

## **An Analysis of the Public Benefits Test of the Bank Holding Company Act**

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This article investigates the nature of the public benefits required by the Board of Governors of the Federal Reserve System in connection with the applications of bank holding companies to acquire both banks and nonbanking firms. The findings are based on an inspection of the Board's orders in all bank and nonbank cases published in the *Federal Reserve Bulletin* since January 1971. In addition, approximately thirty nonbank orders published only in the *Federal Register* were examined.

The Board, in considering proposals of bank holding companies to acquire banks, is required by Section 3 of the Bank Holding Company Act as amended (hereafter referred to as the Act) to deny a proposed acquisition if its

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 [the Board] 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.

In addition, the Board is required to consider the financial and managerial aspects of the proposal. Thus, it would appear that the Board could approve a proposed bank merger where the proposal would yield relatively modest benefits for the public's convenience and needs, provided any anticompetitive effects were not substantial and no adverse financial or managerial factors militated against approval.

The requirements relating to public benefits are stated

somewhat more explicitly regarding proposed acquisitions of nonbanking firms by bank holding companies. Section 4(c)(8) of the Act requires the Board to determine if a proposed nonbanking activity is

so closely related to banking or managing or controlling banks as to be a proper incident thereto. In determining whether a particular activity is a proper incident to banking or managing or controlling banks the Board shall consider whether its performance by an affiliate of a holding company can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interests, or unsound banking practices.

In essence, the test contained in Section 4(c)(8) suggests that every nonbank acquisition must yield net benefits to the public for it to be approved.

To learn how the Board has interpreted these requirements relating to public benefits, we examined 434 orders where the Board approved acquisitions of banks and 104 orders where nonbank acquisitions were approved. As a control group, we studied 47 bank and nonbank cases in which the Board denied the proposed acquisitions.

### **SUMMARY OF FINDINGS**

Analysis of the Board's decisions revealed six types of public benefits: (1) improvements relating to convenience and needs of the community to be served, (2) increased competition, (3) improved operational efficiency, (4) expanded financial resources for the firm to be acquired and/or the holding company, (5) improved management for the acquired firm, and (6) other benefits unique to the particular case.

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Benefits that improve public convenience or meet expanded needs were manifest primarily in the introduction of new financial services, the provision of an alternative or expanded source for presently offered services, or an expansion in the geographic scope of the services being offered. Increased market competition was viewed by the Board to result from *de novo* entry into either banking or nonbanking markets, reduction of rates charged on loans or other services, a strengthening of a small firm through affiliation with a bank holding company, and the reorientation of management policies from conservative to aggressive. Improvements from economies of scale and complementary expertise have also been recognized by the Board. The injection of new equity capital into a firm to be acquired as well as the acquisition of a financially weak firm also has been construed to be in the public interest. Improved managerial resources and the provision of needed management depth are still further benefits. Other benefits include the elimination of a specific unfair competitive situation, the lowering of management fees for subsidiary banks, and the continuation of a particular financial service being provided in an area. It is worth noting that all these public benefits are not mutually exclusive since, for example, an alternative or more efficient source of financial services may also stimulate additional competition.

In both bank and nonbank cases where the proposal was denied, the principal adverse effects cited by the Board comprised: (1) significantly reduced existing competition within a well-defined geographic market for a particular product(s), (2) probable elimination of significant amounts of future or potential competition in a particular market where alternative forms of entry (i.e., *de novo* or foothold entry) were feasible, (3) the accumulation of financial resources to such an extent as to lead to possible abuse of economic power, (4) a possible weakening of the holding company's ability to support the growth of its banking subsidiaries, and (5) covenants restricting competition.

We conclude from the examination of bank and nonbank cases undertaken in this study that the willingness of the Board to attach significance to the public benefits cited by an applicant was heavily dependent on the severity, or lack thereof, of any adverse competitive, financial, or managerial factors the Board perceived to be inherent in the application. Where the Board determined a proposal involved no seriously adverse competitive or other effects, it generally accepted the applicant's claim of probable benefits to the public and approved the acquisition. We believe it is particularly significant, however, that the Board appears never to have found, so far as we can tell,

proposed public benefits sufficient to outweigh the adverse effects of a substantial reduction of competition, unsound banking practices, or undue concentration of resources. In view of the often unique circumstances of each case, it is difficult to generalize on the exact situation in which the Board would conclude that public benefits would outweigh or be outweighed by adverse effects. Our review of the Board's orders suggests, however, that approval has required increasingly substantial evidence or demonstration from applicants that their proposals would yield net public benefits, particularly in cases where significant adverse effects were present.

#### THE ROLE OF PUBLIC BENEFITS IN SELECTED BOARD ORDERS OF APPROVAL

The following discussion of the role of specific public benefits is organized by the type of benefit most frequently cited by the Board. A listing of these benefits by type is available in Table I. In general, these cases all involved applications that presaged no severely adverse consequences from the loss of existing, future, or potential competition, or significant danger to the public interest from unsound banking practices. Neither did they involve the weakening—financially or managerially—of the parties concerned. The Board's treatment of public benefits in cases where adverse factors were important is discussed in the next main section.

**CONVENIENCE AND NEEDS.** Improvements affecting the convenience and needs of the community are the most significant public benefits that have been accepted by the Board in its approvals of bank acquisitions and bank holding company formations. Such improvements have often taken the form of new services, or the expansion of existing services or facilities, thereby facilitating the economic growth of an area. The Board has been especially responsive to the introduction of new services not yet offered in a locale. However, it has also recognized benefits in the provision of an alternative source of services that are already provided in an area and has frequently stated that an alternative source of services would stimulate competition.<sup>1</sup>

<sup>1</sup> See, for example, Missouri Bancshares (71 FRB 143) and First Florida Bancorporation (73 FRB 183)—the former an alternative source for retail services, the latter a source of wholesale banking services. FRB refers to the *Federal Reserve Bulletin*. The number preceding FRB represents the year of the *Bulletin*, and the number following FRB is the page on which the order appears.

