



# DEPARTMENT OF JUSTICE

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## **“MEGA-MERGERS” IN THE BANKING INDUSTRY**

Address by

ROBERT KRAMER  
Chief, Litigation II Section  
Antitrust Division  
U.S. Department of Justice

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Antitrust Section

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## Introduction

Thank you for the invitation to discuss “mega-mergers” in the banking industry. Over the last decade, we have seen an explosion both in the number of mergers in banking and, in the past few years, in large deals that have caught the public imagination and concern.<sup>1</sup> Since the early 1980s, mergers have resulted in the number of banks in the U.S. declining from about 15,000 to about 9,000.<sup>2</sup> The number of bank mergers is only part of the story; equally significant is the fact that a number of individual mergers during the 1990's ranked among the largest U.S. bank mergers ever, in terms of the real value of assets involved, and in terms of the share of total U.S. bank assets accounted for by the merging banks. Many of these deals have occurred under my watch, and I would like to use 1998's mega-mergers to give you a sense of how the Antitrust Division handles them.

One caveat. The mergers that are today's topic may be large in an absolute dollar sense, but nothing we have seen or are likely to see soon, involves the type of nationwide concentration issues that were faced by Canada during the past year. U.S. overall banking concentration remains low, and while the U. S. mergers have raised local horizontal concentration issues, the transactions often significantly expanded the product or geographic market coverage of the merged firms. The limited number of competitive problems from mergers is glimpsed from the statistics from 1998. During fiscal 1998, the Antitrust Division's bank merger unit, which is a part of the Litigation II Section, screened 1,923 applications. Of those, thirteen were restructured at the request of the Division and 1,910 were not. Eight cases resulted in divestitures--and in many cases, the divestitures involved

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<sup>1</sup> The views expressed in this paper are my own and do not necessarily reflect the views of the Antitrust Division.

<sup>2</sup> NIC Data Base, Board of Governors of the Federal Reserve System

deposits of over \$1 billions dollars. In five cases, other conditions were imposed--such as the application was restructured at the Divisions' request or the parties agreed to include conditions that alleviated the competitive concerns raised by the transaction. All were resolved prior to approval by the appropriate regulatory agency.

Let me make one further preliminary comment. Because of the time concerns, I am going to assume that the mechanics of our merger screening program and how our investigations are handled are pretty well understood by the audience. I am also going to have to assume that you are generally familiar with our focus on the credit needs of small and medium sized businesses. Just to be clear, however, let me define terms that I will be using. At the Division we usually think of small businesses as having annual revenues ranging from about \$1 to \$10 million. The loans we typically are concerned about include start-up and working capital loans which may be provided through lines of credit or through term loans, with initial credit facilities of up to \$1 million. Medium sized businesses (annual revenues ranging from about \$10 million up \$250 million depending on the market) often have additional credit requirements, typically from \$1 million to \$10 million, and may require more sophisticated services such as cash management/treasury services, specialized lending areas, pension/benefit services, advising services, that many small banks may not offer. Our investigations have suggested that small and medium sized businesses have fewer credit alternatives and options available than retail consumers or large businesses. Small and medium-sized businesses tend to have credit needs that do not attract distant banks and they tend to rely on and value their relationships with their local bankers.

## Case Studies

We have had a number of major deals, primarily in the first half of 1998 that I will try to take in chronological order.

### A Corestates/First Union

The first of the mega-mergers I am going to talk about was actually announced in late 1997, but was approved almost one year ago exactly. First Union announced plans to acquire Corestates. The competitive overlaps in this transaction were mainly in eastern Pennsylvania and New Jersey.

As you know, the FRB and Justice in their analysis use different product markets and this played a significant role in this matter. The FRB views banking as a cluster product market. Justice follows the DOJ-FTC Merger Guidelines and defines markets based on consumer demand. We view banks as multi-product firms with different products that consumers do not find to be good substitutes for one another we view small business and middle market lending as relevant product markets. This difference has ramifications for geographic market definition. In Philadelphia, the FRB geographic market definition encompassed five counties in Pennsylvania and four counties in New Jersey. This was somewhat broader than the geographic market used in United States v. Philadelphia National Bank, 374 U.S. 321 (1963). (Parenthetically, the Court used a four-county market which included Philadelphia and its three contiguous counties, Bucks, Montgomery, and Delaware. One of the reasons for the four-county geographic definition was that banks at that time were allowed to branch only within those contiguous counties. The branching laws have since changed, and banks in Philadelphia are now permitted to branch beyond the four-county area.)

