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# ANGLO AMERICAN COMPETITION ASPECTS OF BANK MERGERS

**Genci Bilali**

**Degree of Doctor of Philosophy  
The University of Edinburgh**

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## DECLARATION

I confirm that this thesis has been composed by me, that the work contained in this thesis is my own and has not been submitted for any other degree or professional qualification.

**/gencibilali/**

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Genci Bilali  
Old College, University of Edinburgh  
3 January, 2017



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## ABSTRACT

This thesis analyses the competitive aspects of bank merger transactions under the law of the United Kingdom ('UK') and the United States ('US'), including the applicable law of the European Union ('EU'). This thesis, also, covers bank mergers and competition in view of the financial crisis 2007-08 that is known as the Global Financial Crisis ('GFC').

The analysis under UK and EU law focuses on competition issues in the banking and financial sector, notwithstanding that competition laws in these jurisdictions apply broadly to all sectors of the economy. The US law analysis is based on competition law from federal antitrust and bank regulatory authorities, case law, as well as consumer protection regulation.

This thesis establishes a comparative framework for understanding the competition provisions, examination methods of mergers, administrative proceedings, and case law development among the UK law, applicable EU cases, and US agencies and courts. It highlights potential improvements in the analysis of banking competition and the financial sector as whole. The ultimate goal of any proposed improvement should be to make banks and other financial institutions provide more efficient services and less costly products to consumers, while reducing systemic risk and preserving the soundness and safety of the financial system.

The GFC led UK and US policy makers to introduce a number of laws and regulations aimed at addressing excessive bank risk taking and improving financial regulatory enforcement. The increasing interconnection between competition law and bank regulation means that the competition and banking regulators are well positioned to play an active and wide-ranging role.

The actions taken by the UK, the US as well as other national and international bodies, upon the occurrence of the GFC, were arguably necessary and perfectly justifiable on regulatory and financial stability grounds. The GFC revealed a number of significant regulatory and central bank failures, and especially in terms of defective regulation, supervision, resolution, support and macro prudential oversight. A substantial amount of

work has been undertaken to correct all of these. It is arguable that sufficient action has been taken to remove the worst threats that arise with ‘too-big-to-fail’.

This paper takes a comparative approach and examines the applicability of competition laws, policies, and methods in bank mergers in the UK and the US. It, also, discusses how to improve these laws, policies and methods to make them more efficient and better equipped to preserve and enhance competition in banking and financial system.

## LIST OF ABBREVIATIONS

Abbey	-	Abbey National
Banking Reform Act 2013	-	Financial Services (Banking Reform) Act 2013
BHCA	-	Bank Holding Company Act 1956
BMA	-	Bank Merger Act 1960
BoE	-	Bank of England
CA98	-	Competition Act 1998
CAT	-	Competition Appeal Tribunal
CBCA	-	Change in Bank Control Act 1978
CC	-	Competition Commission
CFPB	-	Consumer Financial Protection Bureau
CMA	-	Competition and Markets Authority
Commission	-	European Commission
Common Market	-	market within the EU
CRA	-	Community Reinvestment Act 1977
Cruickshank Report	-	Don Cruickshank, 'Competition in UK Banking: A Report to the Chancellor of the Exchequer'
DG Competition	-	Directorate-General for Competition
DGFT	-	Director General of Fair Trading
Dodd-Frank Act	-	Dodd-Frank Wall Street Reform and Consumer Protection Act 2010
DOJ Guidelines	-	2010 Horizontal Merger Guidelines
DOJ	-	US Department of Justice, Antitrust Division
EA02	-	Enterprise Act 2002
EC	-	European Community
ECB	-	European Central Bank
ECJ	-	European Court of Justice
ECMR	-	European Community Merger Regulation 2004
EC Treaty	-	European Community Treaty
ERRA13	-	Enterprise and Regulatory Reform Act 2013
EU	-	European Union
EUBC	-	European Union Banking Committee
EUFCC	-	European Union Financial Conglomerates Committee
FAQs on Antitrust Review of Bank Mergers	-	Frequently Asked Questions Regarding Applications filed with the Board of Governors of the Federal Reserve System
FCA	-	Financial Conduct Authority
FDIC	-	Federal Deposit Insurance Corporation
Federal Reserve	-	Board of Governors of the Federal Reserve System
FPC	-	Financial Policy Committee
FSA	-	Financial Services Authority
FSA 2012	-	Financial Services Act 2012
FSCS	-	Financial Services Compensation Scheme

FSMA	-	Financial Services and Markets Act 2000
FSOC	-	Financial Stability Oversight Council
FSB	-	Financial Stability Board
FTC	-	Federal Trade Commission
GFC	-	Global Financial Crises
G-SIFIs	-	Globally Systemically Important Financial Institutions
HBOS	-	Halifax Bank of Scotland
HHI	-	Herfindahl-Hirschman Index
HOLA	-	Home Owners Loan Act 1933
HSBC	-	Hong Kong and Shanghai Banking Corporation Standard Chartered Bank
HSR	-	Hart-Scott-Rodino Antitrust Improvements Act 1976
IA	-	Insolvency Act 1986
IMF	-	International Monetary Fund
Internal Market	-	market within the EU
LIBOR	-	London Inter-Bank Offered Rate
Liikanen Report	-	High-level Expert Group on Reforming the Structure of the EU Banking Sector, Final Report (2012)
Lloyds	-	Lloyds Banking Group
MAG	-	Merger Action Group
Member States	-	Member states of the EU
MRPI	-	Merger Review Process Initiative
NRSROs	-	nationally recognized statistical rating organizations
OCC	-	Office of the Comptroller of the Currency
OFT	-	Office of Fair Trading
<i>Philadelphia National Bank</i>	-	<i>United States v Philadelphia National Bank</i> (1963) 374 US 321
PRA	-	Prudential Regulation Authority
PSR	-	Payment Systems Regulator
RBS	-	Royal Bank of Scotland Group
Retail Banking Report	-	Competition and Choice in Retail Banking Report 2011
Riegle-Neal (Act)	-	Riegle-Neal Interstate Banking and Branching Efficiency Act 1994
RMA	-	Ranally Metropolitan Area
RRD	-	European Recovery and Resolution Directive
Santander	-	Santander, UK
SEC	-	Securities and Exchange Commission
SIB	-	Securities and Investment Board
SIFI	-	systemically important financial institution
Single Market	-	market within the EU
SLC	-	substantial lessening of competition
SLHCs	-	savings and loan holding companies
SME(s)	-	small and medium-sized enterprise(s)

SoFFin	-	Financial Market Stabilization Fund
SoS	-	Secretary of State for Business, Innovation and Skills
SROs	-	self-regulatory organizations
SSNIP	-	small but significant and non-transitory increase in price
TARP	-	Troubled Asset Relief Program
TBTF	-	'too-big-too-fail'
TEU	-	Treaty on European Union (Consolidated version 2012) OJ C326/01
TFEU	-	Treaty on the Functioning of the European Union (Consolidated version 2012) OJ C 326/01
Vickers' Report	-	Independent Commission on Banking, Final Report (2011)
Volcker Rule	-	Section 619 of the Dodd-Frank Act 2010

*Of all the human powers operating on the affairs of mankind, none is greater than that of competition.* (Henry Clay, 1832)<sup>1</sup>

## CHAPTER 1 - INTRODUCTION

This chapter discusses this thesis' principle purpose: the research scope, issues, arguments, and the benefits to society – namely, the consumers' benefits from competition in banking.

### 1.0 Bank mergers and competition concerns in Anglo-American economies

Traditionally, competition policy concerning mergers in the banking sector has varied between efforts to suppress rivalry and to promote liberalization and competition. The 2007 - 2008 global financial crisis ('GFC') raised new questions about the relationship between financial competition and stability, and hence between bank competition policy and regulation.<sup>2</sup> The emergence of extensive systemic risk created from the GFC reopened concerns about the role of competition policy in the banking sector.

There are different 'schools of thought' regarding whether competition is good for banking and bank mergers. Some experts argue that competition undermines the stability of the banking and financial system.<sup>3</sup> Other experts argue that competition in banking is good for stability.<sup>4</sup> The GFC, and especially the post-crisis period, reignited the debate of promoting bank competition and preserving financial stability.<sup>5</sup>

The GFC made governments in the UK and US revisit regulation and competition policy in banking and financial industry. Massive public intervention and significant undermining of competition challenged the *naïve* view that banking is like any other sector

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<sup>1</sup> Henry Clay, American Statesman, Secretary of State and Presidential Candidate, speech to the US Congress, 1832.

<sup>2</sup> J A Bikker and M van Leuvensteijn, *A New Measure of Competition in the Financial Industry* (London: Routledge 2014), pp 1-7.

<sup>3</sup> J H Boyd et al, 'Bank Competition, Risk and Asset Allocations' (2009) *International Monetary Fund, Working Paper*, ch 5.

<sup>4</sup> S Claessens et al, *Crisis Resolution, Policies, and Institutions: Empirical Evidence* in P Honohan and L Laeven (eds.) *Systemic Financial Distress: Containment and Resolution* (Cambridge: Cambridge University Press 2005), pp 169-96.

<sup>5</sup> A Berges et al, *A New Era in Banking: The Landscape after the Battle* (Brookline: Bibliomotion 2014), pp 61-99.

*vis-a-vis* competition policy. The fundamental concern about competition in financial products and services is a lack of customer focus on the part of providers.

In the last decades, the number and size of bank mergers have been on the rise in the UK and the US. This may be related to several connected factors, such as, regulatory reform, globalisation in both financial and nonfinancial markets, financial distress, and technological innovation including the development of electronic banking.<sup>6</sup>

For too long, competition in the UK and US banking industry has not functioned well.<sup>7</sup> Since then, there have been interventions by competition authorities, consumer bodies, and regulators in both countries.<sup>8</sup> Even where these interventions have had positive effects, progress has been too slow and incremental.<sup>9</sup> Fundamental issues of the competitive structure and performance of banking markets in the UK and US remain unresolved, notwithstanding the regulatory reforms taken in both countries in the last decade.<sup>10</sup>

In terms of new participants in competition, the UK and the US banking markets have already seen the entry of new and smaller banks. New technology may provide increased competition from outside the traditional banking model, for example, from mobile and on-line payments or other innovations. Whether these new competitors will be successful, remain to be seen. A particular challenge for entrants is to attract customers from existing bank providers.<sup>11</sup>

Banks directly affect consumers and businesses because the latter use banks to deposit money and borrow capital. Once a bank is merged or consolidated, the business of customers, in particular for individuals and small and medium-sized enterprises ('SME'), is affected.

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<sup>6</sup> M Burton et al, *An Introduction to Financial Markets and Institutions* (New York: Routledge 2015), p 364.

<sup>7</sup> See generally, S Battilossi and Y Cassis, *European Banks and the American Challenge: Competition and Cooperation in International Banking* (Oxford: Oxford University Press 2002).

<sup>8</sup> X Vives, 'Competition and Stability in Banking: A New World for Competition Policy?' (5 March, 2009) *IESE Business School*, Amsterdam.

<sup>9</sup> *Ibid.*

<sup>10</sup> A Bowman et al, *The End of the Experiment?: From Competition to the Foundational Economy* (Oxford: Oxford University Press 2014), p 86.

<sup>11</sup> B King, *Breaking Banks: The Innovators, Rogues, and Strategists Rebooting Banking* (London: Wiley 2014), pp 151-61.



Overall, consumer opinion is that banks fail to provide sufficient disclosure and transparency of the costs of consumer services.<sup>12</sup>

An important issue is the role of the regulatory process on barriers to entry. In bank mergers, regulators are responsible for reviewing the application to ensure that new entrants and smaller banks are not disproportionately affected. Competition from outside the traditional banking model creates new challenges for the process to grant authorization. Regulators, often, unduly constrain bank competition by implementing the business model of incumbent and traditional banks, as the starting point for the design of new rules.<sup>13</sup> This approach disadvantages new technologies and innovative providers.<sup>14</sup>

Many of the issues that competition authorities have been grappling with stem from a lack of customer focus on the part of financial services providers. But, if regulators make consumer welfare the goal of regulation, and take account of the benefits of dynamic market change through competition, authorities can use their rule-making powers to tackle longstanding problems in the market.<sup>15</sup>

The UK and US governments' legislative power in a bank merger to overstep concerns about competition in the name of preserving financial stability appeared justifiable and necessary.

The recent financial services reforms<sup>16</sup> in the UK regulate, among others, competition aspects in banking.<sup>17</sup> Some regulatory initiatives, like the separation of retail banking activities from investment activities, enhanced supervision on capital requirements,

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<sup>12</sup> S Lumpkin, 'Consumer Protection and Financial Innovation: A Few Basic Propositions' (2010) 10 *OECD Journal: Financial Market Trends* 1.

<sup>13</sup> C England, *Governing Banking's Future: Markets vs. Regulation* in E J Kane (eds.) *Tension Between Competition and Coordination in International Financial Regulation* (Massachusetts: Kluwer Publishers 2013), pp 33-48.

<sup>14</sup> D Harrison, *Competition Law and Financial Services* (Oxon: Routledge 2014), pp 75-80.

<sup>15</sup> D Singh, *Banking Regulation of UK and US Financial Markets* (Hampshire: Ashgate 2012), pp 30-42.

<sup>16</sup> For an in-depth discussion of the financial services reforms in the UK, see the following chapters in this thesis: 2.4 ('Vickers' Report and the government's response'); 2.5 ('HM Treasury blueprint report'); 2.6 ('Financial Services Act 2012'); 2.7 ('Financial Services (Banking Reform) Act 2013'); and 2.8 ('Enterprise and Regulatory Reform Act 2013'), pp 18-30.

<sup>17</sup> R Kellaway et al, *UK Competition Law: the New Framework* (Oxford: Oxford University Press 2015), chs 4 and 6; For a detailed discussion of the role of the recent financial services reforms and its effects on competition in banking, see chapters 2.4 - 2.8 in this thesis, pp 18-30.

improvement of account switching, reducing entry barriers, combined with State aid divestments, and new entrants, appear to be a step in the right direction. However, this thesis addresses whether these developments are sufficient and go deep enough to properly enhance and preserve competition in banking. The Brexit referendum result of 2016 has thrown the UK towards uncharted waters in terms of the future relationship between the UK and the EU, including implementation of EU provisions and the UK's access in the EU market. However, the foregoing is not part of the analysis in this thesis, notwithstanding its importance.

In the US, each bank merger must comply with antitrust laws. The regulatory approvals require that before a merger goes forward regularly refer to those laws. In measuring banks against the relevant antitrust laws, the test laid down by the American courts since 1960s continues to control.<sup>18</sup> The courts hold that the relevant geographic area that defines a bank market is local in nature. The market that is tested to establish whether a bank merger violates the antitrust laws can be as small as one or more counties in a metropolitan area.<sup>19</sup>

Accordingly, the largest bank in the US can merge with the third largest bank. The resulting bank can cover a dozen of US states and involve billions of dollars. Whether the merger violates the antitrust laws, however, is a question that can ultimately turn on the situation in a half-dozen counties in a state. There is something wrong with this approach.<sup>20</sup>

No bank merger in the US has been derailed by an antitrust review in the last several decades. Occasionally, local branches will overlap in an undesirable manner. The solution is to sell off a few bank branches and, thereby, resolve the problem. The antitrust laws are a bug to be brushed off, not a fundamental protection of economic liberties.<sup>21</sup>

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<sup>18</sup> The landmark case concerning competition aspects in a bank merger is *United States v Philadelphia National Bank* (1963) 374 US 321. For a discussion of *Philadelphia National Bank* case law, see chapter 8.1 of this thesis, pp 219-23.

<sup>19</sup> C Felsenfeld, 'The Antitrust Aspects of Bank Mergers' (2008) 13 *Fordham Journal of Corporate & Financial Law* 4 ('Felsenfeld'), p 508; see, also, E Ellinger et al, *Ellinger's Modern Banking Law* (5th edn, Oxford: Oxford University Press 2011), pp 3-29.

<sup>20</sup> *Felsenfeld* (n19), pp 5-24.

<sup>21</sup> L Sullivan, *The Law of Antitrust: An Integrated Handbook* (3rd edn., St Paul: West Academic 2015), ch 1; see, also, A Lista, *EU Competition Law and the Financial Services Sector* (New York: Routledge 2013), pp 17-9.

One sees the process continuing. Massive multi-national banks like HSBC, Barclays, Royal Bank of Scotland, Lloyds Banking Group, JPMorgan Chase, Bank of America, Citigroup, and Wells Fargo are gradually becoming the norm. There seems no practical limit, except for proposals to break banks up;<sup>22</sup> to how far the market and regulators will go to allow the reduction of bank numbers and the growth in bank size and concentration.<sup>23</sup>

The obvious question is whether the concentrated market structure of banking sector due to bank mergers remains a concern? One way to consider this question is to look at the current competition law and its enforcement from banking and competition authorities in the UK and US. This thesis addresses this issue.

## 1.1 Thesis' research scope, issues and arguments; Benefits to society

This thesis' research scope concerns the competitive aspects of bank mergers in the UK, the EU, and the US, and seeks to identify current concerns in each jurisdiction that require further consideration in the light of bank consolidations and developments in financial markets due to the Global Financial Crisis ('GFC').

It also offers a comparative analysis of the approaches to the UK and the US competition policies in the context of bank mergers, with the aim of making recommendations for enhancing banking competition and improving consumers' banking services. The term 'competition' and 'antitrust' within the scope of law that are used throughout the thesis bear a similar meaning.

Another important characteristic of this thesis is that although some laws and regulations could be applicable to mergers in all sectors of the economy, for example, in the

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<sup>22</sup> There have been numerous proposals of breaking up the banks, such as, separation of commercial from investment banking, but none of these proposals has come into fruition. Breaking up the banks might shield commercial banking and thereby the economy to a certain degree. However, it cannot ensure financial stability. A Dombret and P S Kenadjian, *Too Big to Fail III: Structural Reform Proposals: Should We Break Up the Banks?* in A Dombret (eds.) *Cutting the Gordian Knot or Splitting Hairs – The Debate About Breaking Up the Banks* (Berlin: Walter de Gruyter 2015), chs 1.1 - 1.5; see, also, S Bair, *Bull by the Horns: Fighting to Save Main Street From Wall Street and Wall Street From Itself* (New York: Simon & Schuster 2012), p 328.

<sup>23</sup> M Dewatripont and J Rochet, *Balancing the Banks: Global Lessons from the Financial Crisis* (New Jersey: Princeton University Press 2010), pp 101-7.

UK and the EU merger and competition legislative system,<sup>24</sup> this thesis narrows its discussion of their legislative applicability strictly within the bank merger's aspects.<sup>25</sup> This is particularly seen in the competition laws and regulations in the UK and the EU, which, unlike most of the American laws and regulations, regulate merger transactions of business across various sectors of the economy.

The author seeks to discuss and answer issues about: (i) the actual efficiency of competition laws for bank mergers in UK and the US; (ii) whether are there no significant legal impediments to banks seeking to merge; (iii) whether the review process of bank merger cases by the courts shaped bank merger competition laws in the UK and the US, or they changed over time; (iv) the role of bank regulators and governmental authorities in the UK and the US in harmonizing and regulating bank merger transactions; (v) the effects on market concentration as a result of bank mergers within particular markets and in markets across the Atlantic; (vi) elements of current competition laws in the UK and the US that need to be improved, changed, or implemented to make them more efficient and effective; and (viii) whether the goals of competition law are undermined when regulators approve of bank mergers intended to reduce systemic risk and whether more rigorous enforcement of competition policy can prevent banks from posing a systemic risk in the first place?

The author, also, seeks to develop arguments within the frame of the foregoing antitrust bank merger issues by analysing each specific jurisdiction's legislative framework, institutional structure, case law analysis, and empirical examination of competition analysis methods over the markets. Thereafter, the author discusses common issues affecting both the UK and the US banking system as a result of the 'too-big-to-fail' ('TBTF') aspects, governments' bailouts towards large banks, and whether competition policies should be sacrificed in the name of the asserted financial stability.

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<sup>24</sup> For a discussion of the applicable competition laws in the UK and the EU, pertaining to bank mergers, see chapter 2 in this thesis, pp 10-47.

<sup>25</sup> *Ibid.* Unlike the US law (such as, Bank Merger Act 1960, 12 USC § 1828), the UK (such as, Competition Act 1998, c.41) and the EU (such as, EC Merger Regulation, Council Regulation 139/2004 on the control of concentrations between undertakings *OJ L24/1*) laws that regulate the competition issues in bank mergers are applicable to all sectors of the economy, including banking sector.

Further, the arguments are developed over a comparative discussion of the specifications between the UK and the US over the bank merger competition systems, with the aim to identify elements that one system may embrace from the other system, as well as what each system, respectively, needs to modify and improve in the interest of the present reality of the bank consolidations market.

The goal of the foregoing arguments is not only to identify issues in each jurisdiction, but also to provide modest recommendation to contribute in the efforts for enhancement of the competition methods in the areas of bank mergers.

The author provides a framework of the existing EU legislation, competition authority, and the case law development over the bank mergers within the EU context. However, such framework is provided only as a natural extension within the context of the discussion over the competition issues in the UK bank merger transaction, considering the UK, as a member of the EU, sustains implementation duties over the EU legislation, EU courts case laws, and the EU competition regulatory authority. It is outside the scope of this thesis any comprehensive discussion of the EU antitrust policies over the bank mergers.

The comparative aspects of this thesis will be developed against the background of the GFC.

## **1.2 Thesis structure**

This thesis is principally structured in four parts.

The first part<sup>26</sup> of this thesis focuses on the UK. It analyses the role of competition and financial authorities in implementing competition provisions, in particular different methods of applicability of the bank merger competition aspects.<sup>27</sup> This thesis, also, will look closely at certain important bank mergers in the UK and the EU that have occurred in the last decade and beyond, analysing the methods employed by the competition agencies to examine bank

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<sup>26</sup> See chapters 2 through 5 in this thesis, pp 10-177.

<sup>27</sup> See chapters 3 and 5 in this thesis, pp 50-79, and 132-177.

mergers in the light of any potential competition issues, as well as the remedies applied by the agencies to resolve such issues.<sup>28</sup>

The Brexit referendum result of 2016 has thrown the UK towards uncharted waters in terms of the future relationship between the UK and the EU, including implementation of EU provisions and the UK's access in the EU market. However, the foregoing is not part of the analysis in this thesis, notwithstanding its importance.

The second part<sup>29</sup> of the thesis deals with the tests implemented by competition and banking agencies in relation to the application of antitrust laws in the US, looking closely at the evolution of American legislation concerning competition in the banking system.<sup>30</sup> It seeks to determine whether this legal evolution has led to a competitive and efficient banking system in the US. The research focuses on the important role of the American courts in accommodating the realities of the banking industry, and on analysing steps taken by the American courts to shape the competition policies in bank mergers.<sup>31</sup>

The third part<sup>32</sup> of this thesis focuses on the aspects of bank consolidation, with emphasis on 'too-big-to-fail' ('TBTF') banks and other financial institutions during the Global Financial Crisis ('GFC') and the role of the UK and the US banking and competition authorities. The author analysis issues whether the actions taken by officials on both sides of the Atlantic were necessary to correct problems exposed by the GFC in terms of defective regulation, supervision, resolution, support and macro prudential oversight; whether sufficient actions has been taken from the foregoing authorities, and elsewhere, to remove the worst threats that arise with TBTF; and whether it was worth sacrificing the implementation of competition provisions in order to prevent banks from failing.<sup>33</sup>

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<sup>28</sup> See chapter 4 in this thesis, pp 81-129.

<sup>29</sup> See chapters 6 through 9 in this thesis, pp 181-299.

<sup>30</sup> See chapters 6, 7, and 9 in this thesis, pp 181-215, and 256-299.

<sup>31</sup> See chapter 8 in this thesis, pp 218-252.

<sup>32</sup> See chapter 10 in this thesis, pp 301-332.

<sup>33</sup> *Ibid.*

The last part<sup>34</sup> of the dissertation discusses substantial differences in the UK and the US approaches to bank mergers in relation to competition. In addition, it looks for opportunities where one jurisdiction might learn from the other jurisdiction; whether one jurisdiction may adopt, within its own specifications, a certain approach or policy from the other jurisdiction in order to enhance its review of the competitive aspects of bank mergers; and whether there are possible recommendations to improve cooperation and coordination between the UK and the US authorities in a bank merger of a common interest.<sup>35</sup>

Finally, it appears that presently there is not much significant academic or scholarly work that provides a comparative analysis of Anglo-American approaches to competition in bank mergers.<sup>36</sup> As such, considering also that the UK and the US are, and remain, the two most important centres of financial services in the world, the role of competition in bank mergers in the UK and in the US, deserves analysis. This thesis endeavours to accomplish that.

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<sup>34</sup> See chapter 11 in this thesis, pp 336-391.

<sup>35</sup> *Ibid.*

<sup>36</sup> The foregoing conclusion is drawn, based on the author of this thesis extensive research.

## CHAPTER 2 – APPLICABLE COMPETITION LAWS IN THE UNITED KINGDOM PERTAINING TO BANK MERGERS

This chapter discusses the applicable UK and EU legislation, including important legislative initiatives taken by the lawmakers and the Government, which regulates the competition aspects in bank mergers in the UK. Prior to the foregoing discussion, the author analyses theoretical issues pertaining to the nature of the relationship between competition and financial stability, including the ‘public interest’ exemption.

Competition laws in the UK apply not only to banks and other financial institutions, but also to other businesses in the economy. Nevertheless, for the purpose of this thesis, discussion of these laws is made only in relation to banks and other financial institutions.

### **2.0 Theoretical issues concerning the nature of the relationship between competition and financial stability; Public interest exemption**

Competition policy in the banking sector considers the interplay between financial stability and competition, which is more complex than a simple balance between competition and financial stability.<sup>1</sup> However, a good starting point would be to understand behind the reason that when competition increases, it might reduce economic stability.

A suitable balance between financial stability and competition assumes a structure that identifies the welfare benefits and costs of contrasting levels of financial stability and competition.<sup>2</sup>

Generally speaking, banking system presents oligopolistic fabric. However, it does not, necessarily, mean such system do not lead to competitive results.<sup>3</sup> Some of the broadest approaches that define and evaluate competition in banking are (i) the structure-conduct-performance (SCP) model; (ii) contestability - centres on conduct dependent on latent entry; and (iii) price responsiveness to cost shifts.<sup>4</sup>

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<sup>1</sup> M Canoy *et al*, ‘Competition and stability in banking’ (2001) *IDEAS Working Paper Series from RePEc*.

<sup>2</sup> W Arnoud *et al*, ‘Can relationship banking survive competition?’ *Centre for Economic Policy Research (UK)* 1997, pp 20-35.

<sup>3</sup> A N Berger *et al*, *Competition in banking* (2<sup>nd</sup> ed., The Oxford Handbook of Banking, Oxford, UK), c 25.

<sup>4</sup> M Baldassarri and L Lambertini, *Antitrust, regulation and competition* (Palgrave Macmillan, 2003), pp 123-9.



The SCP approach connects the structure of a market to the behaviour (and performance) of financial institutions in that market. Especially, the SCP model asserts that there is a growing relationship between the level of market concentration and market power, exerted individually or jointly through collusion. Either way, market efficiency would be supposed to languish. Pursuant to the notion behind the SCP model, pure competition is the sole market structure where the financial institutions competing lack any level of market influence.<sup>5</sup> Genuine monopolists, in contrast, and banks functioning upon conditions of oligopoly or monopolistic competition acknowledge their own product decisions can have a non-trivial impact on price. The SCP model is based on the notion that the latter group will indeed exercise their market influence. Several measures of market structure have been conceived and are largely utilized in empirical work. For instance, banks' holdings of deposits and assets are characteristically used to create measures of concentration in the banking industry,<sup>6</sup> asserted for example as the share of the biggest three or five institutions. Rises in concentration ratios are broadly interpreted as indications of elevated consolidation. The interpretation given to contractions in a concentration ratio is less forthright. A drop in the ratio might echo a drop in the share of the biggest banks, owing possibly to new entrants securing some customers. Yet, it could, also, be the situation that consolidation has, indeed, increased, but concentrated among smaller banks.<sup>7</sup>

A contestability<sup>8</sup> approach evaluates competitive conditions not regarding concentration but rather concerning the theory of contestable markets that has placed importance because easing competitive entry can avert the market power exercise. Concentration, among other structural pointers, is not a good substitute for competition in financial services.<sup>9</sup> A market can have a high level of concentration by conventional measures, still however be perceived competitive, in the event the existing firms are dynamically competing with each other and with likely new entrants. Though financial

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<sup>5</sup> T Beck et al, 'Bank competition and stability: Cross-country heterogeneity' (1995) *Journal of Financial Intermediation* 5, pp 23-38.

<sup>6</sup> The Herfindahl-Hirschman Index (HHI) is another widely-used measure of concentration.

<sup>7</sup> G B Adhamovna, 'Banking competition and stability: Comprehensive literature review' (2014) 2 *International Journal of Management Science and Business Administration* 6, pp 26-33.

<sup>8</sup> G A Jehle, 'Regulation and the public interest in banking' (1986) *Journal of Banking & Finance* 10, p 549.

<sup>9</sup> B Christophers, 'Banking and competition in exceptional times: The future of financial and securities markets' (2013) 36 *Seattle University Law Review* 2, pp 563-76.

institutions with market influence may earn rents, they do not need to do so. Even in the situation of monopoly, the degree where output can be limited to affect price will depend on the level of the existence of obstacles to entry and, more commonly, on the extent of 'contestability' of that specific market portion. Hence, contrary to the predictions of the SCP pattern, more concentrated market structures might still experience appealing results from a consumer welfare outlook.<sup>10</sup> Competition policy, which deals mainly with restricting the creation, augmentation and exploitation of market influence, considers clearly this prospect. As competition regulators utilize structural measures to carry out an initial examination of competition, these measures are solely a first step in considering whether concentration in a particular market will form or boost the exercise of market influence. This evaluation needs that the existence of entry obstacles, as well as activity limitations and other supply and demand-side rigors are considered in assessing banks' conduct, both in constant and active situation.<sup>11</sup>

The approach of a price responsiveness to cost shifts can be used to evaluate competition in financial services assesses the strength of competition directly, by measuring the reactions of prices or outputs to changes in costs. Several studies of banking utilizing the so-called H-statistic based on the methodology<sup>12</sup> that proxies the response of output to input prices.<sup>13</sup> This methodology implements firm-level data. It examines the level where a change in factor input prices is echoed in (equilibrium) revenues earned by a particular bank. The basic concept is that profit-maximising banks in equilibrium will select quantities and prices such that marginal cost matches their apparent marginal revenue. Under ideal competition situation, a rise in input prices would increase total revenue and marginal cost by the same amount as the increase in costs. For a monopolist, nevertheless, a rise in input prices would escalate marginal cost, but lessen equilibrium output and so decrease total revenues.<sup>14</sup> The model renders a measure (the - H-statistic) of the level of competition, with a value of zero or

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<sup>10</sup> The SCP paradigm has well-known weaknesses. Structure may not be exogenous, but instead it might be the result of firms' behaviour. A more concentrated market structure could be the result of better, more efficient performance, contrary to the predictions of the SCP paradigm.

<sup>11</sup> K Schaeck and M Cihak, 'Banking competition and capital ratios' (2007) *IMF Working Paper*.

<sup>12</sup> J Panzar and J Rosse, (1987), 'Testing for monopoly equilibrium' (1987) 35 *Journal of Industrial Economics*, pp 443-56.

<sup>13</sup> Other studies use the Lerner index, which expresses market power as the difference between the market price and the marginal cost divided by the output price. The index ranges from a high of 1 to a low of 0, with higher numbers implying greater market power. It has the problem that it requires information prices and marginal costs, which is very difficult to gather.

<sup>14</sup> K M Schaeck et al, 'Are more competitive banking systems more stable?' (2006) *IMF Working Paper*.

less suggesting a collusive (joint monopoly) result, a value of one implying ideal competition situation, and intermediate values suggesting monopolistic competition. Some studies utilizing the H-statistic method show no connection between competition and concentration.<sup>15</sup> Nevertheless, several studies indicate that such outcomes are inconsistent by misspecification issues.<sup>16</sup> For instance, the H-statistic foists constricting assumptions on financial institutions' cost operations. Its conclusion that rises in input prices in unsoundly competitive markets cause marginal costs and total revenue not to move together is solely valid, in the case the concerning sector is in equilibrium. Its distinct measure, also, disregards variances among financial institutions such as size, product, size or geographic distinction. Yet, this method is gradually utilized in empirical research as it measures banks' conduct and so competition directly.<sup>17</sup> The studies centred on indicated models indicate that competition has weakened over time, as concentration has increased, meliorating the market influence of big financial institutions, and that the existence of abundant small financial institutions does not decrease that influence. This latter conclusion could be connected to the fact that small financial institutions are unable to compete in the range of sophisticated products, especially, products linked to derivatives.<sup>18</sup>

Most of the traditional models or approaches concerning the relationship between competition and financial stability assume that financial institutions function in an ideal competitive setting or in a monopoly situation.<sup>19</sup> In both situations, systemic crises or runs emerge in equilibrium due to co-ordination failure among depositors or as a balanced reaction by depositors to the coming of negative information of banks' future solvency. However, some models tackle the relationship between competition and liability risk. Some authors examined<sup>20</sup> this issue in a context<sup>21</sup> in which financial institutions compete to attract depositors, which have diverse prospect distributions over the withdrawal dates. In the event of occurrence of an adverse selection problem, depositors only know their own prospect of

<sup>15</sup> T Beck et al, 'Bank concentration and fragility: Impact and mechanics' (2005) *NBER Working Papers*.

<sup>16</sup> J Bikker and K Haaf, 'Competition, concentration and their relationship: An empirical analysis of the banking industry' (2002) *Research Series No. 30, De Nederlandsche Bank*.

<sup>17</sup> R Fischer et al, 'Banking competition and economic stability' (2013) *IDEAS Working Paper Series RePEc*.

<sup>18</sup> J Bikker et al., 'The impact of bank size on market power' (2006), *De Nederlandsche Bank Working Paper*.

<sup>19</sup> D Diamond and P Dybvig, 'Bank runs, deposit insurance, and liquidity' (1983) *Journal of Political Economics*, pp 401-19.

<sup>20</sup> B D Smith, 'Private information, deposit, interest rates and the "stability" of the banking system' (1984) 14 *Journal of Monetary Economics*, pp 293-317.

<sup>21</sup> D W Diamond and P Dybvig, 'Bank runs, deposit insurance and liquidity' (1983) 91 *Journal of Political Economy*, pp 401-19.

withdrawals. In that situation, may not exist any equilibrium. The equilibrium contract, either separating or pooling, is destroyed by the likelihood of financial institutions offering positive profit contracts to a particular part of depositors. In that situation, the banking system is not stable.<sup>22</sup> Therefore, competition for deposits makes financial institutions weak in an environment of adverse selection issues. Some authors argue that this issue can be resolved by suitable regulatory standards, like upper limits on deposit rates.<sup>23</sup> Competition by itself does not necessarily produce instability. Other authors argue that financial institution vulnerability to bank runs can emerge, also, independently of competition, and can, thus, ensue in any market structure.<sup>24</sup> This outcome is reached in a model enhanced by bank failures, duopolistic product differentiation, and network externalities.<sup>25</sup> Some authors argue that the distress likelihood of a financial institution is decided by depositors' anticipations that can be self-fulfilling, considering the presence of scale economies. A financial institution assumed to be safer commands a larger market share and a higher margin that in turn makes it safer due to better diversification. The self-fulfilling character of depositors' anticipations implies manifold equilibriums. Potential equilibriums contain corner solutions in which only one bank is active and even equilibriums in which no banks are active. The latter situation is defined as a 'systemic confidence crisis' that is due to a co-ordination issue among depositors that arises for similar reasons to those met in the network literature, regardless of the level of competition in the deposit market. In the model the co-ordination failure can be resolved by introducing deposit insurance.<sup>26</sup> Nevertheless, by warranting that all financial institutions stay in business, deposit insurance may impede the achievement of desirable variation and encourage intense competition for deposits that in turn escalates the failure probability of financial institutions. The net welfare outcomes of deposit insurance are unclear and cannot be measured separately from the market structure.<sup>27</sup>

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<sup>22</sup> J F De Guevara et al, 'Banking competition and economic growth: cross-country evidence' (2011) 17 *The European Journal of Finance* 8, pp 739-64.

<sup>23</sup> C J Jacklin and S Bhattacharya, 'Distinguishing Panics and Information-based Bank Runs: Welfare and Policy Implications' (1988) 96 *Journal of Political Economy*, pp 568-92.

<sup>24</sup> C Matutes and X Vives, 'Competition for deposits, fragility and insurance' (1996) 5 *Journal of Financial Intermediation* 2, pp 184-216.

<sup>25</sup> D W Diamond, 'Financial intermediation and delegated monitoring' (1984) 51 *Review of Economic Studies*, pp 393-414.

<sup>26</sup> J Andres et al, 'Banking competition, collateral constraints, and optimal monetary policy' (2013) 45 *Journal of Money, Credit and Banking* s2, pp 87-125.

<sup>27</sup> T Prosser, 'The limits of competition law: markets and public services' (2005) *Oxford Studies in European Law*, pp 175-86.

Other authors discuss more directly the consequences of bank mergers on the competition and liquidity risk in the banking industry.<sup>28</sup> They create a model in which financial institutions compete for loans and participate in interbank lending to deal with liquidity shocks on the liability side. The competition consequences of mergers, as determined by the degree of post-merger loan rates, depend on the corresponding importance of augmented concentration and prospective cost reductions.<sup>29</sup> Mergers tend to lead to higher loan rates, when the market influence outcome dominates, and to lower loan rates alternatively. The stability outcomes of mergers, as determined by the likelihood that the interbank market experiences to amass liquidity shortages and by the medium size of shortages, rely on the liquidity shocks structure, the proportionate cost of retail deposit financing as related to interbank refinancing (determining reserve holdings) and the post-merger distribution of market shares (depending on the competition consequences created by mergers). The examination shows numerous situations where a merger elevates competition or stability issues (in the sense of interbank money market liquidity risk) or both.<sup>30</sup>

Speaking of the theoretical literature on the consequences of competition, in the deposit or loan markets, on banks' risk taking conduct, the literature (the so called 'charter value') focuses especially on the incentive consequences of high charter values for bank risk taking.<sup>31</sup> In the context of relationship banking, some authors show that augmented competition prompts banks to select riskier portfolio approaches.<sup>32</sup> In relation to the bank's rapport with their borrowers, banks obtain private information, which produces informational rents. As long as banks utilize, at minimum, part of these rents, they are motivated to limit their risk vulnerability so as to relish the value of the relationship.<sup>33</sup> Though, when the banking sector becomes more competitive, relationship banking drops in value and banks become more risk takers, especially, when deposits are supported by a risky insurance

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<sup>28</sup> E Carletti et al, 'Bank mergers, competition and financial stability' (2002) *Mannheim University and ECB*, available at <http://www.bis.org/cgfs/hartmann.pdf>.

<sup>29</sup> B M Tabak, 'The relationship between banking market competition and risk-taking: Do size and capitalization matter?' (2011) 5 *Journal of Banking and Finance* 23, pp 24-32.

<sup>30</sup> A Lowe and S Marquis, *European competition law annual 2012: competition, regulation and public policies* (2014, Hart Publishing, New York), pp 112-36.

<sup>31</sup> M Lucchetta, 'Banking competition and welfare' (2016) *Annals of Finance* 43, pp 1-14.

<sup>32</sup> D Besanko and A V Thakor, *Relationship banking, deposit insurance and bank portfolio* in C Mayer and X Vives (eds) *Capital markets and financial intermediation* (1993, Cambridge University Press), pp 292-318.

<sup>33</sup> X Freixas et al, 'Banking competition and stability: The role of leverage' (2014) *IDEAS Working Paper Series from RePEc*.

arrangement. Some authors<sup>34</sup> conclude comparable outcomes in a two-period model where financial institutions can amass funding-like reputational advantages and improve their rents over costly monitoring.<sup>35</sup> Other papers address how competition for deposits influences financial institutions' risk taking and on how suitable regulation can improve the relation between competition and disproportionate risk taking. Other authors<sup>36</sup> tackle the connections between competition for deposits, banks' risk taking conduct and diverse deposit insurance schemes in a model of multidimensional competition in which banks select privately their portfolio risk. They indicate that with fixed-rate deposit insurance, improved competition surges deposit rates and risk over lower product distinction and lower margins. However, when deposit insurance premiums are risk-adjusted, deposit rates and asset risk are lower than under a flat-rate pricing arrangement. Consequently, when risk-based deposit insurance premiums are applied, banks are compelled to lessen asset risk, so lowering the cost of funds and enhancing their comprehensive performance notwithstanding competition on deposits. Other authors<sup>37</sup> look into the relation between imperfect competition in the deposit market, banks' risk taking and deposit insurance in a model in which banks are prone to limited liability and their insolvency entails social costs. One outcome ensues of the model is that in the lack of deposit insurance deposit rates are disproportionate (and thus bank asset risk high), when the insolvency costs are high and competition acute.<sup>38</sup> Another outcome is that when deposits are insured over a flat rate arrangement, competition prompts to disproportionate deposit rates, even without insolvency costs and banks take the utmost asset risk. Deposit regulation and investment constraints are required to remove the obstructive consequence of competition. In the event deposit insurance premiums are risk adjusted, deposit rates and bank asset risk are lower than in an economy without deposit insurance. Nonetheless, both may yet be disproportionate, so that it may yet be optimum to introduce deposit regulations. The rapport between competition for deposits, excessive risk taking, and regulation is, also,

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<sup>34</sup> A W Boot and S Greenbaum, *Bank regulation, reputation and rents; theory and policy implications* in C Mayer and X Vives (eds) *Capital markets and financial intermediation*, (1993, Cambridge University Press), pp 262-85.

<sup>35</sup> V V Chari and R Jagannathan, 'Banking panics, information, and rational expectations equilibrium' (1988) 43 *Journal of Finance*, pp 749– 63.

<sup>36</sup> T Cordella and L Yeyati, 'Financial opening, deposit insurance and risk in a model of banking competition' (1998) *CEPR Discussion Paper*, no. 1939.

<sup>37</sup> C Matutes and X Vives, 'Imperfect competition, risk taking and regulation in banking' (2000) *European Economic Review* 44(1), 1-34.