Table I  
**TYPES OF BENEFITS CITED BY THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM  
 IN ORDERS OF APPROVAL OF BANK HOLDING COMPANY ACQUISITIONS\***

Type of benefits	Bank	Nonbank
<b>Convenience and needs:</b> Providing an alternative source of services to a market ..... Increased lending capacity to support strong economic growth in an area ..... or to stimulate growth in economically depressed areas ..... Expansion of specialized credit services .....  Geographic expansion of service ..... Improving allocational efficiency .....	Missouri Bancshares, Incorporated (71 FRB 143) Southeast Bancorporation, Incorporated (71 FRB 41) First Union Incorporated (71 FRB 531) [see Table II]	Imperial Bancorp (72 FRB 503)  Marine Bancorporation (72 FRB 504) Mortgage: First Chicago Corporation (72 FRB 175). Consumer: First Bank System, Inc. (72 FRB 172). Commercial: Bank of Virginia Company (72 FRB 934). Agricultural: Western Kansas Investment Corporation, Inc. (72 FRB 737). Leasing: Provident National Corporation (72 FRB 933). American Fletcher Corporation (72 FRB 741) First Union National Bancorp, Inc. (72 FRB 72)
<b>Increased competition:</b> Increased competition through <i>de novo</i> entry ..... Reduction of rates charged on loans or other services ..... Strengthening the competitive position of a small firm through affiliation with a larger bank holding company ..... Increasing competition by changing a limited-service institution into a full-service firm ..... Changing a conservative firm into a more aggressive competitor .....	Atlantic Bancorporation (71 FRB 689) First National City Corporation (71 FRB 944) First Florida Bancorporation (71 FRB 256) Barclays Bank DCO (71 FRB 45) Barnett Banks of Florida, Inc. (71 FRB 529)	U.N. Bancshares, Inc. (73 FRB 204) Northwest Bancorporation (38 FR 14205)  Bank of Virginia Company (72 FRB 934)
<b>Improved efficiency</b> Economies of scale ..... Complementary skills .....	First Security National Corporation (71 FRB 1005) First American Bancshares, Inc. (72 FRB 730)	Zions Utah Bancorporation (72 FRB 72)
<b>Improved financial resources:</b> Acquiring a financially weak firm ..... Improving the debt-to-equity ratio of the acquired firm ..... Injecting a specific amount of equity capital into the acquired firm ..... Providing "access to the greater financial resources" of the holding company .....	State Street Boston Financial Corporation (73 FRB 526) Continental Bancor, Inc. (71 FRB 676) Great Lakes Holding Company (71 FRB 545) First Alabama Bankshares, Inc. (71 FRB 404)	BankAmerica Corporation (73 FRB 687)  Manufacturers Hanover Corporation (73 FR 27659) Third National Corporation (38 FR 9686)
<b>Improved managerial resources:</b> Alleviating management succession problems ..... Providing management depth .....	Depositors Corporation (71 FRB 36) First National Charter Corporation (71 FRB 37)	Northwest Bancorporation (73 FRB 701) Zions Utah Bancorporation (72 FRB 72)
<b>Other benefits:</b> Correcting an unfair competitive situation ..... Preventing the termination of a financial service..... Lowering management fees for subsidiary banks ....	Bank Securities Inc. (72 FRB 280)	Newport Savings and Loan Association (72 FRB 313) American Fletcher Corporation (38 FR 14203)

\* All references are to the *Federal Reserve Bulletin* (FRB) or the *Federal Register* (FR).

Table II lists a sampling of the new services that bank holding companies have proposed to introduce in bank acquisitions.

In nonbank cases the introduction of new, or the extension of existing, services to a market is also cited as a public benefit, notably the provision of specialized credit services. For example, many of the recent approvals of acquisitions of mortgage banking firms by bank holding companies have been granted on the expectation that such affiliation would result in increased flows of funds into residential or low-income housing and urban renewal. In these instances, however, the applicant must indicate that the acquisition would not cause a reduction of credit to independent mortgage companies that may be customers of the bank affiliates of the holding company.<sup>2</sup>

Increases in the supply and availability, as well as reductions in the cost, of consumer credit to individuals have been cited frequently as significant public benefits in approvals of acquisitions involving consumer finance companies<sup>3</sup> and firms that extend second mortgages.<sup>4</sup> Further, acquisitions of commercial finance firms and factoring concerns have been granted on the expectation of expanded flows of commercial credit,<sup>5</sup> yielding benefits particularly for small businesses<sup>6</sup> and high risk enterprises.<sup>7</sup> Also cited by the Board as beneficial to the public are the provision of agricultural lending through the acquisition of agricultural credit companies<sup>8</sup> and the provision of personal property leasing services.<sup>9</sup>

The Board has held as beneficial the geographic expansion and the offering of new products by bank holding companies in the fields of mortgage, consumer, and commercial credit. Several applicants have specifically stated that their newly acquired affiliates would expand outside their respective current market areas.<sup>10</sup> In one order ap-

<sup>2</sup> See First Union National Bancorporation (72 FRB 72) and First Chicago Corporation (72 FRB 175).

<sup>3</sup> First Bank System (72 FRB 172) and American Fletcher Corporation (72 FRB 741).

