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Bank Mergers in North America: Comparing the Approaches in the United States and Canada

*Eric J. Gouvin**

This paper provides a summary comparison of the processes in the United States and Canada for governmental approval of bank mergers. The topic came to prominence in 1998 when four of Canada's five largest banks unveiled plans that would have resulted in the Royal Bank of Canada merging with the Bank of Montreal¹ and the Toronto Dominion Bank combining with the Canadian Imperial Bank of Commerce ("CIBC").² These proposed mergers were rejected by the then Finance Minister, Paul Martin.³ The reasons given included:

- the resulting banking industry structure would have concentrated too much economic power in the hands of too few financial institutions;
- the combinations would have reduced competition in the Canadian financial services sector; and
- the reduction in the number of banks would have reduced the Canadian government's flexibility to address future concerns.⁴

Although the government rejected the 1998 mergers, the Finance Department in 1999 acknowledged that business combinations could be an appropriate business strategy in some circumstances.⁵ The government promised guidance as to when such combinations of large banks would be permitted.⁶ In 2001, the Department of Finance set forth its broad outlines for bank merger policy.⁷ One of the obvious differences with U.S. law is that the Canadian approach explicitly provides that the views of the public and political leaders are to be incorporated

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1. MAURIZIO BEVILACQUA, M.P. CHAIRMAN, *THE FUTURE STARTS NOW: A STUDY ON THE FINANCIAL SERVICES SECTOR IN CANADA*, REPORT OF THE STANDING COMMITTEE ON FINANCE, Dec. 1998, available at <http://www.parl.gc.ca/InfocomDoc/36/1/FINA/Studies/Reports/finarp112-e.htm>.

2. *Id.*

3. Steven Theobald, *Big 4 Lash Out at Scrapped Linkups*, THE TORONTO STAR, Dec. 15, 1998.

4. See STANDING COMMITTEE ON FINANCE (DEB.), Nov. 6, 1998, available at <http://www.parl.gc.ca/InfoComDoc/36/1/FINA/Meetings/Evidence/finaev154-e.htm>; HON. LORNE NYSTROM, M. P., *THE PUBLIC INTEREST IMPLICATIONS OF LARGE BANK MERGERS: A DISSENTING OPINION*, Mar. 2003, available at <http://www.parl.gc.ca/InfoComDoc/37/2/FINA/Studies/Reports/finarp03/17-ndp-e.htm>.

5. See DEPT. OF FIN., *REFORMING CANADA'S FIN. SERVICES SECTOR: A FRAMEWORK FOR THE FUTURE*, at 22 (June 25, 1999), available at http://www.fin.gc.ca/finserv/docs/finservrept_e.pdf.

6. *Id.*

7. See DEPT. OF FIN., *MERGER REVIEW GUIDELINES*, available at http://www.fin.gc.ca/news01/data/01-014_2e.html.

into the merger approval process. Since the issuance of the bank merger policy, the government has promised specific guidance about what types of combinations will be permitted, but it has yet to complete that policy document.

This paper provides a comparison, in summary form, of the U.S. and Canadian approaches to the approval of bank mergers. It starts with a brief explanation of U.S. bank merger law and then lays out the evolving Canadian approach to large bank mergers. It concludes with a discussion of whether the Canadian approach will help the regulators of Canadian financial institutions address the deficiencies identified in the 1998 transactions.

I. A SUMMARY OF THE U.S. BANK MERGER PROCESS

In the United States, all bank acquisitions are subject to review for anticompetitive effect, but such review involves different regulatory statutes and different regulatory agencies depending on whether banks or bank holding companies are involved.⁸ In general, acquisitions involving a merger of two banks are regulated under the Bank Merger Act⁹, with the key regulator dependent on the type of institution involved. By contrast, acquisitions by holding companies are governed by Section 3(c) of the Bank Holding Company Act (“BHCA”),¹⁰ with the Federal Reserve being the key regulator. In both cases however, the operative statutory standards are essentially the same. Each statute prohibits transactions that have an anticompetitive effect.¹¹

8. See PATRICIA A. MCCOY, *BANKING LAW MANUAL* § 10 (2d ed. 2001) (for an overview of the U.S. scheme for approving mergers and acquisitions of banks); Joseph J. Norton & Christopher D. Olive, *A By-Product of the Globalization Process: The Rise of Cross-Border Bank Mergers and Acquisitions—The U.S. Regulatory Framework*, 56 *BUS. LAW.* 591 (2001).

