EVOLUTION IN BANKING COMPETITION

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The Supreme Court view of commercial banking as a "distinct line of commerce" no longer reflects market realities in many sections of the United States. The argument used by the Court to support its findings were not universally endorsed at the time. Today they have been sufficiently eroded by changing competitive conditions and financial innovations in the markets for financial services to require a reassessment of the competitive position of commercial banks.

The "line of commerce" view remains an integral part of the competitive analysis conducted by federal banking agencies in connection with proposed bank mergers and acquisitions. Supreme Court determinations of the appropriate definitions of the product line and geographic markets in banking directly influence the market structure variables that are used by regulators as indicators of market competition. Experience over the last two decades has led regulators to the general view that, for competitive analysis purposes, banks can be considered to compete only with other banks.

Commercial banking has been treated as a separate line of commerce because it was thought to offer a unique package or "cluster" of independent depository and credit services to bank customers. This treatment has the effect of excluding from definitions of product markets firms that compete with banks in some but not all service lines. For example, in their role as financial intermediaries, banks face competition for funds from other depository institutions as well as from a myriad of liability instruments offered in the money market. Moreover, on the asset side of the balance sheet, bank credit is offered in competition with thrift institutions, nonbank firms such as finance and insurance companies, and retailers, as well as the markets for securities and commercial paper. Exclusion of this competition may at times result in overstatements of anticipated anticompetitive results from bank consolidations.

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Innovations in the financial sector are undermining the line of commerce view by eliminating unique banking services and reducing interdependence among banking products. Developments encouraging the separate pricing and marketing of banking services are further increasing the effective competition between banks and other providers of financial services. Recent legislation extends interest-bearing transaction account authority nationwide to thrift institutions, substantially expands the scope of their activities, and provides for the phase-out of deposit interest rate ceilings. In this environment, a reevaluation of competitive analysis in banking is necessary to ensure that it reflects the realities of the marketplace.

The Supreme Court Position: Product and Geographic Markets The Supreme Court, in ruling that commercial banking is the relevant "line of commerce" in bank merger cases,[1] relied upon the following arguments: (1) some bank products and services are so distinctive that they are essentially free of effective competition from other financial institutions; (2) other bank products and services enjoy cost advantages that insulate them from competition from substitutes offered by other institutions; (3) banking facilities enjoy a "settled consumer preference" that gives them an advantage over similar nonbank services; and (4) the "cluster" of products and services termed commercial banking has economic significance well beyond the various products and services involved.

In the Philadelphia National Bank case, the Court declared that banks offer a cluster of products (various kinds of credit) and services (such as checking accounts and trust services) that are "so distinctive that they are entirely free of effective competition from products or services of other financial institutions." In the Court view, banks played a vital and unique role in the national economy since they alone were permitted to accept demand deposits. This

[1] See the following Supreme Court decisions: United States v. Philadelphia National Bank, 374 U.S. 321 (1963); United States v. Phillipsburg National Bank, 399 U.S. 350 (1970); and United States v. Connecticut National Bank, 418 U.S. 656 (1974).

distinctive power made banks the intermediaries in most financial transactions. As chief repositories for consumer and commercial liquid balances, banks facilitate the efficient transfer of funds from units with surplus funds (creditors) to deficit units (borrowers). Our fractional reserve system, moreover, allows banks to create new money (deposits) and credit and magnifies banks' importance to the economy.

Control of the checking account system was believed by the Court to invest banks with such advantages as to necessitate customer relations with banks. Checking account powers were sufficiently important to distinguish banks from the institutions that most closely resembled them, the thrifts. Later, in the Connecticut case where thrifts had recently received authority to offer check-like Negotiable Order of Withdrawal (NOW) accounts to individuals, the Court again rejected inclusion of savings banks in the same product line as banks since Connecticut savings banks could not provide comparable commercial services to business customers.

In the Philadelphia case, the Court found that in other product lines (e.g., small consumer loans) banks held a competitive advantage over financial institutions that offered similar products. Banks, the Court argued, relied upon lower cost funds (i.e., demand and savings deposits) than did their chief rivals in this market (consumer finance companies) who purchased funds at market interest rates, in substantial part, from banks. As stated by the Court, the reason for this competitive disadvantage is that "only banks obtain the bulk of their working capital without having to pay interest . . . thereon, by virtue of their unique power to accept demand deposits. . . ."