<sup>4</sup> Bank of Virginia Company (72 FRB 934) and Dominion Bankshares Corporation (72 FRB 597).

<sup>5</sup> Industrial National Corporation (72 FRB 171) and Bank of Virginia Company (72 FRB 935).

<sup>6</sup> Citizens and Southern Holding Company (71 FRB 1037).

<sup>7</sup> Lincoln First Banks (72 FRB 169).

<sup>8</sup> Western Kansas Investment Corporation, Inc. (72 FRB 737).

<sup>9</sup> Marshall and Ilsley Bank Stock Corporation (72 FRB 74) and Provident National Corporation (72 FRB 933).

<sup>10</sup> First Bank System (72 FRB 172) and American Fletcher Corporation (72 FRB 741).

Table II  
NEW SERVICES PROPOSED IN BANK ACQUISITION CASES

Service	Reference*
Trust services .....	Society Corporation (71 FRB 52)
Electronic data processing .....	Security New York State Corporation (71 FRB 133)
Increased and larger commercial lending..	Commerce Bankshares, Inc. (71 FRB 146)
Bond portfolio management (internal) .....	Florida National Banks of Florida, Inc. (71 FRB 939)
New physical facilities .....	Boatmens Bancshares, Inc. (71 FRB 39)
Leasing .....	First National Charter Corporation (71 FRB 754)
Internal auditing .....	Florida National Banks of Florida, Inc. (71 FRB 939)
International services .....	Huntington Bancshares Incorporated (71 FRB 940)
Venture capital .....	Central and State National Corporation of Alabama (71 FRB 860)
Marketing (internal) .....	Florida National Banks of Florida, Inc. (71 FRB 939)
Urban and business development .....	First Virginia Bankshares Corporation (71 FRB 1022)
Federal Housing Administration and Veterans Administration loans .....	BancOhio Corporation (71 FRB 1035)
Overdraft checking and other deposit services .....	First Virginia Bankshares Corporation (72 FRB 288)
Accounts receivable financing .....	Shorebank Inc. (72 FRB 914)
Investment management services for small investors .....	First National Boston Corporation (73 FRB 759)
Municipal bond financing .....	Security New York State Corporation (71 FRB 133)
New branches .....	Merrill Bankshares Company (71 FRB 262)
Credit cards .....	State Street Boston Financial Corporation (73 FRB 526)
Wholesale banking services .....	First Florida Bancorporation (73 FRB 183)
International trade financing .....	Dai-Ichi Kangyo Bank, Ltd. (72 FRB 49)

\* All references are to the *Federal Reserve Bulletin* (FRB).

proving the acquisition of a mortgage banking firm,<sup>11</sup> the Board noted that an improved flow of funds would take

<sup>11</sup> First Union National Bancorporation (72 FRB 72).

place from capital-surplus areas to those in deficit. Moreover, in the BankAmerica-GAC Finance case, the Board, on reconsideration of a revised application, determined that one of the benefits inherent in the acquisition would be a more efficient allocation of consumer credit.<sup>12</sup>

The introduction of more active lending and business development policies by banks has been held by the Board to be beneficial in those areas that have been economically depressed.<sup>13</sup> Also considered beneficial were the expansion of bank lending and the introduction of new credit services necessary to sustain the rate of economic expansion in those areas experiencing strong economic growth.<sup>14</sup> Providing a stimulus to the economic growth of an area has been cited as an important public benefit in several non-bank cases where the applicant argued that approval would result in increased flows of mortgage credit to depressed areas and would aid municipal governments in obtaining long-term funds.<sup>15</sup>

**INCREASED COMPETITION.** *De novo* entry into a market either by a bank or nonbank affiliate of a bank holding company has usually been regarded by the Board as an enhancement of competition, on the grounds that such entry adds "a new decision maker" to the market.<sup>16</sup> Also, in several cases the shift of a limited "loan production office", located off the premises of a subsidiary bank, to a full-service facility was held by the Board to be a stimulant to competition. These instances involved such nonbank firms as factoring companies<sup>17</sup> or mortgage banking firms,<sup>18</sup> which

formerly had been acquired under Section 4(c)(5) of the Act prior to 1970 and operated as loan production offices.<sup>19</sup>

Rate reductions on banking and nonbanking services are regarded as an important direct benefit to the public and conducive to an improvement in the quality of competition in the markets for the services involved. In a number of proposed acquisitions of banks, applicants promised to reduce interest rate charges on loans below those charged by other banks in the market<sup>20</sup> or to eliminate fees or service charges on demand deposits,<sup>21</sup> or to pay more competitive rates on time and savings accounts.<sup>22</sup>

Reductions in interest rates on loans also have been viewed by the Board as a significant public benefit in non-bank cases.<sup>23</sup> Indeed, with regard to applications to acquire credit-life insurance underwriters or reinsurers, Regulation Y explicitly requires an applicant to demonstrate

that approval will benefit the consumer or result in other public benefits. Normally such a showing would be made by a projected reduction in rates or increase in policy benefits due to bank holding company performance of this service.

The Board has approved applications which have provided for rate reductions of 2 to 20 percent below existing average levels for each state in which consumer credit is extended by the bank holding company.<sup>24</sup> Moreover, the Board has held that credit-life insurance subsidiaries of bank holding companies must refrain from issuing level term insurance to cover instalment loans, i.e., coverage in excess of the outstanding loan balance.<sup>25</sup>

The affiliation with a large bank holding company by a small bank that competes ineffectively with much larger

<sup>12</sup> 73 FRB 687. On July 27, 1973, the Board denied BankAmerica Corporation's application to acquire GAC Finance, Inc., on the grounds that the acquisition would result in reduced competition and an undue concentration of resources. On reapplying, the applicant proposed the divestiture of a significant amount of sales finance and commercial finance receivables and of all of GAC's offices that were competitive or potentially competitive with the applicant. The Board determined that such divestiture removed its initial objections to the acquisition on competitive grounds. Moreover, based on new information, the Board concluded "that [GAC] Finance must be sold . . . to a buyer of considerable financial strength to avoid the collapse of Finance and its parent, and possibly serious financial repercussions of a more general nature".