9. The Bank Merger Act, Pub. L. No. 89-356, 80 Stat. 7 (1966) (codified as amended at 12 U.S.C. §1828(c)(5) (2005)). Despite its name, the Act now applies to a merger involving any insured depository institution.

10. 12 U.S.C. § 1842(c) (2005).

11. *Id.* at § 1842(c)(1)(A)-(B).

The specific language prohibits transactions that:

[A] . . . would result in a monopoly, or which would be in furtherance of any combination or conspiracy to monopolize or to attempt to monopolize the business of banking in any part of the United States, or

[B] . . . whose effect in any section of the country may be substantially to lessen competition, or to tend to create a monopoly, or which in any other manner would be in restraint of trade, unless it finds that the anticompetitive effects of the proposed transaction are clearly outweighed in the public interest by the probable effect of the transaction in meeting the convenience and needs of the community to be served.

Id.

Bank regulators engage in a standard antitrust analysis of the merger to determine anticompetitive effects. The antitrust inquiry focuses on the market concentration that results from the merger in the relevant product and geographic markets. The case of *United States v. Phillipsburg National Bank and Trust Company* sets forth the classic formulation of this test:

[A] merger which produces a firm controlling an undue percentage 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 anti-competitive effects.¹²

The merger approval analysis also requires that any anticompetitive effects be balanced against community needs. A range of specific factors may figure into a determination of community needs. Particularly important factors include improving the ability of the surviving bank to provide a broader spectrum of services and products, improving its ability to respond to the community's borrowing needs with larger lending limits, and the potential of the merger to spur economic growth of the community.¹³

However, bank mergers and holding company acquisitions are also subject to antitrust challenge after a regulatory decision is made.¹⁴ In such a challenge, the Bank Merger Act generally provides that acquisitions to which it is applicable are governed by the standard quoted above, rather than the general antitrust merger standard.¹⁵ Even with the same statutory standard, competitive factors are likely to receive greater emphasis by antitrust enforcers making case selection decisions and perhaps by courts applying that standard.

In 1978, Congress passed the Change in Bank Control Act.¹⁶ Broadly speaking, the Act requires covered "persons" to notify the relevant banking regulator of a purchase of "control" of a bank. The regulatory agency then has a

12. *United States v. Phillipsburg Nat'l Bank & Trust Co. et al*, 399 U.S. 350, 366 (1970). The classic antitrust case discussing the geographical and product market analysis required to determine anticompetitive effects is *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321 (1963).

13. MICHAEL MALLOY, 2 *THE CORPORATE LAW OF BANKS-REGULATION OF CORPORATE AND SECURITIES ACTIVITIES OF DEPOSITORY INSTITUTIONS* §§ 9.2.4, 833-34 n.47 (1988) (collecting the relevant cases and other authorities).

14. 12 U.S.C. § 1828(c)(6). The Act requires that notice of the merger be sent to the Attorney General, as well as other bank regulators, as part of the regulatory approval process. *Id.*

15. 12 U.S.C. § 1828(7)(B). *See also* 15 U.S.C. § 18 (2005) (the general antitrust merger statute is § 7 of the Clayton Act).

16. Pub. L. No. 95-630, § 901, 92 Stat. 3678 (codified as amended in 12 U.S.C. § 1817(j) (2005)). Similar provisions apply to terminating federal insurance coverage on such a change in control. *See id.* § 1730(q). The Act was amended in 1989 to reach all insured depository institutions. Pub. L. No. 101-73, § 204(c), 103 Stat. 103 (amending 12 U.S.C. § 1817(j)). For a general discussion of the Act, *see* MALLOY, *supra* note 13, at § 4.3.

specified period to disapprove the transaction.¹⁷ The definition of these two statutory terms is crucial to the Act's application. "Person" is defined broadly to include individuals, a long list of different types of business organizations, and "any other form of entity not specifically listed herein."¹⁸ "Control" is defined as the direct or indirect power "to direct the management or policies of an insured depository institution or to vote 25 per centum or more of any class of voting securities . . ."¹⁹ This expansive definition is well adapted to deal with the realities of control and to reach any actual changes of control. Agency regulations, authorized by the statute, further expand this definition and create presumptions of control at lower thresholds of stock ownership.²⁰

The Act gives several standards for disapproval. First, the transaction may be disapproved if it has the anticompetitive effects described above.²¹ Disapproval is also authorized if the agency makes a finding that the acquiring person's financial condition, competence, or integrity is suspect.²² Finally, disapproval is appropriate if the transaction would have an adverse effect on the federal deposit insurance funds.²³

When acting on a bank holding company's application to acquire a bank under section 3 of the BHCA,²⁴ section 210 of the Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA")²⁵ requires the Federal Reserve Board to consider the managerial resources of a bank holding company or a bank. This includes evaluating the competence, experience, and integrity of the officers, directors, and principal shareholders of each institution.

