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Banking Acquisition and Merger Procedures

M. Maureen Murphy
Legislative Attorney
American Law Division

Summary

This report discusses in general terms the basic process and time line for banking industry acquisitions and mergers and briefly discusses the May 4, 1998 application by Travelers Group to merge with Citicorp. When banking concerns, such as NationsBank and BankAmerica, announce plans to merge, they begin a process that involves applications under various federal statutes that must be approved by the Federal Reserve Board, by the primary federal regulator of the banking institutions involved, and by the state banking authorities in states in which the banks are chartered. The review includes public notice and opportunity for comment. In the course of the review, an assessment will be made of the companies' management, safety and soundness, capitalization, Community Reinvestment Act record, as well as the potential impact of the transaction on competition. Approval may not occur if a monopoly would result or if competition would be substantially lessened unless the anticompetitive effects are found to be outweighed by community convenience and needs.

The structural and procedural components for affiliation among financial services companies and activities are the subject of H.R. 10, the Financial Services Act of 1998, which was passed by the House on May 13, 1998. That legislation would rewrite the rules for affiliations in the financial services industry. It would, thus, directly affect the procedures that are discussed in this report that will govern current acquisitions and mergers. At an April 29, 1998, hearing, the House Banking Committee heard testimony on the mergers within the context of the financial modernization debate. Among the issues discussed were: potential impact on consumers; whether the new entities would be too big to fail; and, whether competitive equity calls for financial modernization legislation with functional regulation of the securities, banking, and insurance sectors of companies offering customers a full range of financial products and services. Legislative developments on financial modernization issues in the 105th Congress are reported in CRS Issue Brief 97034, which is available on the Legislative Information System [http://www.congress.gov].

Approvals Required

Proposals by banks or companies that own banks, bank holding companies, to merge with one another, to form a new bank holding company, or to acquire further banks or nonbanking interests require approval by the primary federal banking regulator of the institutions involved; any state regulator of any state-chartered banks involved; state insurance regulators if there is to be acquisition of insurance interests; and, the Securities and Exchange Commission if the transaction involves acquisition or exchange of stock. The primary federal regulators are: Comptroller of the Currency (OCC), national banks; Federal Reserve Board (Fed or Board), bank holding companies and state-chartered banks that are members of the Federal Reserve System; the Federal Deposit Insurance Corporation (FDIC), state-chartered non-member banks; and the Office of Thrift Supervision, federally insured thrifts and savings associations. The Department of Justice is consulted by the banking agencies and has the authority to initiate a suit before any approval may be implemented. Mergers involving the creation of a new bank holding company or the exchange of bank stock require stockholder approval and, thus, involve the Securities and Exchange Commission.

Applicable Banking Laws

The Bank Merger Act, 12 U.S.C. § 1828(c), applies to mergers of federally insured depository institutions. When two or more banks merge, the approval of the primary regulator of the acquiring bank is required. Under section 343 of the Riegle-Neal Community Development and Regulatory Improvement Act, Pub. L. 193-325, 108 *Stat.* 2160, there is a one-year time limit for agency approval. When individuals seek to acquire control of a bank, the Change in Bank Control Act, 12 U.S.C. § 1817(j), applies, requiring the bank's primary regulator to assess the suitability of the individual and to make a decision within 180 days (with extensions, including one which may be needed for the agency to determine that no acquiring party has failed to comply with the anti-money laundering requirements of the Currency and Foreign Transaction Reporting Act, 31 U.S.C. § 5301 -5322).

Corporate acquisitions of banks, bank holding company mergers, and the formation of new bank holding companies are governed by the Bank Holding Company Act (BHCA), 12 U.S.C. § § 1841 - 1850. Section 3 of the BHCA governs the acquisition of banks by bank holding companies and the merging of bank holding companies. 12 U.S.C. § 1842. If nonbanking interests are involved, section 4 of the BHCA, 12 U.S.C. § 1843, applies. Regulations detailing the procedures are found at 12 C.F.R. Part 25. Approval orders are issued by the Federal Reserve Board, upon consultation with the primary federal regulator of any banks involved in the transaction. If any state-chartered banks are involved, there must be approval from the state bank regulator.

