Comments

Bank Holding Company Regulatory Experience Since 1970

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JACOBUS T. SEVERIENS**

Throughout the history of American banking there has been public concern regarding unsound banking practices. At the same time a fear of excessive concentration of financial, economic, and political power has prevailed. In this tradition, Congress passed the Bank Holding Company Act of 1956,1 subsequently amended in 19662 and 1970,3 which subjects bank holding company acquisitions and activities to approval by the Federal Reserve System. By this legislation, Congress has created something of a novelty in American law—it has charged a regulatory body with shaping the structural profile of an industry. The purpose of this Comment is to examine the Federal Reserve’s role as regulator of bank holding companies since 1970, when one-bank organizations were added to the multi-bank firms already subject to its jurisdiction.4 Of particular interest are the policies it has developed in coming to grips with the issue of excessive concentration. The discussion that follows reviews bank holding company legislation, current administrative procedures under the Act, and Board of Governors decisions in appellate cases for acquisition approvals. The concluding section offers some observations on current and future problems in the area of bank holding company regulation.

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4Id. § 101(a) (codified at 12 U.S.C. § 1841 (1970)).
I. HOLDING COMPANY LEGISLATION

The Bank Holding Company Act of 1956 required that all holding companies that owned or controlled twenty-five percent or more of the stock of two or more commercial banks be registered with the Federal Reserve Board of Governors. The Act compelled these companies to divest themselves of control over all nonbank-related corporations, with exceptions allowed only for activities of a financial, fiduciary, or insurance nature and those other activities determined to be so closely related to the business of managing or controlling banks as to be "a proper incident thereto." The Act further required Board approval for any bank acquisition. In reaching its decision, the Board was required to consider: (1) the financial history and conditions of the banks involved, (2) their earnings prospects, (3) the general characteristics of management, (4) the convenience, needs, and welfare of the communities and areas concerned, and (5) whether or not the "effect of such acquisition ... would be to expand the size or extent of the bank holding company system involved beyond limits consistent with adequate and sound banking, public interest, and the promotion of competition in the field of banking." The first four factors direct Board attention toward traditional banking factors. The fifth requires that it consider the competitive aspects of the acquisition. All of these factors were later incorporated in the Bank Merger Act of 1960, which requires public agency approval of bank mergers.

Both statutes, however, were ambiguous as to the relative weight to be accorded each of these factors. Moreover, the question of the application of antitrust laws to bank acquisitions and mergers was left open. The latter issue was conclusively settled by Supreme Court action in the early 1960's. In *United States v. Philadelphia National Bank* and *United States v. First National Bank & Trust Co.*, the Court ruled that bank mergers (and by extension, bank holding company acquisitions) approved by fed-

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5Act of May 9, 1956, ch. 240, § 2(a), 70 Stat. 133.
7Id. § 1843(c) (8).
8Act of May 9, 1956, ch. 240, § 3(c), 70 Stat. 133, 135. The 1966 Amendments substituted for this criteria the following:
In every case, the Board shall take into consideration the financial and managerial resources and future prospects of the company or companies and the banks concerned, and the convenience and needs of the community to be served.
eral banking agencies could be challenged by the Attorney General under antitrust laws. In the former case, the Court held that the proposed merger of two large Philadelphia banks, which would have resulted in a single bank controlling thirty-six percent of the bank deposits in a four-county area, was sufficiently anti-competitive as to be in violation of section 7 of the Clayton Act.\(^\text{12}\) The decision also established that commercial banking was a "distinct line of commerce."\(^\text{13}\) As a consequence, the banking market was to be distinguished from that of savings and loan associations, credit unions, and other thrift institutions. With respect to banking factors, the Court maintained:

[A] merger the effect of which may be substantially to lessen competition is not saved because, on some ultimate reckoning of social or economic debits and credits, it may be deemed beneficial . . . . In proscribing anticompetitive mergers, benign and malignant alike, we must assume that some price must have to be paid.\(^\text{14}\)

In 1966, the Bank Holding Company and Bank Merger Acts were revised to accord with these Court decisions. In amendments to both statutes, Congress affirmed the applicability of antitrust laws to bank acquisitions and mergers that would substantially lessen competition or tend to create a monopoly.\(^\text{15}\) Competition became the paramount factor. Exceptions were allowed primarily when the anticompetitive effects were clearly outweighed by the probable beneficial effects of the transaction in meeting the convenience and needs of the community to be served.\(^\text{16}\)

\(^{12}\)374 U.S. at 355-72.

\(^{13}\)Id. at 356.

\(^{14}\)Id. at 371.

\(^{15}\)Act of July 1, 1966, Pub. L. No. 84-485, § 7(a), 80 Stat. 236. The amendments to the Bank Holding Company Act are codified at 12 U.S.C. § 1842(c) (1970) and those to the Bank Merger Act at id. § 1828(c).

