

THE REVIEW OF  
**BANKING & FINANCIAL  
SERVICES**  
AN ANALYSIS OF  
CURRENT LAWS AND REGULATIONS  
AFFECTING BANKING AND RELATED INDUSTRIES

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## CANADA SAYS NO TO BANK MEGA MERGERS

*After an Extensive Investigation, Canada's Competition Bureau Found that Two Proposed Mergers Would Substantially Reduce Competition in Branch Banking, Certain Credit Card Markets, and in Full-Service Brokerage. In Adopting these Findings and Blocking the Mergers, the Minister of Finance Added the Concern that the Size of the Merged Banks Would Limit the Government's Policy Options in the Event of Financial Difficulty.*

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On December 14, 1998, the Canadian Minister of Finance announced that two high profile bank mergers would not be allowed to proceed because they were not "in the best interests of Canadians."<sup>1</sup> The Minister's decision was founded on three conclusions: the mergers would lead to an unacceptable concentration of economic power in the hands of a few banks; they would result in a significant reduction of competition; and they would reduce the government's policy flexibility to address potential future prudential concerns. These conclusions were based on an analysis undertaken by the Director of Investigation and Research of the Competition Bureau ("Director") of the potential competitive effects of the mergers. The Director's views were formed following an extensive investigation by the Competition Bureau, which

was unprecedented in scope and importance to the Canadian economy.

From the perspective of a student of antitrust analysis, the Minister's conclusion regarding competitive effects should not be seen as "not now, not ever" prohibition of deals such as these. Rather, it must be understood and evaluated in the political context in which it was made. Whereas the merger proponents wanted the mergers in order to change the status quo, the Minister, and the Liberal government, believe the status quo must be changed before any merger can be considered.

### **THE PROPOSED MERGERS**

On January 23, 1998, Royal Bank of Canada ("Royal Bank") and Bank of Montreal announced their intention to merge. Given the size of the parties, and something of a Canadian fixation with the health, wealth and influence of the banking sector, the deal became and remained front page news. Royal Bank and Bank of Montreal are two of

1. Department of Finance Canada, News Release 98123, "Minister of Finance Announces Decision on Bank Merger Proposals" (14 December 1998). <<http://www.fin.gc.ca/newse98/98123e.html>>

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Canada's five largest national banks. In addition to national banks, regional banks (many of which tend to focus on commercial business), trust companies, local credit unions, asset-based lenders, leasing companies, mortgage providers and insurance companies provide credit and other products in Canadian financial services markets.

Royal Bank and Bank of Montreal operate significant retail networks (Royal Bank has about 1500 branches, Bank of Montreal about 1,100 branches) throughout the country and provide retail banking services through automatic banking machines, telephone banking, PC banking and Internet banking. The banks derive significant revenue from non-core banking activities such as investment banking, retail brokerage, credit card services and insurance.

In April 1998, spurred by the Royal Bank/Bank of Montreal breakaway from the pack, Canadian Imperial Bank of Commerce ("CIBC") and Toronto-Dominion Bank ("TD Bank") announced their own merger of equals. CIBC and TD Bank are ranked as the second and fifth largest banks in Canada and, like Royal Bank and Bank of Montreal, offer an extensive range financial services throughout the country.

### **TYPICAL MERGER REVIEW**

The Competition Act provides for the review and possible prohibition or restructuring of mergers that are likely to "prevent or lessen competition substantially" in Canada. There are two key players in this process — the Competition Bureau (headed by the Director), which plays an investigative role, and the Competition Tribunal, which has an adjudicative function. A reference to the Competition Tribunal occurs only if the Director identifies competition law concerns that he is unable to resolve with the parties, usually by an agreed-upon restructuring of the deal. When the Director does take a case to the Tribunal, the onus is on him to prove, on a balance of probabilities, that competition will be prevented or lessened. The division of responsibilities and functions between the Director and the Tribunal provides an impor-

tant check and balance to the merger review system.