Standards

An application to form a new bank holding company or to merge bank holding companies may be denied on the basis of competitive, banking, community reinvestment, and supervisory factors. 12 U.S.C. § 1842(c). Where a holding company is acquiring banks in states other than its home state, there must be an evaluation of whether the holding company is adequately capitalized and managed, whether state age requirements

have been met for banks acquired by out-of-state bank holding companies, and whether concentration limits on deposits have been exceeded. These limits are: (1) a nation-wide limit of 10% of the deposits in the nation and (2) a state-wide limit of 30% of the deposits in a state unless increased by state law. 12 U.S.C. § § 1842(d). The Board must take into account the Community Reinvestment Act (12 U.S.C. § § 2901 - 2906) record of the institutions involved and their compliance with applicable state community reinvestment laws. 12 U.S.C. § 1842(d)(3). The approval or disapproval order emanates from the Board, which would have consulted with the Department of Justice and appropriate banking regulators.

Procedures

Two sets of procedures may be involved in a bank holding company transaction: acquisition of interests in banks and acquisition of interests in non-banking concerns. Under the BHCA procedural regulation for bank acquisitions, 12 C.F.R. § 225.15, the application is filed with a Federal Reserve bank, which has authority delegated from the Board to approve applications in many instances, but will refer an application to the Board if delegated authority is inappropriate. 12 C.F.R. § 225.15(d). An application would be referred to the Board, therefore, if it were seen as presenting a policy issue or a case of first impression.

The law specifies that the Fed must act within 90 days of receiving a complete application or the transaction will be deemed to have been approved. The 90-day period begins when the completed application is received. The regulation specifies what is meant by a completed application. For example, extension of the public comment period or holding a hearing means that the 90-day period does not begin until the comment period expires or the hearing is concluded.

While the application is pending, the Fed must solicit public comment through notices in newspapers and in the *Federal Register*. It also must seek approval from state and federal banking regulatory agencies, which have 30 days to respond. 12 C.F.R. §225.24(b). It generally consults the Department of Justice on the antitrust issues.

If the primary regulator disapproves or if other concerns prompt the Fed to do so, a hearing will be held, tolling the limitation period until the hearing is completed. If and when approval is granted, the Department of Justice is to be notified and has 30 days of approval to bring suit which will enjoin the transaction until the case is decided. During that 30-day period the transaction may not be consummated.

Although the Board is permitted to hold a hearing on a merger or acquisition application under the BHCA, hearings are not generally required. A hearing must be held if the primary regulator provides a timely disapproval of the application. Where interests in nonbanking concerns are involved, a hearing must be held only if there are "disputed issues of material fact that cannot be resolved in some other manner." 12 C.F.R. § 225.25(a)(2). Although not required to do so, it is not without precedent for the Fed to hold a hearing on community reinvestment and fair lending aspects of a proposed acquisition under the BHCA. Such a hearing was held in connection with the acquisition of CoreStates Financial Corp. by First Union Corp., which was approved on April 13, 1998, on the condition that 32 Pennsylvania branches of CoreStates be divested.

If the Fed issues an order disapproving the application, the applicant may request an administrative hearing, the outcome of which would be appealable to a federal appellate court.

Antitrust Review

The BHCA and the Bank Merger Act standards have been interpreted to be essentially the same as that of Sections 1 and 2 of the Sherman Antitrust Act, 15 U.S.C. § § 1 and 2, and the Clayton Act, 15 U.S.C. § 18. *United States v. Third National Bank*, 390 U.S. 171 (1968). As contained in the BHCA , 12 U.S.C. § 1842(c), the standard is that the Board may not approve:

> (A) any acquisition or merger...which would result in a monopoly, or which would be in furtherance of any combination or conspiracy to monopolize or to attempt to monopolize the business of banking in any part of the United States, or
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> (B) any other proposed acquisition or merger or consolidation under this section whose effect in any section of the country may be substantially to lessen competition, or to tend to create a monopoly, or which in any other manner would be in restraint of trade, unless it finds that the anticompetitive effects of the proposed transaction are clearly outweighed in the public interest by the probable effect of the transaction in meeting the convenience and needs of the community to be served.

The bank regulatory agency review and that of the Department of Justice proceed with a structural analysis of the proposed transaction using the Department of Justice guidelines. While there may be differences in the approaches the banking agencies and the Department of Justice take, they proceed from the same guidelines and have made efforts to reduce disparities. See Martha Vestal Clarke, "The Impact of Emerging Payment Systems and Products on Banking Competition and the Competitive Analysis of Bank Mergers and Acquisitions," 16 *Annual Review of Banking Law* 161 (1997).

Bank holding company applications involve massive amounts of data and material to be scrutinized by the agencies. When the orders are issued, they include careful examination of each of the banking markets involved. They may also include divestiture requirements respecting various bank branches or provisions for selling or placing such branches in trust pending sale. Similar conditions may apply for impermissible non-banking activities or interests.

