Convenience and needs: a post-audit survey

David R. Allardice

Review of bank holding company applications submitted in the Seventh Federal Reserve District during the first half of the 1970s shows that, on average, holding companies made few firm commitments to change or expand services of the banks they acquired. It appears, however, that where changes were proposed, the holding companies carried through with the proposals. Compliance with proposed changes tended to benefit the banking public by leading to longer banking hours and improved bank facilities.

These findings were the result of a survey conducted in an effort to determine the kind of changes in bank services usually proposed in bank holding company applications and the extent to which holding companies lived up to the proposals.

Convenience and needs criteria

In considering bank holding company applications, whether to form the company itself or for the company to acquire a subsidiary bank, the Federal Reserve considers the effect on competition, the financial and managerial resources of the applicant and prospects for its success, and the convenience and needs of the public.

Crucial to the decision is whether approval of the application will have anticompetitive effects. The Bank Holding Company Act, however, allows slightly adverse competitive effects to be outweighed by considerations of convenience and needs. Though the act does not define what is meant by "convenience and needs," a review of orders issued by the Federal Reserve, both approving or denying applications, provides some insight into what types of changes bear on convenience and needs.

Generally, any change that increases the number of banking services, improves the quality of service, or expands the geographic scope of banking operations can be viewed as promoting the convenience and needs of the banking community. The public also benefits from changes that cut the cost of bank operations, to the extent, at least, that the cost reduction is passed on to the public in the form of lower charges for bank services and loans or higher rates of return on deposits.

These orders show the Federal Reserve has given particular attention to the introduction of new services not available in a banking market. Saturday banking hours, overdraft checking, accounts receivable financing, and trust and credit card services—all have been cited as services contributing to the convenience and needs of the public.

To help in its determination of whether an application should be approved, the Federal Reserve asks applicants to describe the changes they expect to make and the new services they plan to offer. Though holding company responses vary from "no change" to detailed discussion of the services to be offered, the answers are usually taken by the Federal Reserve as consistent with approval of the application. Except in rare instances, as for example, where the bank to be acquired is floundering, consideration of convenience and needs is seldom given the same weight as adverse competitive effects.

Little effort has been made to show the extent to which holding companies have lived up to their commitments to meet the convenience and needs of the public. Part of the problem is that without measures that can be

NOTE: A more detailed presentation of the findings reported in this article may be found in *Convenience and Needs Considerations: A Post-Audit Survey*, by David R. Allardice, Staff Memorandum No. 78-2, Federal Reserve Bank of Chicago.

statistically quantified, there is little way to judge how well companies have met their commitments. But if some companies have done well in providing new services, a moderate policy shift that put more emphasis on convenience and needs might be warranted. On the other hand, if some companies have not done well, further acquisitions might be denied where the competitive effects are slightly adverse, unless the company is willing to enter a binding agreement to provide additional services.

Few commitments to change

To see how well plans for meeting convenience and needs had been translated into public benefits, 44 of the bank holding company applications approved in the Seventh Federal Reserve District from 1971 through 1976 were selected for review. These applications were filed by 24 holding companies for the acquisition of banks in Iowa, Michigan, and Wisconsin—the three states of the district that allow multibank holding companies. Though most of the acquisitions were by multibank holding companies, some of the cases reviewed involved one-bank holding companies.

For purposes of analysis, plans and intentions stipulated in the applications were broken down into seven main areas. These were plans involving demand deposit accounts, time and savings accounts, loan interest rates and maturities, loan and investment portfolios, physical facilities, banking hours, and any new or expanded services. On the whole, holding company statements of planned alterations in these seven areas were often ambiguous, firm commitments to change being the exception rather than the rule.

Often vague and nearly always lacking in detail, all applications, nevertheless, showed plans for at least one improvement in service. Over two-thirds of the companies said they would either expand trust services or initiate trust services at the bank for the first time. Also frequently mentioned—often to be provided through nonbank subsidiaries—were computer services, credit cards, training for bank employees, and audit services.

In areas where specific responses are required, the survey showed applicants often responded "no change." About 70 percent of the applications indicated the companies did not intend to change loan rates or maturities at the acquired bank. In nearly that many

Characteristics of banks and holding companies surveyed

1. Location.

State	Number of banks	Number of holding companies
Iowa	2	1
in SMSA	2	
not in SMSA	0	
Michigan	31	14
in SMSA	19	
not in SMSA	12	
Wisconsin	11	9
in SMSA	5	
not in SMSA	6	
Total	44	24

2. Bank size, deposits as of December 31, 1976.

State	Mean	Largest	Smallest
		(million dollars)	
Iowa	14.0	14.6	13.3
Michigan	29.1	175.6	2.7
Wisconsin	18.7	33.4	8.8

3. Holding company size, deposits as of December 31, 1976.

State	Mean	Largest	Smallest
		(million dollars)	
Iowa	501.8	501.8	501.8
Michigan	987.4	4,801.7	22.5
Wisconsin	526.7	2,356.7	10.2

Comparison of planned changes to actual changes

	Planned changes		Actual changes		
	No change	Some alteration mentioned	No change	More services than planned	Less services than planned
			(percent)		
Demand deposits	57	43	45	9	18
Time and savings deposits	54	46	32	14	4
Loan rates and maturities	70	30	39	14	16
Portfolio alteration	27	73	16	n.a.	16
Physical facilities	36	64	20	25	14
Banking hours	68	32	59	18	7
New expanded services	7	93	2	14	n.a.

n.a. Not applicable due to nature of question or type of response.

cases, there was no commitment to change the hours the banks would be open. In over half the cases, there was no firm commitment to change pricing or service policies for either demand accounts or time and savings accounts.