\(^{16}\)12 U.S.C. § 1842(c) (1970) provides in relevant part:

The Board shall not approve—

. . . .

(2) any . . . proposed acquisition or merger or consolidation under this section whose effect in any section of the country may be substantially to lessen competition, or tend to create a monopoly, or which in any other manner would be in restraint or [sic] trade, unless it finds that the anticompetitive effects of the proposed transactions are clearly outweighed in the public interest by the probable effect of the transaction in meeting the convenience and needs of the community to be served.

In United States v. First City Nat'l Bank, 386 U.S. 361, 366 (1967), the Court held that the burden of proving that considerations of convenience and need outweigh the anticompetitive effects of the merger or acquisition rests upon the defendant company.
Despite this revision, it was soon evident that the Bank Holding Company Act was not sufficiently encompassing. Particular concern arose over the fact that a holding company which owned or controlled twenty-five percent or more of the stock of only one bank did not need to register under the Act and thus was not subject to the required divestiture of its nonbanking business. Since one-bank holding companies were exempt from the Act, they were unrestricted as to the types of business that they could operate. Consequently, a substantial number of large banks formed one-bank holding companies and acquired subsidiaries that engaged in numerous commercial activities. Twin incentives existed for such reorganization. One incentive was the need to obtain new sources of funds from which loans could be made. For many years the primary source of bank funds—demand deposits—had declined as a percentage of liabilities, and imaginative bank managements were forced to look elsewhere for funds. The second incentive was that bankers had found that their investment in computers and trained personnel gave them excess productive capacity, and that they could offer additional services by utilizing equipment and skills already at hand. This possibility drew management's attention to product expansion, since they had already made the initial investment required to sell insurance, underwrite revenue bonds, perform accounting, data processing, and leasing services, and operate mutual funds.

The one-bank holding company appealed as a vehicle which offered the flexibility needed to obtain more funds and to expand services. However, this organizational emergence threatened the traditional separation of banking and commerce. As a result, Congress passed the Bank Holding Company Act Amendments of 1970.\textsuperscript{17} The Amendments eliminated the legal distinction between one-bank and multi-bank holding companies by defining a bank holding company as "any company which has control over any bank or over any company that is or becomes a bank holding company."\textsuperscript{18} The Board of Governors of the Federal Reserve System was given discretion to determine that ownership, control, or voting power over as little as five percent of the shares of a company or bank could constitute control.\textsuperscript{19}

The Amendments broadened section 4(c) (8) of the Act by establishing a two-part test for nonbank acquisitions.\textsuperscript{20} Under this section, the Board was required to determine whether an activity was so closely related to the business of banking or managing

\textsuperscript{18}Id. § 101(a) (codified at 12 U.S.C. § 1841(a) (1) (1970)).
\textsuperscript{19}Id. (codified at 12 U.S.C. § 1841(a) (2), (3) (1970)).
\textsuperscript{20}Id. § 103 (codified at 12 U.S.C. § 1843(c) (8) (1970)).
or controlling banks as to be a proper incident thereto. More importantly, in deciding the issue of proper incidence, the Board had to consider whether the performance of services by an affiliate of a holding company could reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that would outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interests, or unsound banking practices. Thus, operations that might be acquired by holding companies were no longer restricted to those of a financial, fiduciary, or insurance nature. The test, balancing public benefits against adverse effects, extended the notion of what was to be a proper incident to banking. The determination of this matter was left with the Federal Reserve Board of Governors.

II. Administration of the Bank Holding Company Act As Amended

Under its rules regarding delegation of authority, the Board of Governors shares the burden of administering the Act with the Federal Reserve Banks.21 The application procedure is initiated at the District Bank level, where an acquisition request is reviewed for legal sufficiency and informational adequacy. Following this preliminary screening, notice of an accepted application is given to the Board of Governors,22 who in turn inform the Comptroller of the Currency if the firm proposed to be acquired is a national bank or a bank located in the District of Columbia.23 If the bank to be acquired is state-chartered, the appropriate state authority is notified.24 In the case of a non-bank acquisition under section 4, the Board publishes a notice of this application in the Federal Register, giving interested parties an opportunity to express their views.25

In the meantime, each application is reviewed by the Federal Reserve Bank to see if it meets conditions of approval. The determinations are based upon general guidelines provided by the Board as well as precedents established within the particular Federal Reserve district. As a rule, an application is approved if all relevant departments of the Reserve Bank recommend ap-

