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THE INFLUENCE OF ENHANCED THRIFT INSTITUTION POWERS ON COMMERCIAL BANK MARKET EXPANSION

LISSA LAMKIN BROOME†

The Monetary Control Act of 1980 and the Garn-St Germain Act of 1982 allowed savings and loan associations and savings banks to take deposits and lend funds in ways previously available only to commercial banks. One of the most important effects of this enhancement of thrift powers has been an increase in market expansion opportunities available to banks and bank holding companies. In this Article, Professor Broome describes the enhanced powers granted thrifts and how this enhancement resulted in changes in the application of legal rules limiting bank market expansion. She examines whether these changes are warranted, especially in the light of the failure of thrifts generally to take advantage of their new powers to a significant extent. Finally, the Article speculates that the increases in banking market expansion opportunities may have potentially far-reaching effects on the structure of our depository institutions system, including increased centralization of banking and a breakdown of the separate regulatory structures applicable to banks and thrifts at the state and federal level.

In the early 1980s Congress granted thrift institutions deposit-taking and lending powers previously reserved to commercial banks. Prior to these changes, thrifts could generally make only home mortgage loans¹ and offer only savings accounts.² Commercial banks, however, were permitted to make a variety of loans, including commercial loans, and could offer customers checking accounts in addition to savings accounts.³

Thrift institutions include savings and loan associations and savings banks.

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1. 12 U.S.C. § 1464(c) (1976) (current version at 12 U.S.C. § 1464(c) (1982 & Supp. IV 1986)); see E. SYMONS & J. WHITE, *BANKING LAW TEACHING MATERIALS* at 54 (2d ed. 1984) ("[T]he loan portfolio of a savings and loan association has been highly specialized in that its primary function has been to finance the purchase or construction of housing."); Fein, *The Fragmented Depository Institutions System: A Case for Unification*, 29 AM. U.L. REV. 633, 643 (1980).

2. 12 U.S.C. § 1464(b)(1) (1976 & Supp. V 1981) (amended 1982); see Housing and Urban Development Act of 1968, Pub. L. No. 90-448, § 1716, 82 Stat. 476, 608 (current version at 12 U.S.C. § 1464(b)(1) (1982)) (amending the Home Owners' Loan Act expressly to prohibit checking accounts).

3. E.g., 12 U.S.C. § 24 (seventh) (Supp. IV 1986); N.C. GEN. STAT. § 53-43(1) (1982); see also Fein, *supra* note 1, at 676 ("Until recently, commercial banks were the only financial institutions vested with unquestioned legal authority to offer demand deposit accounts.").

Both may receive federal charters from the Federal Home Loan Bank Board.⁴ Alternatively, state charters are available from state authorities for savings and loan associations in all states⁵ and for savings banks in those states that issue a separate charter for such institutions.⁶ Commercial banks may also choose between a national charter, issued by the Office of the Comptroller of the Currency,⁷ or a state charter issued by state banking authorities.⁸

Following the enactment of the Monetary Control Act of 1980 and the Garn-St Germain Act of 1982, all federally insured thrift institutions (state and federally chartered) may offer NOW accounts—the functional equivalent of interest-bearing checking accounts—to consumer customers.⁹ These acts also authorized federally chartered thrift institutions to devote a portion of their assets to loans other than home mortgage loans, including nonresidential real estate loans, nonmortgage consumer loans, and commercial loans,¹⁰ and to offer non-interest bearing checking accounts to commercial loan customers.¹¹ Finally, the acts granted federally chartered thrifts authority to exercise trust and fiduciary powers and to provide credit card services.¹² Many states have granted correspondingly extensive powers to state-chartered thrift institutions, either specifically¹³ or through “wild card” provisions that permit state-chartered thrift institutions to engage in any activity authorized for federally chartered thrift institutions from time to time.¹⁴ Since checking accounts and commercial loans were previously the exclusive domain of commercial banks, the enhancement of thrift powers necessarily gave thrifts a bank-like appearance. It is therefore not

4. 12 U.S.C.A. § 1464(a) (West Supp. 1988) (the Federal Home Loan Bank Board is authorized to issue charters to “associations to be known as Federal savings and loan associations, or Federal savings banks”).

5. 2 M. MALLOY, *THE CORPORATE LAW OF BANKS* 962-63 (1988) (listing state savings and loan association chartering statutes).

6. Currently only 17 states provide for the chartering of savings banks. ALASKA STAT. § 06.15.020 (1962); CONN. GEN. STAT. ANN. § 36-1421 (West 1987); IND. CODE ANN. § 28-6-1-1 (Burns 1986); ME. REV. STAT. ANN. tit. 9-B, §§ 111, 511 (1980); MD. FIN. INST. CODE ANN. § 4-201 (1986); MASS. ANN. LAWS ch. 168, § 4 (Law. Co-op. 1987); MINN. STAT. ANN. § 47.12(3) (West 1988); N.H. REV. STAT. ANN. § 386A:1 (1983); N.J. STAT. ANN. § 17:9A-7 (West Supp. 1988); N.Y. BANKING LAW § 230 (McKinney 1971); OR. REV. STAT. § 716.028 (1987); 7 PA. CONS. STAT. ANN. § 1002 (Purdon Supp. 1988); R.I. GEN. LAWS § 19-2-1 (1982); VT. STAT. ANN. tit. 8, § 552 (1984); WASH. REV. CODE ANN. §§ 33.08.020, 33.08.030 (1986); WIS. STAT. ANN. § 222.01 (West 1982); see DEL. CODE ANN. tit. 5, § 933 (1985). The lack of geographical diversity in the states offering a savings bank charter stems from the “relatively small number of wage earners in the agricultural South and West during the early nineteenth century, and hence the small demand for places to deposit savings. By the time such institutions were required their need was filled by already existing commercial banks and savings and loan associations.” E. SYMONS & J. WHITE, *supra* note 1, at 52.

Some states allow state-chartered savings and loan associations to use the words “savings bank” in their names, but name notwithstanding, these institutions are savings and loan associations. *E.g.*, N.C. GEN. STAT. § 54B-26 (Supp. 1987) (A state-chartered savings and loan association may use in its name “the words ‘savings bank’ in lieu of the words ‘savings and loan association.’”).

7. 12 U.S.C. §§ 1-14 (1982).

8. 2 M. MALLOY, *supra* note 5, at 958-59 (listing state bank chartering statutes).

9. See *infra* note 43 and accompanying text.

10. See *infra* notes 44-53 and accompanying text.

11. See *infra* note 54 and accompanying text.

12. See *infra* notes 47-48 and accompanying text.

13. See *infra* note 58 and accompanying text.

14. See *infra* note 57 and accompanying text.

surprising that decision-makers now view thrifts as the functional equivalent of commercial banks in evaluating proposed expansions by banks and bank holding companies.

Such expansion may occur in a number of ways. A bank may expand the market it serves within a state either by establishing a new branch¹⁵ or by combining with an existing commercial bank through merger or acquisition.¹⁶ Two additional market expansion methods are available to bank holding companies that allow, in certain cases, for expansion into additional states. A bank holding company may acquire another bank as a bank subsidiary¹⁷ or may acquire a nonbanking subsidiary whose activities are considered closely related and a proper incident to banking.¹⁸ Recent bank and bank holding company expansion has occurred through all of these methods.

Most academic and popular attention has focused on interstate banking expansion by bank holding company acquisition of a bank subsidiary.¹⁹ The Douglas Amendment to the Bank Holding Company Act prohibits such an acquisition unless specifically permitted by statute in the target bank's state.²⁰ Until the 1970s, no state had enacted a statute authorizing interstate bank acquisitions.²¹ Now, almost every state permits interstate acquisitions to some degree, and a large number of interstate bank acquisitions have been consummated.²²

Changes in the legal rules governing the remaining three market expansion methods available to banks and bank holding companies have received less attention than interstate bank acquisitions. These changes are nevertheless equally significant in their potential effect on the structure of the depository institutions system. The 1987 decision of the United States Court of Appeals for the Fifth Circuit in *Department of Banking and Consumer Finance v. Clarke (Deposit Guaranty)*²³ eased restrictions on branching by national banks. *Deposit Guaranty* found that state-chartered thrifts with bank-like powers were carrying on the banking business for purposes of the McFadden Act,²⁴ which provides that national banks may branch only to the extent permitted by state law for

15. See *infra* notes 94-106 and accompanying text.

16. See *infra* notes 151-58 and accompanying text.

17. 12 U.S.C. § 1842(a) (1982).

18. 12 U.S.C. § 1843(c)(8) (1982); see *infra* notes 304-08 and accompanying text.

19. See, e.g., Eisen, *Banking Acquisition Procedures by Holding Companies*, 101 BANKING L.J. 681 (1984); Fischel, Rosenfield & Stillman, *The Regulation of Banks and Bank Holding Companies*, 73 VA. L. REV. 301 (1987); Ginsburg, *Interstate Banking*, 9 HOFSTRA L. REV. 1133 (1981); Note, *The Constitutionality of State Statutes Governing Interstate Acquisitions by Bank Holding Companies: Northeast Bancorp, Inc. v. Board of Governors of the Federal Reserve System*, 59 ST. JOHN'S L. REV. 380 (1985).

20. 12 U.S.C. § 1842(d) (1982); see *infra* text accompanying notes 84-88.

21. See *Northeast Bancorp, Inc. v. Board of Governors of the Fed. Reserve Sys.*, 472 U.S. 159, 163 (1985).

22. See *id.* at 174-78 (upholding the constitutionality of a popular type of interstate banking statute—a regional, reciprocal interstate compact); 6 H. PITT, D. MILES & A. AIN, *THE LAW OF FINANCIAL SERVICES* app. DD (1988) (compilation of state interstate banking statutes).

23. 809 F.2d 266 (5th Cir.), *cert. denied*, 107 S. Ct. 3240 (1987).

24. McFadden Act, ch. 191, § 7, 44 Stat. 1244 (current version at 12 U.S.C. § 36(c) (1982)).

state institutions carrying on the "banking business."²⁵ *Deposit Guaranty* thus allows a national bank to establish a branch in a location authorized for a state-chartered thrift, even though state banks are subject to more restrictive branching provisions.²⁶ Scrutiny of the antitrust consequences of commercial bank mergers has similarly eased in reviews by the federal banking agencies and the Department of Justice which now routinely include thrift institutions in the market for purposes of evaluating a proposed merger's effect on competition.²⁷ Finally, the Federal Reserve Board has promulgated a proposed regulation that would allow a bank holding company to expand its market by the acquisition of a healthy thrift institution as a nonbanking subsidiary.²⁸ Such acquisitions are generally limited to the acquisition of financially troubled thrifts under current regulatory interpretations implementing the Bank Holding Company Act.

Part I of the Article sets out the enhancement of thrift powers enacted in the 1980 and 1982 legislation and the effect of the legislation on the activities of thrifts.²⁹ Part II then describes how that enhancement resulted in changes in the application of legal limitations on market expansion by banks and bank holding companies and evaluates these changes in the light of the fact that thrifts have not generally taken advantage of many of their new bank lending powers. Section A examines branching opportunities for national banks under the McFadden Act provision allowing a national bank to branch to the same extent as a state institution carrying on the banking business. The section concludes that state-chartered thrifts that have been authorized to engage in enhanced powers are carrying on the banking business and that national banks should therefore enjoy branching privileges equivalent to state thrifts. Section B reviews judicial and regulatory decisions setting out the standards under which bank mergers are evaluated for antitrust purposes and examines whether the products and services thrifts presently offer, or might offer in response to noncompetitive pricing by banks, should be included in the market in which a merger's effect on competition is measured. The section concludes that existing Supreme Court precedent excluding thrifts entirely from the market definition is unwarranted and proposes that an approach employing separate product markets be adopted. Section C evaluates the proposed regulation permitting bank holding company acquisition of healthy thrifts and concludes that such acquisitions should be allowed. In view of the specific provisions of the 1982 legislation addressing failing thrift acquisitions, however, the proposal should be effected through congressional authorization rather than regulatory revision. Section D of Part II concludes that the enhancement of thrift powers has made it appropriate to consider thrift institutions functionally equivalent to commercial banks for purposes of these banking market expansion methods. Part III suggests that these increased bank and bank holding company market expansion methods may have important effects on the structure of our depository institutions system by leading to greater cen-

25. See *infra* notes 119-32 and accompanying text.

26. *Deposit Guaranty*, 809 F.2d at 270-71.

27. See *infra* notes 204-09 and accompanying text.

28. See *infra* notes 338-46 and accompanying text.

29. See *infra* notes 40-58 and accompanying text.

tralization of banking and to the eventual breakdown of the separate regulatory structures governing commercial banks and thrift institutions.

I. STATUTORY CHANGES IN THE POWERS OF THRIFT INSTITUTIONS IN 1980 AND 1982

A. Problems Experienced by Commercial Banks and Thrift Institutions Before 1980

The statutory changes in the powers of thrifts in the 1980s were brought about by the inflation of the late 1970s, which increased market interest rates and seriously impaired the earnings of commercial banks and thrift institutions.³⁰ One effect of inflation was that customers withdrew savings and time deposits from commercial banks and thrifts for investment in competing products, most notably money market mutual funds, that offered higher returns than those paid by depository institutions subject to regulated interest rate ceilings.³¹

30. HOUSE COMM. ON BANKING, FINANCE, AND URBAN AFFAIRS, 96TH CONG., 2D SESS., REPORT OF THE INTERAGENCY TASK FORCE ON THRIFT INSTITUTIONS 3-4 (Comm. Print 1980) [hereinafter 1980 TASK FORCE REPORT]; Huertas, *The Regulation of Financial Institutions: A Historical Perspective on Current Issues*, in FINANCIAL SERVICES: THE CHANGING INSTITUTIONS AND GOVERNMENT POLICY 6, 26 (G. Benston ed. 1983) [hereinafter FINANCIAL SERVICES]; Langevoort, *Statutory Obsolescence and the Judicial Process: The Revisionist Role of the Courts in Federal Banking Regulation*, 85 MICH. L. REV. 672, 681-82 (1987); Simpson, *Developments in the U.S. Financial System Since the Mid-1970s*, 74 Fed. Res. Bull. 1, 1-2, 4 (1988); see F. BALDERSTON, THRIFTS IN CRISIS: STRUCTURAL TRANSFORMATION OF THE SAVINGS AND LOAN INDUSTRY 5 (1985) (interest rates became increasingly volatile in 1979 when the Federal Reserve Board announced that it would no longer try to restrain inflation by maintaining interest rates but instead would attempt to fight inflation by restricting the growth of the money supply).

31. See PRESIDENT'S INTER-AGENCY TASK FORCE ON REGULATION Q, DEPOSIT INTEREST RATE CEILINGS AND HOUSING CREDIT 8-9 (1979) [hereinafter 1979 REGULATION Q REPORT] (This process is often referred to as disintermediation.); Mahoney & White, *The Thrift Industry in Transition*, 71 Fed. Res. Bull. 137, 137 (1985); see also Eisenbeis, *Inflation and Regulation: The Effects on Financial Institutions and Structure*, in HANDBOOK FOR BANKING STRATEGY 65, 68 (1985) (depositors became more sensitive to slight differentials in interest rate movements). From 1968 to 1981 passbook savings accounts declined from 77% of total savings and loan assets to below 25%. Kane, *Impact of Regulation on Economic Behavior*, 36 J. FIN. 355, 359 (1981). In turn, money market mutual funds grew from \$2 billion in 1974 to \$200 billion in 1982. F. BALDERSTON, *supra* note 30, at 6.

Money market mutual funds are mutual funds created by investment companies that allow small investors to pool their funds and invest in short-term, money market instruments, such as treasury bills, that earn market rates of interest. Benston, *Introduction to FINANCIAL SERVICES*, *supra* note 30, at 1, 2. As inflation increased interest rates and computer technology reduced the cost of effecting financial transactions, new institutions entered this newly attractive market. *Id.* at 2; see R. LITAN, WHAT SHOULD BANKS DO? 33 (1987); Kane, *supra*, at 359-61.

Interest rate ceilings at commercial banks and thrifts were imposed by Regulation Q, 12 C.F.R. § 217.7 (1980). See Special Project, *Usury and Monetary Control Act of 1980*, 1981 ARIZ. ST. L.J. 27, 233 (It was hoped that by restricting interest rates paid on deposits, stable deposit costs would eliminate the need for bank investment in risky, but high yielding, assets.).

In March of 1980 commercial banks were limited to five and one-quarter percent interest on savings accounts, and thrift institutions were limited to the slightly higher rate of five and one-half percent. See S. REP. NO. 1601, 89th Cong., 2d Sess. 2, reprinted in 1980 U.S. CODE CONG. & ADMIN. NEWS 2994, 2996 (Thrifts were granted a slightly higher ceiling interest rate than the ceiling that was made applicable to commercial bank deposits to assist thrifts in attracting deposits that could be used for home mortgage lending.); A. CARRON, THE PLIGHT OF THRIFT INSTITUTIONS 5, 7 (1982); C. HENNING, W. PIGOTT & R. SCOTT, FINANCIAL MARKETS AND THE ECONOMY 190 (4th ed. 1984). In contrast, money market mutual funds were offering investors the Treasury bill rate of return which was between fourteen and fifteen percent. 1980 TASK FORCE REPORT, *supra* note 30, at 11.

Commercial banks also lost checking account deposits to money market mutual funds. Although commercial banks were then the only institutions authorized to offer checking accounts for making payments to third parties (sometimes referred to as demand deposits),³² they could not pay interest on these accounts.³³ Money market mutual funds paid interest on invested funds and offered limited third-party payment features.³⁴

To meet withdrawal demands, some depository institutions borrowed money at high market interest rates or sold, at large discounts, assets earning below-market interest rates, such as low-interest-rate mortgage loans.³⁵ Moreover, without newly deposited funds to invest, depository institutions were deprived of opportunities for earnings growth.³⁶

Thrift institutions were especially disadvantaged by inflation.³⁷ Rising market interest rates made deposits more costly, yet the statutory requirement that thrifts devote the principal portion of their assets to long-term, fixed-rate mortgage loans constrained earnings from those deposits.³⁸ Existing home mort-

32. Demand deposits are accessible upon the customer's demand and may be used to make payments to third parties. Thrift institutions were not authorized to offer these accounts, 12 U.S.C. § 1464(b)(1) (amended 1982), "in recognition of their role as thrift institutions designed to encourage savings." Fein, *supra* note 1, at 676 & n.266.

33. 12 U.S.C. § 1828(g) (1976) (amended 1980); *id.* § 371a.

34. C. HENNING, W. PIGOTT & R. SCOTT, *supra* note 31, at 124 (A limited number of checks, usually restricted to amounts exceeding \$500, could be written on money market funds each month.); Barr & Soloway, *Deposit Account Developments*, 43 BUS. LAW. 987, 987 (1988) ("[b]rokerage firms began to offer money market mutual fund accounts with transaction capabilities").

35. Savage, *Depository Financial Institutions*, in HANDBOOK FOR BANKING STRATEGY 177, 200 (1985).

36. Special Project, *supra* note 31, at 251-52 (reduced lending supplies are a result of a shift of funds by savings depositors away from thrifts and commercial banks and into market securities); see E. ROUSSAKIS, *COMMERCIAL BANKING IN AN ERA OF DEREGULATION* 73 (1984) (when market interest rates rose above the deposit interest ceiling rates, "thrifts suffered sharp contractions in the growth of mortgage funds").

37. L. SPELLMAN, *THE DEPOSITORY FIRM AND INDUSTRY: THEORY, HISTORY, AND REGULATION* 32-37 (1982) (general discussion of inflation's effect on thrifts). Although commercial banks also felt the deleterious effects of inflation, because of their wider investment authority these institutions had a different portfolio structure and their shorter-term loans were earning interest at or near the current market rates. A. CARRON, *supra* note 31, at 15 ("Commercial banks hold a substantially smaller share of their assets in long-term fixed-rate investments [than do thrifts]. . . . So policies addressing the thrift industry's asset inflexibility need not affect the operations of commercial banks.").

38. Benston & Kaufman, *Risks and Failures in Banking: Overview, History, and Evaluation*, in DEREGULATING FINANCIAL SERVICES: PUBLIC POLICY IN FLUX 49, 55 (1986); Gagnon & Yokas, *Recent Developments in Federal and New England Banking Laws*, NEW ENG. ECON. REV., Jan.-Feb. 1983, at 18 ("Thrifts, which had been legally obligated to invest primarily in long-term mortgages, saw their cost of funds rising faster than the return on their mortgage portfolios."); Huertas, *supra* note 30, at 26 ("regulations had induced [thrifts] to take a large interest rate risk—their fixed-rate, long-term mortgages were funded with short-term depositors"); Kaufman, Mote & Rosenblum, *The Future of Commercial Banks in the Financial Services Industry*, in FINANCIAL SERVICES, *supra* note 30, at 94, 103 (Thrifts "were locked in to low fixed-rate mortgages that they had made in earlier periods of slower inflation, and payment of the higher deposit rates would have been a serious drain on their resources."); Roster, *The Modern Role of Thrifts*, 18 LOY. L.A.L. REV. 1099, 1100 (1985); see S. REP. NO. 536, 97th Cong., 2d Sess. 5, reprinted in 1982 U.S. CODE CONG. & ADMIN. NEWS 3054, 3059 ("The problems . . . have largely resulted from an economic environment characterized by high and volatile interest rates, in which the cost of funds has increased rapidly while slow repayment of old mortgages has led to an extremely sluggish increase in gross asset yields.").

This maturity mismatch between long-term thrift assets being funded by short-term thrift liabil-

gage loans could not be repriced to meet the increasing costs of attracting deposits.³⁹

B. Congressional Responses: The Monetary Control Act of 1980 and the Garn-St Germain Act of 1982

Congress responded to these problems with the Monetary Control Act of 1980⁴⁰ and the Garn-St Germain Act of 1982.⁴¹ The Monetary Control Act provided for the elimination of interest rate ceilings on savings account balances⁴² and granted to all federally insured commercial banks and thrift institutions the ability to offer consumer depositors negotiable order of withdrawal (NOW) accounts—the functional equivalent of interest-bearing checking accounts—to aid depository institutions in competing with money market mutual funds.⁴³

The Monetary Control Act also granted federally chartered thrifts opportu-

ities was not a problem when there was no inflation and interest rates remained relatively stable. *Id.* ("Thrifts had been accustomed to a relatively stable economic environment in which a positive yield curve was the norm, and they had been able to remain profitable by borrowing short and lending long.").

39. See Special Project, *supra* note 31, at 250-51.

40. Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, 94 Stat. 132 (current version in scattered sections of 12 U.S.C.).

41. The Garn-St Germain Depository Institutions Act of 1982, Pub. L. No. 97-320, 96 Stat. 1469 (current version in scattered sections of 12 U.S.C.).

42. Monetary Control Act of 1980, Pub. L. No. 96-221, § 204, 94 Stat. 132, 143 (current version at 12 U.S.C. § 3503(a)-(b) (1982)) ("to provide for the orderly phase-out and the ultimate elimination of the limitations on the maximum rates of interest and dividends which may be paid"). The phase-out of Regulation Q was to be executed over a period of years in order to give thrift institutions time to take advantage of newly authorized lending powers. Thrift institutions thus would have an opportunity to increase their earnings and be in a position to attract deposits by paying market interest rates. H.R. CONF. REP. NO. 842, 96th Cong., 2d Sess. 73, reprinted in 1980 U.S. CODE CONG. & ADMIN. NEWS 298, 303 (The extension of Regulation Q is intended "to permit thrifts to organize themselves to compete in a market environment.").

43. Pub. L. No. 96-221, § 303, 94 Stat. 132, 146 (current version at 12 U.S.C. 1832(a)(1) (1982)). A NOW account technically is a savings account that permits the customer to transfer funds from the account to a third party by use of a negotiable order of withdrawal that directs the depository institution to pay the funds withdrawn to the third party. *Fein, supra* note 1, at 676-77. The customer's funds are transferred from a savings account, so interest may be paid on what, in effect, is a checking account. *Id.* at 677.

State-chartered thrift institutions in several northeastern states developed NOW accounts in the early 1970s in response to inflationary pressures and the resulting loss of deposits to unregulated money market mutual funds. See, e.g., MASS. ANN. LAWS ch. 168, § 26 (Law. Co-op. 1977). Federally insured depository institutions could begin offering NOW accounts as of December 31, 1980. Monetary Control Act of 1980, Pub. L. No. 96-221, § 306, 94 Stat. 132, 147 (current version at 12 U.S.C. § 371a note (1982)). NOW account funds may be held only by "one or more individuals or by an organization which is operated primarily for religious, philanthropic, charitable, educational, or other similar purposes and which is not operated for profit." *Id.* § 303(2) (current version at 12 U.S.C.A. § 1832(a)(2) (West Supp. 1988)).

The Monetary Control Act also specifically authorized other forms of demand deposit substitutes that had been developed by commercial banks and thrifts in the late 1970s. *Id.* § 302 (amending 12 U.S.C. § 271a) (automatic transfer accounts—these accounts would be beneficial for business customers not eligible for NOW accounts); *id.* § 304 (amending 12 U.S.C. § 1464 (b)(1)) (remote service units for federally chartered savings and loan associations); see Special Project, *supra* note 31, at 261.

Finally, in an effort to help depository institutions attract large deposits, Congress increased federal deposit insurance coverage from \$40,000 per account to \$100,000 per account. Pub. L. No. 96-221, § 308, 94 Stat. 132, 147 (current version at 12 U.S.C. §§ 1724, 1811 note (1982)); H.R.

nities to make short-term loans to help alleviate their mismatch in deposit and loan maturities.⁴⁴ The Act gave federally chartered thrifts the power to invest a limited percentage of their assets in secured or unsecured consumer loans⁴⁵ and loans secured by improved nonresidential real estate.⁴⁶ In addition, the Act granted federally chartered thrifts trust and fiduciary powers⁴⁷ and the authority to provide credit card services.⁴⁸ Finally, the Act granted federal savings banks the authority to devote a small percentage of their assets to commercial loans and to offer demand deposits to those commercial loan customers.⁴⁹

Apparently finding the 1980 measures insufficient, Congress enacted the Garn-St Germain Act in 1982 to grant thrifts even greater powers.⁵⁰ This Act expanded consumer loan authority for federal thrifts to thirty percent of assets⁵¹ and enlarged nonresidential real estate loan authority to forty percent of as-

CONF. REP. NO. 842, *supra* note 42, at 78, *reprinted in* 1980 U.S. CODE CONG. & ADMIN. NEWS 298, 308.

