

FEDERAL RESERVE SYSTEM

J.P. Morgan Chase & Co.
New York, New York

Order Approving Acquisition of a Savings Association

J.P. Morgan Chase & Co. (“Morgan Chase”), a financial holding company within the meaning of the Bank Holding Company Act (“BHC Act”), has requested the Board’s approval to acquire all the voting shares of Chase FSB, Newark, Delaware, a *de novo* federal savings bank, pursuant to section 4(c)(8) and 4(j) of the Bank Holding Company Act (12 U.S.C. § 1843(c)(8) and 1843(j)) (“BHC Act”) and section 225.24 of the Board’s Regulation Y (12 C.F.R. 225.24).¹

Notice of the proposal, affording interested persons an opportunity to submit comments, has been published (68 Federal Register 68,925 (2003)), and the time for filing comments has expired. The Board has considered the proposal and all comments received in light of the factors set forth in section 4 of the BHC Act.

Morgan Chase, with total consolidated assets of \$771 billion, is the second largest banking organization in the United States.² Morgan Chase controls \$194.5 billion in deposits in depository institutions nationwide, representing approximately 4 percent of the total deposits in insured depository institutions in the United States.³ Morgan Chase proposes to operate Chase FSB as a direct

¹ Morgan Chase has previously received the required approvals to establish Chase FSB from the Office of Thrift Supervision (“OTS”) on November 28, 2003, and from the Federal Deposit Insurance Corporation on December 3, 2003.

² Asset data for Morgan Chase are as of December 31, 2003, and nationwide ranking data are as of September 30, 2003.

³ Deposit data are as of September 30, 2003. In this context, depository institutions include commercial banks, savings banks, and savings associations.

subsidiary that will market and originate certain retail and consumer finance products currently offered by other Morgan Chase subsidiaries. Morgan Chase has represented that it intends for Chase FSB to principally serve the national market, which Morgan Chase describes as the United States outside the tri-state area of New York, New Jersey, and Connecticut. Morgan Chase would continue to serve its retail banking customers in the tri-state area principally through JPMorgan Chase Bank, New York, New York (“JPMCB”), Morgan Chase’s lead subsidiary bank. Chase FSB’s activities would initially focus on home mortgage lending, marketing of credit cards, and automotive finance.⁴ To facilitate these activities, 302 offices throughout the United States of Chase Manhattan Mortgage Corporation, Edison, New Jersey (“CMMC”), which is Morgan Chase’s principal mortgage lending subsidiary, would become offices of Chase FSB.⁵

The Board previously has determined by regulation that the operation of a savings association by a bank holding company is closely related to banking for purposes of section 4(c)(8) of the BHC Act.⁶ The Board is required to review each proposal by a bank holding company to acquire a savings association.⁷ In reviewing the proposal, the Board is required by section 4(j)(2)(A) of the BHC Act to determine that the acquisition of Chase FSB by Morgan Chase “can reasonably

⁴ Chase FSB will market credit cards issued by Chase Manhattan Bank USA, N.A., Newark, Delaware (“Chase USA”), which currently issues all Morgan Chase credit cards. Chase USA’s automotive finance business will be transferred to Chase FSB.

⁵ Of these 302 offices, 19 will be administrative offices not open to the public. The remainder will be loan production offices of Chase FSB.

⁶ 12 C.F.R. 225.28(b)(4)(ii).

⁷ 12 U.S.C. § 1843(j) and 1843(k)(6)(B).

be expected to produce benefits to the public ... that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interests, or unsound banking practices.”⁸ As part of its evaluation of a proposal under these public interest factors, the Board reviews the financial and managerial resources of the companies involved as well as the effect of the proposal on competition in the relevant markets.⁹ In acting on notices to acquire a savings association, the Board also reviews the records of performance of the relevant insured depository institutions under the Community Reinvestment Act (12 U.S.C. § 2901 et seq.) (“CRA”).¹⁰

Competitive Considerations

As part of its consideration of the public interest factors under section 4 of the BHC Act, the Board has considered carefully the competitive effects of the proposal in the relevant markets in light of all the facts of record. The proposal involves the formation of a *de novo* savings association that would operate nationwide.

Commencement of activities *de novo* is presumed under Regulation Y to result in benefits to the public through increased competition in the market for banking and similar services.¹¹ The proposed acquisition would have no adverse effect on the concentration of banking resources in any relevant banking market. Moreover, the Board has received no objections to the proposal from the Department of Justice or any federal banking agency. In light of all the facts of

⁸ 12 U.S.C. § 1843(j)(2)(A).

