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Bank Mergers in Concentrated Markets: The Role of Mitigating Factors

I. INTRODUCTION

In the past three years, merger and acquisition activity in the United States and abroad has been at record levels. In 1997, more than $375 billion in bank and thrift assets were acquired in over 350 banking mergers. North Carolina banks have played a major role in this merger trend. Four of the ten largest mergers in 1997 included North Carolina banks. Additionally, NationsBank and First Union, both North Carolina banks, were recently involved in the two largest bank mergers in history. Experts contend this trend will continue into 1998 as banks try to establish economies of scale in order to compete in the global financial market and try to achieve stability in order to deal with the uncertainty of bank technology after the year 2000.

With bank merger activity at an all-time high, bank merger antitrust guidelines and the effects of mergers on market competition have become increasingly important issues to banks and consumers alike. Generally, the Board of Governors of the Federal Reserve (Board) uses the Herfindahl-Hirschman Index (HHI) to evaluate the effects of mergers on competition and to measure post-merger market concentrations. However, there has been some debate during

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2. See In the Financial Services Business, the Prevailing Wisdom is that Bigger is Better, FORBES, Jan. 12, 1998, at 152.
5. The HHI is a federal merger guideline used to evaluate post-merger market
the last year as to whether the Board actually uses the HHI standards of review and whether those standards actually serve as an impediment to proposed bank mergers that do not fall within its parameters.

In the last two years, the Board approved thirty-one merger applications\(^6\) that substantially exceeded the federal merger guidelines set by the HHI (Merger Guidelines).\(^7\) Additionally, in 1997, the Board suggested that bank mergers might actually fall under a more relaxed standard than the one established by the HHI and would face “clear sailing” through the review process even if they exceeded Merger Guidelines.\(^8\) These representations combined with the large number of mergers approved during 1996-97 that exceeded the Merger Guidelines seemed to confirm what most attorneys suspected, that the Board used a more relaxed standard to review bank mergers and that gaining approval for mergers that exceeded the current standard was not a difficult task.

However, during the last half of 1997, the Board sent out several signals that in the future it might not be as receptive to merger applications that excessively push guideline limits. The Board’s first signal came in June when Southern National proposed merging with United Carolina Bancshares Corporation.\(^9\) In that proposal, the Board approved the merger with a rare 3-2 split with concentration of banking resources. In bank mergers, an 1800/200 HHI ratio has been established as a safe harbor. See JOSEPH ANGLAND ET AL., ANTITRUST LAW DEVELOPMENTS 1238 (4th ed. 1997). The Board generally does not challenge mergers that have post-merger market concentration levels below this ratio. See id. Merger proposals with markets where the concentration levels exceed this ratio can still be approved if the acquiring bank can show the presence of mitigating factors that reduce the anticompetitive effects of the merger in the non-complying markets or can use divestitures to bring the post-merger HHI ratios in those markets within the safe harbor. See infra notes 35-39 and accompanying text (discussing the HHI in detail).

6. This Comment will use the words application(s) and proposal(s) interchangeably.

7. See infra notes 47, 50 and accompanying text. This Comment will use Merger Guidelines as a reference to the 1800/200 HHI standard for market concentration used by the Board when evaluating bank mergers. Also, this Comment will use the phrases Merger Guidelines and HHI Merger Guidelines interchangeably.

8. R. Christian Bruce, Mergers and Acquisitions: Fed Likely To Ease Bank Mergers By Using Relaxed Screening Criteria, 68 Banking Rep. (BNA) 712 (Apr. 14, 1997). In April 1997, Stephen Roades, Chief of the Federal Reserve’s financial structure section, told an ABA meeting that post-merger HHI’s that fell under a 2200/250 ratio would not be challenged by the Board. See id. Roades’ comment is some evidence that the safe harbor for bank mergers is actually greater than the 1800/200 ratio the Board holds it out to be.

the dissenters citing concern over the need for divestitures in three local markets in order to offset the potential adverse effects on competition threatened by the merger. Then, in September, Federal Reserve Governor Lawrence Meyer issued a warning following the Board’s approval of the Commercial Bank & Trust Co. merger. Meyer warned that due to the rapid pace of bank mergers the Board might in the future require more divestitures before granting approval of merger proposals. Finally, in December, the Board retracted even further from its hands off attitude regarding the use of the HHI Merger Guidelines when it approved the merger of NationsBank Corporation and Barnett Banks (NB-Barnett) after NationsBank agreed to divest over 100 branches in fifteen markets. In signing off on the deal, the Board released a statement saying that in the future it would be paying closer attention to merger applications that exceed the HHI standards, especially those that have potential adverse effects on a large number of markets.

If the Board has shifted its attitude toward bank merger review, it could mean substantial changes attorneys, banks, and businesses. After the NB-Barnett decision, one prominent industry attorney noted that banks may have to work harder to get approval of questionable proposals. With little indication of bank mergers declining in 1998 and the Board seemingly taking a firmer stance regarding the extent that future mergers may exceed the established guidelines, the next several years may be tough on attorneys and banking organizations trying to gain approval of mergers that push

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10. See id. at 602; see also UCB Merger Leads to Rare Split by Fed, THE BUS. J. (Charlotte), June 16, 1997, at 3 (discussing the split decision in the Southern National merger proposal).


15. See id.

Merger Guidelines. If attorneys hope to gain approval of questionable merger applications, they must return to the basics of showing why proposed mergers will not have adverse effects on competition despite a post-merger HHI ratio that substantially exceeds Merger Guidelines.

This Comment discusses in detail the merger applications approved and denied over the past two years that exceeded the HHI Merger Guidelines. The scope of this Comment is limited to evaluating the Board’s review of bank merger applications and its justifications for approving merger applications that substantially exceeded Merger Guidelines.17 More specifically, this Comment begins by explaining the HHI and its use in the review of bank merger applications.18 Second, the Comment addresses the bank merger applications approved during 1996-97 that either used divestitures to meet Merger Guidelines or exceeded Merger Guidelines but provided sufficient mitigating factors to gain approval.19 Third, the Comment analyzes the mitigating factors considered by the Board in approving the thirty-one applications that exceeded Merger Guidelines.20 Finally, the Comment discusses the two applications denied approval by the Board during 1996-97 and the recently approved applications that indicate a less lenient stance by the Board toward future merger review.21

II. THE HERFINDAHL-HIRSCHMAN INDEX

Bank mergers are generally controlled by the same legal rules regarding market concentration as those used in other industries.22 The Bank Merger Acts of 196023 and 196624 and the Bank Holding

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17. This Comment does not address bank merger review by the Office of the Comptroller of the Currency, the Federal Deposit Insurance Company, or the Department of Justice Antitrust Division.
18. See infra notes 22-39 and accompanying text.
19. See infra notes 40-53 and accompanying text.
20. See infra notes 54-135 and accompanying text.
21. See infra notes 136-86 and accompanying text.
22. See ANGLAND, supra note 5, at 1233.
Company Act incorporate the standards and language of Section 7 of the Clayton Act to formulate the general procedures and rules governing bank mergers. The goal of these laws is to prohibit any transaction "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 . . . ."

The agencies enforcing these laws have the added responsibility of not allowing applications "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." Three federal agencies review most commercial bank mergers: the Office of the Comptroller of the Currency (OCC), the Federal Deposit Insurance Company (FDIC), and the Board. Before a merger can be carried out, each of these three agencies must approve it. The Department of Justice Antitrust Division (DOJ) must also give a report approving an application before it can go

26. See id.
27. See id. § 1828(c)(5)(B).
28. See id. § 1828(c)(5)(A).
29. For a discussion on the standards for analyzing the competitive effects of bank mergers by the three agencies; see generally Martha Vestal Clarke, The Impact of Emerging Payment Systems and Products on Banking Competition and the Competitive Analysis of Bank Mergers and Acquisitions, 16 ANN. REV. BANKING L. 161, 171-86 (1997); Yvonne S. Quinn, Practical Aspects of Defending Bank Mergers Before the Federal Reserve Board and Department of Justice, 62 ANTITRUST L.J. 91, 101-04 (1993) (comparing Federal Reserve Board and Department of Justice bank merger review standards).
30. See 12 U.S.C. § 1828(c)(2)(A) (1994); see also ANGLAND, supra note 5, at 1235. The OCC reviews applications "where the ‘acquiring, assuming or resulting bank’ is a national bank." See id. If a merger were between two state chartered banks, it could be possible that the merging banks would not need approval of the OCC. See JONATHAN R. MACEY & GEOFFREY P. MILLER, BANKING LAW AND REGULATION 446-48 (2d ed. 1997).
31. See 12 U.S.C. § 1828(c)(2)(C) (1994); see also ANGLAND, supra note 5, at 1235. The FDIC reviews applications "where the acquiring or resulting bank will be a federally-insured, state-chartered bank that is not a member of the Federal Reserve System." See id.
32. See 12 U.S.C. § 1828(c)(2)(B) (1994); see also Angland, supra note 5, at 1235. The Board reviews applications "where the acquiring or resulting bank will be a state-chartered bank that is a member of the Federal Reserve System." See id. Board approval is also needed when Bank Holding Companies are involved in the proposed mergers. See MACEY & MILLER, supra note 30, at 446-48.
33. See supra note 30 for a situation when not all three agencies would need to approve a merger.
As noted above, this comment is limited to a discussion of the Board’s review of bank mergers during 1996-97.

