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# THE BANK MERGER REVIEW PROCESS: INTERNATIONAL COMPARISONS

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# THE BANK MERGER REVIEW PROCESS: INTERNATIONAL COMPARISONS

In light of renewed interest in the possibility of mergers among Canada's five largest banks – the TD Bank Financial Group, the BMO Financial Group, the Bank of Nova Scotia, RBC Financial Group and the Canadian Imperial Bank of Commerce – this paper provides a brief overview of how jurisdictions other than Canada conduct bank merger reviews, concentrating on the review processes in Australia, the United States and Germany.

All industrialized countries have a system for reviewing proposed bank mergers, either through generally applied competition law or through a special financial services/bank-specific process. Canada (along with France, Italy and Switzerland) is among those countries that address proposed bank mergers through a special process (see Table 1). In every case, regulators have the power to deny proposed mergers deemed to be anti-competitive. As well, most – including Canada – go further and explicitly take account of wider-ranging, "public interest" issues.

As the Organisation for Economic Co-operation and Development (OECD) notes, "[i]n some jurisdictions, such as the European Union, Italy, Japan, Korea and the United States, anti-competitive bank mergers will always, at least in theory, be blocked. In others, including Australia, Canada, France, Germany, Switzerland and the United Kingdom, it is possible that anti-competitive bank mergers could sometimes be permitted."(1) For example, in Switzerland, since 1996 the law has allowed the federal council to override a decision by the country's Competition Commission to block a merger, at the request of the merging parties, if "in exceptional cases, it is necessary in order to safeguard compelling public interests."(2)

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(1) OECD, "Bank Mergers," *OECD Journal of Competition Law and Policy*, 2001, Vol. 2, No. 4, p. 36.

(2) *Ibid*., p. 55.

**Table 1: Competition Law Applied in Banking – Examples of Special Regimes**

| Country | Special Features Pertinent to Merger Review |
|---|---|
| **Canada** | The Minister of Finance has the option to remove the Competition Bureau's power to block an anti-competitive merger if s/he certifies "it is, or would be, in the public interest." (*Competition Act*, s. 113 (a.1)) |
| **France** | Bank mergers are exempt from application of France's general competition law and formal review by its competition authorities. |
| **Italy** | The Bank of Italy applies the country's general competition law to bank mergers. In doing so, it is required to consider, but not necessarily follow, the opinion of the Italian competition agency. |
| **Switzerland** | The Swiss competition law is applied by the general competition agency, but there is one potentially important exception. If the country's Federal Bank Commission (FBC) deems it necessary to take action to protect creditors (presumably including depositors), the FBC effectively replaces the Competition Commission as regards those actions. The FBC might therefore have to balance creditor protection and competition concerns in mergers involving failing banks. |

Source: OECD "Bank Mergers," *OECD Journal of Competition Law and Policy*, 2001, Vol. 2, No. 4, p. 37.

The examples of Australia, the United States and Germany can help to illuminate the nature of the Canadian bank merger review process. Australia offers an example of a country that has a financial sector that is similar to that in Canada. The United States, despite having a financial system that is quite different from that in Canada, is an important example, both because its geographical proximity and economic and social/political importance to Canada make it very familiar to Canadians, and because it has experienced a large number of financial-sector mergers over the past decade. Finally, Germany demonstrates that competition and public interest issues are considered in bank merger reviews even in banking systems that are different from that in Canada.

## AUSTRALIA

Like Canada, Australia's banking sector is dominated by a small number of large, nationally branched institutions serving a geographically dispersed population. Australia's four

largest banks accounted for 67.8% of total banking assets as of March 2002.[3] Australia's banks, like those in Canada, have been experiencing a gradual deregulation of the financial sector, resulting in an increasing number of mergers and acquisitions over the 1990s. According to the MacKay Task Force, "[t]he rationales for these mergers have been to regionalize operations and to acquire a critical mass in order to compete in the global marketplace."[4]