<sup>13</sup> New Mexico Bancorporation (71 FRB 134) and First Union Incorporated (71 FRB 531).

<sup>14</sup> Southeast Bancorporation (71 FRB 41) and Commerce Bancshares, Inc. (71 FRB 146).

<sup>15</sup> See, respectively, Marine Bancorporation (72 FRB 504) and Northwest Bancorporation (73 FRB 701).

<sup>16</sup> See, for example, Atlantic Bancorporation (71 FRB 689), Imperial Bancorporation (72 FRB 503), and U.N. Bancshares, Inc. (73 FRB 204).

<sup>17</sup> Bank of Virginia Company (72 FRB 934).

<sup>18</sup> United Virginia Bankshares (72 FRB 938).

<sup>19</sup> Subject to Board regulations and interpretations, limited-purpose subsidiaries can be acquired by bank holding companies under Section 4(c)(5), which allows the ownership of shares in firms that a national bank could own under Section 5136 of the Revised Statutes.

<sup>20</sup> First National City Corporation (71 FRB 944).

<sup>21</sup> First Holding Company (71 FRB 139).

<sup>22</sup> First National State Bancorporation (38 FR 6236) and Chemical New York Corporation (38 FR 31472). FR refers to *Federal Register*. The number preceding FR represents the volume.

<sup>23</sup> BankAmerica Corporation—GAC Finance, Inc. (73 FRB 687).

<sup>24</sup> See, for example, Fourth Financial Corporation (73 FRB 208) and Northwest Bancorporation (38 FR 14205).

<sup>25</sup> Fidelity Corporation of Pennsylvania (73 FRB 472). However, the Board has determined that the issuance of level term credit-life insurance is permissible in connection with single-payment loans (Winters National Corporation, Board Press Release, December 27, 1973).

banks in its market area has been recognized by the Board as strengthening the competitive position of the smaller bank.<sup>26</sup> Also, the formation of regional bank holding companies within a state has been viewed by the Board as a competitive stimulant to the larger statewide holding companies.<sup>27</sup>

Other examples of proposed actions the Board has regarded as beneficial to the public through the enhancement of competition include the following: (1) changing a foreign banking agency into a full-service bank,<sup>28</sup> (2) acquiring a conservative bank and reorienting its operating policies to make it aggressively compete for funds and expand its lending activities,<sup>29</sup> and (3) the severing of chain banking ties leading to reduced concentration of resources.<sup>30</sup>

**IMPROVED EFFICIENCY.** Both bank and nonbank acquisitions and holding company formations may give rise to operating efficiencies or economies of scale. On several occasions, the Board has taken the view that the organizational form of the bank holding company is conducive to such economies. In a case involving the "corporate reorganization of established interests and relationships" into a multibank holding company, the Board noted that

Although Applicant proposes no significant changes in services to the public as a result of the proposed acquisitions, the convenience and needs of the communities involved should benefit from the improved economies and efficiencies of operation expected to result from the proposed restructuring of Applicant into a coordinated multibank holding company organization.<sup>31</sup>

Furthermore, in a concurring statement to the order approving The First National Bancorporation's acquisition of The Exchange National Bank of Colorado Springs,<sup>32</sup> Governor Mitchell cited various studies which indicate that significant economies of scale exist in banking, econ-

omies that tend to be passed on to the public through additional convenience in offices and facilities. He noted that "banking competition can only exist in a meaningful sense if at least some banking units have the capacity to broaden their services and make them more conveniently available. Their capacity to do so is a matter of realizing economies of scale."

Other references to such efficiencies are frequently found in Board orders, which often also refer to the "pooling of resources and complementary skills" allowing the holding company to utilize the expertise of one affiliate to expand the services of the other affiliates.<sup>33</sup>

**IMPROVED FINANCIAL RESOURCES.** The infusion of capital funds to a newly acquired bank or nonbank subsidiary is an often-quoted (indirect) benefit to the public. There have been several cases where the applicant holding company has promised a specific amount of capital contribution to the proposed bank<sup>34</sup> or nonbank affiliate.<sup>35</sup> More frequently, applicants have argued that affiliations of the proposed nonbank firms with bank holding companies would provide "access to the greater financial resources of applicant".<sup>36</sup>

This argument regarding access to a holding company's resources implies that the affiliation of a small bank-related firm with a large bank holding company gives that small firm an "assured" source of working funds at probably a lower cost than is obtainable as an independent firm.<sup>37</sup> It has been argued that this source of funds would be likely to be more "stable" than one obtainable independently.<sup>38</sup>

Finally, there are examples in both bank and nonbank cases where holding company affiliation was expected to result in the strengthening of a financially weak firm. In several bank<sup>39</sup> and nonbank<sup>40</sup> acquisitions, the acquired firm

<sup>26</sup> See, for example, First Alabama Bankshares (71 FRB 404) and First American Bankshares (72 FRB 730).

<sup>27</sup> Great Lakes Holding Company (71 FRB 545).

<sup>28</sup> First Arkansas Bankstock Corporation (73 FRB 28), Deposit Guaranty Corporation (73 FRB 593), and Manufacturers Hanover Corporation (73 FRB 27659).