Most commitments fulfilled

The survey showed most holding companies had complied with their commitments. In almost all instances where companies had planned at least one improvement in services, some change had been made. In some instances, the change was not the one described in the application. An applicant might, for example, have planned international banking services but instead provided leasing services. In some cases, companies made more changes than originally planned. In a fourth of the cases, for example, more changes in physical facilities were made than planned at the time of the application.

While applicants tended generally to comply with their commitments, there were exceptions. In 18 percent of the acquisitions, for example, the change in demand deposit services fell short of the plans stated in the application. If a company said, for example, overdraft checking would be provided and it was not, it was concluded that less service had been provided than planned. In 16 percent of the acquisitons, the company did not make the change it said it would in loan rates and maturities. There was about the same proportion of failures to make the changes planned in loan or investment portfolios.

These instances of noncompliance raise questions of whether holding companies were inclined to promise more than they could deliver, whether they were intentionally misleading in their statements, and whether there were other factors that prevented them from carrying out their plans.

The survey provided some answers to these questions. Given the low percentage of noncompliance and the number of instances where acquired banks provided more services than planned, it is hard to conclude that there was any systematic effort on the part of companies to be misleading in their statements. It is also hard to figure that the companies committed themselves to more than they could deliver. This conclusion is based, in part, on the fact that as most of the companies surveyed rank among the larger banking organizations in their states, they have the financial and managerial resources to provide most modern banking services.

In response to the survey, however, several companies cited external factors as reasons for their delay in making proposed changes in banking services. These external factors include, for example, higher operating and construction costs, which were cited by some companies as being partially responsible for delays in expansion projects. Others cited internal factors, such as changes in the management structure of the acquired bank that led to postponements in changes in services. Consideration of these factors, along with a review of the cases themselves, lead to the conclusion that the reasons for not complying are often the applicant company's inaccurate appraisal of market conditions and inadequate attention to details of the changes they propose, special problems of the acquired banks, or some combination of the two.

Reasons for making changes

As part of the survey, companies were asked what factors they considered most important in the initiation of changes in services and operations at the banks they acquired.

Operating policies of the holding companies themselves were listed most often as the main reason for changes. Next in importance was customer demand for new and improved banking services, followed by competitive pressures from other banks in the local market and management policies of the acquired bank.

Companies did not consider competitive pressure from commercial banks outside the immediate area very important in stimulating change in the bank's services and operations. Nor did they consider competition from other financial institutions, such as savings and loan associations, outside the area important in influencing changes.

Much attention has been given in recent years to technological changes in banking, such as the introduction of automated teller machines. Surprisingly, the companies did not consider technological changes alone as significant factors in bringing about changes in services and operations of acquired banks.

Influence of holding companies

Though data show the holding companies committed themselves to few changes in the services and operations of the banks they acquired, the data must be interpreted with care.

A reply of "no change," for example, could indicate the acquired bank was already meeting the convenience and needs of the community when it was acquired. If it was already offering free or low-cost checking accounts, if it was already staying open longer than other banks, if it was already in a modern building, or if it was already paying ceiling rates on time and savings accounts—clearly there would have been little opportunity for a measurable improvement in the situation.

Also, a "no change" reply could indicate that in the early stages of preparing the application the holding company was not familiar enough with the operations of the bank or its competitive situation to commit itself to major changes in the bank's operations. Tentative support for this proposition can be found in applications stipulating that changes would be considered upon approval of the application and after the company had studied the needs of the bank.

In addition, a reply of no change could reflect the lack of flexibility banks have in changing some of their rates and services. Asked whether the acquired bank would increase the rates paid on time and savings deposits, for example, applicants often answered, "no change—except as permitted by regulation." This answer implies the bank was already paying the highest rates allowed.

Despite the gap between the improvements in services that were planned and the improvements that were finally made, in almost every instance, at least some change was made—though the changes made were not always the changes mentioned in the application. The study showed applicants had problems complying with commitments they made in three areas: changes relating to service charges on demand deposit accounts, in the composition of the loan and investment portfolios, and in loan rates and maturity terms. These are three areas that applicants should probably give close attention in the future.

The study further showed that holding companies will probably modify the physical facilities of the acquired bank. If the hours of operation are changed, they are apt to be longer. And if ceilings permit, interest rates paid on time and savings deposits can be expected to rise rather than fall.

Where companies did not comply, the failures were more often errors of omission than commission. The study indicates a need for more accurate appraisals of market conditions and closer attention to detail in the types of changes planned for acquired banks and the banking needs of the communities they serve.