⁹ 12 C.F.R. 225.26.

¹⁰ See, e.g., Banc One Corporation, Inc., 83 Federal Reserve Bulletin 602 (1997).

¹¹ See 12 C.F.R. 225.26(c).

record, the Board concludes that consummation of the proposed transaction would not result in a significantly adverse effect on competition or on the concentration of banking resources in any relevant banking market, and that competitive factors are consistent with approval.

Financial and Managerial Factors

In reviewing the proposal under section 4 of the BHC Act, the Board also has carefully reviewed the financial and managerial resources of Morgan Chase and Chase FSB. The Board has reviewed these factors in light of all the facts of record, including confidential reports of examination assessing the financial and managerial resources of Morgan Chase and its subsidiary banks, information provided by Morgan Chase, and public comments on the proposal.¹² In addition, the Board has consulted with the OTS, which will be the primary federal regulator of Chase FSB. The Board notes that Morgan Chase and its

¹² A commenter opposing the proposal cited press reports of Morgan Chase's connection to investigations, lawsuits, and settlements relating to Enron Corp. and asserted that these issues reflected unfavorably on the managerial resources of JPMCB. The commenter also provided press reports of litigation involving the acquisition of a small number of mortgage loans from a mortgage broker by CMMC and asserted that Morgan Chase and CMMC lacked adequate policies and procedures for monitoring the acquisition of loans on the secondary market. The Board previously has considered these comments in the context of a recent application by JPMCB to acquire trust deposits from subsidiary banks of Bank One Corporation, Chicago, Illinois, and hereby adopts the findings in that case. See JPMorgan Chase Bank, 89 Federal Reserve Bulletin 511, 512 (2003) ("JPMCB/Bank One Order").

In addition, the commenter raised concerns about an investigation by the Oregon Department of Justice ("Oregon DOJ") into the alleged use by borrowers of fraudulent Social Security numbers in three mortgage loans underwritten by CMMC. By a letter dated June 10, 2003, to CMMC, the Oregon DOJ closed its inquiry into this matter due to "insufficient evidence."

subsidiary depository institutions currently are well capitalized and are expected to remain so after consummation of the proposal. Chase FSB also would be well capitalized at consummation. Based on all the facts of record, the Board concludes that the financial and managerial resources of the institutions involved are consistent with approval of the proposal.¹³

Records of Performance Under the Community Reinvestment Act

As previously noted, the Board reviews the records of performance under the CRA of the relevant insured depository institutions when acting on a notice to acquire any insured depository institution, including a savings association. The CRA requires the Board to assess each insured depository institution's record of meeting the credit needs of its entire community, including low- and moderate-income neighborhoods, consistent with the institution's safe and sound operation, and to take this record into account in evaluating bank holding company notices.¹⁴

The Board has carefully considered the CRA performance records of each subsidiary insured depository institution of Morgan Chase in light of all the facts of record, including public comments on the proposal. A commenter opposing the proposal has alleged, based on data reported under the Home Mortgage Disclosure Act ("HMDA"),¹⁵ that CMMC denied home mortgage loan

¹³ After consulting with the OTS and reviewing all the facts of record, including in particular its approval of Morgan Chase's application to form Chase FSB (OTS Order No. 2003-60 (Nov. 28, 2003)), the Board also has determined that, on consummation of the proposal, Chase FSB would be well managed for purposes of section 4(l) of the BHC Act (12 U.S.C. § 1843(l)).

¹⁴ 12 U.S.C. § 2903.

¹⁵ 12 U.S.C. § 2801 et seq.

applications from minorities more frequently than it denied applications from nonminorities in certain Metropolitan Statistical Areas (“MSAs”).¹⁶

A. CRA Performance Examinations

An institution’s most recent CRA performance evaluation is a particularly important consideration in the notice process because it represents a detailed, on-site evaluation of the institution’s overall record of performance under the CRA by its appropriate supervisor.¹⁷ JPMCB and Chase USA have each received “Outstanding” ratings from their respective regulators at their most recent examinations for CRA performance.¹⁸ Examiners commended the community development lending of both JPMCB and Chase USA. JPMCB was also found to have an excellent level of qualified investments and to be a leader in providing community development services. Examiners also praised Chase USA’s flexible loan programs and found it to be very responsive to the credit and community development needs of its assessment area.

