area that is serviced jointly by both banks. This area is the relevant market area and is critical in determining the extent to which the two banks compete directly. The competitive analysis is done by determining what portion of each bank's business is conducted in this jointly serviced area and what effect the merger would have on competition in this area.

Delineation of the relevant geographic market for antitrust purposes can seldom be precise and in many cases remains one of the most difficult determinations facing a regulatory agency in analyzing bank merger cases. The Supreme Court has held that it is vital to consider the places from which a bank draws its business, the location of its offices, and the areas in which it seeks business. A key factor to be considered in relevant market delineation is the identification of the area within which both large and small bank customers can conveniently turn to do their banking.

The Federal regulators have established different standards for determining the relevant geographic market.

FDIC's relevant market approach

In a presentation on merger policy, a former Chairman of the FDIC Board stated that,

> "* * * the FDIC begins its efforts to delineate the local banking market by examining the area within about 15 miles from each office of the bank to be acquired. The resulting approximation of the area within which a potential bank customer might be expected to turn for alternatives might then be cut back by such natural barriers as mountains, rivers, parks

> or forests or by an interstate highway or incorporated area that serves, similarly, as an outer boundary. In some cases, where the bank to be acquired is in a small community and people are regularly drawn to the nearest population centers for employment, shopping or entertainment, the initial area might be expanded to include such population centers if they are near the perimeter of the 15 mile zone. In no event, however, is the Corporation likely to expect a dissatisfied bank customer to travel more than 25 miles to seek out a banking alternative. On the other hand, in areas of relatively high population density which do not have mass transit facilities, a reasonable distance within which to expect a bank customer to seek alternatives might be significantly less than 15 miles. The FDIC is attempting, in short, to delineate a realistic geographic area within which a potential bank customer might turn for banking service if he becomes dissatisfied with the bank being acquired."

We were informed by an FDIC official that FDIC still uses the aforementioned approach to define the relevant market. Also, FDIC officials stated that FDIC does consider the facts of each individual case including the applicant's delineation of the relevant markets.

Of the 26 cases we analyzed, 7 were decided by FDIC. In five of the seven mergers FDIC used a 12 to 15 road mile analysis of the relevant geographic market. In the other 2 FDIC cases, the relevant market was approximated by a county and a portion of a county.

<u>FRS's relevant market approach</u>

FRS officials said that they use a "predetermined market" approach as a basis for delineating the relevant geographic market. This approach consists of using markets which have been previously defined. Each of the 12 Federal Reserve banks and headquarters maintain a compilation of uncontested markets which are used, where applicable, as the relevant market for evaluating the competitive effects of proposed mergers. We contacted the Federal Reserve banks which had the most merger activity for calendar years 1979 and 1980. We were informed by officials located at these Federal Reserve banks that predetermined markets are used almost exclusively and that rarely are new relevant markets established, although these markets are updated when economic changes affect the market. We were also informed that in the event a new relevant market delineation becomes necessary, the Ranally Metropolitan Area (RMA) 1/ is used as an initial task definition of the relevant market. RMAs are defined as including central cities as well as the surrounding satellite communities and suburbs and are not restricted to following county lines. RMAs enable the user to locate the actual extent of urban and rural development. Once the relevant market has been derived, it is adjusted for census tract data and topographical considerations, i.e., geographical features such as mountains, swamps, marshes, rivers, and lakes as well as features such as parks and forests which serve to limit and sometimes distort the delineation of a particular banking market.

OCC's relevant market approach

OCC officials request applicants to establish the service areas for the merging banks. As a general rule, this service area is established by determining where approximately 80 to 85 percent of the IPC (Individual, Partnership, and Corporate account) deposits are concentrated. The agency will instruct the applicant to present the relevant market using this general standard as a basis and to specify what other banks are competing in these service areas.

OCC generally accepts the service area delineations proposed by the banks. OCC evaluates the competitive effects of each merger on a case-by-case basis and proposes no set standard for determining whether the merger of the banks involved will result in anticompetitive effects on the communities involved. The OCC competitive analysis focuses on the service area of the bank targeted for acquisition to determine the extent to which competition will be reduced in this area. Special emphasis will be given to any overlap in the service areas of the two banks. As with the other regulators, OCC also takes into consideration topographical features which can further limit or define the relevant area to be considered when assessing the competitive effects of proposed mergers.

Bank regulators often differ in relevant market delineation

In many instances Federal bank regulators, using the same market area data, defined the relevant market differently. Often this resulted in vastly different opinions being rendered as to the effect the proposed merger would have on competition.

1/Statistical areas developed by Rand McNally and Co. These areas are based on commuting patterns and population density.

We analyzed all bank mergers which were approved or denied during calendar years 1979 and 1980 where one or more of the commenting agencies concluded that the effects of the proposed merger on competition would be significantly adverse. Of the 485 proposed mergers during calendar years 1979 and 1980 upon which the three Federal regulators acted, 57 percent represented corporate reorganizations and phantom mergers where competition was not an issue. Of the remaining mergers, a considerable number consisted of regular mergers involving limited competitive aspects. We selected the 26 cases (20 approvals and 6 denials) where regulators differed significantly in their assessment of the competitive effects of the proposed merger.

Our analysis of the 26 cases showed that 17 of these proposed mergers represented cases where one or more Federal regulators defined the relevant market differently and subsequently rendered different opinions as to the effect the proposed transaction would have on competition. The following case depicts such an occurrence.

The proposed merger involved two institutions which for purposes of discussion will be called State Bank and National Bank. The proposal provided for State Bank to merge into National Bank under its charter and title. State Bank operates three offices, all of which are located in the northwest portion of Any County. National Bank operates 44 offices in four western counties.

OCC, the regulator responsible for deciding on the merger, delineated the relevant market in which to assess the competitive effects of the proposed transaction as the service area of State Bank. This area encompassed 142 square miles, with a population of about 30,000. This relevant market consisted mostly of undeveloped forestland and was surrounded on three sides by water and by forestland to the north. Also, this geographic area was connected to the mainland of Any County by a four lane bridge. There were four commercial bank offices in the relevant market, three of which were operated by State Bank. OCC did not delineate the relevant market to include any offices of National Bank.

In a draft opinion 1/ OCC stated that the volume of banking business derived by National Bank from customers residing within the service area of State Bank raised troublesome antitrust issues. However, OCC further stated that residents of the service area of State Bank regularly commute to work and other activities within

1/This draft opinion was never signed by the Senior Deputy Comptroller for Policy. OCC never issued an official written opinion on the proposed merger although the merger was approved.

the service area of National Bank. Therefore it is reasonable to assume that many if not all of National Bank's major competitors have similar amounts of business from the service area of State Bank. OCC concluded that the amount of competition between the banks that would be eliminated as a result of the merger would not be substantial and that its elimination would not violate the anticompetitive standards found in the Bank Merger Act.

FDIC defined the relevant market to include approximately 226 square miles with a population of about 180,000. Sixty-one offices of 12 commercial banks were located in the relevant market. National Bank dominated the area with 22 banking offices. FDIC stated that National Bank was not currently represented on the peninsula where State Bank operated its three offices, but the closest offices of the proponents were only separated by 5 road miles and were connected by a major highway and bridge. FDIC further stated that the proposed merger would result in the loss of existing competition and would unduly increase the level of concentration of commercial banking resources in the market. As a result, FDIC concluded that the proposed transaction would have substantially adverse effects on competition.

FRS delineated the relevant market to include approximately 1,986 square miles, with a population of about 2 million. There were 48 commercial banking offices located in the relevant market at the time of the proposal. The Federal Reserve stated that the proposed merger would eliminate some direct competition and thereby concluded that the merger would have an adverse effect on competition.

BANK REGULATORS DIFFER IN CONSIDERING POTENTIAL COMPETITIVE EFFECTS

The theory of potential competition and its application to the banking industry has been a subject of continuing controversy since the 1960s when banks and bank holding companies began to expand the geographic scope of their activities through mergers and acquisitions. Essentially, the potential competition doctrine asserts that the merging of two banking organizations not now in competition with each other may nevertheless have an anticompetitive effect because the merger may eliminate the probability that the two banking organizations might become competitors in the future. It is, perhaps, inevitable that there should be qualms regarding the application of the potential competition standard. The very nature of potential competition, i.e., judgments regarding probable future competitive developments, is ambiguous and difficult to prove. Thus, the bank regulatory agencies may at times be reluctant to disapprove a merger on such a basis, or the courts to find a violation of the banking or antitrust laws on such grounds.

In potential competition cases brought to court by the Department of Justice, it is generally alleged that the acquiring banking organization was one of a limited number of "likely potential entrants" in the market area of the acquired bank. Consequently, consummation of the proposed merger would eliminate a particularly significant portion of the force tending to restrain the exercise of market power in the relevant market area. The Department of Justice has litigated and lost 12 potential competition cases involving bank mergers.

Our analysis showed that the Federal regulators generally lack guidance as to whether or not and to what extent the potential competition doctrine should be considered in their competitive analyses. This lack of consistent application has led to differing opinions being rendered as to the competitive effects of proposed mergers. The following case is an example of such an occurrence.

This case involved a merger between two national banks. The proposal provided for Bank B to merge into Bank A under its charter and title. Bank A was a wholly owned commercial banking subsidiary of a BHC.

Bank B, the bank to be acquired, was the tenth largest banking organization in the State and held approximately one percent of the State's total commercial bank deposits. It operated a main office and two branch offices in Any County. Bank A, the acquiring institution, controlled approximately 20 percent of the State's commercial bank deposits, operated 46 branches in 14 of the State's 29 counties, but did not operate any banking offices in Any County. Bank A was the principal banking subsidiary of the second largest banking organization in the State.

All three Federal bank regulators and the Department of Justice concluded that the relevant geographic market in which to assess the competitive effects of the proposed merger was Any County. The advisory reports submitted by the Department of Justice and the other two commercial bank regulatory agencies reflect a wide range of conclusions regarding the competitive prospects for the market subsequent to the proposed merger.

The Department of Justice, while conceding that the proposed acquisition would not eliminate any significant amount of direct competition, concluded that the merger would pose significant potential competition problems. The Department's report added that commercial banking in Any County was highly concentrated. The Department of Justice concluded that Bank A was by far the most significant and most likely potential entrant into Any

County and that the proposed transaction would have a significantly adverse effect on competition.

The FDIC concluded that no significant competition exists between the two institutions. (The distance between the nearest offices of the applicants is 42 miles.) FDIC stated that Bank A was the only one of the four largest banking organizations in the State that was not represented in the area. As such, it was one of the most likely candidates for new entry. FDIC added that if the merger was approved, not only would a potential new entrant be eliminated, but the second largest banking organization in the State would acquire a significant portion of another market in the State. FDIC concluded that the merger would have an adverse effect on potential competition and overall competition in the relevant market area and in the State.

FRS stated that no meaningful competition existed between the participating institutions. The FRS also stated that consummation of the proposed merger would eliminate some potential for the development of competition between the subject institutions and thereby concluded that it would have slightly adverse competitive effects.

OCC, the regulator responsible for approving or denying the transaction, concluded that the proposed acquisition would not result in a lessening of competition but would be procompetitive and would lead to an immediate enhancement of market performance. OCC agreed with the Department of Justice and the other regulators that no direct competition existed between the two proponents but strongly disagreed with the Department of Justice that the proposed merger would have a significantly adverse effect on competition because of its potential future effects.

OCC's opinion was that the Supreme Court has carefully distinguished between two different aspects of the potential competition doctrine--the "perceived potential entrant" theory 1/ and the "actual potential entrant" theory 2/.

1/Perceived potential entrant - a potential competitor who exerts a present influence on the behavior of the firms in the market thereby causing them to maintain competitive pricing policies.

2/Actual potential entrant - a potential competitor who would be expected to actually enter the market at some point in the future, thereby making the market less concentrated and more competitive at that time.

On the basis of its view that the Supreme Court had withheld judgment on the prospect of using the "actual potential entrant" theory in antitrust law, OCC took the position that the merger in question would have violated Section 7 of the Clayton Act and the Bank Merger Act only if it conflicted with the "perceived potential entrant" doctrine. An OCC official stated that:

> "Indeed, as an administrator and conduit of federal law, it is equally troublesome to this Office since the speculative nature of the concepts comprising the doctrine of potential competition, and especially those of the actual potential entrant theory, leave us with a sparcity [sic] of concrete practical standards to envoke in its application. Consequently, should the courts see fit to accept a theory such as actual potential entrance, we would hope that they might set forth the practical standards by which agencies, such as the Comptroller's Office, are to implement it."

The concept of potential competition is not applied uniformly by the regulatory agencies to decisions regarding bank mergers. While its impact on merger decisions can be significant, there is a lack of concrete practical standards. While this is to be expected in some areas of antitrust law, the use of uniform general guidance by the regulators and Justice on the extent to which potential competition should impact merger decisions would be desirable.

NEED FOR NEW DEFINITION OF LINE OF COMMERCE

The financial system is comprised of many different types of institutions. Financial services are traditionally provided by depository institutions such as commercial banks, savings and loan (S&L) associations, mutual savings banks, and credit unions--as well as mortgage bankers, finance companies, federally sponsored credit agencies, insurance companies, pension funds, investment bankers, securities brokers, real estate service firms, and even the financial activities of retailers and other nonfinancial businesses.

Over the years, financial institutions have been identified with specific groups, each group offering a different service to the public. For example, in terms of credit, each institution has had its specialty, e.g., commercial loans for banks and residential mortgage loans for S&L associations. This specialization has been reinforced by legislation narrowly defining permissible product lines.

Where the distinctions between banks and thrift institutions 1/ and between depository and nondepository institutions were once clear, such differences are disappearing. Different types of financial institutions increasingly offer similar products and services and compete in the same markets (see the following table).

1/The term "thrift institutions" used in this report is defined as savings and loan associations, credit unions, and mutual savings banks.

DISTRIBUTION OF ASSETS--COMMERCIAL BANKS AND THRIFTS

	End of Year		
	1970	1975	1980
	---------(billions)---------		
COMMERCIAL BANKS (Insured only)			
Business loans	$112.2	$174.3	$ 280.8
Mortgages	73.1	134.6	261.6
Consumer loans	66.0	106.0	180.1
U.S. Treasury and agency securities	61.6	117.6	162.3
State and local securities	69.4	101.8	145.0
Other assets	194.1	310.4	496.9
Total	$576.4	$944.7	$1,526.7
SAVINGS & LOAN ASSOCIATIONS			
Mortgages	$150.3	$278.6	$502.8
Investment securities	13.0	30.9	57.6
Other assets	12.8	28.8	69.4
Total	$176.1	$338.3	$629.8
MUTUAL SAVINGS BANKS			
Mortgages	$57.8	$ 77.2	$ 99.8
U.S. Government securities	3.2	4.7	8.9
State and local securities	.2	1.5	2.4
Corporate and other securities	12.9	28.0	39.3
Other assets	5.0	9.6	21.1
Total	$79.1	$121.0	$171.5
CREDIT UNIONS			
Loans outstanding	$14.1	$28.2	$47.8
Other assets	3.8	9.9	23.9
Total	$17.9	$38.1	$71.7

Traditionally the Federal regulators have chosen "commercial banking" to be the relevant line of commerce. This definition is based on the Supreme Court's Philadelphia National Bank decision in 1963. In that decision the court concluded that commercial banks have an advantage over other financial institutions in attracting funds for loans and other services since only banks can legally accept demand deposits. In addition banks were said to enjoy "settled consumer preferences" for full-service banking.