It is interesting to note the policy choice made by Congress in selecting the decision-making forum with primary responsibility for bank and bank holding company mergers. Both statutes specify that the initial determination is to be made by the appropriate banking agency, rather than by the courts or by the legislative branch. The reasons for that choice are likely rooted in one of the classic arguments for the administrative state: the banking agencies know more about banking than other bodies might, so they should be entrusted with making this decision. In addition, the administrative agencies may be the designated decision makers because of the politically insulated position they hold. While agencies are perhaps seen as likely to be more sympathetic to community needs than are the courts, they are less likely to be swayed by public opinion than the legislature. Decisions that a legislature might be tempted to make solely on

17. 12 U.S.C. § 1817(j)(1) (2004).

18. *Id.* § 1817(j)(8)(A).

19. *Id.* § 1817(j)(8)(B).

20. 12 C.F.R. §§ 303.4(a), 550(d) (Comptroller), and § 225.4(d) (Federal Reserve Board).

21. 12 U.S.C. § 1817(j)(7)(A) and (B).

22. *Id.* § 1817(j)(7)(C) and (D).

23. *Id.* § 1817(j)(7)(F).

24. *Id.* § 1842(c).

25. Pub. L. No. 102-242, § 303, 105 Stat. 2236 (1991) (codified as amended in 12 U.S.C.A. § 1831a (West 2005)).

political grounds can be handled in a more technocratic manner by the administrative agencies by virtue of the political insulation those agencies enjoy.

However, the regulatory agencies do solicit public comment during the merger approval process. The public comment process goes hand-in-hand with the agencies' required review of the institutions' Community Reinvestment Act ("CRA") compliance.²⁶ The CRA was enacted in 1977 to create incentives for depository institutions to address the credit needs of the communities in which they operate, especially in low- and moderate-income neighborhoods, consistent with safe and sound banking operations. The CRA requires that each insured depository institution's record in helping meet the credit needs of its entire community be evaluated periodically. That record is taken into account, among other times, when an institution applies for additional powers under the Gramm-Leach-Bliley Act, or when the institution seeks to expand its business, including through mergers and acquisitions.

II. A SUMMARY OF THE CANADIAN BANK MERGER PROCESS

In 2001, the Department of Finance kept its promise to provide guidelines for mergers of large banks. It set forth its broad outlines for bank merger policy in a press release.²⁷ The Merger Review Guidelines ("MRG") seek to find the optimal size for internationally active financial institutions while avoiding the problems of undue concentration of economic power and reduced competition in the banking sector at home. On their face, the MRG set out an extensive review process for merger proposals involving large banks and bank holding companies (i.e., those organizations with equity in excess of \$5 billion). However, under closer inspection, the guidelines lack specific content as to what kinds of combinations might raise concerns based on competitive, prudential, or public interest matters. The government has promised additional guidance to spell out those factors, but political concerns have delayed their publication. Under the MRG, the banks proposing to merge would be required to prepare a public interest impact assessment ("PIIA"). The PIIA would have to justify the business objectives of the merger and provide a discussion of a range of effects of the merger, such as job losses and branch closures, as well as the impact of the transaction on the structure of the Canadian banking industry and the place of Canadian banks in the international financial services marketplace.

If the proposed transaction would require remediation or mitigation of adverse effects, such as by divesting certain assets to avoid undue concentration, the PIIA would have to contain those plans as well. The PIIA should be informed

26. 12 U.S.C. § 2901; 12 C.F.R. §§ 25, 228, 345, and 563e.

27. See DEPT. OF FIN., MERGER REVIEW GUIDELINES, available at http://www.fin.gc.ca/news/01/data/01-014_2e.html. The discussion that follows is a short summary of the guidelines found at that URL. Specific citations will not be provided for each point.

by public needs and sentiments and the proposed review process would include an avenue for obtaining input from the public.

Once the PIIA was complete, the proposed transaction would then be referred to the House of Commons Standing Committee on Finance and to the Standing Senate Committee on Banking, Trade, and Commerce for consideration and public hearings. These committees, in turn, would report to the Minister of Finance on the matters of public interest raised by the proposed transactions. This overtly political process has no specific analogue in U.S. law. On a separate track, both the Competition Bureau and the Office of the Superintendent of Financial Institutions (“OSFI”) would also review the merger proposal and report to the Minister of Finance their views on the competitive and prudential aspects, respectively, of the proposed transaction. The Minister of Finance, after balancing all of this data, would then approve or disapprove the transaction in light of any prudential, competitive, or public interest issues raised during the review process.