When looking specifically at small business lending, however, the broad market did not match what we were hearing in our interviews or in the CRA data that was available. It appeared

that New Jersey banks made few loans into Philadelphia. On the Pennsylvania side of the Delaware, many suburban banks had no branches in the City and did not lend to small businesses in Philadelphia. In fact, several banks told us that they avoided branching into and lending in the city at least in part because of CRA related issues. CRA data corroborated that suburban banks were making few loans into the City. We ended up believing that the transaction created a competitive problem was Philadelphia and close in Delaware county.

The best proxy we had for that area was the entire 2 county area, and in it, the post-merger HHI was about 2500 and the change was about 450. For C&I loans over \$100,000, the post-merger HHI was 2208 with a change of 650. The comparable deposit HHI for a broader five county area was 1999 with a change of about 400. In this case, we negotiated a significant divestiture of 32 branches and \$1.1 billion in deposits. The divestiture package was sold to Sovereign Bancorp, an in-market thrift that had recently made several purchases of commercial banking operations and was an active small and middle market lender.

**B. Washington Mutual/Home Savings (H.F. Ahmanson)**

The second large merger that I want to cover is the acquisition by Washington Mutual of Home Savings (H.F. Ahmanson), announced in March 1998, just about the time we were finishing CoreStates/First Union. This was a \$10 billion stock swap that combined the nation's two largest thrifts. This was a deal that had no small business lending or middle market lending issues because Washington Mutual was not a commercial lender in any of the markets that exceeded our screening guidelines. I'll use it however to make the point that we do investigate mergers that have their primary impact in retail banking markets and in small geographic markets. Our screening showed that the merger exceeded guidelines in three fairly rural California FRB markets (Lancaster, Yuba

City and Los Banos) markets. Our initial HHI in Lancaster based on commercial bank and thrift deposits was 2478, a change of 784. Our investigation showed that retail customers had additional alternatives. The market had five credit unions and that when their deposits were considered, the post-merger HHI was 1895 with a change of 576. In this case the HHI was slightly over our screening guidelines but the change in market structure was significant. Rather than insist on a divestiture, we asked for alternative relief that would make entry quicker and less costly than building a de novo branch. We were hearing from market interviews in the three markets was that the merging parties had been on an acquisition spree over the past few years, and had tied up much of the prime real estate for branch locations. In response to our concerns, the parties agreed for a period of three years to not impose any conditions that would preclude the future use by a FDIC insured institution of any of Washington Mutual or Home Savings branch offices in California that Washington Mutual closed and thereafter leased or sold as a result of this transaction. In addition, Washington Mutual also agreed to suspend the operation of any existing non-compete agreements and to not enter into any new non-compete agreements with any current loan officer or branch manager of Home Savings in California who would become an employee of Washington Mutual as a result of this transaction. This relief recognizes that the branch manager and loan officer are critical in small business and retail lending and that tying up good branch managers or loan officers with non-compete agreements can be detrimental to a new entrant's ability to attract or retain customers.

These conditions are a normal piece of any negotiated divestiture package and are also increasingly being used to resolve competitive concerns that do not rise to the level of requiring a divestiture.

### **C. Citicorp/Travelers**

June used to be the busiest month for weddings but that month was April in 1998. Not only did we witness some marriages among the country's biggest banks but we also witnessed the marriage of a bank and an insurance company. A year ago yesterday, the \$70 billion merger of Citicorp and Travelers was announced.

The Citicorp/Travelers transaction was reviewed by our bank merger unit although depending on the competitive concern, one of these mixed weddings might be reviewed in the Computers and Finance section. Since Travelers did not control a commercial banking subsidiary, this transaction did not result in the elimination of bank competition in any local banking market. We ended up looking at a wide range of corporate and retail overlaps, ranging from investment banking debt underwriting, equity underwriting and advisory services to credit card processing, annuities and mutual funds. As you can guess, we found that while there were several overlaps, that the markets with some exceptions appeared to be national markets with numerous competitors. The overlaps did not raise significant antitrust concerns, either from a horizontal or vertical integration perspective.