The Australian government currently prohibits mergers between the big four banks "until such time as competition in retail markets, and particularly for small business banking, (is) more evident."[5] Other financial-sector mergers are allowed, subject to a competition review if market concentration levels exceed, or will exceed, specified thresholds. Mergers that would have the effect, or are likely to have the effect, of substantially lessening competition in a substantial market for goods or services are prohibited. Australian law also allows mergers to be assessed through an "authorization" procedure in which the merging institutions can point to benefits that would offset the negative consequences of a merger; this approach, however, has never been used.[6]

Australia's bank merger review process resembles its Canadian counterpart. The Australian Competition and Consumer Commission (ACCC) is responsible for examining a proposed merger's potential effects on competition (in Canada, this is the responsibility of the Competition Bureau), while the Australian Prudential Regulation Authority (APRA), the counterpart of Canada's Office of the Superintendent of Financial Institutions (OSFI), examines the prudential aspects of the proposed merger.

In the Australian system, the public interest is the responsibility of the federal Treasurer. In his or her deliberations on the public interest, the Treasurer considers: overall and regional economic development; economic efficiencies (especially those promoting international

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(3) Australia, Australian Prudential Regulation Authority, *Australian Banking Statistics, March 2002*, "Table 2: Assets on Australian books of individual banks," http://www.apra.gov.au/Statistics/Australian-Banking-Statistics.cfm.

(4) Canada, Task Force on the Future of the Canadian Financial Services Sector (hereafter the MacKay Task Force), *Competition, Competitiveness and the Public Interest*, Background Paper No. 1, September 1998, p. 144.

(5) Allan Fels, Chairman, Australian Competition and Consumer Commission (ACCC), "Financial Services Mergers and Acquisitions: The ACCC's Policy Framework," Speech, 9 March 1998, http://www.accc.gov.au/docs/speeches/bbyfels.html.

(6) Garry Goddard and Greg Walker, *Bank Mergers in Australia: Competition Assessment of the Commonwealth Bank of Australia's Acquisition of Colonial Limited*, Working Paper No. 2/01, April 2001, p. 7.

competitiveness); import substitution and export promotion; employment; the environment; industrial harmony; small-business efficiency; the quality and safety of goods and services; the breadth of consumer choice and information supplied to consumers; and the promotion of equitable dealings in the marketplace. Of these, efficiency factors are considered to be the most important.

Though the Treasurer has the "reserve power to block mergers," unlike the Canadian Minister of Finance he or she cannot permit proposed mergers blocked by the regulatory agencies.

When the reports of the ACCC and APRA are completed (the reviews are undertaken concurrently), their findings are reported to the federal Treasurer, who takes them into consideration, along with wider public policy issues, in making his or her final "national interest decision."(7) The Treasurer can block a proposed merger deemed not to be in the national interest.

In conducting its analysis, the ACCC uses a five-stage process to assess market power, consisting of the following elements of analysis:

1. Definition of the relevant markets impacted by the merger, particularly in terms of their product and geographic dimensions;
2. Calculation of the post-merger market shares of the combined entity in each of the relevant markets, and comparison of those market share numbers with the concentration threshold levels;
3. Assessment of the extent of import competition;
4. Assessment of the height of barriers to entry; and finally
5. Consideration of a range of other factors, which may be relevant to competition in the markets impacted by the merger.(8)

Like Canada's Competition Bureau, the ACCC examines specific product and geographic markets to determine whether the merged entities would be in a position to exert market power in price, access and service quality; likewise, it uses specific thresholds: "Where the merged entity has a market share of 15% or more and the four largest firms have a combined market share … of 75% or more (post-merger), then the ACCC considers [that] the potential for

(7) *Ibid.*

(8) *Ibid.*, p. 8.

coordinated or interdependent (oligopoly) market power exists."[9] The ACCC also considers the strength of new and potential competition. Finally, also like the Competition Bureau, the ACCC considers the efficiency argument for mergers only for "those efficiencies that cannot be achieved through other means and which contribute to increased competition in the markets impacted by the merger, say through increased output, product innovation or reduced prices."[10]

One interesting aspect of the ACCC is the speed with which it seems able to undertake reviews. According to the ACCC, it was able to complete its review of the purchase in 2000 by the Commonwealth Bank of Australia Limited, then Australia's second-largest bank, of Colonial Limited, its sixth-largest, in eight weeks. This timeframe compares with a predicted time of five to six months for the OSFI and the Competition Bureau to complete their review of a proposed merger between two large banks in Canada.