<sup>38</sup> P Lowe and M Marquis (ed), *European competition law annual 2012: competition, regulation and public policies* in R Allendesalazar *Does merger to monopoly become efficient when it refers to sector regulators and the competition authority?* (2014, Hart Publishing, New York), pp 103-12

examined by some authors<sup>39</sup> in a dynamic context in which banks select privately their asset risk and compete for deposits. In step with the charter value literature, competition wears down profits and consequently makes banks to risk in their investments. A likely alternative to reinstate prudent bank conduct is to introduce capital requirements. Yet, in an active environment, they emerged to be an inept policy.<sup>40</sup> As long as deposit rates can be freely established, in an active condition, banks are incentivised to increase them in order to grow their deposit base and profit a higher margin from risking (market-stealing effect). Adding deposit rate controls as a regulatory instrument permits optimal results in this model. By augmenting charter values, deposit rate controls avert the market-stealing outcome, therefore increasing augmenting banks' incentives to conduct pragmatically. A different regulatory mechanism to form charter value and control banks' risk taking in competitive markets is examined by some authors.<sup>41</sup> They created a duopolistic model in which banks compete in the deposit market and can invest in sensible or speculative lending. If a bank becomes insolvent, the regulator has to determine whether to wind up the failing bank or to merge it with another financial institution, which can be an incumbent or a new entrant. Either a rescue or entry merger policies entail a balance between competition and stability. By lessening competition and augmenting charter value, a rescue merger concerns monopoly inefficiency and prudent bank conduct, as well.<sup>42</sup> In contrast, entry merger entails more efficiency, but riskier bank conduct. The ideal policy mechanism is a blend of active rescues ensued by entry. This causes *ex ante* motivations for financial institutions to stay solvent to takeover failing banks, while confining the *ex post* market influence, which surviving institutions receive due to the rescue. Hence, the implementation of dynamic merger policy and temporary entry constraints can advocate stability.<sup>43</sup> However, not all papers find a positive connection between competition and risk taking. In a model where banks compete for loans and can utilize costly monitoring or credit rationing to cope with a moral hazard issue on the part of the

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<sup>39</sup> T F Hellman et al, 'Liberalization, moral hazard in banking and prudential regulation: are capital requirements enough?' (2000) 90 *American Economic Review* 1, pp 147-65.

<sup>40</sup> T Damjanovic et al, 'Universal banking, competition and risk in a macro model' (2012) *IDEAS Working Paper Series* from RePEc.

<sup>41</sup> E Perotti and J Suarez, 'Last bank standing: what do I gain if you fail?' (2001) *University of Amsterdam and CEMFI*.

<sup>42</sup> G A Tabacco, 'A new way to assess banking competition' (2013) 121 *Economics Letters* 2, pp 167-9.

<sup>43</sup> C Calomiris and C Kahn, 'The role of demandable debt in structuring optimal banking arrangements' (1991) 81 *American Economic Review* 81, pp 497-513.

entrepreneur, some authors<sup>44</sup> argue that a monopoly bank may confront a higher risk of collapse than a competitive bank. The concept is that a monopoly bank utilizes more monitoring and less credit rationing, while dealing with the borrower's moral hazard issue. This could prompt a monopoly bank to lend more monies than competitive institutions and consort to a higher likelihood of failure, due to the fact that loans are prone to multiplicative uncertainty. As a result, the rapport between market influence and failure prospect is unclear.<sup>45</sup>

While most papers conclude for some balance between bank competition and stability, the assertion they are commonly negatively pertinent is not essentially potent.<sup>46</sup> There are situations where raised loan competition decreases asset risk-taking or rises the capability of the interbank market to insure counter to liquidity shocks. Although ill-designed policies may produce or bolster a balance between competition and stability in banking, such as static capital requirements, risk insensitive deposit insurance, theory advocates there are policy alternatives that would ensure competitive and unwavering banking systems, such as mixed approaches to failure resolution over mergers, risk-based deposit insurance.<sup>47</sup>

### Competition v public interest

Besides helping attain sustainable development goals, like poverty relief (decreasing prices and raising consumer election) and economic progress (forming enterprise rivalry and encouraging productivity),<sup>48</sup> a solid competition policy structure can, also, specifically seek public interest objectives. These objectives may often conflict with the essential competition objective: a public interest test may allow an anti-competitive merger or limiting trade practice to ensue or a pro-competitive merger or trade practice to be remedied or barred, to

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<sup>44</sup> R Caminal and C Matutes, 'Market power and banking failures' (2002) 20(9) *International Journal of Industrial Organization*, pp 1341-61.

<sup>45</sup> S Nagarajan and C W Sealey, 'Forbearance, deposit insurance pricing and incentive compatible bank regulation' (1995) 19 *Journal of Banking and Finance*, pp 1109-30.

<sup>46</sup> W Chen et al, 'Financial development and financial openness nexus: The precondition of banking competition' (2015) *Applied Economics*, pp 1-10.

<sup>47</sup> M Hsieh, 'The puzzle between competition and profitability can be solved: International evidence from bank-level data' (2010) 38 *Journal of Financial Services Research* 2, pp 135-7.

<sup>48</sup> J Davies and A Thiemann, 'Competition Law and Policy: Drivers of Economic Growth and Development' (2015) *OECD Coherence for Development*.



serve the public interest.<sup>49</sup> Most of competition watchdogs do not typically look at elements that go past the essence of competition goals.<sup>50</sup> Competition regulators that consider public interest factors normally implement them narrowly.<sup>51</sup> Public interest considerations sustain more importance in emerging economies<sup>52</sup> and accordingly, such economies tend to utilize public interest considerations more.<sup>53</sup> The argument whether or not to contain the notion of public interest in competition law is under way.<sup>54</sup> Public interest objectives are mostly broad and hence challenging to define and implement in an independent, clear and steady manner. Their inclusion consequently forms risks of legal ambiguity and unpredictability in the application of competition law. Many authors argue that public policy issues such as preserving the financial stability can be undertaken better by sectoral regulation<sup>55</sup> or direct policies<sup>56</sup>. Integrating the analysis of public interest considerations in merger control might cripple the basic competition assessment in mergers, accordingly impairing the broad ‘public interest’ that competition policy intends to uphold.<sup>57</sup> Commentators who argue in support of competition law and policy going further than the crux competition objective indicate that competition cannot exist in a vacuity.<sup>58</sup> Competition regulators are responsible to governments that seek policies in addition to the furtherance of market competition.<sup>59</sup> The comprisal of non-competition criteria permits countries to project their competition law to suit

<sup>49</sup> F Allen and D Gale, ‘Comparing financial systems’ (2000) 14 *The Review of Financial Studies* 2, pp 577-81.

<sup>50</sup> X Freixas et al, ‘Systemic risk, interbank relations, and liquidity provision by the central bank’ (2000) 8 *Journal of Money, Credit and Banking* 1.

<sup>51</sup> E Koskela and R Stenbacka, ‘Agency cost of debt and lending market competition: A re-examination’ (2000) *Bank of Finland Discussion Paper* 12.

<sup>52</sup> D Lewis, ‘The role of public interest in merger evaluation’ (2002) *International Competition Network Merger Working Group*, Naples, (28-29 September, 2002), published on: <http://www.comptrib.co.za/Publications/Speeches/lewis5.pdf>.

<sup>53</sup> UNCTAD, ‘The importance of coherence between competition and government policies’ (19-21 July, 2011) *Note by the UNCTAD Secretariat presented at the Eleventh session of the Intergovernmental Group of Experts on Competition Law and Policy*, Geneva.

<sup>54</sup> A Shalal, ‘Pentagon eyes proposal for M&A changes in weeks’ (22 December, 2015), *Reuters*.

<sup>55</sup> T Cheng et al, ‘Competition and the State’ (2014) *Stanford University Press*.

<sup>56</sup> ICN, ‘Merger Working Group: Analytical Framework Sub-group, The Analytical framework for merger control’ (2002), *Final paper for ICN annual conference*, Office of Fair Trading, London.

<sup>57</sup> J Balkin and M Mbikiwa, ‘South Africa: Have the competition authorities correctly applied the public interest test in the Competition Act?’ (2015), *Mondaq*.

<sup>58</sup> F Banda et al, ‘Review paper two: The links between competition policy, regulatory policy and trade and industrial policies’ (2015) *CCRED Working Paper* 5, pp 1-31.

<sup>59</sup> UNCTAD, ‘The importance of coherence between competition and government policies’ (July 2011) *Note by the UNCTAD Secretariat presented at the Eleventh session of the Intergovernmental Group of Experts on Competition Law and Policy*, Geneva.

their socio-economic specific<sup>60</sup> and may also, in some instances, improve the standing of the competition watchdog.<sup>61</sup> There are no impact analysis of the consequences of competition enforcement decisions based only on public interest basis, most likely due to methodological snags, like the failure of transparent and comparable results and assumptions. Hereafter, whether the comprisal of public interest objectives in competition laws counterbalances anti-competitive outcomes in the market has not been analysed provisionally.<sup>62</sup> Maintaining the suitable right trade-off between competition and public interest criteria is not always easy; the analysis of the same merger on the grounds of both competition standards, and the public interest that contains socio-economic and political considerations,<sup>63</sup> may not always achieve the same outcomes. This may trigger to an anti-competitive merger being approved, or a pro-competitive merger being barred on public interest basis.<sup>64</sup> The research shows there are more instances of public interest basis ensuing from an anti-competitive merger being approved than of a merger approved by the competition watchdog being forbidden. In the specific competence model, the proper authorities might encounter an arduous trade off exercise in weighing public interest benchmark against competition associated components.<sup>65</sup> Public policy goals may be inclusive, diverse and alter over time that makes the interpretation of public interest provisions challenging. Such provisions are occasionally relied on in foreseeable conditions such as a financial crisis that makes it even harder to interpret and apply them.<sup>66</sup> Obviously identified and articulated provisions<sup>67</sup> may help predictability and transparency of their interpretation. Also, the interpretation of public interest provisions can be made more objective, clear and foreseeable over soft law documents (guidance, notes,

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<sup>60</sup> M S Gal and E M Fox, 'Drafting competition law for developing jurisdictions: learning from experience' (2014) *New York University Law and Economics Working Papers* 374, available at [http://lsr.nellco.org/nyu\\_lewp/374](http://lsr.nellco.org/nyu_lewp/374).

<sup>61</sup> OECD, 'Roundtable on competition and poverty reduction' (2013), p 7, available at <http://www.oecd.org/daf/competition/competition-and-poverty-reduction2013.pdf>.

<sup>62</sup> OECD, 'Public interest considerations in merger control' (2016), *Co-operation and Enforcement, Working Paper N 3*, DAF/COMP/WP3(2016)3.

<sup>63</sup> Z Buthelezi and Y Njisane, 'The incorporation of public interest considerations during the assessment of prohibited conduct: a juggling net' (2015), available at [www.cresse.info/uploadfiles/2015\\_pa13\\_p3.pdf](http://www.cresse.info/uploadfiles/2015_pa13_p3.pdf).

<sup>64</sup> S Tavuyanago, 'Public interest considerations and their impact on merger regulation in South Africa' (2015), 15 *Global Journal of Human-Social Science* 7.

<sup>65</sup> D Poddar and E Stooke, 'Consideration of public interest factors in antitrust merger control' (2014), 2 *Competition Policy International*, pp1-5.

<sup>66</sup> A Chisholm and N Jung, 'The public interest and competition-based scrutiny of mergers: Lessons from the evolution of merger control in the United Kingdom' (2014), *CPI Antitrust Chronicle*.

<sup>67</sup> J Bikker et al, 'Assessing competition with the Panzar Rosse Model: The role of scale, costs and equilibrium' (2009) *Working Papers 09-27, Utrecht School of Economics*.

etc.).<sup>68</sup> Also, to permit judicial review of decisions, their reasoning and the interpretation of public interest in the precise case requires to be actual, comprehensive and in writing. Competition watchdogs mostly pursue a progressive way in merger control, meaning that analysis aim to decide the prospective consequence of a merger on competition in the medium to long term. Merger examinations based on public interest basis usually reflect present public policy considerations, and might pursue to remedy short-term issues. An intervention that may seem a good resolution in the short term could result in harmful effects for consumer welfare and competition in the long term. Mergers that lead to very concentrated markets especially are nearly unattainable to reverse.<sup>69</sup> The trade-off between short-term gains and the long-term benefits of nourishing competitive markets is not easy.<sup>70</sup> Merger specificity is a standard of merger control enforcement, which needs an adequate casual connection between the merger and its asserted consequence before a competition regulator intervenes. Questionably, public interest considerations should, also, be merger-specific, which is the situation in which a merger is blocked or cleared on public interest basis, these bases require to be soundly connected to the plausible consequences of the specific merger<sup>71</sup> Nevertheless, when implementing public interest provisions, pertinent authorities may tackle policy goals surpassing the specific merger.

Even if public interest considerations are surely characterized, not all circumstances where public interest is called upon can be covered by law or soft law, the role of competition law in situations of financial crises demonstrates there have been arguments for holding off competition rules for span of the crisis.<sup>72</sup>

Pursuant to the theoretical survey, the notion that competition is something perilous in the banking industry, since it normally creates instability can be dismissed. In view of the significance of the market setting for the prosperity of industrial countries, competition

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<sup>68</sup> J Bikker and L Spierdijk, 'How banking competition changed over time' (2008) *De Nederlandsche Bank Working Paper*.

<sup>69</sup> OECD, 'Roundtable on the failing firm defense' (2009), available at [www.oecd.org/competition/mergers/45810821.pdf](http://www.oecd.org/competition/mergers/45810821.pdf).

<sup>70</sup> D Claudia, 'The financial crisis and the role of competition authority in banking sector' (2015) 8 *European Journal of Science and Theology*, pp 53-63.

<sup>71</sup> Y Njisane, 'The rise of public interest: Recent high profile mergers' (2011), *Public Interest Law, Gathering*, pp 1-24.

<sup>72</sup> OECD, 'Competition and the financial crises' (2009), available at [www.oecd.org/competition/sectors/42538399.pdf](http://www.oecd.org/competition/sectors/42538399.pdf).

aspects are required to be cautiously considered, also in banking. One implication is that there should be well-defined measures of the respective roles of supervisory and competition regulators. The empirical and theoretical literature suggest that the stability effects of changes in market structures and competition are particularly case-dependent. It seems that there is much space for research to shed more light into this rather unclear issue.<sup>73</sup>

The theoretical literature does not appear to be irrefutable on the rapport between competition and stability.<sup>74</sup> Theories of bank runs and systemic risk essentially neglect the effects of different bank market structures for the safety of the industry.<sup>75</sup> Theories based on the notion of ‘charter value’ assert that market influence alleviates bank risk taking, since high margins act as a shield against portfolio risk and increase the cost of bankruptcy. Nevertheless, a more recent literature indicates that stronger competition does not inevitably impair stability.<sup>76</sup> In relation to bank liability side risk, it argues that coordination issues among depositors triggering bank fragility can surface independently of competition. Also, it demonstrates that some bank mergers can make liquidity shortages in the interbank market more possible. Concerning asset side risk, it argues that there can be situations where a concentrated banking industry would be riskier than a competitive industry. Finally, it is also indicated that some policies, like risk-adjusted deposit insurance premiums, could alleviate any balance between bank risk taking and competition.<sup>77</sup>

Explicit features of financial intermediation, like switching costs in retail banking, information unevenness in corporate borrowing, or network externalities in payment systems, take the banking sector outside the regular structure-conduct-performance pattern.<sup>78</sup> In addition, the structure and concentration undertakings do not measure correctly competition among banks. Competition in banking is characteristically imperfect and many obstacles to entry could generate rents. In retail banking, switching costs for customers are quite essential,

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<sup>73</sup> H Harfield, ‘Legal restraints on expanding banking facilities, competition and the public interest’ (1959) 14 *The Business Lawyer* 4, pp 1016-30.

<sup>74</sup> G A Jehle, ‘Regulation and the public interest in banking’ (1986) 10 *Journal of Banking and Finance* 4, pp 549-73.

<sup>75</sup> P Genschel et al, ‘Regulatory competition and international co-operation’ (1997) 4 *Journal of European Public Policy* 4, pp 626-42.

<sup>76</sup> G Mitchell, ‘Competition, regulation and the public interest’ (1983) *Annual Review of Banking Law* 2, p 153.

<sup>77</sup> D M Covitz and E A Heitfield, ‘Monitoring, moral hazard, and market power: a model of bank lending’ (2000) paper presented at the *Center for Financial Studies Conference* on ‘Competition among banks: Good or bad?’ in Frankfurt, April.

<sup>78</sup> E G Corrigan, ‘Banking and commerce belong apart’ (1987) *Wall Street Journal*, p 1.

and reputation and branch networks act as entry obstacles. In corporate banking created uneven information and lending relationships offer banks some market power in relation to firms and investors.<sup>79</sup> Stability and competition can exist side-by-side in the banking sector. Competition makes the banking sector more effective and ensures that stimulus and rescue packages advantage final consumers. The results of the analytical studies connecting competition and stability are vague, though.<sup>80</sup> Structural and non-structural undertakings of competition are deemed to be both positively and negatively affiliated with financial stability, depending on the country and the sample assessed and the measure of financial stability utilized. In the final assessment, the blueprint of financial regulation matters, at minimum, nearly of market structure for the stability of the financial sector.<sup>81</sup>

The concept of a simple negative balance is, again, too simple: often competition reduces stability and often perfect competition is harmonious with the socially ideal level of stability.

## 2.1 Competition Act 1998

The Competition Act 1998 ('CA98')<sup>82</sup> is currently the most important UK statute in the area of competition law across all sectors of the economy, including the banking and financial services sector, other than the Enterprise Act 2002<sup>83</sup>. The CA98 creates a new system of regulation in order to identify and deal with restrictive business practices and abuse of a dominant market position. Synchronization of the CA98 and EU competition approach is demonstrated by the content of the CA98. For example, chapters I and II of the CA98 resemble Articles 101 and 102 of the Treaty on the Functioning of the European Union ('TFEU').<sup>84</sup>

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<sup>79</sup> H Degryse and S Ongena, *Competition and regulation in the banking sector: A review of the empirical evidence on the sources of bank rents* in A Thakor and A Boot (eds., *Handbook of Financial Intermediation and Banking*, Elsevier, 2013), pp 483-542.

<sup>80</sup> M Neumann, 'Comment on "competition tests with a non-structural model: the Panzar-Rosse method applied to Germany's savings banks"' (2011) 12 *German Economic Review* 2, p 239.

<sup>81</sup> A De Palma and R J Gary-Bobo, 'Coordination failures in the Cournot approach to deregulated bank competition' (1996) *THEMA Working Paper*.

<sup>82</sup> Competition Act 1998, 1998 c.41 ('CA98').

<sup>83</sup> Enterprise Act of 2002, 2002 c. 40 ('EA02'). For a discussion of the EA02, see chapter 2.2 in this thesis, pp 14-16.

<sup>84</sup> Treaty on the Functioning of the European Union (Consolidated version 2012) *OJ C 326/01 P. 0001-0390* ('TFEU'), art101 (concerted practices that restrict competition) and art 102 (abuse of dominant position); see, also, Regulation No. 1/2003, art. 11-24, *OJ L1/1*; see, further, BJ Rodger and A MacCulloch, *The UK*

The CA98 regulates restricted methods or practices by banks in the UK that damage, limit or destroy a competitive environment in the financial system. These practices mainly take the form of horizontal agreements, being arrangements contrived between businesses (like financial institutions) providing the same services (for example, wholesale or retailer banking operations). The purpose of a horizontal agreement varies. It could be created to curb output, fix prices, share deceitful information, make joint offers, or surreptitiously divide markets.

The Financial Conduct Authority ('FCA')<sup>85</sup>, as the Governmental watchdog for competition issues in the financial services sector, concurrently with the Competition and Markets Authority ('CMA'),<sup>86</sup> is authorized to take necessary actions to prevent banks, other financial institutions and businesses in other industries in the UK from carrying out these activities.<sup>87</sup>

The CA98 addresses situations of financial institution dominant position abuse involving the following types of method or practice: predatory pricing, refusals to supply, discriminatory pricing and vertical restraints to boost profit, exorbitant pricing, obtaining competitive advantage or otherwise restricting competition.

The CA98 includes two prohibitive provisions, under chapters I and II. The chapter I prohibition relates to agreements between financial institutions (or other businesses), which prevent, restrict or distort competition in the UK to a considerable degree.<sup>88</sup> The chapter II prohibition deals with actions that result in abusive dominant position conduct in the market.<sup>89</sup>

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*Competition Act: A New Era for UK Competition Law* (Oxford: Hart 2000), pp 26-36; For a discussion of the enforcement of Articles 101 and 102 TFEU in bank mergers, see, also, chapter 2.10 in this thesis, pp 31-47.

<sup>85</sup> For a discussion of the role of the Financial Conduct Authority, see chapter 3.2.2 in this thesis, pp 62-3.

<sup>86</sup> For a discussion of the role of the Competition and Markets Authority, see chapter 3.1.1 in this thesis, pp 51-7.

<sup>87</sup> The Financial Conduct Authority can acquire concurrent functions under Part 1 of the Competition Act 1998, so the powers will be exercisable by both the Financial Conduct Authority and the Competition and Markets Authority. However, the Competition and Markets Authority is the principal enforcer for the purposes of ss 211 and 212 of the Enterprise Act 2002 pursuant to the Enterprise and Regulatory Reform Act 2013.

<sup>88</sup> CA98 (n1) s 2.

<sup>89</sup> *Ibid*, s 18.

In the vast majority of cases, whether the provisions of the CA98 or TFEU apply to competition aspects of banking mergers is of little practical consequence because the substantive provisions are broadly the same.

## 2.2 Cruickshank report

Significant competition law-based scrutiny has been applied to the UK banking industry due, in part, to its reputation with politicians and consumers. Following this pattern of scrutiny, in 1998, the UK Treasury began an assessment of competition aspects of the banking industry. In 2000, this review process culminated in a published report entitled ‘*Competition in UK Banking*’, by Sir Don Cruickshank (the ‘Cruickshank Report’).<sup>90</sup>

The Cruickshank Report noted that banks were making substantially more money than their capital costs.<sup>91</sup> In the event that such a trend continued for any length of time, customers were bound to pay banks considerably higher prices than what the banks were paying the customers in exchange for the banking services and products provided by the banks.<sup>92</sup> The report highlighted that both personal customers and small and medium-sized enterprises (‘SMEs’) were contributing factors to banks generating excessive profits.<sup>93</sup>

The Cruickshank Report indicated that the banks’ costs to service their customers were likely to decrease in the near term.<sup>94</sup> This would occur due to excessive profit absorption. However, if profits in the short to medium term were not excessive, the report noted that costs to service customers would drop further.<sup>95</sup> The Cruickshank Report, also, outlined a series of

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<sup>90</sup> D Cruickshank, ‘Competition in UK Banking: A Report to the Chancellor of the Exchequer’ (March, 2000) (‘Cruickshank’), available at [www.hmtreasury.gov.uk/documents/financial\\_services/banking/bankreview/fin\\_bank\\_reviewfinal.cfm](http://www.hmtreasury.gov.uk/documents/financial_services/banking/bankreview/fin_bank_reviewfinal.cfm); see, also, D Cruickshank, ‘Clearing and Settling European Securities: Where Competition Works (and Where It Doesn’t)’ (22 March, 2002) *European Harmonisation of Cross-Border Settlement, Conference*, available at <http://www.londonstockexchange.com/en-gb/about/Newsroom/Media+Resources/Speeches/speeches15.htm>.

<sup>91</sup> *Cruickshank* (n9), pp 24, and 124-5.

<sup>92</sup> *Ibid*, p 44.

<sup>93</sup> *Ibid*, pp 124, and 154-5. In the context of the report’s inquiry, this included small and medium-sized enterprises (‘SME’) customers of banks

<sup>94</sup> *Ibid*, pp 130, and 155.

<sup>95</sup> *Ibid*.

issues<sup>96</sup> in the banking and financial market; finding such market to be largely concentrated and especially so in the SME sector.<sup>97</sup>

In addition, the Cruickshank Report noted that banks provided insufficient information to individual as well as SME customers about their bank accounts' rights and restrictions.<sup>98</sup> The report, further, indicated that banks' customers experienced substantial difficulties in transferring their current accounts between banks.<sup>99</sup>

The Cruickshank Report, also, highlighted that financial institutions were in full domination of money transmission services.<sup>100</sup> As a result, this created entry impediments for smaller banks and financial institutions, imposition of high charges and unsatisfactory level of services in money transmission and related banking services. Furthermore, this also discouraged modernization and innovation in banking products and services.<sup>101</sup>

The Cruickshank Report, also, stressed that the money payment systems in the British banking system would require thorough modernisation and restructuring.<sup>102</sup> In addition, it noted concerns regarding the applicability of competition law to banking services for SMEs. However, the banking services market for personal customers appeared to be relatively competitive.<sup>103</sup>

The Report, in the end, recommended an inquiry into the competitiveness of the entire banking and financial market in respect of the flow-in of banking services from payment clearing institutions to the SME sector.<sup>104</sup>

## 2.3 Enterprise Act 2002

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<sup>96</sup> *Ibid*, pp 155, and 162. The report found that a 'small number of banks have significant market power in the provision of current account services and debt to SMEs. Concentration levels are very high, both nationally and in the relevant local geographic market'.

<sup>97</sup> *Ibid*.

<sup>98</sup> *Ibid*, pp 139, and 156.

<sup>99</sup> *Ibid*, p 130.

<sup>100</sup> *Ibid*, p 69.

<sup>101</sup> *Ibid*, p 68.

<sup>102</sup> *Ibid*, p 94.

<sup>103</sup> *Ibid*, p 166.

<sup>104</sup> *Ibid*, pp 93-4.



In the early 2000s, the Enterprise Act 2002 ('EA02')<sup>105</sup> was enacted as part of an ambitious plan to bring UK competition law further into line with EU competition law.<sup>106</sup> The EA02 transformed British merger control provisions, improved enforcement procedures applying to restrictive agreements, and introduced *de novo* measures regarding market review processes.<sup>107</sup>

The EA02 included three distinctive and significant developments in relation to merger control, namely elimination of the political impact of merger determinations, a significant competition-related test for merger assessments, and a new antitrust legislative platform.<sup>108</sup>

The EA02 regulates competition aspects not only in banking and financial system, but also in other sectors of the economy. Due to its important role in the economy, bank merger control has been vulnerable to political pressure. Pursuant to the merger provisions of the EA02, the Secretary of State for Business, Innovation and Skills ('SoS')<sup>109</sup> has final decision-making power as to whether a merger is approved following primary assessment or is to be handed over to the British competition authority to carry out a thorough examination.<sup>110</sup> Prior to the EA02, the relevant competition authorities were originally the Office of Fair Trading ('OFT') and the Competition Commission ('CC').<sup>111</sup> However, following certain legislative amendments introduced in 2013, and effective from 2014, the OFT and the CC were replaced by one competition authority named the Competition and Markets Authority ('CMA'), which assumed the powers and responsibilities previously exercised by the OFT and the CC under the EA02.<sup>112</sup>

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<sup>105</sup> EA02 (n2).

<sup>106</sup> B E Hawk, *International Antitrust Law & Policy* in P A Geroski (eds.) *The UK Market Inquiry Regime* (New York: Juris Publishing 2005), pp 1-2.

<sup>107</sup> I Lianos and D Geradin, *Handbook on European Competition Law: Enforcement and Procedure* in A P Komninos (eds.) *Private Enforcement in the EU with Emphasis on Damages Actions* (Cheltenham: Edward Elgar Publishing 2013), p 245.

<sup>108</sup> EA02 (n2), preamble; see, also, J Parker and A Majumdar, *UK Merger Control* (Oxford: Hart 2011), ch 1.4.

<sup>109</sup> EA02 (n2), s 54(2). For a discussion of the role of Secretary of State for Business, Innovation and Skills, see chapter 3.1.2 in this thesis, pp 57-8.

<sup>110</sup> EA02 (n2), ss 54-55; Sched 7.

<sup>111</sup> EA02 (n2), pts 1 and 5; Schedules 1 and 11.

<sup>112</sup> The Enterprise and Regulatory Reform Act 2013, c.24 ('ERRA13'), pt 3, ss 25-26; Sched 4.

The EA02 created a new competition-related test for the analysis of merger situations, known as the ‘substantial lessening of competition’ (‘SLC’) test.<sup>113</sup> The SLC applies a public interest standard so that a bank merger will not be approved where it is shown that the proposed merger could operate contrary to the public interest in preserving UK ‘financial stability’.<sup>114</sup>

The EA02 deals with two specific kinds of merger case. Firstly, those that contain public interest considerations, such as, financial stability related institutions, defence-based businesses, mass-media businesses, water entities, sewerage businesses, and ‘special merger situation’ relating to British government contractors.<sup>115</sup> The second type of merger situations is those relating to all other types of mergers, known broadly as ‘relevant merger situations’.<sup>116</sup>

In addition, a number of legislative and administrative provisions include specific ‘carve outs’ in order to facilitate mergers and takeovers in particular sectors of the economy, such as banking and financial sector, or in specific defined situations, such as preservation of the ‘financial stability’ in the UK.<sup>117</sup>

The enactment of the EA02 added considerable ‘teeth’ to competition regulation of mergers in the UK, such as rooting out forms of anti-competitive behaviour,<sup>118</sup> and redressing injured parties in distortions of competition.<sup>119</sup> Although more requires to be done to ameliorate enforcement of this legislation,<sup>120</sup> the EA02 is a step in the right direction.<sup>121</sup>

## 2.4 Report on banking services for SMEs

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<sup>113</sup> The term ‘SLC’ is not defined in the EA02 (n2), but there are references in the Act, which dictate that the Competition Markets Authority must publish advice and information as regards to an ‘SLC’. For instance, EA02 (n2), ss 22, 33, 35(1), and 36(1).

<sup>114</sup> EA02 (n2), s 58.

<sup>115</sup> *Ibid*, ss 59-70.

<sup>116</sup> *Ibid*, ss 23, and 59(3).

<sup>117</sup> *Ibid*, s 58; see, also, CMA, ‘Mergers: Guidance on the CMA’s Jurisdiction and Procedure’ (January, 2014) CMA2, paras 3.8 - 3.10.

<sup>118</sup> EA02 (n2), ss 188-202.

<sup>119</sup> *Ibid*, s 18.

<sup>120</sup> Enactment of *ERRA13* (n31) (see chapter 2.8 in this thesis, pp 29-31) improved the EA02 (n2), such as, consolidation the competition regulator in one authority, the Competition and Markets Authority. However, it is too early to conclude whether the *ERRA13* (n31) has fulfilled its role.

<sup>121</sup> M Furse, ‘Competition and the Enterprise Act 2002’ (London: Jordans Publishing 2003), p 73.

Early in 2002, the Secretary of State for Business, Innovation and Skills ('SoS') and the Chancellor of the Exchequer presented a report entitled, '*The Supply of Banking Services by Clearing Banks to Small and Medium-Sized Enterprises*' (the 'Competition Commission Report') to the UK Parliament.<sup>122</sup> The Report was part of a broader investigation into the supply of banking services to small and medium-sized enterprises ('SMEs') by banks.

The Competition Commission Report's analysis of banking services included business current accounts, short-term bank deposit accounts, overdraft facilities, commercial lending to SMEs, as well as other SME deposits.<sup>123</sup>

Markets appeared to be defined by an unwillingness of SMEs to switch banks, the reasons for which included the apparent difficulty of switching banks for small financial rewards, the recognized importance of retaining relationships with a specific bank or bank manager, and the tendency of banks to offer lower charges in the event of a possible customer banking provider switch.<sup>124</sup>

The Report also noted confusion regarding access to, and the rate of, overdraft payment instruments and of commercial loans.<sup>125</sup>

The Competition Commission Report identified a series of particular practices that limited or altered price competition.<sup>126</sup> For instance, there was a similarity in the pricing structures of the clearing banks, including interest free current accounts, distinctions in costs applied by the clearing financial institutions, with free banking broadly limited to particular types of SMEs, as well as utilization of bargaining power to reduce costs in switching accounts.<sup>127</sup>

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<sup>122</sup> Competition Commission, '*The Supply of Banking Services by Clearing Banks to Small and Medium-Sized Enterprises* (March, 2002) Cm5319 ('Competition Commission Report'), available at [www.competition-commission.org.UK/rep\\_pub/reports/2002/fulltext/462c1.pdf](http://www.competition-commission.org.UK/rep_pub/reports/2002/fulltext/462c1.pdf).

<sup>123</sup> *Ibid*, p 3.

<sup>124</sup> *Ibid*, pp 50, and 54-5.

<sup>125</sup> *Ibid*, pp 19, and 151.

<sup>126</sup> *Ibid*, pp 26-7, and 121-7.

<sup>127</sup> *Ibid*, pp 33-6.

The Report identified obstacles to entry for new players and for access of liquidity and commercial lending markets.<sup>128</sup> In part, this resulted in reduced and misuse of price competition, and consequent disproportionate pricing and bank profits.<sup>129</sup>

In relation to prices set by the clearing financial institutions for SMEs, the Report analysed the general range of disproportionate prices and profits related to services for the SMEs.<sup>130</sup> The ratio of SME's deposits to business lending deposits increased so that these categories were at the same level overall. The Report did not clearly connect extra charging for banking services to SME customers and the lack of banking services competitiveness.<sup>131</sup>

Although the Report noted the disproportionate prices and profits of the largest clearing financial institutions rendering banking services to SME customers, it found that this did not create a contrary effect on the conditions upon which banks lend funds to their business customers.<sup>132</sup> However, the Report found no reason for the clearing institutions to raise money transfer prices or lending interest rates, or decrease loans to SME customers.<sup>133</sup>

Finally, the Report directed that after implementation of its recommendations were completed,<sup>134</sup> the competition authority would assess, if additional undertakings were required, or if any of the findings or recommendations in the Report needed to be changed.<sup>135</sup>

## 2.5 Vickers' Report and the government's response

After the Global Financial Crisis ('GFC'), the British banking authorities revisited oversight of banking activities, including the need for further required modifications to the current

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<sup>128</sup> *Ibid*, pp 44-53, and 57-9.

<sup>129</sup> *Ibid*, pp 61, and 63.

<sup>130</sup> *Ibid*, pp 157-60.

<sup>131</sup> *Ibid*, p 160.

<sup>132</sup> *Ibid*, pp 317, 471, 476, and 479.

<sup>133</sup> *Ibid*, p 119.

<sup>134</sup> *Ibid*, p 160. The Report did not specify any certain time for implementation of its recommendations.

<sup>135</sup> *Ibid*. In fact, presently the Competition and Markets Authority is undergoing a market investigation into personal current accounts and the SMEs. According to the authority's timeframe, it is expected a published final report on July/August, 2016. See CMA, 'Retail Banking Market Investigation: Case Timetable' (2016), available at [https://assets.digital.cabinet-office.gov.uk/media/56d9bcc8ed915d0376000006/Retail\\_banking\\_market\\_investigation\\_case\\_timetable\\_-\\_7-3-16.pdf](https://assets.digital.cabinet-office.gov.uk/media/56d9bcc8ed915d0376000006/Retail_banking_market_investigation_case_timetable_-_7-3-16.pdf).

banking and financial system. The financial downturn reinforced the already existing need for an overall reassessment of the rules governing the British banking system.<sup>136</sup>

In 2010, the UK Government announced a review of the banking system with the objective of producing a proposal to reform the supervisory structure of the British financial services industry.<sup>137</sup> As a result, an independent commission, under the chairmanship of Sir John Vickers, on the banking sector was formed to look at the structure of banking industry, the level of competition in the banking sector, and how consumers could obtain improved services for reduced costs.<sup>138</sup> The result of this review was the publication of a final report by the commission (the 'Vickers' Report').<sup>139</sup>

The Vickers' Report concentrated broadly on questions regarding the ring fencing of retail banking, being the division between investment banking, on one hand, and lending activities and deposit holdings, on the other hand.<sup>140</sup>

The Report proposed that structural reform could end the regulation of banking under one unified system, and instead introduced distinct regimes for retail banking and investment and wholesale banking, with each service being provided by different financial institutions.<sup>141</sup> The policy objective for this suggested course of action was to separate retail banking services and individual consumers from the more hazardous wholesale banking sector.<sup>142</sup>

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<sup>136</sup> HM Treasury and Department for Business Innovation & Skills, 'Banking Reform: Draft Secondary Legislation' (July, 2013) *Cm 8660*, p 75.

<sup>137</sup> HM Treasury, 'Speech by the Chancellor of the Exchequer' (16 June, 2010) *Mansion House London*, available at [www.hm-treasury.gov.uk/press\\_12\\_10.htm](http://www.hm-treasury.gov.uk/press_12_10.htm); see, also, Financial Secretary, 'Statement by the Financial Secretary before the Commons' (17 June, 2010) UK Parliament, available at [www.hm-treasury.gov.uk/statement\\_fst\\_170610.htm](http://www.hm-treasury.gov.uk/statement_fst_170610.htm).

<sup>138</sup> Independent Commission on Banking, 'Issues Paper: Call for Evidence' (September, 2010) London, available at

<http://webarchive.nationalarchives.gov.uk/20121204124254/http://bankingcommission.independent.gov.uk/wp-content/uploads/2010/07/issues-paper-24-september-2010.pdf>; see, also, Independent Commission on Banking, 'Interim Report: Consultation on Reform Options' (April 2011) London, available at [http://webarchive.nationalarchives.gov.uk/20121204124254/http://www.hm-treasury.gov.uk/d/icb\\_interim\\_report\\_full\\_document.pdf](http://webarchive.nationalarchives.gov.uk/20121204124254/http://www.hm-treasury.gov.uk/d/icb_interim_report_full_document.pdf).

<sup>139</sup> Independent Commission on Banking, 'Final Report' (September, 2011) London (the 'Vickers' Report'), available at [www.hm-treasury.gov.uk/d/ICB-Final-Report.pdf](http://www.hm-treasury.gov.uk/d/ICB-Final-Report.pdf).

<sup>140</sup> *Ibid*, pp 35-78.

<sup>141</sup> *Ibid*, pp 9-10

<sup>142</sup> *Ibid*, pp 233-37.

The Report, also, found<sup>143</sup> that systematically significant financial institutions would need to maintain at least a 10 per cent equity capital buffer to safeguard against losses, and they should have a primary loss-absorbing capacity of at least 17 to 20 per cent.<sup>144</sup> In this regard, banks are required much more equity capital, and their debt must be capable of absorbing losses on failure, while ordinary depositors can be protected.<sup>145</sup>

In relation to the structural cornerstone of access to capital, the Vickers' Report saw strong reasons for ring-fencing domestic retail banking.<sup>146</sup> This approach requires global financial institutions to hold an adequate retail capital ratio.<sup>147</sup> These institutions would not hold less than the capital that they require to underwrite their UK retail banking operations in the UK. The public interest consideration and desire to reduce risk should be considered along with retaining the advantages associated with unified banking regulation.<sup>148</sup>

As for the issue of competition in banking, the Vickers' Report saw the need for reform across the banking system.<sup>149</sup> Measures to curtail implicit state guarantees, enjoyed by 'systematically important financial institutions' ('SIFIs'),<sup>150</sup> are good for competition and financial stability, in terms of ensuring that these organizations face the consequences of risk-taking activities.<sup>151</sup> However, further measures were required to address the crippling of competition in the British retail-banking sector following the GFC.<sup>152</sup> In its findings, the Vickers' Report made three ambitious proposals beyond the continued application of broad competition and merger legislation, for the purposes of improving competition in the banking sector.<sup>153</sup>

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<sup>143</sup> *Ibid*, pp 13.

<sup>144</sup> *Ibid*.

<sup>145</sup> *Ibid*, pp 8-13.

<sup>146</sup> *Ibid*, pp 12, 54, and 135-36.

<sup>147</sup> *Ibid*.

<sup>148</sup> *Ibid*, pp 29, and 274.

<sup>149</sup> *Ibid*, pp 153-55, and 156-64.

<sup>150</sup> A 'systematically important financial institution' ('SIFI') is a bank, or other financial institution, whose failure might trigger a financial crisis.

<sup>151</sup> *Ibid*, pp 162, and 286-88.

<sup>152</sup> *Ibid*.

<sup>153</sup> *Ibid*, see generally ch 9. In particular, the Vickers' Report recommended not only significant structural reform of the UK's banking sector, but also measures designed to increase the capacity of UK banks to absorb losses. For other benefits related to the Report, see, also, J Hill and E Ligere, 'The UK's Financial Services (Banking Reform) Bill: Expect the Unexpected' (2013) 130 *Banking Law Journal* 334, pp 334-35.

One proposal related to structural undertakings to advance competition.<sup>154</sup> Despite the fact that merging banks are required to dispose of assets and liabilities to meet public financial assistance approval criteria, such action would result in reduced competition if this situation was not considerably improved.<sup>155</sup>

The second proposal concerned competition among banks.<sup>156</sup> Such competition dynamics are damaged because of present and recognized problems experienced by customers in switching their current accounts, together with associated hardships.<sup>157</sup> In addition, the Vickers' Report noted broader unsatisfactory situations regarding consumers' alternatives to changing banking service providers, and cumbersome barriers to entry for customers seeking to use the services of smaller banks.<sup>158</sup> The Vickers' Report recommended presentation of mechanisms to significantly improve bank account switching and associated cost competition. In this respect, for making simpler for consumers to switch bank accounts, the independent commission recommended introduction of a free current account redirection service.<sup>159</sup> This would include determining a time limit of seven working days for transferring an account and ensuring that all direct debits and payments are automatically redirected to the customer's new account.<sup>160</sup> British banks and building societies have already started to implement the recommendation from the Vickers' Report on the seven-day switching account in 2013.<sup>161</sup>

The final proposal was to create a strong and pro-competitive institution, namely the Financial Conduct Authority.<sup>162</sup> This was motivated by a part of the Government's reforms of the regulatory architecture as potentially a vital spur to competition in banking. The Vickers' Report indicated that the new regulator would be tasked with advancing efficient competition in UK banking.<sup>163</sup>

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<sup>154</sup> *Vickers' Report* (n58), ch 8.

<sup>155</sup> *Ibid*, pp 203-05.

<sup>156</sup> *Ibid*, pp 166-71.

<sup>157</sup> *Ibid*, pp 179-86.

<sup>158</sup> *Ibid*.

<sup>159</sup> *Ibid*, pp 218-226.

<sup>160</sup> *Ibid*.

<sup>161</sup> *Ibid*, p 17; see, also, S Goff and L Warwick-Ching, 'Banks Set to Launch Seven-Day Account-Switching Service' (16 August, 2013) *Financial Times*.

<sup>162</sup> *Vickers' Report* (n58), pp 16, 24-42, and 227. Subsequently, the Financial Conduct Authority ('FCA') came into effect on 1 April, 2013. For a discussion about the FCA, see chapter 3.2.2 in this thesis, pp 62-3.

<sup>163</sup> *Vickers' Report* (n58), p 241.

The Vickers' Report concluded that the 'too-big-too-fail' ('TBTF') participants in the UK banking system should not be looked at as giving rise to issues that were too delicate to reform.<sup>164</sup> Such issues should be tackled through the implementation of provisions to ensure financial stability, and by harmonizing domestic law with the European Union legislation and other international financial regulation, especially the laws of the US.<sup>165</sup>

The Government responded to the Vickers' Report by supporting the report's proposals in large part.<sup>166</sup> While accepting that big retail banks would be required to retain equity capital of at least 10 per cent of risk weighted assets as well as absorb the possibility of losses of approximately 17 per cent, the Government, in its response to the Vickers' Report, noted<sup>167</sup> that adjustments to these numbers could be made for financial institutions with sizable international operations that would not present a risk to British banking and financial stability, if any of these banks were to collapse.<sup>168</sup>

In relation to depositors' banking choices and improvement of competition in this area, while the Government backed further convenience for the seven-day bank accounts switching between financial institutions,<sup>169</sup> it disagreed with the Vickers' Report's findings on the divestment of branches from Lloyds Banking Group ('Lloyds') that should exceed requirements set under the EU State aid rule.<sup>170</sup> As a matter of fact, in 2013 the Government directed the then Office of Fair Trading ('OFT') to review the impact of divestment of branches from Lloyds and Royal Bank of Scotland ('RBS'), respectively, in the competition

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<sup>164</sup> *Ibid*, pp 14, 16, 124-25, 158-59, and 160-63.