22 Id. § 262.3(a), (b).
25 12 C.F.R. § 225.4(a) (1974). Such notice is published only in the event that the Board believes the holding company has a reasonable basis for believing that the proposed acquisition is closely related to banking or managing or controlling banks.
proval, if no substantive objection to the proposal has been made by a Board member, bank supervisory agency, the United States Department of Justice, or a member of the public, if no significant policy issue is raised by the proposal as to which the Board has not expressed its view, and if certain competitive and banking criteria are met. With respect to competition, it is generally expected that:

1. Applicant is not one of the dominant banking organizations in the state, and, unless the proposed subsidiary is a proposed new bank, Applicant will control no more than 15 percent of the total deposits in commercial banks in the state after consummation of the proposal;

2. if the bank to be acquired is an existing bank and if no banking offices of Applicant's existing subsidiary bank are located in the same market as the proposed subsidiary, the proposed subsidiary has no more than $25 million in total deposits or controls no more than 15 percent of deposits in commercial banks in the market;

3. if the bank to be acquired is an existing bank and if any of Applicant's existing subsidiary banks compete in the same market as the proposed subsidiary, Applicant will control no more than 10 percent of total deposits in commercial banks in the market after consummation;

4. if the bank to be acquired is a proposed new bank, bank subsidiaries of Applicant will not hold in the aggregate more than 20 percent of the total deposits in commercial banks in the relevant market area and Applicant will not be one of the dominant banking organizations in the state; and

5. neither Applicant nor the bank to be acquired has entered into or proposes to enter into any agreement with any director, officer, employee, or shareholder of the bank that contains any condition that limits or restricts in any manner the right of such persons to compete with Applicant or any of Applicant's existing or proposed subsidiaries.

The banking factors taken into consideration mainly involve determinations of holding company capital adequacy and acquisition debt. For instance, acquisition debt must be amortized within

26Id. § 265.2(24).
a reasonable period of time, such period normally not exceeding twelve years.\(^{26}\)

In the case of nonbank acquisitions, a competitive limitation is that:

If Applicant or any of Applicant's existing or proposed nonbanking subsidiaries compete in the same geographic and product market as any proposed subsidiary, the resulting organization will not control more than 10 percent of that product or service line after consummation of the proposal.\(^{27}\)

While the guidelines denote areas of general Board concern, they do not cover all situations.

In addition to the other conditions, the Federal Reserve Bank must determine whether the proposed activity falls within the meaning of section 4(c)(8). In Regulation Y,\(^{30}\) which is periodically amended, the Board has listed a number of permissible activities. As of January, 1975, a bank holding company could, with certain qualifications, make or acquire loans and other extensions of credit for its own account or for the account of others, operate as an industrial bank, service loans and other extensions of credit, and perform trust activities.\(^{31}\) The Regulation also permitted the holding company to act as an investment or financial advisor or as an insurance agent or broker, to lease real and personal property, to make equity and debt investments in corporations or projects designed primarily to promote community welfare, and to provide bookkeeping, data processing, courier services, and management consulting advice to nonaffiliated banks.\(^{32}\)

Each of the above categories carries exceptions and limitations. For instance, conventional life insurance may be sold by banks in very small communities. Data processing must be bank-related; it cannot be employed for accounting services. The term courier services comprises messengers, but not armored car deliveries.

III. Decisions Under the Act

Once an application is approved, the holding company may proceed with the acquisition. Should a particular application be denied, however, and its proponents have reason to believe in its viability, it is presented to the Board for review. As a matter of fact, by far the major proportion of the applications, eighty

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\(^{27}\) Id. § 265.2(24) (viii).

\(^{30}\) Id. § 225.1 to .4.

\(^{31}\) Id. § 225.4.

\(^{32}\) Id.
percent, go to the appellate level, since most cases do not fall within the delegated guidelines. The Board thus operates largely on a case-by-case basis. In doing so, it has built a body of administrative law in the bank holding company area.

It becomes worthwhile to examine this "corpus juris" in order to gain a better understanding of Board policies and to discern possible trends with respect to concepts the Board considers of increasing importance. The following review deals solely with Board denials since 1970, when the Act was amended to include one-bank holding companies. An analysis of what is not permitted may help to distinguish the key hurdles that must be overcome if a bank holding company is to be successful in its application.

A. Bank Acquisitions

The Board has denied about six percent of the applications it has received under section 3 of the Act, which governs acquisitions of banks. As shown in Table I below, applications have been turned down for reasons of existing and potential competition, financial considerations, and transactional factors. This last item encompasses the various aspects of the acquisition transaction—the mechanics of the formation or acquisition. For example, is the offer substantially equal among all shareholders? Are there post-employment contracts that would constitute an unreasonable restraint of trade? While these and similar matters are not specifically alluded to in the Act, they can be considered a logical by-product of the statutory requirement that financial and managerial resources and future prospects of the holding company be considered.