44. See Special Project, *supra* note 31, at 257 ("the Act contains several measures designed to improve the earning power and competitive ability of thrift institutions").

45. Pub. L. No. 96-221, § 401, 94 Stat. 132, 151, 153 (current version at 12 U.S.C.A. § 1464(c)(2) (West Supp. 1988)) (up to 20% of assets); H.R. CONF. REP. NO. 842, *supra* note 42, at 76, *reprinted in* 1980 U.S. CODE CONG. & ADMIN. NEWS, 298, 306.

46. Pub. L. No. 96-221, § 401, 94 Stat. 132, 153 (current version at 12 U.S.C.A. § 1464(c)(2) (West Supp. 1988)) (up to 20% of assets).

47. *Id.* § 403, 94 Stat. at 156 (current version at 12 U.S.C. § 1464(n) (1982)); H.R. CONF. REP. NO. 842, *supra* note 42, at 76, *reprinted in* 1980 U.S. CODE CONG. & ADMIN. NEWS 298, 306; see also S. REP. NO. 368, 96th Cong., 2d Sess. 12-13, *reprinted in* 1980 U.S. CODE CONG. & ADMIN. NEWS 236, 248 (by providing trust services, in addition to other newly authorized powers, federal savings and loan associations will be able to provide consumers with all of their household borrowing needs).

48. Pub. L. No. 96-221, § 402, 94 Stat. at 155-56 (current version at 12 U.S.C. § 1464(b)(4) (1982)); H.R. CONF. REP. NO. 842, *supra* note 42, at 76, *reprinted in* 1980 U.S. CODE CONG. & ADMIN. NEWS 298, 306.

49. Pub. L. No. 96-221, § 408, 94 Stat. at 160 (current version at 12 U.S.C.A. § 1464(a) (West Supp. 1988)) (up to 5% of assets, limited to borrowers located within the state or within 75 miles of the home office of the mutual savings bank); H.R. CONF. REP. NO. 842, *supra* note 42, at 77, *reprinted in* 1980 U.S. CODE CONG. & ADMIN. NEWS at 307.

50. Pub. L. No. 97-320, 96 Stat. 1469 (current version in scattered sections of 12 U.S.C.). The goals of the Garn-St Germain Act were similar to those of the Monetary Control Act—"to enhance the competitiveness of depository institutions" vis-à-vis nondepository institutions, such as money market mutual funds, and "to expand the range of services provided by such institutions," especially thrift institutions. See S. REP. NO. 536, *supra* note 38, at 1, *reprinted in* 1982 U.S. CODE CONG. & ADMIN. NEWS 3054, 3055. The Garn-St Germain Act also eliminated all previous distinctions between federally chartered savings and loan associations and federal savings banks. *Id.* at 87, *reprinted in* 1982 U.S. CODE CONG. & ADMIN. NEWS 3054, 3130.

In increasing the loan powers of federally chartered thrifts, Congress pointed to evidence that savings and loan associations chartered by the state of Texas earned a higher return on nontraditional assets than they earned on mortgages, thus increasing their earnings and strengthening their financial position. *Id.* at 13, *reprinted in* 1982 U.S. CODE CONG. & ADMIN. NEWS 3054, 3067. At the same time, however, Texas thrifts remained firmly committed to home mortgage lending. *Id.* Other states also granted state thrift institutions increasingly flexible lending powers, and it was noted that liberalization of investment powers of federal thrifts would make federal thrifts more competitive with their state counterparts. *Id.*

51. Pub. L. No. 97-320, § 329, 96 Stat. 1469, 1502 (current version at 12 U.S.C. § 1464(c)(2)(B) (1982)). The consumer lending authority also extends to investments in inventory and floor planing. "[T]he Committee intends that any inventory or similar financing be arranged in conjunction with extensions of consumer credit or, in other words, to facilitate the purchase by consumers of retail goods." S. REP. NO. 536, *supra* note 38, at 16, *reprinted in* 1982 U.S. CODE CONG. & ADMIN. NEWS 3054, 3070.

sets.⁵² Finally, the Act authorized federal thrifts to devote up to ten percent of assets to secured or unsecured loans for commercial purposes⁵³ and to offer non-interest-bearing demand deposits to their commercial loan customers.⁵⁴ Congress also directed that a new account be created for depository institutions that would be directly equivalent to and competitive with money market mutual funds with no limitation on the maximum interest rate payable on the account.⁵⁵

Congress recognized in the Garn-St Germain Act that the financial condition of some depository institutions was so poor that only special measures might preserve these institutions. Accordingly, the Act authorized, in certain circumstances, the acquisition of a failed thrift or bank by either a bank holding company or a savings and loan holding company on an interstate basis overriding other federal statutory provisions that might limit such interstate and inter-industry acquisitions.⁵⁶

The 1980 and 1982 legislation also affected the powers of state-chartered thrifts in the majority of states that had "wild card" provisions authorizing state thrifts to engage in those activities permitted their federally chartered counterparts.⁵⁷ Many of the states without wild card provisions authorized similar ex-

52. Pub. L. No. 97-320, § 322, 96 Stat. 1469, 1499 (current version at 12 U.S.C. § 1464(c)(1)(B) (1982)).

53. *Id.* § 325, 96 Stat. 1469, 1500 (current version at 12 U.S.C. § 1464(c)(1)(R) (1982)) (From the effective date of the Act until January 1, 1984, federally chartered savings and loan associations could devote only 5% of assets to commercial loans; federally chartered mutual savings banks could devote 7.5% of assets to commercial loans.); S. REP. NO. 536, *supra* note 38, at 16, *reprinted in* 1982 U.S. CODE CONG. & ADMIN. NEWS 3054, 3070 (the percentage-of-assets limit on commercial loans will permit thrift institutions to diversify their portfolios and remain profitable throughout business cycles).

54. Pub. L. No. 97-320, § 312, 96 Stat. 1469, 1496-97 (current version at 12 U.S.C. § 1464(b)(1)(A) (1982)). Section 312 further provides that federal thrift institutions may not pay interest on these demand accounts. *Id.* (current version at 12 U.S.C. § 1464(b)(1)(B) (1982)).

55. Pub. L. No. 97-320, § 327, 96 Stat. 1469, 1501 (current version at 12 U.S.C. § 3503(c) (1982)) (directing the Depository Institutions Deregulation Committee, which had been formed by the Monetary Control Act of 1980, to create a new account that would allow up to three preauthorized or automatic transfers per month and up to three third-party transfers per month); S. REP. NO. 536, *supra* note 38, at 88, *reprinted in* 1982 U.S. CODE CONG. & ADMIN. NEWS 3054, 3131.

56. Pub. L. No. 97-320, § 121, 96 Stat. at 1479-80 (current version at 12 U.S.C. § 1730a(m) (1982)) (emergency acquisitions of failed or failing thrift institutions insured by FSLIC); *id.* § 116, 96 Stat. at 1476-77 (current version at 12 U.S.C. § 1823(f) (1982)) (emergency acquisitions of failed or failing commercial banks insured by the FDIC); *see infra* notes 322-30 and accompanying text (discussing bank holding company acquisitions of failing thrifts).

57. *See, e.g.,* ARIZ. REV. STAT. ANN. § 6-402(B) (1974); ARK. STAT. ANN. § 67-1860.1 (1980); CONN. GEN. STAT. ANN. § 36-178g (West 1987); DEL. CODE ANN. tit. 5, § 1921 (1985); IDAHO CODE § 26-1934 (1977); ILL. ANN. STAT. ch. 17, § 3301-9(a) (Smith-Hurd Supp. 1988); IOWA CODE ANN. § 534.111 (West Supp. 1988); KAN. STAT. ANN. § 17-5601 (1988); KY. REV. STAT. ANN. § 289.705(1) (Michie/Bobbs-Merrill 1988); MD. FIN. INST. CODE ANN. § 5-504 (1986); MINN. STAT. ANN. § 51A.53 (West 1988); MO. ANN. STAT. § 369.144(7) (Vernon Supp. 1989); MONT. CODE ANN. § 32-2-111 (1987); NEB. REV. STAT. § 8-355 (1987); NEV. REV. STAT. § 673.225 (1979); N.H. REV. STAT. ANN. § 394-A:4 (1983); N.J. STAT. ANN. § 17:12b-48(21) (West 1984); N.M. STAT. ANN. § 58-10-50 (1978); N.D. CENT. CODE § 7-02-14 (1987); OHIO REV. CODE ANN. § 1155.18 (Anderson 1988); OKLA. STAT. tit. 18, § 381.9 (1971); OR. REV. STAT. § 722.204 (1987); PA. STAT. ANN. tit. 7, § 6020-101(22) (Purdon Supp. 1988); R.I. GEN. LAWS § 19-23-15 (1982); S.C. CODE ANN. § 34-1-110 (Law. Co-op. 1987); TENN. CODE ANN. § 45-3-106 (1980); TEX. REV. CIV. STAT. ANN. art. 852a, § 5.05 (Vernon Supp. 1989); UTAH CODE ANN. § 7-741

tensive powers for their state-chartered thrifts through specific legislation.⁵⁸

The enhancement of thrift powers in the 1980 and 1982 legislation gave thrifts the ability to offer products and services that previously had been provided exclusively by commercial banks. These products and services included checking accounts, nonresidential real estate loans, nonmortgage consumer loans (including credit card loans), commercial loans, and the ability to exercise trust and fiduciary powers. All federally chartered thrifts and many state-chartered thrifts are now specifically authorized to offer these products and services.

C. *Direct Effects of the 1980 and 1982 Legislation*

Most thrifts have taken advantage of increased deposit-taking powers authorized in the 1980 Act and offer NOW accounts to consumers,⁵⁹ but few thrift institutions have shortened the maturity of their loan portfolios by taking advantage, to any significant extent, of the shorter-term lending opportunities made available to them in the form of commercial loans and nonmortgage consumer loans.⁶⁰ Thrift assets remain concentrated in home mortgage loans.⁶¹ In 1987 only 1.88% of the assets of FSLIC-insured institutions were invested in commercial and industrial loans, although up to 10% of the assets of federal thrift institutions may be committed to commercial loans.⁶² Thrifts have devoted a

(1988); VT. STAT. ANN. tit. 8, § 1836(b) (1984); WASH. REV. CODE ANN. §§ 33.12.012, 33.12.014 (1986); WIS. ADMIN. CODE § S-L 30 (1986).

For the most part, the powers of state-chartered and federally chartered thrift institutions have stayed roughly equivalent. SUBCOMM. ON FINANCIAL INSTITUTIONS OF THE SENATE COMM. ON BANKING, HOUSING AND URBAN AFFAIRS, 94TH CONG. 2D SESS., COMPENDIUM OF ISSUES RELATING TO BRANCHING BY FINANCIAL INSTITUTIONS 364 (Comm. Print 1976) (FHLBB Staff Study, "Branching in the Savings and Loan Industry: Economic Analysis and Federal Policy Review") ("[O]ne finds that as innovations and new practices . . . are introduced into some of the State systems or, alternatively, into the Federal system, the result is to induce the adoption of many of these innovations and practices by most or all of the systems.").

58. See, e.g., CONN. GEN. STAT. ANN. § 36-182c (West 1987); N.Y. BANKING LAW § 383(13) (McKinney Supp. 1988).

59. See Fortier & Phillis, *Bank and Thrift Performance Since DIDMCA*, ECON. PERSPECTIVES, Sept.-Oct. 1985, at 58, 58-59.

60. Mahoney & White, *supra* note 31, at 137 (There is still a "fundamental imbalance in the asset and liability structure of thrift[s].").

61. See UNITED STATES GENERAL ACCOUNTING OFFICE, TRENDS IN THRIFT INDUSTRY PERFORMANCE: DECEMBER 1977 THROUGH JUNE 1987 20-21 (1988) [hereinafter GAO REPORT ON TRENDS IN THRIFT PERFORMANCE] (mortgage assets continue to dominate the thrift industry's asset portfolio, but mortgage assets have declined from 85.63% of thrift industry assets in December 1977 to 69.68% in June 1987).

62. *Id.* at 21; Burke, Rhoades & Wolken, *Thrift Institutions and Their New Powers*, J. OF COM. BANK LENDING, June 1987, at 43, 47-48 (In mid-1986 only 1.7% of FSLIC-insured institutions invested assets in commercial and industrial loans compared with 19.6% of commercial bank assets although the percentage of thrift assets invested in commercial and industrial loans has increased from 1983 when it was only .2%).

Nor have state-chartered thrift institutions exercised their increased lending powers to any significant extent. Arshadi, *The Impact of Deregulation on S&Ls: Slow Use of New Opportunities*, J. RETAIL BANKING, Spring 1985, at 41, 47-47 (State-chartered thrift institutions in Florida and Texas have expanded their consumer and commercial loans slowly and they do not yet represent a significant percentage of their total assets.); Baker, *Florida S&Ls' use of Expanded Powers*, ECON. REV. (Fed. Res. Bank of Atlanta), 7, 15 (1982) ("[I]n the short-run Florida chartered associations have done very little to exercise the expanded authorities their state statutes provide them."); Dunham &

slightly greater percentage of their assets to nonmortgage consumer loans, but the disparity between the actual percentage of assets of FSLIC-insured institutions invested in consumer loans, 4.41% in 1987, and the authorized percentage, 30%, is even greater than in the case of commercial loans.⁶³ In fact, the thrift institutions that have taken advantage of their new nonmortgage lending powers have not fared well. In June 1987 insolvent thrifts held 40.01% of their asset portfolio as nonmortgage assets while solvent thrifts held only 29% of their asset portfolio as nonmortgage assets.⁶⁴ Apparently other institutions are meeting the demand for nonmortgage loans at a lower cost. During the 1980s the percentage

Guerin-Clavert, *How Quickly Can Thrifts Move Into Commercial Lending?*, NEW ENG. ECON. REV., Nov.-Dec. 1983, at 42, 43, 54 (although commercial lending by mutual savings banks located in the northeast rose from \$79 million in 1980 to \$538 million in 1982, on average only about one-half of 1% of total assets of mutual savings banks were in commercial loans, and one-half of all New England savings banks and an even greater percentage of savings and loans made no commercial loans in 1982); McCall & Peterson, *Changing Regulation in Retail Banking Services: The Evidence from Maine*, J. RETAIL BANKING, Sept. 1980, at 46, 54 (Participation by state-chartered thrift institutions in the commercial loan market in Maine was very small.); see also Dunham, *Mutual Savings Banks: Are They Now or Will They Ever Be Commercial Banks?*, NEW ENG. ECON. REV., May-June 1982, at 51, 61-62 (Mutual savings banks have long offered commercial loans under "leeway" or "prudent loan" rules. In Connecticut commercial loans constituted 2.5% of mutual savings bank assets in 1980. In New England, commercial loans made up 2.6% of mutual savings bank assets in 1980. In two New Hampshire markets, however, mutual savings banks had over 10% of assets invested in commercial loans.).

Although in the aggregate thrift institutions have not taken advantage of their increased lending powers, some individual thrift institutions now have portfolios that closely resemble those of commercial banks. Burke, Rhoades & Wolken, *supra*, at 62 ("Disaggregated data suggest that many banks and thrifts have similar loan-to-asset ratios, despite substantial differences in aggregate balance sheet ratios"); *id.* at 54 ("[T]here is a growing subset of banks and nonbank thrifts which hold similar proportions of transactions accounts and commercial loans."); Roster, *supra* note 38, at 1104-05 (1985) (Although the "bulk of the industry remains traditional, notwithstanding the expanded powers described above," some thrifts operate in retail, wholesale, or diversified form.); see A. CARRON, *Reforming the Bank Regulatory Structure* 10 (1984) ("The differences in portfolio structure between large and small banks is now often more pronounced than that between the small banks and thrifts.").

Conversely, some commercial banks have conducted their operations in the manner of a traditional thrift institution, by specializing in mortgage lending. Eisenbeis, *New Investments Powers for S&Ls: Diversification or Specialization?*, ECON. REV. (Fed. Res. Bank of Atlanta), July 1983, at 53, 59 (specialization in real estate lending was profitable for commercial banks); see R. LITAN, *supra* note 31, at 102-03 (some limited evidence on bank holding company profitability shows that the operation of mortgage banking subsidiaries may be profitable for bank holding companies.).

63. GAO REPORT ON TRENDS IN THRIFT PERFORMANCE, *supra* note 61, at 35; Burke, Rhoades & Wolken, *supra* note 62, at 47-49 (In 1982 only 1.3% of the assets of FSLIC-insured institutions were invested in consumer loans.). For mutual savings banks, 3.4% of assets in June 1983 were in consumer loans compared with 5.7% of assets in June 1986. *Id.*; see also Mahoney & White, *supra* note 31, at 149 (In mid-1984 virtually all FSLIC-insured institutions held some consumer loans including home improvement loans and loans on savings accounts, while less than 40% of such institutions held some form of commercial and industrial loans.).

64. GAO REPORT ON TRENDS IN THRIFT PERFORMANCE, *supra* note 61, at 36-37. In addition to commercial and consumer loans, nonmortgage assets include direct investments (such as realty held for development or equity in service corporations), *id.* at 42-43, and investment securities, *id.* at 48-49.

Although the 1980 and 1982 legislation were enacted to strengthen thrifts, the aggregate financial condition of the thrift industry has continued to decline. In 1987 the thrift industry lost \$7.8 billion. 50 Banking Rep. (BNA) 1105 (1988). In June 1987 over 15% of all institutions insured by the Federal Savings and Loan Insurance Corporation (FSLIC) were insolvent although only 4% were insolvent in June 1982. GAO REPORT ON TRENDS IN THRIFT PERFORMANCE, *supra* note 61, at 11. Moreover, FSLIC is also insolvent. 50 Banking Rep. (BNA) 693 (1988) (at year-end 1987, the FHLBB calculated FSLIC's negative net worth to be \$11.6 billion); 51 Banking Rep. (BNA) 40 (1988) (the GAO estimated FSLIC's negative net worth to be \$13.7 billion). Private analysts predict

of commercial bank assets devoted to commercial loans decreased dramatically,⁶⁵ as many large corporations have turned to the commercial paper market as a lower cost source of working capital than short-term bank or thrift loans.⁶⁶ Consumer loans also are now provided by sellers of consumer goods engaged in direct financing of consumer purchases.⁶⁷ Thus, the demand for commercial and consumer loans from commercial banks decreased at the same time that thrift institutions were authorized to provide these loans. In addition, significant costs are associated with entering new lending markets.⁶⁸ Some observers have noted that thrift institutions historically lacked the management expertise to make commercial loans,⁶⁹ and the start-up costs of establishing such expertise may well be high.⁷⁰

Many thrift institutions have been able to maintain an adequate performance in their traditional lines of business without exercising their new lending powers. Notwithstanding the common impression that thrifts are financially

that it will cost some \$100 billion for FSLIC to save all insolvent thrift institutions. 51 Banking Rep. (BNA) 655 (1988).

65. Banking Week, June 6, 1988, at 1, col. 4 (Since 1984, commercial lending, formerly the "bread and butter of banking," has become virtually obsolete.). In 1984 growth in commercial loans accounted for 50% of the growth in short-term business borrowing. In contrast, in 1988 growth in commercial loans represented only 23% of the growth in short-term business borrowing. *Id.* at 8, col. 1. At the beginning of 1988, however, corporations increased their short-term bank borrowing. *Id.* at 1. This trend is expected to continue. Sudo & Cacace, *Growing Business Loan Market Slips Past Big Banks' Reach*, Banking Week, June 27, 1988, at 1, col. 2.

66. Banking Week, June 6, 1988, at 1, col. 4 ("Since 1984, the nation's largest banks catering to the largest businesses have steadily lost many of their traditional customers to the commercial paper market, which offers more advantageous pricing."); *id.*, May 31, 1988, at 1 ("The two biggest blows to corporate lending business at commercial banks have been commercial paper and junk bonds.").

67. Seger, *Financial Markets and Reform*, in EXPANDED COMPETITIVE MARKETS AND THE THRIFT INDUSTRY 19, 21 (1987) ("[M]ore and more consumers are obtaining car loans from the automobile companies, rather than going to their bank, thrift, or credit union.").

68. F. BALDERSTON, *supra* note 30, at 157 ("Each new activity requires set-up costs as well as variable costs."); Mahoney & White, *supra* note 31, at 148 ("The considerable start-up costs . . . may have deterred many institutions from exercising these new powers."); see F. BALDERSTON, *supra* note 30, at 157 ("The difficulties of new market entry are, of course, reduced to the extent that the financial firm hires exceptionally experienced and competent managers for a new division, and to the extent that top management itself develops capabilities for effective oversight.").

69. COMMERCIAL LENDING BY THRIFT INSTITUTIONS: A MANAGEMENT PERSPECTIVE 4 (Robert Morris Assoc. 1984) (manual emphasizing expertise differences in establishing commercial loans as opposed to retail loans); Dunham & Guerin-Calvert, *supra* note 62, at 47-48 (differences in institutional experience might make commercial lending more expensive for thrifts than it is for commercial banks); Savage, *supra* note 35, at 201 ("Few thrifts have developed the expertise in the already highly competitive area of commercial lending."); see Eisenbeis, *supra* note 62, at 62 (Expertise problems with commercial lending could be solved by engaging in commercial loan participations with commercial banks or other savings and loan associations.).

70. Burke, Rhoades & Wolken, *supra* note 62, at 49; see Dunham & Guerin-Calvert, *supra* note 62, at 47 ("Several factors suggest that at least some thrifts may have higher commercial lending costs than commercial banks."); Fortier & Phillis, *supra* note 59, at 65 ("Survey results of S&Ls in Illinois and Wisconsin indicate that few . . . are willing to take the associated risks and are able to surmount the start-up costs of entering the business of commercial lending." (footnote omitted)); see also C. HENNING, W. PIGOTT & R. SCOTT, *supra* note 31, at 119 ("It would be difficult for many thrifts, especially small ones, to make many business loans because of the expertise needed, and competing with commercial banks to make such loans would be relatively difficult."). Nor is it likely thrift institutions with weak capital positions and poor earnings will expand into a new line of business. Burke, Rhoades & Wolken, *supra* note 62, at 48 (poor earnings may account for failure of thrifts to expand into commercial lending); Mahoney & White, *supra* note 31, at 150 (Expansion into new lending opportunities may be hampered by the weak capital position of thrifts.).

troubled, the majority of thrift institutions are profitable.⁷¹ Only fifteen percent of these institutions account for the staggering losses suffered by the thrift industry.⁷² Thrift institutions that have remained concentrated in traditional thrift activities generally have experienced more successful earnings performance.⁷³ As one economist suggested, "S&Ls may not have to become clones of commercial banks in order to operate successfully. In fact, they may even continue to exploit their existing expertise as specialized mortgage lenders with the expectation of being as profitable as more diversified lenders."⁷⁴ Moreover, the demand for home mortgage loans has increased in the 1980s as mortgage interest rates have decreased.⁷⁵ Finally, there are also several significant incentives for thrift institutions to concentrate the majority of their assets in housing-related investments. A thrift that maintains a high percentage of its loan portfolio in home mortgage loans or mortgage-backed securities is eligible for certain benefits re-

71. Thrifts located in Louisiana, Oklahoma, and Texas account for "nearly half of all insolvent institutions and 80 percent of the losses at all insolvent institutions in the first quarter [of 1988]." 50 Banking Rep. (BNA) 1105 (1988) (quoting James Barth, chief economist of the FHLBB); accord GAO REPORT ON TRENDS IN THRIFT PERFORMANCE, *supra* note 61, at 16 ("The improvement [in thrift performance] in the 1980s is due to the superior performance of the healthier thrifts and has occurred despite the insolvent thrifts' declining net worth ratio . . .").

72. GAO REPORT ON TRENDS IN THRIFT PERFORMANCE, *supra* note 61, at 10-11 (As of June 1987, 15.39% of FSLIC-insured institutions had a net worth less than or equal to zero.); 50 Banking Rep. (BNA) 694 (1988) (Trade groups and the FHLBB estimate that 80% of thrift institutions are healthy.).

73. The General Accounting Office reported:

Over the last decade, insolvent thrifts have consistently held fewer mortgage assets as a percent of total assets than have the higher net worth thrifts. As of June 1987, insolvent thrifts were holding approximately 60 percent mortgage assets as a percent of total assets while thrifts in the other two [higher] net worth categories were holding slightly more than 70 percent.

GAO REPORT ON TRENDS IN THRIFT PERFORMANCE, *supra* note 61, at 24.

74. Eisenbeis, *supra* note 62, at 62. In addition, thrift institutions have increasingly used variable-rate mortgages and securitization of their mortgage loan portfolios to help alleviate the interest rate risk inherent in making long-term home mortgage loans funded by short-term deposits. GAO REPORT ON TRENDS IN THRIFT PERFORMANCE, *supra* note 61, at 3 (mortgage-backed securities and variable rate mortgage instruments have been the "dominant mortgage asset portfolio change of this decade"); *id.* at 33 (Only 5.72% of all assets of FSLIC-insured institutions were held as adjustable rate mortgages in June 1982, although 30.59% of assets were held in adjustable rate mortgages in June 1987.); Burke, Rhodes & Wolken, *supra* note 62, at 49; Mahoney & White, *supra* note 31, at 145; Simpson, *supra* note 30, at 10.