<sup>29</sup> See, for example, Third National Corporation (38 FR 9686), BankAmerica Corporation (73 FRB 687), and Northwest Bancorporation (73 FRB 701).

<sup>30</sup> Industrial National Corporation (72 FRB 171).

<sup>31</sup> See, for example, concurring statement in the BankAmerica-GAC order (73 FRB 687).

<sup>32</sup> State Street Boston Financial Corporation (73 FRB 526) and The First National Bancorporation (71 FRB 613).

<sup>33</sup> BankAmerica Corporation (73 FRB 687) and Zions Utah Bancorporation (72 FRB 72).

<sup>26</sup> First Alabama Bankshares (71 FRB 404) and First Florida Bancorporation (71 FRB 256).

<sup>27</sup> First American Bankshares (72 FRB 730).

<sup>28</sup> Barclays Bank DCO (71 FRB 44).

<sup>29</sup> Barnett Banks of Florida, Inc. (71 FRB 529), United Missouri Bankshares, Inc. (72 FRB 655), and Missouri Bankshares (71 FRB 542).

<sup>30</sup> First National Bancorporation (71 FRB 345).

<sup>31</sup> First Security National Corporation (71 FRB 1005).

<sup>32</sup> 71 FRB 345.

had been experiencing financial problems and eventually might have become insolvent. In one case the acquisition resulted in the revitalization of a credit office that would otherwise have been closed.<sup>41</sup> In another instance, the Board ruled that it was beneficial for the debt-to-equity ratio to be lowered in the case of an otherwise strong bank through the establishment of a debt repayment program scheduled by the applicant.<sup>42</sup>

**IMPROVED MANAGERIAL RESOURCES.** Another indirect benefit to the public is found in cases where the managerial resources of the acquired firm are to be substantially improved. Applications have been approved where it was found that the acquisitions would alleviate management succession problems<sup>43</sup> or provide needed management depth.<sup>44</sup>

**OTHER PUBLIC BENEFITS.** Other significant benefits to the public which have been cited in the Board's orders include: (1) agreement by the applicant holding company to lower its management fees charged its subsidiary banks,<sup>45</sup> (2) the correction of an unfair competitive situation,<sup>46</sup> and (3) the continuation of a particular financial service being provided in an area.<sup>47</sup>

#### **THE TREATMENT OF PUBLIC BENEFITS BY THE BOARD IN APPLICATIONS THAT WERE DENIED**

An important consideration regarding the Board's public benefits test is the circumstances under which an applicant's claimed public benefits would outweigh or be outweighed by adverse effects expected to arise from the

transaction. Some insight into this issue may be gained from an examination of the factors that resulted in the denial of bank holding company applications—both in bank and nonbank proposals.

**NONBANK ACQUISITIONS.** As of February 1974, twenty-five orders of denial under Section 4(c)(8) were published in the *Federal Reserve Bulletin*. In addition, four orders of denial were published in other sources. These cases represent a very small percentage of the total number of nonbank applications. Table III gives the distribution of applications by the type of activity and the Board's record of denials and approvals of holding companies' proposed nonbank acquisitions as of year-end 1973. The table shows that about 90 percent of the applications were approved. Most applicants have recognized that the acquisition of close competitors or of major firms where smaller ones are available would encounter stiff Board opposition. Moreover, the Board's practice of formally determining permissible nonbank activities has precluded many opportunities for denial.<sup>48</sup>

In eleven of these denials, public benefits were not treated in detail—i.e., the benefits the applicants claimed would result from the acquisition were not mentioned or received only brief mention in the order.<sup>49</sup> Apparently in these cases the Board believed the adverse effects from the reduction of existing and potential competition or the undue concentration of resources to be so obvious and overwhelming and/or the benefits to be so weak that no explicit treatment was deemed necessary.

In eighteen cases in which the proposals were denied, the Board treated the public benefits explicitly. In these orders the Board not only discussed the expected adverse effects, but enumerated each of the applicant's arguments as regards public benefits and, in turn, presented its observations on each argument.

Half of the eighteen denials involved the proposed acquisition of a mortgage banking firm. In every one of these cases disapproval was based primarily on the reduction of existing and/or potential competition. One benefit claimed

<sup>41</sup> First National City Corporation (38 FR 31711).

<sup>42</sup> See Continental Bancor, Inc. (71 FRB 676).

<sup>43</sup> See, for example, Depositors Corporation (71 FRB 36) and Northwest Bancorporation (73 FRB 701)—bank and nonbank cases, respectively.

<sup>44</sup> First Banc Group of Ohio (71 FRB 418).

<sup>45</sup> Bank Securities Inc. (72 FRB 280).

<sup>46</sup> Newport Savings and Loan Association (72 FRB 313) and Old Colony Co-Operative Bank (72 FRB 417). As a result of various legal and regulatory restrictions, savings and loan associations in Rhode Island have been at a competitive disadvantage with respect to other thrift institutions in providing checking account services. Mutual savings banks have been able to issue demand deposits through commercial bank subsidiaries acquired prior to 1971. Since 1971, credit unions with shares of more than \$1 million have been permitted to accept demand deposits. Noting this competitive disadvantage, the Board has allowed each of the above savings and loan associations to become a bank holding company and acquire a commercial bank in Rhode Island.

<sup>47</sup> American Fletcher Corporation (38 FR 14203).

<sup>48</sup> There have been four proposed nonbank acquisitions that were denied on the grounds that the activities were not closely related to banking. See R.I.H.T. Corporation (72 FRB 595), First Commerce Corporation (72 FRB 674), and Marine Midland Banks, Inc. (72 FRB 676). BankAmerica's proposed formation of BAC Computer Corporation—a nonpayout computer leasing firm—was denied by letter in 1972.

