BANK MERGER POLICY
IN A TOO-BIG-TO-FAIL ENVIRONMENT
Too-Big-to-Fail (TBTF): An Intractable Problem?

- Past legislation and regulation have not solved the problem.
- Unclear whether current proposals will be effective.
- A revision of bank merger policy can contribute to mitigation.
TBTF Has Two Faces.

- **Crisis Face**
  - Failure of large financial companies
  - Materialization of systemic threat
  - Anxiety in balancing costs and benefits of government support

- **Prosperity Face**
  - Implicit guarantees for those TBTF lowers funding costs
  - Encourages greater risk-taking
  - Provides competitive advantage over rivals “too-small-not-to-fail”
Crisis Produce Reforms
Prosperity Produces Apathy

• In tranquil periods, high profits appear to augment bank safety.
Bank Merger Movement

• Contemporary bank merger movement began in 1980s.
• Between 1980 and 2009 about 10,500 mergers.
• Largest banks in country shaped by large mergers.
• Since 1991, the modern Bank of America, largest in U.S. today, has been involved in 18 large bank mergers.
BANK MERGER MOVEMENT
Structural Consequences
Period: 1980 - 2009

• Reduction in numbers of banks
  – Number of banking organizations in the U.S. declined from about 12,000 to about 6,000.

• Increase in national concentration
  – Proportion of bank deposits held by the 5 largest banks increased from about 12 percent to 43 percent.

• The largest banks are now present in most major metropolitan areas.
Bank Merger Evaluation

- **Federal Reserve** -- principal regulatory authority for large bank merger proposals.
- **Antitrust standards** applicable.
- **Since mid-1980s, few mergers denied; no large bank mergers denied.**
- **Reasons:**
  - Deregulation permits freer entry into local markets (principal merger evaluation focus) and more potential competition
  - New technology and changes in law expand economic markets.
  - Justice Department Merger Guidelines provide an economically sound basis for local market determination that tends to expand markets
  - Effect is to reduce pre-merger concentration levels, and post-merger changes in concentration in local markets.
- **Modification of Federal Reserve Standards**
  - Preliminary acceptance of Justice Department “Concentration” Guidelines
  - If concentration levels are violated, negotiated divestitures
  - When insufficient, mitigating factors
Merger Decisions Ignore TBTF

• Neither Federal Reserve nor any other Federal banking agency has ever considered the competitive effects of a merger that would create or augment a bank TBTF.

• Neither the Federal Reserve nor any other Federal banking agencies has ever considered the systemic threat posed by mergers that create or augment a bank TBTF as a “banking factor;” that is, as an issue affecting “convenience and needs of the community or “the safety and soundness” of the resulting institution.

• The Justice Department has also never considered anticompetitive effects of mergers creating or augmenting a bank TBTF.
Proposed Revision of Merger Policy

• More complete analysis of proposed bank mergers.
  – Addition of TBTF as an aggravating factor.
  – Negative weights with rising concentration.
  – Restrict negotiated divestitures for banks TBTF
  – Additional Capital and Higher Insurance Premiums for Large Banks.
  – Annual Reports to Congress.
CONCLUSIONS

• TBTF has been an intractable problem.
• Bail-outs in crises and injury to competition are two sides of the same TBTF coin.
• Merger policy has facilitated growth of banks TBTF.
• The 2008-09 crisis was a missed opportunity.
• A new merger policy to help mitigate the problem is necessary.
**Table 1  Numbers of Mergers, 1980-2009**

- Bank Mergers……...10,787
- Large Bank Mergers….583
- Mega-bank Mergers……64

**NOTES:** Mergers include combinations of thrift institutions with commercial banks. Large Mergers” are defined as mergers in which organization had $1 billion or more in assets. “Mega-bank-mergers” defined as mergers in which each organizations had $10 billion or more in assets.
Table 2: Structural Change in U.S., 1980-2006

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<th>1980</th>
<th>2006</th>
<th>2009</th>
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<td>Insured U.S. commercial banks</td>
<td>14,407</td>
<td>7,321</td>
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<td>No. of banking organizations</td>
<td>12,342</td>
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<td>No. of banking offices</td>
<td>52,710</td>
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<td>Held by top 5</td>
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