Many thrifts hold a greater percentage of their mortgage-related assets in mortgage-backed securities instead of mortgage loans than in prior years. GAO REPORT ON TRENDS IN THRIFT PERFORMANCE, *supra* note 61, at 22-23 (In June 1987, 14.97% of the assets of FSLIC-insured institutions were invested in mortgage-backed securities, compared with 6.96% of assets in mortgage-backed securities in June 1982.); Mahoney & White, *supra* note 31, at 146 (Since 1978, "[t]he most dramatic change . . . in the composition of mortgage assets of thrift institutions has been an increase, from 3.7 percent to more than 15 percent, in the proportion of these assets that FSLIC-insured institutions hold as mortgage-backed securities."). A lender may originate and then pool together a number of home mortgage loans. The mortgages in the pool serve as collateral for securities that are issued to purchasers, including thrift institutions. Mahoney & White, *supra* note 31, at 146. By purchasing these securities, thrift institutions may invest deposits in housing-related assets with a much shorter term than traditional home mortgage loans. GAO REPORT ON TRENDS IN THRIFT PERFORMANCE, *supra* note 61, at 22 ("Although thrifts receive a lower yield on [mortgage-backed securities] than they would if they held the mortgage loans directly, [mortgage-backed securities] do provide other advantages, including greater liquidity and ready collateral for borrowing purposes."); Mahoney & White, *supra* note 31, at 146; Simpson, *supra* note 30, at 9-10.

75. Burke, Rhodes & Wolken, *supra* note 62, at 49; Mahoney & White, *supra* note 31, at 148.

lating to branching,⁷⁶ the scope of activities of its affiliated companies,⁷⁷ and tax treatment.⁷⁸ These benefits are not available to thrift institutions that do not concentrate in home mortgage lending.

Thus, thrift institutions have not extensively engaged in the new lending powers authorized for them in 1980 and 1982. Thrifts and banks have lost loan business to nondepository institutions that are able to provide funds at lower costs. The institutions that have increased their nonmortgage loans have experienced earning problems, while thrifts that have continued to concentrate their assets in home mortgage loans have performed relatively well. The effect of the statutory enhancement of thrift powers on the lending activities of thrifts has so far not been great. As the next Part demonstrates, however, the increases in thrift powers have significantly affected the market expansion opportunities of banks and bank holding companies.

II. THE INFLUENCE OF ENHANCED THRIFT POWERS ON BANK AND BANK HOLDING COMPANY MARKET EXPANSION

A bank may expand its market within a state by establishing a new branch or by combining with an existing commercial bank through merger or acquisition. New branches for state banks may be established only as permitted by state law,⁷⁹ and new branches for national banks may only be established pursuant to the McFadden Act in those locations allowed by state law to institutions carrying on the banking business.⁸⁰ A merger between two banks may not be consummated without the approval of the appropriate federal banking agency.⁸¹ In conducting the review the federal banking agency considers, among other factors, the possible effect of the merger on competition in the relevant geographic market.⁸²

A bank holding company may expand its market by the acquisition of an additional bank subsidiary. Such an acquisition must be approved by the Federal Reserve Board pursuant to the Bank Holding Company Act.⁸³ If the bank to be acquired operates in the same market as an existing bank subsidiary, the

76. 12 U.S.C. § 1464(r)(1) (Supp. IV 1986). A federally chartered thrift institution may establish a branch in a state other than the state of its principal office if the institution meets the Internal Revenue Code's definition of a domestic building and loan association. *Id.*; see I.R.C. § 7701(a)(19) (Supp. IV 1986) (60% of assets must be committed to mortgage-related investments).

77. The nonthrift subsidiaries of a savings and loan holding company that owns only one savings and loan are exempt from the nonthrift activity restrictions applicable to savings and loan holding companies that own more than one savings and loan under the SLHCA, so long as the thrift subsidiary satisfies the "qualified thrift lender" test. 12 U.S.C.A. § 1730a(o)(1) (West Supp. 1988). To be a qualified thrift lender, the thrift institution must have 60% of its assets invested in mortgage-related investments. *Id.* § 1730a(o)(1), (5).

78. A thrift institution that has 60% of its assets committed to mortgage-related investments, as defined in I.R.C. § 7701(a)(19) (1982) may deduct 5% of its income as an addition to its reserve for bad debts. I.R.C. § 593 (1982 & Supp. IV 1986) (a significantly greater percentage of income deduction was allowed until the Tax Reform Act of 1986 amended this provision).

79. See *infra* notes 94-95 and accompanying text.

80. See *infra* notes 96-106 and accompanying text.

81. See *infra* notes 152-53 and accompanying text.

82. See *infra* notes 154-55 and accompanying text.

83. 12 U.S.C. § 1842(a) (1982).

antitrust review discussed in connection with a bank merger must be conducted by the Federal Reserve Board.⁸⁴ If the bank to be acquired operates outside the state where the bank holding company's bank subsidiaries currently operate, the acquisition must comply with the Douglas Amendment to the Bank Holding Company Act.⁸⁵ The Douglas Amendment prohibits interstate acquisitions unless specifically authorized by the target bank's state.⁸⁶ Many states have enacted legislation in the 1980s permitting such interstate acquisitions, at least to a limited extent.⁸⁷ Finally, a bank holding company may expand its market by the acquisition of a nonbanking subsidiary whose activities are closely related and a proper incident to banking.⁸⁸ The Douglas Amendment does not limit the permissible locations of nonbanking subsidiaries.⁸⁹

The enhancement of thrift powers has affected all of these methods of bank and bank holding company market expansion, other than interstate banking pursuant to the Douglas Amendment. Each method merits separate discussion, however, because different legal standards are applicable to each. The next three sections deal with each of the three affected methods of market expansion. Each section describes the legal analysis applicable to the particular market expansion method and the changes in the application of that analysis as a result of the enhancement of thrift powers. Each section then considers whether the change in application is warranted, especially considering the fact that few thrifts have exercised their bank-like lending powers to a significant extent.

A. *Commercial Bank Market Expansion by the Establishment of a Branch*

A commercial bank may seek to expand its operations within a state by establishing a branch. Historically, courts rejected approvals of branch applications filed by national banks seeking to establish branches in locations allowed to state thrifts, but not allowed to state commercial banks.⁹⁰ Recent court decisions, however, have allowed national banks to establish branches in the same locations permitted to state-chartered thrift institutions in states where thrifts have been found to be carrying on the banking business pursuant to state law.⁹¹ These decisions are explained by the statutory enhancement of thrift powers in the early years of this decade.⁹² This section examines these decisions and concludes that the decisions represent a proper application of the legal framework relating to bank branching in the light of the enhancement of thrift powers. The section concludes that the decisions are proper even though thrifts in the aggregate have not yet taken advantage of their enhanced lending powers to a signifi-

84. See *infra* notes 156-58 and accompanying text.

85. 12 U.S.C. § 1842(d) (1982).

86. *Id.*

87. See *supra* note 22 and accompanying text.

88. 12 U.S.C. § 1843(c)(8) (1982); see *infra* notes 304-06 and accompanying text.

89. 12 U.S.C. § 1842(d) (1982) (applies only to bank holding company acquisitions of banks).

90. See *infra* notes 109-18 and accompanying text.

91. See *infra* notes 119-32 and accompanying text.

92. See *infra* notes 140-41 and accompanying text.

cant extent.⁹³

1. State Bank and National Bank Branching Restrictions

A state-chartered bank may branch as permitted by state law. The states have adopted various branching schemes ranging from no branching (sometimes referred to as unit banking), to limited branching within a specified geographic area (such as a city or a county or within a certain radius of a bank's principal office), to statewide branching.⁹⁴ Only a few states have legislation that would permit a bank located outside the state to establish a branch within the state.⁹⁵

A national bank wishing to establish a branch is subject to the McFadden Act, which amended the National Bank Act to provide limited branching opportunities for national banks.⁹⁶ As originally enacted, the National Bank Act provided no authority for a national bank to establish a branch.⁹⁷ When state banks began to branch to a limited extent, however, fear of national banks converting to state charters to take advantage of the state bank branching privileges led to the enactment of the McFadden Act in 1927.⁹⁸ The Act now provides in section 36(c) that a national bank may establish a branch anywhere within the state in which it is located, if state law specifically grants a state bank the authority to establish a branch at that location.⁹⁹ The Act only contemplates branching by a

93. See *infra* notes 133-50 and accompanying text.

94. See 1 Fed. Banking L. Rep. (CCH) ¶ 3106 (1987) (collecting the branching statutes of each state); 1 W. SCHLICHTING, T. RICE & J. COOPER, *BANKING LAW* § 5.01 (1986) (same); see also Butler & Macey, *The Myth of Competition in the Dual Banking System*, 73 CORNELL L. REV. 677 (1988) (branching restrictions at the state level "restrict output and raise prices for consumers").

95. See, e.g., MASS. ANN. LAWS ch. 167, § 39 (Law. Co-op. Supp. 1987) (regional reciprocal interstate branching authorization that is ineffective because none of the states in the designated region currently have a reciprocal interstate branching provision); NEV. REV. STAT. § 666.305(2) (1986) (a depository institution whose home office is located outside of Nevada "may establish a branch office in a county [in Nevada] whose population is less than 100,000").

96. McFadden Act, ch. 191, § 7, 44 Stat. 1224 (current version at 12 U.S.C. § 36(c) (1982)); see generally DEPARTMENT OF THE TREASURY, *GEOGRAPHIC RESTRICTIONS ON COMMERCIAL BANKING IN THE UNITED STATES* (1981) (report to the President on the applicability of the McFadden Act in the current financial environment).

97. It was assumed, from the absence of specific legislative authorization, that national banks could not branch. Langevoort, *supra* note 30, at 720; see *First Nat'l Bank v. Missouri*, 263 U.S. 640, 659 (1924) (states may prohibit branching by a national bank because branching not a "necessary incident of a banking business" under federal law).

98. McFadden Act, ch. 191, § 7, 44 Stat. 1224 (1927). In the early 1900s some states began to allow their banks to branch within the county of their principal office. E. WHITE, *THE REGULATION AND REFORM OF THE AMERICAN BANKING SYSTEM, 1900-1929* 156-60 (1983). In a report to Congress recommending congressional action on national bank branching, the Comptroller stated that "if state banks continue to engage 'in unlimited branch banking it will mean the eventual destruction of the national banking system.'" *First Nat'l Bank v. Walker Bank & Trust Co.*, 385 U.S. 252, 257 (1966) (quoting H.R. DOC. NO. 90, 68th Cong., 1st Sess. 6 (1924)); see Langevoort, *supra* note 30, at 721 (Congress feared that if national banks converted to state charters, the Federal Reserve System, which national banks were required to join, would suffer.).

The McFadden Act was viewed as a victory for those who wished to limit the branching opportunities of national banks. Langevoort, *supra* note 30, at 721-22. Congressman McFadden described the bill as an antibranch banking measure. 68 CONG. REC. 2166 (1927); see H. BURNS, *THE AMERICAN BANKING COMMUNITY AND NEW DEAL BANKING REFORMS 1933-1935* 53-61 (1974) (discussion of the post-enactment branching controversy).

99. The McFadden Act provides, in relevant part:

A national banking association may, with the approval of the Comptroller of Currency, establish and operate new branches: (1) Within the limits of the city, town or village in

national bank "within the state" and thus does not permit interstate branching.¹⁰⁰ Congressional intent, according to the Supreme Court, was "to place national and state banks on a basis of 'competitive equality' insofar as branch banking was concerned."¹⁰¹ The notion of competitive equality "reflects the congressional concern that neither [the state nor the federal] system have advantages over the other in the use of branch banking."¹⁰²

The McFadden Act is not concerned with the wisdom of a state's banking limitations, but rather defers to state law to determine whether, where, and by what method a national bank may establish a branch.¹⁰³ The reference to state law in section 36(c) of the McFadden Act implements that congressional intent and is a "self-executing provision to accommodate to changes in state regulation."¹⁰⁴

which said association is situated, if such establishment and operation are at the time expressly authorized to State banks by the law of the State in question; and (2) at any point within the State in which said association is situated, if such establishment and operation are at the time authorized to State banks by the statute law of the State in question by language specifically granting such authority affirmatively and not merely by implication or recognition, and subject to the restrictions as to location imposed by the law of the State on State banks.

12 U.S.C. § 36(c) (1982).

Congress broadened the McFadden Act to its present scope in 1933. Banking Act of 1933, ch. 89, § 23, 48 Stat. 162, 189-90 (1933). Previously, it limited national banks and federal reserve member banks to branching within the city, if such branching was allowed to state banks. The push for expansion of branching privileges for national banks was, in part, a result of the economic depression of the 1930s. Proponents hoped that broad branching opportunities would encourage large, strong banks to establish branches that would replace smaller, undercapitalized, rural banks that many felt contributed to the number of depression-era bank failures. *First Nat'l Bank v. Walker Bank & Trust Co.*, 385 U.S. 252, 259 (1966); H. BURNS, *supra* note 98, at 56 (expanded branching opportunities would increase competition, eliminate weak competitors, and thereby strengthen the banking system); Ginsburg, *supra* note 19, at 1154.

100. 12 U.S.C. § 36(c)(2) (1982).

101. *First Nat'l Bank v. Walker Bank & Trust Co.*, 385 U.S. 252, 261 (1966).

102. *First Nat'l Bank v. Dickinson*, 396 U.S. 122, 131 (1969); see Butler & Macey, *supra* note 94, at 702 ("The greatest impact of the competitive equality doctrine is its restrictions on the ability of national banks to branch.").

103. *Walker Bank & Trust Co.*, 385 U.S. at 261-62 (a national bank may establish a branch only in accordance with all the requirements and conditions applicable to state banks by state law). Professor Langevoort explained:

[T]he Act represented the judgment of Congress that in general it was appropriate as a matter of regulatory policy to limit geographic expansion. The reasons for this determination vary; no doubt special-interest pressure for home market protection was a (probably the) dominant factor. But the legislative history expresses facially legitimate—though not necessarily persuasive—"public-regarding" concerns as well, and it is likely that these in fact played an honest role in the formulation of the law. Foremost among them was the channeling objective: promoting local reinvestment of deposits by preserving local control over banking institutions, thus avoiding the drain of funds from remote regions to the money centers that was feared if authority over use of the funds was placed in a distant bank headquarters. Closely related was the desire to avoid concentrating too much economic power in money-center banking institutions, quite apart from where the money was used. Closing local markets to expansion by growth-oriented banks would indirectly accomplish this. Statutory interpretation of the McFadden Act that seeks to adhere to the legislative intent could legitimately use these considerations as touchstones of legislative purpose.

Langevoort, *supra* note 30, at 723 (footnotes omitted). But see Butler & Macey, *supra* note 94, at 703 (the McFadden Act "stabilizes the regulatory cartel and, in fact, limits competition").

104. *Dickinson*, 396 U.S. at 133.

While deferring to state branching schemes, Congress also included specific definitions of "branch" in section 36(f) and "State bank" in section 36(h).¹⁰⁵ "State bank" is defined "to include trust companies, savings banks, or other such corporations or institutions carrying on the banking business under the authority of State laws."¹⁰⁶ Prior to the early 1980s most state-chartered thrift institutions were not considered to be carrying on the banking business because they lacked the statutory authority to make commercial loans and nonmortgage consumer loans and could not provide checking accounts or equivalent transaction accounts.¹⁰⁷ National bank branching was, therefore, limited to branching opportunities available to state-chartered commercial banks, although many states afforded state-chartered thrift institutions broader branching privileges than state-chartered banks.¹⁰⁸

2. National Bank Branching Decisions Prior to the Enhancement of Thrift Powers

The 1979 opinion of the United States Court of Appeals for the Ninth Circuit in *Mutschler v. Peoples National Bank of Washington*¹⁰⁹ illustrates the ap-

105 12 U.S.C. § 36(f), (h) (1982). "Branch" is defined to include any "place of business . . . at which deposits are received, or checks paid, or money lent." *Id.* § 36(f).

106. McFadden Act, ch. 191, § 7(h), 44 Stat. 1224, 1229 (1927) (current version at 12 U.S.C. § 36(h) (1982)). See generally Griffin, *Branching by National Banks: Must the "(h)" Always be Silent?*, 3 J.L. & COM. 243 (1983) (discussing the proper interpretation of the "state bank" definition in § 36(h) of the McFadden Act).

107. See *supra* notes 7-8 and accompanying text.

108. Compare COLO. REV. STAT. § 11-6-101(1) (1987) (state banks may not branch) with *id.* § 11-41-120 (state savings and loan associations may branch with approval of commissioner); Compare IND. CODE ANN. §§ 28-2-13-19, -20 (Burns Supp. 1988) (state banks may branch in same county as home office or in counties contiguous to county of home office) with *id.* § 28-4-3-2 (state building and loan associations may branch statewide); compare MICH. STAT. ANN. § 23.710(171) (Callaghan Supp. 1988) (state banks may branch within same city or county as home office, within 25 miles of home office, or in counties contiguous to county of home office) with *id.* § 23.602(522) (Callaghan 1983) (state savings and loan associations may branch statewide with approval of commissioner); compare MO. ANN. STAT. § 362.105.1(1) (Vernon 1986) (state banks may not branch) with *id.* § 369.329 (state savings and loan associations may branch with approval of commissioner); compare TENN. CODE ANN. § 45-2-614 (1980) (state banks may branch in same county as home office) with *id.* 45-3-301 (1980) (state savings and loan associations may branch statewide if chartered for five years); compare WIS. STAT. ANN. § 221.04(j) (West 1982) (state bank may branch within 25 miles of home office or in same county as home office, whichever is greater) with *id.* §§ 215.13(39), .21(2) (West Supp. 1980) (state savings and loan associations may branch within "normal lending area" (100 mile radius)).

One possible explanation for the disparity in branching privileges many states have granted to the different types of depository institutions may be that federal regulations provide that federally chartered thrifts may branch freely throughout a state and, in some circumstances, across state lines. 12 C.F.R. § 556.5(a)(2) (1988) ("As a general policy, the [Federal Home Loan Bank] Board permits a Federal association to branch within the state in which its home office is located."); see 12 U.S.C.A. § 1464(r) (West Supp. 1988); see also 12 C.F.R. § 556.5(a)(3) (1988) (circumstances in which interstate branching by federal thrift institutions permitted). Congress has specifically declined to adopt a McFadden Act equivalent requiring federal deference to state branching laws applicable to state-chartered thrifts. See *United States v. First Fed. Sav. & Loan Ass'n*, 151 F. Supp. 690, 698 n.5 (E.D. Wis.) (detailing failed legislative attempts to introduce a McFadden-type statute into the laws relating to branching by federally chartered savings and loan associations), *judgment modified*, 284 F.2d 804 (7th Cir. 1957), *cert. denied*, 355 U.S. 957 (1958). No doubt state legislatures were mindful of the possibility that state thrifts might convert to federal branching entitlements if the states were not similarly generous in affording branching rights to state-chartered thrifts.

109. 607 F.2d 274 (9th Cir. 1979); see also *First Nat'l Bank & Trust Co. v. Empie*, No. 78-296-C,

proach taken by the courts prior to the statutory enhancement of thrift powers. In *Mutschler*, a national bank applied to the Comptroller of the Currency, the federal banking regulator charged with the supervision of national banks, for permission to relocate a branch to an unincorporated area in a county other than the county of the bank's principal place of business. Washington state law restricted branching by a state-chartered bank outside the bank's home county to incorporated cities and towns.¹¹⁰ State-chartered mutual savings banks, however, were authorized to establish branches in any county in the state.¹¹¹ The national bank argued that it was entitled to branch to the same extent as a "state bank," that the McFadden Act defined a "state bank" to include a savings bank, and that the national bank therefore should be entitled to establish a branch at any location in the state at which a state-chartered savings bank could establish a branch.¹¹²

The Ninth Circuit rejected this argument, ignoring the definition of "state bank" in section 36(h) and relying on section 36(c)'s general deference to state law.¹¹³ The Ninth Circuit reasoned that because national bank branching is only permitted if expressly authorized by state law, a national bank wishing to branch in the manner authorized for a state mutual savings bank under state law must satisfy all the provisions of the state statute and show that it engages itself exclusively as a mutual savings bank.¹¹⁴ The national bank did not engage itself exclusively as a mutual savings bank and thus was denied mutual savings bank branching privileges.¹¹⁵ A contrary holding, the court stated, would give national banks a "rather significant competitive advantage" over state-chartered commercial banks.¹¹⁶

The Ninth Circuit noted that the increasing overlap in services offered by mutual savings banks and commercial banks was diminishing the traditional differences between the two types of institutions, but remained convinced that, in 1979, a mutual savings bank was a "separate and distinct legislative creation" from a state commercial bank.¹¹⁷ Although not specifically discussed in the opinion, Washington mutual savings banks actually were not authorized to

(E.D. Okla. Dec. 17, 1982), *appeal dismissed*, No. 83-1071 (10th Cir. 1983), *reprinted* in 2 H. PITT, D. MILES & A. AIN, *supra* note 22, app. B-3 (holding that a national bank was not entitled to establish a branch in the same locations available to a state-chartered trust company, in part because of the striking differences between trust companies and commercial banks); *State Chartered Banks v. Peoples Nat'l Bank*, 291 F. Supp. 180, 199 (W.D. Wash. 1966) (holding that a national bank was not entitled to establish a branch in the same locations available to a state-chartered mutual savings bank because the national bank did not "satisfy all the provisions of [the] statute" relating to the operation of a mutual savings bank).

110. *Mutschler*, 607 F.2d at 279 (This was an interpretation of Washington statutory law made by the Washington Supreme Court in *Hart v. Peoples Nat'l Bank*, 91 Wash. 2d 197, 203-02, 558 P.2d 204, 208 (1979)).

111. *Id.*

112. *Id.*

113. *Id.*

114. *Id.*

115. *Id.* The court did not consider the specific language of § 36(h), which seems to raise the possible argument that a savings bank is a "state bank" whether or not it is carrying on the banking business. See *infra* note 106.

116. *Mutschler*, 607 F.2d at 279.

117. *Id.* at 280.

make commercial loans at the time of the decision.¹¹⁸

3. National Bank Branching Decisions After the Enhancement of Thrift Powers

More recent judicial interpretations of section 36(h), however, allow national banks to establish branches within a state to the same extent that state law authorizes state-chartered thrift institutions to establish branches.¹¹⁹ The leading case is *Department of Banking and Consumer Finance v. Clarke (Deposit Guaranty)*, in which the United States Court of Appeals for the Fifth Circuit held that Mississippi-chartered thrift institutions were "state banks" for purposes of the McFadden Act because they were "'carrying on the banking business under the authority of State laws.'" ¹²⁰ Deposit Guaranty National Bank applied to the Comptroller for permission to establish a branch in a location that would not have been permitted for a state-chartered commercial bank seeking to branch.¹²¹ Mississippi law, however, authorized state-chartered thrift institutions to branch statewide.¹²² Deposit Guaranty's application to the Comptroller alleged that Mississippi thrifts were carrying on the banking business under the authority of state law and thus met the definition of "state bank" in section 36(h) of the McFadden Act.¹²³ The Comptroller agreed and granted the bank permission to establish the branch.¹²⁴

The Fifth Circuit upheld the Comptroller's approval of the branch application.¹²⁵ In determining whether Mississippi thrift institutions were engaged in

118. See WASH. REV. CODE ANN. § 32.20.230 (1961) (loans may be secured by collateral securities or real estate mortgages); *id.* § 32.20.240 (loans may be secured by pledge of passbook); *id.* § 32.30.250 (loans may be secured by real estate mortgages). Washington mutual savings banks were able to offer NOW accounts to consumers, however. *Washington Bankers Ass'n v. Washington Mutual Sav. Bank*, 92 Wash. 2d 453, 598 P.2d 719 (1979).

119. *Department of Banking and Consumer Fin. v. Clarke (Deposit Guaranty)*, 809 F.2d 266 (5th Cir.), *cert. denied*, 107 S. Ct. 3240 (1987); *Texas v. Clarke*, 690 F. Supp. 573 (W.D. Tex. 1988); *Volunteer State Bank v. National Bank of Commerce*, 684 F. Supp. 964, 967 (M.D. Tenn. 1988) (the court took "judicial notice of the dramatic changes that have occurred in recent years in the financial industry, and in particular, of the expanded powers and competitive advertising of thrift institutions in their successful attempt to engage in the 'banking business'"). A similar lawsuit is pending in Florida. *Barnett Bank, N.A. v. Office of the Comptroller*, No. 88-8225-Civil-Payne (S.D. Fla.).

120. 809 F.2d 266, 270 (5th Cir.) (quoting 12 U.S.C. § 36(h) (1982)), *cert. denied*, 107 S. Ct. 3240 (1987).

121. *Id.* at 267-68. Mississippi law then provided that a state-chartered commercial bank could establish a branch only in the county in which the bank's principal office was located or within 100 miles of the bank's principal office. Deposit Guaranty, however, wished to establish a branch more than 100 miles from its main office and in a different county. *Id.*

122. *Id.* at 268.

123. Decision of the Comptroller of the Currency on the Application of Deposit Guaranty Nat'l Bank, Jackson, Miss., to Establish a Branch Office in Gulfport, Miss. (July 9, 1985), *reprinted in* 2 H. PITT, D. MILES & A. AIN, *supra* note 22, app. at E-10, E-10.4 (1988) [hereinafter Decision of the Comptroller on Deposit Guaranty].

124. *Id.* at E-10.31.