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1. Competition

In cases concerning competition, the Board's decisions reflect a policy of encouraging deconcentration. It has taken its direction from the Supreme Court's opinion in *Philadelphia National Bank* that, if concentration is already great, the importance of preventing even slight increases in concentration and preserving possible deconcentration is also great. Board decisions involving existing competition (expansion within a market in which the holding company is already represented) have expressed serious concern about increasing deposit concentration and removing banking alternatives in local markets. Proposed acquisitions by dominant banking organizations in an already concentrated area are prime candidates for denials. In turning down Dominion Bankshares Corporation's application to acquire a small bank in Roanoke, Virginia, the Board noted that "although the applicant's share of market deposits would increase by only .8 percentage points consummation would aggravate the high level of deposit concentration in the market." At the time of application, four banking organizations controlled eighty-five percent of local market deposits, with Dominion Bankshares' leading bank accounting for forty-three percent of total deposits in the Roanoke market. Thus, it was clearly the predominant bank in the area. In the opinion of the Board, an acquisition by a holding company of a bank outside of the market would have had a more beneficial effect upon competition.

In finding undue concentration, the Board has occasionally extended the scope of the relevant market area. In doing so, it has established a doctrine of market overlap under which existing competition is no longer confined to specific geographic lines such as standard metropolitan statistical areas. The Board ruled in *Old Kent Financial Corp.* that "while Old Kent and bank are in banking markets that are regarded as separate at this time, there is some competition between them." The overlap in the instance was hardly large. The holding company obtained only $1 million of its $775 million in deposits from the proposed subsidiary's bank's market area, while the latter received $3 million of its $105 million in deposits from the locality served by the holding company subsidiary. The Board stated that approval would have raised Old Kent's deposit share in a four-county region from thirty-seven to forty-two percent, thereby making it the dominant bank in the district.

Applications have also been denied on competitive grounds when the acquiring company was not necessarily dominant

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35Dominion Bankshares Corp., 60 FED. RES. BULL. 49 (1974).
3660 FED. RES. BULL. 133 (1974).
throughout the market and the proposed acquisition would not have added substantially to its deposits. In some cases, the Board has simply subdivided a concentrated market into primary service areas. The extent of existing competition has then been determined within the resultant smaller geographic confines. For example, in First at Orlando Corp., the holding company seeking acquisition approval already controlled the ninth largest bank in the area. This subsidiary had only two percent of market deposits. The bank to be acquired was ten miles away and accounted for three percent of area deposits. Yet, the Board found that each of these relatively small banks obtained seven percent of their deposits from each other’s primary service area. The percentage was considered sufficient to constitute substantial existing competition.

The primary service concept was re-affirmed in New England Merchants Co., in which the acquisition of a Boston area bank, holding .8 percent market deposits, was seen as “aggravating concentration.” It appeared that two branches of the applicant’s sole subsidiary bank derived thirty-five and twenty-six percent respectively of their demand deposits from the primary service area of the bank to be acquired. Although the Board found that these deposits represented only a small percentage of the total deposits of the subsidiary, it noted that the combined deposits and loans of the two branches equalled seventy-eight and fifty-eight percent respectively of the loans and deposits that the bank to be acquired derived from its primary service area. Conversely, the bank to be acquired derived only five percent of its loans and deposits from the two branches’ primary service areas. In denying both this and the Orlando applications, the Board expressly preferred deconcentration via acquisitions of the banks by holding companies outside of the market.

The issue of dominance reappears in applications for the acquisition of proposed or de novo banks. In denying one Florida holding company’s request for an acquisition of a yet-to-be established bank, the Board feared that adverse competitive effects were likely because the applicant’s subsidiary already had nineteen percent of deposits in the local market. It concluded that further offices would raise barriers to entry by other organizations and increase concentration of banking resources in the market. In another Florida denial, the Board concluded that a re-

40Id. at 459-60.
ently established bank would be hurt by the opening of yet another de novo bank in the same market.\textsuperscript{42}

Apparently, the Board has also sought to be a deconcentrating influence by severing affiliations or maintaining the possibilities of disaffiliation. For instance, in \textit{First International Bancshares,}\textsuperscript{43} the applicant requested approval to acquire two banks affiliated with each other in the Houston market. The ruling allowed the company to acquire one bank, but not the other, thereby breaking up the chain. In \textit{Texas Commerce Bancshares, Inc.},\textsuperscript{44} five percent of the shareholders of the applicant held sixty-five percent of the shares in a small Houston bank which the applicant sought to acquire. Moreover, there had existed a history of a close working relationship between one of the applicant’s subsidiary banks and the bank to be acquired, although this relationship had declined in recent years. The Board felt that further disaffiliation was a “reasonable prospect.” In its opinion, a takeover in that instance would have resulted in the loss of an independent bank in a growing market and foreclosed entry into the market by means of acquisition of another bank holding company. Only when an affiliation could be deemed permanent and little chance for de novo entry existed have such applications been approved.\textsuperscript{45}