When financial institutions are involved in a merger, in addition to the Director, the Minister of Finance and the Superintendent of Financial Institutions ("Superintendent") have a legislative mandate to review the transaction. Both the Superintendent and the Director have clear mandates for review based on prudential and competition considerations, respectively. The role of the Minister of Finance is based on much broader public interest considerations, and he has the final say. Under the Bank Act, the Minister has the right to approve or disapprove of mergers, independent of the Competition Act. This creates the possibility that the Minister of Finance may approve (or not approve) a merger that has been challenged (or cleared) by the Director.

### **BANK MERGER ENFORCEMENT GUIDELINES**

In anticipation of mergers in the financial services sector, and because of uncertainty as to how competition law review of those mergers would relate to the Minister of Finance's broader mandate, the Director prepared a discussion paper on the subject in November, 1997, some months before the mergers were announced, and released a discussion draft of proposed Merger Enforcement Guidelines as Applied to a Bank Merger ("BMEGs"). Following extensive public consultations, final BMEGs were issued on July 15, 1998. The BMEGs confirmed that:

- The Competition Bureau would apply its traditional merger review framework to consider the likely effects of a bank merger — i.e. relevant product and geographic markets would be defined, and an assessment made of whether in any defined market the merger would enable the merged entity to exercise a greater degree of market power unilaterally or interdependently with others (by, for example, raising price, which would not be eliminated within two years by competition from existing or new competitors).

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- Shares of market participants would be calculated on the basis of sales volumes rather than unit sales or capacity.
- The existing 35% (combined share of the merged entity) and 65/10% (i.e. whether post-merger the four largest firms would have more than 65%, and the merged entity more than 10% market share) safe-harbor thresholds would be maintained, and applied as an initial screen to help identify potentially problematic markets. Following this screening, competition factors in each "problematic" market would be assessed to determine the effects of the merger in each such market.
- Notwithstanding that the Royal Bank/Bank of Montreal merger was announced some three months prior to the CIBC/TD Bank merger, the Competition Bureau would review both mergers concurrently.

Because of the overriding authority of the Minister of Finance, the Director also consulted and agreed with the Minister of Finance on a coordinated approach to review of the mergers. The agreed approach (set out in an appendix to the BMEGs), contemplated that:

- Immediately after the Competition Bureau had completed its analysis of the merger as proposed, the Director would provide to the parties and to the Minister of Finance a letter setting out the Director's views on the competitive aspects of the proposed merger. (The Minister indicated subsequently that he would make any such letter available to the public.) The Director would not discuss remedies with the parties prior to issuance of the letter.
- After receiving the letter from the Director and taking into account any public interest concerns expressed by the Minister of Finance, the parties to the merger would then be in a position to determine if it was appropriate to explore potential remedies with the Bureau to address the Director's concerns.
- Any remedies agreed between the parties and the Director would require the approval of the Competition Tribunal and the Minister of Finance.

This approach differed fundamentally from the process

normally employed to review non-bank mergers in that the Director agreed with the Minister that he would not negotiate remedies to his concerns (if any) until after the Minister of Finance had identified his public interest concerns. In the Director's view, "it is not practical to consider possible remedies until the Banks have heard the public interest concerns of the Minister of Finance." So, while during the course of the Bureau's investigation the merging banks indicated a willingness to consider remedies to the Director's concerns and their belief that all concerns could be met, the Bureau would not discuss specific solutions during the "Stage 1" issue identification part of its investigation. The process also removed the possibility that the Director would take his case to the Competition Tribunal before the Minister received the Director's views. Thus, Bureau staff did not have the possibility of Tribunal review to act as an overriding discipline of their work.

### **THE COMPETITION BUREAU'S INVESTIGATION**

The Bureau's investigation was extensive. Early on, a dedicated team of commerce officers within the Bureau was assigned to review the mergers, with smaller teams being devoted to particular lines of business. More than 100 individuals (Bureau staff and consultants) worked on the file over the course of the Bureau's 11 month investigation. Cdn. \$4 million of special funding was obtained from Treasury Board to fund the Bureau's efforts. These were the first significant bank mergers investigated by the Canadian Competition Bureau. Unlike in the U.S. where local/regional bank mergers are commonplace and regulators have a wealth of experience in market definition issues, Canadian regulators had to develop analytical tools and approaches to assist in their definition of financial services markets throughout the vast country, in many instances based on incomplete data. The Bureau also consulted extensively with antitrust agencies in the U.S., Europe and Australia, and with industry experts.<sup>2</sup>