125. *Deposit Guaranty*, 809 F.2d 266. The Comptroller's decision was challenged by the Mississippi Department of Banking and Consumer Finance. The United States District Court for the Southern District of Mississippi ruled that the Comptroller's decision could not be upheld because it would force states to change their branching provisions to protect state-chartered banks, contrary to the McFadden Act's purpose of preserving parity in the dual banking system. *Department of Banking and Consumer Fin. v. Selby*, 617 F. Supp. 566 (S.D. Miss. 1985), *rev'd sub nom* Dep't of Banking

the "banking business," the court noted that "the language of § 36(h) expressly requires a consideration of function."¹²⁶ Although there is no explicit federal definition of "banking business," the court looked for guidance to the relevant powers and functions of a national bank enumerated in the National Bank Act: (1) the receiving of deposits; (2) the loaning of money on personal security; and (3) the discounting and negotiating of promissory notes, drafts, bills of exchange, and other evidences of debt.¹²⁷ The Fifth Circuit concluded that "the banking business, reduced to essentials, involves receiving deposits, making commercial loans, and negotiating checks and drafts."¹²⁸

The ability of thrifts to provide products and services functionally equivalent to those traditionally associated with commercial banking, the Fifth Circuit noted, was the result of dramatic changes in Mississippi law beginning in 1980.¹²⁹ Those changes granted to state-chartered savings and loan associations the same powers available to federally chartered savings and loans, which may receive deposits, make commercial loans, and negotiate checks (drawn on demand deposits held by commercial loan customers) and drafts (negotiable orders of withdrawal drawn on NOW accounts held by consumers).¹³⁰ The Comptroller found that Mississippi-chartered thrift institutions "now offer a range of products and services" that constitute the business of banking and concluded

and *Consumer Fin. v. Clarke* (Deposit Guaranty), 809 F.2d 266 (5th Cir.), *cert. denied*, 107 S. Ct. 3240 (1987).

126. *Deposit Guaranty*, 809 F.2d at 270. As the court noted, this functional analysis is also consistent with the Supreme Court's opinion in *Clarke v. Security Indus. Ass'n*, 107 S. Ct. 750, 753, 762 (1987), holding that offices of a discount brokerage operation of a national bank did not constitute "branches" of the national bank subject to the locational limitations of the McFadden Act because such offices did not engage in the core banking functions enumerated in the McFadden Act's definition of branch: receiving deposits, paying checks, or lending money. *Deposit Guaranty*, 809 F.2d at 270.

Moreover, the court concluded that the concept of competitive equality underlying the McFadden Act mandated that "state bank" and "banking business" be defined by federal law. *Id.* at 269-70. The court endorsed the Comptroller's analysis that "competitive equality requires a federal definition of 'State bank' to prevent states from disadvantaging national banks vis-à-vis state-chartered institutions [merely by not] denominating these institutions 'banks' and treating them somewhat differently from state commercial banks, though not so differently as to prevent these institutions from competing with national banks.'" *Id.* at 270 (quoting from Decision of the Comptroller on *Deposit Guaranty*, *supra* note 123). The Decision of the Comptroller on *Deposit Guaranty*, *supra* note 123, at E-10.12, and the Fifth Circuit misquote the original source of this proposition, Griffin, *supra* note 106, at 246, although it is clear from the context that both endorse the correct quotation, which appears above as bracketed.

127. *Deposit Guaranty*, 809 F.2d at 268 (citing 12 U.S.C. § 24 (seventh) (1982)); see Decision of the Comptroller on *Deposit Guaranty*, *supra* note 123, app. at E-10.22.

128. *Deposit Guaranty*, 809 F.2d at 268. Later in its opinion the Fifth Circuit stated the definition of the "banking business" more broadly: "the business of banking, stripped to its essentials, [is] accepting deposits, paying checks, and making loans." *Id.* at 270.

129. *Id.* at 268.

130. *Id.*; see MISS. CODE ANN. § 81-12-49(r) (Supp. 1987) ("wild card" law that permits a Mississippi savings association to engage in any activity permitted a federally chartered savings and loan association located in Mississippi). The Fifth Circuit acknowledged that the Garn-St Germain Act of 1982, while expanding the powers of savings and loan associations, preserved the principal difference between commercial banks and thrift institutions—that being "the limits placed on the commercial and consumer loans and investments of the savings institutions, designed to protect their capacity to make needed home loans." *Deposit Guaranty*, 809 F.2d at 271. But the court found that the legislative distinction "neither proscribes the functional analysis made by the Comptroller nor militates against his interpretation of 12 U.S.C. § 36(h)." *Id.*

that Mississippi thrift institutions were in fact carrying on the business of banking under authority of state laws.¹³¹ Upholding the Comptroller's decision, the Fifth Circuit found that the "Comptroller's factual determination that the savings associations are engaged in the banking business is amply supported by the record."¹³²

4. Evaluation of Recent National Bank Branching Decisions

The *Deposit Guaranty* decision, granting a national bank the same branching privileges available to a Mississippi thrift, is correct in the light of the enhancement of thrift powers in Mississippi according those institutions the functions traditionally associated with commercial banks. The validity of the decision, of course, depends on a proper interpretation of the McFadden Act. This rests on a correct resolution of three critical issues presented by section 36(h) of the Act, namely, (1) what is the role of the federal definition of "state bank" in the light of federal deference to a state's branching scheme, (2) what constitutes the "banking business" under the Act, and (3) what is the meaning of the requirement that the institution be "carrying on" the banking business? These issues shall now be discussed in turn.

Notwithstanding the McFadden Act's deference in section 36(c) to a state's branching scheme, *Deposit Guaranty* is correct that the federal definition of "state bank" in section 36(h) must be utilized.¹³³ Indeed, in 1969 the Supreme Court held that a federal definition of "branch" set forth in section 36(f) was equally important to effectuating Congress' intent in the McFadden Act: "Congress entrusted to the States the regulation of branching as Congress then conceived it. But to allow the states to define the content of the term 'branch' would make them the sole judges of their own powers."¹³⁴

Absent a federal definition of "state bank," a state could call a state-chartered bank by some other name, such as a "financial services institution," grant it statewide branching authority, but prohibit branching for state-chartered "banks," and thus prohibit national bank branching.¹³⁵ The federal definition of "state bank" based on the functions associated with the banking business as set forth in section 36(h) obviously was intended to prevent such a result. Thus, section 36(c) preserves competitive equality between national

131. Decision of the Comptroller on *Deposit Guaranty*, *supra* note 123, app. at E-10.29-.31 (relying on a consultant's report that thrift institutions in Mississippi "are currently offering a range of products and services in competition with commercial banks, including NOW accounts, auto and other consumer loans, construction loans, and commercial loans").

132. *Deposit Guaranty*, 809 F.2d at 271 (stating that the Comptroller's factual determination was "supported by the record," was "neither arbitrary nor capricious," and was "patently correct").

133. See *supra* notes 126-28 and accompanying text.

134. *First Nat'l Bank v. Dickinson*, 396 U.S. 122, 133 (1969) (holding that a national bank may not establish an armored car messenger service or an off-site deposit receptacle because each would constitute a "branch" as defined in § 36(f) of the McFadden Act and could not be established pursuant to Florida state law that prohibited state bank branching).

135. See *supra* note 126; see also Griffin, *supra* note 106, at 255 ("It would further appear that one significant purpose of including an express definition of 'State bank' in section 36 was to prevent states from disadvantaging national banks by permitting state institutions with broader branching power than national banks to engage in the substance of banking business, under another 'form.'").

banks and "state banks" as specifically defined in section 36(h), not just between national banks and state-chartered commercial banks.¹³⁶ If Congress had intended the latter approach, there would be no need for a separate definition of "state bank." The *Mutschler* court mistakenly ignored the federal definition of "state bank" in section 36(h) and relied solely on section 36(c)'s deference to state law to find that a national bank wishing to branch like a state mutual savings bank must satisfy all of the provisions of the state mutual savings bank statutes.¹³⁷ Even had the *Mutschler* court applied section 36(h), it probably would have reached the same result because Washington mutual savings banks were not then authorized to provide all the functions associated with commercial banking.¹³⁸

Addressing the second issue raised by section 36(h), the Fifth Circuit in *Deposit Guaranty* offered a definition of the phrase "banking business" based on the functions associated with banks as set forth in section 24 of the National Bank Act's enumeration of the powers of a national bank "necessary to carry on the business of banking."¹³⁹ Given the similarity of section 36(h)'s reference to "banking business" and section 24's "business of banking," it is logical to conclude that the terms are coterminous.¹⁴⁰ The functions of banking enumerated in section 24 include receiving deposits, paying checks, and making loans on personal security, which since the 1980s have been available to thrift institutions in many states.¹⁴¹ Thus, in those states that have authorized thrifts to engage in these functions, finding that state thrifts carry on the banking business and are therefore "state banks" is a proper construction of the McFadden Act.

Allowing national banks to establish branches in locations permitted for state thrift branches but not state bank branches may seem unfair to state banks. For instance, in Mississippi, a national bank may now establish a branch anywhere throughout the state, but state bank branching restrictions more narrowly constrain a state bank's branch locations.¹⁴² The purpose of the McFadden Act, however, is to preserve competitive equality between national banks and all state institutions carrying on the banking business under the authority of state law,

136. *Texas v. Clarke*, 690 F. Supp. 573, 580 (W.D. Tex. 1988) ("The competitive equality guaranteed by the McFadden Act is mandated between national banks and 'state banks' not national banks and Texas commercial banks."); Griffin, *supra* note 106, at 251.

137. See *supra* notes 113-15 and accompanying text; see also Griffin, *supra* note 106, at 248 (*Mutschler*'s "root fallacy" is to "import deference to state law into the definitional subsection where such deference is not expressed and does not belong").

138. See *supra* note 118 and accompanying text. A state trust company or savings bank should not be considered a "state bank" unless it is also "carries on the 'banking business' under the authority of State laws." See Griffin, *supra* note 106, at 258. This interpretation effectuates the competitive equality principle because allowing a national bank to branch to the same extent as a trust company or a savings bank would only preserve competitive equality if the trust company or savings bank were carrying on the banking business and thus offering competition to the national bank. Moreover, it has been suggested that trust companies and savings banks were separately listed in the statute because those were then common names of state commercial banks. *Id.*

139. See *supra* notes 126-28 and accompanying text.

140. 12 U.S.C.A. § 24 (seventh) (West Supp. 1988) (enacted by National Bank Act of 1864, ch. 106, 13 Stat. 99 (amending and incorporating the National Currency Act of 1863, ch. 58, 12 Stat. 665)).

141. See *supra* text accompanying notes 40-58.

142. See *supra* notes 121-22 and accompanying text.

not just state commercial banks.¹⁴³ Any potential unfairness to state commercial banks as a result of the *Deposit Guaranty* decision stems only from the irrationality of a state's regulation of depository institutions and their branching opportunities, rendering functionally similar institutions subject to different branching restrictions.

A state attempting to restore some rationality to its regulatory structure has several alternative courses of action. It may return to the pre-*Deposit Guaranty* days by legislatively restricting the powers of state thrifts so that they may no longer be said to be carrying on the banking business. This course of action, however, is not likely as state lawmakers may justifiably fear an exodus of state thrift institutions to the federal thrift charter and its more liberal powers. A second alternative is to preserve a system in which state banks may not branch as extensively as national banks. This alternative is also unattractive because states may fear the conversion of state banks to national bank charters for additional branching privileges. As a final alternative, a state may choose to expand state bank branching opportunities to make them equal to those available to state thrifts. Several states have already taken this course of action.¹⁴⁴

The final issue in interpreting section 36(h) is what meaning to give the requirement that an institution be "carrying on" the banking business.¹⁴⁵ If "carrying on" is construed to require a significant level of participation in each of the functions associated with the banking business, then it is doubtful whether state thrifts in many states would be found to be carrying on the banking business.¹⁴⁶ Thrift industry data indicates that in the aggregate thrifts have not taken advantage of their new bank-like lending powers to a significant extent.¹⁴⁷ Nevertheless, in *Deposit Guaranty*, the Fifth Circuit held that Mississippi state thrifts "are engaged in the banking business," relying on the Comptroller's decision, which noted that although the level of thrift institution activity in the banking business was not quantified in the record, the McFadden Act "does not . . . require a showing of a specific level of competitive impact."¹⁴⁸

According to this reasoning, a state institution is "carrying on" the banking business if it has the *legal authority* to offer those products and services traditionally associated with the banking business. Thus, if a national bank may perform its basic banking functions as a state thrift pursuant to state law, there is no

143. See *supra* notes 101-04 and accompanying text.

144. See *infra* note 372 and accompanying text.

145. See 12 U.S.C. § 36(h) (1982).

146. See Griffin, *supra* note 106, at 263 ("an institution should not be considered a 'state bank' unless it engages in each essential activity of the 'banking business' in a substantial way").

147. See *supra* notes 60-63 and accompanying text.

148. *Deposit Guaranty*, 809 F.2d at 271; Decision of the Comptroller on *Deposit Guaranty*, *supra* note 123, at E-10.30-.31; see *Texas v. Clarke*, 690 F. Supp. 573, 577 (W.D. Tex. 1988) (endorsing the Comptroller's finding that Texas thrifts may "provide the same basic products and services that are provided by commercial banks"); Letter from Ballard C. Gilmore, Director for Corporate Activity, Bank Organization and Structure, Office of the Comptroller of the Currency, to Richard R. Cheatham, Kilpatrick & Cody (Mar. 31, 1987), reprinted in 2 H. PITT, D. MILES & A. AIN, *supra* note 22, app. at E-13.1 (1988) (denying the branching application of a Georgia national bank because the application fails to demonstrate that "state-chartered thrifts in Georgia are indeed 'carrying on the banking business'").

legal restriction to keep a national bank from converting its charter to that of a state thrift and conducting its banking business pursuant to state law allowing state thrifts to perform such functions.¹⁴⁹ Pursuant to the McFadden Act, the national bank should be allowed, without conversion to a thrift charter, to branch to the same extent as such a state thrift. This interpretation preserves competitive equality between national banks and state institutions carrying on the banking business. Thus, state thrifts should be found to be "carrying on" the banking business if they have been granted the statutory authority to engage in those functions most closely associated with commercial banking, for it is the statutory authority allowing them to carry on the banking business that presents the competitive equality issue.

In summary, branching limitations applicable to banks are a matter for state decision. The McFadden Act specifically ties the ability of a national bank to establish a branch to the availability of state bank branching. To ensure, however, that state branching restrictions do not discriminate against national banks, the Act authorizes a national bank to branch to the same extent as any state-chartered institution carrying on the banking business under the authority of state laws. In a state that has chosen to allow thrift institutions to engage in the functions traditionally associated with commercial banking and that has granted state thrifts broader branching privileges than state banks, it is consistent with the McFadden Act to allow a national bank to branch to the same extent as a state thrift.¹⁵⁰ This is true even though state thrifts may not be currently exercising some of their bank-like powers to a significant extent. If a state complains of the potential unfairness to its state-chartered commercial banks, the remedy is obvious: the state may rationalize its laws to remove the disparity by either expanding the branching privileges of state-chartered banks or eliminating the banking powers authorized for state-chartered thrifts.

B. *Commercial Bank Market Expansion by Merger With An Existing Commercial Bank*

The second method by which a bank may expand its market is by merging with, acquiring, or otherwise combining with another bank (hereafter referred to as a merger regardless of the form of the transaction).¹⁵¹ The proposed merger

149. There are numerous practical limitations that might discourage a national bank from converting to a state thrift charter. These include the asset percentage limitations that may limit an institution's loan authority and the higher deposit insurance costs for thrifts to obtain deposit insurance from the Federal Savings and Loan Insurance Corporation than for banks to obtain deposit insurance from the Federal Deposit Insurance Corporation.

150. It may be argued that *Deposit Guaranty* and the other similar decisions have not been motivated by concern for the possible prejudice to national banks from the fact that state thrifts may branch statewide, but national banks may not. Rather, the courts may have employed the broad definition of "state bank" in the McFadden Act to effectively remove more restrictive state commercial bank branching statutes feeling that restrictive branching schemes deserve little court protection. Traditional justifications for restricting branch banking, to protect local interests from outside competition and to retain local control over local deposits, are hard to defend. See Butler & Macey, *supra* note 94, at 702-03 (state branching restrictions and the McFadden Act limit competition).

151. As discussed in Part II A, the location of the branch offices of the resulting entity must comply with state branching proscriptions if the resulting entity is a state-chartered bank, or with the McFadden Act's branching restrictions if the resulting entity is a national bank.

first must be approved by the appropriate federal banking agency. The Bank Merger Act sets forth the procedure for review of a proposed bank merger.¹⁵² It delegates to the Office of the Comptroller of the Currency (OCC) review of a merger resulting in a national bank, to the Federal Reserve Board (FRB) review of a merger resulting in a state bank that is a member of the Federal Reserve System, and to the Federal Deposit Insurance Corporation (FDIC) review of a merger resulting in a state bank insured by the FDIC, but not a Federal Reserve System member.¹⁵³ The reviewing agency considers various factors under the Bank Merger Act,¹⁵⁴ including the effect of the proposed merger on competition in the relevant market.¹⁵⁵ A bank holding company may also expand its operations by acquiring the stock of an additional bank.¹⁵⁶ Pursuant to the Bank Holding Company Act, the FRB must approve such an acquisition.¹⁵⁷ If the bank to be acquired operates in the same markets as any existing bank subsidiaries, the FRB must also consider the antitrust consequences of the acquisition.¹⁵⁸

In recent years the practice of the federal banking agencies and the Department of Justice in reviewing the antitrust consequences of these mergers and acquisitions has been to include thrift institutions in the product market when evaluating the effect of a proposed bank merger on competition.¹⁵⁹ Their justification is that enhancement of thrift institution powers in the early 1980s now enables thrifts to offer products and services previously associated exclusively with commercial banks. Thus, the federal banking agencies consider thrift institutions as bank competitors, disregarding contrary Supreme Court precedent predating the enhancement of thrift powers. In 1963 the Court defined the product market in a commercial bank merger as the unique cluster of products and services associated with commercial banking.¹⁶⁰ In 1974 the Supreme Court confined the product market to commercial banks, specifically excluding savings banks because they were not yet "significant participants" in the provision of commercial banking products and services.¹⁶¹

This section sets forth the antitrust review procedures for a bank merger,

152. 12 U.S.C. § 1828(c) (1982) (applicable to the merger of two banks and to an asset purchase and liability assumption by one bank of another); *see also* Change in Bank Control Act, *id.* § 1817(j) (1982 & Supp. IV 1986) (similar procedures set forth for review of an application by an individual to acquire a bank); Bank Holding Company Act, *id.* § 1842(c) (1982) (similar procedures set forth for FRB review of a proposed stock or asset acquisition of a bank by a bank holding company). When a merger involves a state-chartered institution, state law requirements may be applicable. *See M. MALLOY, supra* note 5, at § 9.4 (1988). *See generally* Macey & Miller, *Bank Failures, Risk Monitoring, and the Market for Bank Control*, 88 COLUM. L. REV. 1153, 1212-23 (1988) (setting forth the legal and regulatory constraints relating to bank mergers).

153. 12 U.S.C. § 1828(c)(2)(A),(B) & (C) (1982).

154. The other factors to be considered by the reviewing agency are "the financial and managerial resources and future prospects of the existing and proposed institutions, and the convenience and needs of the community to be served." 12 U.S.C. § 1828(c)(5) (1982).

155. 12 U.S.C. § 1828(c)(5) (1982); *see infra* notes 162-85 and accompanying text.

156. 12 U.S.C. § 1842(a) (1982).

157. *Id.*

158. *Id.* § 1842(c).

159. *See infra* notes 204-09 and accompanying text.

160. *See infra* notes 186-89 and accompanying text.

161. *See infra* notes 194-202 and accompanying text.

examines the development of the Supreme Court's product market definition, critically evaluates its continuing validity, and considers how product market definition should reflect the participation of thrifts in traditional commercial bank products and services.

1. Bank Merger Antitrust Review Procedures

The federal banking agency must determine whether the effect of the proposed bank merger "may be substantially to lessen competition"¹⁶²—language adopted from section 7 of the Clayton Act that has been interpreted to import the Clayton Act analysis into the evaluation of bank mergers.¹⁶³ The Department of Justice also reviews the antitrust consequences of the proposed combination and may challenge the agency's approval of the merger pursuant to section 7.¹⁶⁴ The two levels of antitrust review are unique to bank mergers;¹⁶⁵ other mergers are reviewed only by the Department of Justice or the Federal Trade Commission pursuant to the Clayton Act and the other antitrust laws.¹⁶⁶

Although there are "no definite quantitative or qualitative tests . . . to determine whether [a merger] may 'substantially' lessen competition,"¹⁶⁷ market share figures and other relevant factors such as barriers to entry by new competitors help to gauge a merger's probable effect on competition.¹⁶⁸ Thus, the applicable federal banking agency and the Department of Justice consider the market shares of the parties to the merger and the market shares of other participants in the same market.¹⁶⁹ Market share figures reflect the extent to which the market is concentrated and the extent to which consummation of the proposed merger

162. 12 U.S.C. § 1828(c)(5)(B) (1982). An agency may approve an anticompetitive merger if "it finds that the anticompetitive effects of the proposed transaction are clearly outweighed in the public interest by the probable effect of the transaction in meeting the convenience and needs of the community to be served." *Id.*

A bank merger may also be disapproved based on antitrust considerations in addition to a lessening of competition if it would (1) "result in a monopoly"; (2) "be in furtherance of any combination or conspiracy to monopolize or to attempt to monopolize the business of banking"; (3) "tend to create a monopoly"; or (4) "in any other manner would be in restraint of trade." 12 U.S.C. § 1828(c)(5)(A) (1982). The Bank Holding Company Act, *id.* § 1842(c), and the Change in Bank Control Act, *id.* § 1817(j)(7)(A) & (B), contain similar standards.

163. 15 U.S.C. § 18 (1982); see *United States v. Connecticut Nat'l Bank*, 418 U.S. 656, 663 (1974).

164. 12 U.S.C. § 1828(c)(6), (c)(7) (1982). In most cases, the Department of Justice has only 30 calendar days after the agency approval in which to challenge an acquisition approved by the federal banking agency. *Id.* In the case of certain emergency acquisitions, the period in which the Department may challenge the approval is shorter. *Id.* § 1828(c)(6). In addition, prior to approving a merger, the responsible agency in the "interests of uniform standards" shall request a report on the competitive factors involved in the merger from the Attorney General and the other two banking agencies. *Id.* § 1828(c)(4).

165. Note, *Commercial Bank Mergers: The Case for Procedural and Substantive Deregulation*, 95 HARV. L. REV. 1914, 1915 (1982) ("The agency approval process . . . constitutes a barrier that merging non-bank financial institutions do not face.").

166. 15 U.S.C. § 18 (1982) (Clayton Act). The Department of Justice may also challenge a merger based on an alleged violation of § 1 or § 2 of the Sherman Act, 15 U.S.C. §§ 1, 2 (1982) (making illegal combinations in restraint of trade, monopolies, attempts to monopolize, or conspiracies to monopolize any part of trade or commerce).

167. *Brown Shoe Co. v. United States*, 370 U.S. 294, 321 (1962).

168. *Id.* at 322 & n.38.

169. UNITED STATES DEPARTMENT OF JUSTICE, MERGER GUIDELINES, 49 Fed. Reg. 26,824

will increase market concentration.¹⁷⁰ The more concentrated a market is, the more likely it is that one participant or a small group of participants could successfully exercise market power.¹⁷¹

Definition of the appropriate market in which to measure the merger's potential foreclosure of competition is "complex because of the requirement that it be analyzed in two dimensions: the product market or 'line of commerce' and the geographic market."¹⁷² The relevant geographic market is "where, within the area of competitive overlap, the effect of the merger on competition will be direct and immediate."¹⁷³ The relevant product market is generally thought of as including all products "reasonably interchangeable by consumers for the same purposes."¹⁷⁴

In 1984 the Department of Justice issued revised merger guidelines applicable to mergers between all types of businesses.¹⁷⁵ These guidelines endorse the use of the Herfindahl-Hirschman Index (HHI) as a measure of market concentration.¹⁷⁶ The federal banking agencies also use the HHI in measuring market concentration.¹⁷⁷ The HHI figures measure the presence of all firms in the market and give proportionately greater weight to those firms with large market

(1984), *reprinted in* 2 Trade Reg. Rep. (CCH) ¶¶ 4490, 4493 (1984) [hereinafter DOJ MERGER GUIDELINES].

170. *Id.*; E. SYMONS & J. WHITE, *supra* note 1, at 514.

171. DOJ MERGER GUIDELINES, *supra* note 169, at ¶ 3.1. A significant increase in market concentration is "so inherently likely to lessen competition substantially" that unless there is clear evidence that the merger will not have such anticompetitive effects, it must be enjoined. *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321, 363 (1963).

172. E. SYMONS & J. WHITE, *supra* note 1, at 513.

173. *Philadelphia Nat'l Bank*, 374 U.S. at 357; *accord* *United States v. Marine Bancorporation*, 418 U.S. 602, 620-21 (1974) (The relevant geographic market is "the area in which the goods or services at issue are marketed to a significant degree by the acquired firm."). The geographic market is usually rather small; "[c]ommercial realities in the banking industry make clear that banks generally have a very localized business." *United States v. Phillipsburg Nat'l Bank*, 399 U.S. 350, 362 (1970).

174. *United States v. E.I. duPont de Nemours & Co.*, 351 U.S. 377, 395 (1956).

175. DOJ MERGER GUIDELINES, *supra* note 169. These guidelines replaced guidelines issued in 1982. UNITED STATES DEPARTMENT OF JUSTICE, 1982 MERGER GUIDELINES, *reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,102 (1988).