¹⁶ The commenter expressed concern that the formation of Chase FSB would permit Morgan Chase to transfer its retail lending operations to an OTS-regulated institution with the result that consumer protection laws of the individual states would be preempted. As noted above, bank holding companies are permitted by law to own and control federal savings associations. 12 C.F.R. 225.28(b)(4)(ii). The applicability of state laws to federal savings associations is a matter within the jurisdiction of the OTS to determine.

The commenter also alleged that CMMC’s purchase of certain mortgage loans on the secondary market enabled predatory lending by an unaffiliated consumer lender. The Board previously considered the remedial steps taken by CMMC in this matter and hereby adopts its conclusions in that case. See JPMCB/Bank One Order at 512.

¹⁷ See Interagency Questions and Answers Regarding Community Reinvestment, 66 Federal Register 36,620 and 36,639 (2001).

¹⁸ Ratings as of November 12, 2001, by the New York State Banking Department and March 3, 2003, by the Office of the Comptroller of the Currency, respectively.

The record of Morgan Chase in operating these insured depository institutions indicates that it has the experience and expertise to establish and implement appropriate CRA policies and programs at Chase FSB. The OTS will evaluate Chase FSB's record of CRA-related lending based on its actual lending performance after Chase FSB opens for business. Chase FSB intends to invest in funds that develop low-income residential rental properties in states where it is a major mortgage lender and to seek community development service opportunities in its assessment area.¹⁹ Chase FSB also intends to provide grants to community development organizations in its assessment area and to large regional and national organizations that are active in Chase FSB's top national markets.

B. HMDA Data and Fair Lending Record

The Board has carefully considered the lending records and HMDA data of JPMCB, CMMC, and Chase USA in light of the comments received.²⁰ Based on 2002 HMDA data, the commenter alleged that CMMC disproportionately excluded or denied African-American and Hispanic applicants for home mortgage loans in various MSAs in twelve states and the District of Columbia.²¹ The commenter asserted that CMMC's denial rates for minority

¹⁹ In approving Morgan Chase's application to organize Chase FSB, the OTS concluded that Chase FSB has satisfactorily demonstrated that it will meet its CRA objectives. OTS Order No. 2003-60 (Nov. 28, 2003).

²⁰ The Board has reviewed HMDA data reported by JPMCB, CMMC, and Chase USA in 2001 and 2002 in the markets of concern to the commenter. The Board included data submitted by Chase USA in its review because, as noted above, Chase USA was the parent of CMMC until March 2002. CMMC is now a subsidiary of JPMCB.

²¹ In response, JPMCB noted that the commenter's analysis was based on data from only a few MSAs and included only conventional home purchase loans

applicants were higher than the rate for nonminority applicants, and that CMMC's denial disparity ratios compared unfavorably with those ratios for the aggregate of lenders in the MSAs.²² In the JPMCB/Bank One Order, the Board considered substantially similar comments about Morgan Chase's HMDA data for MSAs in eight of these states and the District of Columbia, and the Board's analysis of Morgan Chase's HMDA data in that order is incorporated by reference.²³

For the MSAs cited by the commenter in Colorado, Mississippi, Oregon, and Washington, the denial disparity ratios reflected in the 2002 HMDA data reported by JPMCB, CMMC, and Chase USA generally were more favorable than or comparable with the ratios reported by the aggregate of lenders in three of the four markets reviewed. The denial disparity ratio approximated, but was somewhat less favorable than, the ratio for the aggregate in the Portland MSA for African Americans.

The HMDA data do not indicate that JPMCB, CMMC, or Chase USA has excluded any segment of the population or any geographic area on a prohibited basis. The Board, nevertheless, is concerned when the record of an institution indicates disparities in lending and believes that all banks are obligated to ensure

originated by CMMC in 2002, and that the sample, therefore, was too small to represent JPMCB's overall mortgage lending performance.

²² The denial disparity ratio equals the denial rate for a particular racial category (for example, African American) divided by the denial rate for whites.

²³ The MSAs reviewed by the Board in the JPMCB/Bank One Order were Benton Harbor and Detroit, both in Michigan; Boston, Massachusetts; Dallas, Texas; Memphis, Tennessee; Raleigh, North Carolina; Richmond, Virginia; San Francisco, California; St. Louis, Missouri; and Washington, DC. The new MSAs reviewed in connection with this order are Denver, Colorado; Jackson, Mississippi; Portland, Oregon; and Seattle, Washington.

that their lending practices are based on criteria that ensure not only safe and sound lending, but also equal access to credit by creditworthy applicants regardless of race or income level. The Board recognizes, however, that HMDA data alone provide an incomplete measure of an institution's lending in its community because these data cover only a few categories of housing-related lending. HMDA data, moreover, provide only limited information about covered loans.²⁴ HMDA data, therefore, have limitations that make them an inadequate basis, absent other information, for concluding that an institution has not assisted adequately in meeting its community's credit needs or has engaged in illegal lending discrimination.