<sup>165</sup> *Ibid*, pp 65, 97, and 149.

<sup>166</sup> HM Treasury, 'The Government Response to the Independent Commission on Banking' (December, 2011) Cm 8252 ('Government Response'), pp 5-8.

<sup>167</sup> *Ibid*, ch 3.57.

<sup>168</sup> *Ibid*.

<sup>169</sup> *Ibid*, chs 4.20 - 4.21.

<sup>170</sup> *Ibid*, chs 4.6 - 4.9; see, also, TFEU (n3), art 107; Council Regulation (EC) No 659/1999 of 22 March, 1999 laying down detailed rules for the application of [Article 108 TFEU] OJ L 83, 27.3.1999, p 1 ('State aids Regulation'), as amended by Council Regulation (EC) No 1791/2006 of 20 November, 2006, OJ L 363, 20.12.2006, p 1 and the Act concerning the conditions of accession of the Czech Republic, the Republic of Estonia, the Republic of Cyprus, the Republic of Latvia, the Republic of Lithuania, the Republic of Hungary, the Republic of Malta, the Republic of Poland, the Republic of Slovenia and the Slovak Republic and the adjustments of the Treaties on which the European Union is founded, OJ L 236, 23.9.2003, p 33; see, further, T Edmonds, 'The Independent Commission on Banking: The Vickers' Report' (30 December, 2013) *House of Commons Library, Business & Transport Section*, p 16, available at [www.parliament.UK/briefing-papers/SN06171.pdf](http://www.parliament.UK/briefing-papers/SN06171.pdf).



in the UK banking industry, as well as in the light of the EU State aid compliance towards these two banks.<sup>171</sup>

The Government agreed with the findings from the then OFT<sup>172</sup> that detailed arrangements for Lloyds and RBS are scrutinised to ensure that they would not hamper any future mergers, acquisitions or other strategic developments.<sup>173</sup> Steps must be taken to ensure that the arrangements do not allow these banks to influence the divested branches' competitive behaviour, facilitate the coordination of the behaviour between each of these banks and their respective divested branches or render the divested branches vulnerable to poor quality of service.<sup>174</sup> Measures to be taken to strengthen the divested operations financially with the objective of providing it with a higher income to enable it to invest and grow into its branch network and to allow it to compete more vigorously in retail banking.<sup>175</sup> The OFT determined that the sell-off of the branches from Lloyds and RBS appeared in compliance with the EU rules on the State aid, and they did not impede the competition in banking system in the UK.<sup>176</sup>

## 2.6 HM Treasury blueprint report

The Government formulated its response to the recommendations of the Vickers' Report into the HM Treasury Blueprint Report of 2011 ('Treasury Report').<sup>177</sup>

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<sup>171</sup> Commission, 'State Aid: United Kingdom Restructuring of Royal Bank of Scotland Following Its Recapitalisation by the State and Its Participation in the Asset Protection Scheme' (14 December, 2009) Nos 422/2009 and 621/2009; see, also, Commission, 'State Aid: United Kingdom Restructuring of Lloyds Banking Group' (18 November, 2009) No 428/2009; The UK Government requested the advice from OFT under section 7 of the EA02 (n2).

<sup>172</sup> HM Treasury, 'Office of Fair Trading Reports to Government on Lloyds and RBS Divestments' (September, 2013), available at [www.gov.uk/government/news/office-of-fair-trading-reports-to-government-on-lloyds-and-rbs-divestments](http://www.gov.uk/government/news/office-of-fair-trading-reports-to-government-on-lloyds-and-rbs-divestments).

<sup>173</sup> *Ibid.*

<sup>174</sup> HM Treasury, 'Annual Speech by Chancellor of the Exchequer' (19 June, 2013) *Mansion House London*, available at <https://www.gov.uk/government/speeches/speech-by-chancellor-of-the-exchequer-rt-hon-george-osborne-mp-mansion-house-2013>.

<sup>175</sup> *Ibid.*

<sup>176</sup> C Maxwell, 'Letter from Clive Maxwell CBE, the Chief Executive of the OFT to the Rt Hon George Osborne MP Chancellor of the Exchequer' (September, 2013) ('OFT's Recommendations of LBG/RBS Divestments, to the UK Government'), available at [www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/239271/Chancellor\\_110913\\_non-confidential.pdf](http://www.gov.uk/government/uploads/system/uploads/attachment_data/file/239271/Chancellor_110913_non-confidential.pdf).

<sup>177</sup> HM Treasury, 'A New Approach to Financial Regulation: The Blueprint for Reform' (2011) *Cm 8083* ('Treasury Report') available at

The Treasury Report called for amendments to the Financial Services and Markets Act of 2000 in order for the Government to implement the reform programme of the financial services.<sup>178</sup> A large proportion of the Treasury Report related to the new draft Financial Services Bill and explanatory notes.<sup>179</sup> The Report indicated the plans from the Government to reform the UK banking and financial system by establishing a macro prudential regulator, the Financial Policy Committee ('FPC') within the Bank of England ('BoE').<sup>180</sup> This would monitor responses to systemic risks.<sup>181</sup> The report, also, supported the transfer of responsibility for prudential regulation to a new regulatory body, the Prudential Regulation Authority ('PRA');<sup>182</sup> and creation of a focused conduct of business regulator, the Financial Conduct Authority ('FCA').<sup>183</sup> In relation to competition powers, the Government remained committed to ensuring that the new regulating system included 'competition' as an important feature.<sup>184</sup> The Government proposed that the FCA sustain the power to initiate and enhance referral to the Competition and Markets Authority ('CMA'), where it had identified a possible competition issue that may benefit from technical competition expertise or require recourse to powers under competition law that sit with the competition authority.<sup>185</sup>

In addition to the Treasury Report, the Government published a series of papers concerning issues within the Vickers' Report's findings.<sup>186</sup> For instance, two significant papers on the competition aspects of British banking were: (i) the *Competition and Choice in*

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[www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/81403/consult\\_finreg\\_\\_new\\_approach\\_blueprint.pdf](http://www.gov.uk/government/uploads/system/uploads/attachment_data/file/81403/consult_finreg__new_approach_blueprint.pdf)

<sup>178</sup> *Ibid*, ch 3 (Draft Financial Services Bill, pt 2).

<sup>179</sup> *Ibid*, chs 3-4.

<sup>180</sup> *Ibid*, paras 1.25 - 1.30; and 2.6 - 2.44.

<sup>181</sup> *Ibid*, para 1.28.

<sup>182</sup> *Ibid*, paras 1.31 - 1.38; and 2.45 - 2.78.

<sup>183</sup> *Ibid*, paras 1.39 - 1.44; and 2.79 - 2.110.

<sup>184</sup> *Ibid*, paras 2.111 - 2.119.

<sup>185</sup> *Ibid*.

<sup>186</sup> For example, HM Treasury, 'Statement by the Chancellor of the Exchequer on the Publication of the Independent Commission on Banking Report' (12 September, 2011) London, available at <https://www.gov.uk/government/speeches/statement-by-the-chancellor-of-the-exchequer-rt-hon-george-osborne-mp-on-the-publication-of-the-independent-commission-on-banking-report>; see, also, HM Treasury, 'Banking Reform Statement by the Chancellor of the Exchequer' (19 December, 2011) London, available at <https://www.gov.uk/government/speeches/banking-reform-statement-by-the-chancellor-of-the-exchequer-rt-hon-george-osborne-mp>.

*Retail Banking* report of 2011 ('Retail Banking Report'),<sup>187</sup> and, earlier, (ii) the 2010 report entitled *Too Important to Fail – Too Important to Ignore* ('TBTF Report').<sup>188</sup>

The Retail Banking Report acknowledged that banking system in the UK was not highly competitive, a reality exacerbated by the imposed consolidations following the Global Financial Crisis ('GFC').<sup>189</sup> The Report, also, noted alternatives to enhance competition, particularly highlighting that, supporting new bank participants was important in achieving this objective.<sup>190</sup>

The Retail Banking Report looked at the long and short term effects of the divestiture of large banks. It found that in the short term, disposal of these banks' assets and liabilities in an unorganized market could likely carry a higher financial return.<sup>191</sup> Nevertheless, in the longer term, a more vibrant and competitive market, with a larger number of participants, could boost economic development.<sup>192</sup>

The 2010 TBTF Report dealt with the role of large and disproportionately significant banks in preserving stability of the financial system and competition in the banking system.<sup>193</sup> The Report indicated that the GFC has significantly reduced the number of banks and building societies operating within the UK.<sup>194</sup> Effective competition will be inhibited for as long as incumbent financial institutions are 'too big or too important to fail'.<sup>195</sup> That is yet another reason why the financial system must be reformed, as quickly as practicable, to ensure that financial institutions are, like the rest of the economy, properly subject to the discipline of the market place.<sup>196</sup> In the end, the 2010 Report failed to make any concrete findings on this point.

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<sup>187</sup> House of Commons, 'Competition and Choice in Retail Banking: Ninth Report Session 2010-11' (2011) *HC 612-I* ('Retail Banking Report').

<sup>188</sup> House of Commons, 'Too Important to Fail – Too Important to Ignore: Ninth Report 2009-10' (March, 2010) *HC 261* ('TBTF Report').

<sup>189</sup> *Retail Banking Report* (n106), paras 8-19; and 38-39.

<sup>190</sup> *Ibid*, paras 139, 142, and especially ch 5.

<sup>191</sup> *Ibid*, paras 158-174.

<sup>192</sup> *Ibid*, paras 223-224; *Ibid*, 'Conclusions and recommendations', pp 84-90.

<sup>193</sup> *TBTF Report* (n107), pp 5-10.

<sup>194</sup> *Ibid*, p 76.

<sup>195</sup> *Ibid*, p 78.

<sup>196</sup> *Ibid*, p 87.

As for the HM Treasury Report,<sup>197</sup> this found that any prospective reform initiatives would have to meet certain criteria.<sup>198</sup> Retail and investment banks need to be permitted to operate freely and without impacting the soundness of the banking system.<sup>199</sup> The failure of any bank ought to be handled without creating a financial burden on British consumers.<sup>200</sup>

Overall, the Treasury Report endorsed the Vickers' Report's recommendation regarding the critical role of competition in banking, the enhancement of consumer banking services, and driving down the cost of these services.<sup>201</sup> It can be said that the Treasury Report was a positive step towards the Government's forthcoming initiatives for addressing competition issues in the UK financial regulatory architecture.

## 2.7 Financial Services Act 2012

The Financial Services Act 2012 ('FSA 2012')<sup>202</sup> established new banking and financial regulation architecture with formation of new regulators, namely the Financial Conduct Authority ('FCA')<sup>203</sup> and the Prudential Regulation Authority ('PRA')<sup>204</sup>, and gave the Bank of England complete responsibility for financial stability.<sup>205</sup> This delegated responsibility was enhanced through formation of the Financial Policy Committee ('FPC') of the Bank of England.<sup>206</sup>

The FSA 2012 achieved other ends beyond the creation of these supervisory institutions. The Act introduced changes to the law relating to market manipulation and misleading statements, both intentionally and recklessly.<sup>207</sup> This was achieved through amendment of various sections of the Financial Services and Markets Act 2000.<sup>208</sup>

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<sup>197</sup> *Treasury Report* (n96).

<sup>198</sup> *Ibid*, para 2.133.

<sup>199</sup> *Ibid*, para 1.7.

<sup>200</sup> *Ibid*, paras 2.146 - 2.149.

<sup>201</sup> *Ibid*, paras 1.1 - 1.9.

<sup>202</sup> Financial Services Act of 2012, c. 21 ('FSA 2012'). The original bill was published on 27 January, 2012 and, after parliamentary scrutiny, received Royal Assent on 19 December, 2012, available at [www.legislation.gov.uk/ukpga/2012/21/contents/enacted](http://www.legislation.gov.uk/ukpga/2012/21/contents/enacted).

<sup>203</sup> *Ibid*, s 6.

<sup>204</sup> *Ibid*.

<sup>205</sup> *Ibid*, s 2.

<sup>206</sup> *Ibid*, s 4.

<sup>207</sup> *Ibid*, ss 89-95.

<sup>208</sup> For example, *Ibid*, ss 13-15, 36, 41, 68-83, and 89-95.

The FSA 2012, among other developments, modernized and expanded the reach of the law on proper regulation of the financial market and enhanced disclosure procedures and due diligence processes in the financial sector.<sup>209</sup> Furthermore, the FSA 2012 expanded the range of the special resolution regime, under the Banking Act 2009,<sup>210</sup> to certain UK investment firms, related companies to UK banks and investments banks and UK clearing houses<sup>211</sup>, established a new platform for regulated activity in connection with credit rating agencies and their rating parameters<sup>212</sup>, and transferred responsibility for consumer credit to the newly formed Financial Conduct Authority.<sup>213</sup>

Overall, the FSA 2012 provided a further important contribution to improving competition in the UK banking industry by creating new banking and financial regulators.<sup>214</sup>

## 2.8 Financial Services (Banking Reform) Act 2013

On 18 December, 2013 the Financial Services (Banking Reform) Act 2013 (the ‘Banking Reform Act 2013’) was enacted.<sup>215</sup> This essential legislation brings into law requirements for a wide-ranging of reforms in the financial services sector.<sup>216</sup>

These reforms include: (i) the introduction of a retail ‘ring-fence’ for banks;<sup>217</sup> (ii) a preference for certain depositors on insolvency;<sup>218</sup> (iii) a new bail-in tool;<sup>219</sup> (iv) a new licensing regime;<sup>220</sup> (v) a new payment systems regulator;<sup>221</sup> and (vi) a cap on the cost of payday loans.<sup>222</sup> The provisions in the Banking Reform Act 2013 are due to come in to force

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<sup>209</sup> *Ibid*, s 41; Sched 12.

<sup>210</sup> Banking Act 2009, c. 1 (‘BA09’).

<sup>211</sup> FSA 2012 (n121), ss 96-106.

<sup>212</sup> *Ibid*, ss 7-9, 11, and 13-15; Sched 5.

<sup>213</sup> *Ibid*, ss 107-08; For a discussion of the Financial Conduct Authority, see chapter 3.2.2 in this thesis, pp 62-3.

<sup>214</sup> FSA 2012 (n121), s 1(E); see, also, N Ryder, ‘The Financial Crisis and White Collar Crime: The Perfect Storm?’ (Cheltenham: Edward Elgar Publishing 2014), pp 38-40.

<sup>215</sup> Financial Services (Banking Reform) Act 2013, c.33 (‘Banking Reform Act 2013’).

<sup>216</sup> *Ibid*, ‘Introductory Text’.

<sup>217</sup> *Ibid*, ss 1-12.

<sup>218</sup> *Ibid*, ss 13-15.

<sup>219</sup> *Ibid*, s 17.

<sup>220</sup> *Ibid*, ss 18-38.

<sup>221</sup> *Ibid*, ss 39-110.

<sup>222</sup> *Ibid*, ss 111-128.

on different dates from the time when the Act was enacted, until 1 January, 2019.<sup>223</sup> Following the enactment of the Act, a series of secondary legislation has been published,<sup>224</sup> and more secondary legislation is to come,<sup>225</sup> which are aimed to clarify certain aspects of the Banking Reform Act 2013.<sup>226</sup> As a result, it is too early to determine effect of the Act towards the enhancement of competition in banking sector.

## 2.9 Enterprise and Regulatory Reform Act 2013

The competition provisions of the Enterprise and Regulatory Reform Act of 2013 ('ERRA13') entered into force on 1st April, 2014.<sup>227</sup> The ERRA13 made changes to the EA02, considerably modifying the way cartel offences are scrutinized and prosecuted, as well as creating a much easier way to criminally prosecute the individuals involved.<sup>228</sup> Additionally, the ERRA13 eliminated both the Office of Fair Trading ('OFT') and the Competition Commission ('CC'),<sup>229</sup> creating the Competition and Markets Authority ('CMA') as the single authority in charge of competition enforcement in the UK.<sup>230</sup>

Unlike the requirement under the ERRA13, the prosecution no longer requires evidence of 'dishonesty' to secure a conviction in the case of a business or person deliberately participating in any type of criminal cartel agreement, including price fixing, market sharing, restrictions on production or supply, and bid rigging agreements.<sup>231</sup> This change introduced by the ERRA13 is expected to substantially diminish the prosecutorial burden, and, therefore,

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<sup>223</sup> *Ibid*, s 148. For example, the Treasury has set 1 January, 2019, deadline for key provisions of the Act, including ring-fencing and depositor preference, to come into force; see, also, HM Treasury, 'A New Approach to Financial Regulation: Securing Stability, Protecting Consumers' (2012) *UK Government*, p 66, available at [www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/236107/8268.pdf](http://www.gov.uk/government/uploads/system/uploads/attachment_data/file/236107/8268.pdf).

<sup>224</sup> The Financial Services (Banking Reform) Act 2013 (Transitional and Savings Provisions) Order 2015, SI 2015/492; The Financial Services (Banking Reform) Act 2013 (Commencement No. 9) Order 2015, SI 2015/490; The Financial Services (Banking Reform) Act 2013 (Commencement (No. 8) and Consequential Provisions) Order 2015, SI 2015/428; The Financial Services (Banking Reform) Act 2013 (Commencement No. 7) Order 2014, SI 2014/3160.

<sup>225</sup> HM Treasury/BIS, 'Banking Reform: Draft Secondary Legislation' (July, 2013); Prudential Regulation Authority, 'The Implementation of Ring-fencing: Consultation on Prudential Requirements, Intragroup Arrangements and Market Infrastructure' (2015) *PS10/15*; Prudential Regulation Authority, 'The Implementation of Ring-fencing: Legal Structure, Governance and the Continuity of Services and Facilities' (2015) *PS10/15*.

<sup>226</sup> *Banking Reform Act 2013* (n134), s 148.

<sup>227</sup> *ERRA13* (n31), s 1.

<sup>228</sup> *Ibid*, ss 47-48.

<sup>229</sup> *EA02* (n2), pts 1 and 5; Scheds 1, and 11.

<sup>230</sup> *ERRA13* (n31), ss 25-28.

<sup>231</sup> *Ibid*, s 47.

it may lead to a greater conviction level. It does, nonetheless, provide exceptions and defences.<sup>232</sup>

Implementation of the ERA13's provisions will be challenging for large financial institutions, and other businesses in the economy, requiring review and amendment of their internal policies and practices.

## 2.10 Banking markets investigation

One of the most recent initiatives implemented by the Competition and Markets Authority ('CMA') to enhance competition in the banking business is the CMA 2014 - 2016 investigation into personal current accounts and SMEs banking.<sup>233</sup>

The CMA published its final report on this investigation in the summer 2016.<sup>234</sup> The investigation focused on three important issues<sup>235</sup>, namely, hurdles of blocking customers from shopping around and switching current accounts; the dominance of the big financial institutions; and the problems of new banks aiming to enter the market.<sup>236</sup> CMA found that a combination of low customer interaction, obstacles to search and switch accounts, and the big banks' benefits in providing accounts leads to an 'adverse effect on competition'.<sup>237</sup> The CMA recommended numerous potential remedies, such as, forcing banks to prompt customers to consider switching to a rival on particular situations; financial institutions need to increase the profile of the current account switching service in order to aid customers to move bank; undertakings to establish a price comparison site for small business bank accounts.<sup>238</sup> The

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<sup>232</sup> *Ibid.*

<sup>233</sup> Competition and Markets Authority, 'Retail banking market investigation: Summary of provisional findings report' (22 October, 2015) ('Retail Banking Market Investigation'), available at [www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/470032/Banking\\_summary\\_of\\_PFs.pdf](http://www.gov.uk/government/uploads/system/uploads/attachment_data/file/470032/Banking_summary_of_PFs.pdf).

<sup>234</sup> Competition and Markets Authority, 'Retail banking market investigation' (9 August 2016) Final report, available at [www.assets.publishing.service.gov.uk/media/57ac9667e5274a0f6c00007a/retail-banking-market-investigation-full-final-report.pdf](http://www.assets.publishing.service.gov.uk/media/57ac9667e5274a0f6c00007a/retail-banking-market-investigation-full-final-report.pdf).

<sup>235</sup> *Ibid.*, pp 708-10.

<sup>236</sup> *Ibid.*, pp 350-75.

<sup>237</sup> *Ibid.*, p 490. The watchdog said: 'With greater customer engagement we would expect banks to have stronger incentives to compete and develop products to benefit all customers which are clearer to and valued by customers.'

<sup>238</sup> *Ibid.*, pp 650-87.

CMA aimed to ensure customers advantages from digital services and that new banks would enable to compete with large financial institutions.<sup>239</sup>

Critics of the foregoing CMA's investigation report questioned whether the new measures under the report were enough to establish reform in retail banking.<sup>240</sup> Nevertheless, the jury is out as to whether the remedies provided under the final report will be sufficient to enhance retail banking in the UK.

## 2.11 EU competition legislation on bank mergers

From time to time, British banks contemplate mergers with banks located within the European Union in order to add or enlarge their present banking operations. Since the UK is a member of the European Union, in the case of an EU related bank merger involving a British bank, such a transaction would be considered as a merger within EU Member State competition legislation (*e.g.*, UK) or the European Union competition provisions. Therefore, a discussion of the present EU competition legislation affecting bank mergers is outlined, below.

Similar to applicability of the UK competition laws, the EU antitrust legislation regulates not only activities in the banking and financial services sector, but also in other sectors of the European economy. Nevertheless, for the purpose of this thesis, discussion of the EU antitrust legislation is made only in relation to banks and other financial institutions.

### 2.11.1 Treaties

At the European Union level, the 1958 Treaty Establishing the European Economic Community ('EEC Treaty')<sup>241</sup> introduced pioneering standards and guidelines regarding concentration issues for business markets across the EU economies.<sup>242</sup> In fact, the Treaty laid

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<sup>239</sup> *Ibid*, pp 699-712.

<sup>240</sup> E Dunkley, 'UK banks told to overhaul retail services' (9 August 2016), *Financial Times*.

<sup>241</sup> Treaty Establishing the European Economic Community (25 March, 1957) 298 *U.N.T.S.* 3 (in force 1 January, 1958) ('EEC Treaty').

<sup>242</sup> *Ibid*, arts 3(f), 29(b) & (c), and especially arts 85-90.



the foundations of competition policies pursuant to the Treaty on European Union ('TEU')<sup>243</sup> and the Treaty on the Functioning of the European Union ('TFEU').<sup>244</sup>

Presently, Articles 101-109 TFEU compose the legal basis of EU competition law.<sup>245</sup>

Article 101 TFEU prohibits agreements between two or more independent market operators that restrict competition.<sup>246</sup> This provision covers both horizontal agreements (namely an agreement between present or potential competitors operating at the same level of the supply chain), and vertical agreements (namely an agreement between businesses operating at different levels).<sup>247</sup> Only limited exceptions are provided for in the general prohibition.<sup>248</sup> The most blatant instance of unlawful conduct infringing Article 101 is the establishment of a cartel between competitors that may concern market sharing and/or price-fixing.<sup>249</sup>

Article 102 TFEU forbids businesses like financial institutions, which sustain a 'dominant position' on a given market to abuse that position, for instance, by charging unfair prices or limitation of production, or placing other competitors at a competitive disadvantage.<sup>250</sup>

The legal definition of a 'dominant position' has been established by the European Court of Justice ('ECJ') as:

a position of economic strength enjoyed by an undertaking which enables it to hinder the maintenance of effective competition on the relevant market by allowing it to behave to an appreciable extent independently of its competitors and customers and ultimately of consumers.<sup>251</sup>

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<sup>243</sup> Treaty on European Union (Consolidated version 2012) *OJ C 326/01* ('TEU').

<sup>244</sup> Treaty on the Functioning of the European Union (Consolidated version 2012) *OJ C 326/01* ('TFEU').

<sup>245</sup> *Ibid*, arts 101-109.

<sup>246</sup> *Ibid*, art 101(1).

<sup>247</sup> *Ibid*, art 101.

<sup>248</sup> *Ibid*, art 101(3).

<sup>249</sup> *Ibid*, art 101(1).

<sup>250</sup> *Ibid*, art 102.

<sup>251</sup> Case No. 322/81, *Michelin v. Commission* [1983] ECR 3461.

Article 107 TFEU prohibits State aid that distorts or threatens to distort competition by favouring certain businesses or products that affect trade between Member States and are incompatible with the internal market.<sup>252</sup>

The Commission is empowered by the Treaty to apply these foregoing provisions,<sup>253</sup> and it has a number of investigative powers to that end, for example, inspection at business and non-business premises, written requests for information.<sup>254</sup> The Commission may, also, impose fines on undertakings, which violate the EU antitrust rules.<sup>255</sup>

Notwithstanding the foregoing consolidation of the competition rules in the Treaties, these rules remain largely unchanged since 1958.<sup>256</sup>

### 2.11.2 Regulation (EC) No 139/2004 (the EU Merger Regulation)

The bank merger control process in the EU is laid out in the EC Merger Regulation ('ECMR')<sup>257</sup> and its implementing regulation<sup>258</sup>, which has been in force from May, 2004.<sup>259</sup>

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<sup>252</sup> TFEU (n159), art 107(1).

<sup>253</sup> *Ibid*, arts 103, and 105.

<sup>254</sup> Council Regulation (EC) No. 1/2003, OJ [2003] L 1/1 (in force 1 May, 2004) ('Regulation 1/2003'), art 21 can be used in the context of inspection where 'a serious violation of Article 101 or 102 TFEU' is suspected (e.g., a cartel).

<sup>255</sup> *Ibid*, art 23.

<sup>256</sup> *EEC Treaty* (n157); see, also, C Barnard and S Peers, *European Union Law* in A Jones and C Townley (eds.) *Competition Law* (Oxford: Oxford University Press 2014), p 504.

<sup>257</sup> Council Regulation (EC) No 139/2004 of 20 January, 2004 on the control of concentrations between undertakings, *OJ L 24/1*, 29 January, 2004 ('ECMR').

<sup>258</sup> Commission Regulation (EC) No 802/2004 of 7 April, 2004 implementing Council Regulation (EC) No 139/2004 (published in *OJ L 133*, 30.04.2004) amended by Commission Regulation (EC) No 1033/2008 of 20 October, 2008 (published in *OJ L 279*, 22.10.2008) – Consolidated version of 23 October, 2008; Annex I: Form CO relating to the notification of a concentration pursuant to Regulation (EC) No 139/2004, consolidated with amendments introduced by Commission Regulation (EC) No 1033/2008 – Consolidated version of 23 October, 2008; Annex II: Short Form CO for the notification of a concentration pursuant to Regulation (EC) No 139/2004, consolidated with amendments introduced by Commission Regulation (EC) No 1033/2008 – Consolidated version of 23 October, 2008; Annex III: Form RS Reasoned Submission (Form RS), Regulation (EC) No 139/2004, consolidated with amendments introduced by Commission Regulation (EC) No 1033/2008 – Consolidated version of 23 October, 2008; Annex IV: Form RM relating to the information concerning commitments submitted pursuant to article 6(2) and article 8(2) of Regulation (EC) No 139/2004, introduced by Commission Regulation (EC) No 1033/2008 – Consolidated version of 23 October, 2008 ('Implementing Regulation').

<sup>259</sup> *ECMR* (n172), arts 2, and 3.

The ECMR contains the main rules for the assessment of concentrations,<sup>260</sup> while the implementing regulation deals with procedural issues, such as, notification, deadlines, and right to be heard.<sup>261</sup>

The enactment of ECMR was accompanied, and followed, by a series of notices and guidelines concerning control of concentrations between undertakings,<sup>262</sup> treatment of certain concentrations,<sup>263</sup> case referral in respect of concentrations,<sup>264</sup> definition of the relevant market for the purposes of Community competition law,<sup>265</sup> assessment of horizontal mergers,<sup>266</sup> and non-horizontal mergers,<sup>267</sup> remedies,<sup>268</sup> restrictions to concentrations,<sup>269</sup> and rules for access to the Commission file in competition related cases.<sup>270</sup>

Broadly speaking, these foregoing notices and guidelines set out thorough information and clarification on the merger application situations notified by the merging parties to the Commission.<sup>271</sup> In addition, they clarify the EU competition law and contributions to legal certainty, increasing efficiency from the Commission in merger review.<sup>272</sup>

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<sup>260</sup> See generally, *Implementing Regulation* (n173).

<sup>261</sup> *Ibid*; The official forms for standard merger notifications (Form CO), simplified merger notifications (Short Form CO) and referral requests (Form RS) are attached to the Implementing Regulation, available at Commission's official website at [http://ec.europa.eu/competition/mergers/legislation/regulations.html#impl\\_reg](http://ec.europa.eu/competition/mergers/legislation/regulations.html#impl_reg)

<sup>262</sup> Commission Consolidated Jurisdictional Notice under Council Regulation (EC) No 139/2004 on the control of concentrations between undertakings (16 April, 2008) *OJ C 95*.

<sup>263</sup> Commission Notice on a simplified procedure for treatment of certain concentrations under Council Regulation (EC) No 139/2004 (5 March, 2005) *OJ C 56*.

<sup>264</sup> *Ibid*.

<sup>265</sup> Commission Notice on the definition of the relevant market for the purposes of Community competition law, (9 December, 1997) *OJ C 372*.

<sup>266</sup> Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings (5 February, 2004) *OJ C 31*.

<sup>267</sup> Guidelines on the assessment of non-horizontal mergers under the Council Regulation on the control of concentrations between undertakings (18 October, 2008) *OJ C 265*.

<sup>268</sup> Commission Notice on remedies acceptable under Council Regulation (EC) No 139/2004 and under Commission Regulation (EC) No 802/2004 (22 October, 2008) *OJ C 267*.

<sup>269</sup> Commission Notice on restrictions directly related and necessary to concentrations (5 March, 2005) *OJ C 56*.

<sup>270</sup> Commission Notice on the rules for access to the Commission file in case pursuant to Articles 81 and 82 of the EC Treaty, Articles 53, 54 and 57 of the EEA Agreement and Council Regulation (EC) No 139/2004 (22 December, 2005) *OJ C 325*.

<sup>271</sup> A Lindsay and A Berridge, *The EU Merger Regulation: Substantive Issues* (4th edn, Sweet & Maxwell 2012), pp 60-75.

<sup>272</sup> R Whish and D Bailey, *Competition Law* (8<sup>th</sup> edn, New York: Oxford University Press 2015) ('Whish and Bailey'), p 875.

In addition to notices and guidelines, the Commission publishes ‘Best Practice Guidelines’<sup>273</sup> that help in better understanding and simplifying information and communication between case team and parties/third parties in every step of the merger procedure, such as pre-notification contacts, meetings, and provision of documents.<sup>274</sup>

The ECMR’s goal is to review and regulate bank (or other businesses) merger transaction, which would precipitate a substantial long-term change within the EU financial market, and the European economy, as a whole. A bank merger is to be notified to the Commission only in the event of formation of a ‘concentration’<sup>275</sup> by the merging parties<sup>276</sup> or the establishment of a joint venture.<sup>277</sup> The concentration in question should relate to the gaining of control on a lasting basis that results from the merger of two or more previously independent financial institutions or parts of these institutions, or the acquisition by one or more undertakings (or persons already controlling at least one undertaking) of direct or indirect control of the whole or parts of one or more other undertakings.<sup>278</sup> ‘Control’ is described as the ability to apply a definite authority over a bank (or other undertaking),<sup>279</sup> such as, the capability to dictate or block business decisions.<sup>280</sup>

A ‘concentration’ becomes subject to the ECMR in the event it has an EU (Community) dimension.<sup>281</sup> This is when the combined global revenue of the merger exceeds €5 billion (so-called the ‘Worldwide Turnover Test’),<sup>282</sup> and the revenue across the EU of each of two merging banks (undertakings) is more than €250 million (so-called the ‘EU-wide Turnover Test’).<sup>283</sup> The relevant merging parties are to notify the Commission before they proceed with the proposed merger.<sup>284</sup>

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<sup>273</sup>European Commission, ‘Best Practice Guidelines in proceedings concerning articles 101 and 102 TFEU’ (20 October, 2011) *OJ C 308*, pp 6-32.

<sup>274</sup> *Ibid*, s 2.

<sup>275</sup> *ECMR* (n172), art 3.

<sup>276</sup> *Ibid*, arts 3(1) to 3(3).

<sup>277</sup> *Ibid*, art 3(4).

<sup>278</sup> *Ibid*, art 3(1).

<sup>279</sup> *Ibid*, art 3(2).

<sup>280</sup> *Ibid*, art 3(3).

<sup>281</sup> *Ibid*, art 1(1).

<sup>282</sup> *Ibid*, art 1(2).

<sup>283</sup> *Ibid*, art 1(2).

<sup>284</sup> *Ibid*, art 4(1).

There are other alternative thresholds, which can define the EU dimension on a bank (or other undertakings) merger. These requirements include the combined global revenue of the merging entities is at least €2.5 billion (so-called the ‘Lower Worldwide Turnover Test’),<sup>285</sup> or the total revenue of the combined merging parties across the EU is over €100 million (so-called the ‘Lower EU-Wide Turnover Test’).<sup>286</sup>

The merger does not have to be notified to the Commission, if either the essential or additional requirements referred to above are met, provided that the ‘two-thirds rule’ is satisfied.<sup>287</sup> This rule states that, if each of the merging parties (*e.g.*, banks) obtains more than two-thirds of its EU gross revenue in one EU member state, then the merger falls outside the applicability of the ECMR provisions.<sup>288</sup> For example, in the merger case of *Royal Bank of Canada/Banque de Montreal*, the Commission ruled that considering that one of the merging banks achieved two-thirds of its Community turnover in the UK, the Commission did not oppose the notified operation and declare it compatible with the common market and the EU merger regulations.<sup>289</sup> Most of the bank mergers following the Global Financial Crisis (‘GFC’) did not meet the aforementioned requirements, and, therefore, were assessed by relevant EU Member State competition and banking authorities.<sup>290</sup>

For a discussion of the competitive analysis in relation to the applicability of the ECMR provisions in a bank merger, and in particular, the matters of *ex-ante versus ex-post* notification control, the significant impediment of effective competition (‘SIEC’) test, and failing firm defence, see subchapters 5.4.1 through 5.4.3 of this thesis.

### 2.11.3 Council Regulation (EC) No 1/2003<sup>291</sup> (implementation of the rules on competition)

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<sup>285</sup> *Ibid*, art 1(3)(a).

<sup>286</sup> *Ibid*, art 1(3)(d).

<sup>287</sup> *Ibid*, arts 1(2)(b), and (3)(d).

<sup>288</sup> E Varona et al, *Merger Control in the European Union* (2nd edn, Oxford University Press 2005), pp 32-40.

<sup>289</sup> Case No. COMP/IV/M.1138 *Royal Bank of Canada/Banque de Montreal* [1998] OJ C144/4.

<sup>290</sup> For example, the Commission did not oppose most of the bank mergers that took place in the UK after the GFC. In those instances that the Commission reviewed the proposed merger(s), for instance in *Lloyds/HBOS* takeover, the Commission did simply recommend divestiture measures. For more information, see chapter 4.3.2(e) in this thesis, pp110-16.

<sup>291</sup> Council Regulation (EC) No 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty (2003) *OJ L 1/1*, as amended by Council Regulation (EC) No 411/2004 of 26 February 2004 repealing Regulation (EEC) No 3975/87 and amending Regulations (EEC) No

The Commission's responsibility for implementation and enforcement of the regulation of both the prohibition of anticompetitive agreements and the abuse of dominance, pursuant to Articles 101 and 102 TFEU is largely governed by Council Regulation (EC) No. 1/2003 ('Regulation 1/2003').<sup>292</sup>

The Regulation 1/2003, also, addresses the relationship between national competition law and EU competition law (*i.e.*, Articles 101 and 102 TFEU).<sup>293</sup> The Regulation provides that Member State competition authorities applying national competition law to cases, which, also, are subject to Article 101 or 102 TFEU by virtue of the inter-state clause, must also apply the provisions of the TFEU.<sup>294</sup> The national competition authorities essentially apply both (EU and domestic) legal systems, without obligation to apply their own laws.<sup>295</sup>

When required to evaluate agreements, decisions or behaviour, pursuant to Article 101 or 102 TFEU, that are already the subject of a Commission decision, the competition authorities of the Member States may not make decisions that would contradict those made by the Commission.<sup>296</sup>

When examining procedural rules, the Commission applies the procedural rules set out in the Regulation 1/2003, while the Member States' authorities apply their respective national procedural laws, within the meaning of EU anti-trust laws.<sup>297</sup> However, the Regulation also contains certain guidelines for the application of national procedural law by the authorities of the Member States.<sup>298</sup>

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3976/87 and (EC) No 1/2003, in connection with air transport between the Community and third countries (2004) *OJ L 68/1* and Council Regulation (EC) No 1419/2006 of 25 September 2006 repealing Regulation (EEC) No 4056/86 laying down detailed rules for the application of Articles 85 and 86 of the Treaty to maritime transport, and amending Regulation (EC) No 1/2003 as regards the extension of its scope to include international tramp services (2006) *OJ L 269/1* ('Regulation 1/2003').

<sup>292</sup> *Ibid.*

<sup>293</sup> *Ibid.*, art 3.

<sup>294</sup> *Ibid.*, arts 3(1) and 3(2).

<sup>295</sup> *Ibid.*, art 3(3).

<sup>296</sup> *Ibid.*, art. 16.

<sup>297</sup> *Ibid.*, art 3(1).

<sup>298</sup> Commission Regulation (EC) No 773/2004 of 7 April, 2004 relating to the conduct of competition proceedings by the Commission pursuant to Articles 81 and 82 of the EC Treaty; see, also, Commission, 'Enhancing Competition Enforcement by the Member States' Competition Authorities: Institutional and Procedural Issues' (9 July, 2014) *Staff Working Paper SWD 231/2*.

Acting on their own initiative, or on a complaint, the national competition authorities may order preliminary measures or the cessation of infringement, may accept commitments and impose fines, penalties and other sanctions provided for under national law in order to implement properly the applicability of Article 101 and/or 102 TFEU.<sup>299</sup> A similar interim measures authority is provided to the Commission.<sup>300</sup>

The national competition authorities may decide not to be necessary to act, if the requirements for a prohibition are not met, based on the information they have before them.<sup>301</sup> The basis for such a decision may be that the national authority has exercised its discretion so as not to start proceedings, or that such proceedings resulting in a finding that Articles 101 and/or 102 TFEU were not violated.<sup>302</sup> Nonetheless, such a decision is not binding on other authorities and courts.<sup>303</sup>

The principle of having the respective national competition authorities applies their national law results, particularly, in the situation that the likelihood of imposing fines on individuals and on undertakings must be provided for in national law.<sup>304</sup> The individual legal systems provided for both differing methods of evaluation, as well as different upper limits on the imposition of fines, so that very different sanctions may be imposed, depending on the respective national law subject to merger application.<sup>305</sup>

In essence, at the EU level, if a ‘concentration’<sup>306</sup> has a Community ‘dimension’<sup>307</sup> it is down to the Commission;<sup>308</sup> but a merger that does *not* have a Community ‘dimension’, national law and procedures apply, provided that the concentration without a Community dimension does not threaten to ‘significantly affect competition’ in the territory of the EU

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<sup>299</sup> Regulation 1/2003 (n206), art 5.

<sup>300</sup> *Ibid*, art 8(1).

<sup>301</sup> *Ibid*, art 3(2).

<sup>302</sup> W Frenz, Handbook of EU Competition Law (New York: Springer 2015) (‘Frenz’), pp 827-830.

<sup>303</sup> Regulation 1/2003 (n206), recital 9.

<sup>304</sup> *Ibid*, art 23.

<sup>305</sup> Frenz (n217), p 829.

<sup>306</sup> ECMR (n172), art 3.

<sup>307</sup> *Ibid*, art 1(3).

<sup>308</sup> *Ibid*, arts 1(4) to 1(5); and recital 46.

Member States.<sup>309</sup> And, of course, banks and other financial institutions are required to comply with general competition rules of 101 and 102 TFEU<sup>310</sup> at all times – which may bring in the Commission and/or national competition authorities and/or national courts.

A discussion of the role of the Commission, the Competition and Markets Authority, and the EU and British courts in bank mergers review is provided in chapter 4 of this thesis.

#### 2.11.4 Banking retail report 2007

The Commission deemed achieving progress in the EU banking industry to be critical to meeting the objectives of its antecedent policy initiatives and specific measures aimed at enhancing the financial services single market.<sup>311</sup> One of the concrete steps taken by the Commission consisted of a review on the competition aspects of retail banking in the EU.<sup>312</sup> For this task, the Commission undertook a thorough assessment of retail banking services and issued its recommendations and findings in the 2007 ‘Report on the retail banking sector inquiry’ (the ‘Banking Retail Report’).<sup>313</sup> The Commission reviewed the market for current accounts and associated services, as well as the payment systems and payment cards markets.<sup>314</sup>

With reference to the retail banking market, the Commission identified important issues with supply operations. The Commission found that payment systems, credit registers<sup>315</sup> and other credit data collectors seemed to be broadly fragmented across EU Member State boundaries.<sup>316</sup> Another notable observation was the frequently demonstrated significant levels of collaboration between retail banking market participants that compete

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<sup>309</sup> *Ibid*, art 22(1); see, also, Regulation 1/2003 (n206), art 3(3).

<sup>310</sup> TFEU (n159), arts 101, and 102.

<sup>311</sup> Commission, ‘Financial Services: Implementing the Framework for Financial Markets: Action Plan’ (1999) *COM 232 final*; see, also, Commission, ‘White Paper on Financial Services Policy 2005-2010’ (2005) *COM 629* (‘2005 White Paper’), Impact Assessment Annex, 9.

<sup>312</sup> Commission, ‘Competition: Commission Opens Sector Inquiries into Retail Banking and Business Insurance’ (13 June, 2005) *Press Release, IP/05/719*.

<sup>313</sup> Commission, ‘Report on the Retail Banking Sector Inquiry’ Commission Staff Working Document accompanying the Communication from the Commission - Sector Inquiry under art 17 of Regulation 1/2003 on retail banking (Final Report) *COM 2007/33* (the ‘Banking Retail Report’).

<sup>314</sup> *Ibid*, paras 1-5.

<sup>315</sup> Credit registers collect various kinds of financial information on individuals.

<sup>316</sup> *Banking Retailer Report* (n228), paras 6, 8, 11, 26-28, 43, 47, 49-50, and 53.



against each other in different Member States' product markets.<sup>317</sup> The Commission also highlighted persistent obstacles to entry in the retail banking market.<sup>318</sup> Several potentially inevitable barriers occur as a result of regulatory measures or the anticompetitive conduct.