176. DOJ MERGER GUIDELINES, *supra* note 169, at ¶ 3.1; *see generally* Calkins, *The New Merger Guidelines and the Herfindahl-Hirschman Index*, 71 CALIF. L. REV. 402 (1983) (evaluating the advantages and consequences of the change to the HHI). The HHI replaces the four-firm concentration ratio as a measure of market concentration. DOJ MERGER GUIDELINES, *supra* note 169, at ¶ 3.1. The four-firm concentration ratio was calculated by summing the market shares of the four largest firms in the relevant market. A highly concentrated market was one with a four-firm concentration ratio of 75% or higher. UNITED STATES DEPARTMENT OF JUSTICE, 1968 MERGER GUIDELINES, *reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,101, at ¶ 5 (1988). A merger in such a market would ordinarily be challenged if firms with the following market shares were involved:

Acquiring Firm	Acquired Firm
4%	4% or more
10%	2% or more
15% or more	1% or more

In less concentrated markets, different levels applied to determine if a proposed merger was likely to be challenged. *Id.*

177. *See, e.g.*, FDIC Notice Requesting Comments on Revised Proposed Policy Statement on Bank Merger Transactions, 53 Fed. Reg. 39,803 (1988) [hereinafter FDIC Revised Proposed Policy Statement] (a merger will normally be approved unless the post-merger HHI exceeds 1800 points and the merger would increase the HHI by 200 or more points).

shares.¹⁷⁸ To calculate the HHI figures, the market share of each firm in the market is determined.¹⁷⁹ Traditionally, the market shares of banks have been approximated by the percentage of deposits held by each bank in the relevant geographic market. The individual market share percentages are squared and then summed.¹⁸⁰ The resulting number is the HHI for the premerger market.¹⁸¹ The same calculation is then performed assuming that the proposed merger has taken place to determine the postmerger HHI.¹⁸²

The Department of Justice's merger guidelines state that it is likely to challenge a merger as anticompetitive if the merger would increase the HHI by over 50 points and would result in a postmerger HHI of over 1800 points.¹⁸³ The Department has indicated, however, that it will challenge a bank merger with a postmerger HHI of over 1800 points only if the merger would increase the HHI by over 200 points.¹⁸⁴ The Department has explained that it uses higher-than-

178. DOJ MERGER GUIDELINES, *supra* note 169, at ¶ 3.1 (giving greater weight to the larger firms in the market "probably accords with their relative importance in any collusive interaction").

179. *Id.* at ¶ 3.1.

180. *Id.*

181. *Id.*

182. *Id.* at ¶ 3.11. The following example illustrates the HHI market concentration calculations:

<u>Pre-Merger</u>		
Market Participants	Market Shares (As % of Total Deposits)	Market Share Squared
A	30%	900
B	20	400
C	20	400
D	10	100
E	10	100
F	5	25
G	5	25
	<u>100%</u>	<u>1950</u>
		Premerger HHI

Upon the merger of C and E, the market share structure would be as follows:

<u>Pre-Merger</u>		
Market Participants	Market Shares (As % of Total Deposits)	Market Share Squared
A	30%	900
C & E	30	900
B	20	400
D	10	100
F	5	25
G	5	25
	<u>100%</u>	<u>2350</u>
		Post-merger HHI

In this example, the postmerger HHI is 2350 and the increase in the HHI as a result of the merger is 400. This merger is one that the Department of Justice would be likely to challenge. See *infra* notes 183-85 and accompanying text.

183. DOJ MERGER GUIDELINES, *supra* note 169, at ¶ 3.11. If the postmerger HHI substantially exceeds 1800 and the increase in the HHI as a result of the merger exceeds 100, the Justice Department has stated that "only in extraordinary cases" will other factors establish that the merger is not likely to lessen competition substantially. *Id.*

184. McQuinn & Strom, *What is Behind Justice's Laxity in Regulation of Bank Mergers?*, Nat'l L.J., Sept. 21, 1987, 28, 29 (citing letter dated Feb. 8, 1985, from Charles F. Rule, Acting Assistant

normal HHI thresholds for bank mergers to take account of "the competitive effect of limited-purpose lenders and other non-depository financial entities" that are not otherwise specifically considered in the HHI calculation.¹⁸⁵

2. The Supreme Court's Product Market Definition for Bank Mergers

In 1963, on its first occasion to define the product market or line of commerce in the case of a merger of two commercial banks, the United States Supreme Court in *United States v. Philadelphia National Bank*¹⁸⁶ found a single, broad product market consisting of "the cluster of products (various kinds of credit) and services (such as checking accounts and trust administration) denoted by the term 'commercial banking.'" The Court set forth several reasons for defining a single product market. First, the court observed that some commercial bank products and services, such as checking accounts and short-term commercial credit, were then offered only by commercial banks.¹⁸⁷ For some products provided by other financial institutions, such as consumer loans offered by consumer finance companies, commercial banks had a significant competitive advantage because noninterest-bearing checking accounts provided their source of funds.¹⁸⁸ Finally, although some commercial bank products and services could be offered by other financial institutions without cost disadvantages, such as savings accounts offered by thrift institutions, many of the products provided by commercial banks enjoyed a settled customer preference over the alternative products, further insulating commercial banks from effective competition from any financial institutions other than commercial banks.¹⁸⁹

In 1970 the definition of the product market in a commercial bank merger was before the Supreme Court again in *United States v. Phillipsburg National Bank & Trust Co.*¹⁹⁰ The proposed merger was between two small commercial

Attorney General, to C. Todd Conover, Comptroller of the Currency, and letter dated Aug. 7, 1985, from Mr. Rule to Paul A. Volcker, Chairman of the Federal Reserve System Board of Governors); see *infra* notes 227-64 and accompanying text.

185. See Fleet Fin. Group, Inc., 74 Fed. Res. Bull. 62, 64 n.11 (1988).

186. 374 U.S. 321, 356 (1963). The district court rejected the government's proposed multiple product lines. *United States v. Philadelphia Nat'l Bank*, 201 F. Supp. 348, 361-62 (E.D. Pa. 1962), *rev'd*, 374 U.S. 321 (1963). The line of commerce definition was not contested on appeal, but nevertheless the Supreme Court devoted a significant portion of its opinion to the proper definition of the line of commerce. 374 U.S. at 335; see Rosenblum, O'Brien & DiClemente, *On Banks, Nonbanks, and Overlapping Markets: A Reassessment of Commercial Banking as a Line of Commerce*, 51 TENN. L. REV. 401, 409 (1984); accord *United States v. Phillipsburg Nat'l Bank & Trust*, 399 U.S. 350, 360 (1970) ("Commercial banks are the only financial institutions in which a wide variety of financial products and services—some unique to commercial banking and others not—are gathered together in one place. The clustering of financial products and services in banks facilitates convenient access to them for all banking customers."). As one commentator noted, it is

the aggregate of a commercial bank's products and services [that] set it discernibly apart from other financial institutions. . . . [N]owhere else could a consumer of banking products find those products so conveniently gathered under one roof. The whole, in a real sense, was something qualitatively different from the sum of its individual parts.

May, *Redefining the Product Market: Commercial Bank Mergers in the New Competitive Era*, 103 BANKING L.J. 124, 130 (1986).

187. *Philadelphia Nat'l Bank*, 374 U.S. at 356 & n.33.

188. *Id.*

189. *Id.* at 357.

190. 399 U.S. 350 (1970).

banks whose activities more closely resembled those of thrift institutions than those of large commercial banks. The Comptroller of the Currency approved the merger based on a product market definition that included finance companies and savings and loan associations.¹⁹¹ Although the Supreme Court recognized the thrift-like character of the two banks proposing to merge, it rejected the inclusion of finance companies and savings and loan associations in the product market, stating that "the cluster of products and services termed commercial banking has economic significance well beyond the various products and services involved."¹⁹² One commentator interpreted the Court's product market holding as suggesting that "a commercial bank's *authority* to provide a relatively broad cluster of powers, rather than the degree to which it exercised that authority, distinguished it from thrifts and other financial institutions."¹⁹³

The most recent Supreme Court decision on the product market definition in a commercial bank merger is its 1974 decision in *United States v. Connecticut National Bank*.¹⁹⁴ The Comptroller approved a merger of two commercial banks located in Connecticut based on a product market definition that included Connecticut savings banks as well as commercial banks.¹⁹⁵ At the time of the proposed transaction, Connecticut savings banks were authorized to make consumer and commercial loans as well as real estate mortgage loans.¹⁹⁶ In addition to savings and time deposits, they were soon to receive the authority to accept demand deposits from consumers, but not business customers.¹⁹⁷ Notwithstanding these bank-like powers, the Supreme Court held that the Comptroller was "mistaken in including both savings and commercial banks in the same product market for purposes of this case."¹⁹⁸

The Court acknowledged that "'complete inter-industry competitive overlap need not be shown'" before savings banks may be included along with commercial banks in the line of commerce.¹⁹⁹ Nevertheless, it stated that commercial banks "continue to be able to provide a cluster of services that [savings banks] cannot, particularly with regard to commercial customers."²⁰⁰ Specifically, the Court noted that savings banks could not provide demand deposit services to commercial customers, and that, given the level of commercial loans offered by savings banks in comparison with commercial banks, savings banks were not meaningful competitors of commercial banks in the commercial loan market.²⁰¹ The Court concluded its analysis of the product market, noting:

191. *Id.* at 358-59.

192. *Id.* at 361.

193. Dunham, *supra* note 62, at 53 (emphasis added).

194. 418 U.S. 656 (1974) (geographic market extension merger as divestiture of offices in overlapping markets eliminated any direct competition).

195. See *United States v. Connecticut Nat'l Bank*, 362 F. Supp. 240, 280 (D. Conn. 1973), vacated and remanded, 418 U.S. 656 (1974).

196. *Connecticut Nat'l Bank*, 418 U.S. at 661.

197. *Id.*

198. *Id.* at 662.

199. *Id.* (quoting *United States v. Continental Can Co.*, 378 U.S. 441, 457 (1964)).

200. *Id.* at 664.

201. *Id.* at 665-66 ("At the end of 1971 commercial banks in Connecticut had outstanding \$1.03 billion in commercial loans. Savings banks, by comparison, had \$26 million in such loans outstand-

At some stage in the development of savings banks it will be unrealistic to distinguish them from commercial banks for purposes of the Clayton Act. In Connecticut, that point may well be reached when and if savings banks become *significant participants* in the marketing of bank services to commercial enterprises.²⁰²

3. Product Market Definitions Used by the Federal Banking Agencies and the Department of Justice

As demonstrated by *Connecticut National Bank* and *Phillipsburg National Bank*, in certain circumstances the OCC was willing to include thrifts as participants in the product market in evaluating the antitrust consequences of a commercial bank merger.²⁰³ Although the Supreme Court rebuffed these efforts, the federal banking agencies now routinely consider thrift institutions as competitors of commercial banks and include thrift institutions in the product market. The federal banking agencies have justified the addition of thrifts to the product market by the statutory enhancement of the powers of thrift institutions in the early 1980s, a development subsequent to the Supreme Court's 1974 *Connecticut National Bank* decision refusing to include savings banks in the product market.

In recent merger decisions the OCC has conducted its analysis of the effect of the proposed merger on competition by including all "depository institutions" in the product market.²⁰⁴ The FDIC has also defined the product market broadly to include thrift institutions.²⁰⁵ The FRB has been willing to consider thrift institutions as competitors of commercial banks, but it normally includes only fifty percent of thrift institution deposits in the product market.²⁰⁶

ing at that time." "Moreover, commercial banks in the State offer credit-card plans, loans for securities purchases, trust services, investment services, computer and account services, and letters of credit. Savings banks do not." *Id.*

202. *Id.* at 666 (emphasis added).

203. See *supra* notes 191 and 195 and accompanying text.

204. See, e.g., Decision of the Comptroller of the Currency on the Application to Merge Bank of Washington, Bellingham, Wash., into Bellingham National Bank, Bellingham, Wash., Merger No. 88-7 (Mar. 30, 1988) (approval of an application to merge the second and eighth largest depository institutions in a market that was defined to include sixteen depository institutions, including offices of the state's two largest thrifts "which represent a major competitive force" within the market); Decision of the Comptroller of the Currency on the Application to Merge the Connecticut National Bank, Bridgeport, Fairfield County, Conn., into Hartford National Bank and Trust Co., Hartford, Hartford County, Conn. (Mar. 26, 1982), reprinted in *BANKING EXPANSION IN THE '80s* 210, 218, 220 (J. Hawke ed. 1982) ("thrifts should be included within the line of commerce used in evaluating mergers between commercial banks" in the light of the recent expansion of their powers); see also Bleier & Eisenbeis, *Commercial Banking as the "Line of Commerce" and the Role of Thrifts*, 98 *BANKING L.J.* 374, 380-81 (1981); May, *supra* note 186, at 140.

205. Federal Deposit Insurance Corporation, Proposed Policy Statement on Bank Merger Transactions, 50 Fed. Reg. 40,599 (1985), reprinted in [1985-1987 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 86,423; McQuinn & Strom, *supra* note 184, at 29 (discussing *In re Savings & Trust Co. of Pennsylvania*, Indiana, Pa., FDIC Order dated April 14, 1987, and *In re Summit Bank*, Fort Wayne, Ind., FDIC Order dated March 17, 1987); see FDIC Revised Proposed Policy Statement, *supra* note 177 ("[T]he relevant [deposit] shares of savings and loan associations and other depository institutions with offices in the relevant geographic market will be considered unless their loan, deposit or other business varies markedly from that of the merging institutions.").

206. Loeyes, *Bank Acquisitions: The Mitigating Factors Defense*, 103 *BANKING L.J.* 427, 433, 435 (1986) (The FRB generally includes only 50% of thrift institution deposits in the line of commerce, reflecting its belief that thrift institutions are not yet "active competitors of commercial banks.").

The Department of Justice, however, has abandoned the single product market composed of the cluster of commercial banking products and services in favor of a separate consumer (or retail) market and a business (or wholesale) market, each of which is composed of separate banking services that may themselves constitute relevant product markets.²⁰⁷ Thrift institutions providing comparable services are included in each separate product market. In the consumer banking market, the Department includes one hundred percent of the deposits of thrift institutions in its market share calculations.²⁰⁸ In the business banking market, however, the Department includes only twenty percent of the deposits of thrift institutions.²⁰⁹

4. Evaluation of the Cluster Product Market Definition Versus Alternative Product Market Definitions

In *Philadelphia National Bank* the Supreme Court found a single product market consisting of the cluster of products and services of commercial banking.²¹⁰ The Court felt that its approach was warranted by the special economic niche then occupied by commercial banks. Economic and statutory changes, however, suggest that commercial banks are no longer the sole occupants of this special niche. Thus, it is appropriate to reconsider the product market definition in the light of those changes and the general principle established by the Supreme Court in *United States v. E.I. duPont de Nemours & Co.* that the prod-

study of merger applications decided by the FRB between November 1982 and July 1985 determined that "[u]ntil April 1984, the Fed usually reported how the level and change in the HHI would be affected if thrift deposits were included at their full value. After April 1984, the Fed usually included thrift deposits only at 50 percent of their value, presumably because thrifts were not considered full competitors of commercial banks." *Id.* at 435; *see, e.g.*, *Union State Bancshares, Inc.*, 74 Fed. Res. Bull. 328 (1988); *Valley Bank of Nevada*, 74 Fed. Res. Bull. 67 (1988); *see also* *Hartford Nat'l Corp.*, 73 Fed. Res. Bull. 720, 721 (1987) (considered HHI calculations with 50% and with 100% of thrift deposits included because of the competitive influence exerted by thrifts in the consumer market and their use of their commercial lending powers); Annotation, *Denial by Board of Governors of Federal Reserve System of Application for Bank Merger, Consolidation, or Acquisition on Anticompetitive Grounds under § 3(c) of Bank Holding Company Act of 1956* (12 USCS § 1842(c)), 71 A.L.R. FED. 438, 566-71 (1985).

The FRB may also include thrift institutions in the line of commerce for a commercial bank merger if the commercial banks involved are active participants in the real estate lending market.

Whereas thrift involvement in traditional commercial bank products is one measure of the competitive importance of thrifts, the reverse situation—banks competing in traditional thrift areas—is another. In several cases, mainly involving banks located in Florida, the Fed cited the similarity in portfolios of banks and thrifts, with banks investing most of their funds in residential real estate loans, as an important factor in favor of including thrifts in competitive analysis.

Loeys, *supra*, at 434; *accord* Bleier & Eisenbeis, *supra* note 204, at 379 ("The weight given to the presence and role of thrift institutions [by the FRB] has been the greatest in those cases where thrift institutions are large in absolute size or play a dominant role in providing financial services within either a specific market or state."); *see, e.g.*, *NCNB Corp.* 70 Fed. Res. Bull. 225, 226 (1984) (commercial bank portfolios and thrift portfolios were similar in that 52% of the commercial bank loans were real estate loans, while only 15% of commercial bank loans were commercial loans).

207. McQuinn & Strom, *supra* note 184, at 29; *see infra* notes 227-31 and accompanying text.

208. McQuinn & Strom, *supra* note 184, at 29 (citing letters from the Department of Justice to the Comptroller of the Currency and the Chairman of the Federal Reserve System Board of Governors); *see infra* note 254 and accompanying text.

209. McQuinn & Strom, *supra* note 184, at 29; *see infra* note 262 and accompanying text.

210. *See supra* notes 186-89 and accompanying text.

uct market should consist of all products "reasonably interchangeable by consumers for the same purposes."²¹¹

The three reasons the Supreme Court gave in *Philadelphia National Bank* to justify its decision to define a single product market in a commercial bank merger may no longer be valid.²¹² First, the Court stated that "[s]ome commercial banking products or services are so distinctive that they are entirely free of effective competition from products or services of other financial institutions."²¹³ The Court cited checking accounts and short-term commercial credit as examples of distinctive products offered exclusively by commercial banks.²¹⁴ The Court was of the view that these bank products had no available substitutes. Today, few, if any, services are offered by commercial banks that are not also offered either by thrifts, non-depository financial institutions, or both. Thrifts, of course, may now offer checking accounts to their commercial loan customers, NOW accounts to their consumer customers, and short-term commercial credit.²¹⁵

The second justification for the cluster of products and services definition given in *Philadelphia National Bank* was that some products and services "enjoy such cost advantages as to be insulated [from competition] within a broad range from substitutes furnished by other institutions."²¹⁶ As an example, the Supreme Court noted that commercial banks have a significant cost advantage in pricing consumer loans vis-à-vis small loan companies that also provide such loans.²¹⁷ One important reason for this cost advantage, according to the Court, was that commercial banks obtain the bulk of their working capital from checking accounts for which they do not have to pay interest.²¹⁸ This cost advantage, however, is diminishing; since the authorization in 1980 of NOW accounts for the consumer customers of commercial banks, an increasing percentage of com-

211. 351 U.S. 377, 395 (1956); see *United States v. Aluminum Co. of Am.*, 377 U.S. 271, 273-77 (1964); *Brown Shoe Co. v. United States*, 370 U.S. 294, 325 (1962) (separate product markets (submarkets) would be identified by "industry or public recognition of the submarket as a separate economic entity [and] the product's peculiar characteristics and uses"); Cairns, *Retail and Wholesale Banking: Diverging Markets and Lines of Commerce*, 37 SYRACUSE L. REV. 713, 736-37 (1981) (applying *Brown Shoe* to recognize retail banking and wholesale banking as separate submarkets); May, *supra* note 186, at 147-48 (suggesting that the *Brown Shoe* analysis may be applied to find various submarkets for commercial banks such as transaction accounts, time deposits, commercial loans, consumer loans, and trust services, but concluding that a submarket analysis is undesirable); Note, *The Line of Commerce for Commercial Bank Mergers: A Product-Oriented Redefinition*, 96 HARV. L. REV. 907, 917-18 (1983) ("The basic principles of product market definition rest on the concept of substitutability.").

212. Vartanian, *Potential Competition and Bank Mergers: Defense Blueprint for the 1980s*, 99 BANKING L.J. 882, 901 (1982).

213. *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321, 356 (1963).

214. *Id.*

215. May, *supra* note 186, at 145 ("As a result of these recent [legislative] enactments, it is no longer possible to say, as the Supreme Court did in 1963, that the checking account is a commercial banking product 'entirely free of effective competition.'").

216. *Philadelphia Nat'l Bank*, 374 U.S. at 356.

217. *Id.*

218. *Id.* at 357 n.33. An additional reason given by the Court for the cost of funds advantage for commercial banks is that the loan "companies' working capital consists in substantial part of bank loans." *Id.* at 356.

mercial bank checking accounts are interest-bearing.²¹⁹ In addition, commercial customers now undertake sophisticated cash management techniques to avoid leaving large balances in noninterest-bearing checking accounts.²²⁰ These commercial bank products, therefore, are no longer insulated by cost advantages from competition with substitute products provided by other financial institutions.

Finally, the Supreme Court noted that the cluster of products and services offered by commercial banks "enjoy[ed] a settled consumer preference insulating them, to a marked degree, from competition."²²¹ This settled consumer preference for commercial banks was used to explain why customers kept money on deposit in savings accounts at commercial banks when in many markets they could earn a one-half percent higher interest rate in savings accounts at nearby thrift institutions. Again, it is arguable whether this customer preference for products and services provided by commercial banks still exists. Consumer and business depositors have become more interest-rate sensitive, particularly during inflationary times.²²² In the late 1970s and early 1980s depositors withdrew funds from commercial bank and thrift accounts to invest in money market mutual funds not constrained by the deposit interest rate ceilings that still applied to commercial banks and thrifts.²²³ Moreover, many customers no longer seek all of their bank services from the same institution but may have checking and savings accounts at one institution and loans (consumer, home mortgage, or commercial) at other institutions.²²⁴ In addition, for customers still seeking the convenience of "one-stop" financial shopping, thrift institutions may also provide all financial services previously only available from a commercial bank.²²⁵ If there is no longer a customer preference for products provided by commercial

219. See Simpson, *supra* note 30, at 8 ("The added premium [on deposits] that many banks now pay has put upward pressure on bank costs, and therefore more high-grade corporate borrowers have gone directly to the open market for credit.").

220. For instance, some commercial customers have "sweep accounts" that sweep checking account balances at the end of each day to overnight investments and some have "controlled disbursement accounts" that clear debits early in the day, allowing greater short-term investment flexibility. See Mahoney, *The Recent Behavior of Demand Deposits*, 74 Fed. Res. Bull. 195, 201 (1988).

221. *Philadelphia Nat'l Bank*, 374 U.S. at 357.

222. May, *supra* note 186, at 126 ("economic conditions have increased the competition that banks face from the unregulated financial institutions").

223. Cummings, *Commercial Banking as a Line of Commerce: Time for Change?*, ECON. REV. (Fed. Res. Bank of Dallas), Sept. 1982, at 11, 13-14 (money market mutual funds have attracted interest sensitive bank customers); see *supra* note 31 and accompanying text.

224. Sunwest Financial Services, Inc., 73 Fed. Res. Bull. 463, 469 (1987) (separate statement by Governors Johnson and Heller) ("Improved technology, communications, and marketing [have] broadened significantly the alternatives available to customers for both credit and deposit services," so that "consumers are no longer confined to their neighborhood bank as the sole source of banking services."); Bleier & Eisenbeis, *supra* note 204, at 384 (In today's economic environment "both consumers and business[es] have become increasingly more sophisticated in unbundling their banking relationships, seeking the highest returns on invested funds while obtaining loans at the lowest possible cost."); Cairns, *supra* note 211, at 739 (discussing "changes in the buying practices of commercial banks' customers, who have begun to shop comparatively for individual banking services").

225. See S. REP. NO. 368, *supra* note 47, at 13, *reprinted in* 1980 U.S. CODE CONG. & ADMIN. NEWS at 248 (The Monetary Control Act of 1980 "should enable thrifts to become one-stop family financial centers.").

banks over similar products provided by other institutions, the competing products should be included in the product market.

If the cluster approach to product market definition no longer reflects market conditions, it should be abandoned in favor of separate product markets, each of which include all reasonably interchangeable products.²²⁶ For instance, it may be argued that because consumer loans are not reasonably interchangeable with or reasonable substitutes for commercial loans, each constitutes a separate product market.

The Justice Department has attempted to identify separate product markets of economically distinct products. Its letter to the Federal Reserve Board regarding the anticompetitive effects of a proposed acquisition by Comerica Incorporated, the second largest bank holding company in Michigan, of the third largest bank holding company in Michigan is referred to here as an illustration of this approach.²²⁷ The Department identified two major categories of services in which both bank holding companies competed—consumer banking services and business banking services.²²⁸ Within each broad service category the Department specified separate products that might constitute individual product markets.²²⁹ Consumer banking services included transaction accounts, time accounts, savings accounts, consumer loans, and residential mortgage loans.²³⁰ Business banking services included demand deposit accounts and commercial loans.²³¹

Identification of separate product markets also requires identification of separate geographic markets for each product market.²³² For example, a prod-

226. Cairns, *supra* note 211, at 734 (proposing a division of the cluster into wholesale and retail banking); Cummings, *supra* note 223, at 16-17 (advocating disaggregating cluster by customer groups rather than product type); Rosenblum, O'Brien & DiClemente, *supra* note 186, at 442 (proposing an examination of a merger's effect on competition on a product-by-product basis); Vartanian, *supra* note 212, at 908-09 (advocating the use of two clusters of services for consumer financial services and wholesale financial services); Note, *Bank Mergers: Agency Review and the Changing Line of Commerce*, 11 *FORDHAM URB. L.J.* 307, 323 (1982) ("The Supreme Court's definition of the line of commerce, though arguably apropos when first announced . . . , has become anachronistic due to changes in the financial marketplace."); Note, *supra* note 211, at 912-16; Note, *Banking Mergers and "Line of Commerce" After the Monetary Control Act: A Submarket Approach*, 1982 *U. ILL. L. REV.* 731; see Gilbert & Murphy, *Competition Between Thrift Institutions and Commercial Banks, An Examination of the Evidence*, *J. BANK RES.*, Summer 1971, 8, 18 ("increased competition among commercial banks and thrift institutions for savings-type liabilities in the 1960's suggests that some reconsideration of the commercial bank product line specification may be in order"); Hale, *Comment on Dr. Austin's Article: The Evolution of the Commercial Bank Merger Antitrust Law*, 39 *BUS. LAW.* 1557, 1564 (1981); Lovatti, *The Growing Similarity Among Financial Institutions*, 59 *FED. RES. BANK OF ST. LOUIS REV.* 8, 11 (1977).