The Board, like the other reviewing agencies, uses several steps to decide whether to approve a merger application. After the Board specifies the product and geographic market, it analyzes the market(s) degree of concentration before and after the proposed transaction. The Board uses the HHI, which “is a function of the number of firms in a market and their respective market shares,” to measure post-merger market concentration.

The HHI is calculated by squaring the market shares controlled by the individual market participants and adding the totals together. The Board considers both the post-merger market concentration and the raw increase in market concentration resulting from the merger. A merger will normally be approved, absent objection from the DOJ, where the post-merger HHI in a relevant geographic market is 1800 points or less or, if more than 1800, would have a raw increase of less than 200 points. This Comment will discuss the merger applications approved by the Board during 1996-97 where the post-merger HHI exceeded 1800 points and increased by more than 200 points.

34. See ANGLAND, supra note 5, at 1235. After the Board approves mergers, the DOJ can object during a thirty-day holding period. Thus, the DOJ’s role in the review process is more of an oversight role. See MACEY & MILLER, supra note 30, at 446-48. The Board is not required to get a DOJ report before approving applications, but it usually does so as a matter of practice. See ANGLAND, supra note 5, at 1235.

35. See MACEY & MILLER, supra note 30, at 482.


37. See id. For example, a market consisting of four firms with market shares of 30% for firm A, 30% for firm B, 20% for firm C, and 20% for firm D has an HHI of 2600 (30^2 + 30^2 + 20^2 + 20^2 = 2600). If firms A and B were to merge, the post-merger HHI would be 4400 (60^2 +20^2 + 20^2). The raw increase in HHI would be 1800 (4400-2600). The post-merger HHI over the raw increase is the post-merger HHI ratio, 4400/2600 in this example.

38. See id. See supra note 37 for an example of how the Board would calculate the post-merger HHI and the raw increase in HHI. Also note, the raw increase in market concentration can be calculated independently of the overall market concentration by doubling the product of the market shares of the merging firms. For example, the merger of firms A and B (each with 30% of the market share) from supra note 37 would increase the HHI by 1800 points (30 x 30 x 2 =1800).

39. See MACEY & MILLER, supra note 30, at 484 (citing 54 Fed. Reg. 39,043 (Sept. 22, 1989). Note that the HHI standards applied to bank mergers are less stringent than those in other industries. For a discussion of the general standards applied to horizontal mergers in other industries, see generally MACEY & MILLER, supra note 30, at 482-84. See infra note 107 and accompanying text for a more specific example of how the standards are less stringent than in other industries and how that affects the bank merger review process.
III. **Bank Mergers Approved During 1996-97**

Bank merger applications that could not initially meet the HHI Merger Guidelines gained the Board’s approval in several ways. First, several applications used divestitures to meet Merger Guidelines and to fall within the HHI safe harbor.\(^4^0\) Second, numerous applications used mitigating factors or a combination of mitigating factors and divestitures to gain the Board’s approval.\(^4^1\) This section discusses how both types of applications circumvented problems with HHI Merger Guidelines and gained the Board’s approval of otherwise questionable merger proposals.

### A. Pure Divestiture Proposals

During 1996-97, the Board approved twenty applications that initially exceeded Merger Guidelines and included divestitures as part of their proposal.\(^4^2\) Of those twenty applications, the Board approved eight that could not meet Merger Guidelines before divestitures but with divestitures were able to meet the market concentration guidelines as measured by the HHI.\(^4^3\) In those

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40. See infra notes 42-45 and accompanying text.

41. See infra notes 46-53 and accompanying text.


proposals, the merging banks generally only agreed to divest the number of branches necessary to allow the merger to meet HHI Merger Guidelines. As a result, the number of banks and the amount of deposits divested by each bank in the respective mergers varied greatly. Using divestitures to meet Merger Guidelines can be complicated and expensive, in terms of both lost bank business and costs associated with divestiture. Yet, when merger proposals do not present satisfactory mitigating factors, divestitures, if successfully used to meet Merger Guidelines, are a guaranteed way to gain the Board’s approval.

B. Hybrid Divestiture Proposals

Of the twenty applications approved by the Board during 1996-97 that included divestitures, twelve could not meet Merger Guidelines even with divestitures in local markets. Since these

44. For example, in the First State Bancshares merger, First State only divested one bank in order to meet the Merger Guidelines for market concentration. See First State Bancshares, 83 Fed. Res. Bull. at 46. This is a stark contrast to the Wells Fargo merger where 61 branches and $2.5 billion in deposits were divested in order to meet the Merger Guidelines for market concentration. See Wells Fargo, 82 Fed. Res. Bull. at 446.

45. For example, the Board approved the merger of NationsBank Corporation, Charlotte, North Carolina (NationsBank), with Bank South Corporation, Atlanta, Georgia (Bank South) after divestitures were used to meet HHI Merger Guidelines. See NB-Bank South, 82 Fed. Res. Bull. at 172. Before the merger, NationsBank and Bank South competed directly in five markets in Georgia. See id. Without divestitures, two markets, the Fitzgerald and Savannah markets, would have had a significant increase in market concentration. See id. In the Fitzgerald market, the HHI would have increased by 716 points to 2827, and in the Savannah market, the HHI would have increased by 213 points to 1827. See id. at 172 n.10. To meet the Merger Guidelines and mitigate the potential adverse market effects of the merger, NationsBank agreed to sell one branch in the Fitzgerald market to an out-of-market competitor. As a result, the HHI in that market remained unchanged. See id. at 173. To mitigate the adverse effects on competition in the Savannah market, NationsBank sold one branch to a market competitor. This divestiture allowed the HHI to increase by 185 points to 1799 in the Savannah market, and correspondingly met Merger Guidelines. See id. The Board concluded that in light of the divestitures and the numerous competitors that remained in both the Fitzgerald and Savannah markets, the merger was not likely to adversely affect market competition. See id.

46. See supra note 42 and accompanying text.

proposals could not meet Merger Guidelines with divestitures, the merging banks had to give the Board additional reasons not to deny their applications. Consequently, the Board was able to justify the approval of these twelve proposals only after concluding that other mitigating factors were present in addition to the divestitures. Most of the banks in the hybrid group used divestitures as a means solely to reduce their share of the market concentration. Thus, the banks were able to meet Merger Guidelines in most of the markets that exceeded the HHI safe harbor. The only difference between the

“Hybrids” will be used in this Comment to describe the twelve proposals approved due to a combination of divestitures and mitigating factors, which the Board felt reduced the potential anti-competitive effects of those proposals threatened by their post-merger HHI ratios.

48. For example, the Board approved the acquisition by Fleet Financial Group, Inc., (Fleet) of Shawmut National Corporation, (Shawmut) after considering divestitures made by Fleet and several mitigating factors. See Fleet Fin., 82 Fed. Res. Bull. at 50. Of the 26 markets where Fleet and Shawmut competed directly, 12 could not meet Merger Guidelines for market concentration without divestitures. See id. at 51. Even with divestitures, two markets, Hartford and Old Saybrook, both in Connecticut, were not within the HHI Merger Guidelines safe harbor. In those two markets, the Board used a combination of divestitures and other mitigating factors to justify its approval of the merger.

1. Hartford Banking Market

Upon consummation of the merger, without divestitures, Fleet would have become the largest depository institution in the Hartford banking market representing nearly 50% of market deposits. Fleet entered divestiture agreements to sell 25 branches and approximately $1.6 billion of deposits to mitigate the potential anti-competitive effects of this merger on the Hartford market. However, even with divestitures, the HHI increased 469 points to 1827. See id. at 51. In addition to the divestitures, the Board cited three reasons that the HHI tended to overstate the effect on competition that this merger would have on the Hartford market: as a result of the divestitures, two depository institutions in the market became more competitive, a large number of competitors remained in the market after the merger, and the market was attractive for entry. See id. at 52.

2. Old Saybrook Banking Market

Without divestitures, on consummation of the merger Fleet also would have become the largest depository institution in the Old Saybrook market, representing 33.2% of market deposits, and controlling $167 million in deposits. To reduce the potential adverse effects on competition in the Old Saybrook market, Fleet agreed to divest two branches and $32.3 million in deposits. Even with the divestitures, the HHI in the market increased 298 points to 1904, exceeding the HHI Merger Guidelines. See id. The Board cited three factors mitigating the potential adverse effects on the Old Saybrook market: six depository institutions competent to compete with Fleet remained in the market after the merger, thrift institutions in the Old Saybrook market provide a full range of banking services and competed with the commercial banks, and the Old Saybrook market was uniquely situated such that an unusually large number of banking and business alternatives were available for market residents. See id.
hybrid proposals and the pure divestiture proposals is that the hybrids were not able to meet Merger Guidelines in all of the markets where the merging banks directly competed.\(^4\)

Banks involved in the hybrid proposals used divestitures to place their applications closer to meeting Merger Guidelines and to strengthen their arguments that the post-merger HHI ratios tended to overstate the merger's anti-competitive effects on the markets concerned. Furthermore, the divestitures showed that the merging banks realized the potential adverse effects on competition raised by their merger proposals, and that they were taking steps to reduce those effects. These steps, combined with the mitigating factors found in each merger, helped the merging banks convince the Board to approve their applications. Appendix A provides a listing of the hybrid proposals the Board approved and the mitigating factors the Board considered in its decision to approve each application.