Cost differentials have not been consistently cited by the Court, however, to distinguish between bank and competitor services. Regulation Q authorizes thrift institutions to pay an interest premium on savings and small time deposits (presently ¼ percent) above what banks can offer on identical instruments. The Court did not believe this provided a significant competitive advantage to thrifts, however, in the rivalry for depositors' funds. On the contrary, bank savings retained the advantage of "settled consumer preference" due to coincident checking account relationships. In the Court's words, "customers are likely to maintain checking and savings accounts in the same local bank even when higher savings interest is available elsewhere." Since thrifts were not authorized to offer checking accounts, it was reasoned, consumers were willing to forego some interest for the convenience of one-stop banking.

Most importantly, perhaps, the Court has held that it is the cluster of products and services that full-service banks offer that makes banking a distinct line of commerce.

> 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. For some customers, full-service banking makes possible access to certain products or services that would otherwise be unavailable to them. . . .

The department store nature of banks, in other words, represents the only meaningful alternative for a significant class of customers—reducing the effective competition provided by nonbank firms. The Court recognizes that banks do face direct competition in some individual product and service lines, or submarkets (savings, personal loans, mortgage lending, etc.). Such submarkets, however, "are not a basis for the disregard of a broader line of commerce that has economic significance."[2]

In the Court's view, one-stop banking provides individual bank customers with unique access to the wide range of financial services a bank offers. Maintaining a personal checking account, for example, provides a customer with access to a wide range of other bank services, to seek free financial advice from bank management, and increases the chances of obtaining credit when needed. These services would not be available to a significant number of customers outside of the banking relationship, the Court argued. In addition, since customer-bank relationships were usually established because of locational convenience (near residence, employment, or within shopping patterns), bank customers could minimize the time and resources expended (transactions costs) searching for and obtaining financial services. In this way, the Court believed banks maintained a competitive advantage over thrifts and nondepository institutions and, therefore, the aggregate of bank products and services should be treated as the relevant product line for competitive analysis in bank consolidation proposals.

The uniqueness of some commercial bank products and services, cost advantages, "consumer preference," one-stop banking, and the importance of locational

[2] The Court declared that analysis of individual submarkets are appropriate, however, when considering the effect on competition of a merger between a commercial bank and another type of financial institution. United States v. Phillipsburg National Bank.

convenience have been the dominant considerations in the Court's position on the appropriate definition of the product market in bank merger cases. Locational convenience has also played a key role in Court and regulatory definitions of the geographic markets in competitive analyses.

The Philadelphia National Bank Case In United States v. Philadelphia National Bank, the Supreme Court stated that the area of effective competition in the known line of commerce must be selected from the market area in which the seller operates and to which the buyer *can practicably turn for supplies.* In banking, the Court observed that individuals and businesses typically do most of their business with banks in their local communities since they find it impractical to conduct their banking business at a distance.

The Court recognized that individual bank customers, however, have different capabilities in shopping for banking services—"the relevant geographical market is a function of each separate customer's economic scale." In general, said the Court, "the smaller the customer, the smaller is his banking market geographically." In the Court's view, both small borrowers and depositors were largely limited to their localities for the satisfaction of their financial needs. Large customers, on the other hand, often have convenient access to banking services outside the local area.

Since the economic scale of consumers of bank services varies, the Court settled on a "workable compromise" to "delineate the area in which bank customers that are neither very large nor very small find it practical to do their banking business." The Court acknowledged that this compromise could only approximate the geographic scope of the relevant market, and that "an element of fuzziness would seem inherent in any attempt to delineate the relevant geographical market." The use of a single "fuzzy" approximation of the geographic market flows directly from the choice of a single product line in banking—the cluster of bank products and services. Clearly, a disaggregated product line (e.g., demand deposits, consumer installment loans, commercial loans, etc.) might dictate the use of multiple geographic markets for analytical purposes, depending on the respective geographic areas over which the customers might practicably turn for alternative supplies.

To date, the Court has agreed with the federal banking agencies that the local area in which the banks had their offices was an area of effective competition. The competitive effects of proposed mergers, therefore, have generally been judged within localized geographic markets.