Short of outright denial, the Minister could negotiate remedies or modifications to the merger plans that could allow the transaction to move ahead while addressing the concerns. Specifically, if the concerns stemmed from competition effects, the Competition Bureau would arrange the appropriate remedies, while if the concerns involved primarily safety and soundness issues the OSFI would take the lead on remediation discussions. The Competition Bureau and the OSFI together with the Department of Finance would jointly address other public interest issues.

After the MRG were issued and had been discussed in the political arena, the Minister of Finance in October 2002 asked the House of Commons Standing Committee on Finance and the Standing Senate Committee on Banking, Trade, and Commerce for their views on the major considerations that would apply in determining whether a merger proposal between large banks is in the public interest. The Senate Committee issued its report on this matter in December, 2002,²⁸ and the House of Commons committee issued its report in March, 2003.²⁹

While the Government has responded to both the Senate and Commons reports,³⁰ the Government itself has yet to articulate its own views about when bank mergers would be in the public interest. The Government’s guidance was supposed to be issued by June 30, 2004,³¹ but in the spring of 2004 they were

28. THE HON. E. LEO KOLBER., CHAIR, COMPETITION IN THE PUBLIC INTEREST: LARGE BANK MERGERS IN CANADA, THE STANDING SENATE COMMITTEE ON BANKING, TRADE AND COMMERCE SIXTH REPORT, Dec. 2002, available at <http://www.parl.gc.ca/37/2/parlbus/commbus/senate/com-e/bank-e/rep-e/rep06dec02-e.htm>

29. SUE BARNES, M.P. CHAIR, LARGE BANK MERGERS IN CANADA: SAFEGUARDING THE PUBLIC INTEREST FOR CANADIANS AND CANADIAN BUSINESSES REPORT OF THE STANDING COMMITTEE ON FINANCE, Mar. 2003, available at <http://www.parl.gc.ca/committee/CommitteePublication.aspx?SourceId=37542>.

30. DEPARTMENT OF FINANCE, RESPONSE OF THE GOVERNMENT TO LARGE BANK MERGERS IN CANADA: SAFEGUARDING THE PUBLIC INTEREST FOR CANADIANS AND CANADIAN BUSINESSES, A REPORT OF THE HOUSE OF COMMONS STANDING COMMITTEE ON FINANCE, AND COMPETITION IN THE PUBLIC INTEREST: LARGE BANK MERGERS IN CANADA, A REPORT OF THE STANDING SENATE COMMITTEE ON BANKING, TRADE AND COMMERCE, 25, June 23, 2003 [hereinafter “Government Response”].

31. *Id.* at 25.

officially postponed until the fall.³² Unfortunately, elections were called for late June and resulted in a minority government. Neither the New Democratic Party nor the Bloc Quebecois, the two parties with whom the Liberals will have to work most closely, are supportive of bank mergers.³³ In light of political realities, it seems that the merger guidelines will be held in limbo for the foreseeable future.³⁴ As of this writing, the guidelines are still under development.

III. WILL THE DIFFERENCES IN THE CANADIAN PROCESS ADDRESS THE CONCERNS OF THE 1998 MERGERS?

As observers of the Canadian banking scene patiently await the government's final guidelines on the kinds of transactions that will raise concerns, we might profitably ask whether the guidelines will have any effect on large bank mergers in light of the existing banking market in Canada and the approval process that is currently in place.

Specifically, if we return to the concerns raised by Paul Martin in 1998, will the government's guidelines, regardless of their content, be capable of correcting the problems of undue concentration, decreased competition, and impact on Canada's economic and social policies?

A. *Will the Canadian Banking Market Be Too Concentrated?*

Concern about the concentration of economic power is a legitimate focus of banking policy. In the United States, concern over the concentration of economic power explains quite a bit about the structure of the banking industry. Throughout U.S. banking history the prohibition on interstate banking and the odd mixture of state branching policy was largely concerned with preventing undue concentration of economic power—in the first instance to prevent money center banks from dominating the banks in neighboring states, and in the second instance to prevent city banks from dominating country banks. Although U.S. interstate banking policy and branching policy has changed dramatically, federal banking law is still concerned with undue concentration. For example, as part of the antitrust analysis in bank mergers the Department of Justice calculates changes in the Herfindahl-Hirschman Index (“HHI”), which is a measure of

32. See Sinclair Stewart, *No Merger Guidelines for Banks Until Fall: Goodale*, GLOBEANDMAIL.COM, May 17, 2004, available at <http://www.theglobeandmail.com/servlet/ArticleNews/TPPrint/LAC/20040517/RBANK17/business/ROB>.