C. Solely Mitigating Factor Proposals

During 1996-97, the Board approved nineteen merger applications that exceeded the HHI Merger Guidelines after concluding that there were sufficient mitigating factors present to minimize the proposed merger's potential adverse effects on competition.\(^5\) In those nineteen applications, numerous mitigating

\(^4\) In 10 of the 12 proposals, divestitures permitted the merger candidate to meet HHI Merger Guidelines in all markets except one or two. Compare with NB-Barnett, 84 Fed. Res. Bull. 129 (stating that seven markets needed additional mitigating factors to reduce the potential anti-competitive effects of the proposed merger) and Southern Nat', 83 Fed. Res. Bull. at 597 (stating that seven markets needed additional mitigating factors to reduce the potential anti-competitive effects of the proposed merger).

Factors such as the number of competitors remaining in the market, the attractiveness of the market for entry, and the amount the HHI exceeded Merger Guidelines were some of the most commonly cited. Appendix B lists the solely mitigating factor proposals the Board approved during 1996-97 and summarizes the factors that the Board considered mitigating in each application. The next section provides an in-depth discussion of the actual mitigating factors considered by the Board in the twelve hybrid and nineteen solely mitigating factors proposals.

IV. MITIGATING FACTORS ANALYSIS

The Board approved thirty-one merger proposals during 1996-97 where the post-merger HHI substantially exceeded Merger Guidelines. Of those thirty-one, the Board approved nineteen after it concluded sufficient mitigating factors were present to minimize the potential adverse effects on competition threatened by the proposal. A combination of divestitures and various mitigating factors was used to gain approval in the other twelve applications.

The Board identified three factors that mitigated the potential adverse competitive effects on the Lincoln market threatened by the proposal. One, 18 competitors would remain in the market after the merger, including one that controlled 31.2% of the total deposits in depository institutions in the market. See id. Two, the market was attractive for out-of-market entry. Four factors made the market attractive for entry: (1) the market was the second most populous in Nebraska, (2) market population growth exceeded the national average between 1980-1992, (3) the market’s unemployment rate was half that of the national average, and (4) the market’s per capita income exceeded the national average. See id. Finally, the Merger Guidelines were only exceeded by a small amount. See id. For these reasons, the Board approved the merger of FSB and FirstTier despite the post-merger HHI ratio in the Lincoln Market substantially exceeding the Merger Guidelines. See id.

51. See infra notes 54-135 and accompanying text.
52. The First Bank System application is a good example of a typical application where the Merger Guidelines were exceeded but the proposal was approved based solely on the presence of mitigating factors. In that proposal, First Bank System Inc. (FBS), sought approval of a merger with FirstTier Financial, Inc. (FirstTier) based on several mitigating factors. See First Bank, 82 Fed. Res. Bull. at 169. FBS and FirstTier directly competed in four markets prior to the merger proposal. Consummation of the proposal would have caused the market concentration as measured by the HHI to exceed Merger Guidelines in the Lincoln, Nebraska, banking market. See id. at 171. In that market, the proposed merger would have increased the HHI by 222 points to 2207. See id.

53. See infra notes 54-135 and accompanying text.
54. See supra notes 47, 50 and accompanying text.
55. See supra note 50.
56. See supra note 47.
The Board cited fourteen different mitigating factors in those thirty-one proposals.\(^{57}\)

A. **Number of Competitors Remaining in the Market as a Mitigating Factor**

The most commonly cited mitigating factor was the number of competitors remaining in the market. In eighteen of the nineteen applications approved solely based on the presence of mitigating factors,\(^ {58} \) and in all twelve hybrid proposals,\(^ {59} \) the number of competitors remaining in the market was cited as a mitigating factor. Even more notable, within the twelve hybrid proposals, the Board considered the number of remaining competitors as a mitigating factor in all thirty markets where the Merger Guidelines threshold was exceeded.\(^ {60} \) The number of competitors remaining in the market ranged from four to fifty-eight.

\(^{57}\) See infra notes 54-135 notes and accompanying text (discussing the use of mitigating factors in the bank merger review process).


B. Nature of the Remaining Competitors

The Board considered not only the number of competitors remaining in the market but also the nature of those competitors. In seventeen of the thirty merger proposals where the number of remaining competitors was cited as a mitigating factor, the Board also considered the amount of market deposits controlled by the remaining competitors.61 Where the remaining competitors controlled a significant share of the market deposits, the Board considered the merger less likely to have adverse effects on market competition.

In addition to the market deposits controlled by the remaining competitors, the Board considered the size of the remaining competitors. Specifically, when the remaining competitors were bank holding companies,62 subsidiaries of bank holding companies,63 multi-billion dollar banking organizations,64 large multi-state banking organizations,65 or large in size relative to other banks in the state or in similar markets,66 the Board concluded that the merger was unlikely to adversely affect market competition.


C. Attractiveness for Market Entry as a Mitigating Factor

The second most commonly cited mitigating factor was the market's attractiveness for entry.\textsuperscript{67} In numerous merger applications, this factor was instrumental in mitigating the potential adverse effects on competition threatened by the proposals.\textsuperscript{68} The Board cited numerous factors making a market attractive for entry.

1. Population Factors Making a Market Attractive for Entry

In the solely mitigating factors proposals, various aspects of the market's population were cited in seven proposals as making a non-complying market attractive for entry.\textsuperscript{69} The biggest factor concerning population in these seven proposals was its growth in the market. For example, when the population growth exceeded the national\textsuperscript{70} or state average,\textsuperscript{71} increased at a higher rate than the surrounding rural areas\textsuperscript{72} or other similar counties,\textsuperscript{73} or increased by a large amount in general,\textsuperscript{74} the Board considered the population growth a factor making the market attractive for entry. Also, in these seven proposals, the Board considered the market population


\textsuperscript{68} See supra note 67.


\textsuperscript{72} See Nacogdoches, 82 Fed. Res. Bull. at 1122.

compared to other similarly situated markets in the state. When the market was one of the state’s most populous, the Board considered that a factor making the market attractive for entry.75 Finally, if the population per banking office exceeded the average population per banking office in other similarly situated markets, the Board considered the market attractive for entry.76

Aspects of the population of the market were also the leading factors making a market attractive for entry among the twelve hybrid proposals.77 The Board made a direct link between population growth and the attractiveness of a non-complying market for entry. For example, in six hybrid proposals the Board cited some form of population growth as making a market attractive for entry.78 The Board also cited other general aspects of market population as making a market attractive for entry in two hybrid proposals.79 When trying to evaluate the attractiveness of a market for entry, a good place to start is by evaluating the different aspects of a non-complying market’s population, especially its growth. The Board cited numerous other factors that made a market attractive for entry.

2. Other Factors Making a Market Attractive for Entry

The Board cited a number of factors in addition to the population factors that made a market attractive for entry.80 First, the Board noted that three aspects of market deposits made a market

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80. Unlike the previous section, this section does not separate the “other factors” making a market attractive for entry from those cited in solely mitigating factors proposals and those cited in hybrid proposals.
attractive for entry: growth, \textsuperscript{81} a relatively high level of total deposits, \textsuperscript{82} and an above average number of deposits per banking office. \textsuperscript{83} Second, recent market entry by other banking organizations made a market attractive for entry. In twelve merger applications, banks had recently entered the non-complying market or had made known their intention to enter the market. \textsuperscript{84} It did not seem to matter to the Board whether the recent entries were de novo or by acquisition. \textsuperscript{85} However, the Board did seem to give greater weight to recent entries made with the intention of entering the market than to those where entry had been made merely incidental to acquisition. \textsuperscript{86} Finally, the Board concluded seven other factors made a market attractive for entry: the size of the market, \textsuperscript{87} a low unemployment rate, \textsuperscript{88} a relatively high per capita income, \textsuperscript{89} a higher rate of return than banks statewide, \textsuperscript{90} a period of recent job growth, \textsuperscript{91} a relatively high household income ranking, \textsuperscript{92} and new roads connecting the market to a nearby larger city. \textsuperscript{93}


Where the Board found the markets attractive for entry, it was willing to give less weight to post-merger HHI ratios that substantially exceeded Merger Guidelines. In every proposal where the Board classified a market as attractive for entry, it used a combination of the above factors. Although no single factor seemed controlling in the Board’s decisions to classify certain markets as attractive for entry, it appeared that population factors, especially growth, and recent market entry by other banks, were significant to the Board. Also, when deciding what factors made a market attractive for entry, the Board seemed to make no real distinction between the hybrid and solely mitigating factors proposals.