2. \textit{Potential Competition}

Many bank holding companies, denied expansion opportunities within their existing markets, have eyed acquisitions elsewhere. In denying applications for acquisitions of banks in markets where companies are not already represented, the Board has relied increasingly over the years on the factor of potential competition. In pursuit of its policy of deconcentration, the Board has tried to preserve, when possible, the acquiring bank as a source of future competition. For example, in denying the application for First International Bancshares’ acquisition of Citizens First National Bank of Tyler, Texas, the Board established a doctrine barring the largest companies in the state from absorbing leading banks in secondary markets if there is the likelihood that the acquisition would reduce potential competition.\textsuperscript{46} With this ruling—reaffirmed in the denial of First International’s application to acquire the largest bank in Waco, Texas,\textsuperscript{47} and in

turning down the takeover of Meyerland Bank of Houston by First City Bancorporation—*the Board expressed its concern over the rise of concentration in the state as well as in local banking markets. In its order denying the Citizens Bank application, the Board said it did not have to await the development of undue concentration among bank holding companies to stop the trend. Taking its cue from the United States Supreme Court decision in *United States v. Brown Shoe Co.*, the Board considered that it had a mandate to break the force of a trend toward undue concentration "before it gathers momentum."

The Board reasoned in such cases that if one of the large companies enters a market by creating a new bank or acquiring a small bank or "toehold," additional competition will be created. But if one of these firms enters by acquiring one of the leading banks in the market, the acquisition will not amount to additional competition in the market. Either development would remove the acquiring company from the ranks of *potential* competitors. But if the company entered the market by acquiring the leader, there would be no increase in *actual* competition to offset the lessening of potential competition. Moreover, an opportunity to reduce market concentration would have been lost. The acquisition would solidify the acquired bank's market position while foreclosing the possibility of its either remaining a significant competitor or becoming affiliated with one of the smaller bank holding companies.

Even a small or "toehold" acquisition may not meet with approval if the holding company is exceptionally large. Such was the case in *Northwest Bancorporation*. There, the second largest banking organization in Minnesota, which controlled forty-eight banks within the state and many out-of-state subsidiaries, sought approval to acquire the smallest bank in a county, one which had only two percent of market deposits. Continuing in the vein of *Brown Shoe*, the Board stated that whether the process was a nibble or a gobble, the end result was the same—concentration. It suggested that an acquisition by a smaller bank holding company would have been preferable.

It should be noted at this juncture that the United States Department of Justice has sought to extend the doctrine of potential competition even further—to mergers of banks operating in separate geographic markets which may contribute to state-

46Id. at 318.
49Id. at 201.
wide concentration. It has done so by challenging several applications approved by the Board. 54 But so far, success has eluded it. In *United States v. Marine Bancorporation*, 55 the Supreme Court rejected the Government's claim that a statewide linkage of oligopolies might arise and that large banks across the state might engage in more standardized behavior as a result. It held that "[i]n applying the doctrine of potential competition to commercial banking courts must . . . take into account the extensive federal and state regulation of banks." 56 Particularly, the Court noted the restraints on entry unique to this line of commerce. In the circumstances of that case, the relevant geographic market of the acquired bank was the local area in which that bank was in significant direct competition with other banks. This ruling was recently re-affirmed in *United States v. Connecticut National Bank*. 57 Again, competition was considered in terms of local banking markets. Incidentally, the Court also acknowledged that "at some stage in the development of savings banks it will be unrealistic to distinguish them from commercial banks for the purpose of the Clayton Act." 58 It would appear, therefore, that the Board has rejected applications on anticompetitive grounds that the Department of Justice would have lost in court. On the other hand, the Department has failed to have any of the Board's challenged approvals reversed. But, it should be noted that only bank mergers and holding company acquisitions have been challenged, not those of nonbank subsidiaries.

3. Financial Considerations

A growing source of Federal Reserve Board concern has been the safety of bank deposits. The turbulence which has struck the financial markets in recent months and culminated in the nation's first multi-billion dollar bank failure has brought a new caution to regulatory agencies. 59 Board Chairman Arthur Burns has let it be known that the Board is putting on the brakes as arbiter of holding company proposals for new ventures and ac-

56 Id. at 641.
58 Id. at 666.
59 On October 8, 1974, Franklin National Bank of Mineola, New York, was declared insolvent by Currency Controller James E. Smith. This was the largest bank failure in American banking history. Franklin was immediately taken over by European-American Bank and Trust Company in an agreement that guaranteed no losses to any Franklin depositors. N.Y. Times, Oct. 9, 1974, at 1, col. 1.
Any company seeking Board approval for an acquisition can expect its capital position to be thoroughly scrutinized. The Board has been especially anxious about acquisition programs comprised substantially of debt capital. It feels that the borrowing capacity of the holding corporation should be reserved primarily to support the company’s potential for assisting its subsidiaries. The holding company should be a source of strength, whose vitality must not be sapped by acquisitions of undercapitalized and weak banks.