227. Letter to Paul A. Volcker, Chairman of the Federal Reserve Board of Governors, from Charles F. Rule, Acting Assistant Attorney General, Antitrust Division, Department of Justice (Aug. 7, 1985) (concerning application filed by Comerica Incorporated and sent to the FRB pursuant to 12 U.S.C. § 1828(c)(4) (1982)) [hereinafter DOJ Comerica Letter]. This letter is discussed and cited in McQuinn & Strom, *supra* note 184, at 29. A copy of the letter may be obtained from the Justice Department through a Freedom of Information Act request.

228. DOJ Comerica Letter, *supra* note 227, at 2.

229. *Id.*

230. *Id.*

231. *Id.*

232. Note, *supra* note 211, at 922-23 ("After the crucial product lines are established, the geographic market for each line should be determined.").

uct market composed of large commercial loans could well be nationwide in geographic area, while the consumer loan product market might well be limited to the local area.²³³ Because a proposed merger will be disapproved if it forecloses competition in *any* relevant market, an analysis of the separate product markets involved in a commercial bank merger may be simplified by concentrating exclusively on those product markets likely to be associated with small geographic markets in which a merger would most likely have the effect of lessening competition.²³⁴ Thus, in the Comerica letter the Justice Department evaluated competition for consumer banking services provided in the local geographic market and confined its evaluation of competition for business banking services to the small business loan market—the product market in which competition for business services was most likely to be adversely affected.²³⁵

After defining the relevant product and geographic markets, the participants in each of those markets must be identified. In the Comerica letter the Justice Department considered only banks and thrift institutions as participants in the market for consumer banking services. In a letter to the Comptroller of the Currency relating to competitive factors in another proposed bank merger, the Department recognized the competitive significance in that geographic market of certain nondepository financial institutions such as consumer finance companies.²³⁶ The Department relied on market share calculations based on deposit shares of only thrifts and banks, however, because the Department's threshold HHI levels for bank mergers have been set higher than for mergers of other businesses to "implicitly recognize the competitive effect of such limited-purpose lenders and other non-depository financial entities."²³⁷

In the Comerica review the Department considered local commercial banks, local thrift institutions, commercial credit companies, and out-of-market banks with local loan production offices or officer call programs, as possible par-

233. Cairns, *supra* note 211, at 743 ("a national market often will be appropriate for analysis of the effect on competition of a merger of wholesale banks").

234. *Brown Shoe Co. v. United States*, 370 U.S. 294, 325 (1962) (substantial elimination of competition in any identifiable economically significant submarket is a violation of the Clayton Act); see Cairns, *supra* note 211, at 715 (it is sufficient for enjoining a merger on antitrust grounds to find a single product market of reasonable importance in which competition is substantially lessened); May, *supra* note 186, at 148-49 ("Submarket analysis might also have the effect of making it difficult to approve even meritorious bank mergers, for the variety of financial products is so great that almost certainly some submarket could be defined in which competition would be lessened by the merger of two banks.").

235. DOJ Comerica Letter, *supra* note 227, at 6-7. The Department concluded that business banking services provided to medium and large size corporations were competitive because of the substantial number of credit sources available to these customers in the larger regional and national markets. *Id.* at 7. Thus, the Department focused only on small business customers with annual sales of less than \$5 to \$10 million as the business customer group most likely to be affected by the proposed acquisition. *Id.* These businesses, the Department stated, were limited to local depository institutions for unsecured credit and checking accounts. *Id.* at 8 n.19.

236. Letter to C. Todd Conover, Comptroller of the Currency, from Charles F. Rule, Acting Assistant Attorney General, Antitrust Division, Department of Justice (Feb. 8, 1985) (regarding the application of First National Bank of Jackson), *cited in* McQuinn & Strom, *supra* note 184, at 29. This letter is available from the Department of Justice pursuant to a Freedom of Information Act request.

237. *Id.* at 5 n.10.

ticipants in the small business loan market.²³⁸ All these institutions could legally offer small business loans, but not all were currently exercising this power. The Department recognized, however, that although the product market focuses "primarily on firms that currently produce and sell the relevant product,"²³⁹ "firms that do not currently sell the relevant product, but that could easily and economically sell it using existing facilities, are included in the market and are assigned a market share."²⁴⁰ The Justice Department's merger guidelines suggest including an institution in the product market if it could sell the relevant product within one year in response to a "'small but significant and nontransitory' increase in price."²⁴¹ Including potential market participants recognizes the competitive effect exerted by these institutions with the legal authority to offer particular commercial bank products and services on commercial banks. These institutions may be perceived by commercial banks in the market as potential competitors waiting in the wings.²⁴² If commercial banks in a concentrated market attempt to exercise their market power by charging supracompetitive prices on commercial loans, for instance, thrifts or commercial credit companies may find it profitable to enter this line of business in a significant manner.²⁴³ The specter of potential entry will currently serve to limit the

238. DOJ Comerica Letter, *supra* note 227, at 8.

239. DOJ MERGER GUIDELINES, *supra* note 169, at ¶ 2.2.

240. DOJ MERGER GUIDELINES, *supra* note 169, at ¶ 3.3.

241. DOJ MERGER GUIDELINES, *supra* note 169, at ¶ 2.21. The Department has cautioned that a firm that "would have significant difficulty distributing or marketing the new product or for some other reason would find the substitution unprofitable . . . will not be included in the market." *Id.*; see also Dunham & Guerin-Calvert, *supra* note 62, at 54 ("the estimated volume of commercial loans a thrift would make in response to a hypothetical increase in local market prices" would be a good measure of thrift competition for commercial loans).

242. The Supreme Court has recognized the doctrine of perceived potential competition in determining whether a proposed acquisition of a market participant by a perceived potential market participant will act to substantially lessen competition in the market. *United States v. Marine Bancorp., Inc.*, 418 U.S. 602, 639-40 (1974); *United States v. Falstaff Brewing Corp.*, 410 U.S. 526, 531-32 (1973) ("Suspect also is the acquisition by a company not competing in the market but so situated as to be a potential competitor and likely to exercise substantial influence on market behavior."); *United States v. Penn-Olin Chem. Co.*, 378 U.S. 158, 174 (1964) ("The existence of an aggressive, well equipped and well financed corporation engaged in the same or related lines of commerce waiting anxiously to enter an oligopolistic market would be a substantial incentive to competition which cannot be underestimated.").

A question of paramount importance in any discussion of the competitive consequences of a merger is whether potential competitors face significant barriers to entry. Unfortunately, this question cannot be answered under the cluster rule. That is, the effect of potential competition in restraining the exercise of market power of firms cannot be assessed.

Rosenblum, O'Brien & DiClemente, *supra* note 186, at 443.

243. [I]f local thrift institutions are perceived as potentially capable of making commercial loans at competitive prices, commercial banks may respond by lowering their commercial loan prices and limiting profitability. Their action may effectively discourage the thrifts from actually making any commercial loans. Nevertheless, the thrifts' competitive influence in commercial lending in this local banking market is undeniable.

Dunham & Guerin-Calvert, *supra* note 62, at 52; see also Hannan, *Competition Between Commercial Banks and Thrift Institutions: An Empirical Examination*, 15 J. BANK RESEARCH 8, 9 (1984) (concluding, contrary to most previous studies, that thrifts "substantially influence certain aspects of the behavior of commercial banks, thus casting doubt on the 'unique line of commerce' doctrine, even as it applied on the pre-1980 environment"). But see Cox & Parker, *Do Banks Price as if Thrifts Matter?*, ECON. REV. (Fed. Res. Bank of Atlanta) 49, 51 (April 1982) (finding no empirical support for the proposition that banks price retail services as if thrifts matter).

pricing decisions of the commercial bank market participants.

In the Comerica letter the Department did not include commercial credit companies or out-of-market banks in the product market, however, because they were not important providers of credit to small businesses in the market and because no evidence indicated that these institutions would shift resources to this market in the event of a significant nontransitory increase in small business loan prices by commercial banks.²⁴⁴ The Department concluded that local thrift institutions had the potential to provide small business loans, although they had not yet utilized fully their commercial loan powers, and should be included in the market.²⁴⁵

Calculating market share in separate product markets identified for each economically distinct bank product and service is difficult.²⁴⁶ The traditional measure of a bank's market share is the bank's share of the total bank deposits in the market.²⁴⁷ This measure is easy to calculate because bank deposit data is readily available. The approach has a number of defects, however. The approach is not a good measure of participation in a product market defined for a distinct product or service, rather than a product market composed of the cluster of products and services, because there may be no stable relationship between the amount of the product offered and the amount of the institution's deposits.²⁴⁸ Deposit shares also obviously account only for competition provided by depository institutions.²⁴⁹ The competition that may be provided by finance companies, mortgage loan companies, and other nondepository financial institutions in particular product markets is not measured. Nor do deposit shares account for competition that may be provided by depository institutions with deposits located outside the relevant geographic market.²⁵⁰

Obviously, a better measure of market share would be based on the dollar amount of the particular product provided by each institution in the market.²⁵¹

244. DOJ Comerica Letter, *supra* note 227, at 8-9. In addition, the Justice Department noted that restrictive branching and interstate banking provisions made it unlikely that out-of-market institutions would enter in the near future to provide banking services to small business customers. *Id.* at 13.

245. DOJ Comerica Letter, *supra* note 227, at 11. Factors limiting the commercial lending of thrifts were the asset percentage limitations on commercial lending, the start-up costs associated with commercial lending, the traditional emphasis of thrifts on real estate lending, and the tax and other incentives for thrifts to remain concentrated in real estate lending. *Id.* at 9.

246. McQuinn & Strom, *supra* note 184, at 29 ("bank records typically do not distinguish between small-business loans . . . and other commercial loans," and thus a submarket approach may "not [be] readily susceptible to proof in a court of law"); Vartanian, *supra* note 212, at 909 ("the lack of available industry and regulatory data to support such changes in product market analysis is the greater stumbling block to establishing distinguishable congeries of financial services that cut across traditional and institutional lines of demarcation"); see May, *supra* note 186, at 148 (the use of submarkets "would be an extraordinarily cumbersome procedure for courts to apply, requiring a detailed analysis of what could be stretched into an almost endless procession of submarkets").

247. See *supra* notes 179-80 and accompanying text; see also DOJ MERGER GUIDELINES, *supra* note 169, at ¶ 2.4.

248. Vartanian, *supra* note 212, at 910 ("Deposits say nothing about a bank's share of the loan market . . .").

249. Vartanian, *supra* note 212, at 910-11.

250. Vartanian, *supra* note 212, at 911.

251. See DOJ MERGER GUIDELINES, *supra* note 169, at ¶ 2.4 (market shares may be expressed in dollar terms through measurement of sales); Note, *supra* note 211, at 923 ("to determine the

Because of practical difficulties in obtaining the necessary data, however, the Department of Justice has relied in some instances on deposit share data to provide an approximate measure of market share. For instance, in its Comerica letter the Department included commercial banks along with thrift institutions in a broadly defined consumer banking product market and calculated market concentration based on the deposit shares of these institutions.²⁵² The Department acknowledged that disaggregated product data for each separate consumer banking service would provide a more accurate measure of market share than total deposit data for the broader product market.²⁵³ Nevertheless, the Department calculated market concentration in the consumer banking market based on the total deposit shares of banks and thrifts because deposit data is more readily available than data regarding the volume of specific banking services and "in many cases provides a reasonable proxy for the likely competitive effects of bank mergers."²⁵⁴

The Department encountered even more difficulty in calculating market concentration in the market for small business loans. It considered two possible methods for measuring the participation of banks and thrifts in the small business loan product market. One measure of market participation was the actual volume of small business loans and the second measure was based on the weighted total deposits of the banks and thrifts in the market.²⁵⁵ Call report data for all commercial loans made by banks and thrifts was available, but it included loans to nonlocal businesses and to larger corporations.²⁵⁶ Therefore, the Department relied on survey data submitted by the parties concerning the volume of "middle-market" commercial lending by local banks.²⁵⁷ Although this data included loans to larger corporations that were not limited to local credit providers, the Department found this data more useful than the even more general call report data.²⁵⁸ To this data on commercial bank lending the Department added its own estimate of the current volume of thrift lending to small businesses and then tripled this estimate to account for the likely increase in small business lending by thrifts in the next several years, thus accounting for the effect the potential competition of thrifts likely exerted on pricing decisions by commercial banks in the small business loan market.²⁵⁹ Under these assumptions, the Department found the acquisition would be significantly adverse to

market share of a commercial bank in the local business, short-term loan market, a court would simply divide the dollar amount of that bank's outstanding short-term loans to local businesses by the total amount of outstanding short-term loans to local businesses, from banks and nonbanks, in the geographic market").

252. DOJ Comerica Letter, *supra* note 227, at 7.

253. DOJ Comerica Letter, *supra* note 227, at 7 n.16.

254. DOJ Comerica Letter, *supra* note 227, at 7 n.16 (indicating that the limited data available concerning discrete products was consistent with its analysis based on deposit share data).

255. DOJ Comerica Letter, *supra* note 227, at 10.

256. DOJ Comerica Letter, *supra* note 227, at 11.

257. DOJ Comerica Letter, *supra* note 227, at 11.

258. DOJ Comerica Letter, *supra* note 227, at 11 n.25 ("With more time, more accurate market share data could be developed.").

259. DOJ Comerica Letter, *supra* note 227, at 11.

competition.²⁶⁰

An alternative measure of market share for small business loans was then calculated based on an institution's weighted total deposits as a proxy for its small business loan market share.²⁶¹ The Department considered one hundred percent of each bank's deposits, but concluded that only a twenty percent weight should be assigned to thrift deposits based on their current and likely future participation in small business lending.²⁶² Under this measure of market concentration, the acquisition also was found to have a significantly adverse effect on competition for small business loans.²⁶³ The Department concluded that divestiture of some small business loans in the market would be necessary to mitigate the anticompetitive effects of the acquisition while preserving its benefits.²⁶⁴

The Department's experience indicates that the identification of separate product markets and properly accounting for the participation of all providers of those products is at best difficult and imprecise. Indeed, perhaps because of the practical difficulties in the evaluation of competition in separate product markets, the FDIC, OCC, and FRB have continued to follow the cluster approach.²⁶⁵ Lower courts also have rejected the Justice Department's attempts to define separate product markets, apparently feeling bound by the contrary Supreme Court precedent.²⁶⁶ Needless to say, the cluster product market definition does have certain benefits. It is easy to administer, data is readily available, and the merging banks can easily forecast the likelihood that the merger will be found anticompetitive.

If the cluster approach to product market definition is retained because of its ease of application, then it is clear that thrifts should be included in that product market when judging the effect of a bank merger on competition.²⁶⁷

260. DOJ Comerica Letter, *supra* note 227, at 11.

261. DOJ Comerica Letter, *supra* note 227, at 12.

262. DOJ Comerica Letter, *supra* note 227, at 12 & n.27. The 20% weight was chosen based on the tax incentives for thrifts to retain a high percentage of real estate mortgage loans, the costs associated with increased commercial lending, and the statutory limitation of commercial lending to ten percent of thrift assets. *Id.*

263. DOJ Comerica Letter, *supra* note 227, at 12.

264. DOJ Comerica Letter, *supra* note 227, at 15.

265. See *supra* notes 204-06 and accompanying text.

266. In *United States v. Central State Bank*, 621 F. Supp. 1276, 1292 (W.D. Mich. 1985), *aff'd*, 817 F.2d 22 (6th Cir. 1987), the district court held that the relevant line of commerce was the cluster of products and services provided by commercial banks, rejecting the Justice Department's identification of three separate product markets of transaction accounts, business transaction accounts, and small business loans. The district court acknowledged that there may be identifiable submarkets within the commercial banking market, but that "submarkets are not a basis for the disregard of a broader line of commerce that has economic significance." *Id.* at 1291 (quoting *United States v. Phillipsburg Nat'l Bank & Trust Co.*, 399 U.S. 350, 360 (1970)); cf. *Irving Bank Corp. v. Board of Governors of the Fed. Res. Sys.*, 845 F.2d 1035, 1037 (D.C. Cir. 1988) (finding that a proposed merger would have no adverse effect on competition measured in the cluster product market or alternatively in a product market including only certain quite specialized banking services).

267. See, e.g., Bleier & Eisenbeis, *supra* note 204; Dunham, *supra* note 62, at 51; Friedlander & Slayton, *Determination of the Relevant Product Market in Bank Mergers: A Time for Reassessment?*, 36 BUS. LAW. 1537 (1981); May, *supra* note 186, at 149-50 ("The inclusion of whole categories of nonbank financial institutions in the commercial banking market appears to offer the best means of balancing the need to take nonbank competition into account to provide a judicially manageable method of analyzing bank mergers."). Several district courts have included thrifts in the line of

The credit offerings of thrifts no longer are limited to home mortgage loans and now include a limited ability to offer short-term commercial credit, identified in *Philadelphia National Bank* as a "critical area" in which most other depository institutions were at a disadvantage with commercial banks.²⁶⁸ Thrift institutions also offer NOW accounts to consumer customers, and many thrifts are authorized to offer checking accounts to their commercial loan customers.²⁶⁹ Finally, federally chartered thrift institutions may exercise trust and fiduciary powers.²⁷⁰ Thus, the "cluster of products and services" identified by the Supreme Court in 1963 as the product market in a commercial bank merger is provided by thrifts as well as by commercial banks.²⁷¹

It is important to recall, however, that thrift institutions in the aggregate have not yet exercised their commercial lending powers to a significant extent.²⁷² Thus, it may be argued that the OCC and FDIC approaches—including one hundred percent of thrift deposits in the product market—overstate the competitive effect of thrifts, whose enhanced lending powers are subject to specific asset percentage limitations and which have not yet exercised those lending powers even to the extent of the statutory limits.²⁷³ The FRB seems to have implicitly recognized this possible distortion by including only fifty percent of thrift deposits in the product market.²⁷⁴ Until thrifts are significant participants in the commercial lending area, the weighted deposit approach seems to be an acceptable way of dealing with the concerns expressed by the Supreme Court in *Connecticut National Bank*.²⁷⁵

The enhancement of thrift powers in the 1980s justifies a reexamination of the Supreme Court's definition of the product market used to judge the effect of a proposed bank merger on competition. With the authority to offer those products and services identified with traditional bank functions—such as commercial loans and transaction accounts—thrift institutions should be regarded, at least in some respects, functionally equivalent to commercial banks, and considered when judging the effect of a proposed bank merger on competition. In the light of the changing regulatory and market structures, the Supreme Court's product market definition based on the "cluster" of products and services traditionally

commerce. *E.g.*, *United States v. Idaho Nat'l Bank*, 315 F. Supp. 261, 267 (D. Idaho 1970); *United States v. First Nat'l Bank*, 310 F. Supp. 157, 168 (D. Md. 1970); *United States v. Phillipsburg Nat'l Bank & Trust Co.*, 306 F. Supp. 645, 647 (D.N.J. 1969), *rev'd*, 399 U.S. 350 (1970); *United States v. First Nat'l Bank*, 301 F. Supp. 1161, 1180-81 (S.D. Miss. 1969); *United States v. Provident Nat'l Bank*, 280 F. Supp. 1, 7-8 (E.D. Pa. 1968); *United States v. Crocker-Anglo Nat'l Bank*, 277 F. Supp. 133, 154-57 (N.D. Cal. 1967).

268. See Rosenblum, O'Brien & DiClemente, *supra* note 186, at 426-27; *supra* notes 186-89 and accompanying text.

269. See Whitehead, *The Line of Commerce Issue in Commercial Banking: An Overview*, ECON. REV. (Fed. Res. Bank of Atlanta), April 1982, at 6, 9; *supra* notes 43 and 54 and accompanying text.

270. See *supra* note 47 and accompanying text.

271. See *supra* notes 186-89 and accompanying text.

272. See *supra* notes 60-63 and accompanying text.

273. See *supra* notes 204-05 and accompanying text; Note, *supra* note 211, at 925 (adding thrifts to the cluster product market may be overinclusive if thrifts are not competing substantially in various products and services).

274. See *supra* note 206 and accompanying text.

275. See *supra* notes 194-202 and accompanying text.

provided by commercial banks is no longer meaningful.²⁷⁶ Because commercial banks are no longer the exclusive source of these products and services, and because bank customers now view many of the traditional commercial banking products and services as distinct from a cluster of related products, separate product markets should be identified for each distinct bank product and service.²⁷⁷ The approach employed by the Justice Department illustrates and realistically resolves many of the practical application problems engendered by the identification of separate product markets.²⁷⁸ Although there are numerous economically distinct bank products and services, only those products with a relatively limited geographic market need be examined closely; in a larger regional or national geographic market it is not likely a proposed merger will have an adverse effect on competition.²⁷⁹ Thrift institutions legally authorized to provide a product should be included as market participants. Although the level of thrift participation in a particular product may not yet be significant, the thrift should be assigned a market share based on its likely response to a significant nontransitory price increase imposed by commercial banks.²⁸⁰ This approach properly accounts for the effect on commercial bank competition exerted by thrifts as potential competitors waiting in the wings.²⁸¹

Market shares in distinct product markets are best calculated based on evidence of the dollar volume of product each participant currently provides or is likely to provide in the event of supracompetitive price increases.²⁸² In many instances, absent evidence provided by the merging parties, this data is not readily available.²⁸³ An alternative and approximate market share measure may be calculated using deposit shares.²⁸⁴ In the case of products provided to business customers, the deposit shares should be weighted by a factor that accounts for the statutory and practical limitations on the level of business products that may be provided by thrift institutions.²⁸⁵ Deposit share data also requires correction because it precludes direct consideration of competition provided by nondepository institutions.²⁸⁶ This competition may be indirectly accounted for by employing higher HHI threshold levels in judging the anticompetitive effects of bank mergers than for other mergers.²⁸⁷

Although the separate product market approach suggested in this section would result in a more meaningful measure of concentration than the cluster approach now applied by the federal bank regulatory agencies, the cluster approach has many practical advantages. It is easy to administer, the necessary

276. See *supra* notes 212-16 and accompanying text.

277. See *supra* note 226 and accompanying text.

278. See *supra* notes 227-64 and accompanying text.

279. See *supra* notes 232-35 and accompanying text.

280. See *supra* notes 239-41 and accompanying text.

281. See *supra* notes 242-43 and accompanying text.

282. See *supra* note 251 and accompanying text.

283. See *supra* notes 254-59 and accompanying text.

284. See *supra* notes 254 and 261-62 and accompanying text.

285. See *supra* note 262 and accompanying text.

286. See *supra* notes 246-50 and accompanying text.

287. See *supra* note 237 and accompanying text.

market data is readily available, and the merging entities may easily predict the outcome of the antitrust analysis. It is clear, however, that if the cluster approach to product market definition is retained, thrift institutions legally authorized to provide each of the products and services previously identified exclusively with commercial banks should be included in the product market.²⁸⁸ Including one hundred percent of thrift deposits in the commercial banking product market, however, is problematical and may overstate the competitive effect of thrifts when they are not taking advantage of their commercial lending powers to a significant extent.²⁸⁹ Irrespective of the method of analysis adopted, the enhancement of thrift powers in the early 1980s giving thrifts the functions of commercial banks compels the conclusion that thrift institutions are competitors of commercial banks and should be considered in any analysis of commercial bank competition.

D. *Bank Holding Company Market Expansion by Acquisition of a Healthy Thrift Institution*

The Federal Reserve Board (FRB or the Board) has proposed an amendment to its regulations implementing the Bank Holding Company Act (BHCA) that would allow a bank holding company to expand its market by acquiring a healthy thrift institution as a nonbanking subsidiary.²⁹⁰ The FRB stated that the proposed regulatory revision is prompted in part by "recent changes in the law substantially broadening the powers of thrift institutions."²⁹¹ This section examines the evolution of the FRB's position on the acquisition of healthy thrift institutions. It analyzes whether the FRB proposal is justified by the expansion of thrift powers and whether the proposed regulatory revision exceeds the FRB's statutory authority. It concludes, as a matter of policy, that the affiliation of a bank holding company and a healthy thrift institution should be allowed.

1. The Bank Holding Company Act

A bank holding company is a company that controls one or more banks.²⁹² It is regulated by the FRB pursuant to the BHCA²⁹³ and the FRB regulations implementing the BHCA (known collectively as Regulation Y).²⁹⁴ One purpose of the BHCA is to ensure the separation of the banking business from more

288. See *supra* notes 267-71 and accompanying text.

289. See *supra* notes 272-75 and accompanying text.

290. 52 Fed. Reg. 36,041, 36,043 (1987) (proposal to amend 12 C.F.R. § 225.25(b)).

291. *Id.*

292. 12 U.S.C. § 1841(a)(1) (1982). A bank holding company may be a "corporation, partnership, business trust, association, or similar organization." *Id.* § 1841(b).

293. *Id.* §§ 1841-1850.

294. 12 C.F.R. § 225.1-43 (1988). The law of the state of the holding company's incorporation must also be considered. Most states provide for the incorporation of a bank holding company and may have a state bank holding company act setting forth further regulation of the company. See 2 M. MALLOY, *supra* note 5, § 8.4. For instance, a handful of states prohibit a bank holding company from owning more than one bank. *E.g.*, NEB. REV. STAT. § 8-1512 (1987); VA. CODE ANN. § 6.1-392 (1988).

general commercial enterprise.²⁹⁵ Accordingly, under the BHCA a bank holding company may own bank subsidiaries²⁹⁶ and only those nonbanking subsidiaries whose activities are "so closely related to banking . . . as to be a proper incident thereto."²⁹⁷ As previously discussed, the Douglas amendment to the BHCA restricts location of the bank holding company's bank subsidiaries.²⁹⁸ The locations of a bank holding company's nonbanking subsidiaries, however, are not restricted.²⁹⁹

Prior to 1982 the BHCA defined a bank to be an institution that both "(1) accepts deposits that the depositor has a legal right to withdraw on demand, and (2) engages in the business of making commercial loans."³⁰⁰ Since federally chartered thrift institutions and most state-chartered thrift institutions were not authorized to provide either demand deposits or commercial loans, a bank holding company could not acquire a thrift institution pursuant to its authority to acquire an additional bank.³⁰¹ In 1982 when Congress granted federally chartered thrift institutions the ability to make commercial loans in amounts not exceeding ten percent of an institution's assets and to offer demand deposits to commercial loan customers, it also amended the BHCA definition of "bank" specifically to exclude any FSLIC-insured or federally chartered thrift institution.³⁰² Congress redefined "bank" for purposes of the BHCA in 1987 to preclude bank holding companies from avoiding the Douglas Amendment by establishing limited purpose institutions, but it preserved this specific exclusion of thrift institutions.³⁰³

295. P. HELLER, FEDERAL BANK HOLDING COMPANY LAW § 4.01 (1988); see S. REP. NO. 1095, 84th Cong., 1st Sess. 1 (1955), *reprinted in* 1956 U.S. CODE CONG. & ADMIN. NEWS 2482 (bank holding companies should confine their activities to the management and control of banks).