D. Amount Post-Merger HHI Exceeds Merger Guidelines

Another mitigating factor the Board considered was the amount the post-merger HHI exceeded Merger Guidelines. Changes in the HHI that only exceeded Merger Guidelines by a “small amount” were considered mitigating. The Board did not specifically state what would constitute a “small amount.” It did, however, make note in two cases where it considered the HHI to exceed the Merger Guidelines by only a “small amount.” In First Bank System, the HHI increased 222 points to 2207, and in Norwest Corporation, the HHI increased 201 points to 2066. Therefore, it seems safe to say that if the raw increase in HHI is 222 points or less and the post-merger HHI does not exceed 2207 points, the Board would consider the HHI only to have exceeded Merger Guidelines by a “small amount” and would give that factor some mitigating value. The fact that the Board found the small increase in HHI to be a mitigating factor is basically consistent with the

94. See supra note 67 and accompanying text.
95. See supra notes 69-78, 84-86 and accompanying text.
representations made by the Board that mergers falling under a 2200/250 HHI ratio will face “clear sailing” through the review process.\footnote{100}

E. Other Factors Mitigating Potential Adverse Effects on Market Competition

In eight applications, the Board cited ease of entry into the market as a mitigating circumstance.\footnote{101} Low state legal barriers to bank expansion was the most specific factor the Board noted as making a market easy to enter. Once the Board established that the state allowed for interstate and statewide banking it was quick to find low legal barriers to market entry in all eight applications.\footnote{102} Since low legal barriers made it easy for banks to enter the markets in question, the Board gave less weight to the potential anti-competitive effects in those markets predicted by their high post-merger HHI ratios.

In several proposals, credit unions or savings and loan associations (thrifts) competing in a market also mitigated the anti-competitive effects of applications in numerous proposals.\footnote{103} The Board considered credit union participation in a market as a mitigating factor if the credit union was large\footnote{104} or made up a substantial portion of market deposits.\footnote{105} When thrifts provided a full

\footnote{100. \textit{See} Bruce, \textit{supra} note 8, at 712. In the Board’s representation, merger proposals that have a raw increase of 250 points or less and have a total post-merger HHI of 2200 points or less will not be challenged by the Board during the review process. \textit{See} id.}


range of banking services and/or could compete with the market’s commercial banks, the Board said this mitigated the mergers potential anti-competitive effects on competition.106 An interesting point to note is that part of the reason the guideline for raw HHI increase in bank mergers is 200, as opposed to 50 or 100 as it is in guidelines for other industries, is because the guidelines for bank mergers take into account limited purpose lenders, such as credit unions and thrifts, and other non-depository financial entities.107 By counting credit union and thrift participation in the markets as a mitigating factor, the Board may in essence be counting these institutions twice. This further supports the argument that in the past few years the Board has reviewed bank mergers leniently with regard to the HHI.

Physical market descriptions and various reasonable ways to calculate the HHI were additional factors that the Board found mitigated potential adverse effects on market competition. For example, when the non-complying markets were small,108 rural,109 sparsely populated,110 or strategically located near other comparable business and banking alternatives,111 the Board decided that the HHI might overstate the anti-competitive effects of the merger. Also, in three applications, the Board concluded there was more than one reasonable way to calculate the market HHI. Thus, after recalculating the HHI, the Board concluded that the HHI overstated the anti-competitive effects of the proposal and went on to approve the application.112

Res. Bull. at 168.

110. See Community Bancshares, 82 Fed. Res. Bull. at 736. Note: Do not confuse this mitigating factor with the population factors making a market attractive for entry.
112. In Banco Santander, 82 Fed. Res. Bull. 833, 834-35 (1996), and Banco Popular de Puerto Rico, 83 Fed. Res. Bull. 612, 613 (1997), if cooperatives (commonwealth-insured depository institutions that provide a wide range of banking services to customers including transaction accounts, personal loans, and small business loans) were included in the HHI calculation, the proposal would have met Merger Guidelines. In Interwest Bancorp, 82 Fed.
Another factor mitigating a merger’s potential adverse effects on competition was the competitive trend in the market in the years prior to the proposed merger. When the HHI decreased in the years prior to the merger, adverse effects were mitigated.\textsuperscript{113} Adverse effects were also mitigated when the largest depository institution’s share of market deposits had decreased and the smallest depository institutions’ market shares had increased.\textsuperscript{114} Generally, the Board viewed recent trends making markets more competitive as reducing the anti-competitive effects of proposed mergers in those markets.\textsuperscript{115}

The Board also used the product focus and customer make-ups of the merging banks as mitigating factors.\textsuperscript{116} In Aspen Bancshares, the merging banks dealt primarily with mortgage and commercial lending respectively.\textsuperscript{117} Since the merging banks really did not compete for the same product or the same customers, the Board felt the HHI overstated the anti-competitive effects of the merger.\textsuperscript{118} In Exchange Bancshares, a substantial portion of the bank customers involved were military personnel living outside the market.\textsuperscript{119} The Board considered this a mitigating factor as well.\textsuperscript{120}

In five hybrid proposals, the Board concluded several factors stemming from divestitures reduced the adverse effects on market competition threatened by the proposed merger.\textsuperscript{121} In Fleet Financial,\textsuperscript{122} divestitures allowed two depository institutions in the non-complying market to increase their amount of deposits and their

\textsuperscript{116} Arguably, these factors were decided in the phase of the review that evaluates the appropriate product market and should not be considered again as a mitigating factor.
\textsuperscript{118} See id.
\textsuperscript{120} See id.
\textsuperscript{122} 82 Fed. Res. Bull. at 52.
share of market deposits. In *Southern National*, divestitures caused a similar action in the Goldsboro, North Carolina, banking market where two smaller competitors increased their market deposits by three percent. Also in *Southern National*, divestitures to an out-of-market competitor allowed a comparable bank to replace Southern National as the second largest deposit holder in the Columbus County, North Carolina, banking market. The Board held this replacement reduced the merger's anti-competitive effects in that market. In *U.S. Bancorp*, sixteen divestitures in the Portland banking market reduced U.S. Bancorp's market deposits by $341 million; the Board held this large reduction in market deposits mitigated the merger's potential adverse effects on competition. Finally, in *Wachovia Corporation* and *NB-Barnett*, divestitures allowed the number of competitors in the market to not change as a result of the proposed merger. The Board also found this a mitigating factor.

Finally, the Board found that the special circumstances surrounding three of the merger applications mitigated those mergers' potential adverse effects on market competition. In *G.B Financial Services*, the merging banks had a long history of affiliation and were controlled by basically the same Board of Directors and shareholders for the years leading up to the merger proposal. This situation mitigated the potential anti-competitive effects of the merger, since the market would not really change after the merger. In *NB-First Nat'l*, after the merger, NationsBank would be acting solely in a fiduciary relationship for family trusts they acquired as part of an acquisition where they acquired banks that were holding the trusts at the time of the merger. Since NationsBank was acting solely in a fiduciary relationship and controlled only a small voting share in each bank, the possible adverse effects of the merger were mitigated. In *Southern National*, since the amount of market deposits the largest competitor controlled in the Columbus County, North Carolina, banking market after the merger was only a small amount larger than the amount of market deposits controlled by the largest competitor before the merger, the adverse effects on competition threatened by the proposed merger

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123. See id.
125. See id.
126. See id.
127. See id.
129. See id.
133. In *G.B Financial Services*, the merging banks had a long history of affiliation and were controlled by basically the same Board of Directors and shareholders for the years leading up to the merger proposal. This situation mitigated the potential anti-competitive effects of the merger, since the market would not really change after the merger. In *NB-First Nat'l*, after the merger, NationsBank would be acting solely in a fiduciary relationship for family trusts they acquired as part of an acquisition where they acquired banks that were holding the trusts at the time of the merger. Since NationsBank was acting solely in a fiduciary relationship and controlled only a small voting share in each bank, the possible adverse effects of the merger were mitigated. In *Southern National*, since the amount of market deposits the largest competitor controlled in the Columbus County, North Carolina, banking market after the merger was only a small amount larger than the amount of market deposits controlled by the largest competitor before the merger, the adverse effects on competition threatened by the proposed merger
special circumstances mitigating factor was unique to the proposals and markets in question and was used in addition to other mitigating factors in the market. 134

The mitigating factors the Board found in the hybrid and in the solely mitigating factors proposals were identical in some respects and very different in others. In both types of proposals, the Board cited some of the same factors, such as the number of competitors remaining in the market and attractiveness of a market for entry. However, the Board did cite some factors that were unique to the hybrid proposals like the factors deriving from divestitures. In both sets of proposals, the Board used a combination of factors to mitigate the anti-competitive effects of the questionable mergers. The Board did not indicate that any of the factors cited in either set of proposals would have been sufficient by themselves to mitigate the potential adverse effects of the mergers, but it did seem to give substantial weight to the number of competitors remaining in the market and the market's attractiveness for entry. 135 These two factors were prevalent in almost every proposal the Board approved where the HHI Merger Guidelines were exceeded. Barring a unique situation or outlier, any successful proposal to the Board where the HHI Merger Guidelines have been exceeded will need to contain these mitigating factors, regardless of whether the proposal is a hybrid or one that only cites mitigating factors.