## UNITED STATES

In contrast to Canada, until 1994 banks in the United States lacked a national presence; it was only in 1994 that barriers to national banking were completely removed. As a result, the latter half of the 1990s saw a wave of consolidation sweep through the U.S. financial services industry. For example, between 1994 and 1998 the percentage of total deposits held by the top 25 banking organizations rose to 51% from 42%.[11] Furthermore, U.S. authorities "have reviewed well in excess of a thousand merger transactions a year since 1990."[12] These figures suggest that market concentration concerns are less significant than in Canada, where the five largest banks account for the vast majority of banking assets. In the United States, even a merger between two large banks would be unlikely to raise the competition issues that it would in Canada.

In the United States, bank mergers are examined independently by two institutions: the relevant banking regulator and the U.S. Department of Justice. The Office of the Comptroller of the Currency reviews those mergers that would result in a national bank; the

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(9) *Ibid*., p. 9.

(10) *Ibid*., p. 11.

(11) Stephen A. Rhoades, "Bank Mergers and Banking Structure in the United States," Board of Governors of the Federal Reserve System, Staff Study No. 174, August 2000, Table 15, http://www.federalreserve.gov/pubs/staffstudies/174/ss174.pdf.

(12) Donald G. McFetridge, *Competition Policy Issues*, Research Paper prepared for the MacKay Task Force, September 1998, p. 49, http://finservtaskforce.fin.gc.ca/research/pdf/rr2_e.pdf.

Federal Deposit Insurance Corporation (FDIC) reviews proposed mergers if the resulting institution would be a state-chartered bank that is not a member of the Federal Reserve System. Finally, the Board of Governors of the Federal Reserve System reviews those mergers that would involve an acquisition by a bank holding company if the merged entity would be a state-chartered member of the Federal Reserve System. Meanwhile, the Antitrust Division of the Department of Justice (DOJ) "which has general enforcement authority under federal antitrust laws, reviews proposed mergers and acquisitions approved by the banking regulators."(13) Mergers are analyzed on a first-come, first-served basis.

The DOJ and the relevant banking regulator apply the same antitrust criteria, as well as other relevant legislated limits, at both the state and national levels; however, they employ somewhat different methodologies. For example, the Federal Reserve employs a set of "'mitigating factors' that would permit approval even if concentration thresholds were violated"; these include "the continued presence of potential competition, the existence of a substantial number of remaining banks in the market, improvements in efficiency and related 'convenience and needs' considerations."(14)

Beyond anti-competitive issues, larger public interest concerns are not a part of the bank merger review process. The assessments by both the DOJ and the Federal Reserve "have a strict competition focus. Neither agency has the objective of protecting U.S. banks from foreign takeovers. Neither agency is charged with the task of preserving bank jobs."(15)

U.S. law forbids banking mergers that would create a monopoly or – to quote the Clayton Act, which deals with competition issues –"substantially lessen competition or tend to create a monopoly in a particular market." As Cyrnak notes, however, "[i]mportantly, the Clayton Act does not define the term 'substantially.'"(16) Shull and Hanweck illustrate the importance of this lack of definition, noting that, "[t]he [Federal Reserve] Board has also made it clear that it will not always adhere to the Justice Department's thresholds. Given some of its decisions, there is a question as to whether there is, at present, any absolute level of concentration that would preclude Board approval."(17) More generally, "[t]he OCC and the

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(13) Anthony W. Cyrnak, "Bank Merger Policy and the New CRA Data," *Federal Reserve Bulletin,* September 1998, p. 703, http://www.federalreserve.gov/pubs/bulletin/1998/998lead.pdf.

(14) Bernard Shull and Gerald A. Hanweck, "Bank Merger Policy: Proposals for Change," *Banking Law Journal*, March 2002, p. 2.

(15) McFetridge (1998), p. 50.

(16) Cyrnak (1998), p. 703.

(17) Shull and Hanweck (2002), p. 6.