An applicant must be able to service the debt incurred in financing the acquisition in a reasonable and realistic manner, lest the capital position of either the proposed bank or an existing subsidiary be consequently impaired. A major factor in this area is bank earnings growth rate projections. Overly-optimistic return estimates risk denial. Proposed dividends that are to be used to pay off the debt must be reasonable and in line with established earnings trends. Sudden sharp increases in payouts may not be warranted in view of past bank performance. Such payments are particularly suspect when the proposed bank’s capital-to-assets ratio shows a declining trend. Management fees may be used as a supplement to or in lieu of dividend payments, but they too cannot be relied upon when the proposed bank’s capital structure is fundamentally weak. Moreover, fees paid must be for actual services rendered.

The Board has also made it clear that the holding company itself must be financially sound at the time of the acquisition. In Central Bancorporation, the holding company’s application was denied on the basis of declining holding company income. A stock offering to eliminate the acquisition debt was viewed as unlikely to be successful at the desired price. In United Missouri Bancshares, approval was denied because of what the Board considered an excessive purchase price for the acquisition. The amount proposed was 200 percent of the book value of the bank to be acquired, a premium equal to 22 percent of its bank deposits. This premium was held to have a retarding effect on hold-

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61 Johnson, supra note 34, at 35.
ing company earnings. Finally, excessive holding company leverage has been a cause of denial. In Financial Securities Corp.,70 a capital structure of $5,000 stockholder equity and $1.6 million debt was considered to be a clearly disproportionate level of borrowing.

4. Transactional Factors

As Table I suggests, transactional factors have not been a major concern in the denials of applications. One case dealt with the need to offer equal share prices to all stockholders.71 This requirement has since been incorporated into the delegated guidelines.72 A more recent denial points out the problem of aggravating dissension among stockholders. In NBC Corp.,73 the applicant sought a minority interest in a bank, but a majority of the bank's stockholders had expressed their opposition to this acquisition. The Board felt that the conflicts which would inevitably ensue with respect to management and dividend policies would not contribute to the financial soundness of the holding company.

B. Nonbank Acquisitions

As Table II indicates, from 1971 through 1974, forty-seven orders of denial under section 4 were reported—representing about ten percent of nonbank applications to the Board.74 The causes for denials of nonbank acquisitions have typically been the same as for bank acquisitions. Further, it is likely that the Board's practice of formally determining permissible nonbank activities has precluded some other opportunities for denial.75

In its consideration of bank acquisitions, the Board has scrupulously followed the Philadelphia Bank rule—that banking is a “unique cluster of services.”76 In nonbank cases, however, holding company activities are unbundled, and each service line is presumably considered separately. If, for example, a holding

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72Johnson, supra note 34, at 11.
75There have been five proposed nonbank acquisitions denied on the grounds that the activities were not closely related to banking. See, e.g., Bank America Corp., 60 Fed. Res. Bull. 674 (1974).
company seeks to acquire a mortgage lending firm, the competitive considerations should focus on the company's penetration of mortgage lending in the market involved—mortgage lending by its present subsidiary banks and nonbanks. The delegated guideline of ten percent market share of the relevant service line parallels the percentage established by the Board in bank cases.  

Table II

Nonbank Acquisitions Denied Under Section 4 of the Bank Holding Company Act of 1970

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<td>8</td>
<td></td>
</tr>
<tr>
<td>(e) Transactional Factors</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>3</td>
<td></td>
</tr>
<tr>
<td><strong>Totals</strong></td>
<td>1</td>
<td>17</td>
<td>15</td>
<td>20</td>
<td>53</td>
</tr>
<tr>
<td><strong>Both (a) and (b)</strong></td>
<td>2</td>
<td>1</td>
<td>1</td>
<td>4</td>
<td></td>
</tr>
<tr>
<td><strong>(a) and/or (b) and (d)</strong></td>
<td>1</td>
<td>1</td>
<td>2</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Adjusted totals</strong></td>
<td>1</td>
<td>14</td>
<td>14</td>
<td>18</td>
<td>47</td>
</tr>
</tbody>
</table>