Thus, the "general store" nature of the banking business made it a distinct line of commerce distinguishing banks from other financial institutions. However, these distinctions may be fast eroding.

In March 1980, the Congress passed the Depository Institutions Deregulation and Monetary Control Act (Public Law 96-221). This act broadened both the asset and liability powers of S&Ls, mutual savings banks, and credit unions to include activities traditionally limited to commercial banks. An important change was the authorization of interest-earning "transaction" accounts at both banks and thrift institutions. This was achieved by permitting the use of negotiable order of withdrawal (NOW) accounts, automatic transfer service (ATS) accounts, and credit union share drafts. 1/

A question arises then whether thrift institutions should be considered as a factor in the competitive analysis used for determining the competitive effects of a proposed bank merger. Our analyses showed that Federal regulators are not including thrifts on a uniform basis which could lead to differing opinions being rendered regarding the competitive ramifications of proposed mergers. In four of the cases we reviewed, the deciding agency considered S&Ls in the competitive evaluation process. In many of the remaining 22 cases, S&Ls were located in the market area but were not included in the competitive analysis. In one instance we noted that both FRS and FDIC did not include other types of competing financial institutions in their competitive analyses and concluded that the proposed merger would have adverse and significantly adverse effects on competition, respectively. On the other hand, OCC, the deciding agency, included thrifts in its competitive analysis as a factor in mitigating the adversity of the proposed merger. OCC concluded that the proposed transaction would not violate the anticompetitive standards found in the Bank Merger Act. 2/

1/ATS and NOW accounts represent a type of individual "checking" account. By providing for the automatic transfer of funds from a savings account to cover checks drawn against a zero balance ATS account, individuals can earn interest on checking balances. NOW accounts are interest-earning savings accounts against which customers can write "negotiable drafts." Similarly, credit union share drafts permit payable drafts drawn on a credit union member's interest earning share account.

2/OCC did not issue an official written opinion for this merger. Consequently, all comments made regarding OCC's competitive analysis were taken from a draft opinion not signed by the Senior Deputy Comptroller for Policy.

On the basis of the Philadelphia Bank case and references in the Bank Merger Act to banks, the bank regulatory agencies are somewhat reluctant to give full consideration to all other types of financial institutions and services when making their competitive analyses of bank mergers. Also, we have noted that, in an effort to clarify this issue, Federal bank regulators have proposed changes to the Bank Merger Act which would establish some basis for considering other types of financial institutions in their competitive analyses.

AGENCY SHOPPING EXISTS IN THE BANKING INDUSTRY

The situation where one Federal agency is regarded as "more lenient" in approving bank mergers than another produces a situation whereby a prospective applicant seeking expansion can "shop" for a regulatory agency by, in many instances, simply designating which bank will survive. This process is known as "agency shopping," or "forum shopping." During our review we found evidence that "agency shopping" is practiced.

Some feel that the ability to "shop" for a regulator is healthy in that a possible abuse of power by one regulator can be offset by the more reasonable actions of another. However, the Congress emphasized the importance of using uniform standards when evaluating bank mergers. This intent is expressed in the Bank Merger Act and its legislative history. The Bank Merger Act states:

> "In the interests of uniform standards, before acting on any application for approval of a merger transaction, the responsible agency, unless it finds that it must act immediately in order to prevent the probable failure of one of the banks involved, shall request reports on the competitive factors involved from the Attorney General and the other two banking agencies * * *"

The Senate report accompanying the Bank Merger Act of 1960 emphasized the need for all Federal regulators to uniformly review merger applications so that one agency would not be more lenient than the others, thereby attracting banks to their supervision. (See p. 11 for further discussion of the Senate report.)

During our review we contacted the president of a national bank which had recently merged with a State bank. The management of the merging institutions decided to apply for merger approval under OCC rather than FDIC because of the conservative position which FDIC had been taking with regard to bank mergers in their State. The president said that bankers in his State have become wary of going to FDIC for merger approval.

The following case is another example of agency shopping.

The case involved the merger of national banks A and B under the charter of Bank A. Bank B, the bank to be acquired, operated its two offices, including its main office, in Any County. Bank A, a subsidiary of XYZ multibank holding company, was headquartered in Some County which was contiguous to Any County.

In April 1980, FRS denied an application by XYZ multibank holding company to acquire Bank B as a subsidiary. This denial was based upon a finding that Bank A was already owned by XYZ multibank holding company and Bank B competed in the same market.

Subsequently, the bankers involved contacted OCC officials to ascertain (1) whether OCC would automatically turn down the application because of the FRS action and (2) some estimate of the probabilities of success. OCC officials informed the bankers that they would not automatically reject an application because of FRS action but that they do not speculate on possible outcomes. OCC officials also urged them to consider the antitrust implications with great care.

Approximately 3 months later Bank A filed a merger application with OCC. OCC disagreed with the FRS argument that the banks were in direct competition in the same market and that the proposed merger would thereby result in a substantial lessening of competition. OCC stated that the facts presented in the application refute a finding that Bank B and Bank A are substantial, direct competitors. OCC concluded that although some direct competition between Bank A and Bank B did exist, it was not substantial and its elimination did not constitute a substantial lessening of competition in any relevant market. Consequently, OCC approved the merger.

COMPETITIVE FACTOR REPORTS ARE NOT TIMELY AND ARE NOT ALWAYS USED

In an effort to promote uniformity among the Federal bank regulators in evaluating the competitive effects of proposed mergers, the Bank Merger Act requires the responsible agency to request reports on the competitive factors from the Attorney General and the other two banking agencies before acting on any application for approval of a merger transaction. The commenting agencies must submit the reports within 30 calendar days of the date on which they were requested.

Our analyses have shown that the Federal regulators are not meeting this requirement. Of 78 possible competitive factor reports which should have been received in the cases we reviewed, 8 reports were not received at all. Of the remaining 70 reports only 3 were received within the 30-day period in which they were due. The average time for the 70 reports was 70.6 days with one report being received as long as 195 days after it was requested.

In reviewing justifications for final merger decisions, we seldom noted any analysis regarding the competitive opinions of the other two bank regulators or the Department of Justice. Agency officials informed us that they felt that these competitive factor reports were rarely used when evaluating the competitive aspects of a proposed merger.

CONCLUSIONS

Although efforts have been made by the Congress to promote uniform decisions with regard to the competitive effects of proposed mergers, the Federal bank regulators are not assessing the competitive effects of proposed bank mergers uniformly. Our analyses showed that Federal regulators are defining the relevant market differently using the same market data and rendering different decisions on the extent that proposed mergers would adversely affect competition in the market that is jointly serviced by the two merging banks.

This inconsistency is largely due to the lack of uniform standards for evaluating the competitive factors involved in proposed mergers. Federal regulators also differ on the extent that consideration should be given to the potential effects that the proposed merger could have on future competition in the bank's market.

The bank regulatory agencies have not developed a uniform approach to considering other types of financial institutions when evaluating their competitive effects on a proposed bank merger. Also, the barriers between banks and other types of financial institutions have eroded significantly since commercial banking was first considered as being a single line of commerce, and many types of financial institutions now compete with banks for credit and services.

Because of prior court cases, Federal regulators have been reluctant to consider nonbank financial institutions as competitors of banks in the same fashion as they consider competing banks. We believe that the Congress should amend the Bank Merger Act to specifically provide that the regulating agencies consider competing nonbank financial institutions in evaluating the competitive effects of a bank merger.

We recognize, however, that if the regulators consider nonbank financial institutions in their analyses, some problems could surface. Federal bank regulators could have some difficulty in obtaining needed records and data about nonbank financial institutions which are not subject to their supervision. Another problem could arise in determining the extent to which the wide variety of nonbank financial institutions such as savings and loan associations, credit unions, mortgage bankers, finance companies, and investment bankers may compete with banks. We believe the agencies should have considerable discretion in using these factors in their competitive analyses.

We also noted that the Federal bank regulators are not providing competitive factor reports to the deciding agency within 30 days as required by law. When these reports are furnished, we found little evidence of their consideration by the deciding agency.

AGENCY COMMENTS AND OUR EVALUATION

The three Federal bank regulatory agencies and the Department of Justice, in commenting on our draft report, disagreed with our proposal that the Congress amend the Bank Merger Act to clarify that the Federal agencies should consider competing nonbank financial institutions in evaluating the competitive effects of a bank merger. The agencies believed that any list of competitors set forth by statute would soon become outdated and that agencies should have the flexibility to determine what institutions are competitors of banks.

We made our proposal to the Congress because we believe that the courts need some guidance from the Congress on this matter. We did not, however, expect the Congress to develop a specific list of bank competitors. As we point out in our report, the types of competitors would vary from bank to bank. We agree that agencies should enjoy a certain degree of flexibility in evaluating the competitive effects of a bank merger. We also appreciate that agencies are cognizant of other competing institutions in the relevant markets of the merging banks. We perceive, however, a reluctance on the part of agencies to fully consider other competing institutions in view of the Supreme Court decisions which define banking as a distinct line of commerce. In view of these Court decisions and the agencies' general reluctance to assess the degree of competition with banks by nonbank institutions, we believe that the Congress should amend the Bank Merger Act to provide that agencies, to the extent practicable and within available data limitations, consider competing nonbank financial institutions in their analyses. We have clarified our recommendation to recognize the agencies' need for flexibility in determining which institutions should be included in their competitive analyses.

In our draft report we had proposed that the Federal Financial Institutions Examination Council, in conjunction with the Federal bank regulatory agencies, formulate principles and standards for use in considering what effect a proposed merger would have on future competition in the market area of the bank being acquired. We also proposed that the Council work with FDIC, FRS, and OCC to establish more uniform standards for defining the relevant market when evaluating the competitive aspects of proposed mergers.

We directed our recommendations to the Council because the need for uniform standards in evaluating proposed mergers was common to all three Federal bank regulators and we believed that the Council was a proper forum for developing uniform principles and standards. The Council was created to develop uniform principles and standards and report forms for the examination of financial institutions and to make recommendations for uniformity in other supervisory matters.

In commenting on our draft report, the Council advised us that it defines "other supervisory matters" rather narrowly and that it believes that the Congress did not intend to authorize it to consider matters relating to the application process under the Bank Merger Act. We believe that it would be appropriate and within its legislative purview for the Council to develop and recommend uniform standards for evaluating proposed mergers. Neither Title X of the Financial Institutions Regulatory and Interest Rate Control Act of 1978 (12 U.S.C. 3301 et. seq.) nor its legislative history defines the phrase "other supervisory matters" or the scope which the Congress intended that phrase to have. We are not persuaded that the language in the act is so delimiting as to exclude supervisory guidance in the bank merger process. We defer, however, to the Council for the manner in which it believes its charter should be carried out. In any event, we have modified our recommendation to direct it at the three Federal bank regulators rather than the Council.

With regard to the merits of our proposal to establish more uniform standards for defining the relevant market when evaluating the competitive aspects of proposed mergers, FRS stated that it is most willing to work with other agencies to establish uniform standards. OCC stated that

> "It would be difficult, perhaps impossible, to achieve agreement among all parties on a single best approach."

FDIC stated that our proposal was unnecessary. In support of its position FDIC points to the large percent of the cases where the three agencies agree on the competitive effects of the proposed mergers. As we point out in the report, the competitive effects of many mergers are rather easily determined and require very little analysis. We agree that to handle these cases, uniform standards are not needed. We believe, however, that uniform standards are needed to analyze the more complex and controversial cases. It is these cases where the competitive effects of proposed mergers come into play in deciding whether to approve or disapprove the merger.

The Department of Justice was concerned that implementation of our proposal may result in uniformity but not necessarily the correct analysis. The Department suggested that under the present system, a more practical recommendation might be for the regulators to work together with the Department in reaching a useful method of analysis.

GAO shares the concern expressed by several agencies about differences in the agencies' points of view and the ability to compromise. We believe that the Department of Justice correctly summarized this problem in its comments on our draft report in stating that

> "The draft report has pointed to a fundamental problem in this Federal regulatory scheme: multiple agencies each reviewing the same type of transaction and each applying the same statutory standard in 'splendid isolation'--a most unfortunate result, especially for the members of the industry regulated in this manner."

OCC like the Department of Justice, also questioned the merits of the present regulatory structure. The Comptroller of the Currency stated that

> "Basic to the entire question of differences, however, is the need to study the possibility of granting U.S. banks blanket authority to merge without seeking prior approval from <u>any</u> bank regulatory agency. However, should prior approval be retained, regulatory uniformity can be realized best by focusing responsibility for mergers in a single bank regulatory agency rather than the present three. The issue broadens, then, to include the need to re-examine the entire regulatory structure, with an even broader goal of rationalizing the present system under which U.S. financial institutions now operate."

The scope of this review was limited to the merger application process. Any change in the regulatory scheme would impact on all aspects of bank supervision, and we are not prepared to offer any suggestions on this issue at this time. We believe, therefore, that on the basis of this review the agencies should make a renewed effort to develop common standards for analyzing bank mergers.

With regard to our proposal that the Council formulate principles and standards for use in considering the effects that a merger would have on future competition, the FDIC stated that our proposal was unnecessary. The agency believes that the courts have provided all the guidance needed for considering the effects of potential competition because the Department of Justice has litigated 12 such cases and lost them all. As can be seen from its comments FDIC does not believe that the potential competitive effects of a proposed merger should be considered. In varying degrees the other agencies, however, do not share FDIC's viewpoint. It is because of these differences in agency beliefs and interpretations that uniform agency standards are needed.

The FRS stated that it has recently issued for public comment a policy statement setting forth proposed guidelines for analyzing the impact of market extension proposals on future competition. FRS stated that it hoped the guidelines might form a basis for more uniformity among the agencies. OCC and the Department of Justice did not specifically comment on our proposal.

In our draft report we also proposed that Federal regulators be more timely in furnishing competitive factor reports to the requesting agencies and that the requesting agency fully consider the comments received. In commenting on the draft report, there was substantial agreement with the proposal although some of the agencies expressed the belief that reports are submitted in a timely manner and are fully considered. The OCC suggested that we should consider recommending that the Congress eliminate the statutory requirement for advisory opinions from the other banking agencies. The FRS suggested that the advisory reports only be prepared on a selective basis. We believe that the FRS suggestion would be preferable to the current system.