V. PROPOSALS DENIED DUE TO POST-MERGER HHI RATIOS EXCEEDING MERGER GUIDELINES AND THE BOARD'S SHIFTING APPROACH TOWARD MERGER REVIEW

The large number of mergers approved over the last two years despite post-merger HHI ratios that exceeded Merger Guidelines are strong evidence that the Board has been less than stringent in its application of the Merger Guidelines during the bank merger review process. In fact, one could argue that the Board really does not apply the guidelines except in the most extraordinary circumstances.

135. The number of competitors remaining in the market and the attractiveness of a market for entry were cited as mitigating factors in thirty and eighteen proposals respectively. See supra notes 58-59, 67 and accompanying text.
However, this generalization of the Board’s approach to the bank merger review process may not be solidly founded. Even if this generalization is solidly founded, it may not hold true for the future. During 1996-97, the Board did deny two merger applications and sent out several signals that in the future it was planning to evaluate bank mergers with respect to the HHI Merger Guidelines more closely. A leading industry attorney has noted that banks may have to work harder in the future to gain approval of mergers that push and exceed the HHI Merger Guidelines.\textsuperscript{136} This section examines the two applications the Board denied during 1996-97 and looks at signals the Board sent out in the latter half of 1997 indicating that in the future it might be reviewing bank mergers more closely.

A. Applications Denied Approval by the Board

During 1996-97, the Board denied two proposals by bank holding companies to acquire thrift holding companies.\textsuperscript{137} Even though the two proposals were ultimately denied for different reasons, they were similar in several respects.

First, the applicants would have been in relatively similar situations with respect to their market positions after the proposed mergers. In both First State Bancshares’ proposal to acquire First Southwest Bancorp\textsuperscript{138} and BancSecurity Corporation’s proposal to acquire Marshalltown Financial Corporation,\textsuperscript{139} had the mergers been approved, they would have more than substantially exceeded the HHI Merger Guidelines.\textsuperscript{140} Also, the surviving banks in both proposals would have controlled an inordinate amount of market deposits.\textsuperscript{141}

In addition to their unfairly advantageous post-merger positions, these two proposals were similar in their inability to

\footnotesize{\textsuperscript{136} See Banks May Have to Work Harder, supra note 16, at 904.  
\textsuperscript{140} See BancSecurity, 83 Fed. Res. Bull. at 125 (the HHI would have increased by 849 points to 3032); First State, 82 Fed. Res. Bull. at 955-56 (the HHI would have increased by 1208 points to 5549).  
\textsuperscript{141} See BancSecurity, 83 Fed. Res. Bull. at 125 (BancSecurity would have controlled just less than 50% of market deposits); First State, 82 Fed. Res. Bull. at 955 (First State would have controlled more than 66% of market deposits).}
establish the presence of any of the commonly cited mitigating factors.\textsuperscript{142} For example, the Board did not find the presence of competitors remaining in the market a significant mitigating factor in either denied proposal.\textsuperscript{143} Without mitigating factors, the merging banks were left with extraordinarily high post-merger HHI ratios. In both \textit{First State} and \textit{BancSecurity}, the adverse effects on competition threatened by the high post-merger HHI ratios could not be discounted through divestitures, mitigating factors, or a combination of the two. Therefore, the Board followed Merger Guidelines and refused to approve the applications due to their potential adverse effects on market competition.\textsuperscript{144}

While \textit{First State} and \textit{BancSecurity} were aberrations from the Board’s rubber stamp approach to reviewing bank merger applications, the Board has taken several actions indicating that it may deny more proposals in the future. The split opinion in the Southern National merger,\textsuperscript{145} Governor Meyer’s warning that the rapid pace of bank mergers might lead the Board to require more divestitures in future mergers before granting approval,\textsuperscript{146} and the Board’s statements following the recent decision in \textit{NB-Barnett} all indicate that the Board will probably more closely scrutinize bank merger proposals in the future. These warning signals are analyzed below to demonstrate what, if any, impact they may have on industry attorneys preparing to present to the Board a proposed merger that will exceed the HHI Merger Guidelines.

\textbf{B. The Southern National Dissent}

Vice Chairwoman Alice Rivlin and Governor Meyer (the dissenters) believed the Southern National application should have

\begin{itemize}
\item 142. \textit{See} Appendix C.
\item 143. \textit{See} \textit{First State}, 82 Fed. Res. Bull. at 956; \textit{BancSecurity}, 83 Fed. Res. Bull. at 125-26. This is even more important when you consider that thirty of the thirty-one proposals approved during 1996-97 despite exceeding the HHI Merger Guidelines contained the number of competitors remaining in the market as a mitigating factor. \textit{See supra} notes 58, 59 and accompanying text.
\item 144. Appendix C discusses these applications in detail in order to facilitate understanding why they were not approved while so many other applications were.
\item 146. \textit{See} \textit{Federal Bank Regulator Threatens Strict Stance on Future Mergers, supra} note 11, at F7.
\end{itemize}
been denied because of its potential adverse effects on competition in the Columbus County, Statesville, and Goldsboro, all in North Carolina, banking markets. The Merger Guidelines in all three non-complying markets were exceeded to a degree found questionable by the Board. Also, in two of the three non-complying markets, the surviving bank controlled a large portion of market deposits. The dissenters argued that additional divestitures were needed in those markets to reduce the merger’s potential anti-competitive effects.

The dissenters’ greatest concerns were over the Columbus County banking market. In that market, the HHI increased to almost 4500 after the merger, and Southern National controlled nearly sixty-four percent of market deposits. The dissenters argued that “failure to reject the merger or to make the merger conditional on further divestitures in this market (Columbus County) . . . sets an undesirable precedent and allows a level of concentration and market share . . . too high to warrant Board approval.” Further, the dissenters did not feel that the mitigating factors cited by the majority reduced the merger’s anti-competitive effects in the Columbus County market. Two banks had planned to enter the Columbus County market. The majority had noted that if these two banks could procure $5 million in deposits, the proposal would meet the HHI Merger Guidelines in the Columbus County market. The dissenters contended there was not sufficient evidence to show the two firms entering the market were likely to obtain the amount of deposits necessary to reduce the anti-competitive effects of the merger.

148. See Southern Nat’, 83 Fed. Res. Bull. at 598-99. In the Columbus County market, the HHI increased by 277 points to 4493; in the Statesville market, the HHI increased 400 points to 2265; and in the Goldsboro market, the HHI increased 248 points to 2295. See id.
149. See Southern Nat’, 83 Fed. Res. Bull. at 598-99 (In the Columbus County, Statesville, and Goldsboro banking markets, Southern National controlled 63.8, 29.8, and 35.6% of market deposits after the merger, respectively).
150. See id.
151. See id.
152. Id.
153. See id.
154. See id. at 598.
155. See id.
156. See id. at 602.
dissenters concluded there were no other valid mitigating factors. Therefore, they believed the merger should have been denied unless further divestitures were made.\footnote{157}

The potential adverse effects on competition in the Statesville and Goldsboro banking markets also troubled the dissenters. The Statesville market had the merger’s second highest raw increase in HHI, 400 points.\footnote{158} The HHI increase moved the Statesville market from being reasonably competitive to being highly concentrated.\footnote{159} Consequently, the dissenters described the HHI increase as pushing and exceeding the outer limits of what the Board should approve.\footnote{160}

In the Goldsboro market, the proposal resulted in Southern National controlling 35.6 percent of the market deposits and the HHI increasing 248 points to 2295.\footnote{161} The dissenters did not feel there were any mitigating factors in the Goldsboro market. As in the Statesville market, the dissenters concluded the Goldsboro market exceeded the market concentration level to such an extent that the Board should not have approved the merger application.\footnote{162}

The most notable aspect of the Southern National opinion is that it indicated that the entire Board was uncomfortable with the growing number of mergers that exceeded Merger Guidelines in a number of local markets. Governor Meyer used Southern National to state his concerns over the state of bank mergers and the need for more divestitures when there are few or no mitigating factors in a local market that reduce the adverse effects on the market caused by a merger.\footnote{163} Governor Meyer was consistent with this position following the Commercial Bank & Trust Co. decision when he stated the Board may require more divestitures in the future.\footnote{164} Finally, the Southern National dissent provided a basis for the pushing the

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envelope language supported by the whole Board in its statements following the recent *NB-Barnett* decision.\(^\text{165}\)

**C. Recent NB-Barnett Decision**

The statement the Board released after the decision in the recent *NB-Barnett* proposal was the most solid evidence yet that in the future the Board plans to review bank merger proposals with a closer eye to post-merger market concentrations. Several factors seem to have led to the Board's plan for a refocused emphasis on post-merger market concentrations. The most notable factor is the increased number of bank mergers testing the outer limits of the HHI Merger Guidelines.\(^\text{166}\) An additional factor is a Board that is seemingly less tolerant of merger applications that substantially exceed Merger Guidelines.\(^\text{167}\) Whatever the reason, banking industry attorneys need to take notice because the Board has sent a message and its content is clear. Big deals like the ones highlighting the latter half of 1997 are going to be subjected to closer scrutiny “when market concentration guidelines are exceeded in a large number of local markets.”\(^\text{168}\)

The Board’s statement indicated, however, that there would not be a total break from bank merger review standards. The decision did not change the HHI Merger Guidelines.\(^\text{169}\) The federal merger guidelines for a bank merger are still 1800/200.\(^\text{170}\) The Board’s statement also did not reflect a major change in the policy stance of the Board concerning bank mergers.\(^\text{171}\) What the statement did highlight was the Board’s plan to change the emphasis during the review process, especially in proposals dealing with large mergers that included transactions likely to affect numerous markets.\(^\text{172}\)

\(^{165}\) See *Southern Nat'l*, 83 Fed. Res. Bull., at 602; see also *Bruce*, *supra* note 14, at 904.