### **THE DIRECTOR'S CONCLUSIONS**

On December 11, 1998 the Director delivered letters to the merger parties and the Minister of Finance indicating that the Competition Bureau had examined the likely impact on competition of the two mergers and deter-

2. The Bureau retained a number of outside consultants and economists to assist with its investigation. Coincidentally, an exchange officer from the Australian antitrust agency (who had worked on the Westpac/Bank of Melbourne merger) was seconded to the Bureau during 1998, and was part of the Bureau's merger team.

mined that a detailed analysis was required only for three major lines of business: branch banking services, credit cards, and securities. Other areas of the parties' businesses did not pose competition concerns and therefore were not subject to detailed review. In each case, the Bureau concluded the mergers likely would lead to a substantial lessening of competition in some aspect of branch banking, credit cards and investment banking.

The Bureau was operating under third party imposed time constraints and other restrictions, which led to a number of its conclusions being preliminary and subject to further work. This is noted by the Director in several instances in his letters to the parties. For example, the Director indicated the Bureau was prepared to review many of its conclusions regarding market concentration in branch banking and full service brokerage services based upon additional local level data, which it did not have at the time the letters were drafted. In addition, while the Bureau concluded that the merger would result in a substantial lessening of competition in many markets for branch banking and full service brokerage, in an almost equal number of markets the Bureau made the preliminary conclusion that there might be a substantial lessening of competition and that the detailed review was required before that conclusion could be confirmed. As contemplated in the BMEGs, the Director invited the merging banks to discuss remedies with him after the Minister of Finance had identified his public interest concerns.

The Competition Bureau's analytical approach and conclusions are discussed more fully below.

### **Branch Banking**

*Product Markets:* Banking services provided through branches to individuals and businesses were considered separately. The Bureau defined as relevant antitrust markets the following personal branch banking products:

- personal transaction accounts
- personal long-term investments
- personal short-term savings instruments
- residential mortgages
- personal loans/lines of credit (excluding credit cards and credit provided by consumer finance companies)
- student loans

A detailed review of the effect of the transactions on markets for personal long-term investments, personal short-term savings instruments, and student loans was determined to not be required because remaining competition was effective and the market share safe-harbour thresholds were not exceeded. The remaining three product markets were analyzed in detail.

Within the category of branch banking services provided to businesses, the Competition Bureau defined the following three antitrust product markets:

- Business transaction accounts and related services (such as night depository, coin and cash services)
- term loans (including leases and non-residential mortgages)
- operating loans

A detailed review of term loans was not conducted because the Bureau concluded that remaining competition was effective. The remaining two defined product markets were analyzed further, with the operating loans product market being subdivided into three distinct segments: loans less than C\$200,000; loans between C\$200,000 and C\$1 million; and loans between C\$1 million and C\$5 million. Banking services provided to commercial and large corporate entities were not viewed as being problematic because of effective remaining competition.

*Geographic Markets:* The Competition Bureau concluded that relevant geographic markets were local for all products, other than operating loans between C\$1 million and C\$5 million, for which markets were defined as regional (province). In support of this conclusion, the Bureau relied upon bank documents, interviews with industry participants, econometric analyses prepared by the Bureau, and advice of experts retained by the Bureau.<sup>3</sup>

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3. Royal Bank and Bank of Montreal had argued that relevant geographic markets were national. The banks' arguments were premised on a number of factors including national pricing for many products, the easy accessibility by way of automated teller machines, telephone banking, PC banking and Internet banking of substantially all services traditionally offered through branches, use of electronic credit scoring techniques, mobility of account managers, centralized management of loan portfolios and recent successful entry of a number of virtual banks.