Because of the limitations of HMDA data, the Board has considered these data carefully in light of other information, including examination reports that provide on-site evaluations of compliance with fair lending laws by JPMCB and its predecessor bank, Chase Manhattan Bank, New York, New York.²⁵ Examiners found no evidence of prohibited discrimination or other illegal credit practices at JPMCB, Chase Manhattan Bank, Chase USA, or CMMC.

²⁴ The data, for example, do not account for the possibility that an institution's outreach efforts may attract a larger proportion of marginally qualified applicants than other institutions attract and do not provide a basis for an independent assessment of whether an applicant who was denied credit was, in fact, creditworthy. Credit history problems and excessive debt levels relative to income (reasons most frequently cited for a credit denial) are not available from HMDA data.

²⁵ JPMCB was formed in the fourth quarter of 2001 by the merger of Chase Manhattan Bank and Morgan Guaranty Trust Company. The CRA performance of Chase Manhattan Bank was last evaluated by the Federal Reserve Bank of New York as of July 9, 2001.

As noted in the JPMCB/Bank One Order, JPMCB and CMMC have taken several affirmative steps to ensure compliance with fair lending laws. Management at JPMCB and CMMC conduct comparative file reviews for most of their loan products. JPMCB and CMMC have a secondary review process that includes regression analysis of all applications to identify possible instances or indications of disparate treatment, and JPMCB indicated that it acts promptly to correct inappropriate underwriting decisions that are identified, including sending offers of credit to individuals whose applications were denied in error. In addition, an independent review team, under the direction of the fair lending unit, reviews applications identified by the regression analysis and reports its findings to the audit department quarterly.

The Board also has considered the HMDA data in light of other information, including the CRA performance records of JPMCB, Chase Manhattan Bank, and Chase USA. The Board concludes that, in light of the entire record, the HMDA data indicate that JPMCB's record of performance in helping to serve the credit needs of its community is consistent with approval of the proposal.

C. Conclusion on CRA Performance Records

The Board has carefully considered all the facts of record, including reports of examination of CRA records of the institutions involved, information provided by Morgan Chase, all comments received and responses to the comments, and confidential supervisory information. Based on a review of the entire record, and for the reasons discussed above, the Board concludes that the CRA performance records of the institutions involved are consistent with approval.

Other Considerations

As part of its evaluation of the public interest factors, the Board also has carefully reviewed the public benefits and possible adverse effects of the proposal. The record indicates that consummation of the proposal would result in

benefits to consumers and businesses. The proposal would enable Morgan Chase to streamline the way in which it provides consumer finance products and services to customers throughout the national market, by creating a single institution through which customers can obtain home and automobile financing and credit card products and services now offered by different Morgan Chase affiliates. Morgan Chase expects that additional retail products and services will eventually also be offered in the national market through Chase FSB. Based on all the facts of record, the Board has determined that consummation of the proposal can reasonably be expected to produce public benefits that would outweigh any likely adverse effects under the standard of section 4(j)(2) of the BHC Act.

Conclusion

Based on the foregoing and all the facts of record, the Board has determined that the notice should be, and hereby is, approved. The Board's approval is specifically conditioned on compliance by Morgan Chase with all the commitments made in connection with the notice and all the conditions in this order. The Board's determination also is subject to all the conditions set forth in Regulation Y, including those in sections 225.7 and 225.25(c) (12 C.F.R. 225.7 and 225.25(c)), and to the Board's authority to require such modification or termination of the activities of a bank holding company or any of its subsidiaries as the Board finds necessary to ensure compliance with, and to prevent evasion of, the provisions of the BHC Act and the Board's regulations and orders thereunder. For purposes of this action, the commitments and conditions relied on by the Board in reaching its decision are deemed to be conditions imposed in writing by the Board in connection with its findings and decision and, as such, may be enforced in proceedings under applicable law.

The proposal may not be consummated later than three months after the effective date of this order, unless such period is extended for good cause by

the Board or by the Federal Reserve Bank of New York, acting pursuant to delegated authority.

By order of the Board of Governors,²⁶ effective January 30, 2004.

(signed)

Robert deV. Frierson
Deputy Secretary of the Board

²⁶ Voting for this action: Chairman Greenspan, Vice Chairman Ferguson, and Governors Gramlich, Bies, Olson, Bernanke, and Kohn.