In relation to current accounts and associated services, the Banking Retail Report<sup>319</sup> indicated that in some EU Member States, the market for providing credit information services is restricted. Indeed, the markets for credit information were likewise found to be fragmented across EU Member States.<sup>320</sup> Regulatory obstacles at a national level greatly restrict the enhancement of data sharing between EU Member States. The majority of banks in most EU Member States link current accounts to mortgages, small and medium-sized enterprise ('SME') loans, and consumer loans. This causes concentration of these banking products and services in the hands of limited and powerful banks, and, also, makes it difficult for customers to look for other banks that offer banking products or services with lower costs and more efficient service than the present banks that serve these customers.<sup>321</sup>

Product linking to retail banking could dilute competition on several fronts.<sup>322</sup> Linking increases the costs of switching between bank service providers, and, as a result, could potentially reduce customer flexibility.<sup>323</sup> Obligating customers to purchase various products from the same bank, linking may also dissuade both the entry of new market participants and the expansion of smaller participants. Featuring more, non-standard products inside a banking transaction, linking decreases price clarity among banking providers. Increased switching charges in the retail banking could seriously hamper competition.<sup>324</sup> Consumers will be dissuaded from engaging the services of alternative banking service providers and, thus, new entrant banks will have much difficulty in establishing a sufficient customer base to make their businesses viable. Switching costs could, also, increase established banks' market capacity, allowing them to charge exorbitant prices to clients

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<sup>317</sup> *Ibid*, paras 3, and 26.

<sup>318</sup> *Ibid*, paras 3, 36-37, and 54.

<sup>319</sup> *Ibid*, para 6.

<sup>320</sup> *Ibid*, paras 27, and 50.

<sup>321</sup> *Ibid*, paras 7, 29, and 34.

<sup>322</sup> *Ibid*, paras 34-37.

<sup>323</sup> *Ibid*, paras 33, 37, and 52.

<sup>324</sup> *Ibid*, para 34.

effectively tied to their banking services.<sup>325</sup> Large costs of switching and little customer flexibility could restrict market entry in the whole retail banking services sector.<sup>326</sup> Therefore, balanced measures to decrease switching costs would improve and develop competition in retail banking.<sup>327</sup>

After almost one decade from the Banking Retail Report's findings, the retail banking market at the EU level remains fragmented and concentrated at the national level.<sup>328</sup> In the event of competition concerns, the Commission assesses, if demonstrated anticompetitive conduct is caused or sustained by an EU Member State's legislation or other measures.<sup>329</sup> The Commission's position appears to be that it shall not refrain from exercising its powers pursuant to Articles 101 and 102 TFEU<sup>330</sup> in order to ensure that the competition provisions are followed in relation to retail banking and the several payment markets.<sup>331</sup> The Commission tends to operate in areas in addition to competition law to help elevate the interests of consumers in the retail banking market.<sup>332</sup>

#### 2.11.5 The Liikanen report and EU regulation on structural reform of the EU banking sector

At the start of the Global Financial Crisis ('GFC'), the EU had a harmonized system of financial regulation where banks along with securities and insurance firms licensed in one EU country could engage in business across the EU, based on their home state authorization. However, harmonization of financial regulation remained incomplete.<sup>333</sup> Structurally, the EU's system of financial regulation was based on the division of competences between the

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<sup>325</sup> *Ibid*, paras 36, and 53.

<sup>326</sup> *Ibid*, para 37.

<sup>327</sup> *Ibid*, paras 34, and 52.

<sup>328</sup> D Nouy, 'The Banking Union and Financial Integration' (27 April, 2015) *Speech at the Joint conference of the European Commission and European Central Bank, Brussels*, available at <https://www.bankingsupervision.europa.eu/press/speeches/date/2015/html/se150427.en.html>.

<sup>329</sup> *Banking Retailer Report* (n228), paras 39-44.

<sup>330</sup> *TFEU* (n159), arts 101, and 102.

<sup>331</sup> *Banking Retail Report* (n228), para 54.

<sup>332</sup> M Ioannidou, *Consumer Involvement in Private EU Competition Law Enforcement* (Oxford: Oxford University Press 2015), p 164.

<sup>333</sup> N Moloney, *EU Securities and Financial Markets Regulation* (Oxford: Oxford University Press 2014), preface.

Member States regulators' and EU institutions. In 2001, the Lamfalussy Report<sup>334</sup> triggered substantial changes to the EU's financial services regime.

The Report recommended that EU securities regulation comprise a system of framework rules, detailed implementation of rules and cooperation between regulators concerning implementation of the EU rules and enforcement by the Commission.<sup>335</sup> The EU created several committees related to banking, insurance and securities, which during the GFC were transformed into EU-level authorities with boosted powers.<sup>336</sup>

By the end of 2011, the Commission established the Liikanen Group.<sup>337</sup> The purpose of the group was to determine whether structural reforms of EU banks were necessary to establish a safe, stable and efficient banking system serving the needs of citizens, the EU economy and the internal market. In October, 2012, the Liikanen Group released its report on reforming the structure of the EU banking sector (the 'Liikanen Report'),<sup>338</sup> recommending macro and micro-prudential reforms in order to reduce systemic risks. In particular, the Liikanen Report recommended maintaining the universal banking model.<sup>339</sup> It proposed that the trading arms of banks exceeding certain thresholds should be operated by entities that are legally separate from the entities carrying out deposit-taking activities if the activities to be separated amount to a significant share of the bank's business.<sup>340</sup> The reasoning underlying the separation concept is because the separated trading activities would not be financed any longer through protected deposits, nor would such activities benefit from an implicit state

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<sup>334</sup> Commission, 'Final Report of the Committee of Wise Men on the Regulation of the European Securities Markets' (15 February, 2011) (the 'Lamfalussy Report'), available at

[www.ec.europa.eu/internal\\_market/securities/docs/lamfalussy/wisemen/final-report-wise-men\\_en.pdf](http://www.ec.europa.eu/internal_market/securities/docs/lamfalussy/wisemen/final-report-wise-men_en.pdf)

<sup>335</sup> *Ibid*, pp 14-15.

<sup>336</sup> Council Regulation 1093/2010, 'Establishing a European Supervisory Authority' (2010) *OJ L331/12* ('European Banking Authority'); Council Regulation 1095/2010, 'Establishing a European Advisory Authority' (2010) *OJ L331/84* ('European Banking Authority'); Council Regulation 1094/2010, 'Establishing a European Supervisory Authority' (2010) *OJ L331/48* ('European Insurance and Occupational Pensions Authority').

<sup>337</sup> Commission, 'Banking Structural Reform: The Liikanen Group' (February, 2012) Press Release, available at [http://ec.europa.eu/finance/bank/structural-reform/index\\_en.htm](http://ec.europa.eu/finance/bank/structural-reform/index_en.htm).

<sup>338</sup> High Level Expert Group on Reforming the Structure of the EU Banking Sector, Final Report (2 October, 2012) (the 'Liikanen Report'), available at [http://ec.europa.eu/internal\\_market/bank/docs/high-level\\_expert\\_group/report\\_en.pdf](http://ec.europa.eu/internal_market/bank/docs/high-level_expert_group/report_en.pdf).

<sup>339</sup> *Ibid*, p 102.

<sup>340</sup> *Ibid*, pp 98-102.

guarantee.<sup>341</sup> In addition, banks that would be subject to separation of their activities would be easier to resolve.<sup>342</sup>

In response to its endorsed recommendations from the Liikanen Report, in early 2014 the Commission published a draft Regulation on Structural Measures Improving the Resilience of EU Credit Institutions ('Proposal').<sup>343</sup> The Proposal addresses the 'too-big-too-fail' ('TBTF') dilemma through structural measures designed to decrease the risk and complexity of large banks in the EU.<sup>344</sup> Under the Proposal, certain large banks would not be permitted to engage in proprietary trading in financial instruments and commodities.<sup>345</sup> In addition, these banks may be ordered by their national regulators to separate specified risky business activities from their deposit-taking, lending and certain other business activities;<sup>346</sup> notwithstanding the fact that they would be permitted to remain under the control of a single bank holding company,<sup>347</sup> provided that the activities to be separated are carried out in a legally and economically independent entity or sub-group.<sup>348</sup>

The Proposal is intended to apply to those banks in the EU that are determined to be 'global-systemically important institutions' ('G-SIIs'),<sup>349</sup> have had total assets of at least €30 billion over three consecutive years, and with trading activities of at least €70 billion or 10 per cent of their total assets.<sup>350</sup>

### 2.11.6 European Banking Union

In response to the pressure of the Eurozone's enduring sovereign debt and banking crisis, following the Global Financial Crisis ('GFC'), in June, 2012 the EU Member States and

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<sup>341</sup> *Ibid*, pp 94-107.

<sup>342</sup> *Ibid*, pp 104-107.

<sup>343</sup> Proposal for a Regulation on structural measures improving the resilience of EU credit institutions, *COM* (2014) 43 final. The proposed regulation is presently under discussion between the Council Presidency and the European Parliament on the final version of the regulation.

<sup>344</sup> *Ibid*, pp 2, and 14-15.

<sup>345</sup> *Ibid*, pp 6-9, and 12.

<sup>346</sup> *Ibid*, pp 2-4.

<sup>347</sup> *Ibid*, pp 7-9, and 14.

<sup>348</sup> *Ibid*, pp 14, 18, and 20.

<sup>349</sup> Directive 2013/36/EU on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms (2013) *OJ L176/338*.

<sup>350</sup> *Ibid*, art 6(1).

institutions agreed to establish a Eurozone Banking Union.<sup>351</sup> The Banking Union architecture was based on three pillars, joint supervision, resolution, and deposit insurance.<sup>352</sup>

The Banking Union would create ‘federal’ resolution powers to be exercised by a new EU resolution authority granted access to a new ‘federal’ rescue fund.<sup>353</sup> Under its present structure, the Banking Union is mainly a framework for the Eurozone Member States, but is open for all other EU Member States (such as, the UK) too, through a ‘close cooperation’ agreement with the European Central Bank (‘ECB’).<sup>354</sup> The purpose for ‘federalizing’ these powers is to build up an adequate approach to bank oversight and resolution, therefore, mitigating forbearance and moral hazard.<sup>355</sup>

The first pillar was the formation of a Single Supervisory Mechanism (‘SSM’)<sup>356</sup> for Eurozone banks in 2014. The ECB is given the power to supervise all ‘significant’ Eurozone banks.<sup>357</sup> A bank is deemed ‘significant’ when it meets one of the following five conditions<sup>358</sup>: (i) the total value of its assets exceeds €30 billion; (ii) the value of its assets exceeds both €5 billion and 20 per cent of its state gross domestic product; (iii) the bank is among the three most significant’ banks established in a Member State; (iv) the bank conducts significant cross-border activities relative to its total assets/liabilities; and (v) the bank receives assistance from a Eurozone bailout fund, the European Stability Mechanism (‘ESM’).<sup>359</sup> On these criteria, to date, 120 banks across the Euro area have been classified as ‘significant’.<sup>360</sup>

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<sup>351</sup> Council, European Council Conclusions 28/29 June, 2012, EUCO 76/12 (‘Banking Union’), available at [http://www.consilium.europa.eu/uedocs/cms\\_data/docs/pressdata/en/ec/131388.pdf](http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/131388.pdf)

<sup>352</sup> See a discussion about the three pillars in the present subchapter, below, of this thesis.

<sup>353</sup> *Second Pillar* (Single Resolution Mechanism) (n276).

<sup>354</sup> European Council, Policies: Banking Union (Overview), available at <http://www.consilium.europa.eu/en/policies/banking-union/>

<sup>355</sup> *Ibid.*

<sup>356</sup> European Central Bank, ‘Guide to Banking Supervision’ (2014) 8 *ECB*; European Union, ‘Regulation No 1024/2013 of the European Parliament and of the Council of 15 October, 2013 Conferring Specific Tasks on the European Central Bank Concerning Policies Relating to the Prudential Supervision of Credit Institutions’ (2013) *OJ L287/ 63*; European Union, ‘Regulation No 1022/2013 of the European Parliament and of the Council of 22 October, 2013 Amending Regulation No 1093/2010 Establishing a European Supervisory Authority (European Banking Authority) as Regards the Conferral of Specific Tasks on the European Central Bank Pursuant to Council Regulation No 1024/2013’ (2013) *OJ L287/5* (‘First Pillar’).

<sup>357</sup> *TFEU* (n159), art 352.

<sup>358</sup> Council Regulation (EU) No 1024/2013 of 15 October, 2013, conferring specific tasks on the ECB concerning policies relating to the prudential supervision of credit institutions, *OJ 2013 L287/63*, art 6(4).

<sup>359</sup> *Ibid.*

<sup>360</sup> European Central Bank, ‘The List of Significant Supervised Entities and the List of Less Significant Institutions’ (4 September, 2014).

The second pillar is the Single Resolution Mechanism ('SRM'), which comes into effect in 2016.<sup>361</sup> The relevance of the SRM is in its fundamental departure from a parallel post-GFC enactment, namely the Bank Recovery and Resolution Directive ('BRRD')<sup>362</sup>. While the BRRD harmonizes national resolution instruments and improves the coordination between them, the purpose of bank resolution under a Banking Union means that it becomes centralized.<sup>363</sup> The Banking Union aims to safeguard impartial decision making in dealing with failed EU based banks, consequently reducing any prospect of national financial burden.<sup>364</sup> Additionally, the EU aims to better deal with cross-border bank collapses.<sup>365</sup>

The third pillar, a joint deposit guarantee scheme, presently appears to be abandoned.<sup>366</sup> Vigorous objections to joint deposit insurance from several EU Members States forced the Banking Union architects to give up on this element.<sup>367</sup> Instead, the EU is seeking to find a loose approach towards the deposit insurance scheme.<sup>368</sup>

Banking Union represents an important direction towards integration for EU financial regulation. Most likely, a future Banking Union would stand on two pillars, instead of three. Only the first pillar (supervision) is comparatively solid, while the second pillar (resolution) appears to be a weak compromise. The third pillar might not come to fruition, at least in the

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<sup>361</sup> Commission, 'Commission Proposal for a Regulation of the European Parliament and of the Council Establishing Uniform Rules and a Uniform Procedure for the Resolution of Credit Institutions and Certain Investment Firms in the Framework of a Single Resolution Mechanism and a Single Bank Resolution Fund and Amending Regulation N 1093/2010 of the European Parliament and of the Council' (2013) COM, pp 2, 7 ('Second Pillar'); Regulation (EU) No 1022/2013 of the European Parliament and of the Council of 22 October, 2013 amending Regulation (EU) No 1093/2010 establishing a European Supervisory Authority (European Banking Authority) as regards the conferral of specific tasks on the European Central Bank pursuant to Council Regulation (EU) No 1024/2013.

<sup>362</sup> Council Directive 2014/59, of the European Parliament and of the Council of 15 May 2014 Establishing a Framework for the Recovery and Resolution of Credit Institutions and Investment Firms and Amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No. 1093/2010 and (EU) No. 648/2012, of the European Parliament and of the Council (2014) *OJ L173/190* ('Bank Recovery and Resolution Directive').

<sup>363</sup> *Ibid*, paras 44, and 89.

<sup>364</sup> *Ibid*, paras 27, 69, and 100.

<sup>365</sup> *Second Pillar* (n276), pp 3-5.

<sup>366</sup> E Ferran, 'European Banking Union: Imperfect, But It Can Work' (2014) 3 *University of Cambridge Faculty Law Legal Studies Research Paper Series*, Paper No 30/2014, available at <http://www.law.cam.ac.uk/people/academic/ev-ferran/28>

<sup>367</sup> Many Northern EU Member States, such as, Germany, have interpreted the joint deposit guarantee scheme as a way for their taxpayers to 'absorb' the losses of the depositors from Southern EU Member States; see, also, A Barker, 'Brussels Shelved Bank Deposit Scheme' (13 September, 2012) *Financial Times*.

<sup>368</sup> European Political Strategy Centre, 'Towards a European Deposit Insurance Scheme' (2015) *European Political Strategy Centre Issue 01/14*, available at [http://ec.europa.eu/epsc/publications/series/5p\\_edis\\_en.htm](http://ec.europa.eu/epsc/publications/series/5p_edis_en.htm)

foreseeable future.<sup>369</sup> The open question remains whether the European Banking Union would be able to withstand a regulatory structure without the fully fledged three pillars.

## 2.12 Conclusion

In relation to the theoretical issues pertaining to the nature of the relationship between competition and financial stability, a suitable balance between financial stability and competition assumes a structure that identifies the welfare benefits and costs of contrasting levels of financial stability and competition.

Generally speaking, banking system presents oligopolistic fabric. However, it does not, necessarily, mean such system do not lead to competitive results. Some of the broadest approaches that define and evaluate competition in banking are the structure-conduct-performance (SCP) model; contestability - centres on conduct dependent on latent entry; and price responsiveness to cost shifts.

Most of the traditional models or approaches concerning the relationship between competition and financial stability assume that financial institutions function in an ideal competitive setting or in a monopoly situation. In both situations, systemic crises or runs emerge in equilibrium due to co-ordination failure among depositors or as a balanced reaction by depositors to the coming of negative information of banks' future solvency.

In terms of 'public interest' exemption, public policy issues such as preserving the financial stability can be undertaken better by sectoral regulation or direct policies. Integrating the analysis of public interest considerations in merger control might cripple the basic competition assessment in mergers, accordingly impairing the broad 'public interest' that competition policy intends to uphold.

Maintaining the suitable right trade-off between competition and public interest criteria is not always easy; the analysis of the same merger on the grounds of both competition standards, and the public interest that contains socio-economic and political considerations,

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<sup>369</sup> J N Gordon and W G Ringe, 'Bank Resolution in the European Banking Union: A Transatlantic Perspective on What It Would Take' (2015) 115 *Columbia Law Review* 1297.

may not always achieve the same outcomes. This may trigger to an anti-competitive merger being approved, or a pro-competitive merger being barred on public interest basis. There are more instances of public interest basis ensuing from an anti-competitive merger being approved than of a merger approved by the competition watchdog being forbidden.

Even if 'public interest' considerations are surely characterized, not all circumstances where public interest is called upon can be covered by law or soft law, the role of competition law in situations of financial crises demonstrates there have been arguments for holding off competition rules for span of the crisis.

The empirical and theoretical literature suggest that the stability effects of changes in market structures and competition are particularly case-dependent. It seems that there is much space for research to shed more light into this rather unclear issue.

The theoretical literature does not appear to be irrefutable on the rapport between competition and stability. Theories of bank runs and systemic risk essentially neglect the effects of different bank market structures for the safety of the industry.

Competition in banking is characteristically imperfect and many obstacles to entry could generate rents. In retail banking, switching costs for customers are quite essential, and reputation and branch networks act as entry obstacles. In corporate banking created uneven information and lending relationships offer banks some market power in relation to firms and investors. Stability and competition can exist side-by-side in the banking sector. Competition makes the banking sector more effective and ensures that stimulus and rescue packages advantage final consumers. In the final assessment, the blueprint of financial regulation matters, at minimum, nearly of market structure for the stability of the financial sector.

Often competition reduces stability and often perfect competition is harmonious with the socially ideal level of stability.

The UK and EU legislation in relation to the competition aspects of bank mergers have evolved and continue to do so. Both aim to respond to the expansion of banking products and



services, and protect consumers in their relationships with banking service providers, while at the same time ensuring that the UK financial services market continues to thrive.

Implementation of the ‘ring-fencing’ (retail activities separated from the wholesale operations in banking) provisions to the Financial Services (Banking Reform) Act 2013 in the UK; and the Liikanen Report’s initiative followed by the European Banking Union directives to enhance the EU regulation on financial structural reform, appear to be a step in the right direction.

Nevertheless, banks in the UK are heading for the kind of legal uncertainty that has dogged the introduction of the Volcker rule<sup>370</sup> in the US. Radical financial services legislation reforms undertaken in the last decade appear to create unintended consequences to banks and other financial institutions. Like the Volcker rule, the proposed UK ring fencing (the Vickers’ Report) seems to be a simple concept.<sup>371</sup> While the Volcker rule bans proprietary trading, the UK ring-fencing separates investment banking from retail activity. However, one consequence of a ring-fence is that small businesses could be left with a much narrower alternative of trade finance and derivative products. Costs also will be higher. Small banks could find their ability to do business with big ring-fenced counterparts is curtailed.

The UK banking and financial system is not even at the end of the beginning. The work started with the enactment of the Financial Services (Banking Reform) Act 2013. Presently, it is up to the banking industry to put the issues clearly to the UK Government and show their gravity that these are issues for customers and not simply for the banks.

The latest financial services laws, in particular the Financial Services (Banking Reform) Act 2013, do not alter the substance of competition law in its application to financial services. Rather, it makes important institutional changes to the enforcement of competition laws and the promotion of competition in the banking industry. Having more regulatory bodies capable of enforcing competition law, and requiring them to give specific

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<sup>370</sup> The Volcker Rule, under § 619 (codified 12 USC §1851) of the Dodd-Frank Wall Street Reform and Consumer Protection Act 2010, restricts US banks from making certain kinds of speculative investments that do not benefit their customers; For a discussion of the Volcker Rule, see chapter 6.6.1 in this thesis, pp 192-3.

<sup>371</sup> A Berger et al *The Oxford Handbook of Banking* in A D Morrison *Universal Banking* (2nd edn, Oxford: Oxford University Press 2015), p131.

consideration to applying competition law, with the Financial Conduct Authority, along with the Competition and Markets Authority, having the role of competition enforcer, may increase the number of competition investigations in financial services. It may also promote a culture of compliance within the industry.

Whether this will lead to an increase in the imposition of competition law enforcement orders and financial penalties would depend on several factors. One factor would be whether the banking industry takes notice of the warnings inherent in the changes made in the regulation of the financial services, ensuring compliance with competition law. Another factor would be whether the banking regulators, which have greater knowledge of the banking and financial industry than the Competition and Markets Authority, become effective in building up a system of adequate competition enforcement.

At the EU level, if a 'concentration' has a Community 'dimension' the Commission is the proper authority to enforce implementation of the EU merger provisions. In a merger that does not have a Community 'dimension', national law and procedures shall apply. Banks and other financial institutions are required to comply with general competition rules of 101 and 102 TFEU at all times that may bring in the Commission, national competition authorities, and/or national courts. In conclusion, the EU will pre-empt any national control of a bank merger that has a Community 'dimension'.

## CHAPTER 3 - COMPETITION AND BANKING AUTHORITIES IN THE UNITED KINGDOM

This chapter discusses the competition and banking authorities in the UK and EU, and the role of these authorities in shaping the competition aspects in bank mergers in the UK.

### 3.0 Relevant regulators that oversee bank mergers

The main UK governmental authorities with competence to review bank mergers, along with any competition aspects such mergers may pose are the Competition and Markets Authority ('CMA'),<sup>1</sup> the Secretary of State for Business, Innovation and Skills ('SoS'),<sup>2</sup> and the Chancellor of the Exchequer.<sup>3</sup>

The main UK banking supervisors to review the same are the Bank of England ('BoE'),<sup>4</sup> the Financial Conduct Authority ('FCA'),<sup>5</sup> the Payment Systems Regulator ('PSR'),<sup>6</sup> and the Prudential Regulation Authority ('PRA').<sup>7</sup>

At the EU level, the competent authority is the Commission.<sup>8</sup>

Although the CMA and the SoS have powers to intervene, investigate and review mergers in banking and other sectors of the economy, this chapter considers the role of these bodies solely in relation to banks and other financial institutions. In addition, while the

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<sup>1</sup> Enterprise and Regulatory Reform Act 2013, c. 24 ('ERRA13'), ss 25 to 28; Sched 4.

<sup>2</sup> Formed by the First Lord of Trade (16 September, 1672). The SoS is cabinet position in the UK Government. This office is responsible for the Department for Business, Innovation and Skills. For more information, available at [www.gov.uk/government/organisations/department-for-business-innovation-skills](http://www.gov.uk/government/organisations/department-for-business-innovation-skills).

<sup>3</sup> The office of the Chancellor of the Exchequer was appointed in 1221. The Chancellor of the Exchequer is head of Her Majesty's Treasury. The Chancellor is responsible for all economic and financial matters. For more information of the Chancellor's duties and responsibilities, available at <https://www.gov.uk/government/ministers/chancellor-of-the-exchequer>.

<sup>4</sup> The Bank of England Act 1694, c. 20 (Regnal. 5 and 6 Will and Mar). For more information of the Bank of England, available at <http://www.bankofengland.co.uk/Pages/home.aspx>.

<sup>5</sup> The Financial Services Act 2012, c. 21 ('FSA12'), ss 6(1A) to (1T) (Amendments of Financial Services and Markets Act 2000); Schedules 1ZA and 1ZB to Financial Services and Markets Act 2000, c. 8 ('FSMA2000')

<sup>6</sup> Financial Services (Banking Reform) Act 2013, c. 33 ('FSA13'), pt 5, ss 40, 49-67; Sched 4.

<sup>7</sup> FSA12 (n5), ss 6(2A) to (2P) (Amendments of FSMA2000 (n5)); Schedules 1ZA and 1ZB to FSMA2000 (n5).

<sup>8</sup> The European Economic Community pursuant to the Treaty of Rome 1957, effective 1958, pt V, title I, ch 1, s 3.

competition legislation and rules, such as the Competition Act 1998,<sup>9</sup> Enterprise Act 2002,<sup>10</sup> the CMA's merger provisions,<sup>11</sup> regulate all sectors of the economy in the UK, this chapter focuses its discussion only in the implementation of the foregoing legislation and rules in a bank merger.

### 3.1 Competition and public authorities

In the UK, the governmental agencies responsible to oversee a bank merger and any competitive effects of it are the CMA, the SoS, and the Chancellor of the Exchequer. On a case-by-case basis, these public institutions coordinate their efforts in the review process of a bank merger, as well as in the process of examination of competition issues that a merger may cause in the banking and financial system.<sup>12</sup> The role of these authorities in bank merger transactions is discussed below.

#### 3.1.1 Competition and Markets Authority

The Competition and Markets Authority (CMA) is the body responsible for assessing bank, or any other business, merger situations in the UK. It was established by the Enterprise and Regulatory Reform Act 2013, which abolished the pre-existing competition regulators, the Office of Fair Trading ('OFT') and the Competition Commission ('CC').<sup>13</sup> The CMA is empowered to safeguard the functioning of competition within the markets and with ultimate responsibility for serving consumers' interests.<sup>14</sup>

Under the competition provisions,<sup>15</sup> merging parties are not required to notify the CMA of a merger transaction, notwithstanding the CMA's jurisdiction over mergers. Merging parties' notification to the UK competition authorities is made on a voluntary basis.

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<sup>9</sup> Competition Act 1998, c. 41 ('CA98').

<sup>10</sup> Enterprise Act 2002, c. 40 ('EA02').

<sup>11</sup> For a discussion of the Competition and Markets Authority's guidelines regulating merger situations, see chapters 3.1.1, and 5.0 to 5.4 in this thesis, pp 51-7, 132-74.

<sup>12</sup> D Currie, 'The New Competition and Markets Authority: How Will It Promote Competition?' (7 November, 2013) Speech to the Beesley Lectures, London, available at <https://www.gov.uk/government/speeches/the-new-competition-and-markets-authority-how-will-it-promote-competition>.

<sup>13</sup> *ERRA13* (n1), s 26.

<sup>14</sup> R Whish and D Bailey, *Competition Law* (8<sup>th</sup> edn, New York: Oxford University Press 2015), pp 955-81.

<sup>15</sup> *EA02* (n10), s 96.

The competition authority may decide to review a bank merger, notwithstanding that the merging parties did not voluntarily notify the merger situation. If the CMA determines that it has jurisdiction over a merger, it may begin a merger analysis.<sup>16</sup>

### Merger Review Test

The CMA applies a two-phase test when it reviews a bank, or any other business, merger.<sup>17</sup>

During the phase 1 review, the CMA considers, based on the objective evidence available, whether there is a practical expectation that the merger will substantially lessening competition.<sup>18</sup> In the event of reasonable doubt regarding the existence of a competition concerns, the inquiry group resolves the same by initiating a phase 2 review.<sup>19</sup> During the phase 2, an inquiry team must justify its decisions, based on the balance of probabilities.<sup>20</sup>

In the phase 1 examination, if a merger is deemed to create possible competition concerns, the merger participants seek to obtain a conditional or unconditional clearance.<sup>21</sup> At the same phase, the parties may also enter into pre-notification consultations to address the competition regulator's possible concerns, and, therefore, establish the likelihood of obtaining unconditional or conditional clearance.<sup>22</sup>

The CMA gathers and analyses information on merger cases, and refers for more rigorous 'phase 2' inquiry any situation where it is determined that the merger has given or could give rise to a 'substantial lessening of competition' ('SLC') within market, *i.e.*, banking and financial market in a bank merger, in the UK.<sup>23</sup>

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<sup>16</sup> *Ibid*, ss 5 to 8, and 109; see, also, G Barling, 'The Role of the Court in the Public Enforcement of Competition Law' (2014) in B Hawk (ed.) *Fordham Competition Law Institute* 5, pp 381-94.

<sup>17</sup> *EA02*(n10), see generally, pt 3.

<sup>18</sup> *Ibid*, ss 22, 23, and 103-104.

<sup>19</sup> *Ibid*, pt 3, ch 1.

<sup>20</sup> Office of Fair Trading/Competition Commission, '[UK] Merger Assessment Guidelines' (1 September, 2010) *CC2/OFT1254*, available at [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/284449/OFT1254.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/284449/OFT1254.pdf); see, also, Office of Fair Trading, 'Mergers Exceptions to the Duty to Refer and Undertakings in Lieu' (12 March, 2014) *OFT1122*, available at <https://www.gov.uk/government/publications/mergers-exceptions-to-the-duty-to-refer-and-undertakings-in-lieu>

<sup>21</sup> *EA02* (n10), ss 103-104, and 105-106.

<sup>22</sup> *Ibid*, s 107(1)(e).

<sup>23</sup> *Ibid*, ss 22, and 33.

After initiation of a phase 2 inquiry, the CMA conducts a more comprehensive review to ascertain whether there is a merger case constituting a UK merger control situation, and whether this has arisen because of or could result in a SLC.<sup>24</sup> The phase 2 inquiry should ultimately remedy any pinpointed SLC concern. Determinations under phase 2 are made by an investigation team of at least three individuals, comprised in every situation of impartial CMA specialists chosen by the SoS.<sup>25</sup>

The CMA informs the SoS of any merger that it deems to cause a relevant public interest issue during phase 1 review.<sup>26</sup> The CMA requires to advise the SoS of a merger situation, which could give rise to a public interest issue or be subject to the special public interest clauses where the SoS has provided a notice of intervention in that situation.<sup>27</sup>

In a prospective or completed merger, *e.g.*, bank merger, the CMA may agree to the imposition of undertakings in lieu of a reference to phase 2 inquiries.<sup>28</sup> Such undertakings can be made as part of the CMA's own determination, or under the 'public interest' concerns identified by the SoS. In these cases, the CMA may also provide informal advice to the relevant parties.<sup>29</sup>

When necessary, the CMA coordinates a bank merger review with the banking regulators, banking sector associations, and the consumer protection organizations concerning their considerations over that merger case.<sup>30</sup>

The competition provisions direct the CMA carry out a completed or planned bank merger situation for a thorough phase 2 review in the event it determines that there is or could be a pertinent merger case that does or could result in a SLC in the market(s) for banking

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<sup>24</sup> *Ibid*, ss 23, and 34.

<sup>25</sup> *ERRA13* (n1), paras 56-58, and 38(1).

<sup>26</sup> *EA02* (n10), s 139.

<sup>27</sup> *Ibid*, ss 140, and 140A.

<sup>28</sup> *Ibid*, ss 154, and 155.

<sup>29</sup> *Ibid*, ss 156-161.

<sup>30</sup> For example, the UK Competition Network ('UKCN') brings together the CMA along with the Financial Conduct Authority and other sectoral regulators. The UKCN was mentioned in the 'UKCN Statement of Intent' published on 2 December, 2013, available at [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/262996/UKCN\\_Statement\\_of\\_Intent\\_FINAL.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/262996/UKCN_Statement_of_Intent_FINAL.pdf)

services and products in the UK.<sup>31</sup>

However, the CMA may decide not to recommend a phase 2 review, when it deems that the relevant banking market is not of sufficient significance to support such a course of action.<sup>32</sup> Also, any applicable customer advantages associated with the merger case in question overrides a SLC and, thus, militate against progression to phase 2 reviews.<sup>33</sup> Additionally, a case will not likely be referred for a phase 2 review where the pertaining merger issues are not adequately enough developed, or do not otherwise support this procedure.<sup>34</sup>

In the event the CMA decides to scrutinize a merger under phase 2 review, it may still impose undertakings in lieu of prohibiting the merger or applying penalties and to reduce the SLC, or any additional consequence of the merger.<sup>35</sup>

The UK competition watchdog will not carry out a thorough investigation of a merger under phase 2, if the SoS has issued a ‘public interest’ intervention notice on the merger, and such notice is still valid, or in the EU level, if the Commission considers investigating the merger.<sup>36</sup>

To make a market investigation reference (‘a reference’),<sup>37</sup> the CMA must have reasonable grounds for suspecting that any feature or combination of features of goods and services market in the UK prevents, restricts or distorts competition in connection with the supply or acquisition of any goods or services in the UK or as part of the UK (the ‘reference test’).<sup>38</sup> Within forty business days of commencement of the bank merger assessment process, the CMA must determine whether the reference test is met.<sup>39</sup> If this threshold is met, then CMA can choose whether to exercise its discretion to make a reference.<sup>40</sup> In the event no such

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<sup>31</sup> EA02 (n10), ss 22, and 33.

<sup>32</sup> *Ibid*, ss 22(2), and 33(2).

<sup>33</sup> *Ibid*, ss 22(3), and 33(3).

<sup>34</sup> *Ibid*, ss 22(2), and 33(2).

<sup>35</sup> *Ibid*, s 73.

<sup>36</sup> *Ibid*, s 22(3).

<sup>37</sup> *Ibid*, ss 35, and 36.

<sup>38</sup> *Ibid*, s 131(1).

<sup>39</sup> *Ibid*, s 97(1).

<sup>40</sup> *Ibid*, s 84.

determination is made, the CMA relinquishes its competence.<sup>41</sup>

Under phase 2, if the CMA determines that a merger, *e.g.*, a bank merger, produces a SLC and remedial measures are required to cure the same; it then acts to implement those remedies.<sup>42</sup> In order to give effect to remedies, the CMA applies a certain timeline within which the interested parties in a merger shall carry out the necessary remedial undertakings.<sup>43</sup> If the merging parties do not implement any of these undertakings, the competition authority may compel compliance by starting a legal action for injunctive relief or other relevant remedy in a local court.<sup>44</sup> Besides this recourse, any party who is damaged or sustained loss due to the failure of the merging parties to implement its required undertakings may commence a legal action for monetary damages and compensation.<sup>45</sup>

The UK competition regulators have historically adopted a relaxed approach towards bank merger review policies. For instance, in 2004 the competition regulators authorized the merger *Bank of America Corporation/FleetBoston Financial Corporation*,<sup>46</sup> determining that the merger did not give rise to a SLC.<sup>47</sup> It, also, determined that notwithstanding the fact that there were overlaps between the banks' UK product markets, the combined portion of supply of these products was minor and impact of the merger insufficient to justify remedial measures.<sup>48</sup>

In the event a merger, *i.e.*, bank merger, does not have an EU 'dimension' pursuant to the ECMR, the merging parties may consider making a pre-notification reference to the Commission.<sup>49</sup> If the merger has an EU 'dimension', the merging participants may approach the CMA to establish whether the competition authority is the appropriate regulator to assess

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<sup>41</sup> *Ibid*, s 74.

<sup>42</sup> *Ibid*, s 41(3).

<sup>43</sup> *Ibid*, s 39.

<sup>44</sup> *Ibid*, s 75.

<sup>45</sup> *Ibid*, s 94.

<sup>46</sup> Office of the Fair Trading, 'Bank of America Corporation/FleetBoston Financial Corporation' (2004) *OFT Merger Phase 1 Clearance* No. ME/1589/04 ('OFT Bank of America/FleetBoston'), available at <https://www.gov.uk/cma-cases/bank-of-america-corporation-fleetboston-financial-corporation>.

<sup>47</sup> *Ibid*.

<sup>48</sup> *OFT Bank of America/FleetBoston* (n46).

<sup>49</sup> Council Regulation (EC) No 139/2004 of 20 January, 2004 on the control of concentrations between undertakings, *OJ L 24/1*, 29 January, 2004 ('ECMR'), art 4(5).



the case, and if pre-notification<sup>50</sup> or post-notification<sup>51</sup> is necessary.

Decisions by the CMA or SoS are subject to appeal before the Competition Appeal Tribunal ('CAT').<sup>52</sup> An appeal may be from a decision of the CMA whether to conduct a phase 2 inquiry of the merger, or against the CMA's conclusive determination at phase 2. Unless the CAT rules otherwise, an appeal filed by the parties in a merger with the Tribunal does not automatically suspend any decision made by the CMA on the merger.<sup>53</sup>

### 3.1.2 Secretary of State for Business, Innovation and Skills

In the UK, the Secretary of State for Business, Innovation and Skills ('SoS') has authority in relation to financial institution merger transactions that are considered as being significant to the national interest. Among other areas of the economy that are of vital interest to the UK, the Government decided, as a result of the Global Financial Crisis ('GFC'), to classify the banking and financial sector as having particular importance to the national interest. Under this general power,<sup>54</sup> the SoS may interfere in a UK bank merger case on national interest grounds.

Historically, the power of the SoS to intervene in merger situations derives from the Industry Act 1975 ('IA75'), having been established to review acquisitions of significant undertakings by non-British businesses or individuals.<sup>55</sup> While the provisions of IA75 seem quite broad, a prohibition order could be compelled by civil proceedings or an application for injunctive relief sought in the courts by the Crown.<sup>56</sup> However, practically speaking, the provisions of IA75 do not commonly appear to apply. Until now, the SoS has not made use of his described IA75 authority.<sup>57</sup> Nevertheless, these provisions may be applied by the SoS if he decides to refer a merger to the CMA for phase 2 investigation.

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<sup>50</sup> *Ibid*, art 4(4).

<sup>51</sup> *Ibid*, art 9.

<sup>52</sup> For more information of the role and functions of the Competition Appeal Tribunal ('CAT'), see chapter 4.1 in this thesis, pp 81-3.

<sup>53</sup> CA98 (n9), s 46(4).

<sup>54</sup> EA02 (n10), see generally pt 3, ch 2; and especially ss 42, and 45.

<sup>55</sup> Industry Act 1975, c. 68 ('IA75'), s 11(2).

<sup>56</sup> *Ibid*, s 17(2).

<sup>57</sup> J Harrison, 'The Protection of Foreign Investment: United Kingdom National Report' (2010) XVIII *International Congress of Comparative Law*, Washington, p 18.

The reform of UK competition legislation, especially the enactment of the Enterprise Act 2002,<sup>58</sup> was intended to remove political interference in mergers, improve the clarity and straightforwardness of the merger control system, and establish wholly competition related benchmarks against which to review merger transactions, *i.e.*, bank merger.<sup>59</sup>

The SoS has been increasingly active in dealing with competition issues in the banking industry and concerning bank mergers. This was clearly exhibited following the GFC, where considerable activities, such as, intervention notices issued to the then Office of Fair Trading based on the ‘public interest’ ground, were undertaken for the purposes of preserving national financial stability.<sup>60</sup>

The SoS’s contribution to enhancing competition in the banking industry remains inconsistent and unclear. Though the intention of the SoS in preserving the financial stability of the UK may have been constructive, in the longer run its interventions in bank mergers may be seen as damaging and counterproductive to competition in the country’s banking system. It is commonly accepted that during the GFC the Government, through the SoS, and the HM Treasury, as well, has been obliged to intervene very heavily in the banking sector by the means of nationalization and State aids in order to ensure its survival and maintain economic stability. In doing so, competition issues have not been a priority.

### 3.1.3 HM Treasury

Her Majesty’s Treasury (‘HM Treasury’) is the British government department responsible for the economy and finance. It supervises government expenditures, directs the country’s economic policy, and operates to achieve strong and durable economic development. The Chancellor of the Exchequer oversees HM Treasury. The Treasury, also, supervised fiscal and monetary policy until 1997, at which point the Bank of England, as the central bank of the

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<sup>58</sup> EA02 (n10), s 42.

<sup>59</sup> B Rodger and A MacCulloch, *Competition Law and Policy in the EU and UK* (5th edn, New York: Routledge 2014), ch 8.

<sup>60</sup> The Enterprise Act 2002 (Specification of Additional Section 58 Consideration) Order 2008 SI 2008/2645; see, also, B Hawk, *Fordham Competition Law Institute* in S Polito (eds) *EU and UK Competition Laws and the Financial Crisis: The Price of Avoiding Systemic Failure* (New York: Juris Publishing 2010), p 154.

UK, obtained self-governing control over interest rate policy.<sup>61</sup>

HM Treasury is authorized to take control or ownership of a deficient financial institution or to authorize conveyance of such an institution to a third party.<sup>62</sup> This authority exists in order to preserve financial stability and safeguard the public interest. In this regard, intervention by the Treasury is intended to protect the financial strength of the entire economy in the UK.<sup>63</sup> In the case of nationalization of failing banks in 2008, such as the Treasury's rescue operation of Northern Rock *via* nationalisation of the ailing bank,<sup>64</sup> or the Treasury's intervention in Bradford & Bingley,<sup>65</sup> the Treasury would require to take proper measures to oversee the transfer of assets and liabilities, ensuring the continuity of bank business operations.<sup>66</sup>

In relation to competition concerns in the banking sector, HM Treasury has retained an active role. It has encouraged and often started various initiatives to support investigative commissions or working groups established by the UK Parliament with the purpose of enhancing the consideration of competition issues in banking activities. In particular, this has been evident in relation to retail banking, payment systems, bank account switching, credit cards, and other banking services for the purpose of protecting the interests of the consumer. However, practically speaking, HM Treasury has failed to uphold a firm and consistent position as to enforcement of competition provisions in relation to bank mergers and other banking operations. This was clear during and especially after, the GFC, when the Government bent competition rules, and justified its decisions, for example in granting public

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<sup>61</sup> Bank of England Act 1998 (as amended), *e.g.*, ss 4(1), and Part II (ss 13-20).

<sup>62</sup> Banking Act 2009, c. 1 ('BA09'), ss 1, 4; The Banking (Special Provisions) Act 2008, 2008 c. 2 has largely been replaced by the Banking Act 2009. The key powers (*i.e.*, ss 2(8), 3 and 6) of the 2008 Act are now no longer applicable.

<sup>63</sup> BA09 (n62), ss 1, 4; see, also, generally, *Ibid*, pt 1 ('Special Resolution Regime').

<sup>64</sup> National Audit Office, 'Her Majesty's Treasury: The Nationalization of Northern Rock' (20 March, 2009) NAO, available at [www.nao.org.uk/publications/0809/northern\\_rock.aspx](http://www.nao.org.uk/publications/0809/northern_rock.aspx).

<sup>65</sup> HM Treasury, 'Bradford & Bingley Plc' (29 September, 2008) *Newsroom & Speeches 97/08*, available at [http://webarchive.nationalarchives.gov.uk/+http://www.hm-treasury.gov.uk/press\\_97\\_08.htm](http://webarchive.nationalarchives.gov.uk/+http://www.hm-treasury.gov.uk/press_97_08.htm),

<sup>66</sup> BA09 (n62), pt 1 ('Special Resolution Regime').

financial support to Lloyds, following its takeover of HBOS,<sup>67</sup> in the name of protecting financial stability.<sup>68</sup>

## 3.2 Banking Authorities

In the UK, the banking agencies responsible for the overall overseeing a bank merger and any competitive effects of it are the Bank of England, the Financial Conduct Authority, the Payment Systems Regulator, and the Prudential Regulation Authority.<sup>69</sup> On a case-by-case basis, these banking institutions coordinate their efforts in the review process of a bank merger, as well as in the process of examination of competition concerns that a merger may cause in the banking and financial system. The role of these institutions in bank mergers is discussed, below.