Hundreds of local markets were identified. To define urban markets, the Bureau used 112 integrated economic areas defined by Statistics Canada as Census Agglomerations ("CA") and 25 areas of more than 100,000 people identified by Statistics Canada as a Census Metropolitan Area ("CMA").<sup>4</sup> Relevant rural markets were identified as those non-urban areas in which the merging parties had branches that were located within 20 km of each other. To define rural markets, Bureau staff drew circles with a radius of 20 km around all non-urban branches of the merging banks that were located within 20 km of each other. The resulting peanut-shaped area was defined as a relevant rural market.

This approach resulted in the identification of 125 urban markets and 99 rural markets in which Royal Bank's and Bank of Montreal's branch operations overlapped. CIBC's and TD Bank's branch operations were found to overlap in 179 local markets (111 urban and 68 rural markets).

As is obvious from its use of mid-point radius measurements to define rural markets, the Competition Bureau's approach to market definition was rigid and formalistic. The markets as ultimately defined in many instances were illogical. For example, in adopting the 20 km mid-point radius approach, it must be assumed the Bureau took 20 km as its best estimate of the extent of the geographic influence of bank branches located in rural areas. Logically, then, branches located within 20 km of each other should be in the same market. However, when the Bureau's methodology was actually implemented in those parts of the country having high population density and/or an abundance of financial institutions, a series of overlapping circles was constructed. In other areas, the rural circles overlapped the boundaries of the defined urban markets. The resulting pattern was a classic example of a "chain reaction" sometimes seen in geographic market definition exercises, where a series of areas that are quite distant from one another (at the extremes) properly are found to form part of the same market because they exert price discipline on immediately neighbouring

4. CAs and CMAs are urban areas which Statistics Canada has determined have a high degree of social and economic interaction. One important factor used to define CAs and CMAs is commuting data. The commuting thresholds utilized by Statistics Canada to define a CA and CMA are far higher than the commuting thresholds underlying the delineation of similar urban areas in the U.S. and are far higher than the commuting thresholds underlying the delineation of local banking markets applied by the U.S. Federal Reserve Board and U.S. Department of Justice.

markets. This notwithstanding, the Bureau chose to ignore the overlap in the circles and treated each primary circle/urban area as a distinct geographic market.<sup>5</sup>

The parties provided considerable evidence to the Bureau to support expansion of many identified urban and rural markets. Data were furnished regarding commuting patterns; media, advertising, shopping and other economic and cultural links between communities; customer locations; and experiences of local branch managers about the geographic extent of their activities. The parties' submissions were largely ignored, although Bureau staff did indicate a willingness to re-consider defined geographic markets in the context of remedial discussions, which might take place after the Minister of Finance had identified his public interest concerns.

It is noteworthy that the Bureau's approach to market definition was inconsistent with the approach typically taken by the U.S. Federal Reserve Board and the U.S. Department of Justice to define geographic markets. Those agencies define "local" banking markets having regard to information on commuting patterns, economic and cultural links between communities and customer data. Under that approach, "local" banking markets often are defined to include numerous urban centres and rural communities. By way of example, in a 1994 decision the Federal Reserve Board defined a single, local banking market in Montana that was over 200 miles long and no less than 60 miles wide at any point.<sup>6</sup> In defining the market, the Board rejected protests that the market should be limited to an area within a 50 mile radius of Great Falls, Montana.<sup>7</sup>

*Market Concentration:* The Bureau obtained financial information that the merging banks and a variety of other financial institutions reported to the Canadian Bankers' Association<sup>8</sup> in order to assess concentration in the

5. This compares to the U.S. where considerable weight is given to the "chain reaction" transmission of market forces that integrate broad geographic areas, even in the fragmented U.S. banking system. See, for example, P. Calum and L. Nakamura, *Branch Banking and the Geography of Bank Pricing* [1997] and L. Radecki, *The Expanding Geographic Reach of Retail Banking Markets* [June 1998].

6. *Norwest Corporation*, 80 Fed. Res. Bull., 455 (1994).

7. See also R. Tannenwald, *The Geographic Boundaries of New England's Middle Lending Markets*, *New England Economic Review*, July/August 1994.