In many mergers the competitive effects of a proposed merger are clearly not of sufficient concern that the regulators would object to the merger. In these cases it would not seem necessary to obtain advisory opinions from the other agencies. We are concerned, however, with the lack of uniformity among the agencies in their assessments of the competitive effects of proposed mergers. We are, therefore, reluctant at this time to recommend to the Congress that the Bank Merger Act be amended to make advisory competitive factor reports from the other banking agencies discretionary rather than mandatory. The Congress, however, may wish to consider this matter in the future when there are uniform standards in place to ensure more uniformity in merger decisions.

The full texts of all comments received appear in appendixes III through VII.

RECOMMENDATION TO THE CONGRESS

The Congress should amend the Bank Merger Act to provide that the banking agencies, to the extent practicable and within available data limitations, consider competing nonbank financial institutions in evaluating the competitive effects of a bank merger. This recommendation recognizes both the need for agency flexibility in determining what entities should be considered as competing institutions and the limitations that the agencies may encounter in obtaining information on nonbank financial institutions' activities.

Suggested draft legislation to implement this recommendation is included in appendix II of this report.

RECOMMENDATIONS TO THE COMPTROLLER OF THE CURRENCY; CHAIRMAN, BOARD OF DIRECTORS, FDIC; AND CHAIRMAN, BOARD OF GOVERNORS, FRS

We recommend that the three Federal bank regulatory agencies, with the advice and assistance of the Department of Justice, work together to formulate a useful and consistent method of analysis for considering what effect a proposed merger would have on future competition in the market area of the bank being acquired.

We also recommend that the three Federal bank regulatory agencies jointly establish a more consistent method of analysis for defining the relevant market when evaluating the competitive aspects of proposed mergers.

We recommend that the Federal regulators take steps to ensure that competitive factor reports are furnished to the requesting agency within the required 30 days and that the requesting agency properly considers the comments received and reconciles major conflicting conclusions.

CHAPTER 3

A MORE DIRECT APPROACH TO THE PHANTOM BANK MERGER PROCESS WILL RESULT IN SAVINGS TO BANKS AND FEDERAL REGULATORS

Despite its frequent use, the phantom or interim 1/ bank merger process is expensive and time consuming and imposes needless burdens on banks, BHCs, and Federal regulators. This process involves a complicated series of steps whereby (1) through a BHC the stockholders who control at least two-thirds of the stock of a bank can gain total control of the bank and (2) a BHC can acquire 100 percent ownership of a previously independent bank.

A typical use of the phantom bank merger process would be as follows. The stockholders who control at least two-thirds of the stock of a bank want to gain total control of the bank. These stockholders file with FRS for approval to establish a BHC. The BHC then obtains a bank charter from either OCC or a State regulatory agency. The newly chartered bank is referred to as a phantom bank because it never exists as an operating entity. The existing bank is merged with the phantom bank which is wholly owned by the BHC. Shareholders of the targeted bank receive BHC stock for their shares at a specified ratio. However, dissenting shareholders who oppose the merger may receive cash in lieu of holding company stock for their shares. The BHC thus will own 100 percent of the surviving bank's stock.

We are advised that the complicated phantom bank merger process is used because banking laws do not provide for shell corporations which serve similar purposes for nonbank corporations. We believe the process could be significantly simplified without losing any of the safeguards that presently exist.

Our proposal would result in the elimination of the need to charter a phantom bank and merge it with the bank targeted for acquisition. In place of these steps we are recommending that the BHC submit a plan of acquisition to the FRS outlining its intentions and methods for acquiring the targeted bank. This plan would be filed in conjunction with the BHC application to FRS for acquiring the target bank. We believe that our proposal would reduce costs and expedite the acquisition process while having no adverse effects on the parties to the transaction or

---

1/OCC prefers the term interim bank merger. However, the term phantom bank merger is widely accepted.

the public because they would be afforded the same safeguards that presently exist.

THE PHANTOM BANK MERGER PROCESS

A number of bank regulatory agencies are involved in a phantom merger transaction. The FRS, under the Bank Holding Company Act, is responsible for approving any action to be taken by a company to become a BHC and any action which causes a bank to become a subsidiary of a BHC. In addition, where the surviving bank is to be a national bank, the OCC is responsible for approving the formation of the phantom national bank and its subsequent merger with the target bank. When the surviving bank is to be a State-chartered bank, the appropriate Federal bank regulatory agency (FDIC or FRS) must approve the merger of the phantom and target banks. Their counterparts at the State level are also involved since State banks receive their charters from the State in which they are located. Thus, the State's involvement consists of chartering the phantom and approving its merger with the target bank.

Processing a phantom bank merger where the resulting bank is a national bank

In situations where the stockholders who control at least two-thirds of the stock of a bank wish to use the phantom bank merger process to gain total control of the bank and the resulting bank is a national bank, the process works as follows. The stockholders form a business corporation under appropriate State law. The corporation then files an application with the FRS for permission to become a BHC through the acquisition of their bank. The FRS reviews the application including an evaluation of the competitive aspects of the acquisition, the adequacy of the managerial and financial resources involved, and how the transaction will affect the convenience and needs of the community.

After receiving FRS approval, the BHC files an application with the OCC to organize a phantom bank and pays a fee of $6,500 to cover OCC's cost of processing the applications to charter the phantom bank and to merge the phantom and target banks. Approval of the phantom bank charter is necessary before any merger can take place. OCC allows mergers only between banks; and with phantom bank mergers, the phantom bank is generally the "surviving bank." Thus, OCC requires that the chartering of the phantom meet all the steps attendant with organizing a new national bank even though it was not an operating bank before the merger. (See app. I for actions necessary to charter a national bank.)

The BHC, after receiving the preliminary approval to charter the phantom bank, files an application with OCC to merge the phantom and target banks under the charter of the phantom bank and generally in the name of the target bank.

Before OCC will approve the merger application, a notice of the proposed merger must be published in the local papers, comments relative to the competitive effects of the proposed merger must be requested from the Attorney General and the other bank regulatory agencies, and the shareholders of the target bank holding at least two-thirds of the outstanding voting shares must consent to the merger. If requested, a hearing will be conducted at which the applicants and protestants will have an opportunity to make oral presentations as well as file written comments. Subsequent to shareholder and OCC approvals, the consenting shareholders exchange their shares for BHC stock while those not voting in favor of the merger have dissenter's rights and receive cash in exchange for their shares. After the exchange, the BHC controls all the shares of the target bank and that bank is now a wholly owned subsidiary of the BHC.

In situations where an existing BHC wants to gain total control of a target bank through the phantom bank merger process, the process is the same as that described above except there would be no need to form a business corporation or obtain permission from FRS to become a BHC.

Processing of phantom bank mergers
involving State-chartered banks

The processing steps followed when the surviving bank is to be a State-chartered bank are essentially the same as those for national banks except that both Federal and State bank regulatory agencies are involved in the approval process. Also State laws vary in the formation of the phantom and in the direction of the merger.

The management of a particular bank, desiring to operate as a wholly owned subsidiary of a BHC, forms a business corporation under appropriate State law. The corporation then files an application with the FRS for permission to become a BHC through the acquisition of their bank. If the BHC is already established and desires to increase its banking interests by acquiring another bank or by gaining total ownership of one of its subsidiary banks, its application to the FRS requests permission to increase its interests.

The FRS review of the BHC acquisition application includes an analysis of the competitive aspects of the acquisition, the adequacy of the managerial and financial resources involved, and how the transaction will affect the convenience and needs of the community. After receiving FRS approval of the BHC acquisition application, the BHC files an application with the State. Depending on State law, this application can be used for organizing a phantom bank or merely for forming a subsidiary corporation to serve as the merger vehicle.

The BHC, after receiving the State's approval for the phantom bank, files an application with the appropriate Federal regulatory agency (FDIC or the FRS) and the State to merge the phantom and target banks. The surviving bank, depending on State law, can either be the phantom or target bank.

The merger is consummated after the Federal and State regulators have granted their approval and the required number of shareholders, pursuant to State law, have consented to the merger. All actions preceding the approval, such as publicizing the proposed merger and soliciting competitive comments as well as the post-approval actions culminating in the transfer of total control to the BHC including the exchange of shares and the exercise of dissenters rights, are generally the same as those for national banks.

Why a phantom bank merger is used

A BHC desiring to gain total control of a particular bank uses the phantom bank merger process primarily for two reasons. First, a bank acquisition through a merger ensures the acquiring entity of total control. When a merger is approved by the stockholders who control at least two-thirds of the stock of the target bank, this has the effect of binding all the shareholders to the agreement. Consenting shareholders exchange their shares for shares of the acquiring entity while dissenting shareholders may elect to receive either (1) the value of their shares from the acquiring entity or (2) shares of the acquiring entity. Thus, when the merger is complete, the acquiring entity (or the BHC) will gain control of all the shares of the target bank.

The second reason for using the phantom merger process is that, while the merger route ensures complete control, BHCs also benefit through the tax laws. Acquisitions under the merger process are given tax treatment which allows for the tax-free exchange of shares between the phantom (BHC stock) and the stock of the target bank.

Another avenue available to BHCs and principal stockholders of a bank for acquiring total ownership of a bank is offering cash for the stock of the target bank. However, it is extremely difficult to obtain 100 percent acceptance of such an offer, and dissenting shareholders in this case generally cannot be forced to give up their shares. BHCs and stockholders, therefore, can end up with less than all the shares, and the desired result--a wholly owned subsidiary or bank--may not be possible.

OBJECTIVE OF PHANTOM BANK MERGER

The requirement to organize a phantom bank and subsequently merge it with the target bank is a burdensome and circuitous route to achieve the desired result. Phantom banks must be formed to facilitate the conversion of the target bank into a wholly owned subsidiary of a BHC. They never emerge as a separate operating entity before the merger and the resulting bank in the merger transaction is, in most cases, indistinguishable in name, location, and services from the target bank. The primary change is in the ownership of the target bank's stock.

The merger has no effect on competition since the phantom bank was not intended to operate as a competing entity in the market but rather to provide a vehicle through which the stockholders who control at least two-thirds of the stock of a bank or a BHC can gain total control of the target bank. The competitive structure of commercial banking in the area served, therefore, remains unchanged.

The process by which BHCs acquire total control of a bank is also expensive. BHC officials' estimates of the total costs for BHC formations, chartering the phantom entity, and consummation of the merger between the phantom and target banks, ranged from about $16,000 to $210,000. These costs include legal fees, accounting charges, time in preparing applications, time spent by bank staff, printing costs, notice publications, and any related application fees. As discussed later, we believe some of these costs can be eliminated by streamlining the acquisition process.

OPPORTUNITIES EXIST FOR IMPROVING THE PROCESS

We believe the process used to obtain total control of national banks can be shortened significantly and result in savings to bank regulators, banks, and BHCs. We believe that this can be accomplished by (1) giving responsibility for the review of the entire BHC acquisition to the FRS thus eliminating the need to charter the phantom and merge it with the target bank, (2) requiring the BHC to file an acquisition plan, and (3) providing the BHC with the same benefits as those achieved under the phantom merger process. Our proposal would have no adverse effects on the target bank's shareholders, the financial institutions involved, or the public since they would be provided the same safeguards that presently exist in phantom bank mergers. BHC and Federal and State regulatory officials generally reacted favorably to our proposal.

Some States have made moves in this direction by enacting legislation which allows a simple and direct approach to effecting BHC acquisitions by adapting the provisions of their merger laws to BHC acquisitions. For example, under New York and Massachusetts law, a corporation which is or will become a BHC may, together with an operating bank, adopt a plan providing for the acquisition of all the bank's stock by the corporation in exchange for stock or securities of the corporation. Upon approval of the plan by the required majority of the bank's shareholders, the plan is consummated and the bank becomes a wholly owned subsidiary pursuant to the terms of the plan.

Potential solution for simplifying the process

We believe the phantom merger process can be eliminated while providing the public and the financial industry with the same safeguards that currently exist. We are proposing amendments to the Bank Holding Company Act which would provide an alternative method that is more efficient and economical for banks, BHCs, and Federal regulators. Our proposed amendments would eliminate the need for a BHC to charter a phantom bank and merge it with the bank targeted for acquisition. In its place, we are proposing that a "plan of acquisition" be filed with the FRS along with the required BHC acquisition application.

The plan would outline the details of the proposed acquisition. Included in the plan would be such information as the process proposed for obtaining stockholder approval (two-thirds of the voting shares for national banks), the manner in which shareholders would be notified of the proposed acquisition, and the method for compensating minority shareholders.

In the case of national banks, the plan of acquisition would eliminate the need for the BHC to deal directly with OCC. This would result in simplifying the processing problems for the applicant. The applicant would, however, be required to notify OCC of the proposed change of ownership, and OCC would be given the opportunity to comment to the FRS on the BHC's proposed acquisition.

BHCs would also save money in their acquisitions of State-chartered banks. Although they would be required to comply with all State laws, they could save costs by eliminating their merger application to the appropriate Federal regulator. They would be required to file a plan of acquisition with the FRS. For State-chartered banks regulated by FDIC, the need for the applicant to deal with FDIC would be eliminated. At the FRS the proposed acquisition plan would be filed along with the BHC application.

Additionally our proposed amendments to the Bank Holding Company Act would provide that:

--A BHC desiring to acquire total control of a particular national bank outline the details of the proposed treatment of the target bank's dissenting shareholders according to the guidelines established in the National Bank Act or, with respect to State banks, in accordance with State law.

--The exchange of BHC stock for stock of the target bank be tax free and qualify as a reorganization under section 368(a)(1)(A) of the Internal Revenue Code.

--The acquired bank continue to be an insured bank subject to the provisions of the Federal Deposit Insurance Act.

--The transaction be subject to all the required SEC disclosure laws.

The following tables highlight the various actions now required to complete a phantom merger as compared to the actions that would be required under the GAO proposal.

National Banks

Actions Now Required	Actions Required under GAO Proposal
BHC application to FRS.	Required. Acquisition plan also required.
Publication of BHC application in local press.	Required.
FRS requests views and recommendations on BHC application.	Required.
Application to OCC to organize phantom bank.	Not required.
Organizers elect directors for phantom bank; directors subscribe to phantom bank stock; etc. (see app. II).	Not required.
Application to OCC to merge phantom and target banks.	Not required.
Publication of proposed merger in local press.	Not required.
OCC requests comments on competitive aspects of phantom merger from the other two regulatory agencies and the Attorney General.	Not required.
Shareholders of the target bank vote on the proposed merger.	Required.
Compliance with SEC requirements.	Required.