Analytical Method: Concentration Ratios Section 7 of the Clayton Act requires the banking agencies to determine whether the effect of a proposed merger may be to substantially lessen competition. In the Philadelphia National Bank case, the Court pointed out that a prediction of anticompetitive effects "is sound only if it is based upon a firm understanding of the structure of the relevant market; yet the relevant economic data are both complex and elusive." The Court felt that it was necessary to simplify the competitive analysis in order to provide a guideline for sound business planning and to insure that Congressional intent was not subverted.

In simplifying the test of illegality, the Court relied on a sense of intense Congressional concern with a trend toward concentration in the U. S. economy. This concern, said the Court, "warrants dispensing, in certain cases, with elaborate proof of market structure, market behavior, or probable anticompetitive effects." The Court thought that "a merger which produces a firm controlling an undue percentage share of the relevant market, and results in a significant increase in the concentration of firms in that market, is so inherently likely to lessen competition substantially that it must be enjoined in the absence of evidence clearly showing that the merger is not likely to have such anticompetitive effects." The Court endorsed the use of concentration ratios, therefore, as an indicator of proposed mergers.[3]

The Court accepts bank deposit concentration ratios as *prima facie* evidence in antitrust cases. The burden of proof is shifted to the banks to show that the ratios do not accurately depict the economic characteristics of the market. The Court requires banks to introduce "significant evidence of the absence of parallel behavior in the pricing or providing of commercial bank services" in the market. This is a

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[3] The use of concentration ratios is not based solely on grounds of simplification, but also has some empirical support. Concentration measures have been positively related with performance variables such as prices and profits for a wide range of industries, including banking. For a summary of this evidence, see Stephen Rhoades, "Structure and Performance Studies in Banking: A Summary and Evaluation," **Staff Economic Studies,** No. 92, Board of Governors of the Federal Reserve System, 1977. The Structure-Performance relationship has been questioned, however, by suggestions that concentration, instead of leading to collusive behavior, actually emerges from competitive behavior and reflects the superior performance of large firms. For example, see Yale Brozen, "The Concentration-Collusion Doctrine," **Antitrust Law Journal** (1977-78).

difficult task since, in the Court's own terms, relevant data is "complex and elusive."[4]

Competitive analysis has focused on shares of bank deposits (as a proxy for bank products and services) controlled by individual banks. Concentration ratios are calculated in cases involving banks determined to be presently competing within the same geographic market, as well as for cases involving banks operating in separate banking markets but viewed as potential or probable future competitors. In existing competition cases, mergers are generally prohibited if the combined market shares significantly increase concentration in the market. In the latter application, a consolidation is generally not allowed if it either (a) eliminates a procompetitive influence exerted by an outside bank on a concentrated market or (b) removes a likely entrant to a concentrated market that can reasonably be expected to contribute to the future deconcentration of the market.

Effects on Bank Markets The line of commerce view and the resultant analytical methodology have provided close approximations of actual competitive conditions in many banking markets. The policy has undoubtedly preserved competition among banking institutions in numerous markets by limiting banks' ability to buy out competitors. This has contributed to preventing increased banking concentration and possible adverse competitive consequences. In some markets, however, the predicted anticompetitive effects of a merger proposal may be overstated, resulting in denials of cases that could have been approved without significant anticompetitive results.

U. S. antitrust standards declare a consolidation is legal unless it tends to create a monopoly or substantially reduces competition. The concern is to prevent one firm or a small group of firms from gaining sufficient market power to charge monopoly prices and realize monopoly profits. In cases where the Court's view misrepresents the actual competitive situation in the market, however, prohibiting a bank consolidation may represent an unwarranted interference with the free flow of commerce. Competition can be stifled by not allowing bank ownership to pass from inefficient, unaggressive hands to more efficient, innovative control. The number of potential bidders for bank stock is reduced by limiting purchase by existing or potential market participants, reducing potential demand for bank stock, and lowering its market value.

Empirical studies indicate that banking is subject to economies of scale, at least for small- and medium-size banks. As output (measured by the number of accounts serviced) increases, average banking costs generally increase less than proportionally. Banks growing through consolidation, therefore, can often economize on resources used to provide banking services. Bank customers can expect to benefit from lower unit costs either through lower prices and/or service charges for bank products or through access to expanded output. If competitive pressures do not force banks to pass on savings to customers, bank profits may increase. Bank capital should benefit through increased retained earnings—enhancing bank asset growth.