296. 12 U.S.C. § 1842(a)(2) (1982). If the bank subsidiary is located within the same state as the bank holding company's other bank subsidiaries, the acquisition is subject to the antitrust considerations discussed in Part II.B, and if the acquired bank subsidiary is to be merged into an existing bank subsidiary, the acquisition is also subject to the branching restrictions discussed in Part II.A.

297. 12 U.S.C. § 1843(c)(8) (1982) (acquisition of interest in nonbanking organizations) (amended 1987). The BHCA provides as a general proposition that "no bank holding company shall . . . acquire direct or indirect ownership or control of any voting shares of any company which is not a bank." *Id.* § 1843(a)(1). There are numerous exceptions to this rule. See *id.* § 1843(a)(2), (c) & (d).

298. See *supra* notes 19-22 and accompanying text.

299. See 12 U.S.C. § 1842(d) (1982) (applies only to acquisition of an additional bank).

300. *Id.* § 1841(c) (1976) (amended 1982 & 1987).

301. See *supra* notes 7-8 and accompanying text.

302. Depository Institutions Act of 1982, Pub. L. No. 97-320, § 333, 96 Stat. 1469, 1504 (amending 12 U.S.C. § 1841(c)) (The definition of bank excludes "an institution the accounts of which are insured by the Federal Savings and Loan Insurance Corporation or an institution chartered by the Federal Home Loan Bank Board.").

It is possible that thrifts were explicitly excluded from the BHCA definition of "bank" because Congress foresaw that some thrift institutions might become engaged in the business of making commercial loans, and some might not. Absent the thrift exclusion, not only would one have difficulty determining whether a thrift was engaged in the commercial loan business, but some thrifts would be considered banks subject to BHCA regulation, resulting in additional complications.

303. The Competitive Equality Banking Act of 1987, Pub. L. No. 100-86, § 101(a)(1), 101 Stat. 552 (codified at 12 U.S.C.A. § 1841(c) (West Supp. 1988)). The 1987 amendment was designed to close the so-called "nonbank bank" loophole, in which a bank holding company attempted to escape BHCA regulation (especially limitations on the activities of its nonbanking subsidiaries and the geographic limitation in the Douglas Amendment on the locations of the bank subsidiaries) by eliminating its bank subsidiaries' demand deposits or commercial loans so that the bank subsidiaries would

2. Bank Holding Company Acquisition of a Thrift Institution Prior to the Enhancement of Thrift Powers

Arguably, the exclusion of thrifts from the BHCA definition of "bank" does not affect the separate issue of whether a bank holding company may acquire a thrift as a nonbanking subsidiary. The BHCA states that the FRB may approve the acquisition of a nonbanking subsidiary if the activities of the subsidiary are "so closely related to banking . . . as to be a proper incident thereto."³⁰⁴ In 1977 the FRB concluded as a general matter in its *D.H. Baldwin Co.* ruling that the activities of a savings and loan association were closely related to banking, but that the operation of a savings and loan was not a proper incident to banking.³⁰⁵ Pursuant to section 4(c)(8) of the BHCA, a particular activity is a proper incident to banking if performance of the activity by a bank holding company subsidiary "can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or

not satisfy the BHCA's two-pronged definition of "bank." See S. REP. NO. 19, 100th Cong., 1st Sess. 5-7, reprinted in 1987 U.S. CODE CONG. & ADMIN. NEWS 489, 495-97.

304. 12 U.S.C.A. § 1843(c)(8) (West Supp. 1988).

305. 63 Fed. Res. Bull. 280, 281-82, 284, 287 (1977). The FRB denied the application of a bank holding company to retain the stock of a savings and loan association and its wholly owned subsidiary. *Id.* at 280. The D.H. Baldwin Company had become a bank holding company as a result of the 1970 amendments to the BHCA subjecting one-bank holding companies to the BHCA. *Id.* at 281. The 1970 amendments gave to these holding companies ten-year grandfather rights for the retention of nonbanking subsidiaries that they acquired between June 30, 1968, and December 31, 1970. D.H. Baldwin Company acquired the savings and loan association in 1969 and filed this application with the Board to retain its savings and loan subsidiary beyond the expiration of the grandfather date. *Id.*; see also 58 Fed. Res. Bull. 717 (1972) (The FRB elected not to include the operation of a savings and loan association in its list of activities in which bank holding companies may engage through their nonbanking subsidiaries because the separate regulatory structure of thrifts and banks "suggests past intent on the part of Congress to maintain savings and loan associations as specialized lenders to finance housing, with specialized rules appropriate to that role."). The FRB also denied several applications filed by bank holding companies to acquire thrift institutions as nonbanking subsidiaries. *E.g.*, Memphis Trust Co., 61 Fed. Res. Bull. 327, 329 (1975) (public benefits to be achieved by the acquisition were outweighed by the possible diversion of holding company funds from the needs of the bank subsidiary to the savings and loan subsidiary); American Fletcher Corp., 60 Fed. Res. Bull. 868, 872 (1974) (public benefits to be achieved by the acquisition did not outweigh the "significant adverse effects" on the bank holding company because of the diversion of holding company funds from the needs of the bank subsidiary and the increase of debt necessary to consummate the transaction).

The Board, however, approved several applications from bank holding companies in Rhode Island to affiliate with Rhode Island mutual building and loan associations, based upon the history of close affiliation between commercial banks and thrift institutions in that state. Indeed, every thrift of any size owned a commercial bank and operated its thrift and bank offices in tandem. *E.g.*, Newport Savings and Loan Ass'n, 69 Fed. Res. Bull. 562 (1983); Old Colony Co-Operative Bank, 69 Fed. Res. Bull. 377 (1983); Old Colony Co-Operative Bank, 66 Fed. Res. Bull. 665 (1980); Old Colony Co-Operative Bank, 58 Fed. Res. Bull. 417 (1972); Newport Savings and Loan Ass'n, 58 Fed. Res. Bull. 313 (1972).

The Board also approved affiliations between New Hampshire bank holding companies and New Hampshire guaranty savings banks, stock savings banks unique to that state. The unique structural and competitive circumstances in New Hampshire influenced the Board to approve these applications. *E.g.*, BankEast Corp., 68 Fed. Res. Bull. 379 (1982); BankEast Corp., 68 Fed. Res. Bull. 116 (1982); First Fin. Group of New Hampshire, Inc., 66 Fed. Res. Bull. 594 (1980); Heritage Banks, Inc., 66 Fed. Res. Bull. 917 (1980); Heritage Banks, Inc., 66 Fed. Res. Bull. 590 (1980); Profile Bankshares, Inc., 61 Fed. Res. Bull. 901 (1975).

unfair competition, conflicts of interest, or unsound banking practices.”³⁰⁶ The Board stated that the potential adverse effects of the affiliation of a bank holding company and a thrift were “sufficiently strong to outweigh such benefits as might result in individual cases”³⁰⁷ and left for Congress to decide whether such affiliations should be permitted on a broad scale.³⁰⁸ The Board’s finding that the activities of a savings and loan association were not a proper incident to banking was expressly limited, however, to the “present regulatory framework and the characteristics of banks and S & Ls as they presently operate within that framework.”³⁰⁹

In reaching its decision in *D.H. Baldwin*, the Board pointed to three areas of concern. First, the Board noted the regulatory conflict that would result from the affiliation of a bank holding company and a thrift institution.³¹⁰ Savings and loan associations were statutorily authorized to engage, either directly or through a service corporation, in some activities that were prohibited for banks and for the nonbanking subsidiaries of bank holding companies.³¹¹ Moreover, a bank holding company owning a savings and loan would also be a savings and loan holding company and subject to conflicting regulation under both the BHCA and the Savings and Loan Holding Company Act (SLHCA).³¹² As a savings and loan holding company, the holding company would be authorized to own a bank subsidiary only if it owned no more than one savings and loan subsidiary.³¹³ The Board thought that it could not responsibly attempt to reconcile unilaterally the regulatory conflicts brought about by the overlap of the BHCA and the SLHCA, but rather should wait for congressional guidance.³¹⁴

306. 12 U.S.C. § 1843(c)(8) (1982) (amended 1987).

307. *D.H. Baldwin Co.*, 63 Fed. Res. Bull. at 284.

308. *Id.*

309. *Id.* at 287. The Board also stated that it did “not intend to suggest that affiliations between banks and thrift institutions should not be permitted under any circumstances.” *Id.*

310. *Id.* at 284. In discussing this concern, the Board acknowledged its statement in its earlier *American Fletcher* decision that the existence of a separate regulatory structure is not sufficient to indicate that Congress intended to prohibit common ownership of thrift institutions and banks, but noted that the Board denied the American Fletcher application on other grounds without having to examine this broader issue in detail. *Id.* at 285 (discussing *American Fletcher Corp.*, 60 Fed. Res. Bull. 868 (1974)).

311. For instance, savings and loans or their subsidiaries could engage in real estate development, property management, and operation of insurance agencies. *D.H. Baldwin Co.*, 63 Fed. Res. Bull. at 284. If the Board permitted a bank holding company to engage in these activities through a savings and loan subsidiary, the holding company would have a competitive advantage over bank holding companies that did not have thrift subsidiaries. Conversely, the Board argued, if the savings and loan subsidiary were only permitted to engage in those activities previously approved for a bank holding company’s nonbanking subsidiaries, the savings and loan subsidiary would be at a competitive disadvantage with other savings and loans not affiliated with a bank holding company and “the Board would be ‘in effect redefining the role of the savings and loan.’” *Id.* at 285 (quoting the FHLBB, which opposed bank holding company acquisitions of savings and loans).

312. *Id.*

313. *Id.*; see 12 U.S.C.A. § 1730a(c)(3), (o) (West Supp. 1988). Thus, if the bank holding company owned only one savings and loan it would be exempt from the SLHCA’s nonsavings and loan activity restrictions, and the savings and loan subsidiary could be operated consistently with both the SLHCA and the BHCA if conditions were imposed on the operation of a savings and loan association to make its operations fit within the proscriptions of the BHCA. Such conditions, however, “could prevent full realization of the public benefits that might be expected from the operation of a savings and loan association.” *D.H. Baldwin Co.*, 63 Fed. Res. Bull. at 285.

314. *D.H. Baldwin Co.*, 63 Fed. Res. Bull. at 285.

The Board also set forth in its *D.H. Baldwin Co.* decision its worry that ownership of a savings and loan association by a bank holding company would lead to the erosion of what it perceived as the beneficial institutional rivalry between banks and thrifts.³¹⁵ Finally, the Board was concerned that approval of a savings and loan acquisition by a bank holding company subject to no statutory location limitations might serve to undermine the interstate banking restrictions of the Douglas Amendment, especially as thrifts exercised more bank-like powers.³¹⁶

In 1982, however, the Board approved two applications by bank holding companies to acquire failing savings and loan associations as subsidiaries.³¹⁷ In both cases the Board concluded that "the substantial benefits to the public associated with preserving [the savings and loan] as a thrift competitor are sufficient to outweigh the generalized adverse effects found by the Board in the *D.H. Baldwin* case."³¹⁸ The bank holding companies could provide new capital to the savings and loan associations, enabling them to continue their operations and remain viable competitors.³¹⁹

To reduce the regulatory conflict that would result from the affiliation of a bank holding company and a savings and loan association, the Board conditioned its approval of one of the acquisitions on the holding company's compliance with both the BHCA and the SLHCA.³²⁰ Although the savings and loan

315. *Id.* at 286. That rivalry had induced thrift institutions to develop NOW accounts in order to compete with commercial bank checking accounts. *Id.* Presumably, a thrift institution affiliated with a bank holding company might not have the same incentive as a nonaffiliated thrift to develop products to compete with commercial banks.

316. *Id.* at 286-87. The Board argued that if it approved an application allowing a bank holding company to acquire a thrift institution in a state in which the Douglas Amendment prohibited the holding company from acquiring a bank, and "if savings and loan association powers expanded [so] that savings and loan associations would satisfy the definition of 'bank' . . . [.] the interstate banking prohibitions of the Act [would be] substantially undermined." *Id.* at 286.

317. Citicorp, 68 Fed. Res. Bull. 656 (1982); Interstate Financial Corp., 68 Fed. Res. Bull. 316 (1982). The first application was submitted by Interstate Financial Corporation, an Ohio bank holding company, to acquire an Ohio savings and loan association whose deposits were insured by the Ohio Deposit Guaranty Fund. 68 Fed. Res. Bull. at 316. The savings and loan was in danger of failing, and the only organization other than the Interstate Financial Corporation that expressed interest in acquiring the savings and loan did not have sufficient financial resources to support the savings and loan. *Id.* at 317 n.8.

The second application was submitted by Citicorp, a bank holding company, to acquire Fidelity Federal Savings and Loan Association of San Francisco. 68 Fed. Res. Bull. at 656. Fidelity was the successor by supervisory conversion of a state savings and loan association that was closed by the State of California and placed under FSLIC receivership. *Id.*

318. Interstate Financial Corp., 68 Fed. Res. Bull. at 317; accord Citicorp, 68 Fed. Res. Bull. at 663 app. (The adverse factors of bank and thrift affiliation noted in *D.H. Baldwin*, were "substantially mitigated by the fact that [the savings and loan] is a failing institution that has lost its competitive vigor and is able to continue operations only through substantial federal financial assistance.").

319. Interstate Financial Corp., 68 Fed. Res. Bull. at 317; accord Citicorp 68 Fed. Res. Bull. at 666 app. In *Citicorp* the Board concluded that based on its *D.H. Baldwin* decision it could only approve an application by a bank holding company to acquire a thrift institution "where public benefits based on the facts in a particular case outweigh adverse effects. Such compelling public benefits have only been found where the thrift institution is failing." *Id.*

320. Citicorp, 68 Fed. Res. Bull. at 663 app. The Board noted that the acquisition would make Citicorp a savings and loan holding company, but that because it would be a savings and loan holding company owning only one savings and loan association, it would be able to continue its bank holding company and banking activities without violating the SLHCA. *Id.* In a later acquisition of an additional failing savings and loan subsidiary by Citicorp, the FHLBB used its authority under

subsidiary of a bank holding company would not be able to participate in some activities authorized for federal savings and loan associations because such activities were not also authorized for the nonbanking subsidiaries of a bank holding company, the Board noted that bank holding company affiliation did not limit the savings and loan's deposit-taking and lending activities.³²¹

In the 1982 legislation expanding the powers of federally chartered thrifts and excluding thrifts from the BHCA definition of a bank, Congress enacted specific statutory provisions authorizing bank holding company acquisitions of failing thrift institutions on an interstate basis³²² in order to provide the Federal Savings and Loan Insurance Corporation (FSLIC) with additional flexibility in dealing with financially distressed depository institutions.³²³ The Act established a priority system to aid FSLIC in selecting among competing bids for failing thrifts. Two guiding principles behind the priority system were "to minimize the cost of financial assistance and to [maintain] . . . specialized depository institutions."³²⁴ Accordingly, priority was given to a bid for a failing thrift from another thrift institution.³²⁵ If no other thrift institution submitted an acceptable bid, however, FSLIC could accept a bid from a bank holding company.³²⁶ Pursuant to this authority, FSLIC began selecting bank holding companies as the successful bidders, and the Board approved several acquisitions of failing

the emergency acquisition procedures to provide that the restrictions limiting the activities of a savings and loan holding company that owned more than one savings and loan shall not apply to Citicorp. Citicorp, 70 Fed. Res. Bull. 149, 153 n.11 (1984).

In 1987 the Board granted Citicorp's request for relief from some of these conditions. FRB Letter, [Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 87,070 (1987) (eliminating tandem operation restrictions between bank holding company and thrift subsidiary located in state in which the bank holding company could own a bank subsidiary consistent with the Bank Holding Company Act).

321. 68 Fed. Res. Bull. at 663 app. & n.20. A further condition of the Board's approval of the acquisition was that the savings and loan association maintain as its principal business the provision of residential housing credit. *Id.* at 659, 644 app.

322. The Garn-St Germain Act of 1982, Pub. L. No. 97-320, § 123(a), 96 Stat. 1469, 1483 (codified as amended at 12 U.S.C.A. § 1730a(m) (West Supp. 1988)). This authority was effective October 15, 1982. *Id.* § 807(a), 96 Stat. at 1548; see 12 U.S.C. § 3801 note (1982).

323. SEN. REP. NO. 536, *supra* note 38, at 1, *reprinted in* 1982 U.S. CODE CONG. & ADMIN. NEWS 3054, 3055.

324. 12 U.S.C. § 1730a(m)(3)(B) (1982).

325. If the offer presenting the lowest expense to FSLIC is from a thrift institution or a savings and loan holding company located in the same state as the failing thrift, FSLIC must accept the offer. 12 U.S.C. § 1730a(m)(3)(A) (1982); see also SEN. REP. NO. 536, *supra* note 38, at 7, *reprinted in* 1982 U.S. CODE CONG. & ADMIN. NEWS 3054, 3061.

326. If the lowest acceptable bid is not submitted by an in-state thrift, FSLIC may ask for a second round of bids from all offerors who submitted bids close in amount to the lowest acceptable offer. 12 U.S.C.A. § 1730a(m)(3)(A) (West Supp. 1988) (only those offerors submitting bids within 15% or \$15,000,000, whichever is less, of the lowest acceptable offer may submit additional bids). The statutory scheme gives first priority to a proposed acquisition between depository institutions of the same type within the same state. *Id.* § 1730a(m)(3)(B)(i). Should a bank holding company's bid for a failing thrift institution be accepted, the thrift may retain its existing branches and facilities but otherwise may only establish new branches subject to the same branching conditions as would be applicable to a national bank located in the same state as the thrift. *Id.* § 1730a(m)(5)(A).

A similar structure was set forth in § 116 of the Garn-St Germain Act of 1982, adding 12 U.S.C. § 1823(f) (amended 1983 & 1987) for emergency interstate, interindustry acquisitions of failed or failing FDIC-insured banks. In the case of a bank acquisition approved pursuant to this authority, the Douglas Amendment does not apply. 12 U.S.C. § 1823(f) (1982) (amended 1983 & 1987); *id.* § 1842(d) (amended 1987).

savings and loan associations by bank holding companies.³²⁷ In 1985 the legislative authorization of these acquisitions expired.³²⁸ After temporary extension,³²⁹ the Competitive Equality Banking Act of 1987 reinstituted on a permanent basis the authority of FSLIC to arrange an emergency acquisition of an insured thrift institution by a bank holding company.³³⁰

Bank holding companies desiring to affiliate with healthy thrift institutions, however, sought to avoid the Board's *D.H. Baldwin* ruling that operation of a healthy thrift institution is not a proper incident to banking. Some arranged to acquire a thrift institution that, just prior to the proposed acquisition, converted its charter from that of a thrift to that of a bank.³³¹ The acquisition of the resulting commercial bank was then subject to approval by the Board as an acquisition by a bank holding company of an additional bank subsidiary.³³² The Federal Home Loan Bank Board, however, asserted that it had to approve a thrift institution's exit from the FSLIC insurance fund to the FDIC insurance

327. *E.g.*, Hibernia Bancshares Corp., 72 Fed. Res. Bull. 342 (1986) (acquisition by a California bank holding company of a California federal savings bank); Citicorp, 70 Fed. Res. Bull. 157 (1984) (acquisition of New Biscayne Federal Savings and Loan Ass'n, Miami, Florida); Citicorp, 70 Fed. Res. Bull. 149 (acquisition of First Federal Savings and Loan Ass'n of Chicago, Illinois).

Between the expiration of the failing thrift acquisition legislation in 1986 and its reinstatement in 1987, the FRB approved a bank holding company's application to acquire a failing thrift institution under its general authority to authorize acquisitions of nonbanking subsidiaries. Ranier Bancorporation, 72 Fed. Res. Bull. 666, 667 (1986).

328. The Garn-St Germain Act of 1982, Pub. L. No. 97-320 § 141(a)(7), 96 Stat. at 1489 (expired Oct. 15, 1985).

329. *E.g.*, Act of Aug. 27, 1986, Pub. L. No. 99-400, § 1(a), 100 Stat. 902, 902 (extended emergency acquisition provision to September 15, 1986); Act of Oct. 8, 1986, Pub. L. No. 99-452, § 1(c), 100 Stat. 1140 (1986) (extended emergency acquisition provisions to October 15, 1986).

330. Competitive Equality Banking Act of 1987, Pub. L. No. 100-86, § 509(a), 101 Stat. 552, 635 (permanently extended emergency interstate, interindustry acquisition authority by deleting the sunset provision of the 1982 act and subsequent amendments to that sunset provision); *see, e.g.*, 52 Banking Rep. (BNA) 10 (1989) (FRB approval of Southeast Banking Corporation's application to acquire two failing savings and loan associations).

331. *E.g.*, Hartford Nat'l Corp., 73 Fed. Res. Bull. 752 (1987) (approval of application by bank holding company to acquire a state-chartered savings bank to be insured by the FDIC that would be the successor by merger of a state-chartered savings and loan association insured by the FDIC); Bank of New England, 72 Fed. Res. Bull. 138 (1986) (approving acquisition of FSLIC insured savings bank where such institution would convert to a national bank upon acquisition).

The purchase of only a portion of the assets of a thrift institution may be an additional way to avoid the *D.H. Baldwin* ruling. In 1987 Citicorp's federal savings and loan association subsidiary in California received the Board's permission to purchase less than one-third of the assets and liabilities of a California-chartered savings and loan association. Citicorp, 73 Fed. Res. Bull. 669 (1987). The Board viewed this transaction "as the permissible acquisition of certain assets and liabilities of S&L branches rather than the acquisition of an S&L" that would have required the Board "to reconsider its *D.H. Baldwin* decision that the acquisition of a healthy thrift is not generally a proper incident to banking." *Id.* at 669. The Board distinguished this order from its ruling in *Old Stone Corp.*, 70 Fed. Res. Bull. 593 (1984), in which it denied a bank holding company's proposal to acquire through an existing savings and loan subsidiary *all* of the assets and liabilities of a healthy savings and loan subsidiary. *Citicorp.*, 73 Fed. Res. Bull. at 669 n.5.

332. 12 U.S.C. § 1842(a) (1982). The Board indicated that these acquisitions did not fall within the *D.H. Baldwin* ruling because the acquired subsidiary was subject to regulation as a bank under the BHCA. *Hartford Nat'l Corp.*, 73 Fed. Res. Bull. at 753. Similarly, state-chartered savings banks that were not exempted by the Garn-St Germain Act from the BHCA definition of "banks," which accept demand deposits and make commercial loans, are treated as "banks" for purposes of the BHCA analysis. *See, e.g.*, First Fidelity Bancorporation, 72 Fed. Res. Bull. 487 (1986) (approving acquisition of state-chartered stock savings bank insured by FDIC); *Hartford Nat'l Corp.*, 72 Fed. Res. Bull. 274 (1986) (same).

fund covering the deposits of commercial banks³³³ and that any exiting institutions must pay FSLIC an exit fee.³³⁴ The Competitive Equality Banking Act of 1987 placed a moratorium on the exit of thrift institutions from FSLIC for the purpose of converting to bank charters and FDIC insurance.³³⁵ The moratorium, originally set to expire in August 1988,³³⁶ has been extended for an additional year.³³⁷

3. Proposed Regulatory Revision Allowing Bank Holding Company Acquisition of a Healthy Thrift Institution

Barely a month after Congress imposed the moratorium on thrift exits from FSLIC, the FRB asked for comments on the proposed rule amending Regulation Y to add "[a]cquiring and operating thrift institutions" to the list of activities considered so closely related to banking as to be a proper incident thereto.³³⁸ The Board pointed to the 1980 and 1982 legislation granting thrifts the ability to make commercial loans, accept NOW accounts, and accept demand deposits from commercial loan customers as supporting the proposal.³³⁹ These economic and regulatory changes reduced the Board's concerns, as expressed in *D.H. Baldwin*, about regulatory conflict and diminished institutional rivalry.³⁴⁰ Furthermore, recently passed state laws that significantly increased interstate banking opportunities in many states lessened the Board's additional concern that the Douglas Amendment's general prohibition against interstate banking would be undermined if a bank holding company could purchase a thrift

333. 12 U.S.C. § 1730(a) (1982) provides that an institution may leave FSLIC upon notice. Nevertheless, the FHLBB issued a "clarification" of its policy statement relating to this provision, providing that a FSLIC exit had to be approved by the FHLBB. The FHLBB was enjoined from enforcing this rule because it was not promulgated in accordance with the notice and comment provisions of the Administrative Procedure Act. The rule was repromulgated in accordance with the Administrative Procedure Act, 52 Fed. Reg. 23,937 (1987).

334. 52 Fed. Reg. 17,408 (1987) (the FHLBB issued a notice of proposed rulemaking regarding exit fees).

335. Competitive Equality Banking Act of 1987, Pub. L. No. 100-86, § 306(h), 101 Stat. 552 (current version at 12 U.S.C.A. § 1730 note (West Supp. 1988)) (the prohibition on exit from FSLIC does not apply in the case of an emergency acquisition arranged by FSLIC).