### 3.2.1 Bank of England

The Bank of England ('BoE') is the central bank of the UK.<sup>70</sup> The bank is generally accountable for preserving and enhancing financial stability in the country.<sup>71</sup> The bank, also, has supervisory authority over the established clearinghouses, and it has the capacity to order a British clearinghouse to act or desist from acting in particular situations.

The BoE is assisted by the Financial Policy Committee ('FPC'),<sup>72</sup> which is an independent committee in charge of assisting the BoE to accomplish its financial strengthening targets, and supporting and instructing the Prudential Regulation Authority

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<sup>67</sup> HM Treasury, 'Financial Support to the Banking Industry' (8 October, 2008) *Press Notice 100/08*, available at [www.hm-treasury.gov.uk/statement\\_chx\\_081008](http://www.hm-treasury.gov.uk/statement_chx_081008); See chapter \_\_\_ for a discussion about the *Lloyds* acquisition of *HBOS*.

<sup>68</sup> J A Bikker and M V Leuvensteijn, *A New Measure of Competition in the Financial Industry* (New York: Routledge 2014), pp 1-3.

<sup>69</sup> Financial Services (Banking Reform) Act 2013, ss 98-102; see, also, J Barty and T Ricketts, 'Promoting Competition in the UK Banking Industry' (June 2014) *British Bankers' Association*, pp 12-34, available at [https://www.bba.org.uk/wp-content/uploads/2014/06/BBA\\_Competition\\_Report\\_23.06\\_WEB\\_2.0.pdf](https://www.bba.org.uk/wp-content/uploads/2014/06/BBA_Competition_Report_23.06_WEB_2.0.pdf)

<sup>70</sup> Bank of England Act 1694, 5 & 6 Will. & Mar. c. 20.

<sup>71</sup> Bank of England Act 1998, c. 11 ('BEA98'), ss 10-20.

<sup>72</sup> *FSIA12* (n5), ss 9B-9ZA; Sched 1.

(‘PRA’) or the Financial Conduct Authority (‘FCA’) to tackle issues that constitute systemic hazards. The FPC functions as an integral part of the BoE.<sup>73</sup>

The FPC contributes to implementation of the financial strategy of the UK Government, together with its goals on employment and economic progress. Therefore, the FPC identifies, monitors, and intervenes to eliminate or reduce systemic threats for the purposes of safeguarding and improving the British financial system. These include systematic risks caused by structural characteristics of financial markets, including relations between banks, hazards traceable to risk diffusion within the financial services industry, and credit or debit augmentation.

The FPC can instruct the FCA or the PRA to use their respective powers to establish whether a macro-prudential action applies in a course provided by the FPC.<sup>74</sup> The Committee can also encourage the BoE to implement financial support to banks, and to address any issues in connection with settlement systems, clearing houses, and the payment systems in the UK.<sup>75</sup>

In practice, the BoE uses its authority, for maintaining the financial and monetary stability in the UK, to have a voice in relation to merger outcome of financial institutions in the country.<sup>76</sup> It achieves this by requesting and exchanging information with the CMA, and other banking regulators, such as, the PRA, over the concerning merger(s).<sup>77</sup>

Notwithstanding the BoE’s assumed ‘authority’ in a bank merger, the *Hong Kong & Shanghai Bank*’s decision<sup>78</sup> to pursue acquisition of the Royal Bank of Scotland despite the disapproval of the central bank, along with the competition authority, demonstrated a level of

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<sup>73</sup> For more information about the role and responsibilities of Financial Policy Committee (‘FPC’), see [www.bankofengland.co.uk/financialstability/pages/fpc/default.aspx](http://www.bankofengland.co.uk/financialstability/pages/fpc/default.aspx).

<sup>74</sup> *FSA12* (n5), s 9Y.

<sup>75</sup> *Ibid*, ss 9Y-Z.

<sup>76</sup> In order to maintain the financial stability in the UK, the Bank of England, among others, ‘collaborat[es] with other UK financial authorities to support UK financial sector business continuity and operational resilience’, see Bank of England public information, available at

<http://www.bankofengland.co.uk/financialstability/Pages/default.aspx>

<sup>77</sup> *Ibid*.

<sup>78</sup> Monopolies and Mergers Commission, ‘Hong Kong and Shanghai Bank/Royal Bank of Scotland’ (1982) *Cmd 847*; In 1980, a proposal was made by the Hong Kong & Shanghai Bank to acquire control of the Royal Bank of Scotland. The Commission found against the merger on the grounds that having a major British bank controlled abroad was in itself ‘against the public interest’. See *ibid*, p 6.

impotence when a bank merger meets the requirements of the relevant banking laws.<sup>79</sup> However, as in the *Hong Kong & Shanghai Bank* case, competition legislation has been sufficient in the event of a relevant risk to the public interest.<sup>80</sup>

### 3.2.2 Financial Conduct Authority

The Financial Conduct Authority ('FCA') is in charge of conduct regulation and, moreover, for the efficient regulation of non-Prudential Regulation Authority ('PRA') financial institutions, such as, less significant investment institutions, exchanges, and additional financial services suppliers.

The FCA replaced the Financial Services Authority as the regulator responsible for maintaining and supervising the UK banking and financial system.<sup>81</sup> This is achieved by ensuring that the pertinent markets operate appropriately, creating a suitable level of consumer safety,<sup>82</sup> preserving and amplifying the stability<sup>83</sup> of the British financial system, and fostering effective competition<sup>84</sup> to the benefit of consumers.<sup>85</sup>

The FCA is tasked with overseeing the execution of undertakings by approved financial institutions, observing their compliance and initiating enforcement measures against any delinquent entities.<sup>86</sup>

The FCA and PRA also coordinate their activities. In particular situations, the PRA could, if it deems necessary, order the FCA to cease exerting its authority in insolvency or regulatory matters in respect of a PRA-approved institution.<sup>87</sup> This may happen in the event

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<sup>79</sup> *Ibid*, pp 6-7.

<sup>80</sup> J S Kitchen, 'Review of Foreign Merger and Acquisition Laws: Restrictions on the Acquisition of United Kingdom Corporations by Foreigners' (1983) 52 *Antitrust Law Journal* 1035, pp 1037-39.

<sup>81</sup> *FSMA2000* (n5), pt 1A, ss 1A – 1T; also, Sched 1ZA.

<sup>82</sup> *Ibid*, ss 1 B(3)(a), and 1C.

<sup>83</sup> 'Stability' is a matter for the Bank of England: see *BEA98* (n71), ss 2A, 2B, 2C, 2D, and pt 1A; see, also, the Prudential Regulation Authority that has succeeded a role to 'stability', see, further, *FSMA2000* (n5), ss 2B, 2O, and 2J. 'Stability' is also dealt with under the *BA09* (n62), ss 1, and 11-13 ('Stabilisation Options'); For 'Integrity' power, see *FSMA2000* (n5), ss 1(3)(b), and 1 D.

<sup>84</sup> *FSMA2000* (n5), s 1(3)(c).

<sup>85</sup> A Kovas, *Understanding the Financial Conduct Authority* (Leicestershire: Troubador Publishing 2014), ch 7.

<sup>86</sup> *FSMA2000* (n5), pt 6, s 73.

<sup>87</sup> *FSA12* (n5), c. 21, pt 4.

the PRA concludes that the exercise of the PRA's authority could jeopardize the safety of the British financial system, or result in the collapse of the PRA-approved institution in a manner that may damage the banking and financial system in the UK.<sup>88</sup> In reality, the FCA and the PRA jointly coordinate with the BoE to facilitate the bank's mission of financial stability preservation.

The CMA also consults with the BoE, PRA, and FCA in respect of bank merger situations. Although the participation of these banking supervisory entities in a merger case often appears to be a formality and lacking in activity, their findings are taken into consideration in the CMA's final decision.<sup>89</sup> Directly or through the SoS or another governmental instrumentality, the banking supervisory bodies can influence the decision to prohibit or approve a bank merger.<sup>90</sup>

Considering that the competition law enforcement powers of the FCA came into force in 2015, it is too early to foresee how the regulator will use its broad competition powers over the financial services institutions and in the consumers' protection.<sup>91</sup>

### 3.2.3 Payment Systems Regulator ('PSR')

The Payment Systems Regulator is a subsidiary of the Financial Conduct Authority ('FCA'),<sup>92</sup> and commenced its activity in April, 2015. It is responsible for competition, innovation and the interests of end-users in the market for payment systems.<sup>93</sup> Payment systems include bank transfers, such as, BACS<sup>94</sup> and CHAPS,<sup>95</sup> in addition to card payment systems from

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<sup>88</sup> *Ibid*, s 74; see, also, *FSMA2000* (n5), sched 1ZB.

<sup>89</sup> *FSMA2000* (n5), ch 4 of pt 9A; ss 234I, 234O, and 234H; see, also, *ERRA13* (n1), pt 3.

<sup>90</sup> E Carletti and P Hartmann, 'Competition and Stability: What's Special about Banking!' (May 2002) *European Central Bank Working Paper Series No 106*, available at <http://www.suomenpankki.fi/pdf/104857.pdf>.

<sup>91</sup> D Jones, 'The FCA's New Competition Powers: What Do They Mean for the Financial Services Industry' (November, 2014), available at [www.fca.org.UK/news/new-competition-powers-what-do-they-mean-for-the-financial-services-industry](http://www.fca.org.UK/news/new-competition-powers-what-do-they-mean-for-the-financial-services-industry).

<sup>92</sup> *FSA13* (n6), s 40; also, Sched 4.

<sup>93</sup> *Ibid*, ss 39-58; 68-110; also, Schedules 4 and 5.

<sup>94</sup> The Bankers' Automated Clearing Services ('BACS') is a scheme for the electronic processing of financial transactions between banks in the UK.

<sup>95</sup> The Clearing House Automated Payment System ('CHAPS') is a British company that offers same-day sterling fund transfers.

organisations, such as, Visa and MasterCard. The purpose of the PSR is to make payment systems work well for those that use them.

The PSR ensures that payment systems are operated and developed in a sense that considers and promotes the interests of the businesses and consumers that utilize them.<sup>96</sup> The regulator, also, promotes effective competition in the markets for payment systems and services between operators and payment service providers.<sup>97</sup> It, further, promotes development and innovation in payment systems in the UK, in particular the infrastructure utilized to operate those systems.<sup>98</sup>

The approach provided by the PSR is collaborative. However, if the evidence would indicate that the payment systems industry is failing to deliver greater competition, more innovation and greater benefits for businesses or consumers, the PSR is expected to apply its powers.<sup>99</sup> Its competition and regulatory powers include any direction given to take action and set standards, to impose requirements concerning payment system rules, demand operators to provide direct access to payment systems, demand payment service providers to provide indirect access to smaller payment service providers. In addition, the PSR has the power<sup>100</sup> to amend agreements concerning payment systems, comprising fees and charges, investigate behaviour that is not consistent with the PSR's directions, and act along with the Competition and Markets Authority in the event of anti-competitive behaviour situation from payment systems participants.<sup>101</sup>

Considering its recent formation, it is too early to analyse its role in the enhancement of competition in the payment systems industry in the UK.

### 3.2.4 Prudential Regulation Authority

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<sup>96</sup> *FSA13* (n6), s 49.

<sup>97</sup> *Ibid*, s 50.

<sup>98</sup> Payment Services Regulator, 'Consultation Paper: A New Regulatory Framework for Payment Systems in the UK' (2014) *CP14/1*, available at [www.fca.org.uk/static/documents/psr/psr-cp14-1-cp-a-new-regulatory-framework-for-payment-systems-in-the-uk.pdf](http://www.fca.org.uk/static/documents/psr/psr-cp14-1-cp-a-new-regulatory-framework-for-payment-systems-in-the-uk.pdf).

<sup>99</sup> *FSA* (n6), ss 54-67, and 66-67.

<sup>100</sup> *Ibid*, ss 54-67, 66-67, and 81-90.

<sup>101</sup> HM Treasury, 'Opening up UK Payments' (October, 2013), available at [www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/249085/PU1563\\_Opening\\_up\\_UK\\_payments\\_Government\\_response.pdf](http://www.gov.uk/government/uploads/system/uploads/attachment_data/file/249085/PU1563_Opening_up_UK_payments_Government_response.pdf).



The Prudential Regulation Authority ('PRA') is a secondary body to the Bank of England ('BoE').<sup>102</sup> It is in charge of making the rules applying to deposit takers, investment companies and insurance companies.<sup>103</sup> The PRA, also, increases the safety and stability of accredited financial institutions by tempering the negative consequences associated with their deficiencies, which impact upon the soundness of the British banking and financial system.<sup>104</sup>

The PRA is tasked with fostering the uniform and judicious performance of the financial system by means of the regulation of banks and other financial institutions like building societies and credit unions. The PRA's broad purpose is to nurture and protect PRA-approved financial institutions. To fulfil this responsibility, the PRA works to ensure that the business of PRA-approved institutions is carried out consist with the objective of ensuring the soundness of the UK financial blueprint.

It is, also, intended to safeguard against the collapse of a PRA-approved institution, which would negatively impact upon the health of the financial system in the UK. In performing its varied tasks, the PRA, along with the Financial Conduct Authority ('FCA'), apply similar regulatory standards for the purposes of eliminating negative competition consequences in the financial and banking markets.

The Financial Services (Banking Reform) Act 2013 amended the functioning of the PRA, by providing that it must, so far as is reasonably possible, act in a way which, as a secondary objective, facilitates effective competition in the markets for services provided by PRA-authorized persons in carrying on regulated activities.

The PRA, along with the Competition and Markets Authority, Financial Conduct Authority, and the Payment Systems Regulator, is empowered with the necessary competition enforcement tools towards the regulation of the financial services sector in the UK. However, the jury is still out on whether the foregoing authorities will be able to meet their regulatory

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<sup>102</sup> *FSMA2000* (n5), ss 2A-2P; also, Sched 1ZB. For more information about the role and functions of Prudential Regulation Authority, see [www.bankofengland.co.uk/pr/Pages/about/default.aspx](http://www.bankofengland.co.uk/pr/Pages/about/default.aspx).

<sup>103</sup> *FSMA2000* (n5), ss 2B-2D.

<sup>104</sup> *Ibid*, s 2H.

responsibilities, among others, to facilitate effective competition in the banking and financial system.

### 3.3 The UK Government's framework and approach to the assessment of State aids

The UK Government adopts similar framework and approach like the EU<sup>105</sup> in relation to the examination of the State aid.<sup>106</sup> Below is a brief analysis of the State aid applicability in the UK.

State aid is an advantage provided by the UK Government to undertakings i.e., banks, in particular situations that could likely thwart competition and affect trade in the EU.<sup>107</sup> The State aid definition is met if four characteristics (so-called 'the four tests')<sup>108</sup> are present for assistance to be defined as State aid. Such characteristics are that (i) the assistance is granted by the UK Government or through its resources; (ii) the assistance favours certain undertakings, i.e., banks, or the production of certain goods; (iii) the assistance distorts or threatens to distort competition; and (iv) the assistance affects trade between Member States.<sup>109</sup>

In the event the assistance satisfies the foregoing characteristics it is considered a State aid, and the concerning parties are required to follow the State aid rules of the EU to ensure compliance with the law. In the event one of the above characteristics is not met, the measure is not subject to the State aid provisions. When the test of State aid is all satisfied, it is unlawful for the UK government to render aid without prior approval from the Commission, except for applicability of exemption.

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<sup>105</sup> See in this subchapter a discussion of the 'framework and approach to the assessment of State aids in the EU'.

<sup>106</sup> Department for Business Innovation & Skills, 'Guidance on the state aid rules and how they apply in practice' (2015) ('State Aid Guidance'), available at [www.gov.uk/government/publications/state-aid-manual](http://www.gov.uk/government/publications/state-aid-manual); see, also, Department for Business Innovation & Skills, 'The state aid manual' (July 2015) ('State Aid Manual'), available at [www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/520676/BIS-15-148-state-aid-manual.pdf](http://www.gov.uk/government/uploads/system/uploads/attachment_data/file/520676/BIS-15-148-state-aid-manual.pdf).

<sup>107</sup> C D Ehlermann, 'State aid control in the European Union: Success or Failure' (1994) 18 *Fordham International Law Journal* 1212.

<sup>108</sup> TFEU, art 107(1).

<sup>109</sup> *Ibid.*

Article 107(1)<sup>110</sup> of the TFEU regulates general prohibition on State aid. It indicates aid given within state resources in any form that could impede competition and affect trade by favouring particular undertakings or the production of specific goods is incompatible with the common market unless the Treaty permits otherwise.<sup>111</sup>

Although Article 107(1) regulates general prohibition on State aid, the TFEU provides exceptions where aid is or may be considered compatible with the common market. Broadly speaking, exemptions are divided in (i) State aid that is considered automatically permissible, that is compatible with the EU Treaty;<sup>112</sup> and (ii) State aid that requires approval of the Commission.<sup>113</sup>

It is the UK government's duty to notify the Commission of intended aid measures ahead and to give adequate time for the Commission to comment.<sup>114</sup> The UK Government won't implement intended aid measures unless it received from the Commission a final decision.<sup>115</sup>

The Commission has determined circumstances where the notification process can be avoided and approval can be assumed, subject to specific conditions are satisfied. Especially, the General Block Exemption Regulation ('GBER')<sup>116</sup> is a framework, which affirms certain

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<sup>110</sup> Formerly Article 87(1), available at [http://ec.europa.eu/competition/state\\_aid/legislation/provisions.html](http://ec.europa.eu/competition/state_aid/legislation/provisions.html)

<sup>111</sup> <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:12002E087:EN:HTML>.

<sup>112</sup> TFEU, art 107(2). In relation to the first foregoing exemption, State aid types that the TFEU declares shall be automatically compatible (the Commission does not have discretion to decide whether an exemption ought to be granted): Article 107(2) of the TFEU provides three types of compatible aid, namely (i) social aid granted to individual consumers; (ii) aid to make good damage caused by natural disasters or exceptional occurrences; and (iii) aid to certain areas of Germany affected by the division of Germany. If State aid satisfies Article 107(2), it still has to be notified to the Commission and approved to be compatible.

<sup>113</sup> TFEU, art 107(3). As for the second foregoing exemption, State aid types, which may be considered permissible, such as, compatible with the EU Treaty - Article 107(3) of the TFEU permits the likelihood of rendering State aid to (i) enable development of specific economic activities or of specific economic areas in which case such aid does not harmfully affect trading conditions and competition to an extent adverse to the common interest; (ii) foster economic development of areas of abnormally low standard of living or serious unemployment; (iii) stimulate a significant project of common European interest or to remedy a considerable disturbance in the economy of a Member State; (iv) uphold heritage and culture conservation; (v) other types of aid the Commission may suggest and the Council may specify. Article 107(3) provides that the foregoing types could be compatible, meaning there is a legal obligation for EU national authorities to obtain the Commission's approval prior to granting such aid.

<sup>114</sup> TFEU, 108(3).

<sup>115</sup> *Ibid.*

<sup>116</sup> Commission Regulation (EU) N 651/2014 of 17 June 2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the EU Treaty; see, also, Council Regulation (EC)

types of aid to be consistent with the EU Treaty, in the event they meet specific prerequisites, so freeing them from the obligation of prior notification and Commission approval; and the *de minimis* regulation<sup>117</sup> provides that aid of up to €200,000 over 3 years does not hamper trade between Member States.<sup>118</sup> As result, exempting them from the requirement of prior notification and the Commission's approval. The UK Government largely uses the GBER.<sup>119</sup>

In assessing proposed aid, the Commission is guided by standards in published frameworks and guidelines,<sup>120</sup> which apply to specific aid types or purposes and throughout the EU Member States. The Commission may approve State aid for development of specific economic activities or areas, when a proposed State aid does not strictly comply with formal frameworks or guidelines or is in a type where there are not relevant published frameworks or guidelines, if the Commission considers that the aid won't affect competition and trade to a level adverse to the common interest.<sup>121</sup>

The Commission has adopted a modernization of the State aid regime<sup>122</sup> aimed at cultivating development, focusing on enforcement of the cases that create a larger effect in the market and simplify rules and decision-making.<sup>123</sup> The State Aid Modernisation ('SAM') 2014 package expanded the GBER<sup>124</sup> to enable a more simplified approach to the confer of specific categories of aid, allowing Member States, i.e., UK, to do more without the necessity to go through the approval process, whereas mounting Member States' obligations of transparency, supervision, and compliance.

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No 1588/2015 of 13 July 2015 on the application of Articles 107 and 108 of the TFEU to certain categories of horizontal State aid, OJ L 248, 24.9.2015, p 1.

<sup>117</sup> Commission Regulation (EU) No 1407/2013 of 18 December 2013 on the application of Articles 107 and 108 of the TFEU to *de minimis* aid.

<sup>118</sup> *Ibid.*

<sup>119</sup> Department for Business Innovation & Skills, 'State aid: General Block Exemption Guidance' (2014).

<sup>120</sup> E.g., Commission, 'Common methodology for State aid evaluation' (2014) *Commission Staff Working Document SWD* (2014) 179 final; Commission, 'Competition policy brief on presenting State aid evaluation' (May 2016)

<sup>121</sup> Council Regulation (EU) No 734/2013 of 22 July 2013 amending Regulation (EC) No 659/1999 laying down detailed rules for the application of Article 93 of the EC Treaty, OJ L 204/15 of 31.7.2013.

<sup>122</sup> Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, EU State Aid Modernisation (SAM) (2012) COM/2012/0209 final.

<sup>123</sup> For more information, see [http://ec.europa.eu/competitin/state\\_aid/modernisation/index\\_en.html](http://ec.europa.eu/competitin/state_aid/modernisation/index_en.html).

<sup>124</sup> Commission Regulation (EU) No 651/2014 of 17 June 2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the TFEU, OJ L 187/1 of 26.6.2014.

State guarantees, such as loans, coverage of losses, will normally be deemed to be State aid, pursuant to Article 107(1) TFEU, whether or not the guarantee is required.<sup>125</sup> This is for the reason that they remove a component of risk that the beneficiary institution would otherwise have to endure absent the state's participation.

The *de minimis* regulation permits the UK Government to render moderately small levels of support up to a specific perimeter that may be paid for almost any reason, providing it satisfies the conditions under the *de minimis* regulation. Prior notification and approval are not needed provided that the requirements of the regulation are satisfied.<sup>126</sup>

Services of General Economic Interest ('SGEI') are not defined in the EU Treaty.<sup>127</sup> Therefore, it is for the UK Government to define a unique service as an SGEI. The role of the Commission and Court is to solely determine whether the Government Member has erred in defining the service as an SGEI. Generally, SGEIs lean towards public services, which the market does not provide or does not specify to the quality or extent that the state requires, and is a service generally and not the certain interest. Funding of SGEI is caught by the State aid rules because the state provides an undertaking with financial assistance to render a service. In order to ensure legal certainty on how such assistance can be given in a State aid, lawfully, the Commission provides three sets of rules permitting for different degrees of financial assistance. The first set of rule provides for support of up to €500,000.00<sup>128</sup> during any three-year period, there is the SGEI *De Minimis* Regulation.<sup>129</sup> The regulation is applicable to aid provided as a grant, a loan or a loan guarantee, and subject to the form of the aid satisfies particular unambiguousness requisites.<sup>130</sup> A link of entrustment between the beneficiary and the aid grantor must be established. Aid granted as for the regulation is not required to be

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<sup>125</sup> Commission Notice on the application of Articles 107 and 108 of the EC Treaty to State aid in the form of guarantees. See, also, Commission's draft notice on the notion of aid the notion of State aid pursuant to Article 107(1) TFEU.

<sup>126</sup> Commission Regulation on the application of Articles 107 and 108 of the TFEU to *de minimis* aid.

<sup>127</sup> For more information, see [http://ec.europa.eu/comm/competition/state\\_aid/legislation/sgei.html](http://ec.europa.eu/comm/competition/state_aid/legislation/sgei.html).

<sup>128</sup> Calculating aid over the 3 year period, this should include aid from all sources (including general *de minimis*) and not just under SGEI *de minimis*. See, also, COM(2011) 146 final of 23 March 2011 on the reform of the EU State aid rules on services of general economic interest.

<sup>129</sup> Commission Regulation (EU) No 360/2012 of 25 April 2012 on the application of Articles 107 and 108 of the TFEU to *de minimis* aid granted to undertakings providing services of general economic interest (SGEI), OJ L 114/8 of 26.4.2012.

<sup>130</sup> *Ibid*, arts 2, 4 and 5.

notified to the Commission.<sup>131</sup> However, as with regular *de minimis* aid, the aid provider must notify the recipient it is being granted as *de minimis* aid.<sup>132</sup>

The second set of rules provides for support of up to €15 million for year is blocked exempted, pursuant to the SGEI decision.<sup>133</sup> In reference to SGEI *de minimis*, a form of entrustment between the beneficiary and the aid provider must be in place. The decision indicates what is required to go into an entrustment document, and that the entrustment period should not exceed ten years unless justified.<sup>134</sup> The decision also sets out limits on the amount of compensation and its calculation, and Member States are required to check systematically that the recipient does not receive compensation above the determined sum. While there is no notification requirement where the decision is relied upon, Member States need to report on aid granted under the decision every two years.<sup>135</sup>

The third set of rules provides for aid for SGEI that cannot be granted under SGEI *de minimis* or the SGEI decision must be notified under the SGEI framework<sup>136</sup> and approved by the Commission before it can be granted. The framework<sup>137</sup> usually covers aid for large network public services where the concern over likely hamper of competition is greater, and so approvals can take time.

The Financial Transparency Directive<sup>138</sup> ('FTD') ensures transparency of financial relations between public authorities and certain undertakings. Its aim is to boost the State aid system by requiring aid to be made transparent in terms of what funds have been made available to certain undertakings, and the use to which those funds have in fact been put.<sup>139</sup> Without such transparency, there is a real risk that the Commission's State aid system will be

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<sup>131</sup> *Ibid*, arts 18 and 19.

<sup>132</sup> *Ibid*, arts 2 and 3.

<sup>133</sup> Commission Decision of 20.12. 2011 on the application of Article 106(2) TFEU to State aid in the form of public service compensation granted to certain undertaking entrusted with the operation of SGEI OJ L 7, 11.01.2012.

<sup>134</sup> *Ibid*, art 8.

<sup>135</sup> *Ibid*, arts 9 and 10.

<sup>136</sup> Communication from the Commission, European Union framework for State aid in the form of public service compensation (2011) OJ C 8, 11.01.2012.

<sup>137</sup> *Ibid*.

<sup>138</sup> The Financial Transparency (EC Directive) Regulations 2009 (S.I. 2009/2331) implement Commission Directive 2006/111/EC of 16 November 2006 on the transparency of financial relations between Member States and public undertakings as well as on transparency within certain undertakings ("the Directive").

<sup>139</sup> *Ibid*.

unable to expose funding that is not easily identifiable as State aid and identify funding that may trickle into an organisation's commercial activities, so cross-subsidising those areas with public funds.<sup>140</sup>

Making an adequate assessment of State aid issues is a significant aspect of policy-making right through the UK Government. Failure to properly implement the State aid rules and risk could create effects for the Government to render policy goals. Such a failure could thwart a scheme to be implemented, create damage to the policy goals or even could lead to funds paid under an arrangement to be recovered. A large amount of the assistance schemes in the UK utilizes one of the exemptions – *de minimis* or GBER.<sup>141</sup> The larger State aid schemes have sometime been authorized by the Commission prior to the aid being given.<sup>142</sup> Nevertheless, often it is unclear whether a given measure is a State aid and, if so, how it can be considered according to the rules.

The UK Government aims at taking a 'risk-based' approach<sup>143</sup> to decision-making that both abides by legal obligations and centres on target delivery. In other words, State aid decisions ought to be based on what is 'credible' instead of what necessarily is 'cast-iron'.<sup>144</sup> Nevertheless, the Government is responsible to ensure that it comprehends and deems the effect and prospect of State aid risk concerned and, especially, the degree where any risk would be assumed by business rather than or in addition to the Government and warrant the degree of risk is one that business and the Government can tolerate.<sup>145</sup> The Government has issued provisions that outline a risk-based approach to decision-making in State aid cases.<sup>146</sup> These provisions are aimed at assisting those concerned in each stage of the process, from planning a measure to its actual implementation, and it applies to State aid providers throughout the Government.<sup>147</sup>

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<sup>140</sup> The UK has implemented the Transparency Directive via the Financial Transparency (EC Directive) Regulations 2009 (as amended).

<sup>141</sup> *State Aid Guidance* (n106), p 13.

<sup>142</sup> *Ibid.*

<sup>143</sup> *State Aid Guidance* (n106), p 10.

<sup>144</sup> *Ibid.*, pp 12-4.

<sup>145</sup> *Ibid.*, pp 19-21.

<sup>146</sup> Based on: DTI and HM Treasury (2004) Taking account of State aid issues in policy-making: a risk-based approach.

<sup>147</sup> *State Aid Manual* (n106), pp 7-11.

While presenting a measure, it is significant to count the prospect of a State aid challenge. An affected competitor or individual may launch a complaint to a UK court or the Commission, or the latter may be urged by a Member State's policy declarations or actively scrutinise areas of specific interest.

### 3.4 European Commission

Bank mergers in the EU are regulated similarly like mergers in other sectors of the European economy. The European Commission ('Commission'), together with national competition authorities ('NCAs') of the Member States<sup>148</sup>, directly enforces EU competition rules<sup>149</sup> to make markets within the EU work better by warranting all businesses compete equally and fairly on their merits. This approach would benefit consumers, businesses and the economy throughout the EU. The Directorate-General for Competition ('DG Competition') is the specialized agency within the Commission responsible for the foregoing enforcement authorities.<sup>150</sup>

The Commission sustains exclusive jurisdiction over mergers ('concentrations')<sup>151</sup> between financial institutions, or other businesses, with Community dimension.<sup>152</sup> Merging parties are required to notify the Commission, if the proposed concentration presents a Community dimension, *i.e.*, concentrations that meet the turnover thresholds set out in the ECMR.<sup>153</sup> A concentration does not have a Community dimension, if each of the merging parties attains higher than two-thirds of its combined EU-wide turnover in one and the same

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<sup>148</sup> The national competition authorities and national courts share the enforcement Articles 101 and 102 together with the Commission.

<sup>149</sup> TFEU, arts 101 (concerted practice that restrict competition) and 102 (abuse of dominant position); Council Regulation No 1/2003 (2003) *OJ L 1/1* ('Modernization Regulation 1/2003').

<sup>150</sup> Directorate-General for Competition, available at [http://ec.europa.eu/dgs/competition/index\\_en.htm](http://ec.europa.eu/dgs/competition/index_en.htm); The DG Competition is comprised of nine broadly sector-related directorates. Authority over merger control and, to a certain degree, State aid is divided among a handful of these directorates. A specific directorate is dedicated to working on cartels, financial services, and other areas of the economy shown to be of crucial relevance to the DG Competition's sphere of responsibility. The DG Competition is comprised of one Director-General, and three Deputy Directors-General, one for general operations, one for mergers and antitrust, and one for State aid. The directorate on financial markets is particularly relevant for present purposes, because it analyses a bank merger that is within the scope of EU competition concerns.

<sup>151</sup> Under the ECMR, 'mergers' are defined as 'concentrations'. See *ECMR* (n49), art 3.

<sup>152</sup> *ECMR* (n49), arts 1(2), and (3). For a detailed discussion of the Community 'dimension', see chapters 2.10.2 and 3.3 in this thesis, pp 33-7, and 66-79.

<sup>153</sup> *ECMR* (n49), arts 1, and 21(3). For a detailed discussion of the turnover threshold requirements under the ECMR, see chapters 2.10.2 and 3.3 in this thesis, pp 33-7, and 66-79.



Member State.<sup>154</sup> In such a case, the ECMR provisions do not apply. Instead, the proposed concentration will be subject for review by the Member State's competition authority where the foregoing turnover occurs.<sup>155</sup>

The Commission may notify the relevant Member State to look into whether a concentration threatens to affect substantially competition in a market in that Member State,<sup>156</sup> or whether a concentration affects competition in a market in that Member State.<sup>157</sup>

Any Member State may request from the Commission to assess any concentration that does not have a Community dimension, but affects trade between Member States, and threatens to substantially affect competition in the territory of the Member State(s) making the request.<sup>158</sup> On raw data, since 1990 to date, there have been a total of 32 requests from Member States to Commission considering the foregoing.<sup>159</sup>

Any Member State is automatically relieved from examination of a concentration, once the Commission initiates its examination proceedings over the same concentration.<sup>160</sup> For instance, in the bank merger case of *Chase Manhattan/Chemical Banking*,<sup>161</sup> once the Commission started the review process of the proposed bank merger, some Member States, like the UK, where the merging banks had considerable business presence, were relieved from assessing the merger.<sup>162</sup>

A Member State shall not apply its national laws on competition to any concentration that has a Community dimension.<sup>163</sup> Exception to this rule shall apply, if the Member State invokes the protection under its legitimate interest ground claiming public interest, plurality of

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<sup>154</sup> *ECMR* (n49), arts 1(2), and 1(3).

<sup>155</sup> *Ibid.*

<sup>156</sup> *Ibid.*, art 9(2)(a).

<sup>157</sup> *Ibid.*, art 9(2)(b).

<sup>158</sup> *Ibid.*, art 22.

<sup>159</sup> Commission merger statistics for the period 21 September, 1990 to 31 January, 2016, available at <http://ec.europa.eu/competition/mergers/statistics.pdf> ('Merger Statistics').

<sup>160</sup> *Modernization Regulation 1/2003* (n106); also, *ECMR* (n49), arts 21(2), and (3).

<sup>161</sup> Case No. COMP/IV/M.642 *Chase Manhattan/Chemical Banking* [2008] OJ C 33/7.

<sup>162</sup> *Ibid.* The Commission investigated the competitive effects of a concentration between American banks Chase Manhattan and Chemical Banking and it concluded that the merger did not pose significant impediments to competition.

<sup>163</sup> *ECMR* (n49), art 21(3).

the media, and prudential rules.<sup>164</sup> The Commission provides a narrow interpretation of legitimate interest because its applicability constitutes an exception to the Commission's exclusive jurisdiction to scrutinise concentrations with a Community dimension.<sup>165</sup> For example, in the bank merger case of *Banco Santander Central Hispano/A Champalimand*<sup>166</sup> the Portuguese Government claimed that the merger would interfere with the national interests. The Commission rejected these arguments and required that the Government suspended its opposition to the merger transaction. The Commission, also, held similar findings in the bank merger case of *UniCredito/HVB*<sup>167</sup> against the Polish Government's opposition to block the merger under national interest.

The Commission analyses a concentration to determine if it is compatible with the EU Common Market.<sup>168</sup> A concentration is incompatible in the event it establishes or strengthens a dominant position, based on which effective competition would be substantially hampered.<sup>169</sup>

Prior to initiating the formal investigative proceedings on a merger, the Commission conducts a pre-merger clearance process.<sup>170</sup> During this process, parties to a proposed merger hold informal and confidential consultations with the Commission. In these consultations, parties discuss whether the Commission obtains jurisdiction on the proposed merger, and whether the case could be referred to relevant Member State(s)<sup>171</sup> or from Member State(s) to Commission.<sup>172</sup> In addition, the Commission looks into whether the case qualifies for the simplified procedure,<sup>173</sup> nature of information that the merging parties need to provide

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<sup>164</sup> *Ibid*, art 21(4).

<sup>165</sup> A Jones and S Davis, 'Merger Control and the Public Interest: Balancing EU and National Law in the Protectionist Debate' (2014) 10 *European Competition Journal* 453.

<sup>166</sup> Case No IV/M.1616 *BSCH/A Champalimand* (1999) (Commission decisions on 20 July, 1999 and 20 October, 2000); see, also, the Commission's XXIXth Report on Competition Policy (1999), paras 194-96.

<sup>167</sup> For a discussion of *UniCredito/HVB* case, see chapter 4.4.2(d) in this thesis, pp 127-28.

<sup>168</sup> *ECMR* (n49), art 21.

<sup>169</sup> *Ibid*, art 24.

<sup>170</sup> *Ibid*, art 4.

<sup>171</sup> *Ibid*, art 9.

<sup>172</sup> *Ibid*, art 22.

<sup>173</sup> *Ibid*, art 6.1(b). Under the simplified procedure, the Commission allows the merging parties to submit a Short Form CO. Short Form CO can be used where the concentration is unlikely to raise competition issues and is thereby suitable for review under the Commission's simplified procedure. It requires much less information than the full notification, although information, such as, about the market definition, market shares, where there are horizontal overlaps and/or vertical relationships, and relevant internal company documents must be provided. In

including completion of the premerger forms,<sup>174</sup> and ascertaining important issues, possible competition aspects and meeting procedural deadlines.<sup>175</sup>

In case of the applicability of a merger referral that is eligible for examination in at least three Member States, such merger can be reviewed directly by the Commission.<sup>176</sup> This allows the merging parties to benefit from the Commission's one-stop shop review.

The Commission's investigative proceedings of a merger are divided in two phases, namely Phase 1 and Phase 2.<sup>177</sup>

After the completion of the pre-merger process, the Commission starts Phase 1 investigative proceedings. This phase begins with the merging parties informing the Commission of the proposed merger.<sup>178</sup> Along with the notification from the merging parties to the Commission about the proposed merger, the parties submit to the Commission a completed Form CO.<sup>179</sup> Within twenty-five days from receipt of the notification, the Commission has to render its Phase 1 decision.<sup>180</sup> During this time, the Commission decides

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this case, the Commission will usually adopt a short-form clearance decision within 25 working days from the date of notification; see, also, *Whish and Bailey* (n14), p 902.

<sup>174</sup> Form CO, or Short Form CO (see, *Ibid*) are official forms for standard merger notifications. See Consolidated version of the Commission Regulation (EC) No 802/2004 of 21 April, 2004 implementing Council Regulation (EC) No 139/2004 on the control of concentrations between undertakings (the 'Implementing Regulation') and its annexes (Form CO, Short Form CO, Form RS and Form RM) (*OJ L 133*, 30.04.2004), as amended by Commission Regulation (EC) No 1033/2008 (*OJ L 279*, 22.10.2008) and by Commission Implementing Regulation (EU) No 1269/2013 of 5 December, 2013 (*OJ L 336*, 14.12.2013) with effect as of 1 January, 2014.

<sup>175</sup> Commission Notice (2011/C 308/06) of 17 October, 2011 on best practices for the conduct of proceedings concerning Articles 101 and 102 TFEU, *OJ C308/6* (20 October, 2011), pp 6-32. European Union *Press Release MEMO/11/703*, Competition: Best Practices to increase interaction with parties and enhanced role of hearing officer – frequently asked questions (17 October, 2011); European Union *Press Release IP/11/1201*, Commission reforms antitrust procedures and expands role of Hearing Officer (17 October, 2011); DG Competition Best Practices on the conduct of EU Merger control proceedings ('Best Practices Guidelines'), para 3, concerning the purposes and timing of pre-notification consultations, as well as information to be provided in that process, and the possibility of contacting third party prior to notification, available at <http://ec.europa.eu/competition/mergers/legislation/proceedings.pdf>

<sup>176</sup> *ECMR* (n49), art 4(5).

<sup>177</sup> *Ibid*, arts 4, 6, 8, 9, 21, and 22.

<sup>178</sup> A concentration, which consists of a merger within the meaning of *ECMR* (n49), art 3(1)(a), or in the acquisition of joint control within the meaning of *ECMR* (n49), art 3(1)(b) shall be notified jointly by the parties to the merger or by those acquiring joint control as the case may be. In all other cases, the notification shall be effected by the person or undertaking acquiring control of the whole or parts of one or more undertakings.

<sup>179</sup> Form CO is appended to the Implementing Regulation (EU) No 1269/2013 with effect as of 1 January, 2014. There is no filing fee for filing Form CO. The requirements of the Form CO are onerous and involve the provision of extensive information on the transaction, market definition and market share information.

<sup>180</sup> *ECMR* (n49), art 10.1.

whether the merger (i) is out of scope of the ECMR,<sup>181</sup> (ii) is compatible with the internal market,<sup>182</sup> (iii) or, as modified by the parties, no longer raises serious doubts, and so may be declared compatible with the internal market (subject to fulfilment of commitments),<sup>183</sup> or (iv) raises serious doubts as to its compatibility with the internal market,<sup>184</sup> therefore, referring the case to Phase 2 investigation.<sup>185</sup>

Notification of the merging parties to the Commission in Phase 1 can be based on a letter of intent to merge or acquire in which the parties would need to show to the Commission a good faith intention to consummate a merger agreement.<sup>186</sup> Upon receipt of a merger notification, the Commission shall notify all Member States about the concerning merger, providing to them the necessary information and documentation.<sup>187</sup>

Fifteen days upon receipt of the Commission's notification, Member States should inform the Commission whether they wish to seek referral of the concerning merger.<sup>188</sup> Where referral is sought, the Commission's deadline for the Phase 1 decision is extended by ten days, to thirty-five days.<sup>189</sup>

Within twenty days, upon receipt of the Commission's notification, merging parties (*i.e.*, banks) must submit to the EU competition authority their proposed commitments, such

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<sup>181</sup> *Ibid*, art 6.1(a). From September, 1990 to January, 2016, in a total of 6096 notified concentration cases the Commission has ruled 54 of them to have been outside of the applicability of the ECMR. For more information, see *Merger Statistics* (n116).

<sup>182</sup> *ECMR* (n49), art 6.1(b); From September, 1990 to January, 2016, out of the total of 6096 notified concentration cases the Commission decided that 5358 cases were found to be compatible with the internal market. For more information, see *Merger Statistics* (n116).

<sup>183</sup> *ECMR* (n49), arts 6.1(b), and 6.2. Parties must use a standardized remedies form (Form RM) to provide details of any proposed commitments, including the types of commitments offered and the terms or conditions for their implementation. From September, 1990 to January, 2016, out of a total of 6096 notified concentration cases the Commission decided 254 cases to be in compliance with art 6.1(b) in conjunction with art 6.2 of *ECMR* (n49) (compatible with commitments). For more information, see *Merger Statistics* (n116)

<sup>184</sup> *ECMR* (n49), art 6.1(c).

<sup>185</sup> *Ibid*. See in the present subchapter, below, in this thesis, a discussion of the 'Phase 2' investigation.

<sup>186</sup> *ECMR* (n49), art 4.1. Within 3 days after notification, the Commission must transmit the copies of Form CO provided by the parties to the national competition authorities, see *ECMR* (n49), art 19(1)); and the Commission publishes the fact of notification in the Official Journal, see *ECMR* (n49), art 4(3). Within 15 days after notification, the Commission will offer a 'State of Play' meeting, where it appears that the concentration raises 'serious doubts', *Best Practices Guidelines* (n132), para 15.1 regarding aim and format of 'State of Play' meetings.

<sup>187</sup> *ECMR* (n49), art 9.1.

<sup>188</sup> *Ibid*, art 9.2.