The evidence on scale economies in banking has led George Benston to conclude that "unless a merger reduces meaningful competition, it should not be prevented. Otherwise, operating and other inefficiencies may be continued, desirable change stifled, and owners of resources prevented from using their property as they wish."[5] The vast majority of bank merger proposals, it should be noted, fall well within the range where economies might be anticipated. Since real private and social costs can result from prohibiting these consolidations, the analysis used in evaluating the competitive impact on the relevant product market should be sound.

Inherent Weaknesses The central core of the Supreme Court's line of commerce determination is its finding that the entire aggregate of bank products and services represents an economically significant market. "[I]t is the cluster of products and services that full-service banks offer that as a matter of trade reality makes commercial banking a distinct line of commerce."[6] This finding and the resulting methodology employed by the Court and banking agencies have been criticized since its inception. We believe this criticism reflects some basic flaws in the Court argument.

In a landmark case involving the definition of a relevant product market, the Court declared that "the

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[4] Demonstrating an absence of parallel behavior is difficult for products and services subjected to extensive regulatory price restrictions (e.g., prohibition of interest on demand deposits, deposit rate ceilings, and usury laws). Administered rates have regularly fallen below market rates, forcing institutions to uniformly pay (or charge) the maximum allowable rates. Price competition among depository institutions will be much greater following recent legislative changes.

[5] George Benston, "The Optimal Banking Structure: Theory and Evidence," **Journal of Bank Research** (Winter 1973), pp, 220-37.

[6] United States v. Philadelphia National Bank.

commodities reasonably interchangeable *by consumers* for the same purposes make up that part of the trade or commerce. . . ."[7] Based on this standard, it appears the Court has aggregated bank products and services beyond the point where commodities are reasonably interchangeable[8] by consumers.

The various products and services that banks offer appear to be customer-specific, i.e., they are directed toward specific customer groups. There are at least two distinct categories of customers that use bank services—individuals and commercial enterprises. Banks can be viewed as providing a cluster of consumer products and services to individuals (demand and savings deposits, consumer and mortgage credit, trust services. etc.) and a separate cluster to businesses (cash management services, commercial and industrial loans, etc.). Though individual customers may well benefit from the provision of either of these clusters by a single institution, there is very little reason to expect that individuals or businesses utilize both clusters. There seems to be little or no crossover across cluster categories by customers. The financial needs of each group are distinct and serve to restrict their respective demands to different clusters of bank products and services. Planning and marketing activities reflect this with separate consumer and corporate departments within banks and separate advertising programs. Indeed, many banks have chosen to specialize almost exclusively in either the retail or wholesale sides of the business.

Contrary to the Court's assertion, the entire bank product line, therefore, does not appear to have economic significance—it does not appear to be a relevant market—for it is not marketed to any one class of customers. It is only across the cluster of consumer products and services that the pricing or service level decisions of the commercial bank can have an impact on its consumer clientele.

At the same time, the Court's definition of the line of commerce in commercial banking excludes products and services of other institutions that are "interchangeable" with or close substitutes for individual bank services. Empirical evidence reveals that a high cross-elasticity of demand exists between bank time deposits and savings deposits at thrifts. Moreover, disintermediation from both bank and thrift deposits, when market interest rates increase relative to deposit rates, indicates that other market instruments are at least partial substitutes for these services. Close substitutes for various bank credit services are similarly offered by nonbank institutions. Banks cannot make pricing decisions without regard to the availability of substitute products from both bank and nonbank institutions. Yet the accepted analytical methodology implies they can.

Use of concentration ratios, including only bank deposits, ignores the competitive influences exerted by thrifts and other institutions that supply substitute services. Since the Court's analysis is not affected by the presence of competition for individual bank services from nonbank firms, the significance of computed concentration percentages has been seriously questioned. The Court "blithely assumes that percentages of the same magnitude represent the same degree of market power, irrespective of the amount of competition from neighboring markets." It thus ignores "the extent to which competition from savings and loan associations, mutual savings banks, and other financial institutions that are not commercial banks affects the market power of banks."[9]

If concentration ratios misrepresent the market power of banks, and the existence of nonbank institutions in the market also affects banks' ability to influence prices, the predictive usefulness of concentration ratios that exclude those institutions is diminished. In particular, judgments based solely on bank deposit concentration, ignoring competitive realities in the market, may overestimate adverse competitive effects, leading to unwarranted denials of bank consolidation proposals.

