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Competitive Analysis in the Applications Process

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The Federal Reserve considers several aspects of transactions when deciding whether to permit them. We must consider the transaction's impact on competition for banking services in the affected markets in select cases. We consider competitive implications when: 1) a holding company acquires a bank or thrift, 2) a state member bank or holding company merges with another organization, and 3) individual(s) acquire control of a holding company or state member bank. This article describes how the Federal Reserve analyzes the competitive effect of a proposal and suggests ways an applicant can address competitive issues.

The competitive analysis begins by determining if the parties to the proposal operate in the same market(s). The definition of a banking market is typically based upon factors that include, but are not limited to: 1) trade areas, 2) commuting patterns, 3) shopping patterns, and 4) political boundaries. Many markets follow Metropolitan Statistical Area (MSA) definitions or rural county lines. Other markets comprise multiple MSAs/counties or parts of MSAs/counties. The Federal Reserve Bank of Minneapolis maintains information about Ninth District bank markets on its website at (https://www.minneapolisfed.org/banking/for-banks/market-definitions). This information includes our preliminary banking market definitions and maps of those markets.

We presume no adverse competitive effects if the parties to a transaction do not share markets; that is, the transaction will not result in a reduction in the number of entities or intensity of competition for banking services. We evaluate the impact of combining operations in each market when the parties compete in a common market(s).

The Federal Reserve analyzes competitive effects by reviewing market shares and market concentration as measured by deposits, using the Herfindahl-Hirschman Index (HHI). The HHI is the sum of the squared market shares of each depository institution operating in the market. Generally, when calculating the HHI and market shares we give the deposits of commercial banks, thrifts and credit unions weights of 100 percent, 50 percent and 0 percent, respectively. The primary source for data used to determine market shares is the FDIC's Summary of Deposits. The data, which is collected annually as of June 30, includes the location of each branch and the dollar value of deposits at each branch. The Federal Reserve Bank of St. Louis maintains a website called CASSIDI™ (http://cassidi.stlouisfed.org/) which allows calculation of preliminary market shares and HHI changes for potential transactions nationwide. Users should remember that data from this source is preliminary and may change based on timing or the facts and circumstances of a specific application.

Federal Reserve System standards (which are generally consistent with those of the Department of Justice) suggest that an application may have an adverse impact on competition if: (1) the HHI increases by 200 points or more to a level of 1,800 or higher in any market, or (2) the market share for the acquiring party increases to more than 35 percent. Such applications must be acted on by the Board of Governors. See the Frequently Asked Questions related to competitive analysis available at: http://www.federalreserve.gov/newsevents/press/bcreg/20141009a.htm for additional information.

An applicant can overcome the suggestion of adverse competitive effects in several ways. First, in some circumstances, the Board may adjust the weight we apply to deposits of some thrifts or credit unions. For example, if the applicant can make a persuasive case that the lending activities of a thrift in the market resemble those of a typical community bank, we may assign a 100 percent weight to that thrift's deposits.

Second, an applicant could demonstrate the existence of mitigating factors — characteristics of a particular market that suggests that the market is more competitive than the HHI measure suggests. Mitigating factors can include 1) the attractiveness of a market for entry, 2) the number of competitors, 3) the number of competitors with significant market shares, and 4) a very weak local economy.

Third, the applicant could agree to divest of one or more branches, including the assets and deposits associated with those branches. Sale of deposits to a disinterested third party could reduce the concentration of deposits in the affected market.

Fourth, an applicant may disagree with our preliminary market definition. The applicant would need to propose an alternative market definition which could be larger or smaller than the preliminary market. The applicant must provide evidence that residents of the proposed market tend to obtain banking services within the proposed market and that the market is not unreasonably large.

Finally, facilitating the smooth transfer of assets by acquiring a failing target may outweigh negative competitive effects of a transaction.

The Federal Reserve Bank of Minneapolis encourages any organization contemplating an acquisition that potentially would have a negative effect on competition to contact applications staff early in the process. We can assist you in understanding options available to address potential adverse competitive effects.

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