In practice, however, the Board has probed beyond this guideline to discourage the expansion of leading banks into related product lines in the same market where the nonbank firm is dominant. This predilection has been pronounced in Board denials of mortgage bank acquisitions. In turning down First National City Bank’s acquisition of Advance Mortgage Corporation, 79 the Board called attention to the applicant’s resources, which gave it the ability to enter new markets de novo or through the acquisition of a smaller firm. Concern lay with the possible adverse implications of the acquisition of the third largest mortgage lending firm in the nation by the second largest banking organization. The application was expressly denied on the grounds of reduced existing and potential competition and an undue concentration of resources. The ruling, however, was not unanimous. It met with the dissent that Advance and First National did not compete in any of the same markets for one-to-four family residential mort-  

77 JOHNSON, supra note 34, at 37.
78 To avoid double counting, the last two lines are deducted from the gross totals.
gage loans. The dissenting opinion noted that Advance accounted for less than one percent of total national originations on loans for income properties by mortgage companies and less than .3 percent of all such originations by mortgage lending institutions. Governor Sheehan chided his colleagues for ruling upon bigness per se, not concentration in particular product lines and particular markets.

Chase Manhattan's proposed acquisition of Dial Finance Corporation supplied another instance of denial on the grounds of undue concentration of credit-granting resources and the elimination of potential competition. The Board declared that both Chase and Dial were capable of operating new offices and had planned to do so in the absence of the affiliation. It held that the issue of concentration in credit-granting resources was within the intent of Congress in enacting the 1970 Amendment. This opinion drew the same dissent as did the denial of First National's application.

Out-of-state acquisitions have also been denied on account of size. Manufacturer's Hanover of New York had hoped to acquire a Connecticut-based mortgage firm. In spite of a finding of no existing competition, the Board noted that the holding company, as the fourth largest bank in the general area, would do better to expand de novo. The Board's opinion further observed that consummation of the acquisition would have raised barriers to entry in the field.

Section 4 of the Act contains no requirement that the Board consider the financial resources of both parties in a nonbank transaction. Nevertheless, the Board has recently expressed the view that so-called "go-go" banks should now "go-slow" with expansion into new activities and should direct their energies toward strengthening existing operations, particularly when the proposed expansion would be into new activities in which the bank holding company has not been previously engaged. Moreover, when a holding company goes to the market to obtain capital, the market generally does not adequately appraise the strength of the holding company. It may assume that holding companies are as strong as their banks, which presumably are not so wont to fail because of public agency supervisory activities. Nonbanking subsidiaries, however, are less regulated and supervised. If one of them should fail, holding company management may feel obligated to use bank

80Chase Manhattan Corp., 60 Fed. Res. Bull. 142 (1974). A revised acquisition proposal was also denied. Id. at 874.
81Id. at 145 (Governors Daane & Sheehan, dissenting).
assets to protect holding company integrity. In recently denying the American Fletcher Corporation's acquisition of a savings and loan company in Arizona, the Board noted that the holding company had recently acquired four other nonbank organizations. It said that resources should not be carried away from the possible future needs of subsidiary banks.

The Board's denial of Chemical New York Corporation's application to acquire CNA Nuclear Leasing came as no surprise. CNA had a debt-equity ratio of seventy-four to one, and it would have required heavy financing to meet long-term growth objectives. An affiliation would have required Chemical to increase its short-term borrowings substantially, possibly sapping the financial strength of the holding company. In its order the Board maintained that "one of the primary purposes of a holding company is to serve as a source of strength for its subsidiary banks." The acquisition would have reduced Chemical's ability to supply capital to its banks in the future. In a later instance, the Board denied a leasing acquisition on grounds that additional funds should be used to strengthen the bank rather than support leasing activities. The acquisition would have detracted from the bank holding company's overall financial position and would have reduced its ability to provide additional support to subsidiary banks.

Other financial tests applied by the Board have been similar to those discussed in section 3 applications. Projected earnings must be realistic and sufficient to meet acquisition debt. The holding company must be financially sound at the time of acquisition. It must not be excessively leveraged. The same course has been followed with respect to the transactions criterion. The only aspect so far unique to nonbank acquisitions has been the matter of post-employment contracts. Such covenants, if unreasonably restrictive, have been cited by the Board as anticompetitive.

Id. at 699.
IV. CONCLUDING OBSERVATIONS

In carrying out its responsibility under the Bank Holding Company Act, the Board has actively sought to preserve competition and maintain a sound banking structure. It has done so, however, with diligence and caution, in the interest of maintaining a degree of flexibility. The delegated guidelines are merely general and noncontroversial indicators of concern, leaving the Board free to formulate many policies on a case-by-case basis.

Board classification of nonbanking activities under Regulation Y has been likened to the serpentine wall which Thomas Jefferson built at Charlottesville, Virginia.92 The start was conventional enough, limiting approved activities to those traditionally associated with the intermediation process of getting money in and lending money out. The first jog in the wall came on the issue of certain computer services, and it was an appropriate line of departure for the last third of the twentieth century. Thereafter, the wall has wound one way and then another. Finance companies are in, but savings and loan associations are currently out. Investment advice is in, while management consulting for affiliates is out. The insurance business is partly in and partly out. In viewing the zigs and zags of the wall, it becomes difficult to perceive an abstract principle of architecture underlying the whole.