33. See Peter Moreira & Vipal Monga, *Bank Mergers Likely Loser in Canada*, YAHOO FINANCE, June 4, 2004 (page expired, hard copy on file with author). The NDP's position opposing bank mergers is stated quite clearly in the dissenting opinion filed in connection with the Report of the Standing Committee on Finance of the House of Commons. See LORNE NYSTROM, *THE PUBLIC INTEREST IMPLICATIONS OF LARGE BANK MERGERS: A DISSENTING OPINION*, in Government Response, *supra* note 30.

34. See Bruce Little, *Federal Politics: Four Ministers for Business to Watch*, THE GLOBE AND MAIL, July 21, 2004 at B2 (stating that conventional wisdom holds that “[n]o minority government will go to the wall by permitting unpopular mergers just to make bank shareholders happy.”).

market concentration.³⁵ Similarly, the Reigle-Neal Interstate Banking and Branching Act of 1994 sets concentration limits on combinations—no combinations that result in one banking organization controlling more than 10 percent of the deposits nationwide or more than 30 percent of the deposits in a particular state can be approved under the statute.³⁶

Canada is right to focus on concentration as a problem in of itself, separate from the impact it has on competition. Unfortunately for Canada, they are closing the door after the horse is out of the barn—the Canadian banking industry was already extremely concentrated, and the more broadly defined financial services sector has become increasingly concentrated as banks have bought up trust companies and other providers.

If the Government continues to focus its analysis on concentration in the banking sector of the financial services industry, banks may be better off pushing for approval of so-called “cross pillar” mergers, especially between banks and insurance companies. These types of combinations may be more politically palatable.³⁷

B. What Effect Will Bank Mergers Have on Competition?

Although undue concentration and lack of competition are conceptually distinct issues, they often go hand in hand; highly concentrated markets run a high risk of also being uncompetitive markets. With only five big banks (“Big Five banks”) and a limited number of smaller banks, it is a fair question to ask whether the Canadian banking market is in fact competitive. One factor that could increase competition would be to allow wider access to the Canadian banking market by foreign financial institutions. However, Canadian policy has been hostile to foreign entrants. The widely held rule and barriers to U.S. entry have hobbled real competition in the banking sector.³⁸

Foreign financial service providers, including the Americans, have found it very difficult to establish profitable retail banking operations in Canada.³⁹ Viewed from the outside, the Canadian domestic banking market is relatively

35. See DEPT. OF JUSTICE, BANK MERGER COMPETITIVE REVIEW, available at <http://www.usdoj.gov/atr/public/guidelines/6472.htm>.

36. 12 U.S.C. § 1842(d)(2)(A) & (B)(ii).

37. See Gerard Berube, *Banks need to make their case*, CA MAGAZINE.COM, June/July 2004, available at http://www.camagazine.com/index.cfm/ci_id/21540/la_id/1.htm. (noting that political priorities may be elsewhere).

38. See Eric J. Gouvin, *The Political Economy of Canada's “Widely Held” Rule for Large Banks*, 32 LAW & POL'Y INT'L BUS. 391 (2001) (discussing the genesis of the rule, and comparing its application to that of the Mexican rule).

39. See WILLIAM R. WHITE, THE IMPLICATIONS OF THE FTA AND NAFTA FOR CANADA AND MEXICO 10 (1994) (noting that foreign banks in Canada have failed to achieve rates of return on equity that even equal the return available from Canadian treasury bills and pointing out that in the seventeen years since U.S. banks have been permitted in Canada they have a very limited presence, with Citicorp, the largest, having merely \$4.8 billion in assets, which amounts to about one half of one percent of total Canadian banking assets).

small and thoroughly controlled by the Big Five banks.⁴⁰ Foreign competitors have recognized that the Canadian retail banking market is not worth fighting over.⁴¹ Although many U.S. banks maintain a presence in Canada, it is clear they will never be major players there.⁴²

While foreign banks have had difficulty entering the banking sector, other lines of business have been available. Foreign entrants who have gone into Canada have largely by-passed the banking market and focused on other, less restricted, and more profitable, lines of business, such as credit cards and business lending.⁴³ This niche strategy amounts to cream skimming: taking the profitable lines that used to belong to the Big Five banks and leaving the less profitable aspects of the Canadian banking market for the Canadian banks to maintain.⁴⁴ Even though the Government recognizes that the lack of new entrants harms Canadian consumers, no policy articulated in Ottawa is going to make the Canadian general retail banking market more attractive to foreign entrants.⁴⁵

