I. Elements of Antitrust Analysis

A. Present Competition

The fundamental guideline for evaluating the impact on present competition of any change in market structure is the Clayton Antitrust Act of 1914. Section 7 of the Act prohibits the acquisition of any firm when "in any line of commerce in any section of the country the effect of such acquisition may be to substantially lessen competition."[3] Thus, for each proposed merger or acquisition, the relevant product market ("line of commerce") and the relevant geographic market ("section of the country") must first be established to determine whether the proposed structural change would substantially lessen competition in that market.

The Relevant Product Market In order for firms to be direct competitors, they must be in the same market. The U.S. Supreme Court has ruled in the past that the relevant product market for affiliations of commercial banking organizations is limited to commercial banking.[4] Consequently, regulators have assumed that the only direct competitors of commercial banks are other commercial banks. However, as a result of legislation in the 1980s that expanded the powers of thrift institutions, thrifts are now assumed to compete with commercial banks to some degree.

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[3] See Clayton Act, Section 7, 15 U.S.C. 18.

[4] The U.S. Supreme Court defined the relevant product market for commercial banks for the first time in United States v. Philadelphia National Bank, 374 U.S. 321 (1963), and most recently reaffirmed its earlier definition in United States v. Connecticut National Bank, 418 U.S. 656 (1974).

THE RELEVANT GEOGRAPHIC MARKET The Federal Reserve Bank of Boston considers a local, economically integrated area to be a banking market. It assumes that the boundaries of these markets coincide with the boundaries of mutually exclusive, predefined, economically integrated regions. A banking organization in a region is assumed to compete directly with all of the other banking organizations within that region, but not with banking organizations outside the region.

In specifying geographic boundaries of the markets, the Reserve Bank relies heavily on the geographic delineations of other organizations. Specifically, Ranally Metro Areas (RMAs) form the basis of market definitions in New England, although Metropolitan Statistical Areas (MSAs) and Labor Market Areas (LMAs) are also considered.[5] An RMA represents the developed areas around each major U.S. city, as defined by Rand McNally & Company, a geographic research and mapping company based in Skokie, Illinois. RMAs include one or more central cities, satellite communities, and suburbs, but unlike MSAs, they are not restricted to following county boundaries. As a first step in the delineation of each market, a "core area" is chosen. In urban areas, the RMA is the core area. In nonurban areas, the largest town or the town with the highest employment is chosen as the core area.

Next, town-to-town commuting data from the Census Bureau are examined for surrounding towns. Towns or townships contiguous to the core area (first-tier towns) are included in the same market if 15 percent (20 percent for nonurban areas like Maine) of their residents commute to the core area for work. Next, towns contiguous to the first-tier towns (second-tier towns) are included in the market if at least 18 percent (or 23 percent) of their residents commute to the first-tier or core area for work. Likewise, towns in the next tier are included in the market if at least 21 percent (or 26 percent) of their residents commute into towns already included in the market. This process continues as long as the increase in commutation from the outlying tier to inner tiers is at least 3 percentage points for each successive tier. Additional economic and geographic factors considered relevant for market definitions include shopping and entertainment patterns, advertising patterns of financial institutions, perceptions of area bankers regarding competitors, special characteristics or services of an area, telephone surveys of area consumers and/or small businesses, and natural geographic barriers.

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[5]MSAs are defined by the U.S. Office of Management and Budget, using standards developed by the Federal Committee on Standard Metropolitan Statistical Areas. When two or more areas that would otherwise be classified as independent MSAs show close economic and social ties, they are designated PMSAs, or "Primary Metropolitan Statistical Areas," and the larger area of which they are component parts is then called a CMSA, or "Consolidated Metropolitan Statistical Area." LMAs are defined by the Labor Department of each individual New England state.

The geographic boundaries of the banking markets have been affected by technological changes, such as the growth of automated teller machine networks and remote banking services, and by financial innovations, such as money market funds and deposit brokerage. Such technological and financial changes can create difficulty in establishing geographic boundaries that accurately separate groups of banking competitors into distinct geographic markets. In a 2001 study of the Federal Reserve Board's 1998 Survey of Consumer Finances, Amel and Starr-McCluer conclude that although financial institutions face increasing competition from distant and/or non-depository institutions, consumers still rely predominantly on local depository institutions for many key banking products. Consequently, they argue, current market definitions still accurately reflect competitive conditions for these products. [6]

WHEN IS COMPETITION SUBSTANTIALLY LESSENED? A document, "U.S. Department of Justice Merger Guidelines," [7] (the Guidelines) has provided regulators with a consistent standard by which to measure the anti-competitive effects of specific horizontal bank mergers and acquisitions. Recognizing that these horizontal affiliations generally result in the elimination of some degree of "present" competition in each market in which both of the affiliating banks are located, the Department of Justice, in forming its guidelines, considered both the increase in concentration resulting from the merger and the level of concentration in the market after the merger. In order to measure these values, the Department of Justice uses the Herfindahl-Hirschman Index (HHI), defined as the sum of the squares of the individual market shares of all the firms operating in a particular market.[8]

According to the Guidelines, a bank merger will adversely affect competition if it increases the HHI by 200 points or more and results in a highly concentrated market. A highly concentrated market is defined as one for which the total HHI equals 1800 or more. The 200-point threshold is more lenient than the 50-point threshold applied to other nonbanking firms, reflecting the impact of competition from thrifts and non-depository financial institutions. The Guidelines also state that a merger is considered to have an anticompetitive effect if the merged

[6] Dean F. Amel and Martha Starr-McCluer, *Market Definition in Banking: Recent Evidence* (Federal Reserve Board Finance and Economics Discussion Series, April 2001).

[7] "U.S. Department of Justice Merger Guidelines," June 14, 1984. The sections on horizontal mergers have been superseded by the "Horizontal Merger Guidelines" (http://www.usdoj.gov/atr/public/guidelines/horiz_book/hmg1.html) issued April 2, 1992, and revised April 8, 1997, by the U.S. Department of Justice and the Federal Trade Commission.

[8] For the purposes of computing a market's HHI, an organization's market share is expressed in percentage terms. Thus, an organization whose deposits constitute 10 percent of the market's total deposits contributes 100 points to the overall HHI level for the market.

institution controls more than 35 percent of all deposits in a market.

B. Other Factors, Including Thrift Competition

In analyzing the effect of a merger on competition, the federal banking supervisory agencies and the Justice Department take into account competition from thrift institutions, which are now allowed to offer many banking services. However, since thrift competition with banks is still limited, especially in the area of commercial and industrial lending, deposits of thrift institutions are counted at 50 percent in computing market concentration. In practice, thrift deposits may be counted at more or less than 50 percent, depending on how active they are in commercial and industrial lending.

The regulators do not automatically deny a merger if it results in concentration that is above the threshold. Instead, each potential merger is analyzed further to consider the presence of possible mitigating factors, such as especially active competition from thrifts and credit unions, ease of entry into the market, attractiveness of the market for entry, out-of-market competition, improvements in efficiency that the merger would achieve, a large number of firms remaining in the market, and other factors that make coordinated interaction and exercise of market power more difficult.

If the increase in concentration is too large to be justified by the mitigating factors, the agencies or the Department of Justice may require divestitures of competing branches and offices as a condition of approval. Such divestitures would usually bring the concentration under or very close to the threshold and allow the merger to be approved. The federal banking supervisory agencies publish orders on specific mergers and acquisitions and provide guidance from the staff to provide a reasonably clear indication as to which mergers are likely to raise anticompetitive issues. As a result, while very few mergers are actually denied on competitive grounds, the process is effective in discouraging many applications that would be judged anticompetitive.