\(^{166}\) See *Bruce*, *supra* note 14, at 904.

\(^{167}\) See *Banks May Have to Work Harder*, *supra* note 16, at 904 (noting a change in the composition of the Board).

\(^{168}\) *Bruce*, *supra* note 14, at 904.

\(^{169}\) See *id.* at 903.

\(^{170}\) See *id.*

\(^{171}\) See *id.*

\(^{172}\) See *id.*
Under the Board’s new emphasis, it has indicated that in large mergers (like the mega-mergers that grabbed the headlines toward the end of 1997) where a significant number of markets are likely to be adversely affected, the Board is going to focus more intently on the possible effects of the merger in the non-complying markets. The Board laid out what it considers important under its new emphasis. First, in highly concentrated markets the Board will make special note of the raw increase in the HHI. Second, the Board will pay close attention to the acquirer’s market share resulting from the merger. Third, the Board will closely scrutinize the strength and nature of the remaining competitors in the market. Finally, the Board has provided a catchall provision requiring it to consider “the strength of additional positive and negative forces that may affect competition for financial services in each market.”

This new emphasis really does not appear to change the Board’s focus because it has always considered these factors when evaluating a merger proposal. However, there are several ways to interpret the new emphasis. For example, it may have simply been that the Board did not consider these factors as closely as thought in the past. It also may be that the Board plans to scrutinize these factors more closely than other factors in the future or it could be that the Board has not really changed its position at all.

Although the full repercussions of the Board’s statement following the NB-Barnett decision are not readily apparent, it would be risky and arguably foolish to ignore them. Industry attorneys must strongly consider the statement in preparing for future proposals before the Board. Attorneys and banks that are contemplating a mega-merger where a large number of markets are going to exceed the HHI Merger Guidelines should be prepared to present numerous mitigating factors because the Board is going to evaluate their applications through a magnifying lens.

Banks can do several things to improve their chances of gaining the Board’s approval under the new emphasis. Banks can

\[ \text{References:} \]

173. See id.
174. See id.
175. See id.
176. See id.
177. Id.
make a stronger case for approval under the Board’s new emphasis if they try to minimize the raw increase in HHI and the acquirer’s post-merger market share.\textsuperscript{178} Arguing not only that there are numerous competitors remaining in the market but also that the remaining competitors are strong is also essential to gaining application approval.\textsuperscript{179} An additional way to gain the Board’s approval is through divestitures. Finally, if a bank is proposing an abnormally offensive merger, it should use the catchall provision to point out factors detracting from the merger’s potential adverse effects on market competition.\textsuperscript{180}

Dissecting the cases approved and denied by the Board over the last few years shows numerous mitigating factors that the Board feels comfortable in using as evidence that merger proposals will not adversely affect market competition, even though the proposals substantially exceed the HHI Merger Guidelines.\textsuperscript{181} Banks should evaluate these factors to understand the types of things the Board looks for in a mitigating factor. Banks should also use these factors as the bases for their arguments that their mergers do not adversely affect market competition. Note, however, that while the Board has created a substantial list of factors attorneys can use to create their arguments, the Board “may not be as receptive to arguments that questionable concentration levels are offset by other factors.”\textsuperscript{182}

The Board’s recent statement and its new emphasis have not dramatically changed preparation for future large mergers, and they have not changed the Board’s criteria concerning small and midsize mergers when large numbers of markets are not affected.\textsuperscript{183} The new emphasis simply places banks and their attorneys on notice of specific areas the Board will be more closely scrutinizing if it feels the merger proposal might be pushing the envelope. Finally, while

\textsuperscript{178} See id.
\textsuperscript{179} See id.
\textsuperscript{180} See id.
\textsuperscript{181} See supra notes 54-135 and accompanying text.
\textsuperscript{182} Bank May Have to Work Harder, supra note 16, at 904.
\textsuperscript{183} See Bruce, supra note 14 at 903. The scrutiny mega-mergers will be placed under probably will not be put on these small to medium-sized applications. Therefore, the mitigating factors arguments made over the last two years should suffice to gain the Board’s approval for small and medium-sized merger proposals that exceed Merger Guidelines. See supra notes 40-53 and accompanying text for the ways to circumvent HHI Merger Guidelines.
the Board may not have greatly changed the review process, it did make it clear that this is a notice case, and it does not want to have to give further notice by denying a merger proposal. The Board has also made it clear that it has seen the edges of the HHI Merger Guidelines pushed for the last two years, and it doesn't like the "creeping." If bank industry attorneys do not take notice, they could be jeopardizing future proposals.

VI. CONCLUSION

Over the past two years, the Board has approved mergers notwithstanding their failure to comply with the HHI Merger Guidelines. Obviously, divestitures can solve market concentration problems, but mitigating factors can be argued in conjunction with divestitures or in the place of them with equal success. The mitigating factors the Board has found most compelling (when supported by the factual record) are the number of competitors remaining in the market, the market's attractiveness for entry, and the amount the post-merger HHI exceeds Merger Guidelines. Merger applications seeking to consummate mergers in concentrated markets should carefully consider the possible application of these mitigating factors, or if they are not present, arrange for divestitures. The Board seems to have signaled its concern over the large merger transactions where there is significant post-merger market concentration in a number of markets. The Board expressed this concern in Southern National and in its statement following the recent NB-Barnett decision. Although the NB-Barnett application was ultimately approved, the Board indicated that it did not like the "creeping" and in the future it was going to more closely scrutinize merger applications for large mergers that exceeded Merger Guidelines in numerous markets. Although the Board has indicated it will use closer scrutiny in certain future proposals, it seems that, for the most part, the HHI guidelines are not strictly adhered to and are not a true impediment to merger proposal approval even when the proposal

184. See id. at 903.
185. Id. at 904.
186. See id.
substantially exceeds Merger Guidelines for market concentration. Unless the Board comes full circle in its view toward merger review, in most cases the road seems clear for future mergers whether they conform to merger guideline standards or not.