<sup>49</sup> See, for example, U.S. Bancorporation (72 FRB 177) and Crocker National Corporation (72 FRB 419).

by practically all of the nine applicants was that affiliation would result in the mortgage firm's assured access to greater working capital at more competitive rates. The Board responded to this argument with the following:<sup>50</sup>

While the acquisition of a mortgage company by a bank holding company could have the effect of strengthening the company in certain markets, it appears certain that such increased ability and service, if it came from a bank holding company not now competing or not likely to compete in the market, would have a substantially more desirable impact on the public interest.

In some instances the Board considered such claims to be "essentially conjectural".<sup>51</sup> Governor Bucher explained, in his concurring statement in two cases involving acquisitions by the Mellon National Corporation<sup>52</sup> and the Manufacturers Hanover Corporation,<sup>53</sup> that:

Serious questions can arise as to whether the public benefits relating to operating efficiency, better services, and lower cost, which are frequently ascribed to proposed affiliations of mortgage banking firms with bank holding companies, exist to a significant degree, especially when larger firms are involved. The advocacy voiced by applicants may not reflect the actual probability of the occurrence of the asserted benefits. Bank holding companies bear the burden of demonstrating that their proposed non-banking acquisition will have public benefits outweighing any adverse effects, inasmuch as the basic balancing test of Section 4(c)(8) requires a showing of public benefits.

Several other cases, denied because of anticompetitive effects, include proposed acquisitions of a sales finance firm,<sup>54</sup> consumer finance companies,<sup>55</sup> and an industrial loan and thrift company.<sup>56</sup>

One denial related to a leasing firm<sup>57</sup> where the principal difficulty involved possible adverse effects for the banking affiliates of the holding company. Chemical New York Corporation sought to acquire CNA Nuclear Leasing, Inc.—a firm which had a high debt-equity ratio and would have required heavy financing to meet its long-term growth objectives. Such an affiliation would have required Chemical to increase its short-term borrowings substantially, possibly sapping the financial strength of the company. In its order of denial, the Board stated that "one of the primary purposes of a holding company is to serve as a source of financial strength for its subsidiary banks". It concluded that this acquisition would reduce Chemical's ability to supply capital to its banks in the future.

Three of the eighteen orders which involved explicit treatment of public benefits were denied on grounds that included undue concentration of resources. These involved BTNB Corporation,<sup>58</sup> First National City Corporation,<sup>59</sup> and The Chase Manhattan Corporation.<sup>60</sup> The latter two orders presented detailed discussions of the applicants' arguments relating to benefits to the public.

First National City Corporation named the following benefits: (1) the affiliation of applicant and Advance Mortgage Corporation (this was a retention application) had made available funds which allowed Advance to increase its volume of originations of construction loans; (2) the applicant allowed Advance to originate and warehouse \$30 million of mortgages without investor take-out commitments—this, the applicant contended, had a countercyclical effect on the flow of funds into mortgage lending; and (3) the applicant would expand Advance's geographic operations.

The Board, however, argued as regards (1) that the construction loans of the applicant's bank had increased by a greater margin during this period than did those of Advance. Moreover, the Board noted that originations of one-

<sup>50</sup> BTNB Corporation (72 FRB 70). See also Marine Bancorporation (72 FRB 504) and Philadelphia National Corporation (73 FRB 913).

<sup>51</sup> See Manufacturers Hanover Corporation (73 FRB 532) and First Tulsa Bancorporation (72 FRB 317). The Board later reconsidered the former case subsequent to an order of denial and approved this acquisition after the applicant submitted pertinent new information. Moreover, the applicant agreed to eliminate a covenant not to compete from various employment agreements. Such covenants, if unreasonably restrictive, have been cited by the Board as anticompetitive—see Manufacturers Hanover Corporation (73 FRB 908). For a further discussion of the Board's view on covenants not to compete, see order denying Citizens and Southern National Bank's acquisition of Ison Financial Corporation (74 FRB 136).

<sup>52</sup> 73 FRB 910.

<sup>53</sup> 73 FRB 908.

<sup>54</sup> First Commercial Banks, Inc. (73 FRB 118).

<sup>55</sup> First National Holding Corporation (73 FRB 203) and Bankers Trust New York Corporation (73 FRB 694).

<sup>56</sup> Tennessee National Bancorporation (73 FRB 700).

<sup>57</sup> Chemical New York Corporation (73 FRB 698).

<sup>58</sup> 72 FRB 71.

<sup>59</sup> 74 FRB 50.

<sup>60</sup> 74 FRB 142.

**Table III**  
**BANK HOLDING COMPANY EXPANSION IN**  
**NONBANKING ACTIVITIES, 1971-73**

Type of activity	Total de novo notifications*	Proposed acquisitions decided by Board of Governors			
		Total	Approved	Denied†	(percent) Approval rate
Finance company (consumer, commercial, general) .....	148	86	80	6	93.0
Mortgage banking .....	173	64	55	9	86.0
Insurance (broker or agency, underwriting) .....	80	55	51	4	92.7
Leasing personal property .....	123	12	10	2	83.3
Advisory services .....	92	8	5	3	62.5
Data processing .....	54	6	6	0	100.0
Trust .....	13	6	6	0	100.0
Factoring .....	22	7	7	0	100.0
Community development .....	13	1	0	1	0.0
Industrial banks .....	0	7	6	1	85.7
Other .....	2	7	6	1	85.7
<b>Total .....</b>	<b>720</b>	<b>259</b>	<b>232</b>	<b>27</b>	<b>89.6</b>

Note: Applications are classified by primary activity only.