FDIC have apparently not denied a merger on competition grounds for ten years, while the DOJ and FRB have caused many proposed mergers to be modified although they have denied only a few." Furthermore, the only denials of merger proposals were the result of the banks' unwillingness or inability to "make the appropriate divestitures."[18]

The relatively concentrated nature of the Canadian banking sector renders it different from that of the United States in the area of bank merger review for at least four reasons. First, the large number of financial institutions in the United States reduces the likelihood that a merger would pose significant competition issues; the same is probably not true in Canada. Second, Canada's concentrated banking sector, as McFetridge notes, has implications for the merger review process: a case-by-case review, as opposed to the simple rules approach used in the United States, would be more appropriate for Canada. Third, with a limited number of banks in Canada, the market for divested lines of business is restricted. Finally, having five large banks in the Canadian financial services sector could create problems for evaluating proposed mergers on a first-come, first-served basis, as is done in the United States. As McFetridge remarks:

> Given that successive mergers leave successively fewer competitors in the market, the likelihood that a given merger will be deemed to lessen competition will be greater the later it is in the queue. This may give rise to arguments that, on fairness grounds, these mergers should be analyzed simultaneously rather than sequentially. But analyzing two or more merger proposals simultaneously involves its own set of problems. If, for example, two mergers are proposed and the state of competition in the market is such that only one can go through, the task of distinguishing between the proposed mergers [on] the basis of their respective net economic benefits may require more accuracy of merger analysis than it is typically able to deliver. This problem would, of course, not arise if neither merger were allowed to proceed or if both were allowed to proceed either with or without divestitures.[19]

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(18) McFetridge (1998), p. 48.

(19) *Ibid.*, p. 50.

**GERMANY**[20]

In the European Union, the European Commission is responsible for cross-border mergers where:

- asset turnover of each company exceeds EUR 250 million;
- total asset turnover of the companies exceeds EUR 5 billion; and
- asset turnover of each company outside its home country exceeds one-third of the total turnover.

In the European Union, a bank merger approval process is undertaken only if serious competition issues are raised.[21] Within-state mergers, however, remain the purview of national governments, and the rules are different in each country.

In Germany, for example, bank mergers must be approved by the prudential regulator, and may be blocked by the Federal Cartel Office (FCO), which is responsible for competition issues. Before it can prohibit a merger, the FCO must allow comments from the state authority in whose territory the banks have their registered headquarters. As the OECD remarks, "the states have ownership interests in some significant banks." FCO decisions to block mergers can be appealed to the courts.

As well, a proposed bank merger can be blocked at the political level by the federal Minister of Economics, though it cannot be blocked if the FCO finds no reason to object to the merger. The Minister can also decide to override an FCO decision to prohibit a merger, in which case the Minister must ask the opinion of the Monopoly Commission. The Commission then conducts its study based on the Minister's mandate to "... consider the benefits of a merger for the economy as a whole and assess whether it would be in the public interest, and then balance these aspects against potential restraints of competition." As the OECD remarks, "[t]he German competition act does not spell out what is meant by 'benefit to the economy as a whole.'" The Monopoly Commission's report is not necessarily published before the Minister

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(20) This section is largely based on OECD, "Bank Mergers" (2001), pp. 54-55.

(21) Otto Sobek, "Bank Mergers and Acquisitions," National Bank of Slovakia, December 2000, p. 30, http://www.nbs.sk/BIATEC/SOBAN.PDF.

makes his or her decision, but it is discussed in the public hearing that usually forms part of the authorization process.

To 2001, ministerial authorization had not been sought in any bank merger, and the low level of concentration in the German banking sector has meant that the FCO has rarely prohibited bank mergers. This lack of concentration makes the German banking sector relatively different from that in Canada. As in Canada, however, the merger review process involves consideration of competition issues, as well as – through ministerial review – the ability to consider wider economic issues and the public interest.

## CONCLUSION

Of the three cases examined in this paper, Australia's bank merger review policy is the most similar to that in Canada, while the review processes in the United States and Germany are less so. At the heart of all these systems, however, lies a concern about concentration and a recognition that, because of the central role of banks in a market economy, bank mergers must be regulated in the public interest, however this interest is defined.