What can be said about the trend of Board case decisions? First of all, there appears to be an essential fusion of sections 3 and 4 with an ongoing homogenization of standards applicable to both bank and nonbank expansion. Second, lying beneath the aggregate decisions is a coherent set of principles of adjudication: competition and concentration, capital adequacy, and conflict of interest. Third, the Board has applied principles established by the courts in nonbanking cases to the holding company system at large.

In particular, it will be very difficult for a bank holding company whose lead bank can in any manner be considered among the dominant in a market to acquire a major bank subsidiary. Nor will leading bank organizations in a state find it easy to acquire a leading bank in the same state, even if that bank is outside the market area currently served by the holding company. Entrance de novo or through “toehold” acquisitions of smaller banks is to be encouraged. The Board has also recognized that expansion of leading banks into related product lines in the same geographic area where the bank is dominant can raise serious competitive questions. Moreover, both the holding company and

92JOHNSON, supra note 34, at 21.
the proposed subsidiary must be in sound financial health. Acquisition debt must not jeopardize the holding company's position as a source of strength.

Yet, within these wide limits, the path of Board interpretations may be as sinuous as the Jeffersonian wall. No hard and fast line has been drawn in case opinions about the precise degree of concentration or percentage of market deposits that would definitely rule out proposed acquisitions. Small percentage holdings may be sufficient in one case, though not in other circumstances. Neither has the concept of reasonable capital adequacy been spelled out. Excessive leverage has been measured only in extreme cases. The Board takes many features into consideration in its deliberations—existing state legal constraints, the degree of concentration within a state as well as in local markets, future projections for banking areas, the current state of the economy, and management practices of financial institutions. What may be cause for approval in one case may not be so for a similar case in another state or another period of time. This practice may prove a blessing or a bane. Perhaps flexibility has been necessary in order to meet new situations.

The Board's task, as reshaper of the legal milieu in the banking industry, is not without problems. One of the major problems confronting the Board in attempting to preserve competition in banking is that Congress failed to provide it with clear guidelines as to what constitutes undue concentration. A few state legislatures have established concentration guidelines. For example, deposit concentration in one holding company system in Missouri is limited to thirteen percent of deposits\(^3\) and in Iowa to eight percent.\(^4\) In most states where holding companies are permitted, there are no specific limits.

Furthermore, the preservation of competition represents a change in the purposes of bank regulation. During most of the history of banking in the United States, the principal consideration in chartering and regulating banks has been to establish and preserve strong viable institutions. For this reason, entry into banking has been and still is restricted. To obtain a bank charter, it is necessary for the applicants to demonstrate that a new bank is needed and that it is likely to operate profitably. Free entry is a mark of pure competition which does not exist in banking.

A study made by the Federal Deposit Insurance Company in 1960 revealed that as of June 30, 1958, there were 7,703 bank-


\(^4\)IOWA CODE § 524.1802 (Supp. 1974).
ing offices in population centers having only one banking office. It is unlikely that this situation has changed greatly. In any event, one-bank population centers are more nearly comparable to an economic monopoly rather than to pure competition. In population centers with more than one banking office, the form of competition is more oligopolistic in nature than one of pure competition. Oligopolistic competition in banking is largely of a nonprice variety; it is typified by product differentiation, such as the use of logos, or by the services offered. This is not to imply that the preservation of an alternative banking choice is undesirable. It does, however, indicate the problem confronted by the Board of Governors in preserving competition in an industry that is not marked by free entry and price competition. In promoting service competition, a balanced system of branching may be superior to the holding company alternative.

It is difficult to predict the future with precision. Current and projected developments in finance and funds transfer may render the Court's rationale in Philadelphia Bank obsolete; that is, banking may lose its "unique" characteristic. This was hinted at in the 1974 Connecticut Bank decision. Savings and loan associations, mutual savings banks, and credit unions are demanding a role in third-party transfers and in an electronic funds transfer system. The bridge has been crossed in two states, New Hampshire and Massachusetts, where mutual savings banks are permitted to utilize third party funds transfers, known as negotiable orders of withdrawal. This development gives mutual savings banks personal deposit accounts that are directly competitive with commercial bank checking accounts. Thrift institutions have received some liberalization in the span of their lending authority and are seeking to broaden their authority still further. There is an erosion in the wall that makes commercial banking unique when compared with nonbank financial institutions. Ultimately Congress must establish new guidelines for evaluating competition and, hopefully, at such a time, it should consider just how much concentration of financial resources is necessary or desirable and what, if any, geographical limits should be imposed.