CHAD F. BROWN
## APPENDIX A
Hybrid Proposals

<table>
<thead>
<tr>
<th>CASE NAME</th>
<th>POST-MERGER AND RAW INCREASE IN HHI</th>
<th>MITIGATING FACTORS</th>
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</thead>
<tbody>
<tr>
<td>Fleet Financial Group (Hartford) (82 Fed. Res. Bull. 50)</td>
<td>(Hartford) 1827/469</td>
<td>(Hartford) Number of competitors remaining in the market, attractiveness of market for entry, and increases in amount of deposits and shares of deposits by two depository institutions as a result of the divestitures.</td>
</tr>
<tr>
<td>(Old Saybrook) 1904/298</td>
<td>(Old Saybrook) Number of competitors remaining in the market, thrift institutions in the market capable of competing with commercial banks, and unique location of the market near three Ranally Metropolitan Areas and two central business districts.</td>
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<tr>
<td>Boatmen’s BancShares (Muskogee) (82 Fed. Res. Bull. 167)</td>
<td>(Muskogee) 2279/236</td>
<td>(Muskogee) Number of competitors remaining in the market, attractiveness of market for entry, and banks in the market that are generally more profitable than other similarly situated banks in the state.</td>
</tr>
<tr>
<td>U.S. Bancorp (Portland) (82 Fed. Res. Bull. 177)</td>
<td>(Portland) 2226/230</td>
<td>(Portland) Reduction in number and percentage of market deposits because of divestitures, number of competitors in market stayed the same after the merger, and attractiveness of market for entry.</td>
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<tr>
<td>CASE NAME</td>
<td>POST-MERGER AND RAW INCREASE IN HHI</td>
<td>MITIGATING FACTORS</td>
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<tr>
<td>CoreStates Financial Corp. (Berks Co.) (82 Fed. Res. Bull. 430)</td>
<td>2304/200</td>
<td>(Berks Co.) Number of competitors remaining in the market and high household income compared to other markets in the state.</td>
</tr>
<tr>
<td>River Valley Bancorp (Madison) (82 Fed. Res. Bull. 1136)</td>
<td>2608/329</td>
<td>(Madison) Number of competitors remaining in the market and increase in market competitiveness in recent years.</td>
</tr>
<tr>
<td>Southern Nat’l Corp. (83 Fed. Res. Bull. 596)</td>
<td>4493/277</td>
<td>(Columbus Co.) Small increase in market control by largest competitor, divestitures allowed a large new market competitor to replace Southern National as the second largest market competitor, number of competitors remaining in the market, and the intention of two new competitors to enter the market.</td>
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<td></td>
<td>2295/248</td>
<td>(Goldsboro) Number of competitors remaining in the market, attractiveness of market for entry, and increased amount of market deposits controlled by two smaller market competitors as a result of divestitures.</td>
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<td></td>
<td>2195/296</td>
<td>(Sanford) Number of competitors remaining in the market and attractiveness of market for entry.</td>
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<td>1988/330</td>
<td>(Moore Co.) Number of competitors remaining in the market and attractiveness of market for entry.</td>
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<td>CASE NAME</td>
<td>POST-MERGER AND RAW INCREASE IN HHI</td>
<td>MITIGATING FACTORS</td>
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<td>Southern Nat'l Corp. (Pitt Co.) 1886/325 (Statesville) 2265/400 (Fayetteville) 2019/500</td>
<td>(Pitt Co.) Number of competitors remaining in the market, attractiveness of market for entry, and the presence of a thrift institution in the market that fully competed with commercial banks in the market. (Statesville) Number of competitors remaining in the market, attractiveness of market for entry, and a decrease in market HHI in years prior to the merger. (Fayetteville) Number of competitors remaining in the market and attractiveness of market for entry.</td>
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<td>Mercantile Bancorporation (Pettis Co.) 2522/223 (Phelps Co.) 2234/204</td>
<td>(Pettis Co.) Number of competitors remaining in the market and attractiveness of market for entry. (Phelps Co.) Number of competitors remaining in the market and attractiveness of market for entry.</td>
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<td>Associated Banc-Corp (Manitowoc-Two Rivers) 2144/305</td>
<td>(Manitowoc-Two Rivers) Number of competitors remaining in the market, attractiveness of market for entry, and low legal barriers to entry.</td>
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<td>Union Planters Corp. (Washington Co.) 2053/280</td>
<td>(Washington Co.) Number of competitors remaining in the market and rural nature of the market.</td>
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<td>CASE NAME</td>
<td>POST-MERGER AND RAW INCREASE IN HHI</td>
<td>MITIGATING FACTORS</td>
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<td>Wachovia Corp. (Charlottesville) (83 Fed. Res. Bull. 1020)</td>
<td>(Charlottesville) 2237/277</td>
<td>Number of competitors remaining in the market, attractiveness of market for entry and other factors occurring due to divestitures.</td>
</tr>
<tr>
<td>NB-Barnett (Naples) (84 Fed. Res. Bull. 129)</td>
<td>(Naples) 1839/548</td>
<td>Number of competitors remaining in the market, attractiveness of market for entry, and two banks announced plans to enter market.</td>
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<td>(Orlando) 2063/445</td>
<td>Number of competitors remaining in the market and attractiveness of market for entry.</td>
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<td>(Polk Co.) 1906/383</td>
<td>Number of competitors remaining in the market and attractiveness of market for entry.</td>
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<td></td>
<td>(Punta Gorda) 2131/400</td>
<td>Number of competitors remaining in the market and attractiveness of market for entry.</td>
</tr>
<tr>
<td></td>
<td>(Tallahassee) 1815/254</td>
<td>Number of competitors remaining in the market and attractiveness of market for entry.</td>
</tr>
<tr>
<td></td>
<td>(Ocala) 2067/503</td>
<td>Number of competitors remaining in the market, attractiveness of market for entry, and market divestitures would add a competitor or make a market competitor more competitive.</td>
</tr>
<tr>
<td>CASE NAME</td>
<td>POST-MERGER AND RAW INCREASE IN HHI</td>
<td>MITIGATING FACTORS</td>
</tr>
<tr>
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<tr>
<td>NB-Barnett</td>
<td>(Fort Myers) 2035/377</td>
<td>Number of competitors remaining in the market, attractiveness of market for entry, and the number of market competitors would remain the same and an effective new competitor would enter the market as a result of divestitures. (Fort Myers)</td>
</tr>
<tr>
<td></td>
<td>(Daytona Beach) 2121/368</td>
<td>Number of competitors remaining in the market and attractiveness of market for entry. (Daytona Beach)</td>
</tr>
<tr>
<td></td>
<td>(Tampa Bay) 1918/467</td>
<td>Number of competitors remaining in the market and attractiveness of market for entry. (Tampa Bay)</td>
</tr>
<tr>
<td></td>
<td>(Brevard) 1962/342</td>
<td>Number of competitors remaining in the market, attractiveness of market for entry, and divestitures strengthen a local competitor's market position. (Brevard)</td>
</tr>
<tr>
<td></td>
<td>(Sarasota) 1808/380</td>
<td>Number of competitors remaining in the market and attractiveness of market for entry. (Sarasota)</td>
</tr>
<tr>
<td></td>
<td>(Brunswick Co.) 2025/421</td>
<td>Number of competitors remaining in the market, attractiveness of market for entry, and a new effective market competitor as a result of divestitures. (Brunswick Co.)</td>
</tr>
</tbody>
</table>
### APPENDIX B

Solely Mitigating Factors Proposals

<table>
<thead>
<tr>
<th>CASE NAME</th>
<th>POST-MERGER AND RAW INCREASE IN HHI</th>
<th>MITIGATING FACTORS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Norwest Corp. (82 Fed. Res. Bull. 156)</td>
<td>(Canton) 2066/201</td>
<td>(Canton) Number of competitors remaining in the market, state’s largest credit union competed in the market, and Merger Guidelines only exceeded by a small amount.</td>
</tr>
<tr>
<td>First Bank System (82 Fed. Res. Bull. 169)</td>
<td>(Lincoln) 2207/222</td>
<td>(Lincoln) Number of competitors remaining in the market, attractiveness of market for entry, and Merger Guidelines only exceeded by a small amount.</td>
</tr>
<tr>
<td>Aspen Bancshares (82 Fed. Res. Bull. 665)</td>
<td>(Cortez) 2367/657</td>
<td>(Cortez) The merging banks consisted of a thrift institution that focused primarily on mortgage lending and a commercial bank that focused primarily on commercial lending, number of competitors remaining in the market, attractiveness of market for entry, and low legal barriers to market entry.</td>
</tr>
<tr>
<td>CASE NAME</td>
<td>POST-MERGER AND RAW INCREASE IN HHI</td>
<td>MITIGATING FACTORS</td>
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</tr>
<tr>
<td>Banco Santander, S.A. (82 Fed. Res. Bull. 833) (San Juan) 1896/231 (Aguadilla) 3001/253</td>
<td>(San Juan) Number of competitors remaining in the market and the ability of the market to meet Merger Guidelines when recalculated to include savings and credit union cooperatives. (Aguadilla) Number of competitors remaining in the market and the ability of the market to meet Merger Guidelines when recalculated to include savings, and credit union cooperatives.</td>
<td></td>
</tr>
<tr>
<td>First Southern Bancorp (82 Fed. Res. Bull. 854) (Danville) 1914/272</td>
<td>(Danville) Number of competitors remaining in the market (with specific mention of the nature of the remaining competitors).</td>
<td></td>
</tr>
<tr>
<td>First Merchants Corp. (82 Fed. Res. Bull. 942) (Muncie) 2184/281</td>
<td>(Muncie) Number of competitors remaining in the market and attractiveness of market for entry.</td>
<td></td>
</tr>
<tr>
<td>InterWest Bancorp (82 Fed. Res. Bull. 944) (Omak-Okanogan) 1875/397 (Chelan) 2981/211</td>
<td>(Omak-Okanogan) Number of competitors remaining in the market and the ability of the market to meet Merger Guidelines when calculated using only individual, partnership, and corporation deposits. (Chelan) Number of competitors remaining in the market, attractiveness of market for entry, and low legal barriers to market entry.</td>
<td></td>
</tr>
<tr>
<td>CASE NAME</td>
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<td>MITIGATING FACTORS</td>
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</tr>
<tr>
<td>First Union Corp. (Highlands Co.) (82 Fed. Res. Bull. 1123)</td>
<td>2273/238</td>
<td>(Highlands Co.) Number of competitors remaining in the market and attractiveness of market for entry.</td>
</tr>
<tr>
<td>G.B. Financial Services (Roseau) (83 Fed. Res. Bull. 509)</td>
<td>3769/414</td>
<td>(Roseau) Basically the same individuals controlled the merging banks before after the merger and a long history of affiliation between the banks and their shareholders.</td>
</tr>
<tr>
<td>NB-First Nat'l (Scott Co.) (83 Fed. Res. Bull. 593)</td>
<td>5141/844</td>
<td>(Scott Co.) More than seventy-two percent of the voting shares controlled by NationsBank were under the principle control of shareholders of another bank.</td>
</tr>
<tr>
<td></td>
<td>2045/299</td>
<td>(Atchison Co.) Number of competitors remaining in a largely rural market and the fact that a substantial portion of one of the bank's business was conducted with military personnel living outside the market.</td>
</tr>
<tr>
<td>CASE NAME</td>
<td>POST-MERGER AND RAW INCREASE IN HHI</td>
<td>MITIGATING FACTORS</td>
</tr>
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</tr>
<tr>
<td><strong>Banco Popular de Puerto Rico</strong></td>
<td>(San Juan) 1950/203</td>
<td>(San Juan) Number of competitors remaining in the market and the ability of the market to meet Merger Guidelines when recalculated to include savings and credit union cooperatives.</td>
</tr>
<tr>
<td><strong>Barnett Banks</strong></td>
<td>(Punta Gorda) 2143/653</td>
<td>(Punta Gorda) Number of competitors remaining in the market and attractiveness of market for entry.</td>
</tr>
<tr>
<td><em>(83 Fed. Res. Bull. 916)</em></td>
<td>(De Soto) 3241/299</td>
<td>(De Soto) Number of competitors remaining in the market and attractiveness of market for entry.</td>
</tr>
<tr>
<td><strong>Citizens Commercial</strong></td>
<td>(Celina-St. Mary's) 1908/645</td>
<td>(Celina-St. Mary's) Number of competitors remaining in the market, the intention of two competitors to open new branches in the market in the near future, and the small rural nature of the market.</td>
</tr>
<tr>
<td><strong>First Natl Sec. Co.</strong></td>
<td>(McCurtain Co.) 1971/285</td>
<td>(McCurtain Co.) Number of Competitors remaining in the market and small rural nature of the market.</td>
</tr>
<tr>
<td><strong>First of Waverly Corp.</strong></td>
<td>(Bremer Co.) 1850/294</td>
<td>(Bremer Co.) Number of competitors remaining in the market, rural nature of the market, recent de novo entry into the market, and the small change in market concentration.</td>
</tr>
</tbody>
</table>
APPENDIX C
ANALYSIS OF THE TWO DENIED PROPOSALS