Both geographic and product markets are relevant to the antitrust analysis. The standard used to determine the appropriate geographic market derives from the Supreme Court's analysis in *United States v. Philadelphia National Bank*, 374 U.S. 321, (1963), and is localized in nature. The product market also derives from that case, and it is "the cluster of products and services offered by banking institutions." 374 U.S. 321, 357. The Department of Justice and Federal Trade Commission Horizontal Merger Guidelines, *reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,104, at 20,572-73 (April 2, 1992), and the Department of Justice 1984 Merger Guidelines, 49 *Federal Register* 26,823 (June 28, 1984), are used. They determine the level of concentration in the markets affected by the merger by analyzing: various factors including product and geographic market definition and concentration; potential anticompetitive effects; and impact on market entry. Post-

merger market share concentration is measured by using the Department of Justice Herfindahl-Hirschman Index (HHI), based on deposits, offices, and loans. While the Department of Justice guidelines are applicable to all mergers, there may be more leniency in applying them in the case of depository institution mergers. In approving the merger of NationsBank Corporation and Barnett Banks, Inc., 84 *Federal Reserve Bulletin* 129, 134 (1998), the Federal Reserve Board seems to have indicated that it expects concentration levels to continue to exceed the Department of Justice guidelines and is considering strategies to deal with the situation:

> The Board's experience in analyzing these cases, however, suggests that, in future cases, increased importance should be placed on a number of factors where the proposal involves a combination that exceeds the DOJ guidelines in a large number of local markets. In these cases, the Board believes that it is important to give increased attention to the size of the change in market concentration as measured by the HHI in highly concentrated markets, the resulting market share of the acquiror [sic] and the pro forma HHIs in these markets, the strength and nature of competitors that remain in the market, and the strength of additional positive and negative factors that may affect competition for financial services in each market.

Nonbanking Interests

A merger such as that of Citicorp and Travelers Group involves the formation of a new bank holding company, Citigroup. The application will require the Board to consider authorizing the formation of a new bank holding company that will acquire interests in banks from the Citicorp side and interests in nonbanking activities both from Citicorp and from the extensive insurance, consumer finance, and insurance interests of Travelers Group. The nonbanking interests will be scrutinized under Section 4 of the BHCA. 12 U.S.C. § 1843. This will require the Board, in addition to and generally prior to the antitrust examination under section 3 of the BHCA, to analyze whether Travelers' non-banking activities are permissible. These activities would be examined to see if one of the exceptions to the BHCA's prohibition on nonbanking activities applied, including whether the activities are "so closely related to banking or managing or controlling banks as to be a proper incident thereto." 12 U.S.C. § 1843(c)(8). The BHCA and the applicable regulation, 12 C.F.R. § 225.24, require divestiture of impermissible interests in nonbanking organizations, such as the insurance underwriting business in the Travelers Group, within two years of the date of becoming a bank holding company, with the possibility of extensions of one-year each up to a total of three extensions. Each extension requires an application, which the Board must judge on the basis of its not being detrimental to the public interest. 12 U.S.C. § 1843(a)(2).

On May 4, 1998, Travelers filed an application and notice to the Federal Reserve of its intention to merge with Citicorp and form a new bank holding company, Citigroup. The application recognizes that Travelers' various insurance underwriting and agency businesses are not permissible affiliates for a bank holding company under the law and does not seek to retain them beyond the period allowed by law. It states that both Citicorp and Travelers hope for reform of the current bank regulatory system to permit unlimited affiliation between banking, securities, and insurance companies. It further states that if

the application is approved, the new bank holding company will conform its nonbanking activities within in two years or such longer period as the Board may grant.

During the period when the insurance underwriting businesses will be operated within the new bank holding company, certain information and reports will be provided to the Federal Reserve which the applicant represents as enabling Federal Reserve monitoring. The application contemplates cross-marketing of services during this period but it declares that such cross-marketing will not inhibit divestitures should they be needed. It further names some measures to prevent competitive injuries. The insurance underwriting components will not offer more favorable terms to customers of the other entities within the holding company. Moreover, they will adhere to BHCA and Federal Reserve Board regulations regarding interaffiliate transactions.

In contrast to the divestiture of the insurance underwriting businesses, the insurance agency companies and the securities affiliates are proposed for retention. The insurance agencies are destined for transfer to banks within the holding company, subject to approval by the banking regulators and in conformity with the insurance powers authorized for the various types of banks in the proposed holding company. Retention within Citigroup is sought for Travelers' securities firms, including Salomon Smith Barney, and its consumer finance businesses. The application requests authorization for this under the same provision that has formed the basis for Citicorp's securities affiliate, section 4(c)(8) of the BHCA, 12 U.S.C. § 1843(c)(8), as activities so closely related to banking as to be a proper incident thereto.