While foreign entrants are finding the Canadian market a difficult nut to crack, Canadian banks themselves are finding opportunities for growth at home to be scarce. An obvious path for these mature businesses to increase their bottom lines would be to consolidate operations, maximize revenues, and squeeze out all inefficiencies by exploiting any economies of scale that might exist in specific product lines or operations.⁴⁶ However, this path is foreclosed to Canadian banks, so they instead are looking south for growth.⁴⁷ Instead, most of the large Canadian banks have significant U.S. financial services businesses.⁴⁸ From the point of view of Canadian policy makers, the predicament of the

40. See James R. Kraus, *Canada Plan Would Permit Cross-Border Branches*, AMERICAN BANKER, May 22, 1997, at 22 (quoting Canadian banking experts, who remark that Canada has a technology and cost efficiency edge on U.S. banks, resulting in lower spreads and the need for high volume to cover costs).

41. See Aaron Elstein, *Canada Bars 2 Megadeals, Sees Threat to Competition*, AMERICAN BANKER, Dec. 15, 1998, at 1 (noting that market conditions discourage foreign buyers). "For all its size, Canada's population is slightly smaller than California's." *Id.*

42. See Kraus, *supra* note 40, at 1 (noting that Canada has been a "tough nut to crack" for U.S. banks and pointing out that in the seventeen years since U.S. banks have been permitted in Canada they have a very limited presence, with Citicorp, the largest, having merely \$4.8 billion in assets, which amounts to about one half of one percent of total Canadian banking assets).

43. See CHARLES FREEDMAN & CLYDE GOODLET, *THE FINANCIAL SERVICES SECTOR: PAST CHANGES AND FUTURE PROSPECTS* 25 (1998) (noting that the dominant position of Canada's banks will be challenged by "global" banks and niche players).

44. See Aaron Elstein, *Canada Bars 2 Megadeals, Sees Threat to Competition*, AMERICAN BANKER, Dec. 15, 1998, at 1 (noting that MBNA has become a major player in credit card operations, Wells Fargo has gone after small business, and ING has made inroads in virtual banking).

45. See Harvey Schachter, *Ottawa Unveils its Plans for Financial Services*, CANADIAN BANKER, July 1, 1999, at 26 (reporting on a government study that found the lack of new entry is not in the best interest of Canadian consumers).

46. See Gouvin, *supra* note 38, at 417-420 (summarizing the research on how the banking industry generally may or may not exhibit meaningful economies of scale).

47. See Berube, *supra* note 37.

48. See, e.g., Kevin Moran, *Developments in Banking Law: 2000, VII. Global Banking—Canada/Latin America/Africa*, 20 ANN. REV. BANKING L. 1, 79 (2001) (describing Royal Bank of Canada's ventures south of the border).

Canadian banks is not a problem, all things being equal. As long as financial services jobs stay in Canada, the government would just as soon see bank operations grow in other parts of the world. Indeed, the Canadian Bankers Association touts international banking as the ideal export.⁴⁹

C. *Will Allowing Consolidation Affect Canada's Ability to Execute its Economic Policy?*

This concern seems to be a variation on the idea that banks are in some way "special," so a government should always have a certain number of them around.⁵⁰ In the United States, the question of bank "specialness" has been thoroughly debated. The proponents of the idea that banks are special⁵¹ argue that banks are unique players in the economy and deserve special treatment under the law because they possess three key characteristics: (1) they offer transaction accounts; (2) they serve as a backup source of liquidity for other financial institutions; and (3) they serve as the transmission belt for monetary policy.⁵² Opponents of the specialness idea have made the counter argument that the purportedly "special" characteristics are no longer unique to banks and that there is no special reason why banks and banks alone must provide those services.⁵³

49. See *Reforms Needed for Financial Services to Flourish Says CBA*, CANADA NEWSWIRE, Oct. 29, 1997 (noting that Canadian banks are major exporters, generating 40 per cent of their earnings abroad while having 90 percent of their workforce located in Canada).