<sup>189</sup> *Ibid*, art 10.1.

as, divestiture of assets, in order to resolve any concerns arisen from Commission.<sup>190</sup> If the parties offer commitments, the deadline for a Phase 1 decision is extended by ten working days, to thirty-five.<sup>191</sup> In the event that the merging parties satisfy the Commission's proposed commitments, the merger is cleared after the thirty-five days' time period.<sup>192</sup>

If the Commission is unable to make a determination within twenty-five days, upon receipt of the complete notification from the merging parties, subject that no extension is made, the merger shall be deemed authorized.<sup>193</sup>

However, in the event that the Commission determines that further investigation is needed over the merger or the commitments made by the parties are proven to be deficient, the Commission shall start the Phase 2 investigative proceeding.<sup>194</sup>

The Commission initiates Phase 2 by issuing to the merging parties a formal, written decision, outlining the Commission's serious doubts about the merger's compatibility with the Common Market.<sup>195</sup> Within this phase the Commission has ninety days to reach a final ruling on the proposed merger.<sup>196</sup> Throughout such period, if the Commission decides that the concentration will have harmful consequences on competition, the EU competition authority will produce a report outlining its objections, and provide the merging parties an opportunity to respond.<sup>197</sup>

The ninety-day timetable can be extended by the merging parties' 'stopping the clock' request to the Commission or the latter's own initiative, or if the merging parties offer remedial commitments after the fifty-fourth day of the Phase 2 investigative proceedings.<sup>198</sup>

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<sup>190</sup> *Implementing Regulation* (n131), art 19.1.

<sup>191</sup> *ECMR* (n49), art 10.1.

<sup>192</sup> *Ibid*, art 10.6.

<sup>193</sup> *Ibid*, arts 6.1, and 10.6. More than 90 per cent of all cases are resolved in Phase 1, generally, without remedies. For more information, see Commission's official website, available at [http://ec.europa.eu/competition/mergers/procedures\\_en.html](http://ec.europa.eu/competition/mergers/procedures_en.html).

<sup>194</sup> *ECMR* (n49), art 6.1.

<sup>195</sup> *Ibid*, art. 6.1(c). Ten days upon the commencement of the Phase 2, the Commission will hold a 'State of Play' meeting with the parties to facilitate the notifying parties' understanding of DG Competition's concerns at an early stage of the Phase 2 proceedings, see *Best Practices Guidelines* (n132), para 33(b).

<sup>196</sup> *ECMR* (n49), art 10.3.

<sup>197</sup> Commission Regulation 447/98 (1998) *OJ L 61/1*, art 13(2).

<sup>198</sup> The time limits for decisions in art 10 of the *ECMR* (n49) are strict and can be tolled only for a delimited period with the consent of the parties. The EU must issue decisions in all cases. If it fails to issue a decision by

If certain situations arise throughout the Phase 2, the ninety-day statutory deadline would be extended automatically.<sup>199</sup> For example, within fifteen days after the start of Phase 2 the merging parties may request an extension of time.<sup>200</sup> Also, the Commission may extend time with the parties' agreement, which cannot be more than twenty days.<sup>201</sup>

The Commission, also, holds meetings with the merging and interested parties as early as possible in the Phase 2. The goal for these meetings is to enable the Commission to reach a more informed conclusion as to the relevant market characteristics of the proposed concentration, and to clarify substantial points before deciding to issue a statement of objections ('SO').<sup>202</sup>

About six weeks from the start of the Phase 2 proceedings, the Commission may conclude its investigation with the issuance of a SO that outlines the Commission's competitive concerns over the proposed merger.<sup>203</sup> Anything on which the Commission wishes to rely on its final decision should be included in the SO. The SO is accompanied by an invitation to the merging parties to reply in writing by a certain time determined by the Commission.<sup>204</sup>

SO issuance triggers the parties' right of access to the Commission's investigative file, including third party written submissions.<sup>205</sup>

Normally two weeks after issuance of the SO, upon the merging parties' request, the Commission holds a formal hearing, at which unsworn testimony is taken from the parties and other interested parties, including customers and competitors.<sup>206</sup>

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the relevant ECMR deadline, the concentration, under art 10.6 of the ECMR, is deemed cleared in the form originally notified.

<sup>199</sup> *ECMR* (n49), art 10.3.

<sup>200</sup> *Ibid*, art 10.3; also, Recital 2.

<sup>201</sup> *Ibid*.

<sup>202</sup> *Ibid*, art 18(3).

<sup>203</sup> *Best Practices Guidelines* (n132), paras 33(c) and (d).

<sup>204</sup> *Ibid*, para 49.

<sup>205</sup> *Ibid*, paras 34-37. Similar access is not afforded in the US unless and until the agencies issue a complaint and the matter goes to litigation.

<sup>206</sup> *Ibid*, para 33(b). Information about Hearings, including the role of the Hearing Officer is available at: [http://eur-lex.europa.eu/LexUriServ/site/en/oj/2001/l\\_162/l\\_16220010619en00210024.pdf](http://eur-lex.europa.eu/LexUriServ/site/en/oj/2001/l_162/l_16220010619en00210024.pdf).

Following the parties' reply to the SO and the hearing, another meeting may take place that may, also, serve as an opportunity to discuss the scope and timing of possible remedy proposals.<sup>207</sup>

Within sixty-five days upon the start of the Phase 2, the merging parties must submit any proposed commitments, such as, divestiture actions, that they wish the Commission to consider settling the merger case.<sup>208</sup>

If the parties submit proposed remedies between fifty-five and sixty-five days, upon the start of the Phase 2 proceedings, the deadline for the Commission's final decision is extended by fifteen days.<sup>209</sup>

Another meeting may be held prior to the 'advisory committee'<sup>210</sup> meeting, primarily to discuss proposed remedies.

On or before the expiration of the foregoing deadline(s), if the Commission has not rendered any decision on the merger, concentration would be presumed to be compatible with the EU Common Market.<sup>211</sup>

The Commission is not empowered to compel oral testimony under oath. However, the Commission may take voluntary interviews and it can obtain answers to written questions. The Commission has the right to inspect the merging parties' premises including the Commission's ability to seal business premises, their books and records.<sup>212</sup>

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<sup>207</sup> *Best Practices Guidelines* (n132), para 33(d).

<sup>208</sup> *Implementing Regulation* (n131), art. 19.2.

<sup>209</sup> *ECMR* (n49), art. 10.3.

<sup>210</sup> An 'Advisory Committee' is made up of representatives of the 27 national competition authorities, reviews the Commission's proposed decision and issues an advisory opinion thereon; see, also, *ECMR* (n49), arts 19.3 - 19.7.

<sup>211</sup> *ECMR* (n49), art 10.6.

<sup>212</sup> *Ibid*, arts 11-13.

The Commission may suspend the decision deadlines, where parties do not timely comply with information requests or on-site inspections.<sup>213</sup>

Upon completion of its Phase 2 investigation, the Commission issues a decision on the proposed merger. In this regard, the Commission may decide to find the merger to be compatible with the Common Market,<sup>214</sup> or it may decide that the merger is compatible with commitments to be undertaken by the undertakings<sup>215</sup> or it blocks (prohibits) the merger<sup>216</sup> considering being incompatible with the Common Market.

Since September, 1990 to date, the Commission has reviewed a total of 6,096 notifications on merger cases, and it has issued only 24 prohibition decisions.<sup>217</sup> Among these decisions only one case, *Deutsche Börse/NYSE Euronext*<sup>218</sup> relates to financial services. In the *Deutsche Börse/NYSE Euronext* case, the Commission blocked the proposed merger asserting that such merger would have eliminated the global competition, and it would have established a quasi-monopoly in a number of assets classes, leading to substantial harm to derivatives users and the European economy in its entirety.<sup>219</sup> The Commission found that without actual competitive restriction left in the market, the price competition benefits would be taken away from customers.<sup>220</sup> In addition, the Commission concluded that there would be less innovation in an area in which a competitive market is important for both small and medium-sized enterprises ('SMEs') and larger firms.<sup>221</sup>

Considering the low number of prohibition decisions issued to proposed mergers, it is clear that in practice many mergers go through because in the course of Phase 2 proceedings the parties hammer out a deal with the Commission whereby they remove the most anticompetitive (in Commission eyes) aspects.<sup>222</sup>

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<sup>213</sup> *Ibid*, art 10.4; Implementation Regulation (n131), art 9 provides more detail as to application of this power.

<sup>214</sup> *ECMR* (49), art 8.1.

<sup>215</sup> *Ibid*, art 8.2.

<sup>216</sup> *Ibid*, art 8.3.

<sup>217</sup> *Merger Statistics* (n116); See, for example, Case No. COMP/M.6663 *Ryanair/Aer Lingus III* [2013] OJ C 216/22; Case No. COMP/M.2220 *General Electric/Honeywell* [2004] OJ L 48/1; Case No. COMP/M.6570 *UPS/TNT Express* [2013] OJ C 137/8.

<sup>218</sup> Case No COMP/M.6166 *Deutsche Börse/NYSE Euronext* [2011] OJ C 199/9.

<sup>219</sup> *Ibid*, para 1483.

<sup>220</sup> *Ibid*, paras 1187, 1328, and 1335.

<sup>221</sup> *Ibid*, para 1130,

<sup>222</sup> *Merger Statistics* (n116).



When the Commission finds that a merger has been consummated however it is declared incompatible with the common market or the EU competition authority finds that the undertakings have implemented the merger in contravention with conditions attached to the merger, *i.e.*, fulfilment of certain commitments, Commission may require that the said concentration be dissolved.<sup>223</sup> From 1990 to date Commission has implemented the dissolution mechanism over a concentration in very rare cases. For example, in a total of 239 merger cases that underwent the Phase 2 proceedings, only in 4 of them Commission decided to ‘restore effective competition’<sup>224</sup> therefore, dissolving them.<sup>225</sup>

The Commission can issue fines<sup>226</sup> of up to 10 per cent of the total turnover of the merging parties where they fail to notify a concentration prior to its implementation, fail to comply with conditions of a Commission’s decision clearing a merger, or consummate a merger in the face of a prohibition decision.<sup>227</sup> Imposition of these fines has been quite rarely implemented by the Commission.<sup>228</sup>

The Commission may also issue fines when merging parties deliberately or negligently fail to inform the authority of the merger, provide requested information, or supply erroneous or deceptive information.<sup>229</sup>

Although a concentration won’t be put into effect either before its notification or until it has been declared compatible with the common market,<sup>230</sup> the Commission may, on request, grant derogation from the obligations imposed taking into account the effects of the suspension

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<sup>223</sup> *ECMR* (n49), art 8.4

<sup>224</sup> *Merger Statistics* (n116).

<sup>225</sup> *Ibid.*

<sup>226</sup> *ECMR* (n49), art 14.

<sup>227</sup> *Ibid.*, art 14.2.

<sup>228</sup> From September, 1990 to January, 2016 there have been only 10 cases out of the total of 6,096 merger cases notified to Commission. For more information, see *Merger Statistics* (n116).

<sup>229</sup> *ECMR* (n49), art 15(1). The Commission may impose fines of up to 1 percent of the total turnover of the parties concerned, where they supply incorrect or misleading information on Form CO or other filings; supply misleading or incorrect information in response to an art 11 (*ECMR*) request/decision, or fail to respond in the time specified; or, refuse to submit to or fail to produce required records in an investigation. The Commission can impose penalty payments of up to 5 per cent of the average daily gross turnover of the parties concerned for day for delays to provide complete and correct information in response to an art 11 request, or for refusal to allow an investigation in the premises.

<sup>230</sup> *ECMR* (n49), arts 6.1(b), 8.2, and 10.6.

on one or more undertakings concerned or on a third party and the threat to competition posed by the concentration.<sup>231</sup> A derogation from the obligation to suspend concentrations is granted only exceptionally; only in 114 mergers, since 1990 to date.<sup>232</sup> For example, in *Macquarie Bank Limited/Crown Castle UK Holdings Limited*<sup>233</sup>, the Commission, based on parties' request, granted a derogation to *Macquarie* from the obligations imposed under the ECMR<sup>234</sup> in accordance with certain terms and conditions until the acquisition has been declared compatible with the common market by means of the Commission's decision.<sup>235</sup> Other derogation related bank merger cases are *Santander/Bradford & Bingley Assets*<sup>236</sup> and *BNP Paribas/Fortis*.<sup>237</sup> In *Santander/Bradford & Bingley*, the Commission received a reasoned request for derogation on the same day that the UK Government received Santander's bid for the assets, indicating the extent of the Commission's ability to proceed quickly and flexibility in times of financial crisis. In *BNP Paribas/Fortis*, prior to the conditional clearance decision, the Commission had granted the parties' request for a derogation to permit BNP Paribas to acquire assets pending the outcome of the Commission's review.<sup>238</sup>

The Commission's decisions on proposed concentrations, including bank mergers, are subject to review by the European Court of Justice ('ECJ').<sup>239</sup>

Of the UK-origin bank mergers adjudicated upon by the Commission in the last decade, all have been authorized.<sup>240</sup> Even in those instances in which the Commission hesitated initially to approve the bank merger(s), on the condition of certain divestures, such merger(s) were eventually approved.<sup>241</sup> For example, in 2015 the Commission approved the bank acquisition of *TSB Banking Group*, a British bank and a spin-off of Lloyds, by *Banco*

<sup>231</sup> *Ibid*, art 7.3.

<sup>232</sup> *Merger Statistics* (n116).

<sup>233</sup> Case No. COMP/M.3450 *Macquarie/MEIF/MCIG/Crown Castle* [2012] published on 03.10.2012 ('Macquarie/Crown Castle').

<sup>234</sup> *ECMR* (n49), arts 6.1(b), 8.2, and 10.6.

<sup>235</sup> *Macquarie/Crown Castle* (n190), para 21.

<sup>236</sup> Case No. COMP/M.5363 *Santander/Bradford & Bingley Assets* [2008] OJ C 7/4.

<sup>237</sup> Case No. COMP/M.5384 *BNP Paribas/Fortis* [2008] OJ C 7/4.

<sup>238</sup> The Commission found that these measures were deemed 'reasonably necessary to safeguard or restore the viability of the Fortis ... and thereby contribute to ensuring financial stability', and, therefore, deserving of a derogation from the normal rules. See *Ibid*.

<sup>239</sup> *ECMR* (n49), arts 21(1), and 16; also, for a discussion of the European Court of Justice, see chapter 4.2.2 in this thesis, pp 85-7.

<sup>240</sup> This finding comes from the author of this thesis, due to an extensive research of the UK bank merger cases before the Commission, during the period from the Global Financial Crisis to date.

<sup>241</sup> *Ibid*.

*de Sabadell, S.A. of Spain*<sup>242</sup> due to successful completion of the divestments commitments from the *Lloyds* following the Commission's 2009 approval of State aid granted to *Lloyds* by the UK.<sup>243</sup>

The foregoing suggests that the Commission adopts a *laissez-faire* attitude towards bank merger regulation. Presently, there is no sign of a change in the competition authority's philosophy. The authority's *laissez-faire* stance could be tested by a surge of future consolidations that may happen due to ongoing relaxation of credit conditions across the markets.

#### Framework and approach to the assessment of State aids in the EU

A multifaceted framework of EU State aid rules is designed to entrust such aid is compatible with the requirements of the Internal Market.<sup>244</sup> The validity of State aid given by Member States is regulated by Articles 107 to 109 TFEU and numerous secondary guidelines and measures.<sup>245</sup>

Any aid authorized by a Member State or through State resources, in any way, is in principle not allowed as discordant with the Internal Market, where it alters or risk to alter competition by advantaging particular undertakings, i.e., banks or the production of given goods; and influences trade between Member States.<sup>246</sup>

In order to be prohibited, an aid must be 'selective',<sup>247</sup> meaning it should influence the balance between the beneficiary institution and its competitors. General measures that apply to all financial institutions in a Member State would not be categorized as aid. Aid must

<sup>242</sup> Case No COMP/M.7597 *Sabadell/TSB* [2015] OJ C 175/01.

<sup>243</sup> Commission, 'State Aid: Commission Approves Restructuring Plan of Lloyds Banking Group' (18 November, 2009) *Press Release IP/09/1728*; also, for a discussion of the takeover of HBOS by Lloyds, see chapter 4.3.2(e) in this thesis, pp110-16.

<sup>244</sup> See the speech given by J Almunia (VP of the Commission in charge of Competition Policy) on the 10<sup>th</sup> Experts' Forum on New Developments in European State aid law, *the State aid Modernisation Initiative*, Brussels, 7 June 2012.

<sup>245</sup> E.g., Communication from the Commission, 'Commission Notice on the notion of State aid as referred to in Article 107(1) TFEU (2016)'; see, also, Communication from the Commission, 'Guidelines on State aid for rescuing and restructuring non-financial undertakings in difficulty' OJ C 249/1 31.7.2014.

<sup>246</sup> TFEU, art 107.

<sup>247</sup> TFEU, art 107(1).

sustain a real or latent impact<sup>248</sup> on trade between Member States, except for in the situation of *de minimis* aid where jurisdictional approach is clearly met.<sup>249</sup>

In the framework laid out in the TFEU and Council regulations made upon Article 109 TFEU, the Commission maintains a crucial position in assessing existing aid and in choosing on plans to give or modify aid.<sup>250</sup>

In relation to banks, the Commission has issued a series of communications adopted during and post GFC.<sup>251</sup> The 2013 Banking Communication<sup>252</sup> and the 2009 Recapitalisation and Impaired Assets Communications<sup>253</sup> tackles state guarantees on liabilities, recapitalisations and asset relief measures. The 2009 Restructuring Communication tackles viability plans or restructuring in the framework of crisis-related State aid granted to banks.<sup>254</sup>

It is not unusual for a Member State to finance certain investments or to make capital contributions to financial institutions, where it holds an interest.<sup>255</sup> These types of transactions concern a transfer of State resources, but may not necessarily concern a selective benefit or ‘net cost’ to, or a burden on, the State in advising that advantage, if the transfer is made on market terms. In this regard, the Commission is required to ascertain whether the State is acting as a private market investor - the so-called ‘private market investor’ test.<sup>256</sup>

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<sup>248</sup> *Ibid.*

<sup>249</sup> Commission, ‘State aid: Commission adopts revised exemption for small aid amounts (de minimis Regulation) Press Release (18 December 2013); see, also, Commission, ‘State aid modernisation (SAM) and its implementation’ (08.05.2012) COM/2012/0209 final.

<sup>250</sup> TFEU, art 109.

<sup>251</sup> *E.g.*, Communication from the Commission on the application, from 1 January 2012, of State aid rules to support measures in favour of banks in the context of the financial crisis’ OJ C 356, 6.12.2011; see, also, Communication from the Commission on the application, after 1 January 2011, of State aid rules to support measures in favour of banks in the context of the financial crisis,, OJ C329, 7.12.2010.

<sup>252</sup> Communication from the Commission on the application, from 1 August 2013, of State aid rules to support measures in favour of banks in the context of the financial crisis (‘Banking Communication’) OJ C 216/1, 30.7.2013.

<sup>253</sup> Communication from the Commission ‘The return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the State aid rules’ OJ C195, 19.8.2009.

<sup>254</sup> *Ibid.*

<sup>255</sup> DG Competition Staff Working Document, ‘The application of State aid rules to government schemes covering bank debt to be issued after 30 June 2011’ (01.06.2011).

<sup>256</sup> Although the ‘private market investor’ test is already applied in quite a number of cases, e.g., WestLB, judgement of 06.03.2003, T-228 & T-233/99, guidance on quite a few issues is still required. In the event that ‘private market investor’ test is passed, funds are considered as a regular market investment that a government happens to give. One main issue in the foregoing test is the proper rate of return (‘reasonable profit’) that serves as a threshold for evaluating its classification.

This approach is criticised for its variation from the classical ‘effects-based’ approach in State aid control through a ‘balancing test’<sup>257</sup> in as much as the meaning behind the issuance of an aid is evidently considered irrelevant in the classical approach.

The Commission’s policy on State aid, during the GFC, evolved from a very lenient approach - prompted by the high economic and political tension of the early days of the GFC - towards a stricter approach as the financial and economic context became more stable. The Commission’s method to increase the toughness of State aid control progressively is based on the publication of soft law instruments stating how it intended to approach the compatibility of aid for banks in different periods of the GFC.<sup>258</sup> This method has been used by the Commission in the past to fill the gap left by the absence of legal (and particularly procedural) instruments, in the field of State aid, as Member States refused to adopt them for many years. The adoption of soft law instruments, together with a permissive interpretation of the rules—essentially accepting all bank-related aid schemes proposed by Member States at the start of the GFC - under exceptional legal basis,<sup>259</sup> was motivated by a desire to avoid direct confrontation with Member States in a difficult economic context, in which it was even proposed, to suspend the application of the State aid discipline altogether.<sup>260</sup> The Commission’s method has attempted to fill a gap in the regulation at EU level concerning banks’ supervision, a regulation that has only been issued during and post GFC.<sup>261</sup> It is accurate to determine that the TFEU bans aids that distort competition. However, it was difficult to find a satisfactory solution, when an emergency, such as the GFC, arises.<sup>262</sup> The Commission responded with a ‘crisis regime’ devised to combine the needs for quick and

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<sup>257</sup> The ‘effects-based approach’ was introduced with the 2005 State Aid Action Plan, State aid action Plan: Less and better targeted State aid: a roadmap for State aid reform 2005-2009, COM(2005) 107 final.

<sup>258</sup> T J Doleys, ‘Managing State aid in a time of crisis: Commission crisis communications and the financial sector bailout’ (2012), *Journal of European Integration* 549.

<sup>259</sup> *TFEU*, art 107(3)(b).

<sup>260</sup> H Ungerer, Deputy Director General of DG Competition with special responsibility for State aids, ‘State aid policy, procedure and enforcement through the economic crisis and beyond business information in a global context’ (2011), available at [http://ec.europa.eu/competition/speeches/text/sp2009\\_11\\_en.pdf](http://ec.europa.eu/competition/speeches/text/sp2009_11_en.pdf).

<sup>261</sup> Council Regulation (EU) No. 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions, and Regulation (EU) No. 1022/2013 of the European Parliament and of the Council of 22 October 2013 amending Regulation (EU) No. 1093/2010 establishing a European Supervisory Authority (European Banking Authority) as regards the conferral of specific tasks on the European Central Bank pursuant to Council Regulation (EU) No. 1024/2013.

<sup>262</sup> H Von der Groeben, *The European Community -The formative years: The struggle to establish the common market and the political union (1958–66)* (Office for Official Publications of the European Communities, 1987), p 215.

flexible State intervention with the safeguard of competition and the avoidance of subsidy races.<sup>263</sup> The Commission, also, pursued a number of regulatory objectives, in addition to the traditional protection of competition and the internal market's integrity. Throughout its enforcement of the State aid rules in the context of the GFC, the Commission tackled issues, i.e., financial stability, or moral hazard.<sup>264</sup>

During the GFC, the Commission adopted a very lax approach with the publication of the Banking Communication 2008,<sup>265</sup> which introduced the new legal basis for compatibility of measures related to the financial sector (TFEU Article 107(3)(b)) that allowed the Commission to treat the financial sector as special, and therefore, to be more flexible and lenient with this sector than with others under the rescue and restructuring compatibility rules, as well as the commitment to approve State aid measures within a short notice, and, in event of doubt, to offer preliminary authorization of them, while continuing to investigate.<sup>266</sup>

During the GFC, the Commission published the Recapitalization Communication<sup>267</sup> that adopted a pragmatic and lax approach towards 'fundamentally sound' banks at the request Member States, while it became stricter *vis-à-vis* distressed banks, imposing conditions for them to obtain compatible State aid that had not been previously demanded of banks in the Banking Communication.<sup>268</sup> The Commission, also, adopted the Impaired Assets

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<sup>263</sup> The crisis regime was based on four communications, namely, the Banking Communication (Communication from the Commission—The application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis [2008] OJ C 270/8), the Recapitalization Communication (Communication on the recapitalization of financial institutions in the current financial crisis: limitation of aid to the minimum necessary and safeguards against undue distortions of competition [2009] OJ C 10/2), the Impaired Assets Communication (Communication on the treatment of impaired assets in the Community banking sector [2009] OJ C 72/1), and the Restructuring Communication (Commission Communication on the return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the State aid rules [2009] OJ C 195/9).

<sup>264</sup> D M B Gerard, *Managing the financial crisis in Europe: The role of EU State aid law enforcement* in M Merola et al (eds) *Competition law at times of economic crisis—In need for adjustment?* (Bruylant, 2013), pp 248–49; see, also, A Andreangeli, 'EU competition law in times of crisis: Between present challenges and a largely unwritten future' (2013) *Competition Law Review* 91, p 103.

<sup>265</sup> Communication on the application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis ('2008 Banking Communication') OJ C 270, 25.10.2008.

<sup>266</sup> *Ibid.*

<sup>267</sup> Communication on the re-capitalisation of financial institutions in the current financial crisis: limitation of aid to the minimum necessary and safeguards against undue distortions of competition ('Re-capitalisation Communication') OJ C 10, 15.1.2009.

<sup>268</sup> *Ibid.*

Communication<sup>269</sup> where it created a balance between accommodating the demands of Member States that wanted to remove toxic assets from the banks' balance sheets, with those of competitors and the financial industry that feared that governments could overvalue the toxic assets, and so confer an unfair advantage to the aided banks.<sup>270</sup>

In 2013, the Commission issued a 'new' communication<sup>271</sup> that replaced the 2008 Banking Communication<sup>272</sup> and supplements the remaining crisis rules. Under the issued communication, Commission further tightens the rules applicable to State aid for the banking sector by, for instance, making the temporary authorizations of recapitalizations exceptional.<sup>273</sup> The 'new' Communication<sup>274</sup> requires banks to work out a restructuring plan, including a capital-raising plan, before they can receive recapitalization measures.

The Commission has emerged, through the application of the State aid rules, as a pragmatic crisis-management and resolution authority that adopted a strategically permissive position at the start of the GFC, when the latter was most needed, and became stricter over time, as the macroeconomic condition became more stable and the political pressure to authorize aid schemes diminished.<sup>275</sup> In the last phase of the GFC, the Commission pursued regulatory objectives past the whole competition preservation in the market and the Internal Market integrity.<sup>276</sup> The Commission found the right balance between preventing significant distortions of competition and allowing national interventions in the absence of a EU framework to deal with such a severe crisis.<sup>277</sup>

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<sup>269</sup> Communication from the Commission on the treatment of impaired assets in the Community financial sector ('Impaired Assets Communication') OJ C 72, 26.3.2009.

<sup>270</sup> *Ibid.*

<sup>271</sup> Communication from the Commission on the application, from 1 January 2013, of State aid rules to support measures in favour of banks in the context of the financial crisis (Banking Communication') OJ 2013/C 216/01, 30.7.2013.

<sup>272</sup> 2008 *Banking Communication* (n265).

<sup>273</sup> *Banking Communication* (n271), art 2.

<sup>274</sup> *Ibid.*, art 3.

<sup>275</sup> J J Piernas Lopez, *The concept of State aid under EU law: From internal market to competition and beyond* (Oxford: Oxford University Press, 2015), pp 224-6.

<sup>276</sup> B Hawk (ed), *Fordham Competition Law Institute* in F Jenny et al *State aids and EU competition law and policy* (2010, New York: Juris Publishing), pp 300-4.

<sup>277</sup> H C H Hofmann et al (eds) *State aid law of the European Union Law* in C Micheau *Evolution of State aid rules: Conceptions, challenges, and outcomes* (2016, Oxford: Oxford University Press), pp 18-35.

The Commission concluded that the financial crisis rules, taken as a whole, resulted in an approach centred on the overall balance of the compatibility conditions, based on a comprehensive assessment of the three pillars of viability, burden sharing, and competition remedies.<sup>278</sup>

The so-called ‘State Aid action plan’ in 2005<sup>279</sup> modernised the State aid control based on less and better targeted State aid, a refined economic approach, more effective procedures and enforcement, greater predictability and transparency, as well as sharing of responsibility between the Commission and the Member States.<sup>280</sup> The foregoing plan set out a vision of simpler, more effective and transparent procedures for State aids that are efficient from an economic perspective.<sup>281</sup> The Commission pursued this approach by introducing several instruments, such as, a ‘new’ *de minimis* Regulation,<sup>282</sup> the general block exemption Regulation (‘GBER’),<sup>283</sup> the introduction of a simplified procedure<sup>284</sup> for the approval of certain types of aid and a Code of Practice<sup>285</sup> for the conduct of State aid control proceedings, notice<sup>286</sup> on the enforcement of State aid law by national courts, and a number of revised guidelines and communications<sup>287</sup> spelling out the State aid rules for specific sectors or objectives of common interest.

A more refined economic approach to State aid has maximizes the benefits of State aid, while minimizing its negative outcomes on competition and the Internal Market.

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<sup>278</sup> Commission communication on the return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the State aid rules, OJ C 195, 19.8.2009 (‘Restructuring Communication’).

<sup>279</sup> State aid action plan – Less and better targeted state aid: A roadmap for state aid reform 2005-2009 (Consultation document) COM (2005) 107 final, 7.6.2005 (‘SAAP’).

<sup>280</sup> *Ibid.*, par III.

<sup>281</sup> *Ibid.*

<sup>282</sup> Commission Regulation (EU) No 1407/2013 of 18 December 2013 on the application of Articles 107 and 108 of the TFEU to *de minimis* aid, OJ L 352/1, 24.12.2013.

<sup>283</sup> Commission Regulation (EU) No 651/2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the TFEU, OJ L 187/1, 26.6.2014.

<sup>284</sup> Commission Notice on a Simplified procedure for the treatment of certain types of State aid, OJ C136, 16.06.2009.

<sup>285</sup> Commission Notice on a Best Practice Code on the conduct of State aid control proceedings, OJ C 136, 16.06.2009.

<sup>286</sup> Notice from the Commission – Towards an effective implementation of Commission decisions ordering Member States to recover unlawful and incompatible State aid, OJ C 272, 15.11.2007; see, also, Commission notice on the enforcement of State aid law by national courts, OJ C 85, 09.04.2009.

<sup>287</sup> For more information, visit [http://ec.europa.eu/competition/state\\_aid/legislation/rules.html](http://ec.europa.eu/competition/state_aid/legislation/rules.html).



Especially, the State Aid Action Plan<sup>288</sup> and the State Aid Modernization Communication<sup>289</sup> look at the notion of market failure and on its importance to justify public intervention, and on the incentive results of the aid. The more economic approach to State aid is implemented through the so-called led ‘balancing test’,<sup>290</sup> which weighs the positive outcomes of the aid against distortions of competition and trade.

Identifying a target of common interest is insufficient for the State aid’s approval, pursuant to TFEU.<sup>291</sup> The Commission’s shift of emphasis to considerations of economic efficiency is reflected in its policy objective of moving from a form-based approach towards a more effects-based approach<sup>292</sup> that shows the economic implications of State aid. The centrepiece of the modernized approach is the adoption of common goals applicable to the assessment of compatibility of all the aid measures conducted by the Commission. These common goals are based on the balancing test,<sup>293</sup> which has three stages. The first stage deems whether the aid is targeted at a ‘well-defined object of common interest’,<sup>294</sup> including efficiency objectives and equity objectives.<sup>295</sup> The second stage deems whether the aid is a ‘well-designed instrument’ with which to transmit the identified objectives.<sup>296</sup> The third stage deems the potential negative consequences of the aid need to be considered and weighed against the positive consequences of achieving the common interest’s objectives.<sup>297</sup> The balancing test uses cost-benefit analysis as a means of identifying the Member State’s aids falling, pursuant to the derogation in TFEU.<sup>298</sup>

### 3.5 Conclusion

In this chapter, a number of different institutional actors play critical roles in maintaining a

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<sup>288</sup> SAAP (n279).

<sup>289</sup> SAM (n249).

<sup>290</sup> In SAAP (n279), the Commission introduced the ‘balancing test’ which is applied to measures that are Stat aid under the meaning of TFEU Article 107(1), and therefore, unlawful, but that might be declared compatible with the Internal Market as being in the common interest under the derogation in TFEU Article 107(3)(c).

<sup>291</sup> TFEU, art 107(3).

<sup>292</sup> SAAP (n279), para 19.

<sup>293</sup> *Ibid*, para 20.

<sup>294</sup> *Ibid*.

<sup>295</sup> *Ibid*.

<sup>296</sup> *Ibid*.

<sup>297</sup> *Ibid*.

<sup>298</sup> TFEU, art 107(3).

competitive environment in the UK banking and finance sector are examined. However, in some instances, these bodies are hampered in the discharge of their functions by competing priorities, such as, the maintenance of broader financial stability or desire to limit interference in markets to the most minimum level. Surveying previous practices and in particular events of the last decade, it is difficult not to suggest that the competition and banking authorities could exercise their responsibilities in more active and effective ways, whilst acknowledging the challenging and constantly circumstances in which they operate.

Where a merger situation affects both EU and UK interests, the Commission is the EU entity responsible for competition oversight. In doing so, the Commission analyses cases with an EU ‘dimension’ against the ECMR. On occasion, Commission decisions have been criticized as including scant reasoning, which is possibly due to the limited time provided to complete investigations and issue decisions. Conversely, the Commission has also been criticized for delay, and issuing decisions at a time when the market has evidently changed from when the merger was initially notified. The Commission has been criticized<sup>299</sup> by many experts of antitrust for reliance upon testimonial evidence of interested parties, focusing on immediate consequences rather than long-term impacts, being toothless in terms of punishments it may impose, and due to the absence of an ability to review decisions on merger situations, which go on to produce unanticipated negative competition consequences. Taking inspiration from the equivalent US regulatory provision,<sup>300</sup> the ability of the Commission to seek treble damages from delinquent parties would constitute an effective deterrent. Additional improvements to Commission’s discharge of its role would be the betterment of evidentiary standards and the ability to reconsider competition based merger determinations that turn out to be erroneous. In common with the CMA and its predecessors, the Commission has an unblemished record in approving bank mergers, which may, in due course, be tested when faced with future market consolidations.

As can be seen, there are both structural and result related similarities between the UK national and EU mechanisms for reviewing competition concerns associated with bank

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<sup>299</sup> J Saurer, ‘The Accountability of Supranational Administration: The Case of European Union Agencies’ (2009) 24 *American University International Law Review* 429, pp 434-442.

<sup>300</sup> Commission, ‘Green Paper on Damages Actions for Breach of EC Treaty Anti-Trust Rules – FAQs’ (20 December, 2005) *European Commission MEMO/05/489*, available at [http://europa.eu/rapid/press-release\\_MEMO-05-489\\_en.htm?locale=en](http://europa.eu/rapid/press-release_MEMO-05-489_en.htm?locale=en).

mergers. In both cases, there is considerable room for improvement, as the present author has identified. In practical terms, the systems could better synergize in cases that give rise to issues that can properly be divided and addressed in tandem, in a way that makes logical sense without unnecessarily duplicating work.

In relation to the UK Government's framework and approach to the assessment of State aid, the latter is an advantage provided by the UK Government to undertakings i.e., banks, in particular situations that could likely thwart competition and affect trade in the EU. The State aid definition is satisfied, if four characteristics of the so-called 'the four tests' are present for assistance to be defined as State aid. Such characteristics are that the assistance is granted by the UK Government or through its resources; the assistance favours certain undertakings, i.e., banks, or the production of certain goods; the assistance distorts or threatens to distort competition; and the assistance affects trade between Member States.

Although Article 107(1) regulates general prohibition on State aid, the TFEU provides exceptions, where aid is or may be considered compatible with the common market. Generally speaking, exemptions are divided in (i) State aid that is considered automatically permissible, that is compatible with the EU Treaty; and (ii) State aid that requires approval of the Commission.

The UK Government aims at taking a 'risk-based' approach to decision-making that both abides by legal obligations and centres on target delivery. In other words, State aid decisions ought to be based on what is 'credible' instead of what necessarily is 'cast-iron'. Nevertheless, the Government is responsible to ensure that it comprehends and deems the effect and prospect of State aid risk concerned and, especially, the degree where any risk would be assumed by business rather than or in addition to the Government and warrant the degree of risk is one that business and the Government can tolerate. The Government has issued provisions that outline a risk-based approach to decision-making in State aid cases. These provisions are aimed at assisting those concerned in each stage of the process, from planning a measure to its actual implementation, and it applies to State aid providers throughout the Government.

While presenting a measure, it is significant to count the prospect of a State aid challenge. An affected competitor or individual may launch a complaint to a UK court or the Commission, or the latter may be urged by a Member State's policy declarations or actively scrutinise areas of specific interest.

In reference to the framework and approach to the assessment of State aids in the EU, a multifaceted framework of EU State aid rules is designed to entrust such aid is compatible with the requirements of the Internal Market. The validity of State aid given by Member States is regulated by Articles 107 to 109 TFEU and numerous secondary guidelines and measures.

Any aid authorized by a Member State or through State resources, in any way, is in principle not allowed as discordant with the Internal Market, where it alters or risk to alter competition by advantaging particular undertakings, i.e., banks or the production of given goods; and influences trade between Member States.

The Commission's policy on State aid, during the GFC, evolved from a very lenient approach - prompted by the high economic and political tension of the early days of the GFC - towards a stricter approach as the financial and economic context became more stable. The Commission's method to increase the toughness of State aid control progressively is based on the publication of soft law instruments stating how it intended to approach the compatibility of aid for banks in different periods of the GFC. This method has been used by the Commission in the past to fill the gap left by the absence of legal (and particularly procedural) instruments, in the field of State aid, as Member States refused to adopt them for many years. The adoption of soft law instruments, together with a permissive interpretation of the rules—essentially accepting all bank-related aid schemes proposed by Member States at the start of the GFC - under exceptional legal basis, was motivated by a desire to avoid direct confrontation with Member States in a difficult economic context, in which it was even proposed, to suspend the application of the State aid discipline altogether. The Commission's method has attempted to fill a gap in the regulation at EU level concerning banks' supervision, a regulation that has only were issued during and post GFC. It is accurate to determine that the TFEU bans aids that distort competition. However, it was difficult to find a

satisfactory solution, when an emergency, such as the GFC, arises. The Commission responded with a ‘crisis regime’ devised to combine the needs for quick and flexible State intervention with the safeguard of competition and the avoidance of subsidy races. The Commission, also, pursued a number of regulatory objectives, in addition to the traditional protection of competition and the internal market’s integrity. Throughout its enforcement of the State aid rules in the context of the GFC, the Commission tackled issues, i.e., financial stability, or moral hazard.

By stating that it wants to base the analysis of compatibility of an aid on a review of its costs and benefits, the Commission has taken a clear step in the direction of a more coherent economic effects-based approach to State aid control. The Commission’s current modernization initiative and the further revision of the guidelines, may move the State aid assessment closer to the more economic approach envisioned by the Commission, leading to decisions that are substantially more grounded in the financial and economic analysis of effects than in the past. There is obviously a conceptual framework, which identifies several substantive points that require to be established, where financial and economic analysis can render the most credible evidence.

During the GFC, the Commission managed to assist Member States avert a banking meltdown, and to avert significant distortions of competition in the Internal Market, while sustaining the State aid rules in place. The Commission’s central position was substantially reinforced by the Member States’ realization that traditional national protectionist policies could be extremely dangerous in the present level of economic integration.

## CHAPTER 4 - ROLE OF UNITED KINGDOM'S COURTS AND GOVERNMENT IN BANK MERGER REVIEWS

This chapter discusses the role of the UK and EU courts, as well as the contribution of the UK Government and the Commission in the enhancement of the bank mergers' review process in the UK.

### 4.0 Courts and competition authorities - review of bank mergers

Courts in the UK and the EU play an important role in the interpretation and enforcement of competition laws in the bank merger cases in relation to UK and non-UK banks merging, or wishing to merge in the UK. The UK court authorized to review bank merger cases is the Competition Appeal Tribunal.<sup>1</sup> At the EU level, the judicial courts authorized to review bank mergers are the General Court (lower court) and the Court of Justice (upper court).<sup>2</sup>

The UK Government and the EU competition authority, also, play a similar important role in the bank merger review process. The Secretary of State for Business, Innovation and Skills is authorized to intervene on behalf of the UK Government, under special situations, in a bank merger review. And the Commission has the power,<sup>3</sup> on behalf of the EU, to review bank mergers (concentration) with the Community dimension.

### 4.1 UK courts and the Competition Appeal Tribunal ('CAT')

The Competition Appeal Tribunal ('CAT') was created in April, 2003,<sup>4</sup> succeeding the Competition Commission Appeal Tribunal, which was created by the Competition Act 1998.<sup>5</sup> Bank merger cases are heard at the Tribunal by a three-judge panel. The Tribunal adopts the same principles that a court would use in adjudicating a merger application for review.<sup>6</sup> It

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<sup>1</sup> Competition Appeal Tribunal, available at <http://www.catribunal.org.uk/>.

<sup>2</sup> General Court, available at [http://curia.europa.eu/jcms/jcms/Jo2\\_7033/](http://curia.europa.eu/jcms/jcms/Jo2_7033/); Court of Justice, available at [http://europa.eu/about-eu/institutions-bodies/court-justice/index\\_en.htm](http://europa.eu/about-eu/institutions-bodies/court-justice/index_en.htm).

<sup>3</sup> Council Regulation (EC) No 139/2004 of 20 January, 2004 on the control of concentrations between undertakings, *OJ L 24/1*, 29 January, 2004 ('ECMR'), art 1(2).

<sup>4</sup> Enterprise Act 2002, c. 40 ('EA02'), s 12; Sched 2.

<sup>5</sup> Competition Act 1998, c. 41 ('CA98'), s 48; Sched 8.

<sup>6</sup> EA02 (n4), s 120.4.

would not be able to substitute these principles with its own views on the merits of the case.<sup>7</sup> Rather, it must examine the lawfulness, rationality and objectivity of the relevant decisions and, if required, it may demand the Competition and Markets Authority ('CMA') or request the Secretary of State for Business, Innovation and Skills ('SoS'), depending on which authority is responsible to authorize the particular merger case at hand, to reconsider the case.<sup>8</sup>

The banks concerned may appeal the Tribunal's decision to the Court of Appeal in England, Wales or Northern Ireland, or to the Court of Session in Scotland, depending on the subject jurisdiction of the bank merger and the merging parties.<sup>9</sup>

The Court of Appeal has acknowledged that the CAT is 'an expert and specialist tribunal, specifically constituted by Parliament to make judgments in an area of law in which judges have no expertise'.<sup>10</sup> Thus, it falls under the category recognized by the court in *Cooke v Secretary of State for Social Security*<sup>11</sup> as a special body whose judgments the Court of Appeal remains hesitant to interfere with. This may be one of the reasons that bank merger reviews by the judiciary in the UK have been dealt almost exclusively by the specialized competition tribunals rather than other courts.<sup>12</sup>

The CAT continues to contribute to the development of the review of merger law. Reviews by the judiciary, heard by the CAT, have seen an enhanced process of collecting evidence and a higher degree of transparency of the bank merger review process.<sup>13</sup> Under the former UK regime of review by the judiciary, competition regulators succeeded in all cases because, to a certain extent, courts would defer the decision to competition and banking

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<sup>7</sup> *Ibid*, s 15.4; see, also, [2001] EWCA Civ 1916, [2002] 1 WLR 2120, para 41.

<sup>8</sup> EA02 (n4), s 120.5; see, also, C Clarke, 'The UK Competition Regime; Recent Changes and Future Challenges' (December, 2004) *Japanese Fair Trade Commission Seminar*, available at [www.jftc.go.jp/cprc/koukai/seminar/h16/02\\_2-report.files/koenku.pdf](http://www.jftc.go.jp/cprc/koukai/seminar/h16/02_2-report.files/koenku.pdf).