First State Bancshares

In August 1996, the Board denied the acquisition by First State Bancshares of Blakely, Inc. (First State) of First Southwest Bancorp, Inc. and its wholly owned thrift subsidiary, First Federal Savings Bank of Southwest Georgia (FFSB).\textsuperscript{187} The Board denied the acquisition of the thrift holding company after deciding the merger would have adverse effects on competition in the Early County, Georgia banking market.\textsuperscript{188}

The Early County banking market only had three depository institutions prior to the proposed merger.\textsuperscript{189} Of the three competitors, First State was the largest and FFSB was the smallest.\textsuperscript{190} First State would have represented market deposits exceeding sixty-six percent and controlled $71.9 million in total deposits if the proposal had been approved.\textsuperscript{191} First State would also have only had to compete with one other depository institution if the merger had been allowed.\textsuperscript{192} The proposed merger would have caused the HHI to increase by 1208 points to 5549.\textsuperscript{193}

First State cited several factors it felt mitigated the potential adverse effects on competition posed by the merger. However, the Board did not find these mitigating factors persuasive. In addition to the adverse competitive consideration discussed below, the Board also considered the public benefit of the proposed merger, and concluded the public benefit did not outweigh the detriment of reduced competition and reduced services.\textsuperscript{194} The Board had no trouble later approving this same proposal after First State agreed to

\begin{itemize}
\item \textsuperscript{188} See id.
\item \textsuperscript{189} See id. at 955.
\item \textsuperscript{190} See id.
\item \textsuperscript{191} See id. at 956.
\item \textsuperscript{192} See id. at 955.
\item \textsuperscript{193} See id.
\item \textsuperscript{194} See id. at 957.
\end{itemize}
The chart below lists the arguments made by First State Bancshares and why the Board denied them.

### First State Bancshares

<table>
<thead>
<tr>
<th>Arguments Made by First State for Merger Approval</th>
<th>Reasons Arguments Rejected by the Board</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) First State and FFSB did not provide the same products and services as FFSB.</td>
<td>The Board agreed that First State and FFSB did not compete for the same products; however, the Board noted that they did compete in four of the same loan product lines. The Board concluded these four lines: commercial and industrial loans, agricultural loans, 1-to-4 family mortgage loans, and consumer loans, were all important to the citizens of Early County and weighed heavily in demonstrating that First State and FFSB did in fact directly compete for the same business.</td>
</tr>
<tr>
<td>(2) Nonbanking competitors in the Early County market demonstrated that the effects of the merger were overstated by the HHI</td>
<td>The Board found the presence of nonbanking competitors did not mitigate the adverse effects of the proposal for several reasons. First, the largest nonbank competitor in the market had membership requirements that would have precluded fifty percent of the market citizens from joining. Second, even if the largest nonbank competitor had been included at one hundred percent, the HHI would have still increased 1205 points to 4182. Third, nearly eighty-five percent, of Early County residents obtained their banking services and products from the markets three depository institutions.</td>
</tr>
</tbody>
</table>

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<table>
<thead>
<tr>
<th>Arguments Made by First State for Merger Approval</th>
<th>Reasons Arguments Rejected by the Board</th>
</tr>
</thead>
<tbody>
<tr>
<td>(3) The Early County economy could not support three depository institutions</td>
<td>The Board found First State’s claim unfounded for several reasons. First, Early County had experienced growth in population and per capita income in the years prior to the proposed merger. Federal Reserve Surveys indicated that this growth should continue in the near future. Second, the three depository institutions had performed relatively well compared to other non-MSA counties in the state. Third, the contention that FFSB had been performing poorly was unfounded. FFSB earned a profit in 1993 and had no sign of a long-term downward trend in profits. FFSB had also experienced a steady growth in deposits over its twenty-year life.</td>
</tr>
</tbody>
</table>

BancSecurity Corporation  

In December of 1996, the Board denied BancSecurity Corporation’s (BancSecurity) proposal to acquire Marshalltown Financial Corporation (MFC) and MFC’s wholly owned thrift subsidiary, Marshalltown Savings Bank (Marshalltown Savings). The Board, after considering the entire record and all relevant factors, concluded the merger would have adverse effects on competition in the Marshall County banking market.

The Marshall County market would have dramatically changed had the merger been approved. BancSecurity would have

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197. See id.
remained the largest depository institution in the market.\textsuperscript{198} It would have controlled $301 million in deposits and represented just less than fifty percent of market deposits.\textsuperscript{199} The merger would have caused the HHI to increase by 849 points to 3032, substantially exceeding Merger Guidelines.\textsuperscript{200} The Board discounted four possible mitigating factors that might reduce the merger’s adverse effects on competition.

**BancSecurity Corp.**

<table>
<thead>
<tr>
<th>Arguments Made by BancSecurity for Merger Approval</th>
<th>Reasons Arguments Rejected by the Board</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) Thirteen depository institutions would remain in the market after the merger.</td>
<td>The Board concluded that the disparity between the market deposits controlled by BancSecurity and the remaining depository institutions diminished any mitigating value the number of competitors remaining in the market might have. BancSecurity would have controlled ten times more market deposits than all but two of the remaining competitors would. Also, of BancSecurity’s twelve remaining competitors, nine would have controlled less than three percent of market deposits and one other would have controlled less than five percent. This disparity would have allowed BancSecurity to maintain an undesirable dominant position in the Marshall County market.</td>
</tr>
</tbody>
</table>

\textsuperscript{198} See id. at 124.  
\textsuperscript{199} See id.  
\textsuperscript{200} See id. at 125. The Board discussed the merger’s possible effects on competition in the different product areas where Security Bank and Savings compete before discounting the mitigating factors proposed by BancSecurity. In the area of mortgage loans, the merger would have caused the HHI to increase by 1758 points to 3953 and would have given BancSecurity control of 60% of the mortgage loan market. See id. In the product area of federally insured deposit accounts, the merger would have caused the HHI to increase 961 points to 2933 and would have given BancSecurity control of 48% of the market. See id.
<table>
<thead>
<tr>
<th>Arguments Made by BancSecurity for Merger Approval</th>
<th>Reasons Arguments Rejected by the Board</th>
</tr>
</thead>
<tbody>
<tr>
<td>(2) Several large banks would compete in the market after the merger.</td>
<td>The Board discounted the presence of other large banks competing in the market as a mitigating factor. The Board noted that there had been no serious encroachment on BancSecurity’s share of market deposits in the five years prior to the proposed merger. According to a survey by the staff of the Board and the Federal Reserve Bank of Chicago, BancSecurity also controlled every lending category in the market. Finally, the Board noted that BancSecurity had maintained this dominant position despite five banks entering the Marshall County market since 1994.</td>
</tr>
<tr>
<td>(3) Market was attractive for entry.</td>
<td>The Board found that the legal barriers imposed by Iowa law for new entrants into the market outweighed the market’s attractiveness for entry. At the time of the proposed merger, Iowa law strictly limited interstate banking and allowed very limited out-of-state banking expansion. Since entry into the banking market was extremely difficult under Iowa law, the Board stated that the market’s attractiveness for entry was all but eliminated.</td>
</tr>
<tr>
<td>(4) Influence by credit unions both inside and outside of the market.</td>
<td>The Board stated that the influence on competition by credit unions both inside and outside the market was minimal. Combined, the four credit unions in the Marshall County market controlled less than seven percent of market deposits. Three of the four credit unions had strict membership requirements. In addition, even if the credit union, without membership requirements, was included in the HHI calculation, the HHI would have increased 818 points to 2903, substantially exceeding Merger Guidelines.</td>
</tr>
</tbody>
</table>