8. The Canadian Bankers' Association is a trade association of Canadian financial institutions. Among other things, it collects and reports to participating members (including the four merging banks) information about assets (e.g. outstanding personal and business loans) and liabilities (e.g. deposits) on a branch basis. Through court order, the Competition Bureau obtained this information from the CBA. The Bureau supplemented the CBA data with similar information obtained (by court order) from other deposit-taking institutions which do not report data to the CBA.

defined product and geographic markets. That data led the Bureau to conclude that the Royal Bank/Bank of Montreal merger would result in the merged entity having more than 35% share of at least one product market in 175 of the 224 local markets identified. With respect to the CIBC/TD Bank merger, the 35% safe-harbour threshold was exceeded in 89 of the 179 local markets in which the banks' branch operations overlap. The banks raised a number of issues with the Bureau regarding the CBA data. The market position of reporting institutions was not accurately portrayed in many instances because of anomalies in the way data were reported to the CBA. For example, information on "business deposits" included all business customers of the banks, not only the small and medium-sized businesses that were of concern to the Bureau. Also, some institutions reported data to the CBA according to where the relevant asset or liability was booked (e.g. central booking point) without regard to the location of the customer or branch at which the customer maintained its primary operating account. In his letters to the banks, the Director noted that the banks had raised these and other issues with the Bureau, and he indicated a willingness to further discuss the issues with the banks. However, because of time constraints and the Bureau's need for some data (however incomplete) to assess market concentration, the CBA data were used by the Bureau as a basis for its conclusions about the possible competitive consequences of the mergers.

*Competitive Effects:* Having identified many markets in which the merging banks had market shares in excess of safe-harbour thresholds, the Competition Bureau then considered a number of factors to assess the competitive effects of the mergers. In summary, the Bureau concluded that:

- barriers to entry (regulatory and economic) are high;
- while technological change is having great impact on the banking industry, it has not resulted in reducing barriers to entry significantly or expanding the scope of geographic markets;
- foreign competition is minimal;
- the transactions would result in the removal of effective and vigorous competitors; and
- remaining competition would be ineffective to discipline the merged entity, and would be unable to replicate the competition removed by the merger.

While each of these factors is important and relevant from a national or regional perspective, the Bureau did not follow the BMEG-stated approach of assessing the competitive effects of the proposed transaction in each geographic market that it defined as relevant. For example, while the Bureau observed that Canada Trust (a large, full service trust company) is an important "regional player" in Ontario, British Columbia, and Alberta, its ability to be an effective, national competitor was discounted. What the Bureau did not consider was whether Canada Trust (or any other regional or local player) could or would provide competitive discipline in some or all of the hundreds of specific local markets that the Bureau identified as being problematic. Bureau staff indicated to the parties that such a detailed analysis could not be completed within the time by which the Director's letter was to be provided to the Minister, but that relevant local factors would be considered during "Stage 2" discussions about remedies.

The merging banks had argued that a prime motivating factor for their deals was to grow in order to capture additional economies of scale and compete more efficiently. Until this case, the Competition Bureau had always regarded efficiencies as pro-competitive and welfare enhancing. However, using logic formerly restricted to the European Union's antitrust authority, the Director concluded that if this were true, remaining competition, all of which would be considerably smaller than the merged banks, would be at a significant cost disadvantage and would not be able to compete effectively with the merged banks. How such a conclusion can co-exist with Canada's legislative efficiency defence remains to be seen.<sup>9</sup>

*Interdependence:* Using the CBA data, the Bureau determined that if the transactions were consummated, the 65/10% safe-harbor threshold would be exceeded in respect of at least one product market in substantially all geographic markets.<sup>10</sup> The Bureau also determined that structural factors which facilitate interdependent behaviour were present in the industry. Based on these structural data, the Bureau expressed concern, supported by an academic analysis received from an expert retained

9. The Competition Act contains a unique provision which precludes the Competition Tribunal from making an order against a merger if it finds the merger is likely to bring about gains in efficiency that will be greater than and will offset anticompetitive effects likely to result from the merger, so long as the efficiency gains are not otherwise obtainable.

10. That is, following completion of the mergers the four largest competitors in the market would have a combined market share of 65% or more and the merged bank's share would be 10% or more.

by the Bureau, that the proposed mergers would increase the risk for reduced competitive vigor among the post-merged major banks. No facts were identified by the Bureau to support any view that its "concern" about interdependence was real, or that the post-merged banks would compete any less vigorously than they compete today. In fact, the Director specifically stated in his letters that the Bureau did not believe that collusion in banking was likely.