The Court and banking agencies appear at least aware of the danger of sole reliance on concentration ratios. In a 1974 decision,[10] the Court acknowledged that concentration ratios "can be unreliable indicators of actual market behavior." In addition, the Comptroller of the Currency and Federal Reserve Board have given limited consideration in recent years to the competitive presence of thrifts in assessing anticompetitive consequences of proposed mergers. Concentration ratios are sometimes "shaded" to reflect

[7] United States v. DuPont & Co., 351 U.S. 377, 395 (1956). The emphasis in this determination, it should be noted, is on the demand characteristics of the consumers of the product.

[8] The Court declared that interchangeability can be shown by demonstrating either (a) products perform the same function or (b) the responsiveness of the sales of one product to changes in the price of the other (high price cross-elasticity of demand). If "a high cross-elasticity of demand exists between them; . . . the products compete in the same market."

[9] Justice Harlan, joined in part by Chief Justice Burger, in a dissenting opinion to the Phillipsburg decision.

[10] United States v. Marine Bancorporation, 418 U.S. 602 (1974).

significant competition from thrifts when concentration data suggest the case might be borderline.[11]

Erosion by Innovations and New Competition However justified and effective established interpretations have been in preserving and promoting competition for banking services, competitive forces in these markets have not stood still. Today, banks face intensive competition across a rapidly broadening scope of product and geographic markets from other banks, thrifts, and other financial and nonfinancial firms. This evolving competition represents an attempt by the market system to meet the financial requirements of the U. S. economy. Price, product, and geographic restrictions have limited the ability of banks to fulfill these needs and have induced unregulated sectors of the economy to fill the void.

The new competition banks face has seriously undermined the relevance of some of the Court determinations in bank competition cases. Today, banks no longer enjoy a monopoly in the provision of transaction accounts to consumers. At the same time, banks are experiencing an all-out invasion of their other product as well as geographic markets from both traditional and new competitors. In addition, cost advantages banks may have once enjoyed over competitors have largely been eliminated as banks increasingly rely on market sources of funds purchased at market interest rates. The thesis that banks enjoy a "settled consumer preference" over competing institutions is hardly supported by the evidence. Finally, strong economic forces are inducing banks and other institutions to "unbundle" service packages and separately market and price financial services.

The Supreme Court deemed some bank services as so unique that they are entirely free of competition from other financial institutions. Demand deposits, commercial loans, trust services, and credit card plans were cited at various times to distinguish banks from nonbank institutions. Developments in recent years, however, suggest that the strength of this argument has been greatly diminished.

Checking accounts were first subjected to thrift competition when S&Ls were authorized to allow telephone transfers from savings accounts to third parties in the 1960s. In 1970, S&Ls were permitted to make preauthorized nonnegotiable transfers from savings accounts to third parties for household related expenditures. This authority was expanded to cover any expenditure in 1975. In a major development in 1972, state chartered mutual savings banks began offering Negotiable Order of Withdrawal (NOW) accounts in Massachusetts and New Hampshire. In 1974, Congress authorized all depository institutions in the two states to offer such accounts, a privilege extended to the remaining New England states in 1976, New York in 1978, and New Jersey in 1979. Pennsylvania savings banks also offered an instrument perceived by the public to be the functional equivalent of checks, the NINOW or noninterest-bearing NOW account. The direct competition between banks and thrifts for these transaction accounts has been fierce.

In response to the apparent success of the NOW experiment, in late 1978 federal regulators authorized automatic transfers from savings to checking accounts nationwide for banks. The Consumer Checking Account Equity Act of 1980 extends NOW account authority nationwide to all federally insured banks, savings banks, and S&Ls.

Another development of large dimension was the credit union share draft, first authorized on an experimental basis in 1974 and made permanent in 1978. Share drafts and consumer lending powers at credit unions present major new competition for banks, since there are over 22,000 credit unions in the country with total membership including nearly 25 percent of all American households.

