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”

Crises Produce Reforms
Prosperity Produces Apathy

- FDICIA (1991) – Attempt to mitigate problem.
- 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
  - Example: Southern National Corporation, 1997.

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

	1980	2006	2009
Insured U.S. commercial banks	14,407	7,321	6,770
No. of banking organizations	12,342	6,228	5,944
No. of banking offices	52,710	82,442	N/A

Table 3: Aggregate Concentration Consolidated for Organizations

(Percent of Deposits)

	1980	2006	2009
Held by top 5	**11.9**	**35.9**	**42.5**
Held by top 10	**18.6**	**45.1**	**52.0**
Held by top 25	**29.1**	**60.0**	**65.6**
Held by top 100	**46.8**	**74.3**	***77.3***