State Banks

Actions Now Required	Actions Required Under GAO Proposal
BHC application to FRS.	Required. Plan outlining proposed acquisition also required.
Publication of BHC application in local press.	Required.
FRS requests views and recommendations on BHC application from bank supervisory authorities.	Required. Comments also requested from the responsible Federal regulator.
Application to State to organize phantom.	Required.
Actions of organizers in connection with forming phantom.	Required.
Application to merge phantom and target banks.	
To Federal regulator	Not required.
To State regulator	Required.
Publication of proposed merger in local press.	Not required.
Federal regulator requests comments on the competitive aspects of phantom merger from the other two regulatory agencies and the Attorney General.	Not required.
Shareholders of the target bank vote on the proposed merger.	Required.
Compliance with SEC requirements.	Required.

Potential benefits from GAO proposal

An acquisition involving national banks will benefit the most from our proposal since there would no longer be a need to organize a phantom bank and merge it with the target bank. Also, our proposal would result in the proposed acquisition being presented to the public in a more direct and revealing manner.

Estimates by BHC officials of the savings that would result with the elimination of these two phases ranged from $8,000 to $54,000. Factors affecting the extent of the savings were whether certain functions, primarily legal and accounting services, were performed by in-house staff or contracted out and whether the BHC had prior experience with phantom mergers or was a first-time applicant.

Summarized below is an example of the estimated savings which would have been realized in a BHC formation. These savings would have resulted under our proposed plan since the bank would not have been required to organize a phantom national bank and merge it with the target bank.

Application filing fee 1/	$ 5,500
Legal services	11,000
Accounting services	1,660
Printing and publication charges	6,220
Staff effort to prepare and review the applications	2,660
Interest on borrowed funds	5,930
Estimated saving by deleting the chartering and merging requirement	$32,970

Federal regulatory agency involvement in phantom mergers pertaining to State-chartered banks, other than the BHC application, is limited to filing an application to merge the phantom with the target bank. BHC estimates for not having to prepare the merger application ranged from $500 to $8,400. There is, however, potential for additional savings in that a change in Federal banking statutes may prompt some States to make similar changes in their statutes.

An additional benefit would be that BHCs would only need to deal with one Federal regulator during the transaction. The elimination of the application to merge the phantom with the target bank would also eliminate a redundancy since the criteria used to evaluate both the BHC application and the phantom bank merger application are very similar.

Our proposal will also eliminate costs to Federal regulators for staff and reproduction. These costs are associated with reviewing and processing the applications as well as the effort connected with the other regulators and the Department of Justice in furnishing comments on the competitive aspects of the proposal. These cost savings will accrue primarily to Federal regulators

---

1/OCC increased this filing fee to $6,500 in March 1981.

processing merger applications involving State-chartered banks since OCC currently assesses a $6,500 fee for processing a phantom bank merger application. This fee is based on OCC headquarters and regional office estimates of the cost to process the applications to charter a phantom bank and to merge the phantom and target banks. The applicant, therefore, realizes the monetary benefits of eliminating the applications while OCC could realize a benefit in that its staff could be used to process more significant applications.

Reactions generally favorable to GAO's proposal

BHC officials that we contacted generally reacted favorably to our proposal for simplifying bank acquisitions. They said our proposal would enable bank acquisitions to be accomplished sooner and at less cost in contrast to the phantom bank merger process which is expensive and time consuming and involves steps of little or no benefit to anyone. Several BHC officials were confident that the States would enact similar legislation if the Bank Holding Company Act were amended along the lines of our proposal. This opinion was shared by several State banking officials.

Comments by Federal regulatory officials, both in headquarters and the regional offices, generally paralleled those of the BHC officials. Several officials also indicated that the bulk of the review of a phantom bank merger transaction is performed by the FRS in connection with its review of the BHC application. Therefore, once the FRS has approved the application, the approval of the merger application is more or less automatic.

AN INCREASE IN PHANTOM BANK MERGERS SEEMS LIKELY

Mergers involving phantom banks became popular in the 1960s, and the following table indicates the trend is upward.

Calendar year	Number of phantom bank mergers approved
1960	15
1970	25
1975	36
1979	61
1980	126

One factor contributing to the growth of phantom bank mergers has been the repealing of State statutes which restricted banking operations to single units or specific geographic areas. As these barriers were eliminated, BHC formations and acquisitions increased. For example, beginning January 1982, Illinois has been permitting multiple bank ownership by BHCs. As a result, an increase can be expected in the number of phantom bank merger applications in the State.

In addition, movement has been underway for some time to repeal or modify the McFadden Act (12 U.S.C. § 36) and the Douglas Amendment to the Bank Holding Company Act (12 U.S.C. § 1842(d)). These statutes limit bank expansion by prohibiting banks and BHCs from operating full-service banks in more than one State. The repeal or liberalization of these statutes will enable BHCs to extend bank acquisitions beyond State boundaries, and many of these acquisitions will undoubtedly be by phantom bank merger.

CONCLUSIONS

Bank acquisitions using the phantom bank merger process have increased significantly in recent years, and there are indications that the trend will continue. The acquisitions, however, involve an expensive, time consuming, and burdensome process of chartering and merging. We believe that for national and State banks the desired result can be accomplished more efficiently and economically by amending the Bank Holding Company Act to establish the FRS as the focal point for the Federal review of all aspects of such proposed BHC acquisitions. In addition, for national banks our proposal would eliminate the need for chartering a phantom bank and merging it with the target bank by requiring instead that an acquisition plan be filed with FRS. Our proposal would benefit Federal regulators, banks, and BHCs while having no adverse effect on the shareholders of the acquired bank, the financial institutions involved, or the public.

RECOMMENDATION TO THE CONGRESS

We recommend that the Congress amend the Bank Holding Company Act to permit a BHC to acquire, by an exchange of stock, total control of an operating national bank subject to approval of the FRS and upon the affirmative vote of the shareholders owning at least two-thirds of that bank's outstanding capital voting stock. The amendment should also provide that:

--The appropriate BHC application be accompanied by a plan of acquisition specifying the manner in which the acquisition is to be accomplished.

--The shareholders of the target bank voting against the acquisition could receive stock in the holding company or a fair value for their shares.

--The exchange of stock qualify as a tax-free exchange.

--The acquired bank continue as an insured bank subject to the provisions of the Federal Deposit Insurance Act.

--The plan of acquisition be in compliance with all applicable Federal securities laws including disclosure regarding the offer and issuance of stock or other securities pursuant to such plan of acquisition.

--For similar acquisitions of State-chartered banks, the BHC application be accompanied by a plan of acquisition rather than the presently required merger application.

Suggested draft legislation to implement this recommendation is included in appendix II of this report.

AGENCY COMMENTS AND OUR EVALUATION

The FDIC, FRS, and OCC concur with our recommendation. The Department of Justice did not specifically address this recommendation in commenting on the draft report.

The full texts of all comments received appear in appendixes III through VII.

CHAPTER 4

THE MERGER APPLICATION PROCESS

SHOULD BE STREAMLINED

While Federal regulators have made some efforts to streamline the merger application process, additional modifications in agency practices and changes in the merger law can be made which would reduce the administrative cost and processing time for merger applications. It currently takes months to process a merger application, and this frequently creates some problems for the applicant such as low employee morale due to future uncertainties. Specifically, we found that merger applications could be processed in a more timely manner and at less cost if

--OCC and FDIC delegated approval authority for the simpler mergers to regional directors;

--FDIC regional offices were permitted to officially accept and immediately start processing all applications;

--the publication and comment periods for applications were made uniform and were shortened;

--the Bank Merger Act was amended to delete the requirement for competitive reports on phantom mergers and corporate reorganizations;

--the Bank Merger Act was amended to remove the requirement for the 30-day Attorney General review period after Federal regulatory agency approval for phantom mergers and corporate reorganizations; and

--FDIC and the FRS would coordinate more effectively their review efforts with State regulators.

COST SAVINGS AND BENEFITS TO BE GAINED IN REDUCING PROCESSING TIME

Federal regulatory agencies take months to process most merger applications. Although the regulatory agencies would receive some benefits by reducing this processing time, the primary benefits would be to applicant banks and BHCs which bear most of the burden in the merger application process.

The elimination of built-in delays and unnecessary requirements in the merger application process discussed in this chapter would make Federal regulators more efficient. The benefits to the regulatory agencies would come in the form of less administrative efforts and paperwork needed to oversee the merger functions.

Bank officials generally could not quantify the cost savings that would result from faster processing of merger applications; however, they identified several benefits. For example, the officials said that once a merger is proposed, target bank employees become concerned about their status and that reduced processing time would relieve this employee morale problem sooner. They also believed that the sooner the merger is effected the sooner the bank can provide new or improved services to the community. Other benefits identified by the bank officials included

--strengthening banks possessing weaknesses,

--providing target banks with additional capital sooner, and

--realizing the time value of money in effecting the merger sooner.

MORE APPROVAL AUTHORITY SHOULD BE DELEGATED TO OCC AND FDIC REGIONAL DIRECTORS

Although most proposed mergers are fairly routine and do not involve significant legal, competitive, or financial policy issues, Federal regulatory agencies have taken months to decide on them. In an effort to reduce processing time, the FRS delegated to its banks approval authority for phantom mergers, corporate reorganizations, and the simpler regular mergers. Recently, FDIC took action to reduce merger application processing time by delegating approval authority for phantom mergers and corporate reorganizations. However, OCC has not delegated any merger approval authority to its regional administrators. Headquarters review adds unnecessary processing time and added cost for routine mergers since the regional staffs would have already formulated positions on them. The headquarters staff primarily reviews the regional staffs' merger evaluation and prepares a recommendation for the Comptroller of the Currency.

Many mergers are straightforward and noncontroversial and would not appear to require any special expertise of the headquarters staff to make a final decision on the application.

Since regional offices are most knowledgeable about the banks in their area and evaluate all aspects of proposed mergers, we believe OCC could process corporate reorganization, phantom merger, and simple regular merger applications in a more timely and efficient manner by delegating approval authority to regional directors. For the same reasons, we believe FDIC should delegate approval authority to its regional directors for simpler regular mergers.

<u>FRS and FDIC have delegated some approval authority</u>

In September 1979, the Federal Reserve Board delegated approval authority to Reserve banks for certain mergers. The criteria provide that the authority to approve merger applications is delegated to the Reserve banks unless

--a member of the Board has indicated an objection;

--the Board has indicated that such delegated authority shall not be exercised by the Reserve bank;

--a written substantive objection to the application has been properly made;

--the application raises a significant policy issue or a legal question on which the Board has not established its position; or

--the proposed transaction involves two or more banking organizations that rank among a State's 10 largest banking organizations in terms of total domestic banking assets, each of which has more than $100 million of total deposits in banking offices in the same local banking market, or that after consummation of the proposal would control over 5 percent of total deposits in banking offices in that local market.

On the basis of this criteria only those merger applications with significant legal, competitive, or financial issues are acted on by the Federal Reserve Board (Board). During the 3-year period from calendar year 1978 through 1980, Federal Reserve banks under delegated authority approved 57 of 77, or 74 percent, of the merger applications processed by the FRS. More specifically, 82 percent of all phantom mergers and corporate reorganizations and 50 percent of all regular mergers were approved by Reserve banks. This has resulted in more timely processing of merger applications and in more efficient use of Board and Federal Reserve bank staff. In this regard, an FRS official estimated that delegated cases in 1980 were processed in an average of about 45 days.

The Bank Merger Act does not place a limit on processing time; however, FRS has established a 90-day limit for processing all merger applications. In addition, FRS has set milestones for major processing steps illustrating that cases not requiring Board approval can be done in less than 90 days. For example, Atlanta Federal Reserve Bank procedures for delegated cases provide that the Reserve bank staff

--receive and accept the merger application and request that the OCC, FDIC, and the Department of Justice submit competitive factors reports to the Board within 30 days with copies to the Reserve bank;

--mail, within 38 days, the Reserve bank's memorandum and proposed approval order to Board staff which must wire the Reserve bank within 10 days indicating any objections to delegated approval; and

--approve, if the wire indicates no objections, the merger no later than the next day.

The procedures for nondelegated applications are about the same as for delegated applications at the Federal Reserve bank level. However, much more time is allowed for Board staff processing and Board approval. For example, 51 business days (about 71 calendar days) are allowed before the proposed order is provided to the Board for consideration.

In September 1981 FDIC delegated authority to regional directors to approve, but not deny, phantom mergers and corporate reorganizations except for proposals challenged under the Community Reinvestment Act (12 U.S.C. §§ 2901 et seq.) by an entity other than a competing institution. FDIC headquarters will still obtain competitive reports from the Department of Justice and the other two Federal regulatory agencies and transmit the results to the regional office by telephone if any of the conclusions in the report are other than "no significant effect."

On the basis of our review of phantom merger and corporate reorganization applications processed by FDIC during 1979 and 1980, delegated authority should substantially reduce the processing time and cost for these types of mergers which comprise over 50 percent of FDIC's merger application volume. It will also eliminate the need for review of the application at both the regional office and headquarters. For example, the processing time for 27 phantom mergers and 20 corporate reorganization applications processed by the Atlanta, San Francisco, and Richmond regional offices in 1979 and 1980 took an average of 128 days from acceptance to headquarters approval. Considering FDIC's policy not to decide on proposed mergers before the State regulatory agency, our analysis showed that FDIC could have saved from 4 to 70 (an average of 21) days in processing these applications if the region had had the authority to approve them without headquarters review.

FDIC regional directors should approve less difficult regular mergers

Currently, FDIC regional offices receive regular merger applications, review them for completeness, and forward them to FDIC headquarters. FDIC headquarters also reviews the applications for completeness; officially accepts them; requests competitive factors reports from the Attorney General, OCC, and FRS; and notifies the regional office to have the applicant initiate publication requirements. The regional office reviews the application content and current bank examinations, makes field investigations if necessary, makes a complete analysis, and submits a recommendation to FDIC headquarters addressing the competitive effects and other factors specified by the Bank Merger Act. The FDIC headquarters reviews the region's evaluation of the proposed merger and prepares a recommendation for the Board of Directors.

Our review of 28 of 31 regular mergers processed by the Atlanta, San Francisco, and Richmond FDIC regions during 1979 and 1980 showed that FDIC headquarters took substantial processing time after the regions' recommendations and the State regulatory agencies' decisions before reaching a decision on regular mergers. Considering FDIC's policy not to decide on proposed mergers before the State regulatory agency, our analysis showed that FDIC could have saved from 9 to 101 (an average of 38) days in processing these applications if the region had had the authority to approve them without headquarters review. Since FDIC does not now have criteria for delegating authority for simpler regular mergers, we could not determine which mergers would have been processed under delegated authority. In this regard, we noted that the FRS has approved about 50 percent of its regular mergers under delegated authority.

An FDIC official stated that headquarters and regional staffs generally agree on decisions regarding noncontroversial mergers. These would constitute mergers which involve no significant legal, financial, or competitive issues. However, agency officials generally expressed a need to establish specific criteria before regular mergers could be handled under delegated authority.

Because of the potential time savings involved, we believe that similarly to FRS, FDIC should establish criteria and delegate approval authority to regional directors for simpler regular mergers. Of all regular merger applications processed in 1978, 1979, and 1980, Federal Reserve banks approved 50 percent under delegated authority. The benefits of reduced processing time were discussed on pages 45 and 46.