The Bureau's conclusions relating to the likelihood of adverse interdependent behaviour were highly theoretical and structuralistic. The Bureau also ignored contrary expert evidence and facts adduced by the parties. Although the approach taken was unprecedented, merging parties in future cases involving highly concentrated industries should be prepared to address this issue. Whether the Director would be inclined to "theory" based opposition where the parties have the option to force the Director to the discipline of presenting an "evidence" based case before the Competition Tribunal is another matter.

*Conclusions:* The Bureau concluded that both mergers would likely result in a substantial lessening of competition and would require a remedy in markets with a combined market share of 45% in either personal or business transaction accounts.<sup>11</sup> It also concluded that a large number of other markets might be problematic, but that further analysis was required. (The discussion that further analysis was required indicates the unfinished state of the Bureau's work at the time of its December report to the parties and the Minister of Finance).<sup>12</sup> A substantial lessening of competition also was found to exist in a number of provincial markets for business operating loans between C\$1 million and C\$5 million.

The Bureau's conclusions were based largely on a narrow, structural approach to considering competitive effects, which was unprecedented in Canada. Indeed, it is not uncommon in Canada for transactions which result in market share of more than 45% to be unchallenged. It is not known whether the Bureau's conclusions would have been materially different if it had the time and

opportunity to improve the CBA data on which so many of its conclusions were based, assess competitive effects in each local market, and consider whether competition in fact would be lessened substantially in the numerous "possibly problematic" markets.

### **Credit Cards**

Royal Bank issues Visa credit cards; Bank of Montreal is the largest issuer of MasterCard credit cards in Canada. Unlike in the US, "duality" is prohibited under the current card association rules in Canada.<sup>13</sup> The Bureau analyzed the transaction on the assumption that these rules would remain in effect, which led it to focus on the competitive impact of the merged Royal Bank/Bank of Montreal converting entirely to Visa or MasterCard.

Both CIBC and TD Bank are major issuers of Visa credit cards, which gave rise to some different issues than in the Royal Bank/Bank of Montreal merger.

*Market Definition:* Six relevant product markets were identified by the Bureau:

- general purpose credit card issuing to businesses
- general purpose credit card issuing to individuals
- general purpose credit card network services
- Visa merchant acquiring
- MasterCard merchant acquiring
- Primary merchant acquiring

The two issuing markets reflected a distinction based on type of customer. They also excluded other payment substitutes (e.g. debit cards, cheques, and the emerging introduction of "smart cards") and other credit substitutes (e.g. merchant credit cards or account financing, lines of credit, personal loans, etc.). However, the Bureau recognized that non-duality rules did not preclude Visa and MasterCard financial institutions from competing with each other or with charge cards such as American Express in the card issuing business.

11. In 104 markets, in the Royal Bank/Bank of Montreal merger, and 36 markets in the CIBC/TD Bank mergers.

12. The possibly "problematic" markets were those with a resulting combined share of between 35% and 45% in either personal or business transaction accounts, or in which the merged banks would have a combined share of any product other than transaction accounts of more than 35%. This involved 71 markets in the Royal Bank/Bank of Montreal merger and 53 markets in the CIBC/TD Bank merger.

13. I.e. a financial institution is prohibited from issuing a competitive brand of credit card.

The concept of a network services market is controversial (although it has also been adopted by the U.S. Department of Justice in its recent complaint against Visa and MasterCard in the U.S.) because the associations do not sell services directly to cardholders or merchants; the "customers" for network services would be the financial institutions who are the members comprising the association. Unlike issuing, the Bureau concluded that non-duality rules resulted in discrete markets for acquiring Visa and MasterCard transactions from merchants. In addition, it identified an interesting and complete bundled market described as "primary acquiring," which typically consists of the provision of acquiring services for debit transactions plus one credit card brand and potentially point-of-sale terminal rentals.

For each product market, the Bureau concluded that relevant geographic markets were either national or in transition to a national market.