The new banking legislation also expands the ability of S&Ls to compete effectively with banks for consumer business. S&Ls are newly enabled to diversify their portfolios to hold up to 20 percent of total assets in consumer loans, commercial paper, and corporate debt securities. They are further authorized to engage in credit card operations and to exercise trust powers similar to national banks. These services eliminate several key distinctions between banks and S&Ls, at least with respect to services offered to consumers.

In addition, S&Ls do make commercial and business loans secured by real estate and, since the 1960s, have offered savings accounts to state and local governments and businesses. Savings banks generally have wider authority to provide business services. In several states these institutions can make commercial and business loans. Though these institutions have not presented major competition to bank commercial services to date, the recent legislation authorizing federally chartered savings banks to hold

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11 A Board order involving First Bancorp of New Hampshire (November 2, 1978), for example, noted that "thrift institutions held a significant amount of deposits which lessened the severity of the effects of the proposed transaction on competition in the market." More recently, the Board approved a large New Jersey bank merger, citing significant thrift competition as a factor (Fidelity Union Bancorporation, June 5, 1980).

up to five percent of their assets in commercial and industrial loans and to accept business demand deposits should give significant impetus to increased competition.

In some key aspects thrifts might even enjoy some competitive advantages over banks. Federally chartered S&Ls enjoy statewide branching privileges in limited-branching and unit-banking states. In addition, through Remote Service Units, S&Ls allow customers to make deposits to and withdrawals from accounts at stores and other places away from the institution's offices. The competitive position of thrifts relative to banks is further enhanced by the 1980 Depository Institutions Deregulation Act provision continuing the ¼ percent differential interest rate ceiling structure for six years.

A second development undermining the Supreme Court arguments supporting the line of commerce view has been the sharp rise in the cost of bank funds. The dominance of noninterest-bearing demand deposits in bank liability structures has been steadily eroded by inflation, high interest rates, and the resulting efforts of consumers and business to economize on holdings of idle, nonearning cash balances. In 1960, demand deposits held by individuals, partnerships, and corporations accounted for 63 percent of total bank liabilities. This figure fell to 40 percent by 1970 and stood at only 31 percent in 1978.[12] Much of the growth in bank time and savings deposits has taken place in negotiable certificates of deposit and other time deposits, particularly those categories exempted from interest rate ceilings. Banks' commercial customers have further attempted to minimize cash balances through use of repurchase agreements that allow firms to earn market interest on excess transactions balances.

Increased reliance on the Federal funds market and other categories such as Eurodollar borrowings have also expanded the portion of bank funds acquired under market conditions. The result has been a sharp increase in banks' marginal cost of funds. Since the *marginal* cost of funds is the prime determinant of bank prices, competitive cost advantages banks once may have enjoyed over nonbank competitors such as finance companies have largely evaporated. In addition, it is not true today that finance companies rely on bank loans as a major source of funds. These companies derive most of their funds from the corporate debt and commercial paper markets, with bank loans accounting for only a small portion.

Relative growth rates of savings deposits in recent years also calls into question the Court argument that banks enjoy a "settled consumer preference" in the competition for consumers' savings due to the convenience of maintaining savings and checking accounts at one institution. Recognizing that competition for the savings dollar among banks and thrift institutions had increased, a 1968 District Court decision[13] concluded that a settled consumer preference no longer prevailed. Competition among these institutions, therefore, was required to be reflected in the concentration ratios used to measure competition.

The nationwide extension of transaction accounts to thrifts suggests these institutions may be the ultimate beneficiaries of "consumers' preference" in the coming years. Though banks and thrifts can both pay 5¼ percent interest on NOW accounts, thrifts are initially pricing this service more liberally than banks (lower minimum balance requirements, etc.). Continuation of the interest differential on savings along with more liberal branching authority in many states may provide a competitive advantage for thrifts. In addition, credit union share drafts pay higher interest than NOW or ATS accounts. We might expect to see, therefore, an acceleration of growth of savings and small time deposits at thrifts relative to commercial banks.