OCC regional administrators should approve routine mergers

OCC has delegated authority to regional administrators for approval of applications for bank branches and many other types of applications. Also, in March 1981 during our review, OCC delegated authority allowing regional administrators to conditionally approve within 2 weeks interim banks for use in subsequent phantom mergers. This delegation of authority should substantially reduce processing time for phantom merger applications. We noted that prior to delegation of authority to regional administrators, the approval of phantom bank charters during 1979 and 1980 showed that the Atlanta region took an average of 92 days, San Francisco 85 days, and Richmond 78 days to process the interim bank applications.

The approval of all merger applications is centralized at OCC headquarters. OCC headquarters officially accepts the application; requests reports on the competitive aspects from the Attorney General, FDIC, and FRS as well as comments from the OCC region on all aspects of the merger; reviews proxy statements; and prepares the proposed decision document for the Comptroller of the Currency. The regional staff evaluates current bank examinations and the application data and comments on the competitive effects and all other factors specified by the Bank Merger Act. On the basis of this extensive analysis made by the region, we believe that the regional office staff has a sufficient basis for making decisions on phantom mergers, corporate reorganizations, and simpler regular mergers.

Our review of 45 of 50 merger applications processed by three OCC regions during 1979 and 1980 showed that OCC headquarters required substantial processing time for approval after the region had made its recommendation. For example, for corporate reorganizations it took an average of 78 days from acceptance to OCC headquarters approval. However, the regional office recommended approval in an average of 28 days.

Both OCC headquarters and regional officials believe that phantom mergers, corporate reorganizations, and the simpler regular mergers could be approved at the regional level under delegated authority. However, some regional officials believe that if regular mergers are included, regions may need additional anticompetitive and legal resources. Also, one regional official stated that since regular mergers affect competition, precise guidelines would be needed for regional approval of any regular mergers. In this regard, as noted on pages 47 and 48, the FRS has overcome this problem.

We believe that delegating authority to regional directors would result in faster approval of phantom mergers, corporate reorganizations, and simpler regular mergers and would provide more time for OCC headquarters to efficiently process more difficult regular mergers.

REVISIONS NEEDED IN FDIC PROCEDURES FOR ACCEPTING AND EVALUATING MERGER APPLICATIONS

We found two instances where delays are built into the FDIC merger application process. First, regional offices must send each regular merger application to FDIC headquarters in Washington, D.C., for official acceptance and return before starting processing. This delay could be eliminated since the region already reviews applications for completeness and could notify applicants that the application is accepted and to start publishing notices of the pending merger. Secondly, one regional office we visited awaits the State's decision on phantom merger and corporate reorganization applications before starting evaluation of the merger. The FDIC region's reasoning for the delay is to avoid expending unnecessary resources should the State chartering agency not approve the application. This delay could be eliminated without incurring undue risk since very few applications are disapproved by the State or FDIC.

Prior to September 1981, a delay was built into the front end of the FDIC processing cycle for all merger applications. Even though the regional staff reviewed applications for completeness, each region was required to submit all incoming merger applications to FDIC headquarters for official acceptance which was actually only a notice to allow the region to tell the applicant it could begin publication requirements. With the newly delegated approval authority (see p. 48), this delay will be eliminated for phantom mergers and corporate reorganizations since the region will now accept and approve these applications. However, this delay will still exist for regular merger applications.

We reviewed available information on 28 regular mergers processed in 1979 and 1980 by the three FDIC regions we visited. The average days from the receipt of the application by the regional office to official acceptance by FDIC headquarters was 11 days for San Francisco, 8 days for Richmond, and 4 days for Atlanta. These numbers do not include estimated mail time of about 2 to 3 days from FDIC headquarters back to the regional office.

At FDIC headquarters, a supervising review examiner said he had no objection to regions accepting regular merger applications and notifying applicants to begin publication. We believe this approach would enable applicants to start publication requirements earlier and, as discussed on page 49, may result in the application being approved sooner. We believe that elimination of this delay would not conflict with FDIC's policy of not approving merger applications before the State agency. For instance, the average number of days between the State's approval and the FDIC's approval were 79, 41, and 120 for the Atlanta, San Francisco, and Richmond FDIC regions, respectively.

The Atlanta FDIC region did not begin evaluation of phantom merger and corporate reorganization applications until the State agency's approval of the merger. Regional officials' rationale was to not unnecessarily expend resources or influence the State agency before it made a decision especially since the State is the chartering authority for FDIC-supervised banks.

Our review of 1980 phantom merger and corporate reorganization applications processed by the Atlanta FDIC region showed that the region allowed an average of 81 days to elapse from the time headquarters officially accepted the application to the time the State approved it before starting the merger evaluation. Whereas, the region spent an average of only 29 days to make a recommendation to FDIC headquarters after the State's approval. Moreover, we found that no 1979 and 1980 Atlanta FDIC phantom merger and corporate reorganization applications and only one regular merger had been disapproved by a State agency. The one denial had been approved by the State agency but later denied because of FDIC's subsequent disapproval. In our opinion, by starting the evaluation upon acceptance of the merger applications, the region could have made its recommendation to FDIC headquarters as much as 81 days earlier, and FDIC headquarters could have approved the application much sooner. Further, we believe eliminating this delay and delegating approval authority will provide for more efficient regional processing of phantom mergers and corporate reorganization applications.

The San Francisco and Richmond FDIC regions did not wait for the State agency's decision before beginning their evaluations of merger applications. One regional official stated that his region takes a calculated risk by performing the analysis concurrently with States but that the risk is minimal because the States rarely deny mergers.

NEED TO REASSESS PUBLICATION AND COMMENT REQUIREMENTS FOR MERGER APPLICATIONS

The Bank Merger Act requires proposed merger transactions to be published in newspapers at appropriate intervals for at least 30 calendar days. The purpose of this publication is to provide the general public with the opportunity to comment on the proposed merger. These publications result in very few comments.

According to agency officials, most comments received relate to the competitive aspects of the proposed merger.

Federal bank regulatory agencies' methods of compliance with the publication provision of the act vary. In addition to the 30-day publication period, FDIC allows an additional 15 days and OCC 21 days for written public comments. The comment period at FRS is limited to the 30-day publication period. These requirements exceed OCC and FDIC publication and comment periods for other types of corporate applications such as those for establishing new branches, new charters, or FDIC membership. We also noted that FRS requires a BHC applicant to publish a notice for only 2 weeks with comments due 30 days from the date of the first publication. We believe that this requirement would be reasonable for mergers.

The Bank Merger Act only stipulates that notice of a proposed merger should be published at appropriate intervals during a period at least as long as the period allowed for the Attorney General and the other two Federal regulatory agencies to furnish competitive factors reports (30 days) and in a newspaper of general circulation in the community where the main offices of the banks involved are located. The three Federal regulatory agencies require the applicant to have a notice of the proposed merger appear in daily newspapers on the same day for 5 consecutive weeks and on the 30th day after the initial publication date.

The Bank Merger Act is silent on the period that should be provided for receiving public comments. As a result, the period for the public to comment on a proposed merger varies among the Federal regulatory agencies. The comment period for the three agencies starts on the first day the notice is published, but FDIC's period ends 15 days after the last publication date while OCC's comment period ends 21 days after the last publication period. In comparison, FRS's comment period ends on the last day of publication. The combined public notice and comment periods for FDIC, OCC, and FRS are 45, 51, and 30 days, respectively.

An FDIC headquarters official said that an additional 15 days were added to the 30-day requirement because the publication periods for other applications provide an additional 15 days for comments after the final publication. It should be noted, however, that the publication period for other applications is much shorter than for mergers, thus the overall comment period for mergers is longer than for other applications. OCC headquarters officials informed us that the 21-day comment period was added to the 30-day merger publication requirement to make it consistent with the time provided for other corporate applications. An FRS official was not sure why the comment period on mergers was held to the 30-day publication period.

Bank merger applications are the only bank applications which require more than 30 days to satisfy the public notice requirement. For example, branch bank applications and Federal Reserve BHC applications require publication on the same day for two consecutive weeks. With the attendant comment period, the public notice period for other FDIC, OCC, and FRS applications are 23, 29, and 30 days, respectively.

The modification of merger publication and comment periods to coincide with a period similar to that used for other applications would result in a significant reduction in the time needed to fulfill this requirement. In addition, it would reduce the number of required publication notices from six to three resulting in a cost savings to the bank merger applicants.

Although their combined publication and comment periods vary, headquarters officials of the three Federal regulatory agencies generally believed that the current periods were adequate. However, some regional officials felt that, similar to other applications, the publication period should be 2 weeks with a total publication and comment period of 30 days. In addition, some of the regional officials believed that this would shorten application processing time for some of the more routine mergers. In this regard, we noted that in July 1981 four FDIC regional directors suggested to FDIC headquarters that the merger publication and comment period be shortened in order to reduce the processing time frame. One of the officials suggested that the period be shortened since no comments have been received in the last few years.

We attempted to determine and evaluate the comments received on merger applications. However, neither headquarters nor regional offices of the FDIC, OCC, or Federal Reserve banks maintain records on the number received. Both headquarters and regional officials told us that very few, if any, comments are received. Also, except for a few Atlanta OCC and FDIC regular mergers, our review of individual merger files for the three OCC and FDIC regions and the three Federal Reserve banks we visited disclosed very few comments.

If all Federal regulators could use the publication and comment period that FRS now requires for applications filed under the Bank Holding Company Act--2 weeks for publication with comments due 30 days after the first publication--the applicant could save several hundred dollars in advertising costs by eliminating three publications. Additionally, it would shorten the time required to process the application by reducing the publication and comment time frames. Agency officials believe that a shorter publication and comment period such as that provided by the Bank Holding Company Act would not inhibit interested parties from commenting on pending applications.

We recognize that Federal regulatory staffs are continuing evaluation of merger applications during the publication and comment periods and that a day-for-day savings may not result in total processing time by shortening the publication and comment periods. However, we believe that shortening the publication and comment requirements would be even more important for phantom mergers and corporate reorganizations since there is no effect on competition. This could further streamline FDIC's own initiative of delegating approval authority to regional directors for phantom mergers and corporate reorganizations.

COMPETITIVE REPORTS ARE NOT NEEDED FROM OTHER AGENCIES ON PHANTOM MERGERS AND CORPORATE REORGANIZATIONS

In the interest of uniform standards, the Bank Merger Act requires that the responsible agency obtain from the Attorney General and the other two Federal banking agencies comments on the competitive aspects of proposed mergers. Except for emergencies, the act provides no exceptions from this requirement, and the comments are required within 30 days of the responsible agency's request. Therefore Federal regulators apply the requirement to phantom mergers and corporate reorganizations which are bank reorganizations that have no effect on competition. Since these transactions presently comprise over 50 percent of the mergers processed by Federal regulators, we believe that the Bank Merger Act should be amended to exempt phantom mergers and corporate reorganizations from the requirement because the reports serve no useful purpose, and their elimination would reduce labor and costs for both applicants and Federal regulators.

The Bank Merger Act requirement for competitive factors reports from the Attorney General and the other Federal banking agencies is, in our opinion, aimed at regular mergers. A regular merger is the combination of a target bank and an acquiring bank. As a result the competitive structure of commercial banking in the market area served will change. In contrast, a phantom merger, as discussed in chapter 3, merely combines an operating bank with a nonoperating bank to facilitate the reorganization of a bank into a wholly owned subsidiary of a BHC; and in a corporate reorganization, two operating banks that are controlled by a holding company unite under one bank charter and name. Thus, there may be a change in the name and control of the subject banks, but they will continue to operate after the merger. The competitive structure of commercial banking in the banking market area served, therefore, remains unchanged.

For both calendar years 1979 and 1980, phantom mergers and corporate reorganizations represented over 50 percent of all three bank regulators' total merger activity. Also, the number of phantom mergers for OCC, FDIC, and FRS increased by 160, 91, and 37 percent, respectively, from 1979 to 1980. Each Federal regulator requires merger applicants to submit the original and multiple copies of applications--OCC, 15 copies; FDIC, 16 copies; and FRS, 18 copies. Regardless of the type of merger, each agency sends a total of nine copies of the application to the Attorney General and the other two Federal banking agencies for their use in analyzing and reporting on the competitive effects of mergers.

Our review of a sample of 33 phantom mergers and corporate reorganizations processed during 1979 and 1980 involving three OCC and FDIC regions and three Federal Reserve banks generally showed that comments received on the competitive effects of the proposed merger from the Attorney General and other Federal banking agencies were very brief. All the comments contained conclusions that the proposed merger would not affect competition. Furthermore, we found that sometimes the required comments were never received or were received late and after the decision was made. We believe this laxity in responses is at least partially due to agency officials knowing that these mergers have no effect on competition.

Federal regulatory officials at both headquarters and regional levels agreed that issuance of competitive factors reports for phantom mergers and corporate reorganizations is unnecessary. Further, some of the officials stated that the Bank Merger Act should be amended to waive this requirement for phantom mergers and corporate reorganizations. Officials of the Attorney General's Office stated that this process is unnecessary and could be eliminated.

FDIC estimated that it spends about $5,000 in annual labor costs for issuing competitive factors reports for phantom mergers and corporate reorganizations. OCC could not provide a dollar estimate but estimated that it took about 270 hours annually to process the reports. FRS stated that the handling and issuing of the reports involved considerable professional and secretarial time, however, it was difficult to estimate the actual time required.

In chapter 3 we address the phantom merger process and make recommendations for establishing an alternative process. If these recommendations are acted upon, the number of phantom merger applications would be reduced significantly. However, the number of corporate reorganization applications would not be affected.

An amendment to the Bank Merger Act to eliminate the need for competitive factor reports from the Attorney General and the other Federal banking agencies for phantom mergers and corporate reorganizations would reduce costs for both applicants and Federal agencies. It would save applicants' copying costs and would reduce Federal agencies' costs for labor and administrative supplies.

PERIOD FOR ATTORNEY GENERAL TO BRING ACTION MAY NOT BE NEEDED FOR PHANTOM MERGERS AND CORPORATE REORGANIZATIONS

The Bank Merger Act requirement that the Attorney General be notified when a regulator approves a merger application can add an additional 30 days before the applicant can consummate phantom mergers and corporate reorganizations. As discussed in the previous section (see pp. 55 and 56), the Bank Merger Act requires the responsible regulatory agency to request comments from the Attorney General and the other two regulatory agencies on the competitive effects of a proposed merger. We suggested that the Bank Merger Act be amended to waive this requirement for phantom mergers and corporate reorganizations which are simply bank reorganizations that do not affect competition. For the same reason, we believe the act should also be amended to waive the 30-day waiting period for any Attorney General action prior to consummation of phantom mergers and corporate reorganizations.