*Conclusions:* The Bureau recognized that neither transaction would lessen competition substantially in issuing markets because of effective remaining competition and recent (plus potential future) entry.

The Bureau concluded that the Royal Bank/Bank of Montreal merger would likely result in a substantial lessening of competition in the market for general purpose credit card network services if Bank of Montreal's MasterCard portfolio was converted to Visa. This conclusion was based primarily on Bank of Montreal being the "dominant" issuer and only national acquirer for MasterCard in Canada. Bank of Montreal's switch to Visa was predicted to seriously undermine MasterCard's funding base, possibly eliminating MasterCard as an effective brand in Canada. If, however, Royal Bank converted to MasterCard, the Bureau's concerns about network competition would have been alleviated (subject to considering questions about corporate governance within MasterCard).

The Bureau's decision to separate Visa acquiring and MasterCard acquiring meant that Royal Bank and Bank of Montreal were competing in different markets. However, the CIBC/TD transaction was determined to result in a substantial lessening of competition in Visa acquiring based on limited effective remaining competition (particularly if Royal Bank were to convert to MasterCard), removal of a vigorous competitor, and high entry barriers.

In the primary merchant acquiring market, the Bureau stated that each of the mergers on its own "may" result in a substantial lessening of competition and that the two

together would do so. This was because of limited effective remaining competition, the removal of vigorous competitors, perceived barriers to entry related to small and medium-sized merchants' preference to obtain these services from local bank branches, third party processors' inability to directly participate in the credit card associations, and economics of scale.

### ***Investment Banking***

The Bureau defined seven product markets relevant to the broadly defined investment banking/brokerage businesses carried on by subsidiaries of the banks.<sup>14</sup> However, concerns expressed by the Bureau were different for each merger.

*Royal Bank/Bank of Montreal:* The Bureau concluded that this merger would likely result in a substantial lessening of competition in markets for full service brokerage and might result in a substantial lessening of competition in the national market for equity underwriting.

The full service brokerage product market was defined narrowly to be the market for "advised trades in securities." Despite the clear migration of customers to the discount side and a long term downward trend for commissions, discount brokerage services were excluded as not sufficiently substitutable for advised trades.

Using the same narrow approach to local market definition adopted by the Bureau to define local markets for branch banking services, the Bureau defined 63 relevant local markets, and identified competitive concerns in all but 8 of the markets. Problematic markets were again identified solely through a structural analysis of market share using as a measure of market share "assets under administration" held by the parties. Consistent with the preferred approach set out in the BMEGs of measuring market share based on sales, the banks had argued that equity trading commissions was a more appropriate measure. As a further indication of the tentative nature of his conclusion, the Director indicated in his December 11,

14. The defined product markets were discount brokerage (execution of trades without advice), debt underwriting, M&A advice, institutional equity trading, institutional debt trading, full-service brokerage (execution of trades with advice) and equity underwriting. The subsidiaries include RBC Dominion Securities (owned by Royal Bank), Nesbitt Burns (owned by Bank of Montreal), TD Greenline and CIBC/Wood Gundy.



1998 letter that the Bureau might be prepared to review its conclusions if trading commission data on a local basis were obtainable.<sup>15</sup>

Although the Bureau concluded the transaction might result in a substantial lessening of competition in equity underwriting, it was conceded that detailed further review was required before that result could be confirmed. Once again, the Bureau's concerns were structural in nature — premised on a post-merger share exceeding 35%, but less than 40%, calculated on a "full credit to lead" basis.<sup>16</sup> Barriers to entry into the market were found to be high, and the industry had characteristics that led the Bureau to believe that market power may occur at lower market share and concentration levels than would normally be of concern to the Bureau. The Director indicated that the "interdependent nature of the industry" compounded these concerns.

*CIBC/TD Bank:* The Bureau concluded that the CIBC/TD Bank merger raised concerns in 3 of the 77 local markets it defined as relevant in the market for full service brokerage services. The Bureau also conducted a detailed analysis of the market for discount brokerage, and concluded that the merger would not result in a substantial lessening of competition in that market even though CIBC and TD Bank together had more than 45% market share. The Bureau's conclusion was based on its determination that barriers to entry were only moderate, CIBC was not considered a vigorous competitor, and that there was effective remaining competition.