Generally, the vertical issue we reviewed was whether the combined firm could use any dominance in any market to eliminate competition in any otherwise competitive market. We didn't find any market sufficiently concentrated to give rise to a serious concern, however. We heard numerous complaints that Citigroup would have an undue aggregation of resources--that the deal would create a firm too big to be allowed to fail. But, we essentially viewed this as primarily a regulatory issue to be considered by the FRB.

#### **D. NationsBank/Bank of America**

Also in April, shortly after Citicorp/Travelers Group was announced, NationsBank and Bank of America announced plans to merge. The deal, valued at about \$60 billion when announced, formed the largest bank in the United States, holding about eight percent of all bank deposits nationwide. The new BankAmerica would have operations in about 21 states and the District of Columbia.<sup>3</sup> The bank was a classic market extension merger since NationsBank's operations focused generally on the east coast and south and Bank of America was largely on the west coast. Despite the size of the transaction, it raised competitive issues in only two states--New Mexico and Texas.

Our investigation focused on the effect the merger would have on small and medium sized businesses in Albuquerque and Dallas. We concluded that divestiture was only necessary in New Mexico. In Dallas, the post merger HHI was around 1950 and we found that Bank of America was a non-factor in small business lending, having entered Dallas through the purchase of failed thrifts and never really created a commercial franchise--we sought no divestiture. In Albuquerque, the HHI increased by about 680 to over 2900. The divestiture, primarily in the Albuquerque market, was of 17 Bank of America branches, plus associated deposits and loans. What was noteworthy, however, was that our investigation focused also on middle market lending. We found that there was a very limited number of middle market players in New Mexico. This concern was met when the parties

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<sup>3</sup> Combined, the bank would have about 5000 offices nationwide with about \$576 billion in assets and about \$486.2 billion in deposits.



divested not only deposits, loans and branches but what ultimately was Bank of America's entire middle market operations in New Mexico.<sup>4</sup>

### **E. Banc One/First Chicago**

Also in April 1998, Banc One announced plans to acquire First Chicago NBD Corporation. The merger, valued at about \$29 billion, was to create the fifth largest bank holding company with total assets of \$231.7 billion.<sup>5</sup> The combined firm also became the second largest credit card issuer in the country. In this case, we not only looked at issues in small and middle market business lending but also at what effect, if any, this transaction would have in credit cards issuing and processing, as well as ATM networks. Neither credit card issuing nor processing exceeded the screening guidelines and thus did not raise competitive concern although credit card processing, without even considering the issues of submarkets, is rapidly concentrating levels that will attract our attention. (HHI is about 1500 but change from transaction was very small).<sup>6</sup>

In addition to a small business problem, we believed there could be a middle market problem particularly at the lower-end, involving loans ranging up to \$3-\$5 million. In Indianapolis, there are

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<sup>4</sup>Bank of America's statewide headquarters office, offered for employment by the buyer the employees in BoA's Commercial Banking Group in New Mexico (i.e., loan officers who generally handle C&I loans of \$1 million or more), the Business Banking Group in New Mexico (i.e., loan officers who generally handle C&I loans between \$100,000 and \$1 million), and the New Mexico Cash Management Relationship Managers. In addition, the buyer was offered BoA's district management team, most of BoA's Financial Relationship Managers (personnel who manage relationships with certain high-end accounts) as well as all back office facilities and support staff, including item processing, cash management services, cash vault services, and ATM servicing.

<sup>5</sup> The combined entity would have about 1,950 branches, predominantly in the Midwestern United States, with approximately \$145.6 billion in deposits and about \$269.7 billion in assets.