The act requires the responsible regulatory agency to immediately notify the Attorney General when a merger application has been approved and, except in emergencies, prohibits the consummation of the merger before the 30th day after the date the regulatory agency approved the merger. This 30-day period is provided for the Attorney General to bring action if he believes the merger will be in violation of antitrust law. After this 30-day period, the Bank Merger Act prohibits challenges to a bank merger on the basis that it violates antitrust law.

The Federal regulatory agency and Department of Justice officials agreed that the 30-day waiting period was not needed for phantom mergers and corporate reorganizations since there is no effect on competition. However, Department of Justice officials stated that no immunity from section 7 of the Clayton Act should attach to these transactions since they would be free from the 30-day waiting period and that the Department should be free to act should someone attempt to use a phantom merger or corporate merger "creatively" under our proposal. We agree, and have included in our proposed legislation in appendix II a provision which makes phantom mergers and corporate reorganizations subject to the same antitrust challenges to which they would be subject if the 30-day waiting period were retained.

We believe the elimination of the 30-day Attorney General review period would benefit the merger applicant because the merger could be consummated immediately rather than 30 days later. As previously noted (see p. 55), phantom mergers and corporate reorganizations comprise over 50 percent of the merger application volume of all three Federal regulatory agencies.

FDIC AND FRS COULD COORDINATE MORE EFFECTIVELY WITH STATE BANKING AGENCIES

State-chartered banks must obtain approval for mergers from the State banking regulator and the appropriate Federal regulator. We found that Federal and State regulators often consider the same information when evaluating a merger application. To promote coordination and avoid duplication, FDIC and State agencies in 18 States presently use common merger applications mostly for phantom mergers. FRS is not attempting to work with State agencies to develop a common application form. We believe that greater efforts should be made to promote effective coordination between Federal and State bank regulators on merger applications. FDIC and FRS should work with the States to develop a common merger application. Also, we found that there is only a limited exchange of information between Federal and State regulators in some States and that more effort is needed to better coordinate merger application reviews.

Joint FDIC and FRS effort is needed to develop common merger applications with States

Although the State banking agency must approve mergers involving both member and nonmember State-chartered banks, there has been no joint effort by FDIC and FRS to develop common merger applications with State agencies. FDIC has started a common application program with some States; however, FRS has not joined FDIC in its program nor has it set up a similar program.

FDIC has instituted a common merger application program with emphasis toward promoting State and Federal coordination and lessening the burden on applicant banks. Currently, 18 State agencies use FDIC's common merger application primarily for phantom mergers. Three of these States--Georgia, North Carolina, and Oregon--were included in our review. In addition, in an effort to induce States to adopt common application forms, FDIC offered draft forms to all States. Also, FDIC expressed a willingness to adjust the forms to suit State needs and to print and supply forms to States free of charge.

Some State agencies will accept FRS's merger application. However, FRS has made no overall effort in the area of common merger applications.

More effort is needed to coordinate merger application reviews

Neither FDIC nor FRS have written procedures for coordinating with States in the merger application review process even though Federal and State regulators often consider essentially the same banking factors, i.e., competitive effects, convenience and needs of the community, and the financial and managerial resources of the banks involved. As a result, FDIC, FRS, and State authorities all make independent analyses in evaluating proposed mergers.

There are varying degrees of interaction between Federal regulatory agencies and their State counterparts for the States included in our review, such as the States' acceptance of the Federal merger application, communication and exchange of information, and bank examinations. Although duplication exists between Federal and State regulatory agencies in the evaluation of proposed mergers, both Federal and State officials generally expressed apprehension and reluctance to accept the other's merger evaluation without an independent review. However, one FDIC regional official did not foresee any problems in completing merger reviews using State evaluations and field investigations. Similarly, some State authorities felt that Federal regulatory agencies are duplicative since the State analyzes merger applications first.

Some of the reasons for Federal and State agencies being reluctant to accept each other's merger evaluations are:

--Some States lack qualified personnel.

--Timing of review work is not concurrent.

--Federal and State policies differ.

--Both Federal and State agencies have approval responsibility, and independent reviews are good to see if common conclusions are reached.

We recognize that Federal and State regulatory agencies each independently have a responsibility for approving proposed mergers. At the present time there is no FDIC or FRS headquarters guidance or directions for coordinating the merger application review process with State regulatory agencies. We believe there should be greater effort to develop coordination between Federal and State regulators since they both review the same information and together could also reduce the time and effort involved in the merger review process. We believe Federal and State coordination of merger reviews could work similar to the cooperative bank examination programs FDIC and FRS now engage in with some State agencies. For example, FDIC has divided examination agreements with 20 State agencies including three that were covered in our review.

CONCLUSIONS

Although Federal bank regulators have taken some steps to streamline the merger application process, we believe that the process could be streamlined further. The lack of delegated approval authority by OCC for any type of merger and by FDIC for the simpler regular mergers has contributed to processing delays. Additional delays are built into the FDIC merger application process because the FDIC regional offices are required to send regular merger applications to FDIC Headquarters in Washington, D.C., for official acceptance and because some regional offices await the State's decision before starting an evaluation of merger applications.

The Federal bank regulators' merger application publication and comment periods result in very few comments being received. The Federal regulators have established varied methods of complying with the public notice provisions of the Bank Merger Act, and these methods are more extensive than for other applications. We believe, therefore, that shortening the publication and comment period and implementing other recommendations in this chapter would expedite the merger application approval process. Moreover, we believe that to end the comment period on the same day as the last publication, as is the FRS practice for merger applications, places an unnecessary burden on the applicant because it is unlikely that an interested party, with no prior knowledge of a proposed merger, would be able to file comments on the same day that they first became aware of the proposed merger. In this regard, we believe a more reasonable approach is FRS's requirement for BHC applications which provides that the applicant publish notice for only 2 weeks with comments due 30 days from the date of the first publication.

The Bank Merger Act requirement for the responsible Federal bank regulator to obtain competitive reports from the Attorney General and the other two Federal bank regulators on mergers has merit only for regular mergers. These reports are a needless exercise for phantom mergers and corporate reorganizations which have no effect on competition. For the same reason, the 30-day period for Attorney General antitrust actions is unnecessary for phantom mergers and corporate reorganizations.

The FDIC and several States have common phantom merger application forms, and both FDIC and Federal Reserve banks have cooperative bank examination agreements with some States. In addition, for some States there is an excellent exchange of information between Federal and State regulators. However, in other States, little or no Federal-State effort is made to coordinate merger application reviews.

RECOMMENDATIONS TO THE CONGRESS

We recommend that the Congress amend the Bank Merger Act to exempt phantom mergers and corporate reorganizations from competitive effects assessments. This would remove the requirement that the responsible agency obtain reports on a proposed merger's competitive aspects from the Attorney General and the other two bank regulatory agencies. We also recommend that these types of mergers be exempted from the 30-day period for Attorney General review prior to consummation.

We recommend that the Congress delete the publication and comment requirement for phantom mergers and corporate reorganizations and reduce the publication period for regular mergers to a period more consistent with that of other types of corporate change applications.

Should the recommendations we made in chapter 3 be adopted to provide an alternative to the phantom merger process, we would still recommend that the above changes be made so that any bank or BHC which still found it necessary to use the phantom merger process could do so in a more expeditious manner.

Appendix II contains suggested legislative language to achieve these recommendations.

RECOMMENDATIONS TO THE COMPTROLLER OF THE CURRENCY; CHAIRMAN, BOARD OF DIRECTORS, FDIC; AND CHAIRMAN, BOARD OF GOVERNORS, FRS

We recommend that:

--OCC and FDIC delegate responsibility to their regional offices for approving less complicated mergers.

--FDIC permit regional offices to officially accept all merger applications and immediately begin their processing.

--FRS and FDIC jointly work with State bank regulators to (1) coordinate the Federal-State review of merger applications and (2) develop common merger application forms.

AGENCY COMMENTS AND OUR EVALUATION

The comments that we received on our recommendations were generally favorable. With regard to our recommendation that FDIC and FRS work more closely with the State bank regulators, FRS stated that

> "The Reserve Banks are in contact with the State Banking regulators and cooperate with them in the processing of mergers."

and FDIC stated that

> "We feel that there is a very high level of coordination and data sharing occurring between the Corporation and State bank regulators * * *."

While our review only included 3 of the 12 Reserve banks and 4 of the 14 FDIC regions, we found limited evidence of meaningful cooperation with the cognizant State supervisors. There was little evidence that the Federal Reserve banks were attempting to develop a common merger application form with the States. FDIC has made some efforts to develop joint applications with States and has conducted some joint investigations with the State supervisors but has not worked with the States in interpreting the results of these investigations or in making the actual analysis of proposed mergers. On the basis of our discussions with Reserve bank and FDIC officials and State supervisors, little evidence was available to suggest that even telephone discussions were conducted concerning any substantive issues relating to the analysis of proposed mergers. In our view, at the three Reserve banks and the four FDIC regions that we visited, coordination with State supervisors could be improved.

The full texts of all comments received appear in appendixes III through VIII.

PREPARATORY ACTIONS AND SUPPORTING DOCUMENTATION REQUIRED BY OCC WHEN ISSUING A CHARTER FOR A PHANTOM BANK

Action	Supporting documentation required by OCC
Prepare Articles of Association to form phantom bank and certificate attesting to the formation.	Articles of Association and Organization Certificate.
Organizers of phantom bank meet to:	Minutes of meeting.
Approve Articles of Association and Organization Certificate.	
Elect interim board of directors to serve until first meeting of phantom bank shareholders.	List of interim directors.
Interim board of directors meet to:	Minutes of meeting.
Administer oath of office to directors.	Oaths of interim directors.
Adopt format for phantom bank stock certificate.	Sample stock certificate.
Adopt corporate seal.	
Designate a bank to act as a depository for proceeds from sale of phantom bank stock.	Copy of agreement with depository. Certificate from depository that capital funds were deposited to the credit of phantom bank.
Authorize application to Federal Reserve to subscribe to Federal Reserve stock.	Advice from Federal Reserve of purchase of stock.
Adopt by-laws of phantom bank.	By-Laws.
Authorize purchase of fidelity insurance.	Confirmation of insurance coverage.
Approve organizational expenses incurred to date.	
Interim directors accept subscriptions to phantom bank stock.	Certificate that each shareholder has paid his subscription in full.

Action	Supporting documentation required by OCC
Prepare and issue notice of shareholder meeting, proxy statements, and proxies.	Copies of notice of shareholder meeting, proxy statement, and proxy. Affidavit of publication of shareholder meeting.
Shareholders meet to: Elect board of directors to serve until merger of phantom and target banks consummated. Ratify all acts, contracts and proceedings of interim directors and organizers. Approve all incurred and anticipated organizational expenses.	Minutes of meeting. List of directors.
Vote on proposed merger between phantom and target bank.	Affidavit of shareholders' vote.
Board of directors meet to: Administer oath of office to directors. Ratify by-laws of phantom bank.	Minutes of meeting. Oaths of directors.
Prepare list of shareholders showing name, address, and number of shares owned.	List of shareholders.
Prepare detail list of disbursements from capital funds of phantom bank.	List of disbursements.

PROPOSED LEGISLATION

A. GAO Proposal to Amend the Bank Holding Company Act to Provide for More Direct Processing of Phantom Mergers

Section 3 of the Bank Holding Company Act, as amended (12 U.S.C. 1842), is further amended by adding at the end thereof the following new subsection:

"Special Acquisitions"

"(e)(1) The Board, subject to the affirmative vote of the shareholders of a national banking association owning at least two-thirds of its capital stock outstanding, may approve the acquisition of such association as a subsidiary of a bank holding company or a company that will, upon consummation of such acquisition, become a bank holding company.

"(i) Together with the appropriate application, a plan of acquisition, specifying the manner in which the acquisition shall be carried out, shall be submitted to the Board for approval under subsection (b) of this section. Such plan must be agreed upon in writing by a majority of the board of directors of the association. Such plan shall specify the amount of stock of the bank holding company to be allocated, and the amount of cash or other consideration (if any), to be paid to the shareholders of the association to be acquired. Such plan shall specify the dates as of which shareholders entitled to participate in such exchange shall be determined, and the manner in which the exchange shall be carried out.

"(ii) The plan of acquisition shall be submitted to the shareholders of the association to be acquired at a meeting to be held on the call of the directors, after publishing notice of the time, place, and object of the meeting for four consecutive weeks in a newspaper of general circulation published in a place where the association is located, or, if there is no such newspaper, then in the newspaper of general circulation published nearest thereto, and after sending such notice to each shareholder of record by certified or registered mail at least ten days prior to the meeting, except to those shareholders who specifically waive notice. Publication of notice may be waived, in cases where the Board determines that an emergency exists justifying such waiver, by unanimous action of the shareholders of the association.

"(B)(i) If an acquisition shall be voted for at the called meeting by the shareholders of such association owning at least two-thirds of the capital stock outstanding of such association, and thereafter the acquisition shall be approved by the Board, any shareholder of such association who has voted against such acquisition at the meeting or has given notice in writing at or prior to such meeting to the presiding officer that he dissents from the plan of acquisition, shall be entitled to receive the value of the shares so held by him when the acquisition shall be approved by the Board upon written request made to the association at any time before thirty days after the date of consummation of the acquisition, accompanied by the surrender of his stock certificates.

"(ii) The value of the shares of any dissenting shareholder shall be ascertained, as of the effective date of the acquisition, by an appraisal made by a committee of three persons, composed of (a) one selected by the vote of the holders of the majority of stock, the owners of which are entitled to payment in cash, by reason of their exercise of rights under this paragraph; (b) one selected by the directors of the acquiring bank holding company; and (c) one selected by the two so selected. The value agreed upon by any two of the three appraisers shall govern. If the value so fixed shall not be satisfactory to any dissenting shareholder who has requested payment, that shareholder may, within five days after being notified of the appraised value of his shares, appeal to the Board, which shall cause a reappraisal to be made which shall be final and binding as to the value of the shares of the appellant.

"(iii) If, within ninety days after the date of consummation of the acquisition, for any reason one or more of the appraisers is not selected as herein provided, or the appraisers fail to determine the value of such shares, the Board shall upon written request of any interested party cause an appraisal to be made which shall be final and binding on all parties. The expense of the Board in making the reappraisal or the appraisal, as the case may be, shall be paid by the acquiring bank holding company. The value of the shares ascertained shall be promptly paid to the dissenting shareholder by the acquiring bank holding company, and the shares of stock of the dissenting shareholder receiving such payment shall be transferred to the acquiring bank holding company or otherwise disposed of as provided by the plan of acquisition.

"(C) The corporate existence of a national banking association which becomes a subsidiary of a bank holding company as a result of an acquisition under this subsection shall not be deemed to have been affected in any way by reason of such acquisition, and such association shall continue as an insured bank subject to the provisions of the Federal Deposit Insurance Act."