\* Through June 30, 1973.

† Includes the denial of proposed acquisitions of three *de novo* firms.

Source: Board of Governors of the Federal Reserve System.

to four-family mortgage loans by Advance had increased by a lesser margin than the industry as a whole. As regards (2) the Board noted that both affiliated and independent mortgage banking firms appeared to warehouse an increased volume of mortgages during periods of tight money. With respect to (3) the Board called attention to the applicant's resources which give it the capability to enter new markets *de novo* or through the acquisition of a smaller firm. In addition, the Board was evidently concerned with the possible adverse implications of the acquisition of the third largest mortgage banking firm in the nation by the second largest banking organization. The application was denied on the grounds of reduced existing and potential competition and an undue concentration of resources.

The Chase Manhattan Corporation's proposed acquisition of Dial Financial Corporation<sup>61</sup> was another application recently denied primarily on the grounds of undue concentration of credit-granting resources and the elimination

of potential competition. The applicant stated that the proposed affiliation would result in the diversification by Dial into such product lines as small business loans, farm loans, and first and second mortgage loans. The Board noted that many consumer finance companies are diversifying into these areas and that Dial has the ability and resources to do so. The order also declared that Dial is capable of opening new offices and, indeed, appears to have planned to do so in the absence of the affiliation. The Board noted that, while rate reductions on consumer loans constitute a significant public benefit, it considered Chase's proposal in this area similar to one that Dial had already instituted and had the resources to expand.

On the subject of increased availability of capital and credit to Dial, the Board noted that Dial was well able to obtain funds in national markets and that its rate of return on equity significantly exceeded the industry average. The Board summarized its arguments in this case as follows:

While the proposed acquisition would clearly lead to some public benefits, there is little indication that the above or other claimed benefits are not likely to be obtained in the absence of the acquisition.

<sup>61</sup> 74 FRB 142.

Moreover, the Board's order noted the following as regards the issue of concentration of resources:

... the issue of concentration in credit-granting resources... was within the intent of Congress in enacting the 1970 Amendments. While the matter is not free of doubt and is one on which reasonable differences of judgment may occur, the Board has concluded that, at a minimum, this factor weighs against approval of the application.

**BANK ACQUISITIONS.** In the Board's denials of proposals by bank holding companies to acquire banks, the principal adverse factors have involved a lessening of existing or potential competition, a weakening of the financial and/or managerial condition of the bank, and unsound banking practices. When considering the proposed benefits embodied in these applications, the Board has not been willing to conclude that the gains from prospective new services would offset the adverse factors unless it was satisfied that the community involved had significant unmet needs that would be fulfilled. In this regard, the Board denied at least three cases where competition or financial factors were adverse and it concluded that the community was already being served adequately.<sup>62</sup>

In the case involving Cegrove Corporation, the Board determined that the applicant would be unable to service the debt incurred in financing the acquisition and suggested that the capital position of both the bank to be acquired and the existing subsidiary bank might consequently be impaired. As a benefit, the applicant proposed to offer services that were not being offered by the banks involved. However, the Board determined that the relevant markets were being adequately served and, therefore, concluded that "considerations relating to the convenience and needs of the community to be served are regarded as consistent with, but lend no weight toward, approval".<sup>63</sup>

In the case of First International Bancshares, Inc., the Board determined that the acquisition would eliminate both existing competition and a foothold for another potential entrant to the market and would also increase deposit concentration among the largest organizations in the market. The Board concluded that the needs of the residents of

the Dallas area were being adequately served by the existing facilities, and that consummation of the proposed acquisition would have little impact. The Board determined, therefore, that the benefits would not outweigh the adverse competitive effects.

Some cases have been denied when there was no existing competition between the holding company's subsidiary banks and the bank to be acquired. One such case (subsequently approved a year later) involved the proposed acquisition of Citizens National Bank, Englewood, New Jersey by Midlantic Banks Inc., Newark.<sup>64</sup> With five governors voting, the Board concluded that the acquisition would result in: (1) the foreclosure of a substantial amount of potential competition, (2) the elimination of a desirable foothold entry for holding companies located in other banking districts within the state, and (3) the possible development of a trend toward concentration within banking districts. The Board determined that the public benefits from the applicant becoming an additional competitive alternative for large customers in the market were not sufficient to outweigh the adverse effects. The Board further concluded that consummation of the acquisition would have an adverse effect on the convenience and needs of the community since it would preserve home-office protection.<sup>65</sup>

In another denial<sup>66</sup> in which existing competition was not an issue, the Board expressed its concern over the size disparity among the holding companies in Texas and the likelihood that the concentration of deposits among the five largest holding companies might increase as a result of the acquisition. The Board stated that it

is not required to await the development of undue concentration among bank holding companies in Texas before it intervenes. Indeed, the underlying purpose of the Clayton Act, as incorporated in The Bank Holding Company Act, is to break the force of a trend toward undue concentration before it gathers momentum. . . . It is, therefore, the tendency toward undue concentration the Board must guard against

<sup>62</sup> See, for example, Central Bancorporation, Inc. (73 FRB 461), Cegrove Corporation (73 FRB 676), and First International Bancshares, Inc. (73 FRB 453).

<sup>63</sup> The Board subsequently approved the acquisition after Cegrove offered to raise additional equity capital (39 FR 8387).

<sup>64</sup> 71 FRB 684.

<sup>65</sup> In 1972, as the holding company movement in New Jersey gathered momentum, the applicant reapplied and the Board in a four-to-three decision approved the acquisition after the applicant indicated that it would move the head office of the bank. This move would open its previous home community to branching by other banks.