50. Probably the clearest expression of the idea that banks are "special" is the so-called "too big to fail" doctrine. Under that policy, the federal deposit insurance funds made whole all of the depositors of key banks, regardless of whether they were fully covered by deposit insurance, on the theory that to allow the affected bank to fail would have caused major systemic disruption. The too big to fail doctrine may have been eradicated by a provision in the Federal Deposit Insurance Corporation Improvement Act, 12 U.S.C.A. § 1823(c)(4) (West Supp. 1996), which seeks to limit the insurance protection of large depositors. But proclaiming the demise of the problem may be premature. While this act ostensibly eliminates the too big to fail doctrine by strengthening the requirement of "least cost resolution" on the FDIC's actions, it should be noted that section 1823(c)(4) coexists with the statutory authority of the FDIC, 12 U.S.C.A. § 1823(c)(G) (West Supp. 1996), to make payments in excess of the insurance coverage amounts if necessary to protect the local economy where the bank failure occurred. How these two provisions will work together in the future remains to be seen.

51. The specialness argument was most clearly articulated by Paul Volcker and Gerald Corrigan in the early to mid 1980s. See Paul A. Volcker, *Statement before the Subcommittee on Commerce, Consumer and Monetary Affairs of the Committee on Government Operations, U.S. House of Representatives*, June 11, 1986, reprinted in 72 FED. RES. BULL. 541, 542-44 (1986); Paul A. Volcker, *Statement before the Committee on Banking, Housing, and Urban Affairs, U.S. Senate*, Sept. 13, 1983, reprinted in 69 FED. RES. BULL. 757, 758-59 (1983); E. Gerald Corrigan, *Are Banks Special?* in FEDERAL RESERVE BANK OF MINNEAPOLIS 1982 ANNUAL REPORT, reprinted in JONATHAN R. MACEY AND GEOFFREY P. MILLER, *BANKING LAW AND REGULATION*, 68-73 (1992). See Anthony Saunders, *Bank Holding Companies: Structure, Performance and Reform*, in RESTRUCTURING BANKING AND FINANCIAL SERVICES IN AMERICA 157-62 (William S. Haraf & Rose Marie Kushmeider, eds. 1988) (generally discussing and critiquing the specialness of banks).

52. Corrigan, *supra* note 51, at 70.

53. See R. Aspinwall, *On the "Specialness" of Banking*, 7 ISSUES IN BANK REG. 16 (1983) (noting for example, that many non-banks provide transaction accounts which are essentially identical to traditional bank checking accounts); see also Jonathan R. Macey & Geoffrey P. Miller, *Nondeposit Accounts and the Future of Bank Regulation*, 91 MICH. L. REV. 237 (1992); David M. Eaton, Note, *The Commercial Banking-Related Activities of Investment Banks and other Nonbanks*, 44 EMORY L.J. 1187, 1200-14 (1995). Similarly, banks are

An idea related to, but distinct from, specialness is that we need banks in order to have a stable financial system. The biggest concern that flowed from the idea of specialness was the fear that bank failures could degenerate into banking panics that could topple the entire banking system.⁵⁴ Having a system of strong banks in Canada could be seen as a bulwark against catastrophic systemic failure.

On closer examination of the available evidence, however, the fear of a bank failure expanding into the potential failure of the entire banking system appears unjustified.⁵⁵ Such a catastrophic domino effect is in reality a very rare event.⁵⁶ It is much more likely that a bank run would result in the redepositing of funds from weak banks into strong banks.⁵⁷ Therefore, if the economic policy justification for denying bank mergers rests on systemic stability, that justification is subject to a strong empirical challenge.

It seems the real "policy" reasons for the government to insist on a certain critical mass of Canadian banks involves social and political considerations. For reasons that are more political than economic, the Big Five banks maintain an extensive branch network across the country.⁵⁸ It is unlikely that most of the rural branches pay for themselves. Traditionally, Canadian bankers have recognized that maintaining a branch system is a cost of doing business and their profitable lines of business have subsidized their community banking activities in small towns across the country. While such a scheme may be desirable social policy,⁵⁹ from the bottom line point of view of running a business it does not make sense.

Of course, if national policies and objectives are under consideration in this context, Canada also needs to keep an eye on the benefits to be gained by

no longer the only mechanism for providing liquidity, as technology has made it possible for borrowers to access the credits markets without using banks as intermediaries. Jonathan R. Macey & Geoffrey P. Miller, *Deposit Insurance, the Implicit Regulatory Contract, and the Mismatch in the Term Structure of Banks' Assets and Liabilities*, 12 YALE J. ON REG. 1, 9 (1995). Finally, banks' role in the implementation of monetary policy is clearly not as important as it may have once seemed. The Federal Reserve carries out its monetary policy goals primarily through the mechanism of open market operations. These purchases and sales of government securities are executed with the cooperation of many players—not just banks, but securities dealers and investors. Aspinwall, *supra*.