"(e)(2)(A) A corporation which is or will become a bank holding company which, together with an existing State bank, adopts a plan of acquisition pursuant to State law providing for acquisition of all the bank's stock by the corporation in exchange for stock or securities of the corporation upon approval by the requisite majority of the bank's shareholders, shall submit a plan of acquisition to the Board for approval under subsection (b) of this section.

"(B) Prior to approval by the Board of any plan referred to in paragraph (A), such plan shall comply with the requirements of paragraph (e)(1)(A)(i) of this section and applicable provisions of State law, including requirements for notice to bank shareholders, approval by board of directors and shareholders, and rights of dissenting shareholders.

"(e)(3)(A) Any plan of acquisition authorized under this subsection shall comply with all applicable Federal securities laws regarding the offer and issue of stock or other securities pursuant to such plan of acquisition."

"(B) An acquisition approved under this subsection shall qualify as a reorganization under section 368(a)(1)(A) of the Internal Revenue Code notwithstanding the fact that the shareholders of a banking association acquired by a company already owning one or more subsidiary banks are not in control of the acquiring company after the acquisition is consummated."

"(e)(4) Approval of a plan of acquisition filed under this section shall not be required under paragraphs (1) or (2) of section 18(c) of the Federal Deposit Insurance Act [12 U.S.C. §1828(c)(1) and (2)] or be subject to any other requirement or condition of that section."

B. Amendment of the Bank Merger Act to: Reduce Publication and Comment Requirement; Provide that the Regulatory Agencies Consider Competing Nonbank Financial Institutions in Evaluating the Competitive Effects of a Bank Merger; Exempt Proposed Acquisition Transactions Under the Bank Holding Company Act from the Requirements of the Bank Merger Act; and Exempt Phantom Mergers and Corporate Reorganizations from the Competitive Reports Requirement, the Merger Application Publication and Comment Requirement and the 30-day Attorney General Review Requirement

Section 18(c) of the Federal Deposit Insurance Act, 12 U.S.C. §1828(c), is amended 1/ by changing subsection (3)(c) to read as follows:

"(C) at appropriate intervals during a fourteen day period beginning from the date on which notice of the proposed transaction is received by the responsible agency, and "

1/This amendment would reduce the publication and comment requirement for regular mergers to a period more consistent with that for other types of corporate change application.

Section 18(c) of the Act is further amended 1/ by changing the sentence immediately following subsection (5)(B) to read as follows:

> "In every case, the responsible agency shall take into consideration the financial and managerial resources and future prospects of the existing and proposed institutions, and the convenience and needs of the community. To the extent practicable and within available data limitations, such consideration should also include the effects of nonbank financial institutions competing in the market to be served."

Section 18(c) of the Act is further amended 2/ by changing subsection (11) to read as follows:

> "(11) The provisions of this subsection do not apply to any merger transaction involving a foreign bank if no party to the transaction is principally engaged in business in the United States, or to a transaction involving a plan of acquisition filed under section 3(e) of the Bank Holding Company Act, as amended [12 U.S.C. §1842(e)]."

Section 18(c) of the Act is further amended 3/ by adding at the end thereof the following new paragraphs:

1/This amendment would provide authority for the financial institutions regulatory agencies to consider competing nonbank financial institutions in evaluating the competitive effects of a bank merger.

2/This would exempt transactions carried out under the Bank Holding Company Act, as amended by the GAO proposal, from the requirements of the Bank Merger Act.

3/This amendment would exempt phantom mergers and corporate reorganizations from the competitive reports requirement, the merger application publication and comment requirement, the 30-day Attorney General review requirement, and the requirement for a description of each merger in the annual agency report to Congress. The amendment also makes phantom mergers and corporate reorganizations subject to antitrust challenges to which they would be subject if the 30-day Attorney General review requirement were retained.

"(12) The requirements of paragraphs (3), (4), (6), and (9) shall not apply to a 'phantom' or 'interim merger' or a 'corporate reorganization.'

"(13) For purposes of paragraph (12)

"(A) 'phantom' or 'interim' merger means

"(i) an acquisition transaction in which a bank holding company, or an organization that will become a bank holding company, desiring to acquire all the stock of an independently owned bank causes the organization of a new bank which merges into the existing bank or into which the existing bank merges, by the exchange of the stock of the existing bank (at least two-thirds where the existing bank is a national banking association) for stock of the bank holding company, and where the resulting bank becomes a subsidiary of the bank holding company; or

"(ii) a formation transaction in which an existing bank converts itself into a bank holding company by causing a bank holding company to be created, together with the formation of a new subsidiary bank which merges into the existing bank or, into which the existing bank merges, by the exchange of the stock of the existing bank (at least two-thirds where the existing bank is a national banking association) for stock of the bank holding company, and where the resulting bank becomes a subsidiary of the bank holding company.

"(14) Notwithstanding the provisions of paragraph (12), a 'phantom' or 'interim merger' or 'corporate reorganization' is subject to the antitrust laws upon consummation, and is thereafter subject to attack in any judicial proceeding on the ground that it alone and of itself constitutes a violation of such antitrust laws."

U.S. Department of Justice

MAR 2 9 1982

Washington, D.C. 20530

Mr. William J. Anderson
Director
General Government Division
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Anderson:

This will respond to your letter of February 24, 1982, enclosing for our review and comment a draft report entitled "Bank Merger Process Should be Modernized and Simplified." As stated in your letter, the review was conducted primarily at the Office of the Comptroller of the Currency (OCC), the Federal Reserve System (FRS), and the Federal Deposit Insurance Corporation (FDIC).

As we understand from your letter, the views of the Department of Justice (Department) are being requested because of our interest in assuring that bank mergers do not have an anticompetitive effect. We have carefully reviewed the draft report from that perspective and offer the following comments regarding the substance of the draft report and its recommendations.

1. We agree that "phantom mergers" and pure corporate reorganizations should be removed from the advisory reporting requirements of the Bank Merger Act and that the 30-day post-approval waiting period before consummating a phantom merger or corporate reorganization is unnecessary.

In fiscal year 1981, the Department reviewed 276 phantom mergers. Thus far in fiscal year 1982 (through March 9), we have been asked to review 220 such mergers. The volume of these phantom mergers, as well as of corporate reorganizations, has been increasing substantially. Since these transactions have no effect on competition, we believe the reporting requirement can and should be eliminated, thereby permitting the Department to concentrate its resources on more significant matters.

We also agree that the 30-day waiting period prior to consummation which usually attaches to bank mergers is not necessary for phantom mergers and corporate reorganizations. Since a phantom merger involves a shell corporation merging with an operating institution, there is no competitive effect on which the Department would act and no useful social goal to be accomplished by the 30-day delay.

However, since under the General Accounting Office's (GAO) proposal there would be no 30-day delay, we believe no immunity from Section 7 of the

Clayton Act should attach to these transactions.[1] Since these mergers have no competitive effect, no excuse for immunity attaches. By the same token, should someone attempt to use the phantom merger or corporate reorganization mechanism "creatively" to shield a transaction properly actionable as a violation of Section 7, the Department would be free to act.

2. We agree with the draft report that regulators should use similar standards in evaluating the competitive effects of bank mergers.

The draft report has identified a major problem that permeates the bank merger process. Each of the banking agencies evaluates bank mergers differently despite the Congress' intent that uniform standards apply. Indeed, despite the fact that the Bank Merger Act and the Bank Holding Company Act specifically incorporate the statutory language of Secton 7 of the Clayton Act, the draft report finds, among other things, that ". . . Federal bank regulators lack uniformity in their application of the line of commerce and potential competition concepts" (p. 10):

--OCC generally accepts the relevant geographic market delineations proposed by the merging banks, relying in the main on service areas to define whether they are competing (p. 15).

--FRS uses predetermined geographic markets, amended for changes in economic conditions (p. 14).

--FDIC appears to use a market analysis which looks first to competition within a 15-mile radius of the acquired bank's offices and then to the factors presented by each particular merger (p. 14).

The draft report makes a number of recommendations based upon the aforementioned findings. First, it suggests that "commercial banking" as a line of commerce has outlived its usefulness and that more sophisticated analysis is required. For example, the draft report notes that the regulators do not uniformly consider thrifts in their analysis (p. 23). To remedy this, the draft report recommends that the Congress instruct the agencies as to which nonbank financial institutions they should consider.

We disagree with the above recommendation. Obviously, the financial services industries are undergoing a competitive revolution. Commercial banks are facing new competition and new innovation on an ever changing basis. While we believe the bank regulators should take account of the commercial realities and should revise their line of commerce analysis, the Department does not

---

[1]The Bank Merger Act provides that, in the event a Section 7 suit is not filed within 30 days after a merger is approved by the regulator, the merger is thereafter immune from attack under Section 7.

believe that the Congress should designate which institutions the agencies should consider as competitors of banks. Any such list would be reflective of the moment, and could become obsolete rapidly. The proposed list thus would present no practical long-run solution and, once in place, would itself become a rigid constraint.

The draft report also recommends that the bank regulators, through the Federal Financial Institutions Examination Council, develop uniform standards and principles for relevant market definitions to be used in examining competitive effects of a merger. Of course, this recommendation assumes that the agencies will now be able to do what they have been unable to accomplish in the past. Moreover, if implemented the recommendation may lead to compromise but not necessarily to correct analysis. Under the present system, a more practical recommendation might be for the regulators to work together with the Department in reaching a useful method of analysis.

The draft report has pointed to a fundamental problem in this Federal regulatory scheme: multiple agencies each reviewing the same type of transaction and each applying the same statutory standard in "splendid isolation"--a most unfortunate result, especially for the members of the industry regulated in this manner. This problem assumes even greater magnitude when one focuses on the fact that the competitive scheme to be applied is fundamentally the standard established by the antitrust laws. Thus, the recommendations set forth in the draft report seem more attuned to preserving a merger regulatory scheme that appears to be essentially unworkable.

Given this fact, it might be fruitful to consider whether the competitive review responsibilities of the regulators should be eliminated or at least cut back. While we take no position on the issue at this time, we note that the draft report has documented an increasingly inefficient system which holds no promise of gettng better. Permitting the antitrust laws to apply freely in banking as they do in other industries would also appear a more cost-effective scenario given the costs of regulation.

The draft report also recommends that the regulators properly consider advisory comments they receive and reconsider their own analysis in light of conflicting conclusions by the other regulators and the Department. The Department wholeheartedly concurs in this recommendation. The present system is particularly frustrating when agencies openly disregard recommendations submitted by coordinate agencies and by the Department and fail to disclose any reason for doing so in their opinions approving or disapproving particular mergers. Moreover, the draft report mentioned that in several situations the OCC has issued no opinion explaining its action. Applicants and the public are both entitled to know the basis for regulatory action.

In summary, we congratulate the GAO for preparing an excellent report. The recommendations contained in the report may lead to a significant reduction in the regulatory burden imposed upon the banking industry.[2] At the very least, they are certain to spark further debate.

---

[2]We have not as yet reviewed the specific statutory language appended to the draft report. We therefore take no position on whether those prov ions as written would be acceptable to the Department.

APPENDIX III

We appreciate the opportunity to comment on the draft report. Should you desire any additional information pertaining to our response, please feel free to contact me.

Sincerely,

Kevin D. Rooney

Kevin D. Rooney
Assistant Attorney General
for Administration

Comptroller of the Currency
Administrator of National Banks

Washington, D.C. 20219

March 26, 1982

Mr. William J. Anderson
Director
General Government Division
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Anderson:

We appreciate the opportunity to comment on your February 24, 1982 draft of a proposed GAO report entitled "Bank Merger Process Should be Modernized and Simplified." We fully support many of the specific recommendations in the report. Our major disagreement concerns the necessity, practicality or even the desirability of seeking uniformity at this time in certain technical aspects of merger analysis through new legislation or inter-agency agreement on standards and principles.

In the draft report GAO recommends that Congress amend the Bank Merger Act and the Bank Holding Company Act to simplify the processing of interim bank (phantom) mergers and corporate reorganizations. We strongly endorse those recommendations as moves to deregulate a process which we believe should be a matter of business judgment on the part of the bank. We suggest that you consider going even further in your recommendation to Congress. In our view this type of corporate reorganization should be removed entirely from the purview of the Bank Merger Act and thus require no regulatory approval.

The draft report suggests that Congress should consider amending the Bank Merger Act to provide guidance on what kinds of nonbank financial institutions should be considered in evaluating the competitive effects of a proposed bank merger. We believe that such guidance is unnecessary. The different agencies, including the Department of Justice, are quite mindful of the changing structure of the financial services industry and have adjusted their analyses to reflect the growing importance of nonbank financial institutions. Given the rapid changes occurring in the financial services industry--as a result of statutory or

Mr. William J. Anderson
Page 2

regulatory changes and market innovations--it would be unrealistic, and perhaps counterproductive, to attempt to establish firm standards in law. The pace of change is unlikely to abate, and any statutory standards could easily become out-of-date or unduly restrictive in a short period of time.

The draft report also recommends that the Federal Financial Institutions Examination Council play a lead role in developing more uniform principles and standards for the bank regulatory agencies to use in defining the relevant geographic market in merger cases and in considering the probable effect of a proposed merger on future competition. We wholeheartedly agree with GAO that uniformity among the agencies is a desirable goal, however, we disagree with the basic recommendation that the Council play the lead role in developing that uniformity. We feel this would be ineffective in accomplishing the goal.

Differences in the agencies' approaches reflect legitimate differences in interpretations, analysis, or points of view -- differences which exist among scholars and practitioners outside the agencies as well and which are the subjects of lively debate. It would be difficult, perhaps impossible, to achieve agreement among all parties on a single best approach. For example, this Office strongly believes in the correctness of our approach to market definition and analysis of potential or future competition. When challenged, we have successfully defended our views in court.

Basic to the entire question of differences, however, is the need to study the possibility of granting U.S. banks blanket authority to merge without seeking prior approval from <u>any</u> bank regulatory agency. However, should prior approval be retained, regulatory uniformity can be realized best by focusing responsibility for mergers in a single bank regulatory agency rather than the present three. The issue broadens, then, to include the need to re-examine the entire regulatory structure, with an even broader goal of rationalizing the present system under which U.S. financial institutions now operate. With this in mind, we offer these remaining comments on GAO's draft report.

We wish to rectify an apparent misunderstanding in the draft report concerning the OCC's approach to delineating relevant markets. The draft report states that the OCC generally accepts the relevant market delineations proposed by the banks. This Office uses a service area concept in delineating the relevant market and our approach is clearly communicated to all potential merger applicants in prefiling meetings. Thus, rather than the

Mr. William J. Anderson
Page 3

Office simply accepting the market area proposed by the applicant, as is stated in the draft report, quite the contrary is true: the applicants' market delineation is acceptable to the Office because it is based on OCC guidance.