<sup>9</sup> EA02 (n4), s 120.6.

<sup>10</sup> *Napp Pharmaceutical Holdings Ltd v The Director General of Fair Trading* [2002] EWCA Civ 796, [2002] UKCLR 726, para 34, *per* Buxton LJ.

<sup>11</sup> [2001] EWCA Civ 734, [2002] 3 All ER 279, para 38.

<sup>12</sup> This finding is based on the author of this thesis' extensive case law research.

<sup>13</sup> K Middleton et al, *Cases & Materials on UK & EC Competition Law* (2nd edn, New York: Oxford University Press 2009), pp 81-3.

regulatory agencies. However, the CAT does not appear to demonstrate any sign of deference.<sup>14</sup>

However, a review of the CAT's role in shaping the bank mergers in the UK and other competition aspects in banking business would reveal a number of shortcomings. It has almost no experience in handling bank merger cases. Since its inception, the CAT appears to have decided one bank merger case,<sup>15</sup> and a very few others that indirectly affect competition aspects in banking operations in the market. This may have been a result of several factors, such as, the efforts by the competition authorities and bank merger parties to resolve their concerns at the merger examination level, or a more compromised or relaxed approach by the competition authorities in approving bank merger notifications. Regardless of the reasons, nevertheless, the CAT deserves more time to consolidate its role and position in enhancing competition aspects in bank merger cases. Whether CAT will be able to step up to the expectations is yet to be seen.

## 4.2 EU courts

The Commission's decisions are conditioned upon legal review by the Court of Justice of the European Union ('ECJ') that is the judicial institution of the European Union.<sup>16</sup> The Treaty on the Functioning of the European Union ('TFEU') provides the ECJ with the authority to review bank merger decisions made by the Commission.<sup>17</sup> The Court is made up of three courts: (i) the General Court,<sup>18</sup> the Court of Justice,<sup>19</sup> and the Civil Service Tribunal.<sup>20</sup> Their

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<sup>14</sup> C Graham, 'The Enterprise Act 2002 and Competition Law' (2004) 67 *The Modern Law Review* 273, pp 273-88.

<sup>15</sup> For a discussion of the appeal of the HBOS takeover by Lloyds before the Competition Appeal Tribunal ('CAT') in 2008, see chapter 4.3.1(a) in this thesis, pp 88-94.

<sup>16</sup> Treaty on the Functioning of the European Union (Consolidated version 2012) *OJ C 326/01 P. 0001-0390* ('TFEU'), art 263; For more information about the role of the ECJ, see 'European Union: Court of Justice of the European Union', available at see [http://curia.europa.eu/jcms/jcms/Jo2\\_7024/#jurisprudences](http://curia.europa.eu/jcms/jcms/Jo2_7024/#jurisprudences).

<sup>17</sup> *TFEU* (n16), art 263, that states that '[t]he Court of Justice ... shall review the legality of legislative acts ... intended to produce legal effects *vis-à-vis* third parties'; see, also, C Kerse and N Khan, *EU Antitrust Procedure* (6th edn, London: Sweet & Maxwell 2012), pp 41-2.

<sup>18</sup> Treaty on European Union (Consolidated version 2012) *OJ C 326/01, P. 0001 – 0390* ('TEU'), arts 19(1) and 19(2); see generally, Statute of the Court of Justice of the European Union (Consolidated version 2015), as amended by Regulation (EU, Euratom) No 741/2012 of the European Parliament and of the Council of 11 August, 2012 (OJ L 228, 23.8.2012, p 1), by Article 9 of the act concerning the conditions of accession to the European Union of the Republic of Croatia and the adjustments to the Treaty on European Union, the Treaty on the Functioning of the European Union and the Treaty establishing the European Atomic Energy Community



primary role is to examine the legality of the EU measures and ensure the uniform interpretation and application of EU law.

Set out, below, is a discussion of the role of the General Court, and the European Court of Justice, respectively, in reviewing the competition aspects related to bank merger cases.<sup>21</sup>

#### 4.2.1 General Court

The General Court is composed of at least one judge from each Member State. Presently, the Court is composed of forty judges, a number, which is expected to increase gradually to fifty-six in 2019.<sup>22</sup> The judges are nominated by joint agreement among the governments of the Member States, upon prior consultation.<sup>23</sup>

The General Court has jurisdiction to hear and rule on actions commenced by any party of interest (*i.e.*, merging banks) to annul the decisions or declare a failure to act by the institutions, bodies, agencies, or offices of the EU.<sup>24</sup>

It, also, has jurisdiction over actions initiated by the EU Member States against the Commission, the Council of the EU concerning undertakings adopted on State aid,<sup>25</sup> and actions by any party of interest (*i.e.*, merging banks) demanding compensation for damage caused by any EU institution, bodies, agencies, or offices<sup>26</sup> or relating to contracts made by the EU where the parties agreed to submit jurisdiction to the General Court.<sup>27</sup>

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(*OJ L 112*, 24.4.2012, p 21) and by Regulation (EU, Euratom) 2015/2422 of the European Parliament and of the Council of 16 December, 2015 (*OJ L 341*, 24.12.2015, p 14) ('Statute').

<sup>19</sup> *TEU* (n18), arts 19.1, and 19.3; see, also, generally, *Statute* (n18).

<sup>20</sup> *TFEU* (n16), art 257; see, also, *Statute* (n18), Annex I, arts 1-13

<sup>21</sup> The role of the Civil Service Tribunal is outside the scope of this thesis; therefore, it is not discussed in this thesis.

<sup>22</sup> *Statute* (n18), art 48. 7 more judges will be added to the Court when the Civil Service Tribunal is dissolved in September, 2016, then another 9 judges will be added to the Court, to total 56 judges by 2019.

<sup>23</sup> *TEU* (n18), art 19.2; *TFEU* (n16), arts 253, and 254.

<sup>24</sup> *TFEU* (n16), art 256.

<sup>25</sup> *Ibid*, art 263.

<sup>26</sup> *Ibid*, arts 268, and 340.2.

<sup>27</sup> *Ibid*, art 340.1.

Moreover, it has jurisdiction over cases concerning the scope of the application of EU competition provisions, cartels, abuse of a dominant position, merger cases where the Court may decide whether the merger is compatible with the common market on the basis that it would rise to a dominant position, the compatibility of State aid with the common market, and related areas.

Unlike the courts of appeal in the US, the General Court does not look at the records on appeal.<sup>28</sup> Nevertheless, the court may demand documents production, call and probe experts and witnesses, and direct additional inquiries.<sup>29</sup> After the General Court renders a ruling, the parties can appeal its decision to the European Court of Justice in a period of two months from the ordered decision.<sup>30</sup> The appeal, when launched, must be based on an issue of law and not of fact.<sup>31</sup>

#### 4.2.2 European Court of Justice

The Court of Justice is composed of 28 Judges<sup>32</sup> and eleven Advocates General.<sup>33</sup> The Court has jurisdiction over references for preliminary rulings<sup>34</sup> and other types of proceedings<sup>35</sup>. To ensure the consistent interpretation and application of EU legislation, national courts may submit to the Court of Justice and request the latter to interpret the EU law in question, so that they may establish whether their national legislation is compliant.<sup>36</sup> The actions for failure to meet obligations may also be commenced, allowing the Court to decide whether a Member State has satisfied its obligations under EU law.<sup>37</sup>

The Court of Justice has a shared jurisdiction with the General Court over actions for

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<sup>28</sup> *Ibid*, arts 278, and 279; see, also, *Statute* (n18), art 60.

<sup>29</sup> *Statute* (n18), art 54.

<sup>30</sup> *TFEU* (n16), art 256.1; see, also, *Statute* (n18), art 56.

<sup>31</sup> *TFEU* (n16), arts 278, 279, and 299(4); see, also, *Statute* (n18), art 58.

<sup>32</sup> *TEU* (n18), art 19.

<sup>33</sup> *TFEU* (n16), art 252.

<sup>34</sup> *Ibid*, art 267. Under the preliminary ruling procedure, the Court can interpret and review validity of acts issued by the EU agencies and offices upon the request of national courts. This would enable the national courts to ascertain if their national legislation is in compliance with the EU laws.

<sup>35</sup> Other proceedings from the Court could be for example, under the *TFEU* (n16), arts 260 (actions brought by the Commission or a Member State against another Member State for failure to fulfil obligations under the EU law), and 263 (conditions for the admissibility of actions brought by individuals)

<sup>36</sup> *TFEU* (n16), art 267.

<sup>37</sup> *Ibid*, arts 258-260.

failure to act, involving the review of the lawfulness of the failure of EU institutions, bodies, agencies, or offices to act.<sup>38</sup> An applicant may also request the Court to annul a measure taken by the same. It has exclusive jurisdiction on actions commenced by a Member State against the European Parliament and/or the Council of the EU, or by one EU institution against another.<sup>39</sup>

Appeals on issues of law can only be filed before the Court of Justice against orders and judgments of the General Court.<sup>40</sup> If the appeal is admissible and justifiable, the Court may stay the judgment or order of the General Court. The Court may decide the case in appropriate circumstances. Otherwise, it remits the case to the General Court, which is bound by the decision of the Court of Justice.<sup>41</sup>

The grounds<sup>42</sup> allowing a party to succeed in an appeal against a decision of the Commission are narrow in scope.

Where the Court of Justice holds that the Commission has contravened the law, it annuls the measures contrary to EU law<sup>43</sup> or it rules against the Commission for failure to act<sup>44</sup>. The Court does not replace the decision of the Commission with its own judgment.<sup>45</sup> Alternatively, the Court may specify issues in which the Commission erred. It may demand the Commission to proceed with the appropriate procedure, application, or law.<sup>46</sup> The Commission must follow the Court's ruling.<sup>47</sup> The Court may also hear appeals relating to the

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<sup>38</sup> *Ibid*, arts 257, and 267.

<sup>39</sup> *Ibid*, art 263.

<sup>40</sup> *Ibid*, art 256.

<sup>41</sup> *Statute* (n18), art 61.

<sup>42</sup> See, for example, the Court of Justice's opinion in ECLI:E:C:2014:42 Case No C-382/12 P *Mastercard and Others v Commission* (2014) ECLI:E:C:2014, where it discusses grounds for appellant's appeal, p 8. Cases where the applicant seeks the annulment of a measure supposedly contrary to EU law (annulment: *TFEU* (n16), art 263) or, in cases of infringement of EU law, where an institution, body, office or agency has failed to act (*TFEU* (n16), art 265).

<sup>43</sup> *TFEU* (n16), art 263.

<sup>44</sup> *Ibid*, art 265.

<sup>45</sup> Case T-11/95 *IECC v Commission* [1998] ECR II-3605, para 33; This case was appealed before the ECJ in *IECC v Commission* (C-449/98 P) [2001] ECR I-3875.

<sup>46</sup> *TFEU* (n16), art 264.

<sup>47</sup> *Ibid*, art 266.

Commission's interpretation of the establishment of a dominant position concerning a submitted bank merger.<sup>48</sup>

The Court of Justice has played an active role in shaping the examination aspects of bank mergers in compliance with the EU provisions. Some of the relevant bank merger case-laws brought before the Court will be discussed in chapter 4.4 of this thesis.

### **4.3. Bank mergers before the UK courts and government**

In this section, several important bank merger reviews before the UK judiciary will be outlined. In addition, there are some significant bank mergers that were reviewed, and then approved by the UK Government in coordination with the competition authority. In the context of UK court bank merger case law analysis, several important bank merger case laws before the EU courts that influenced the competition aspects of bank merger policies in the UK will be examined.

#### **4.3.1 Case laws related to competition aspects in banking and bank mergers before UK courts and tribunals**

Set out, below, is a discussion of four important cases dealing with competition aspects in banking and bank mergers before the UK courts and tribunals.

Issues put before the courts and tribunals in the discussed cases are whether competition implementation should be sidestepped in the name of the financial stability preservation; whether certain banking products and/or services issued from large financial institutions can distort competition.

##### **4.3.1(a) The Merger Action Group v Secretary for Business, Enterprises and Regulatory Reform**

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<sup>48</sup> For example, see Case No. COMP/M.3894 *UniCredito/HVB* [2005] OJ C 278/17, in which Poland filed a complaint in the European Court of Justice challenging the Commission's approval of *UniCredito/HVB* merger, based on dominant position in the Polish market. For a detailed discussion of this case, see chapter 4.4.2(d) in this thesis, pp 127-9.

The most relevant bank merger review cases before the Competition Appeal Tribunal ('CAT') to date<sup>49</sup> is the *Merger Action Group v Secretary for Business, Enterprise and Regulatory Reform* case in late 2008.<sup>50</sup> This was not *per se* a bank merger review case involving merging banks and the authorities. Rather, this involved interested parties against the UK Government challenging the Halifax Bank of Scotland (HBOS) takeover by Lloyds Banking Group (Lloyds).<sup>51</sup>

The case involved a group of individuals and businesses mostly from Scotland, who opposed a decision by the then Secretary for Business, Enterprise and Regulatory Reform Secretary, presently, renamed as the Secretary of State for Business, Innovation and Skills, ('SoS') not to refer to the then Competition Commission ('CC') the takeover of HBOS by Lloyds, pursuant to s 45 of the EA02, on 31 October, 2008 (the 'Decision').<sup>52</sup>

The SoS' decision indicated that the new public interest consideration, namely the stability of the UK financial system, is relevant to the takeover situation.<sup>53</sup> Based on the 'substantial lessening of competition' ('SLC') and the public interest consideration, the SoS determined that the formation of the relevant takeover situation was not envisaged to function against the public interest.<sup>54</sup> The SoS deemed that the takeover would result in important advantages to public interest because it pertained to safeguarding the stability of the financial system in the country and that these advantages offset the potential anti-competitive

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<sup>49</sup> According to the author of this thesis' extensive research, the CAT has reviewed a limited number of bank merger cases. The most relevant cases are those discussed in subchapter 4.3.1 of this thesis; see also Competition Appeal Tribunal, Rules 2015 S.I. 1648, available at [http://www.catribunal.org.uk/files/The\\_Compensation\\_Appeal\\_Tribunal\\_Rules\\_2015.pdf](http://www.catribunal.org.uk/files/The_Compensation_Appeal_Tribunal_Rules_2015.pdf); For a guide to proceedings as to how a case starts and is conducted before the Competition Appeal Tribunal, see Competition Appeal Tribunal Guide to Proceedings 2015, available at [http://www.catribunal.org.uk/files/Guide\\_to\\_proceedings\\_2015.pdf](http://www.catribunal.org.uk/files/Guide_to_proceedings_2015.pdf).

<sup>50</sup> Case No 1107/4/10/08 *Merger Action Group v SoS for Business, Enterprise and Regulatory Reform* [2008] CAT 36 ('MAG v SoS').

<sup>51</sup> MAG v SoS (n158), Summary of Application under S 120 of the EA02 ('Summary of application'), p 1.

<sup>52</sup> For more discussion of the CAT's decision, go to [www.berr.gov.uk/files/file48745.pdf](http://www.berr.gov.uk/files/file48745.pdf) ('Decision').

<sup>53</sup> *Ibid*, paras 8, 11, and 12.

<sup>54</sup> *Ibid*, paras 5, 10, 12, and 14-15.

consequences addressed by the Office of Fair Trading ('OFT').<sup>55</sup> In the end, considering the foregoing arguments, the SoS did not refer the case to the CC.<sup>56</sup>

The group of applicants ('Applicant') claimed that they were aggrieved<sup>57</sup> by the SoS' decision, thus, giving them standing to support the present application with the Tribunal.<sup>58</sup> The Applicant claimed that the takeover should have been sent on to the CC pursuant to the OFT's findings.<sup>59</sup> Alternatively, it argued that the addition of the public interest consideration into the relevant legislation was an attempt to eschew the otherwise functional legal standard.<sup>60</sup> Rather than complying with the legal standard in place when the bank takeover was reported, the SoS relied on a new standard that was implemented to avoid complying with the otherwise functional criteria. The SoS, thereafter, used its discretion, as argued by the Applicant, to arbitrarily and unreasonably refused to refer the bank takeover to the CC without having regard to the prevailing conditions predominant and the OFT's analysis.<sup>61</sup>

In the end, the Applicant requested the CAT to issue an order revoking the SoS's decision,<sup>62</sup> based on the power bestowed by the Enterprise Act 2002 ('EA02')<sup>63</sup>, an order referring to the recommendations made by the OFT in its report to the SoS, including the recommendation that the SoS should refer the takeover to the CC for review, and an order that the SoS fetch the proceedings' costs containing the Applicant's costs.<sup>64</sup>

The Tribunal ordered that the case be considered as a proceeding in Scotland.<sup>65</sup> It took into account statements made by government officials for supporting the bank takeover as their best option both to salvage HBOS and to guarantee the stability of the financial system in the UK, which was at that time believed to be on the verge of collapse. The Tribunal

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<sup>55</sup> Office of Fair Trading, 'Anticipated Acquisition by Lloyds TSB plc of HBOS Plc' Report under s 44 of the EA02' (24 October, 2008) (the 'OFT Report'), available at [www.offt.gov.uk/shared\\_offt/press\\_release\\_attachments/LLoydstsb.pdf](http://www.offt.gov.uk/shared_offt/press_release_attachments/LLoydstsb.pdf); see also *Decision* (n52), para 7.

<sup>56</sup> *Decision* (n52), para 12.

<sup>57</sup> *Summary of application* (n51), p 2.

<sup>58</sup> *Ibid.*

<sup>59</sup> *Ibid.*, pp 1, and 2.

<sup>60</sup> *Ibid.*, pp 2, and 3.

<sup>61</sup> *Ibid.*

<sup>62</sup> *Ibid.*, p 3.

<sup>63</sup> *Ibid.*

<sup>64</sup> *Ibid.*

<sup>65</sup> *MAG v SoS* (n50), Judgment from the Honourable Mr Justice Barling dated 3 December, 2008, p 2.

found<sup>66</sup> that the UK Government was forthright in acting on its stance over the takeover, and its belief that the changes in legislation were required for the clearance of the takeover without the uncertainties and delays created due to a reference to the CC.<sup>67</sup> The government evidently devoted itself to effect such legislative amendments, which included a maintaining ‘financial stability’ factor to the prevailing distinctive public interest.<sup>68</sup> The UK Government committed to this inclusion due to the fact that it desired to accelerate the takeover.<sup>69</sup>

The Tribunal found<sup>70</sup> that the OFT’s findings did not render the information provided by the OFT any less useful, nor was there any indication that the SoS failed to give appropriate weight to the findings. The Tribunal found it difficult to comprehend any benefits that would arise for distorting the views of the OFT and the Financial Services Authority when the SoS was making a decision on the matter.<sup>71</sup> In the Tribunal’s opinion, it was also not the SoS’s intention do so.<sup>72</sup>

The Tribunal did not find any merit in the argument that the SoS sought the Financial Services Authority, rather than the OFT, for competition analysis. It indicated<sup>73</sup> that the SoS did no more than requesting submissions from the OFT, a regulator under a statutory duty to obtain submissions from third parties during its inquiries, and raising the public interest factor.<sup>74</sup> The Financial Services Authority’s submissions related to the issue of sustaining the stability of the financial system, which was the precise issue addressed in the SoS’s decision; this issue was not within the scope of the OFT.<sup>75</sup> The Tribunal did not find anything in the SoS’s decision to suggest that the SoS considered the OFT’s findings on competition as binding, or that the Financial Services Authority’s submission as diminishing the credibility or importance of the OFT’s findings.<sup>76</sup>

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<sup>66</sup> *Ibid*, p 1.

<sup>67</sup> *Ibid*, pp 1, and 2.

<sup>68</sup> EA02 (n4) (Specification of Additional Section 58 Consideration) Order 2008 (S.I. 2008 No 2645), s 58(2D); see, also, *MAG v SoS* (n50), Judgment of 10 December, 2008 [2008] CAT 36 (‘Judgement of 10.12.2008’), paras 21, and 22.

<sup>69</sup> *Judgement of 10.12.2008* (n68), paras 29, and 30.

<sup>70</sup> *Ibid*, paras 24-28.

<sup>71</sup> *Ibid*, paras 74, and 80-82.

<sup>72</sup> *Ibid*.

<sup>73</sup> *Ibid*, paras 57, and 83.

<sup>74</sup> *Ibid*.

<sup>75</sup> *Ibid*, paras 83, and 84.

<sup>76</sup> *Ibid*, paras 85, and 87.

In relation to the Applicant's argument over the consequence of the State aid provisions of the TFEU to a financial institution that was in acceptance of aid, the Tribunal found it a 'hopeless point'.<sup>77</sup> The Tribunal concluded that it did not in any way restrain the SoS's decision.<sup>78</sup> The Tribunal did not see any oversight of the law by the Financial Services Authority. Even if there was an oversight, it did not affect the validity of the SoS's decision of giving effect to the opinion of the Financial Services Authority rather than the OFT decision.<sup>79</sup>

The Tribunal found<sup>80</sup> no merit in the argument that the SoS's discretion was restricted by the statements of the UK Government, and, thus, should be revoked. It also addressed the claim that the SoS ignored or put insufficient focus on the accessibility of the UK Government's financial relief for banks, which was, in the Applicant's submissions, a genuine alternative to the merger for salvaging HBOS.<sup>81</sup> The Applicant claimed that the SoS's did not pay sufficient attention to alternative options of tackling the HBOS issue.<sup>82</sup> The Applicant claimed that the SoS also paid too much emphasis on the takeover and the Financial Services Authority's opinion concerning the HBOS's ability to become an effective standalone competitor should the takeover did not occur, rather than the legally binding recommendations of the OFT.<sup>83</sup> The Applicant contended that an alternative option was the recapitalization scheme declared by the UK Government in late 2008.<sup>84</sup>

However, the Tribunal found<sup>85</sup> no sufficient evidence to conclude that the SoS failed to fully and adequately consider the necessity of the takeover in light of alternative options. The necessity of the takeover, taking into account the UK Government financial relief package, was previously raised by the SoS in the UK parliamentary sessions.<sup>86</sup> The SoS obtained comments from interested groups. In particular, jointly, the Bank of England, the

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<sup>77</sup> *Ibid*, para 86.

<sup>78</sup> *Ibid*.

<sup>79</sup> *Ibid*, para 87.

<sup>80</sup> *Ibid*, para 89.

<sup>81</sup> *Ibid*.

<sup>82</sup> *Ibid*, para 89

<sup>83</sup> *Ibid*, para 90.

<sup>84</sup> *Ibid*.

<sup>85</sup> *Ibid*, para 91.

<sup>86</sup> *Ibid*.



HM Treasury, and the Financial Services Authority strongly maintained that the recapitalization programme was complementary rather than a standalone option in favor of the takeover.<sup>87</sup> The matter was also considered in various written statements issued by the office of the SoS.<sup>88</sup>

Moreover, the Tribunal did not find<sup>89</sup> any substance in the assertion that the SoS erroneously placing the opinion of the Financial Services Authority on the competitive soundness of HBOS over the recommendations of the OFT, or that the SoS failed to consider the EU Commission's standing on State aid. The Tribunal found that these arguments were either irrational or lacked relevant reflections.<sup>90</sup>

As to the argument that the decision of the SoS violated the proportionality principle under EU law, the Tribunal did not address it as the Applicant abandoned the issue during the proceedings.<sup>91</sup>

The Tribunal unanimously ruled that the Applicant were 'persons aggrieved' within relevant legislation,<sup>92</sup> but dismissed the action for the aforementioned reasons,<sup>93</sup> and awarded some costs to the SoS.<sup>94</sup> The Applicant decided on the day following the handing down of the Tribunal's decision not to appeal the Tribunal's decision to the Court of Session.<sup>95</sup>

From the above case, it is clear that the UK Government, along with the regulators, sidestepped the competition issues posed in the takeover of HBOS by Lloyds, in the name of the financial stability preservation. The precedent established in this case is a step backward towards the enhancement of competition enforcement provisions in the banking and financial system.

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<sup>87</sup> *Ibid*, para 90.

<sup>88</sup> *Ibid*.

<sup>89</sup> *Ibid*, para 91.

<sup>90</sup> *Ibid*.

<sup>91</sup> *Ibid*.

<sup>92</sup> *Ibid*, paras 88, and 93(a).

<sup>93</sup> *Ibid*, para 93(b).

<sup>94</sup> *MAG v SoS* (n50), Judgement (Expense) [2009] CAT 19.

<sup>95</sup> S Stefanini, 'Group Drops Legal Fight against Lloyds-HBOS Merger' (11 December, 2008), available at [www.law360.com/articles/79892/group-drops-legal-fight-against-lloyds-hbos-merger](http://www.law360.com/articles/79892/group-drops-legal-fight-against-lloyds-hbos-merger).

#### 4.3.1(b) Barclays Bank Plc v Competition Commission<sup>96</sup>

In 2009, Barclays bank brought an application against the Competition Commission ('CC') before the Competition Appeal Tribunal ('CAT') for a review under the Enterprise Act 2002 ('EA02') regarding particular recommendations made by the CC, including a 2009 report of the Commission named, 'Market Investigation into Payment Protection Insurance'.<sup>97</sup>

Barclays' application contained four grounds of challenge, three of them related to the CC's remedial determination containing a prohibition on the sale of payment protection insurance at the point of sale of the related credit (the 'point of sale prohibition'). In particular, Barclays asserted that the CC failed to consider aspects that are pertinent to the proportionality of the point of sale prohibition.<sup>98</sup> Barclays also contended that the CC did not have the suitable evidential foundation for concluding that the point of sale prohibition was justified. Finally, Barclays asserted that the CC failed to include pertinent considerations in its review of the degree of the consumer disadvantage resulting from the known adverse consequence on competition and whether the advantages of its intervention would offset the loss of the pertinent consumer advantages.<sup>99</sup>

Barclays' fourth basis of challenge related to the CC's review of the relevant market(s) and the degree of the competition concerns that prevailed in the relevant market(s). Barclays asserted that the CC's review was defective due to its failure to take into account relevant consideration.<sup>100</sup>

The Tribunal found that the CC failed to take into account a relevant consideration. In the Tribunal's opinion, the Commission erred in considering the loss of convenience that would ensue from the application of the point of sale prohibition in evaluating whether it was proportional to contain it in its anticipated remedies package.<sup>101</sup> The Tribunal revoked the

<sup>96</sup> Case No 1109/6/8/09 *Barclays Bank Plc v CC* [2009] CAT 27 ('Barclays v CC').

<sup>97</sup> Competition Commission, 'Market Investigation Into Payment Protection Insurance' (30 January, 2009) *Report*, available at [http://webarchive.nationalarchives.gov.uk/20140402141250/http://www.competition-commission.org.uk/assets/competitioncommission/docs/pdf/non-inquiry/rep\\_pub/reports/2009/fulltext/542.pdf](http://webarchive.nationalarchives.gov.uk/20140402141250/http://www.competition-commission.org.uk/assets/competitioncommission/docs/pdf/non-inquiry/rep_pub/reports/2009/fulltext/542.pdf)

<sup>98</sup> *Barclays v CC* (n96), Summary of application, p 1.

<sup>99</sup> *Ibid*, p 2.

<sup>100</sup> *Ibid*, p 1.

<sup>101</sup> *Ibid*, Judgment, p 78.

part of the CC's report that foists the point of sale prohibition as part of the recommended remedies package.<sup>102</sup> It also remitted the issue on whether a point of sale prohibition should be so taken into account as an additional consideration by the CC pursuant to the principles established in the Tribunal's judgment.<sup>103</sup>

This case, although not directly related to bank merger, dealt with competition aspects in banking, such as service of payments, within the UK market. Large banks, like Barclays, continue to maintain a dominant position in providing banking products and services to consumers, while hindering entry of new participant banks in the market.

4.3.1(c) MasterCard UK Members Forum Limited, MasterCard International Incorporated and MasterCard Europe SPRL, Royal Bank of Scotland Group v Office of Fair Trading<sup>104</sup>

This case involved a 2005 decision from the Office of Fair Trading ('OFT') about interchange fees rendered by the banks issuing *MasterCard* within the UK.<sup>105</sup> The applicants, namely MasterCard UK, MasterCard International, MasterCard Europe, and Royal Bank of Scotland ('Applicants') sought that the Competition Appeal Tribunal ('CAT') either permit the Applicants' appeal, or set aside the OFT decision, or order the latter to withdraw such decision.<sup>106</sup> The CAT decided that the Applicants' appeal would not proceed and set aside the OFT decision.<sup>107</sup>

In reaching its conclusion, the Tribunal found that, after years of administrative proceedings, the OFT had established a stance that it should withdraw its decision on the interchange fees provided by the banks issuing MasterCard, particularly in a significant 'frontrunner' case like the present one that has drawn a far-reaching interest not only within

<sup>102</sup> *Ibid*, p 79.

<sup>103</sup> *Ibid*, p 80; also, Ruling, pp 1-10.

<sup>104</sup> Case Nos 1054-1056/1/1/05 *MasterCard UK Members Forum Limited et al v OFT* [2006] CAT 14 ('RBS v OFT').

<sup>105</sup> Office of Fair Trading, 'Decision on Investigation of the Multilateral Interchange Fees Provided for in the UK Domestic Rules of MasterCard UK Members Forum Ltd' (6 September, 2005) *OFT 811, Case CP/0090/00/S*, available at

[http://www.offt.gov.uk/shared\\_offt/ca98\\_public\\_register/decisions/oft811.pdf;jsessionid=6FF02D2689FA2A679783A2BA941602CF](http://www.offt.gov.uk/shared_offt/ca98_public_register/decisions/oft811.pdf;jsessionid=6FF02D2689FA2A679783A2BA941602CF).

<sup>106</sup> *RBS v OFT* (n104), Summary of Appeal, pp 1, and 2.

<sup>107</sup> *Ibid*, Order of the Tribunal, p 2.

the country but also across the EU and elsewhere.<sup>108</sup>

The Tribunal deemed that the setting aside of the OFT decision would in effect be granting the substantive relief requested by MasterCard UK Members Forum Ltd (who comprised most of the banks in the UK) and contained in the notices of appeal filed by the MasterCard International Inc. and Royal Bank of Scotland, respectively.<sup>109</sup> The only additional relief sought was the two further declarations demanded by MasterCard International, Inc. in its notice of appeal.<sup>110</sup> In response to these declarations, the Tribunal did not conclude whether it had jurisdiction to grant the declarations requested or relief that has a similar effect in an appropriate case.<sup>111</sup> Arguments in support of granting these reliefs were, in the Tribunal's point of view, broad enough to include the request for additional relief, or relief of a similar effect.<sup>112</sup> The Tribunal found no evidence of any constraint on the OFT's power to come to a similar conclusion.<sup>113</sup>

As to whether it would be suitable in the circumstances to proceed with the appeals solely to consider the declaratory relief demanded by MasterCard International, Inc., the issue whether the Tribunal had jurisdiction to award the declarations is different from the issue whether the Tribunal, in its discretion, should have exercised that jurisdiction in the specific circumstances of this case.<sup>114</sup> Regarding the latter, the court saw it fit to take into account some relevant considerations.<sup>115</sup> First, the OFT had by that time indicated its intention to withdraw its decision. Second, regardless of whether the decision was withdrawn or set aside, MasterCard UK Members Forum Ltd and Royal Bank of Scotland, in reality, obtained all reliefs sought in these proceedings, and MasterCard International Inc. received, in the Tribunal's view, a large portion of the relief sought.<sup>116</sup> Given the circumstances, a continuation of the review by the judiciary on the declarations sought by MasterCard International Inc. would call for a significant investigation of the merits regarding the defense

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<sup>108</sup> *Ibid*, Judgment (Setting aside the Decision), p 2.

<sup>109</sup> *Ibid*.

<sup>110</sup> *Ibid*, p 3.

<sup>111</sup> *Ibid*.

<sup>112</sup> *Ibid*, p 4.

<sup>113</sup> *Ibid*.

<sup>114</sup> *Ibid*, p 5.

<sup>115</sup> *Ibid*.

<sup>116</sup> *Ibid*, p 6.

arguments and the replies and additional evidence submitted by the OFT in rejoinder.<sup>117</sup>

The Tribunal, also, found that while VisaCard was an intervener rather than an appellant in the action, it is, along with MasterCard, the only two major international credit card institutions.<sup>118</sup> Thus, the Tribunal found it undisputed that VisaCard had standing to take the position against the OFT decision.<sup>119</sup> The Tribunal saw it important that a proceeding with likely global implications, such as, the present one should proceed on sound procedural grounds.<sup>120</sup> The Tribunal was not content that the procedural basis for further pursuing these appeals was sufficient, especially considering the extensive new material that the OFT sought to rely.<sup>121</sup>

The Tribunal found it unsuitable to adjudicate without first reviewing the way the MasterCard structure operates. It found it arduous to undertake such substantive exercise merely to adjudicate the declaratory reliefs sought by MasterCard International, Inc., particularly in light of the admission by the OFT that its decision had to be set aside or withdrawn. Even if the appeals were to proceed, supplementary administrative steps would have been required to deal with MasterCard's previous arrangements, the position of VisaCard, or even any further arguments, based on the law.<sup>122</sup>

In addition, the Tribunal noted the parallel proceedings at the EU level would likely address the issues that MasterCard International, Inc. wished to raise with the Tribunal, notwithstanding the fact that the EU proceedings concerned international instead of the UK interchange fees.<sup>123</sup> The Tribunal noted that whether to hear these appeals on the declaratory relief was discretion for the same court to rule upon. While the Tribunal acknowledged the undesirability of a prolonged administrative procedure, such procedure has commenced at that time and was expected to run in parallel with the European Commission procedure.<sup>124</sup> The

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<sup>117</sup> *Ibid.*

<sup>118</sup> *Ibid.*, p 7.

<sup>119</sup> *Ibid.*

<sup>120</sup> *Ibid.*, p 8.

<sup>121</sup> *Ibid.*

<sup>122</sup> *Ibid.*, p 9.

<sup>123</sup> *Ibid.*

<sup>124</sup> The Commission concluded that *MasterCard/Visa* infringed Article 101 EU Treaty as a result of setting the interchange fee. However, the Commission recognized that having a centrally set interchange is economically desirable and that a lower fee would be exempt under Article 101(3). See Commission, 'Summary of

Tribunal, also, found it inappropriate for the court to continue hearing a case that the competition regulators had shown involved ongoing inquiries, notwithstanding the amount of time spent on such inquiries at that time.<sup>125</sup> While the Tribunal acknowledged the position taken by MasterCard International, Inc., it found no ‘legitimate expectation’, as used in administrative law, had arisen in the proceedings to the extent of compelling the continuation of these appeals despite the OFT’s undertaking to withdraw its decision.<sup>126</sup>

The Tribunal opined that the results of setting aside, or withdrawing, the decision would be largely the same.<sup>127</sup> Nevertheless, in cases like the present there was a necessity for legal certainty and clarity. The Tribunal found that the legal consequence of a ‘withdrawal’ would not be wholly evident, regardless of whether the OFT had the power to ‘withdraw’.<sup>128</sup> It would, also, be likely for third parties to be unaware of such withdrawal. On the other hand, the setting aside of the decision by the Tribunal would be an evident and significant judicial finding, ruling out any uncertainty and in the meantime, gave the appellants their main reliefs sought.<sup>129</sup>

For the foregoing reasons, the Tribunal ordered to set aside the OFT decision. The appeals were, as a result, terminated.<sup>130</sup>

The above interchange fees case shows the tribunal’s role in keeping a balance between the competition enforcement authority and financial institutions in implementing remedies imposed by the authority.

#### 4.3.1(d) Office of Fair Trading v Abbey National

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Commission Decision of 19 December, 2007 relating to a proceeding under Article 81 of the EC Treaty and Article 53 of the EEA Agreement’ Case No. *COMP/34579 MasterCard* [2007], Case No. *COMP/36518 EuroCommerce* [2007], Case No. *COMP/38580 Commercial Cards* [2007] OJ C 264/8; Commission, ‘Decision of 24 July, 2002 relating to a proceeding under Article 81 of the EC Treaty and Article 53 of the EEA Agreement’ [2002] Case No. *COMP/29373 Visa International – Multinational Interchange Fee* [2002] OJ L 318, pp 17-36.

<sup>125</sup> *RBS v OFT* (n104), Judgment (Setting aside the Decision), p 10.

<sup>126</sup> *Ibid.*

<sup>127</sup> *Ibid.*, p 11.

<sup>128</sup> *Ibid.*

<sup>129</sup> *Ibid.*, p 12.

<sup>130</sup> *Ibid.*, Order the Tribunal, p 2.

In 2009, the UK Supreme Court issued the final judgment in *Office of Fair Trading v Abbey National*,<sup>131</sup> which was recognized as phase one of the broadly exposed test case over bank charges.

The Supreme Court found that the unarranged overdraft charges imposed on customers with personal current account created part of the price paid for the package of banking services provided in exchange.<sup>132</sup> Consequently, provided the terms creating those charges were in clear and unambiguous language, any valuation of their objectivity, pursuant to the Unfair Terms in Consumer Contracts Regulations 1999<sup>133</sup> was impermissible in comparison to the services rendered in exchange.

Unarranged overdraft charges would normally be sustained in the case a bank makes a payment upon a customer's request, resulting in the customer exceeding the limit of his arranged overdraft or overdrawn. They could, also, be sustained where a bank declines to make a payment, leading to the same result, had the payment demand been assented to. Banks frequently charge customers a monthly fee for unarranged lending.

Due to a sharp rise of claims from consumers against the retail banks on charges over the unarranged overdrafts, the Office of Fair Trading ('OFT') commenced an investigation on the charges and involved seven big UK banks and one building society (the 'Banks') to resolve many of the crucial legal aspects in a more orderly and efficient manner.<sup>134</sup>

In 2007, following an agreement between the OFT and the Banks, the OFT started a legal proceeding in the High Court against the Banks, seeking from the court provide legal certainty over the crucial legal aspects in the matter. These proceedings before the High Court were known as the 'bank charges' test case'.<sup>135</sup>

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<sup>131</sup> [2009] (UKSC 6), [2010] 1 AC 696 ('OFT v Abbey').

<sup>132</sup> *Ibid*, at [41], [47].

<sup>133</sup> 1999 (S.I. 1999/2083) ('UTCCRs'). These Regulations replaced the Unfair Terms in Consumer Contracts Regulations 1994 (SI 1994/3159).

<sup>134</sup> Office of Fair Trading, 'Personal Current Account Contract Terms: Unarranged Overdraft Charges' (April, 2007), available at <https://www.gov.uk/cma-cases/personal-current-account-contract-terms-unarranged-overdraft-charges>.

<sup>135</sup> I Ramsay, *Consumer Law and Policy: Text and Materials on Regulating Consumer Markets* (3rd edn, Oxford: Hart 2012), ch 6.4.

The High Court was to rule whether the Banks' terms and conditions in force at that time creating charges of the unarranged overdrafts would qualify as penalties at common law.<sup>136</sup> It found that the terms did not qualify as penalties due to the fact that such charges were not 'payable upon a breach of contract'.<sup>137</sup> The court consequently held that all the previous terms and conditions similarly did not qualify as penalties.<sup>138</sup>

The High Court was also asked to rule whether a valuation of the objectivity of the terms and conditions in force at that time giving rise to unarranged overdraft charges under the existing consumer protection regulations was excluded by certain provision(s) of the same regulations<sup>139</sup>. The Banks asserted that such terms and conditions were in apparent comprehensible language and that a valuation of them would connect with the reasonableness of the price or remuneration in contrast to the services or products rendered in exchange and consequently impermissible.<sup>140</sup>

The High Court was satisfied that the terms and conditions of four financial institutions among the Banks were in clear comprehensible language.<sup>141</sup> The terms and conditions of the remaining four were in evident comprehensible language, except for some minor elements. However, it held against the Banks on whether a valuation of them would connect with the reasonableness of the price or remuneration in contrast to the services or products provided in exchange.<sup>142</sup> The Banks appealed this part of the decision.<sup>143</sup>

The Court of Appeal disagreed with the lower court (High Court)'s reasoning.<sup>144</sup> However, it found unanimously that a valuation for objectivity of the terms and conditions at that time giving rise to unarranged overdraft charges was not precluded by certain provisions of the consumers' regulations.<sup>145</sup> The Court of Appeal held that these provisions are only

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<sup>136</sup> *OFT v Abbey National Plc & 7 ors*, [2008] EWHC 875 (Comm) ('High Court'), at [154] to [168].

<sup>137</sup> *Ibid*, at [296].

<sup>138</sup> *Ibid*, at [323], [328] to [331].

<sup>139</sup> *Ibid*, [83], [114]; see, also, *UTCCRs* (n133), s 6(2) states: 'Insofar as it is in plain intelligible language, the assessment of fairness of a term shall not relate – (a) to the definition of the main subject matter of the contract, or (b) to the adequacy of the price or remuneration, as against the goods or services supplied in exchange'.

<sup>140</sup> *High Court* (n136), at [121].

<sup>141</sup> *Ibid*, at [293].

<sup>142</sup> *Ibid*, at [337].

<sup>143</sup> E John, 'Bank Charges Case Goes to Appeal Court' (28 October, 2008) *Guardian*.

<sup>144</sup> *OFT v Abbey National & ors*, [2009] EWCA Civ 116 ('Court of Appeal'), at [115].

<sup>145</sup> *Ibid*, at [116] to [123]; see, also, *UTCCRs* (n133), para 6(2)(b).



applicable to the ‘essential’ services and the ‘core’ price. While applying this test, the Court held that charges of the unarranged overdrafts were not an integral part of the core price, and provision of an unarranged overdraft was found not to be an essential service. On that basis, the Court found against the Banks.<sup>146</sup>

The Banks filed an appeal before the then House of Lords, presently the Supreme Court, in 2009.<sup>147</sup> The House of Lords was faced with the issue whether, at law, the objectivity of charges on the unarranged overdraft could be challenged by the OFT as unwarranted with respect to the services provided to the customer.<sup>148</sup>

In November, 2009, in a unanimous decision, the Supreme Court held that the OFT could not challenge the unarranged overdraft charges of the Banks.<sup>149</sup> It found that the Banks provided a package of services to their current account customers, the price of which could likewise be defined as a package.<sup>150</sup> Charges of the unarranged overdrafts are an integral part of the price paid. Therefore, charges are subject of the language in certain provisions in the consumers’ regulations.<sup>151</sup>

In arriving at this conclusion, the Supreme Court overruled the Court of Appeal’s interpretation that the exemption only shielded the ‘essential’ services and the ‘core’ price. It held that certain provisions of the UTCCR<sup>152</sup> did not include any indication that the exemption was to be constrained in this manner. It also found that, even if the Court of Appeal’s approach was correct, the charges, totally about 30 per cent of a bank’s fee income pertaining to personal current accounts, should establish an integral part of the ‘core’ price. Consequently, the Supreme Court held that as far as terms and conditions are in clear comprehensible language, no valuation of the objectivity of charges of the unarranged overdrafts can be allowed pursuant to the consumers’ regulations provisions<sup>153</sup> where the

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<sup>146</sup> *Court of Appeal* (n144), at [124].