### **Efficiencies**

Efficiency claims were made in respect of both mergers.<sup>17</sup> While the Director acknowledged these claims in his letter, he indicated that to a large extent the efficiency gains likely to arise from the mergers would be shaped by the public interest concerns expressed by the Minister of

Finance. For example, if the Minister required the banks to keep open certain rural branches, gains anticipated by closing these branches would have been lost. The Director accordingly concluded that the magnitude of efficiency gains could not be projected accurately until the Minister of Finance had articulated his public interest concerns.

### **FACTORS AFFECTING THE FUTURE**

In addition to the Competition Bureau's conclusions, the Minister of Finance relied upon a number of background reports prepared by the Superintendent of Financial Institutions. The Superintendent did not rule out either merger for prudential reasons. However, he raised issues about their potential impact on the overall financial system, and recommended that the government take these into consideration in formulating its own decision. The Superintendent's concern was that if one of the merged entities faced financial difficulty, with fewer large domestic institutions the government could find itself in a situation where it might have to put other fundamental policy objectives — such as the need for competition or Canadian control — into question in order to preserve its ability to address the financial instability of the new "big bank." In other words, the Superintendent feared that the size of the institutions that would result from the mergers would constrain the alternatives available to regulators and the government.

A series of other government reports were issued during 1998 which considered the future of the Canadian financial services industry and the desirability of industry consolidation. The first of these, the MacKay Report<sup>18</sup>, was issued by the Task Force on the Future of the Canadian Financial Services Sector in mid-September. The MacKay Report was followed in December by reports of two Parliamentary committees, the Commons Standing Committee on Finance and the Standing Senate Committee on Banking, Trade and Finance. Each was quick to recognize that the national and international context in which banks operate is undergoing rapid and profound change. More importantly, at least for the future, each concluded that mergers, even among the large Canadian banks, can be a legitimate business strategy.

### **CONCLUSIONS**

To the extent that competition law practitioners feel the Bureau's approach was too structural and perhaps mis-

15. The data were readily obtainable from, and offered by, the parties. The Bureau did not collect comparable data from third parties.

16. The banks had argued that a better measure of market share was "bonus credit to lead" or "share of underwriting liability", measures commonly used in the industry. Under either of these measures, the combined share would have been below the 35% safe-harbour threshold.

17. As noted above, efficiency claims historically have been regarded as pro-competitive and welfare enhancing, and can be used as a defence to an anti-competitive merger. Royal Bank and Bank of Montreal made a detailed efficiencies submission to the Competition Bureau in which they claimed that the merged bank would save approximately \$1 billion by eliminating duplication in branch networks, technology spending, and overhead and administration. CIBC and TD made claims to the Bureau to the effect that their merger would result in annual cost savings of at least 10% of the non-interest expense of the combined bank.

18. The Task Force, established by the Minister of Finance in late 1996, was chaired by lawyer Harold MacKay.

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guided, the flaw may be in the process agreed between the Director and the Minister under which there was no role for the Competition Tribunal and remedies were not to be discussed. Time constraints also were a factor.

The Competition Bureau's analysis of the proposed bank mergers was structural and formalistic, notwithstanding early indications in the BMEGs that the mergers would be assessed under a fact-driven analytical framework. The parties knew that adjustments to their transactions might be required in order to address competition concerns and this was signalled to the Bureau. Based upon experience in other jurisdictions, the issues raised by the Director clearly were remediable, but the parties simply were not able to discuss these solutions with the Bureau.

Looking forward, the government proposes to move quickly to redefine the policy and regulatory framework for the financial sector as a whole. This will include putting in place a new review process to assess major bank merger proposals. In the interim (it is hard to say how quickly the government will move — six months to two years provides a realistic range), the government will not consider any mergers among major banks. Even after a new policy framework is in place, the Minister has stated that new merger proponents will first have to demonstrate, in light of the circumstances of the day, that the merger will not unduly concentrate economic power, significantly reduce competition or restrict the government's flexibility to address prudential concerns. ■

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