336. *Id.* § 306(h)(1) (the moratorium applies "during the 1-year period beginning on the date of the enactment of this Act").

337. H.R. 3251, 100th Cong. 2d Sess. (1988). "The FHLBB requested the extension out of concern that healthy, FSLIC-insured thrifts would gain FDIC insurance coverage and cease paying the weakened FSLIC much-needed premiums and special assessments." 50 Banking Rep. (BNA) 947 (1988); accord 51 Banking Rep. (BNA) 80 (1988) (The Senate decided to extend the moratorium on thrift exits citing concern over the health of FSLIC).

Upon expiration of the moratorium, thrift institutions leaving FSLIC for the FDIC pursuant to a thrift-to-bank charter conversion will be required to pay an exit fee to FSLIC equal to twice the annual FSLIC insurance premium and special assessment. Competitive Equality Banking Act of 1987, § 302(f)(4) (current version at 12 U.S.C.A. § 1441(f)(4) (West Supp. 1988)) (the exit fee may be reduced in the case of a weakened institution).

338. 52 Fed. Reg. 36,041, 36,045 (Sept. 25, 1987) (proposal to amend 12 C.F.R. § 225.25(b) by adding the quoted material), reprinted in Fed. Banking L. Rep. (CCH) ¶ 87,084.

339. *Id.* The Board pointed to the elimination of the interest rate ceilings applicable to interest-bearing deposit accounts and the removal of the interest rate differential which previously allowed thrifts to pay a slightly higher interest rate on deposit accounts than commercial banks.

340. *Id.*

institution.³⁴¹

As a final matter, the Board noted that the *D.H. Baldwin* ruling "serves as an incentive for healthy thrifts to seek to leave the FSLIC fund" so that, after conversion to a bank charter, acquisition by a bank holding company would be possible.³⁴² The exit of healthy thrift institutions from FSLIC could affect FSLIC's recapitalization plans, the Board noted, by reducing the number of healthy institutions continuing to pay premiums to support the FSLIC insurance fund.³⁴³

The Board received numerous comments on its proposal to amend Regulation Y but has not yet issued a final rule.³⁴⁴ The Board may be waiting for Congress to enact banking reform legislation before considering this matter further,³⁴⁵ or it is possible the Board has decided to table any further action on the proposal because of the many adverse comments it received.³⁴⁶ Nevertheless, by its proposal the Board has indicated that it believes legislation enhancing the powers of thrift institutions may warrant a significant change in Board policy and justify the affiliation of bank holding companies and healthy thrift institutions.

341. *Id.* At the time of the *D.H. Baldwin* decision, no state had a statute complying with the Douglas Amendment and allowing interstate banking. The Board noted in its request for comments on the proposed rulemaking, however, that "interstate banking has become widespread." *Id.* Almost half of the states now or will soon have statutes authorizing nationwide interstate banking and all the remaining states, except for a handful, authorize interstate banking on a regional basis. Thus, the Board concluded that these developments "undermine one of the basic reasons for the *D.H. Baldwin* decision—concern about impairing the Congressional policy embodied in the Douglas Amendment." Hawke, *It's Time for a Policy Change to Let Banks and S & Ls Affiliate*, *Amer. Banker*, p. 6, col. 3 (Jan. 16, 1987) ("It was Congress itself . . . that expanded the powers of thrifts and excluded FSLIC-insured thrifts from the reach of the Douglas Amendment. Why, then, should the Fed be more concerned than Congress about the interstate banking implications of savings and loan acquisitions?").

342. 52 Fed. Reg. at 36,043.

343. *Id.*

344. The Association of Bank Holding Companies was quick to announce its approval of the Board's proposal, stating that the acquisition of healthy thrifts would provide bank holding companies "'geographic . . . and product options that they don't currently have.'" *Banking Week*, Sept. 21, 1987, at 1 (quoting Richard M. Whiting, general counsel of the Association of Bank Holding Companies). The thrift industry, however, is divided over the Board's proposal. The National Council of Savings Institutions and the Association of Thrift Holding Companies favor the change in acquisition policy, arguing that it would attract much needed capital into the troubled savings and loan industry. 49 *Banking Rep. (BNA)* 1022-23 (1987). In contrast, the U.S. League of Savings Institutions strongly opposes the Board's proposal, maintaining that bank holding company acquisition of healthy thrifts would have a detrimental effect on the FSLIC. 49 *Banking Rep. (BNA)* 872-73 (1987); see *Banking Week*, Jan. 25, 1988, at 5.

The Federal Home Loan Bank Board announced on Oct. 10, 1988, that a bank holding company that agrees to acquire a failing thrift may also acquire a healthy thrift. 51 *Banking Rep. (BNA)* 654 (1988) (FRB approval of the thrift acquisitions would still be required, however).

345. See *infra* note 384.

346. See *supra* note 344. Other comments opposing the proposal were filed by Senator Proxmire (chair of the Senate Banking Committee), Representative St Germain (chair of the House Banking Committee), Representative Wylie (member of the House Banking Committee), and the FHLBB (opposing the proposal unless it is linked with a requirement that the acquiring bank holding company purchase several failing thrifts in addition to the healthy thrifts purchased); see also *Banking Week*, Jan. 4, 1988, at 1 (Board may modify or withdraw proposal in face of congressional opposition). But see *Banking Week*, Nov. 30, 1987 (letters of support for Board's proposal outnumber letters of opposition).

4. Evaluation of Proposed Regulatory Revision

A strong argument may be made that the FRB's proposed regulatory revision exceeds its current statutory authority and that congressional action is required to authorize bank holding company acquisitions of healthy thrifts. It was the FRB's own view in its 1977 *D.H. Baldwin* ruling that Congress, rather than the FRB, should decide whether broad-scale affiliations of bank holding companies and thrifts should be permitted.³⁴⁷ Since that time the need for Congressional authorization has become even clearer. In the Garn-St Germain Act of 1982 Congress made two significant statutory changes. First, Congress amended the BHCA definition of "bank" specifically to exclude thrift institutions.³⁴⁸ Thus, Congress foreclosed the argument that a bank holding company could purchase a thrift under its authority to acquire an additional bank subsidiary, although the Garn-St Germain Act also authorized federally chartered thrifts to exercise powers previously reserved exclusively to banks. The second significant change was the inclusion of statutory provisions setting forth the circumstances and conditions under which a bank holding company could purchase a failing thrift institution.³⁴⁹ This action suggests that if special statutory provisions exist to authorize the acquisition of a failing thrift, the FRB may not by regulation authorize a bank holding company to acquire a healthy thrift institution as a nonbanking subsidiary.

The effect of bank holding company acquisitions of thrift institutions on the Douglas Amendment restrictions relating to interstate bank acquisitions also deserves congressional attention. Congress specifically exempted the acquisition of failing thrift institutions from the scope of the Douglas Amendment by defining "bank" acquisitions subject to the Douglas Amendment to exclude thrift institutions.³⁵⁰ Moreover, the statutory provisions allowing a bank holding company to acquire a failing thrift specifically provide that branches established by a thrift acquired by a bank holding company may be located only where a national bank may establish and operate a branch in the state.³⁵¹ This restriction suggests that banks and thrifts are so similar that they should be subject to the same geographic expansion restrictions.³⁵² Thus, it seems likely that because the stated reason for allowing healthy thrift acquisitions is the increased statutory similarity of thrifts and banks, Congress would also wish to subject healthy thrift acqui-

347. See S. 413, 101st Cong., 1st Sess. § 601 (1989) (proposing an amendment to the Bank Holding Company act that would allow a bank holding company to acquire any thrift institution effective two years after the date of enactment).

348. See *supra* note 302.

349. See *supra* notes 322-30 and accompanying text.

350. See *supra* note 302 and accompanying text.

351. 12 U.S.C.A. § 1730a(m)(5)(A) (West Supp. 1988).

352. The branching restrictions (1) minimize the impact of bank holding company thrift acquisitions on the authority of a state to limit the expansion of financial institutions within its borders, (2) prevent thrifts owned by bank holding companies from branching more freely than local commercial banks, thus avoiding an unfair competitive impact especially in a federally assisted acquisition, and (3) implement the Congressional intent expressed in the legislative history of the Garn-St Germain Act to promote competitive equality between thrifts and commercial bank branches. 52 Banking Rep. (BNA) 9 (1989).

sitions to the Douglas Amendment locational limitations.³⁵³

Nevertheless, a reexamination of the continuing validity of the *D.H. Baldwin* ruling is appropriate. As thrifts have come to resemble banks more closely, operation of a thrift institution by a bank holding company becomes even more closely related to banking than before. Since fewer ill effects would therefore arise from bank holding company and thrift affiliation, it is a proper inference that, as a policy matter, operation of a thrift institution is a proper incident to banking.

The reasons underlying the *D.H. Baldwin* policy that operation of a thrift institution is not a proper incident to banking are not convincing.³⁵⁴ Regulatory conflict has little, if anything, to do with the adverse effects of affiliation, such as undue concentration of resources, enumerated as part of the "proper incident" test in the BHCA.³⁵⁵ Furthermore, the objection is not convincing on a practical level because bank holding companies have acquired failing thrifts and operated them subject to overlapping regulatory structures without adverse consequences.³⁵⁶

Institutional rivalry between banks and thrifts has produced little of consequence other than NOW accounts that were first developed by state thrift institutions attempting to find a legal method to offer a transaction-type account.³⁵⁷ Indeed, if such institutional rivalry spurs desirable competition between banks and thrifts, then healthy competition is likely to increase rather than decrease as a result of the enhancement of thrift powers to make them more like bank powers. Bank holding company ownership of a thrift by itself cannot be said to reduce incentives of the thrift subsidiaries or the bank subsidiaries to compete or innovate.

Finally, whether healthy thrift acquisitions will undermine the intent of the Douglas Amendment is a legitimate concern that should be addressed by Congress. Increasing similarity between thrifts and banks suggests increasing need to subject them, when possible, to similar market expansion restrictions.³⁵⁸ Thus, acquisitions of healthy thrifts should be subject to the Douglas Amendment. This preserves an important inducement to bank holding companies to acquire failing thrift institutions, because failing thrift acquisitions are not subject to Douglas Amendment limitations.³⁵⁹

One of the justifications for the FRB's proposal to amend Regulation Y to allow acquisitions of healthy thrifts is that charter flips from thrift to bank charters will be eliminated because bank holding companies may acquire thrifts without first converting the thrift to a bank charter. If the FRB's proposal is

353. Moreover, if the thrift to be acquired operates in the same geographic market as an existing bank subsidiary, the FRB must determine whether the acquisition may tend substantially to lessen competition as is discussed in Part II.B *supra*.

354. See *supra* notes 307-16 and accompanying text.

355. See *supra* note 306 and accompanying text.

356. See *supra* notes 317-30 and accompanying text.

357. See *supra* note 43.

358. See *supra* note 352 and accompanying text.

359. See *supra* note 322 and accompanying text.

adopted, thrift-to-bank charter conversions will not be necessary to consummate acquisitions, but it still will be possible for a bank holding company to acquire a thrift institution and after the acquisition effect a conversion to a bank charter, operating the new bank as a separate bank subsidiary or merging it into an existing bank subsidiary. The harm from such a conversion is the loss to FSLIC of the deposit insurance premiums and special assessments paid by a healthy thrift institution. To help ensure that few institutions leave FSLIC, exit fees could be charged, as FSLIC has proposed.³⁶⁰ Continuing the FSLIC exit moratorium, however, would seem to be the only way to eliminate entirely FSLIC exits.³⁶¹

The FRB's proposal to increase the market expansion opportunities available to bank holding companies by authorizing the acquisition of healthy thrift institutions as nonbanking subsidiaries arguably exceeds the FRB's statutory authority. Congressional enactment of legislation authorizing the acquisition of failing thrift institutions by bank holding companies gives rise to the inference that, absent further statutory amendment, Congress did not contemplate bank holding company acquisitions of healthy thrift institutions. As a policy matter, however, the proposal is consistent with the enhancement of thrift powers. Ownership of a thrift that is authorized to perform nearly all of the functions traditionally associated with commercial banking appears to be both closely related and a proper incident to banking.

E. Conclusion

Increased market expansion opportunities for banks and bank holding companies by branching, merger, and the proposed regulation to permit bank holding companies to acquire healthy thrifts have been triggered by the same event—the statutory enhancement of thrift institution powers. These changes in thrift powers, which grant thrifts the ability to make loans other than home mortgage loans and to offer transaction accounts in addition to savings accounts, justify reexamination of each of the three methods of bank and bank holding company market expansion discussed in this Article. At bottom the question is, should thrifts be treated as functionally equivalent to commercial banks for purposes of market expansion? The answer must be yes.

First, treating thrifts as the functional equivalents of commercial banks is required by the McFadden Act, in which Congress has allocated to the states determinations relating to a state bank's ability to branch, and has specifically provided that a national bank's ability to branch will be commensurate with state bank branching privileges.³⁶² Congress, however, defined "state bank" broadly to include not only entities chartered as state commercial banks, but also any institution carrying on the banking business under the authority of state

360. See *supra* note 334 and accompanying text.

361. See *supra* notes 335-37 and accompanying text. If the FDIC and FSLIC deposit insurance systems are merged, as the Administration has recently proposed, protection of FSLIC from a loss of revenue no longer serves as a sufficient reason to prohibit FSLIC exits and thrift-to-bank charter conversions.

362. See *supra* notes 99-104 and accompanying text.

law.³⁶³ Thus, if a state has authorized its state-chartered thrift institutions to engage in the functions associated with commercial banking and has granted them broader branching privileges than state-chartered commercial banks, it is entirely proper to permit national banks to establish branches in those locations permitted to state thrifts.³⁶⁴

Treating thrifts as functional equivalents of commercial banks allows a more realistic measure of the competitive effect of bank mergers than the "cluster" approach to product market definition.³⁶⁵ More meaningful markets of particular banking products and services can be identified, and the effect of all institutions, including thrifts, that provide the product in that market can be calculated.³⁶⁶

Finally, treating thrifts as functional equivalents of commercial banks has led the FRB to reexamine its policy regarding bank holding company ownership of healthy thrifts, and the Board has concluded that ownership of a thrift that is the functional equivalent of a bank must perforce be closely related and a proper incident to banking.³⁶⁷ In the light of congressional enactments enabling bank holding companies to acquire failing thrifts, however, similar congressional action is necessary to authorize bank holding company acquisitions of healthy thrifts.³⁶⁸

III. IMPACT OF INCREASED BANK AND BANK HOLDING COMPANY MARKET EXPANSION ON THE STRUCTURE OF THE DEPOSITORY INSTITUTIONS SYSTEM

The changes in the market expansion opportunities of banks and bank holding companies discussed in this Article, as they exist now and as they are likely to develop in the future, will have significant effects on the structure of the depository institutions system. One effect of these changes may be increasingly to centralize our decentralized banking system. These changes present possibilities for expansion into new markets by branching, merger, and by holding company acquisition of healthy thrift institutions. Ultimately, these changes may lead to consolidation of financial institutions and more nationwide financial conglomerates. Branching opportunities for both national and state banks have increased as a result of the *Deposit Guaranty* ruling. In those states where state-chartered thrifts are afforded more extensive branching privileges than state-chartered banks, many national banks have filed with the OCC what are now termed "*Deposit Guaranty* applications" to establish branches in locations permitted for state thrifts but prohibited to state banks.³⁶⁹ Thus far, the OCC has denied only

363. See *supra* note 106 and accompanying text.

364. See *supra* notes 133-50 and accompanying text.

365. See *supra* note 226 and accompanying text.

366. See *supra* notes 227-45 and accompanying text.

367. See *supra* notes 338-46 and accompanying text.

368. See *supra* notes 347-49 and accompanying text.

369. Banking Week, July 25, 1988, at 5, col. 3 (as of June 30, 1988, 100 *Deposit Guaranty*-type branching applications had been filed with the Comptroller); 50 Banking Rep. (BNA) ¶ 670-71 (1988) (Following the Fifth Circuit's holding in *Deposit Guaranty*, 78 banks applied to the OCC for

one such application.³⁷⁰ It has approved almost sixty others.³⁷¹ In addition, the threat of conversion of state banks to national charters has influenced lawmakers in some states to amend state commercial bank branching statutes to allow state-chartered banks to branch as broadly as state-chartered thrift institutions and national banks.³⁷²

Redefinition of the product market in the bank merger context to include additional competitors, such as thrift institutions, will also have a significant effect on the structure of the depository institutions system.³⁷³ Including thrifts in the product market as providers of the traditional commercial bank cluster of products and services has reduced the number of proposed mergers found to increase concentration impermissibly in the market.³⁷⁴ Even though the FRB

permission to branch more freely.); e.g., Decision of the Comptroller of the Currency on the Applications of the National Bank of Commerce, Memphis, Tenn. and the First National Bank of Livingston, Livingston, Tenn. to Establish Domestic Branch Offices in Counties other than in the County in which their Principal Offices are Located, Fed. Banking L. Rep. (CCH) ¶ 87,212 (Oct. 2, 1987), *aff'd*, Volunteer State Bank v. National Bank of Commerce, 684 F. Supp. 964 (M.D. Tenn. 1988); Decision of the Comptroller of the Currency on the Application of the Hibernia National Bank of New Orleans, La. to Establish Domestic Branch Offices Within One Hundred Miles of Its Principal Office, in a Parish Other Than the Parish in which Its Principal Office is Located, [Current] Fed. Banking L. Rep. (CCH) ¶ 87,322 (Dec. 3, 1987).

370. Letter from Ballard C. Gilmore, Director for Corporate Activity, Bank Organization and Structure, Office of the Comptroller of the Currency, to Richard R. Cheatham, Kilpatrick & Cody (Mar. 31, 1987), reprinted in 2 H. PITT, D. MILES & A. AIN, *supra* note 22, app. at E-13.1 (denying the application of a national bank located in Georgia because it failed to demonstrate that Georgia-chartered thrifts are carrying on the banking business). Georgia has no "wild card" statute affording to state-chartered thrift institutions those powers that may be approved for their federally chartered counterparts from time to time.

371. 51 Banking Rep. (BNA) 660 (1988) (as of October 8, 1988, 58 *Deposit Guaranty*-type applications had been approved by the OCC).

372. 50 Banking Rep. (BNA) 865-66 (1988) (Alabama adopted a bill in May 1988 granting state-chartered banks the same powers and privileges as those held by nationally chartered banks, including a national bank's branching privileges); *id.* at 954 (Mississippi enacted legislation granting Mississippi state-chartered banks the branching rights afforded to national banks); 51 Banking Rep. (BNA) 88, 88-89 (1988) (Arkansas legislature passed bill authorizing branching within contiguous Arkansas counties in five years and statewide branching in 10 years as a result of the *Deposit Guaranty* decision); *id.* at 51 (Michigan passed bill authorizing statewide branching for state-chartered commercial banks); *id.* at 948-49 (Florida legislature empowered State Comptroller to approve cross-county branching applications filed by state banks to preserve branching parity with national banks).

373. Eisenbeis, *Regulatory Agencies' Approaches to the "Line of Commerce"*, ECON. REV. (Fed. Res. Bank of Atlanta), April 1982, at 20, 27 ("broadening of the line of commerce . . . has the potential to precipitate a consolidation of the banking system").

374. Bleier & Eisenbeis, *supra* note 204, at 386 ("The broader the [product market] definition, the more permissive acquisition policy would be, and the likelihood of finding substantially adverse competitive effects under the antitrust laws would be reduced."); Dunham, *supra* note 62, at 51 ("If thrift institutions are ever included in the commercial banking line of commerce, large commercial banks would immediately find it easier to merge under existing antitrust guidelines . . ."); Dunham & Guerin-Calvert, *supra* note 62, at 47 ("The result [of including thrifts in the product market] would be a quantum leap in the number of permissible bank mergers.").

Although some may object that including thrifts in the line of commerce will emasculate the antitrust laws in this area by so lowering market shares and concentration ratios that almost any bank merger will be permissible . . . it seems incongruous to argue that there is a serious anticompetitive threat posed simply by more realistically recognizing the unparalleled level of competition existing in today's depository institutions industry.

Comment, *Banking—Mergers—Is Commercial Banking Still A Distinct Line of Commerce?*, 57 TUL. L. REV. 958, 992 (1983); see also Alcalá & Nelson, *Will Including Thrifts in the Banking Market Affect Mergers?*, 97 BANKING L.J. 346, 348-49 (1980) (demonstrating in the context of hypothetical mergers between the second and third largest banks in various local banking markets in New

generally considers only fifty percent of thrift deposits in its market concentration calculation, a study of FRB merger decisions issued between November 1982 and July 1985 indicates that when only commercial banks were considered in the line of commerce, thirty-one proposed mergers were likely to be challenged by the Department of Justice according to the standards set forth in the Department's published merger guidelines.³⁷⁵ When the deposits of thrift institutions were factored into the line of commerce, however, only nine of the proposed mergers were likely to be challenged.³⁷⁶ This increase in the number of merger approvals is further reason to question the continued validity of the cluster approach to market definition.³⁷⁷ Analysis of competition based on markets composed of the separate products and services offered by the merging banks provides a more accurate method of determining which mergers will tend to lessen competition in a particular product market.³⁷⁸

If bank holding companies are allowed to acquire thrift institutions (either through a statutory change in the BHCA or unchallenged FRB action in finalizing the proposed regulatory revision), further expansion of bank holding company financial networks is likely, possibly leading to more nationwide financial conglomerates.

A second major effect of these changes in bank and bank holding company market expansion methods is that they will likely lead to a restructuring of the regulatory systems applicable to banks and thrifts at the state and federal levels. These separate regulatory systems were developed when banks and thrifts performed clearly separate functions. Today, however, irrational and confusing regulatory decisions result from the maintenance of separate structures regulating what are now functionally similar institutions.

This Article has pointed to several areas of regulatory irrationality that result from this situation. For instance, many states allow state thrifts to branch to a greater extent than state banks, but have granted to state thrifts bank-like powers so that they may be said to be carrying on the banking business under the authority of state laws.³⁷⁹ The *Deposit Guaranty* decision has exposed the irrationality of this system by affording national banks the broader branching privileges of state thrifts. The probable result of this decision is that many states

York and New Jersey that in only five of the 54 market areas does inclusion of thrifts reduce the combined market shares of the second and third largest banks to below 10%); cf. Fischel, Rosenfield & Stillman, *supra* note 19, at 333 ("even if economies of scale in banking are significant, we question whether officially sanctioning interstate banking would have much incremental effect on bank market structure").

375. Loeys, *supra* note 206, at 435.

376. Loeys, *supra* note 206, at 435. Of the nine cases in the suspect area, three were denied on competitive grounds and two required divestiture of certain banking operations. All five of these cases were well beyond the Justice Department approval guidelines. Three of the four remaining cases were approved based on other mitigating factors. *Id.*

377. Note, *supra* note 211, at 924 ("combining thrifts and banks in the cluster approach . . . could produce undesirable increases in the concentration of financial resources").

378. See Bleier & Eisenbeis, *supra* note 204, at 386 & n.21 (acknowledging that a broad product market definition will reduce the findings of adverse competitive effects, although a disaggregation of product lines could result in the application of stricter antitrust standards).

379. See *supra* Part II.A.

will rationalize their statutes regulating depository institutions to equalize state bank and state thrift branching privileges.³⁸⁰

A second example of irrationality brought about by the maintenance of separate bank and thrift regulatory structures is the position that a bank holding company should not be able to acquire a healthy thrift institution because operation of such an institution is not a proper incident to banking.³⁸¹ One justification given for this ruling was the conflict in regulatory structures relating to bank holding companies and savings and loan holding companies.³⁸² In the case of acquisitions of failing thrifts this regulatory conflict has been resolved by limiting the activities of the thrift subsidiary to those permissible for holding company subsidiaries under *both* the Bank Holding Company Act and the Savings and Loan Holding Company Act—creating a third, hybrid holding company regulatory structure.³⁸³ The Federal Reserve Board has now asserted that conflicting regulatory structures should not prevent a holding company affiliation that otherwise satisfies the statutory prerequisite of being closely related to banking.³⁸⁴

The Administration, the Department of the Treasury, and the Federal Deposit Insurance Corporation have proposed that the separate regulatory structures relating to banks and thrifts be dismantled in favor of a unified regulatory scheme.³⁸⁵ Although the changes in bank and bank holding company market expansion methods discussed in this Article may not be prominently cited as reasons for this change, they will certainly play an important role in the push for regulatory reform.

380. See *supra* note 144 and accompanying text.

381. See *supra* notes 304-16 and accompanying text. Moreover, if bank holding companies are allowed to acquire healthy thrift institutions, savings and loan holding companies owning more than one savings and loan subsidiary should also be allowed to acquire a commercial bank subsidiary.

382. See *supra* notes 310-14 and accompanying text.

383. See *supra* notes 320-21 and accompanying text.

384. See *supra* note 338 and accompanying text.

385. The Financial Institutions Reform, Recovery, and Enforcement Act of 1989, S. 413, S.774 101st Cong., 1st Sess. (1989), recently proposed by the administration, sets forth extensive reforms to the financial institutions regulatory structure. Pursuant to this bill, FSLIC would be dissolved and the insurance of thrift deposits would be brought under the control of the FDIC. The FHLBB would likewise be abolished and the Secretary of the Treasury would oversee the Chairman of the Federal Home Loan Bank System (a renamed and restructured FHLBB), who would regulate federally chartered thrift institutions. The bill would also allow a bank holding company to acquire healthy thrifts (effective two years after the enactment) and would prohibit the Federal Reserve Board from imposing restrictions on tandem operations of thrifts and banks owned by the same bank holding company. *Id.*; see also [Current] Fed. Banking L. Rep. (CCH) ¶ 87,527 (Jan. 4, 1989) (FDIC proposal to improve federal deposit insurance calling for a comprehensive reform of the thrift regulatory structure, merging the FSLIC and the FDIC and transferring oversight of federally chartered thrifts to the OCC and oversight of thrift holding companies to the FRB).