The draft report further states that the OCC evaluates the competitive effects of each merger on a case-by-case basis and proposes no set standard for determining whether anticompetitive effects will result from the merger. This is true to the extent that the Office has not established quantitative guidelines based on mechanical, structural measures. We believe that such measures do not and cannot reflect the particular facts of each and every case, and a case-by-case approach is more reasonable, especially for the more complex and difficult proposals. As stated more generally above, we take into account the developing merger case law and attempt to communicate our views on competitive effects to prospective applicants. This is not to deny, however, that guidelines, properly qualified, may be useful.

The draft report recommends that the federal bank regulatory agencies take steps to ensure that competitive factor reports are furnished to the requesting agency within the required 30 days and that the requesting agency "properly considers the comments received and reconciles major conflicting conclusions." In the face of increasing workload and continuing staff reduction, provision of advisory opinions by this Office in a timely manner is becoming an increasingly difficult administrative burden. Given the previously described checks and balances afforded by the Department of Justice and the courts, we would suggest that the GAO consider recommending to Congress that the requirement for advisory opinions be eliminated from the law, thereby leaving each agency responsible for processing mergers within its jurisdiction subject only to the overview of the Department of Justice and the courts.

Finally, the draft report recommends that this Office delegate responsibility to its regional offices for approving less complicated mergers. We have embarked on an extensive zero-based review of all our corporate practices and procedures, including mergers, as well as the issue of how and where the decisions are made. Without prejudging the findings of this study, it seems likely that one of its conclusions will be a plan for implementing the type of delegation which your draft report has suggested.

Several minor technical questions and matters have been discussed directly by staff of this Office with Mr. Douglas Nosik of your staff. We are pleased to have been able to handle these matters

 APPENDIX IV

Mr. William J. Anderson
Page 4

in that less formal but highly effective manner and believe that they have been resolved to our mutual satisfaction. We, of course, would be willing to elaborate on any of our comments with you or your staff.

Sincerely,

C. T. Conover

C. T. Conover
Comptroller of the Currency

APPENDIX V

FDIC

FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, D.C. 20429

OFFICE OF DIRECTOR - DIVISION OF BANK SUPERVISION

March 26, 1982

Mr. William J. Anderson
Director, General Government Division
United States General Accounting Office
Washington, D. C. 20548

Dear Mr. Anderson:

Chairman Isaac has asked me to comment on the GAO draft report ("Report") entitled "Bank Merger Process Should Be Modernized And Simplified." We appreciate this opportunity to offer comments on the draft and will confine our remarks to the more substantive issues, inasmuch as the technical aspects are being addressed separately.

Uniform Standards Needed for Evaluating Competitive Aspects of Proposed Mergers

The question of whether and to what extent nonbank financial institutions should be included in the competitive analysis in bank mergers has been and is under consideration at FDIC. The matter is currently treated on a case-by-case basis, and there have been several recent cases in which the Corporation did include nonbank financial institutions in the analysis of the competitive effects. On the other hand, in cases where there is clearly no competitive problem whatever, it seems pointless and not very fruitful to pursue an analysis beyond a demonstration of the lack of anticompetitive effects.

It is noted that in several of the cases in which the Supreme Court addressed the line of commerce issue, it did allow for recognition of "commercial realities" at some future time. We agree with the Report that distinctions between and among financial institutions may be fast eroding, and that significant changes in the industry are continuing. FDIC and the other agencies, however, are capable of recognizing the commercial realities of the marketplace and adapting their policies and making appropriate changes in the analysis.

Accordingly, we would not favor the formal incorporation in the statute of specific types of financial institutions to be considered in a competitive analysis. To do so may reduce the flexibility of the agencies to adapt to future changes.

As to the question of gaining access to data on nonbank financial institutions which are not supervised by any of the federal agencies, we would support exploring options which would not create undue burdens on these institutions.

With respect to the recommendation that the Federal Financial Institutions Examination Council formulate principles and standards concerning potential competition, we believe this is unnecessary and that in any event the Council is not the appropriate forum for such considerations. We believe that the

APPENDIX V

courts have indeed given guidance on this matter over the years. The Report notes that the Justice Department has litigated 12 potential competition cases and has lost them all. Moreover, there is a recent Texas acquisition case where the applicant successfully sued after being denied approval, which provides additional guidance.

The recommendation that the Council work with the three agencies to establish more uniform standards for defining the relevant market when evaluating the competitive aspects of proposed mergers also seems to be unnecessary and does not have much productive promise. As the Report correctly states, "Delineation of the relevant geographic market for antitrust purposes can seldom be precise and in many cases remains one of the most difficult determinations facing a regulatory agency in analyzing bank merger cases." The three banking agencies (and the Justice Department) have been exchanging competitive reports for well over 20 years, and each agency is well aware of the methodology used by the others. In spite of occasional differences, the system seems to work reasonably well given the nebulous nature of the concepts involved in market delineation.

The Report refers to 26 cases where regulators differed significantly in their assessment of the competitive effects. This means that in the remaining 183 cases (88 percent) analyzed, the regulators had no significant differences in their assessment of the competitive effects.

Establishing uniform standards for delineation of relevant markets is an elusive goal and may well be an illusory one. All three agencies, the Justice Department, the courts, applicant banks, bank consultants, various economists and others have engaged in varying degrees in market analysis over many years, and no clearly superior method or system has yet surfaced which would be endorsed by all (or even most) concerned.

Even when the agencies are uniform as to market delineation and conclusion, the final outcome is not always assured. One example of this concerns a 1978 case which the FDIC denied on anticompetitive grounds. Both of the other agencies and the Department of Justice rendered opinions which concluded that the merger would have substantially or significantly adverse effects on competition, and all used essentially the same market. The applicant produced a study by a university economist concluding that the banks operated in different markets, and thus were not direct competitors. The applicant filed suit against the FDIC, and the District Court used the applicant's market and ruled in its favor.

We concur in the recommendation that the agencies take steps to insure that competitive factor reports are furnished to the requesting agency within the required 30 days, and we are in the process of overhauling procedures for dealing with these reports in a timely manner. We fully expect a significant improvement in this area.

FDIC as the requesting agency does fully consider the comments in the competitive factor reports furnished by the other agencies. Copies of those reports are included in the material distributed to the Board of Review members on each case. Any significant differences between those reports and our conclusions are fully explained in the written case and/or orally at the Board of Review meeting.

Mr. William J. Anderson -3-

A More Direct Approach to the Phantom Bank Merger Process will Result in Savings to Banks and Federal Regulators

We fully agree with the proposition that the present requirements for the treatment of phantom bank mergers are unnecessary, costly and burdensome and should be eliminated.

The Merger Application Process Should be Streamlined

The Report recommended that FDIC delegate approval responsibility to the Regional Offices for the less complicated mergers. This possibility has been under consideration for some time, and specific criteria for defining "less complicated" are being formulated with a view toward early implementation of some form of delegation from the Board of Directors.

The Report recommended that FDIC permit Regional Offices to officially accept all merger applications and immediately begin their processing. This change in procedure was implemented on February 8, 1982.

The Report recommended that FDIC jointly work with State bank regulators to (1) coordinate the Federal-State review of merger applications and (2) develop common merger application forms. The Report correctly points out that FDIC has instituted a common forms program which includes phantom merger application forms, and that the Corporation is willing to adjust the forms to suit State needs and print and supply forms to States free of charge. This arrangement would also extend to regular merger forms if any state so desired.

The Corporation has historically cooperated with state regulatory authorities, and will continue to cooperate with state banking departments whenever and wherever possible. For example, in some states the field investigation of merger applications is conducted concurrently with a state examiner. We feel that there is a very high level of coordination and data sharing occurring between the Corporation and state bank regulators and, as previously stated in response to another GAO report, we stand ready to provide additional assistance and information if the need should arise.

General Comments

By implication, this Report raises further questions about other aspects of the Bank Merger Act and the consideration of mergers in the financial institutions industry in general. For example, should Bank Merger Act criteria be applied to mergers of savings and loan associations and other nonbank financial institutions? There are a number of legislative proposals currently in the Congress concerning financial institutions industry changes, and the scope of the Report is confined to banks only.

Finally, we would like to express our appreciation for the courteous and professional demeanor of your staff during the course of the study.

Sincerely,

Quinton Thompson

Quinton Thompson
Director

APPENDIX VI

Federal Financial Institutions **Examination Council**, Washington, D.C. 20219

April 2, 1982

Mr. William J. Anderson
Director
United States General
  Accounting Office
Washington, DC 20548

Dear Mr. Anderson:

On behalf of the Examination Council, I am pleased to respond to the recommendations to the Council in the General Accounting Office's Draft Report, "Bank Merger Process Should Be Modernized and Simplified."

In the report, two recommendations are made to the Council. First, the Council should prescribe principles and standards for the three banking agencies to use in considering what would likely be the effect of a proposed merger on future competition in the service area of a bank being acquired. Second, the Council should work with the three banking agencies to establish more uniform standards for defining the relevant geographic market when evaluating the competitive effects of proposed mergers.

Based upon the legislative history of Title X of the Financial Institutions Regulatory and Interest Rate Control Act of 1978, the Council believes that Congress did not intend to authorize the Council to consider matters relating to the application process under the Bank Merger Act. The consideration of matters relating to probable future competition and the relevant geographic market clearly are not encompassed by the phrase "uniform principles and standards" within the meaning of section 1006(a) of the statute. In addition, it is the Council's judgment that such subjects also are not "supervisory matters" within the meaning of section 1006(b) of the statute. This judgment is based upon its reading of the legislative history of this section which suggests that the purpose of the Council appears limited to the examination and supervisory process, narrowly defined. Strong evidence for this view is provided by the examples of supervisory matters enumerated in section 1006(b), that is, "classifying loans subject to country risk, identifying financial institutions in need of special supervisory attention, and evaluating the soundness of large loans that are shared by two or more financial institutions". Other references in this section to discovering possible fraud or questionable and illegal payments further support this conclusion.

Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Federal Home Loan Bank Board,
National Credit Union Administration, Office of the Comptroller of the Currency

APPENDIX VI

Enclosed is a copy of a memorandum prepared by the Staff Legal Advisory Group that supports in greater detail the conclusions stated above.

We appreciate the opportunity afforded us to comment on the draft report.

Sincerely,

Robert J. Lawrence

Robert J. Lawrence
Executive Secretary

Enclosure

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

April 1, 1982

Mr. William J. Anderson
Director
General Government Division
United States General
Accounting Office
Washington, D.C. 20548

Dear Mr. Anderson:

The Board appreciates the opportunity to respond to the GAO draft report entitled "Bank Merger Process Should Be Modernized And Simplified". The report reviews the regulatory procedures associated with bank merger applications and makes various recommendations to Congress, to the Federal Financial Institutions Examination Council, and to the Federal banking agencies.

The GAO report recommends various actions in the bank merger area that will lessen the burden on both applicants and the regulatory agencies. The GAO proposes the elimination of the filing of a merger application involving a phantom bank. In any event, the GAO recommends that phantom bank mergers and mergers involving subsidiaries of the same bank holding company be exempt from publication notices and the 30-day waiting period after approval of the merger, both of which are required by the Bank Merger Act. In addition, the GAO recommends that competitive factor reports required from the Attorney General and Federal Banking agencies be eliminated for phantom mergers and mergers of the subsidiaries of the same bank holding company.1/ As regards regular mergers, the GAO proposes that the publication notice required by the Bank Merger Act be cut to two notices over a two week period. Phantom bank mergers

---

1/ In line with this recommendation, it is suggested that consideration be given to an amendment to the Bank Merger Act dispensing with the statutory requirement that competitive factor reports on any merger be furnished. Instead, the Bank Merger Act could provide that the Attorney General and Federal banking agencies be notified of all proposed mergers and be invited to comment on the competitive factors involved if they so desire. Many of the regular mergers involve no adverse competitive effects, and thus competitive comments from the Attorney General and Federal banking agencies could be directed to the more significant competitive cases.

Mr. Anderson -2-

and mergers of subsidiaries of the same bank holding company have, within themselves, no competitive effects. In view of this and since all the recommendations mentioned above would significantly decrease the burden on applicants and the bank regulatory agencies without harmful effects, the Board concurs with these GAO proposals.

The GAO recommends that Congress consider amending the Bank Merger Act to clarify the extent to which Federal agencies should consider competing nonbank financial institutions in evaluating the competitive effects of a bank merger. Present law already gives the Federal agencies the authority to consider the impact of nonbank institutions in evaluating the competitive effects of a bank merger, and the Board has used this authority. The Board believes it appropriate to consider the impact of thrift institutions in its competitive analysis of bank acquisitions. It should be emphasized, however , that the degree of competition provided to banks by nonbank institutions, and any implied change in the line of commerce used to analyze bank mergers, is an empirical question. Accordingly, the Board would caution against any legislation that might impair the flexibility that the agencies need to take into account the evolution of competition in the market for bank-type services.

The GAO recommends that the Federal Financial Institutions Examination Council prescribe principles and standards for the Federal bank regulatory agencies to use in considering what probable effect a proposed merger would have on future competition in the service area of the bank being acquired. The Board recently issued for public comment a policy statement setting forth proposed guidelines for analyzing the impact of market extension proposals on future competition. It is hoped the guidelines might form a basis for more uniformity among the agencies in this regard.

The GAO notes the inconsistency among the bank regulatory agencies in defining the relevant market when evaluating the competitive aspects of proposed mergers. Defining a relevant market is one of the most difficult steps in evaluating the competitive aspects of proposed mergers. Board Staff has devoted considerable time in attempting to define banking markets and appreciates the inconsistencies that come about when the agencies differ as to a relevant market in a specific case. The Board is most willing to work with other agencies to establish uniform standards for defining markets when evaluating the competitive aspects of proposed mergers.

Mr. Anderson -3-

The GAO report suggests that the Federal banking agencies make every effort to submit competitive factor reports within the 30-day time limit and that the reports receive careful consideration. The Board has always attempted to furnish competitive factor reports within the time limit and has delegated this function to the Reserve Banks in a further effort to save time. The other agency reports are carefully reviewed during the processing of a merger application. It is noted that if competitive factor reports were to be prepared on a selective basis, such reports would be of more significance to the requesting agency.

The GAO also suggests that the Federal Banking agencies work closely with the State banking regulators in processing mergers. The Reserve Banks are in contact with the State Banking regulators and cooperate with them in the processing of mergers. It should be noted, however, that 32 of the 43 merger applications processed in the Federal Reserve System in 1981 involved phantom bank mergers or mergers of subsidiaries of the same bank holding company which required little coordination among the agencies. The Board's bank merger form is designed to be responsive to the Federal Bank Merger Act, and the form, is, of course, available for use by any State regulator.

The Board generally welcomes flexibility to simplify and reduce regulatory and reporting burden consistent with its statutory responsibilities for compliance and safety and soundness. The Board, therefore, generally concurs with the GAO proposals in the Draft Report.

Sincerely yours,

William W. Wiles

William W. Wiles
Secretary

(233067)

*U.S. GOVERNMENT PRINTING OFFICE : 1982 0-361-843/2184

22785