<sup>6</sup> Based on information available, postmerger, Bank One would have about 10.5% market share of issued credit cards with about 50 million outstanding credit cards. The postmerger change in the HHI was 110 points to 871 points. This is based on the top 50 issuers of credit cards. In credit card processing, Bank One, postmerger, would have about 6% market share. The HHI would increase 3 points to 1483. This is based on the processing volume of the top 25 credit card processors. In merchant processing, the HHI would increase 10 points to 1046. This is based on the Total dollar volume of the top 50 merchant acquirers.

about 40 or so banks and thrifts, although few were engaged in middle market lending. The post-merger structure absent divestiture would have had a single dominant bank with about a 57% market share and almost 200 branches. The next largest bank had about 7% market share and 39 branches. Although several of the banks in the second-tier were relatively large regional banks such as Keycorp, Huntington, and Fifth Third Bank, market shares were very small and these banks had relatively few branches by comparison. To address these concerns, the parties divested 25 branches in Indianapolis with deposits of about \$900.5 million plus one of its middle market lending groups to a large regional bank, Union Planters.<sup>7</sup> The final DOJ divestiture package included 39 branches in Indiana with total deposits of \$1.467 billion.

#### **F. Norwest/Wells Fargo**

The last in the line of big bank deals we reviewed last year was the merger of Norwest/Wells Fargo. This deal was valued at about \$34 billion when announced in early June 1998. Although the operations of Norwest and Wells Fargo did overlap a bit more, Norwest's operations were primarily in the Midwest and southwestern United States and Wells Fargo<sup>8</sup> had its operations primarily in the western and southwestern United States. Competitive issues arose in only two states--Nevada and Arizona.

The parties agreed to divest 26 branches (14 in Arizona markets and 12 in Nevada markets), in 14 FRB markets with deposits totaling approximately \$1.18 billion. The investigation concluded

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<sup>7</sup> The middle market package included approximately \$613.3 million of middle-market commercial loans with associated deposits, 45 middle market relationship managers, along with associated customers accounts, support personnel and nine offices.

<sup>8</sup> Norwest's operations are located in Arizona, Colorado, Illinois, Indiana, Iowa, Minnesota, Montana, Nebraska, Nevada, New Mexico, North Dakota, Ohio, South Dakota, Texas, Wisconsin, and Wyoming, while Wells Fargo's operations operated in California, Arizona, New Mexico, Nevada, Utah, Colorado, Idaho, Oregon and Washington.

that the competitive effects of this merger were limited to small business lending. Norwest was a relatively new entrant in Nevada and entered by thrift acquisition. In Arizona, Norwest was more active in middle market lending but was still considered a minor player. Wells Fargo ranked higher in middle market lending but the combination of Norwest and Wells Fargo did not appear to result in significant concentration. Additionally, middle market businesses in Arizona tended to be smaller in revenue size (about \$10) than in other markets and generally had credit needs around \$1 million. These customers could be served by the Bank One and Bank of America, in addition to a number of the second tier players and the large fringe of smaller institutions competing in Arizona markets. The investigation into small business proceeded along normal lines without remarkable issues.

The name of the resulting institution came into play in determining which branches to accept for divestiture. Since Norwest could assure us early on that Wells Fargo would be the name of the surviving bank, we were confident that we were taking the branches of the customers in play. That contrasted to NationsBank/Bank of America where uncertainty over the bank name led to larger divestiture than was originally agreed. Although there can be equitable reasons in some markets to accept for divestiture the branch of the acquiring/surviving bank, normally we will insist on branches of the acquired or target bank to avoid significant run-off.

## **Summary**

After Norwest was approved in October, the last couple months of the year became quiet as mega-deals took a breather. What should you take from our actions over the last year? First, we think that we have been successful in quickly getting out of the way of the vast majority of

transactions in which there are no real competitive effects. Two, we have and will continue to play a role in bank consolidation. In the normal case, when there are major deals that raise discrete competitive concerns, but which on balance create shareholder and/or customer value, we will work with banks, generally on a voluntary basis, to address our concerns and allow the deal to close expeditiously. Third, we will look at all of the overlaps caused by a merger although most “other” markets will likely still not be a problem. Fourth, we will review middle market issues in virtually every transaction. Finally, staff will spend a lot of time on the exact package to be divested, both to create a viable branch network and ensure that competition is protected in middle market lending.