Finally, economic conditions, innovations in financial markets, and new technology are breaking down traditional methods of marketing banking services. Banking customers are more interest-sensitive than ever before and are demanding higher yields for surplus funds. In response, the financial system is clearly moving toward payment of market rates for all categories of funds. Institutions resisting this trend will experience a reduced ability to attract customers. Government policymakers recognize that restrictions on depository institutions' ability to pay market rates on deposits has contributed greatly to the rapid growth of "near-deposit" market instruments, most notably money market fund shares that reached the $80 billion asset level by mid-1980. These funds provide a highly liquid, low denomination investment yielding a market return not subject to Regulation Q or deposit reserve requirements. To a limited degree, they can even be used as transaction accounts.

In this new environment, an increasing proportion

[12] Marvin Goodfriend, James Parthemos, and Bruce Summers, "Recent Financial Innovations: Causes, Consequences for the Payments System, and Implications for Monetary Control," **Economic Review**, Federal Reserve Bank of Richmond (March/April 1980).

[13] United States v. Provident National Bank, 280 F Supp. 1 E. D. Pa. 1968.

of bank business will likely be conducted on an explicit price basis. Customers receiving market interest on deposits can expect to pay full-cost prices for other services provided by their depository institutions. It may no longer be feasible for firms to offer a wide range of specialized services to their depositors free or at subsidized prices. Another force contributing to this result is recent legislation requiring the Federal Reserve System to charge explicit, per-unit prices for the payment system services provided to depository institutions. These charges, by necessity, will also be passed on to customers.

The emergence of an explicit pricing environment should contribute to the further "unbundling" of bank products and services. Explicit pricing may also reduce customers' costs of obtaining information about financial services. This may reduce the importance of locational convenience in banking relationships—especially in an electronic banking environment.

Electronic Funds Transfer Systems are reducing the importance of one-stop banking. Proliferation of credit and debit cards, preauthorized transfers, automated teller machines, point-of-sale terminals, as well as telephone and mail banking, expand the geographic scope of the "locally-limited" customer and increase the ability of distant institutions to provide effective competition in local areas. As a result, increased scrutiny of geographic as well as product markets will be required in bank consolidation cases.

Changes in Competitive Analysis Some disaggregation of the relevant bank product line seems necessary, therefore, before economically relevant markets can be defined for antitrust purposes. At the same time, significant competition from nonbank firms that affects banks' ability to set prices and service levels must be included in the competitive analysis. We are not suggesting total disaggregation and examination of concentration ratios for every individual service line. Some aggregation still seems relevant. For instance, treating the consumer and commercial (or retail and wholesale) sides of banking as separate lines of commerce would allow an analysis of competition in the products and services produced by institutions separated according to the *types of customers* that use them. This treatment would appear consistent with the emphasis the Court placed on customer demand characteristics in its definition of a relevant product market in United States v. DuPont.

Disaggregation and analysis of multiple product markets will require careful evaluation of the relevant geographical markets over which customers can "practicably turn for supplies." Clearly, the potential of electronic banking and the possibilities of relaxing prohibitions on interstate banking in the near future will blur geographic delineations and require an intensified research effort in this area.

It is our belief that there is no longer sufficient justification for excluding thrift institutions from the competitive analysis in markets for consumer services. These institutions have now attained the status of being fully competitive with banks. In fact, until the interest differential on savings and branching differences are eliminated, thrifts may even enjoy a clear advantage in competing for consumer business. Their deposits should be included, therefore, in the calculation of concentration ratios for antitrust purposes.

Considering the limitations placed on the ability of savings and loan associations and credit unions to compete for commercial business, however, these institutions can probably continue to be excluded from the analysis of the market for commercial services. This may not be the case for mutual savings banks with their commercial lending and deposit-taking powers. The Supreme Court apparently anticipated the inclusion of these institutions as competitors with banks: "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."[14]

A disaggregation of the product line into consumer and commercial categories would require dual analyses, possibly involving the use of an expanded geographic market definition for business services. With this methodology it might be possible to conclude, for instance, that a proposed acquisition would have no significantly adverse competitive consequences on the market for consumer banking services (based on personal deposit market shares) while the impact on the business product line (based on business deposits or commercial loan shares) warrants denial of the application.

The above suggestions are by no means definitive. They are viewed merely as the *minimum* changes necessary at the present time to reflect competitive reality in the marketplace. They may only represent the initial recognition on the part of the Courts and the regulators of the evolution underway in banking competition.

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[14] United States v. Connecticut National Bank.