54. See Anna J. Schwartz, *Financial Stability and the Federal Safety Net*, in RESTRUCTURING BANKING AND FINANCIAL SERVICES IN AMERICA, *supra* note 51, at 39 (1988) ("The main reason for widespread concern about bank failures is that they may degenerate into banking panics that produce a drastic decline of the money stock with disastrous effects on economic activity.").

55. See *id.* at 162 ("One problem [with the specialness idea] has been the tendency to exaggerate the social costs of bank failures by loosely extrapolating the effects of an individual bank failure into a potential failure of the whole system."); Daniel R. Fischel et al., *The Regulation of Banks and Bank Holding Companies*, 73 VA. L. REV. 301, 310-11 (1987) (discussing and dismissing the idea that bank failures are contagious). The economic models that predict dire consequences from bank failure are too oversimplified to justify larger systemic policy decisions. Saunders, *supra* note 51, at 158.

56. Schwartz, *supra* note 55, at 39-40, 51-56 n.1 (noting that prior to 1930 banking panics were uncommon and providing empirical evidence to support her conclusion).

57. See Saunders, *supra* note 51, at 159 (citing a study concluding that most runs on individual banks would result in redepositing to sound banks).

58. See Larry M. Greenberg, *Canada's Banks Question Their Cocoon*, WALL ST. J., Apr. 16, 1998, at A17 (noting the political quid pro quo).

59. See ANDREW H. MALCOLM, THE CANADIANS 242 (1986) (noting the role that Canadian banks play in the community and the opportunity for employment and social mobility afforded by banks in rural areas).

allowing bank mergers. If Canada's banks are not allowed to grow, they may not be able to hold their own against their larger foreign rivals. Indeed, Canada's financial centers are already quite marginalized, surpassed by London, New York, Tokyo, and Hong Kong, where greater market depth, historical international orientation, larger players, and commitment to innovation leaves Toronto, Montreal, and Vancouver at a distinct disadvantage.⁶⁰ By some measures, the world is already passing the Canadian banks by. The largest Canadian banks grow smaller by global standards with each passing year.⁶¹ At times, Citicorp alone has a bigger market capitalization than the Big Five combined.⁶²

While the size of an institution is not necessarily a guarantee of business success, in the financial services marketplace size has some significance, especially in trade finance, an area Canadian banks have identified for growth.⁶³ If Canadian banks intend to continue pursuing the international activity they have begun, they will need to find some way to increase the pool of capital on which they may draw.⁶⁴ Under current ownership rules, their options for increasing their capital are limited by their inability to sell out to a foreign banking organization or be acquired by a large commercial concern or even just to give a substantial equity stake to another Canadian bank.

IV. CONCLUSION

The United States and Canada have adopted different approaches to approving large bank mergers. The U.S. approach places most of the discretion in the hands of administrative agencies, while the Canadian process gives an elected official the final say. Given the important role that the banking industry plays in the Canadian sense of national identity and the political volatility of the issue of bank mergers in Canada, it seems most unlikely that the Canadian bank merger process will permit any mergers to go through, regardless of the guidance eventually provided by the Department of Finance. The process is designed in a way that political sentiment will sway decisions on these matters, and given the current political climate, there is little chance that a member of the cabinet is likely to support bank mergers in any form.

60. See Geoffrey P. Dobilas, *The Canadian Financial System in International Perspective*, in CANADA AND THE GLOBAL ECONOMY: THE GEOGRAPHY OF STRUCTURAL AND TECHNOLOGICAL CHANGE 84, 92 (John N.H. Britton ed., 1996) (observing the disadvantage of Canadian financial centers vis-a-vis London, New York and Tokyo).

61. See Peter C. Newman, *When the Banks Lost, Canada Lost, Too*, MACLEAN'S, Dec. 28 1998, at 76 (pointing out that Canada's banks rank between 70th and 80th worldwide in terms of size).

62. Deirdre McMurdy, *The Globalization Game*, MACLEAN'S, Feb. 2, 1998 at 47.

63. See James R. Kraus, *Swing to Import Finance Favoring Big Banks*, AMERICAN BANKER, Nov. 19, 1998, at 20 (noting that trade finance is a line of business favoring large institutions). *But see* FREEMAN & GOODLET, *supra* note 43, at 17-21 (challenging the assertion that Canada needs large banks to stay competitive on the international market).

64. See Dobilas, *supra* note 60, at 94 (noting the need for Canadian banks to expand their capital bases).