<sup>66</sup> First International Bancshares, Inc. (74 FRB 43).

when viewing the probable effect of an acquisition upon future competition in a banking market.

The Board further concluded that the entry into small markets by the state's largest holding companies through the acquisition of large independent banks would increase the levels of concentration in these markets.

In the cases discussed above, as well as others, the Board concluded that the financial and managerial conditions of the bank and the holding company and their future growth prospects were satisfactory. It, therefore, considered these factors as consistent with approval. However, in none of these cases did these factors lend any weight toward approval.<sup>67</sup>

On March 1, 1974, in an order of denial involving another proposed acquisition by First International Bancshares, Inc.,<sup>68</sup> the Board reaffirmed its position of guarding

against the tendency toward undue concentration not only in a local market but at the Statewide level as well when viewing the probable effect of an acquisition upon potential competition.

The Board concluded that the acquisition would have significantly adverse effects on potential competition in the local banking market and throughout Texas.

In discussing the applicant's proposal to inject equity capital into the bank to be acquired, the Board stated that affiliation with First International Bancshares was not the only means by which the bank's financial resources could be strengthened. The Board indicated that the acquisition of the bank by a smaller holding company could result in similar assistance without the anticompetitive effects attached to the proposal then under consideration. The Board recognized that the applicant's managerial resources and expertise would be available to the bank if the affiliation were approved, resulting in new services being offered to the public, both of which would lend weight toward approval. Nevertheless, it concluded that banking factors and convenience and needs considerations did not outweigh the substantially adverse effects the proposal would have on potential competition.

In at least two cases in which it denied the acquisition of *de novo* banks, the Board found that adverse competitive

effects were likely because the applicant was already represented in the market. The Board concluded that further offices would raise barriers to entry by other organizations and increase concentration of banking resources in the market. It held that the proposed benefits (i.e., the addition of new services not readily available in the market) did not lend sufficient weight to offset the adverse effects.<sup>69</sup> In another denial,<sup>70</sup> the Board concluded that a recently established bank would be hurt by the opening of yet another *de novo* bank in the same market and, consequently, that the proposed new bank would have an adverse effect on the development of future competition. In discussing the applicant's claim that the convenience of the community would be enhanced because the new bank would be closer to its potential customers than existing banks, the Board held that this factor lent very little weight toward approval.

#### PUBLIC BENEFITS IN RETROSPECT

Many public benefits, such as infusions of equity capital, access to lower cost funds, or economies of scale are indirect and yield gains to the public only if the consumer realizes lower prices or better services. Governors Robertson and Brimmer have noted that "it is the public's interest—not Applicant's—that is paramount".<sup>71</sup> In a majority of cases in which the Board has approved applications where the public benefits are indirect, it has done so on the grounds that direct gains to the public would eventually be forthcoming.<sup>72</sup>

In proposals where the anticompetitive effects were either slight or nonexistent, the published orders seldom dwelt on the public benefits of the case. Frequently, the Board has stated that the "banking factors are regarded as consistent with approval" and that "considerations relating to the convenience and needs of the communities to be served are also consistent with approval of the application".<sup>73</sup> Or that "... Applicant will give [the company] access to the greater resources of Applicant, and

<sup>69</sup> See Security Financial Services, Inc. (70 FRB 834).

<sup>70</sup> First at Orlando Corporation (73 FRB 302).

<sup>71</sup> See dissenting statement, Chemical New York Corporation (72 FRB 165).

<sup>72</sup> In a speech before the Bank Counsel Seminar of the California Bankers Association on April 26, 1974, Governor Jeffrey M. Bucher emphasized that "the Board requires measurable indications of gains for the public from bank holding company acquisitions, [and] . . . the Board has moved significantly in the direction of making those gains quite specific".

<sup>73</sup> See C.B. Investment Corporation (71 FRB 142), for example.

<sup>67</sup> See also Dominion Bancshares Corporation (74 FRB 49) and Southeast Banking Corporation (73 FRB 460).

<sup>68</sup> 74 FRB 290.

enable it to compete more effectively".<sup>74</sup>

It is perhaps more significant that the Board's treatment of public benefits suggests only a narrow range within which the types of benefits discussed in this paper would sway the Board when important adverse factors are present in a proposal. Our study indicates many instances where the benefits that might ordinarily be considered significant were viewed as insufficient to outweigh substantially adverse effects. For example, the denial of First Commercial Bank's acquisition of Schenectady Discount Corporation<sup>75</sup> was based primarily on anticompetitive grounds. But a benefit (i.e., that the injection of capital would enhance loan expansion) claimed by the applicant—and recognized in other applications<sup>76</sup>—was discounted

by the Board in this case. The Board noted that this benefit "could be achieved by the investment by Applicant of capital funds into its own mobile home sales finance operations".

A similar example may be found in the order denying First National City Corporation's retention of Advance Mortgage Corporation (cited above). As discussed previously, the Board discounted the applicant's argument that the affiliation had made funds available to Advance which, in turn, increased the latter's volume of originations of mortgage and construction loans.

The overall results of our study suggest that public benefits provide the strongest support for an application when the benefits are concrete, when they result in the alleviation of a specific problem, or when they result in lower prices or increased services to the public. Applicants must recognize that such benefits are essential in cases where even a small amount of competition would be eliminated. Yet the value of substantive benefits is increasingly uncertain the more severe are the anticompetitive or other adverse factors perceived by the Board.

<sup>74</sup> Patagonia Corporation-Model Finance Company (72 FRB 170).

<sup>75</sup> 73 FRB 118.

<sup>76</sup> First Virginia Bankshares Corporation (73 FRB 202).