<sup>147</sup> [2009] UKSC 6 on appeal from: [2009] EWCA Civ 116 (‘Supreme Court’); see, also, M Neligan, ‘UK Banks Appeal Overdraft Charges Ruling’ (23 June, 2009) *Reuters*, available at <http://www.reuters.com/article/britain-banks-overdrafts-idUSLN57558820090623>.

<sup>148</sup> *Supreme Court* (n147), at [3].

<sup>149</sup> *Ibid*, at [51].

<sup>150</sup> *Ibid*, at [42].

<sup>151</sup> *Ibid*, at [64]; see, also, *UTCCRs* (n133) para 6(2).

<sup>152</sup> *Supreme Court* (n147), at [112]; see, also, *UTCCRs* (n133), para 6(2)(b).

<sup>153</sup> *Supreme Court* (n147), at [47].

grounds of the challenge would be that those consumers paying the banks are being charged unwarranted sums of monies in consideration for the inclusive package of current account services.<sup>154</sup>

It is remarkable that the Supreme Court found it incorrect to consider charges of the unarranged overdrafts as payments made in consideration for the particular services, as asserted by the OFT.<sup>155</sup> The consequence of this ruling was that, even as far as any terms arising to charges of the unarranged overdrafts are not in evident comprehensible language, any objection to the degree of those charges on the grounds that they surpass the costs of rendering the particular relevant services would also be not allowed.<sup>156</sup>

The Supreme Court determined that, even though the interpretation of the EU Directive that was adopted by the UTCCR<sup>157</sup> was a matter of EU law, it was unnecessary to refer this matter to the ECJ, thus, making its ruling final.<sup>158</sup>

Although the foregoing case does not relate to a bank merger, it has some relevance to competition aspects of banking products and services rendered in the market. Clearly, the Supreme Court's decision on the unarranged overdraft charges was a setback to the consumer's protection rights, and further consolidated the power of banks over their customers.

#### 4.3.2 Bank merger cases with government approval

The section below outlines some important bank merger transactions that were dealt by the UK Government, without the involvement of the UK courts and tribunals, are discussed below. These bank mergers show the Government's debatable role in implementation of competition policies, while aiming to maintain stability in the financial system.

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<sup>154</sup> *Ibid*, at [78].

<sup>155</sup> J Devenney and M Kenny, *European Consumer Protection: Theory and Practice* in J Devenney and M Kenny (eds) *Unfair Terms and the Draft Common Frame of Reference: The Role of Non-Legislative Harmonisation and Administrative Cooperation?* (Oxford: Oxford University Press 2012), pp 107-108.

<sup>156</sup> D Leczykiewicz and S Weatherill, *The Images of the Consumer in EU Law: Legislation, Free Movement and Competition Law* in N Reich (eds) *Vulnerable Consumers in EU law* (Oregon: Hart Publishing 2016), p 144.

<sup>157</sup> *Supreme Court* (n147), at [32], [48], and [94].

<sup>158</sup> *Ibid*, at [52].

#### 4.3.2(a) RBS and HSBC<sup>159</sup>

The 1982 merger *Royal Bank of Scotland* ('RBC')/*Hong Kong and Shanghai Banking Corporation Standard Chartered Bank* ('HSBC') triggered the public interest ground for opposing inward investment bank merger.<sup>160</sup>

In 1980, a proposal was made by the then non-British bank, HSBC,<sup>161</sup> to gain control over the RBS. The Monopolies and Merger Commission (the then UK competition authority) concluded against the proposal on the basis that sustaining a major UK bank controlled overseas would be against the public interest.<sup>162</sup> The emphasis of the UK competition authority merger investigations pursuant to the competition provisions were on the likely anti-competitive aftermaths of the submitted bank merger.<sup>163</sup>

Notwithstanding this, the 1980s was a period where a substantial burden was placed on the regional policy to reflect the public interest test as set out in the competition provisions. Pursuant to such provisions, the UK competition authority looked at the objective to preserve and endorse the balanced distribution of labor and industry in the UK.<sup>164</sup>

In particular, the Monopolies and Merger Commission issued a number of important reports<sup>165</sup> on mergers and acquisitions of homegrown Scottish businesses. The review method adopted by the UK competition authority in considering the bid for the RBS in 1982 seemed to be especially interesting.<sup>166</sup> It found that the submitted bank merger may work against the public interest as a result of stripping the ultimate control away from Edinburgh.<sup>167</sup> The

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<sup>159</sup> Monopolies and Merger Commission, 'The Hong Kong and Shanghai Banking Corporation Standard Chartered Bank/The Royal Bank of Scotland Group: A Report on the Proposed Merger' (1982), *Cmnd 8472* ('HSBC/RBS').

<sup>160</sup> BJ Rodger, 'Reinforcing the Scottish "Ring-Fence": A Critique of UK Mergers Policy *vis-a-vis* the Scottish economy' (1996) *ECLR* 104.

<sup>161</sup> J Smith, 'United Kingdom: The Royal Bank of Scotland' (1982) 16 *Journal of World Trade Issue* 2, p 176. At that time, HSBC was a Hong Kong based bank.

<sup>162</sup> *HSBC/RBS* (n159), p 88.

<sup>163</sup> *Ibid*, p 90.

<sup>164</sup> Fair Trading Act 1973 (1973 c.41), s 84(d).

<sup>165</sup> For example, Monopolies and Merger Commission, 'Scottish & Newcastle Breweries Plc/Mathew Brown Plc: A Report on the Proposed Merger' (1985) *Cmnd 9645*; see, also, Monopolies and Merger Commission, 'Elders IXL/Scottish & Newcastle Breweries Plc' (1989) *Cmnd 654*.

<sup>166</sup> *HSBC/RBS* (n159), pp 45-47.

<sup>167</sup> *Ibid*, p 58.

regulator, also, found that the merger would diminish the significance of the banking sector in Scotland and reduce employment opportunities in banking and finance in Scotland.<sup>168</sup> It would, also, produce an uncertainty over the formation of a branch economy. Nonetheless, it was clear that the importance of regional policy in UK bank merger control was diminishing.<sup>169</sup>

In April, 1981, eager to establish a stage for its European expansion, the HSBC sent a hostile offer for the RBS, estimated at £498 million.<sup>170</sup> As the RBS accepted a month earlier a friendly offer from Standard Chartered Bank valued at £334 million, the Standard Chartered Bank and the HSBC entered into a bidding war to merger the RBS.<sup>171</sup> In the end, the UK competition authority held that it was not in Scotland's best interests to lose or wane control of RBS, one of the largest banks in Scotland, to foreign banks.<sup>172</sup> As a result, the HSBC pulled out of the acquisition offer for the RBS. Standard Chartered Bank, also, failed to gain approval for the RBS.<sup>173</sup>

In 1992, the HSBC made an offer and successfully took over Midland Bank for £3.9 billion, rising to one of the tenth largest banks in the world.<sup>174</sup> This was then the costliest take-over in the banking history in the UK.<sup>175</sup> It provided the HSBC with strategic standing in the UK market and a safety net for its HSBC bank to move its head-offices from Hong Kong to London.<sup>176</sup> The European Commission, also, gave its approval to the merger, finding it to be in compliance with the merger procedure and that the merger did not create any doubt to the compatibility with the common market.<sup>177</sup>

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<sup>168</sup> *Ibid*, p 64.

<sup>169</sup> *Ibid*, p 76.

<sup>170</sup> R Roberts and D Kynaston, *The Lion Wakes: A Modern History of HSBC* (London: Profile Books 2015) ('Roberts and Kynaston'), pp 34-58.

<sup>171</sup> *Ibid*.

<sup>172</sup> *HSBC/RBS* (n159), p 90.

<sup>173</sup> *Roberts and Kynaston* (n170), p 62.

<sup>174</sup> M Pohl et al, *A Century of Banking Consolidation in Europe: The History and Archives of Mergers and Acquisitions* (Michigan: Ashgate 2001), pp 71-3.

<sup>175</sup> *Ibid*, p 72.

<sup>176</sup> *Ibid*, p 73.

<sup>177</sup> Case No. COMP/M.213 *Hong Kong & Shanghai Bank / Midland Bank* [1992] OJ C 157/18.

On the other hand, in early 2000, the RBS acquired the National Westminster Bank ('NatWest') for £21 billion.<sup>178</sup> Preceding the take-over, the NatWest became the target of two spontaneous hostile acquisition offers by two Scottish banks: the RBS and the Bank of Scotland. In relation to the size of net income and assets, the RBS was almost half the size of NatWest.<sup>179</sup> Conversely, the RBS was deemed to be one of the most technologically advanced financial institutions in the UK. Ultimately, the RBS 'outdid' the Bank of Scotland in the merger of the NatWest. The acquisition was successful because the RBS's approach to the acquisition appeared to be better situated for removing duplicated sustenance operations with NatWest.<sup>180</sup> The RBS, also, showed that revenue rise benefits with NatWest included the combination of products, customers, skills, and brands between NatWest and the RBS.<sup>181</sup>

#### 4.3.2(b) Lloyds and Abbey

Competition concerns were much to the forepart in the UK banking system in the early 2000, as rumours circulated about the likely emergence of a rival acquisition offer for Abbey National plc ('Abbey') from a UK based bank to put out of place the bid made by the Spanish bank Banco Santander Central Hispano.<sup>182</sup> As internationalization and consolidation are taking place simultaneously in the financial services industry, bank merger control is not to be deemed the single aspect of concern in competition law.<sup>183</sup>

Lloyds Banking Group ('Lloyds') was prepared to witness its offer to acquire Abbey, the mortgage and savings bank, opposed by the UK competition authority (Competition Commission),<sup>184</sup> which was acting on the referral of the Secretary of State for Business, Innovation and Skills ('SoS').<sup>185</sup> This merger case was of particular interest because it created

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<sup>178</sup> D Harding and S Rovit, *Mastering the Merger: Four Critical Decisions That Make or Break the Deal* (Massachusetts: Bain & Company 2004), p 85.

<sup>179</sup> *Ibid*, p 86.

<sup>180</sup> *Ibid*, p 87.

<sup>181</sup> House of the Commons, 'Banking Crisis: Dealing with the Failure of the UK Banks: Seventh Report of Session 2008-09' (2009) *HC 416*.

<sup>182</sup> The Economist, 'Abbey Ending?' (29 June, 2004) *The Economist*, pp 18-19.

<sup>183</sup> *Ibid*.

<sup>184</sup> Competition Commission, 'Lloyds TSB Group Plc/Abbey National Plc: A Report on the Proposed Merger' (2001) *Cm5208* ('Lloyds/Abbey').

<sup>185</sup> The former Secretary of State for Trade and Industry referred the merger to the Competition Commission on 23 February, 2001 under the Fair Trading Act 1973, c. 41, ss 64, 75.

precedents in relation to the types of UK bank mergers approved by the competition regulators, namely the Office of Fair Trading and the Competition Commission.<sup>186</sup>

The SoS held up the £19 billion proposed acquisition from Lloyds of Abbey, a decision made after a three-month thorough inquiry by the Competition Commission into the consequence of the bank merger proposal towards consumers.<sup>187</sup> The competition authority found that Lloyds and Abbey clearly dominated the market of the current accounts. As a result, the authority concluded that the merger deemed to be contrary to the public interest.<sup>188</sup>

The SoS endorsed the Competition Commission's recommendation that indicated the banks merger be banned on the basis that it could most likely lessen competition in the market for banking services for small and medium-sized enterprises ('SMEs') and the market for personal current accounts.<sup>189</sup> The SoS, also, endorsed the competition regulator's findings that the merger posed adverse effects in these indicated markets resulting to diminished innovation along with higher prices to customers with respect to banking products and services.<sup>190</sup> The SoS, also, concurred with the Commission Competition's findings that forbidding the merger of Lloyds with Abbey was the only remedy efficient of abundantly tackling the adverse effects of competition in the banking sector.<sup>191</sup>

The findings of the Competition Commission along with the SoS's endorsement caught Lloyds by surprise. The bank was already involved in the process of taking over other targeted banks in the UK.<sup>192</sup> On the other hand, Abbey, which ended merger discussions with the Bank of Scotland in early 2001, was projected to be a likely merger target for National Australia Bank, which held ownership control over the Clydesdale and Yorkshire Banks.<sup>193</sup>

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<sup>186</sup> O McDonald and K Keasey, *The Future of Retail Banking in Europe: A View from the Top* (West Sussex: John Wiley & Sons 2003), p 164.

<sup>187</sup> S Ascarelli, 'Lloyds Continues to Pursue Bid to Buy Abbey National' (26 February, 2001) *Wall Street Journal*.

<sup>188</sup> *Lloyds/Abbey* (n184), pp 50, and 51.

<sup>189</sup> Secretary of State for Trade and Industry, 'Patricia Hewitt Accepts CC Conclusions on Lloyds/Abbey Merger' (10 July, 2001) *Speeches/Reports*, available at <http://www.wired-gov.net/wg/wg-news-1.nsf/54e6de9e0c383719802572b9005141ed/777d0e87e46eadb0802572ab004b43f5?OpenDocument>

<sup>190</sup> *Ibid*.

<sup>191</sup> *Ibid*; see, also, *Lloyds/Abbey* (n184), pp 50-51, and 52-58.

<sup>192</sup> O McDonald and K Keasey, *The Future of Retail Banking in Europe* (West Sussex: Wiley & Sons 2002), p 164.

<sup>193</sup> J Croft, 'A&L and B&B Not Easy Targets' (26 February, 2008) *Financial Times*.

#### 4.3.2(c) UK government's takeover of the Northern Rock

The first important credit crisis situation in Britain happened in the fall of 2007, when the public in the UK suddenly learnt that the Bank of England granted to the Northern Rock bank £25 billions of emergency financial liquidity. This created the first run on a British bank in almost hundred years. As a result, depositors in panic withdrew £1 billion from the Northern Rock bank in one day.<sup>194</sup> Under these circumstances, and in order to avoid the domino effect in other banks and creating a potential collapse of the financial and banking system, the UK Government intervened by guaranteeing savings accounts of depositors in the Northern Rock. Various efforts outside the public view to sell Northern Rock to private sector were unsuccessful. Therefore, the Government in early 2008 decided to nationalize Northern Rock bank by taking it over with the taxpayers' monies in the name of prevention measures for a systemic risk effects in the banking and financial markets.<sup>195</sup>

As the financial meltdown worsened, in April, 2008, the Bank of England injected into the banking and financial market £50 billion to assist struggling banks across the country. Banks were permitted to exchange toxic mortgage debts for secure government bonds by the way of Treasury bills.<sup>196</sup>

#### 4.3.2(d) Barclays and Lehman Brothers

The only Anglo-American bank merger in at least the last decade was the acquisition by the UK bank Barclays of the now defunct American bank Lehman Brothers. In 2008, Lehman Brothers agreed to sell its North American investment banking and capital markets businesses for \$1.75bn to UK lender Barclays. The acquisition was used by Barclays to boost its US investment banking prowess without having to assume Lehman's crippling liabilities.<sup>197</sup> The agreement was reached after an intense negotiation between Lehman and Barclays, at a time when the Lehman Brothers' parent company had already filed for bankruptcy protection in the

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<sup>194</sup> B P Brown, *The Decline and Fall of Banking* (Leicester: Troubador Publishing 2009), p 77.

<sup>195</sup> House of Commons, 'The Run on the Rock: Fifth Report of Session 2007-08' (2008) HC 56-II.

<sup>196</sup> House of Commons, 'Housing and the Credit Crunch: Third Report of Session 2008-09' (2009) HC 101, p 156.

<sup>197</sup> N Bullock et al, 'Lehman Bondholders Could Lose \$110bn' (28 September, 2008) *Financial Times*.

US federal court.<sup>198</sup> Barclays took over ownership of Lehman Brothers' American and Canadian investment banking business, fixed income and equity sales operations, and research divisions. The merger had the approval of the US and UK banking regulators, including the US federal bankruptcy court overseeing Lehman Brothers' insolvency proceedings.<sup>199</sup>

Both the US and UK regulators failed to look at the competition impact of the takeover. Instead, they focused their attention on facilitating a quick acquisition of Lehman Brothers' assets by Barclays.

#### 4.3.2(e) Lloyds and HBOS

In 2008, the then Office of Fair Trading ('OFT')'s restatement of its guidelines was published shortly after the UK Government's withdrawal of jurisdiction from the competition regulators to review the takeover of Halifax Bank of Scotland ('HBOS') by Lloyds Banking Group ('Lloyds'). The government did so by carrying out statutory powers given to the Secretary of State for Business, Innovation and Skills ('SoS').<sup>200</sup>

The OFT noted that, from its assessment, the projected takeover would invoke a 'substantial lessening of competition' ('SLC') in the banking services for small and medium-sized enterprises ('SMEs'), personal current accounts, and mortgages.<sup>201</sup> Nevertheless, regardless of these issues, the SoS utilized his statutory power to emphasize the public interest of financial stability and permitted the case to carry on without reference by the then OFT to the then Competition Commission ('CC').<sup>202</sup>

The Lloyds' takeover is one of the most significant State aid cases in the UK bank merger history. The CC favored a package of financial support undertakings towards the banking sector in the UK in 2008 as a response to the Global Financial Crisis ('GFC'). In

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<sup>198</sup> A R Sorkin, 'Lehman Files for Bankruptcy; Merrill Is Sold' (14 September, 2008) *New York Times*.

<sup>199</sup> M Sandretto, *Cases in Financial Reporting* (Ohio: South-Western 2012), pp 321-7.

<sup>200</sup> House of Commons, 'Banking in Scotland: Second Report of Session 2009-10' (2010) HC 70-I, available at <http://www.publications.parliament.uk/pa/cm/cm/scotaf.htm>.

<sup>201</sup> Office of Fair Trading, 'Report to the Secretary of State for Business Enterprise and Regulatory Reform on Lloyds/HBOS Merger' (20 October, 2008) ('OFT Report to the SoS'), available at [http://webarchive.nationalarchives.gov.uk/20140402142426/http://www.of.gov.uk/shared\\_of/press\\_release\\_attachments/LLloydstsb.pdf;jsessionid=4EBCDA0A4B36535AF8355B90D18E00A2](http://webarchive.nationalarchives.gov.uk/20140402142426/http://www.of.gov.uk/shared_of/press_release_attachments/LLloydstsb.pdf;jsessionid=4EBCDA0A4B36535AF8355B90D18E00A2)

<sup>202</sup> *Ibid*, pp 41, 52, and 58.



addition, in July 2009, the UK Government informed the public about a restructuring strategy for Lloyds concerning the recapitalization measures, which the bank obtained a few months ago.<sup>203</sup>

Lloyds' necessity for State aid was due to the acquisition of HBOS and the consequent financial troubles of the HBOS. Prior to the takeover, HBOS was in near collapse due to its high-risk lending and the unwarranted utilization of leverage. The Lloyds' takeover of the HBOS was conditioned upon the receipt of a substantial amount of the UK Government financial aid required to rescue HBOS.<sup>204</sup>

In early 2009, Lloyds obtained a state recapitalization of £17 billion that resulted in the UK Government owning an equity interest in the bank of 43.5 per cent.<sup>205</sup> The aid permitted Lloyds to take over HBOS, substantially increasing its market shares. The takeover, also, removed a challenger in markets that were at that time concentrated. Certain measures, such as, decreasing the balance sheet of Lloyds, its risk profile, and funding gap were taken to ensure that Lloyds would re-emerge as a profitable and stable financial institution. These, also, aimed at disposing or streamlining non-core operations in wholesale, corporate, individual, and small business.<sup>206</sup>

The European Commission imposed an exhaustive list of requirements, for example on the reduction of the balance sheet, decreasing the risk profile of the business and the funding gap of the bank,<sup>207</sup> on Lloyds. The bank was ordered to carry out a fair and transparent process concerning the divestiture process for sale of the assets that was going to be properly publicized. The Commission, also, ordered Lloyds to take on an asset reduction programme in order to reach a £181 billion reduction in a particular group of assets by the end

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<sup>203</sup> Case N 507/2008 – Financial Support Measures to the Banking Industry in the UK (13 October, 2008) Commission decision, paras 9, 13, and 69.

<sup>204</sup> L Smith, 'The Lloyds-TSB and HBOS Merger: Competition Issues' (15 December, 2008) *House of Commons Library SN/BT/4907*, available at file:///C:/Users/Genci/Downloads/SN04907%20(5).pdf

<sup>205</sup> T Jarrett, 'Taxpayer Direct Support to Banks (Lloyds, RBS, Northern Rock, and Bradford & Bingley)' (3 June, 2010) *House of Commons Library SN/BTS/5642*, available at <http://researchbriefings.files.parliament.uk/documents/SN05642/SN05642.pdf>.

<sup>206</sup> Economist, 'Putting Competition First' (3 November, 2009) *Economist*, p 28.

<sup>207</sup> Commission, 'State Aid No. N 428/2009 – United Kingdom: Restructuring of Lloyds Banking Group' (18 November, 2009) *EC (2009) 9087 final*, p 11.

of 2014. The Commission, further, outlined to the bank a thorough explanation of the characteristics that the prospective purchaser(s) should possess.<sup>208</sup>

Moreover, the Commission outlined a specific divestment package and requirements for purchaser(s) to warrant that the divested institution renders a suitable means of growing competition in the concentrated retail banking market in the UK.<sup>209</sup> With the Lloyds' brand, Scottish branches of Lloyds, the C&G branches, and supplementary branches guaranteeing relative geographical coverage, the carried off entity would result in an sufficiently attractive target for several competitors desiring to enter the UK market.<sup>210</sup>

In September, 2008, the UK Government orchestrated the takeover of the failing HBOS by Lloyds for £12.2 billion.<sup>211</sup> This deal formed the biggest bank and mortgage lending institution in the UK.<sup>212</sup>

For the takeover to succeed, the SoS had to step in. Using his public interest power in Lloyds/HBOS deal, the SoS announced the need to uphold the strength of the financial system in the UK as a new consideration of public interest.<sup>213</sup> The SoS, also, pinpointed the systemic significance of HBOS in the banking system that warranted his intervention, considering the danger to the stability of the financial system upon spelling out his actions.<sup>214</sup>

In OFT's report to the SoS, the regulator found that there was a genuine perspective that the takeover would cause a 'substantial lessening of competition' ('SLC') among banking services for SMEs, personal current accounts, and mortgages.<sup>215</sup> A thorough investigation by the CC was, thus, necessary, even though it was in no way a certainty that the

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<sup>208</sup> *Ibid*, p 19.

<sup>209</sup> *Ibid*, pp 15-21.

<sup>210</sup> T Cottier et al, *International Law in Financial Regulation and Monetary Affairs* (Oxford: Oxford University Press 2012), p 334.

<sup>211</sup> Parliamentary Commission on Banking Standards, "An Accident Waiting to Happen": The Failure of HBOS' *House of Lords, House of Commons, Fourth Report of Session 2012-13, H 416* ('The Failure of HBOS'), p 3.

<sup>212</sup> *Smith* (n204).

<sup>213</sup> Decision by Lord Mandelson, the Secretary of State for Business, Not to Refer to the Competition Commission the Merger Between Lloyds TSB Group plc and HBOS plc under Section 45 of the Enterprise Act 2002 (31 October, 2008) *Department for Business, Enterprise & Regulatory Reform* ('Lord Mandelson Decision'), para 4, available at [www.berr.gov.uk/files/file48745.pdf](http://www.berr.gov.uk/files/file48745.pdf).

<sup>214</sup> *Ibid*, paras 9-12.

<sup>215</sup> *OFT Report to the SoS* (n201), p 5.

CC would find the same under the equilibrium of probabilities pattern, which would apply to the CC's inquires.<sup>216</sup>

Despite these findings, Lord Mandelson concluded not to make a reference to the CC, based on the Enterprise Act 2002 ('EA02'), on the grounds that the advantages of the takeover for the stability of the UK financial system would offset any anticompetitive consequences, notwithstanding the OFT's concerns.<sup>217</sup> He noted that on balance, the SoS determined that safeguarding the stability of the financial system warrants the anti-competitive outcome that the OFT ascertained and that public interest was served at best, if the takeover was to be cleared.<sup>218</sup> The decision of Lord Mandelson relied heavily on the submissions by the Bank of England, the HM Treasury, as well as those of the Financial Services Authority.<sup>219</sup>

The records show an interesting timeline of the steps taken to effectuate the decision to approve the takeover of HBOS by Lloyds. On 18 September, 2008, the takeover was announced. The SoS issued an intervention notice on the same day. On 7 October, a Draft Financial Stability Order was presented before Parliament.<sup>220</sup> The following day, the UK Government revealed a £500 billion bank assistance package.<sup>221</sup> On 13 October, the government announced the recapitalization undertakings for Royal Bank of Scotland, HBOS, and Lloyds.<sup>222</sup>

The draft order was deliberated on in the House of Lords on 16 October,<sup>223</sup> and in the House of Commons on 20 October.<sup>224</sup> On the 23 October, the Financial Stability Order was approved. It became effective on the 24 October.<sup>225</sup> On the same day, the then OFT sent a

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<sup>216</sup> *Ibid*, pp 4, 97, and 103.

<sup>217</sup> *Lord Mandelson Decision* (n213), paras 17, and 27.

<sup>218</sup> *Ibid*, par 19.

<sup>219</sup> *Ibid*, paras 21-25.

<sup>220</sup> EA02 (n4) (Specification of Additional Section 58 Consideration) 2008 Order (SI 2008/2645).

<sup>221</sup> R Winnett and A Porter, 'Financial Crisis: £500 Billion Bail-Out Plan Helps Stabilise Banks' (9 October, 2008), *Telegraph*.

<sup>222</sup> E Engelen et al, *After the Great Complacency: Financial Crisis and the Politics of Reform* (New York: Oxford University Press 2011), p 31.

<sup>223</sup> 704 Parliamentary Debates, House of Lords [2008] 5th Series (2008) 849 (UK).

<sup>224</sup> House of Commons, 'Second Delegated Legislation Committee, Enterprise Act 2002 (Specification of Additional Section 58 Consideration)' Order 2008 (S.I., 2008/2645).

<sup>225</sup> *Ibid*.

report to the SoS on the takeover of HBOS by Lloyds.<sup>226</sup> On 31 October, the SoS issued its decision not to make a reference to the CC.<sup>227</sup> On 10 December, the Competition Appeal Tribunal dismissed the appeal from the interest group against the SoS challenging the merger.<sup>228</sup>

The decisions to clear the takeover of HBOS by Lloyds and to set aside the OFT's competition concerns were widely criticized.<sup>229</sup> The UK Government reassured the public that the merged bank remained subject to competition provisions.<sup>230</sup> However, few were convinced by the government's reassurance. It is common that *ex post* bank merger enforcements are substantially less effective than the initial prevention of the merger.<sup>231</sup>

By the time the Competition Appeal Tribunal issued its ruling about the takeover of HBOS by Lloyds,<sup>232</sup> the £200 billion package of systemic support for the UK banks was already in place, as were the recapitalization measures.<sup>233</sup> The financial package specified undertakings to enhance bank capital, the government subscription of capital, and its guarantees to issue new debt. These undertakings were made to target the systemic problem among banks rather than problems faced by any particular bank.<sup>234</sup> They seemed sufficient to sustain HBOS' survival. Some critics argued that once this financial support of capital was made available, the decision to clear the takeover of HBOS by Lloyds was unnecessary and an economic error.<sup>235</sup> They argued that this gave rise to an irretrievable loss of competition in banking and financial services in the UK, particularly in Scotland.<sup>236</sup>

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<sup>226</sup> *OFT Report to the SoS* (n201), p 1.

<sup>227</sup> *Lord Mendelson Decision* (n213), preface.

<sup>228</sup> For discussion about this case, see *MAG v SoS* in chapter 4.3.1(a) in this thesis, pp 88-94.

<sup>229</sup> B Hawk, *Fordham Competition Law Institute: International Antitrust Law & Policy* in S Polito (eds.) *EU and UK Competition Laws and the Financial Crisis: The Price of Avoiding Systemic Failure* (New York: Juris Publishing 2010), pp 171-172.

<sup>230</sup> HM Treasury, 'Implementation of Financial Stability Measures for Lloyds Banking Group and Royal Bank of Scotland' (3 November, 2009) *Newsroom & Speeches 99/09*, available at [http://webarchive.nationalarchives.gov.uk/20100407010852/http://www.hm-treasury.gov.uk/press\\_99\\_09.htm](http://webarchive.nationalarchives.gov.uk/20100407010852/http://www.hm-treasury.gov.uk/press_99_09.htm)

<sup>231</sup> R Peston, 'Creation of Lloyds HBOS' (17 September, 2008) *BBC News*, available at [http://www.bbc.co.uk/blogs/thereporters/robertpeston/2008/09/the\\_creation\\_of\\_lloyds\\_hbos.html](http://www.bbc.co.uk/blogs/thereporters/robertpeston/2008/09/the_creation_of_lloyds_hbos.html)

<sup>232</sup> For discussion about this case, see *MAG v SoS* in chapter 4.3.1(a) in this thesis, pp 88-94.

<sup>233</sup> HM Treasury, 'Financial Support to the Banking Industry' (8 October, 2008) *Newsroom & Speeches 100/08*, available at [http://webarchive.nationalarchives.gov.uk/+http://www.hm-treasury.gov.uk/press\\_100\\_08.htm](http://webarchive.nationalarchives.gov.uk/+http://www.hm-treasury.gov.uk/press_100_08.htm).

<sup>234</sup> *Ibid.*

<sup>235</sup> L C Bennetts and A S Long, 'The New Autarky? How U.S. and UK Domestic and Foreign Banking Proposals Threaten Global Growth' (21 November, 2013) *Cato Institute, Policy Analysis* N 473, pp 11-12.

<sup>236</sup> *Ibid.*; see, also, BBC News 'Lloyds TSB's HBOS Deal Is Cleared' (31 October, 2008) *Business Section*, available at <http://news.bbc.co.uk/2/hi/business/7702809.stm>.

The conditions surrounding the bank merger clearance showed that notwithstanding the provisions of the EA02 aiming to render the former OFT and former CC (presently CMA) independent authorities, bank mergers competition policy in UK are not free from political pressure.<sup>237</sup> It could be tempting to give in to political pressure in bank merger situations, which is likely to create a major impact in the financial and banking system.

There was prevalent concern within the banking community that the takeover of HBOS by Lloyds could result in less competition in the relevant markets.<sup>238</sup> Even prior to the takeover, the UK banking industry was broadly deemed not entirely competitive and had been extensively analyzed by both the OFT and the CC in the framework of merger control and market examinations.<sup>239</sup>

At the peak of the GFC, the UK Government orchestrated the takeover of HBOS by its competitor, Lloyds.<sup>240</sup> This resulted in the formation of a new banking mammoth that has become the biggest bank and mortgage lender in the UK.<sup>241</sup> To allow the takeover to proceed, the UK Government took the critical step of altering the law<sup>242</sup> to permit the SoS to intervene in the standard bank merger examination process.<sup>243</sup> It, also, permitted the SoS to disregard competition issues on the basis of the public interest to maintain the stability of the financial

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<sup>237</sup> J Vickers, 'Central Banks and Competition Authorities: Institutional Comparisons and New Concerns' (2010) *Bank for International Settlements, Working Papers No 331*, available at <http://www.bis.org/publ/work331.pdf>.

<sup>238</sup> H Mathur, 'The UK OFT Waives Competition Law in the Interest of "Maintaining the Stability of the UK Financial System" and Clears a Major Concentration in the Banking Sector' (Lloyds/HBOS)' (24 October, 2008) *e-Competitions Bulletin N 28250*, available at <http://www.concurrences.com/Bulletin/News-Issues/October-2008/The-UK-OFT-waives-competition-law?lang=en>.

<sup>239</sup> Competition Commission, 'Report on the Proposed Acquisition by Lloyds TSB of Abbey National' (2001) CC; see, also, Competition Commission, 'The Supply of Banking Services by Clearing Banks to Small and Medium-Sized Enterprises' (2002), available at [http://www.competition-commission.org.uk/rep\\_pub/reports/2002/462banks.htm](http://www.competition-commission.org.uk/rep_pub/reports/2002/462banks.htm); see, further, Office of Fair Trading, 'Review of the Undertakings Given by Banks Following the 2002 Competition Commission Report' (2007) OFT937, available at [http://www.offt.gov.uk/shared\\_offt/reports/financial\\_products/offt937.pdf](http://www.offt.gov.uk/shared_offt/reports/financial_products/offt937.pdf); see, also, Competition Commission, 'Personal Current Account Banking Services in Northern Ireland Market Investigation' (2007); see, finally, Office of Fair Trading, 'Personal Current Accounts in the UK: An OFT Market Study' (2008), available at [http://webarchive.nationalarchives.gov.uk/20140402142426/http://oft.gov.uk/shared\\_offt/reports/financial\\_products/OFT1005.pdf](http://webarchive.nationalarchives.gov.uk/20140402142426/http://oft.gov.uk/shared_offt/reports/financial_products/OFT1005.pdf)

<sup>240</sup> *The Failure of HBOS* (n211), p 15.

<sup>241</sup> *Ibid.*

<sup>242</sup> House of Commons, 'Banking Crisis: Dealing with the Failure of the UK Banks' (1 May, 2009) *HC 416*, p 12.

<sup>243</sup> *Ibid.*, pp 14, and 15.

system.<sup>244</sup> This was criticized as ripping up the UK's competition laws by raising significant questions for the status of bank merger enforcement in the country.<sup>245</sup>

#### 4.3.2(f) Thomas Cook and Barclays

In 1994, *Thomas Cook Group Limited* ('Thomas Cook')/*Barclays* bank merger case<sup>246</sup> arose, with the Secretary of State for Trade and Industry ('SoS'), in exercising its legislative powers,<sup>247</sup> making a reference to the Monopolies and Mergers Commission (the former competition authority in the UK) for investigation.<sup>248</sup> The Commission was to report any relevant findings to the SoS.<sup>249</sup> The SoS endorsed the Commission's report, noting that the case presented competition concerns in particular as to whether both merging parties would cease to remain distinct after the consummation of the merger.<sup>250</sup>

The case involved banking services, such as, the inter-payment travelers' cheques issued by Barclays' inter-payment services, which bore the 'Visa' trade mark, upon the issuing institutions becoming a subsidiary of the Thomas Cook or the latter acquisition of the issuing institution's assets.<sup>251</sup>

Upon a thorough investigation, the Commission requested the Thomas Cook to undertake certain conditions prior to the acquisition. These conditions were expected to reduce any competition issues in the market.<sup>252</sup> Subject to the conditions, the Commission revoked the merger reference made by the SoS.<sup>253</sup>

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<sup>244</sup> *Ibid*, p 17.

<sup>245</sup> D A Crane, 'Antitrust Enforcement during National Crises: An Unhappy History' (2008) *Global Competition Policy* 6.

<sup>246</sup> The Merger Reference (*Thomas Cook Group Limited and Barclays Bank plc*) [1994] Order 1994 S.I. 1994/2877 ('Merger Reference').

<sup>247</sup> Fair Trading Act 1973, ss 64, 69(2), and 75.

<sup>248</sup> *Merger Reference* (n246), preface.

<sup>249</sup> Monopolies and Mergers Commission, 'Thomas Cook Group Limited and Inter-payment Services Limited: A Report on the Acquisition by the Thomas Cook Group Limited of the Travellers Cheque Issuing Business of Barclays Bank plc' (March 1995) *Cm 2789*, available at [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/272040/2789.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/272040/2789.pdf).

<sup>250</sup> *Ibid*, pp 5-6.

<sup>251</sup> *Ibid*, pp 3-4, and 23-24.

<sup>252</sup> *Ibid*, pp 17-19. These conditions included the *Group* and the to-be acquired inter-payment services entities preserving the existing legal structure of the latter, upholding the acquired entity as an issuer of inter-payment travellers' cheques in the complete range of issued currencies; prohibition to utilize the *Thomas Cook* name or 'Master Card' trademark in combination with inter-payment travellers' cheques or the marketing of any business

The *Thomas Cook/Barclays* case shows that - unlike the takeover case of HBOS by Lloyds, where the SoS disregarded the UK competition regulators expressed competition concerns over the proposed takeover - the UK Government relied on the regulator's remedial findings. This shows that when the government has the will, it is fully capable to implement competition policies towards bank merger and acquisition transactions.

#### 4.4 Bank mergers before EU courts and Commission

The EU courts and Commission play an important role in shaping competition aspects of bank mergers. Some important bank merger reviews, before the EU courts and the Commission, are discussed below.

##### 4.4.1 Bank merger case laws before EU courts

The following are some relevant bank merger case laws before the EU courts.

##### 4.4.1(a) *Raiffeisen Zentralbank Österreich v Commission*

The 2006 merger case of *Raiffeisen Zentralbank Österreich v. Commission*<sup>254</sup> involved eight banks bringing an action against the Commission, based on Article 81 of the EC Treaty [presently Article 101 TFEU] before the then Court of First Instance (Second Chamber). These banks challenged a decision by the Commission that imposed fines on the banks upon holding that they formed a system of regular meetings (the 'Lombard network').<sup>255</sup> In their meetings, the banks discussed underlying aspects of competition in the Austrian market, which according to the Commission's contested decision amounted to joint practices

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provided by the inter-payment entity; prohibition to utilize the 'Visa' trademark in combination with any travellers' cheque issuing operation provided by *Thomas Cook Group*; ; establishment of a separate and ongoing sales promotion policy for inter-payment travellers' cheques without using the *Thomas Cook* name about the sales or marketing.

<sup>253</sup> *Merger Reference* (n246), para 3.

<sup>254</sup> Joint cases T-259/02 to T-264-02 and T-271/02 *Raiffeisen Zentralbank Österreich v Commission* [2006] ECR II-0569.

<sup>255</sup> *Ibid*, paras 1, 3, and 28.

pertaining to prices, charges, and advertising.<sup>256</sup> The Commission defined the distortion of competition by these banks as voluntary and of quite serious extent.<sup>257</sup>

The Court of First Instance (Second Chamber) looked at the assertion that the determination of the banks' agreements was erroneous.<sup>258</sup> The Court found that the Commission presented evidence to show that the Lombard network was deemed as competent to decide on the prices to be allotted on several significant cross-border deals and that the Lombard network was authorized to decide on the compliance of the participating banks pertaining to the agreements.<sup>259</sup>

The Court noted a compelling assumption that if the practice of curbing competition is used across the territory of a Member State, it would facilitate the 'compartmentalization of the markets' and consequently affect intra-Community trade.<sup>260</sup> The Court determined that the banks were unable to overcome this assumptive argument.<sup>261</sup>

The Court held that the foregoing assumption could only be rebutted by the examination of the aspects of the agreement, and the economic setting of the agreement showing the contrary.<sup>262</sup> Therefore, the Court dismissed the banks' application.<sup>263</sup>

#### 4.4.1(b) ABN AMRO Group v Commission

In *ABN AMRO Group v. European Commission*<sup>264</sup>, the ABN AMRO Group, formed upon the 2014 merger between ABN AMRO and Fortis Bank Netherland, filed an action before the General Court seeking annulment of the decision of the Commission barring ABN AMRO to merger above 5 per cent of any undertaking.<sup>265</sup> The State aid received by the bank by means

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<sup>256</sup> *Ibid*, paras 30-31.

<sup>257</sup> *Ibid*, paras 22-23.

<sup>258</sup> *Ibid*, paras 507, and 564.

<sup>259</sup> *Ibid*, paras 168, and 262.

<sup>260</sup> *Ibid*, paras 180, and 181.

<sup>261</sup> *Ibid*, paras 184, and 186.

<sup>262</sup> *Ibid*, paras 499, and 511.

<sup>263</sup> *Ibid*, para 580(2).

<sup>264</sup> Case T-319/11 *ABN AMRO Group NV v European Commission* EU:T:2014:186.

<sup>265</sup> *Ibid*, paras 13.1, and 22.



of recapitalization assistance was subject to a three-year ban of entering into merger deals.<sup>266</sup> ABN AMRO asserted that such bar was disproportionate and broader than those measures ruled in other decisions of the General Court implemented during similar period concerning State aid.<sup>267</sup>

The General Court relied on the discretion of the Commission in deciding the conditions to be satisfied prior to a State aid measure would be announced and being compatible with the internal market.<sup>268</sup> The Court found that the restraint was compatible with the principles included in the Commission's communication on bank's restructuring.<sup>269</sup> Additionally, the General Court held that the Commission was correct in deciding the maximum duration of the future merger prohibition of ABN AMRO due to the fact that the role of a competition regulator to consider the strategy of the Dutch Government for exiting the capital (divestment) of ABN AMRO.<sup>270</sup>

#### 4.4.1(c) *Bayerische Hypo- und Vereinsbank v Commission*

In 2004, *Bayerische Hypo- und Vereinsbank v Commission*<sup>271</sup>, the bank, Bayerische Hypo- und Vereinsbank ('Bayerische'), filed an action for annulment of the Commission's decision before the then Court of First Instance (Fifth Chamber).<sup>272</sup> This involved a decision of the Commission made in 2001, based on an investigation on 150 banks, including Bayerische.<sup>273</sup> The Commission found that the banks agreed to inform the Bundesbank (central bank of Germany) that they would effectuate the exchange of euro-zone banknotes at the fixed exchange rates and charge a certain commission.<sup>274</sup>

The Court of First Instance (Fifth Chamber) reminded both parties of the Commission's previous decision that found that any German banks, including those they intended to merger between each other, had to express their joint intention to conduct

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<sup>266</sup> *Ibid*, para 13.3.

<sup>267</sup> *Ibid*, para 19.

<sup>268</sup> *Ibid*, para 215.

<sup>269</sup> *Ibid*.

<sup>270</sup> *Ibid*, paras 219, and 220-222.

<sup>271</sup> Case T-56/02 *Bayerische Hypo-und Vereinsbank v Commission* [2004] ECR II-3495.

<sup>272</sup> *Ibid*, para 17.

<sup>273</sup> *Ibid*, para 22.

<sup>274</sup> *Ibid*, paras 33, and 36.

themselves on the exchange of euro-zone banknotes market in compliance with their previous undertakings to the Commission.<sup>275</sup> Nevertheless, the Court held that the evidence presented by the Commission was inadequate to ascertain the presence of a concurrence of wills on the principle of a commission balanced to the volume exchanged.<sup>276</sup> Accordingly, the Court found that the Commission failed to establish the necessary legal parameters that there was an agreement about the charges for currency exchange services.<sup>277</sup> The decision was annulled.<sup>278</sup>

#### 4.4.1(d) Assicurazioni Generali SpA and UniCredit S.p.A. v Commission

The 1999 *Assicurazioni Generali S.p.A. and UniCredit S.p.A. v Commission*<sup>279</sup> was a case before the Court of First Instance (First Chamber) concerning the Commission's finding that the formation of a joint venture, Casse e Generali Vita S.p.A. ('CG Vita'), did not sustain operational autonomy.<sup>280</sup> The bank applicants, upon admitting that CG Vita rose to a concentration, asserted that such concentration did not amount to coordinating the competitive conduct of the founding entities.<sup>281</sup> They claimed to have fulfilled the conditions provided under the merger control in companies' provisions. The applicants alleged that the Commission erred in supporting its decision on a narrow interpretation of the condition pertaining to operational autonomy.<sup>282</sup> According to the applicants, decision conflicted with numerous previous decisions, when the Commission ruled in support of the operational autonomy of joint ventures with more extensive economic relations than the CG Vita case.<sup>283</sup>

The Court of First Instance (First Chamber) agreed with the Commission that it would have been extremely improbable that the joint venture enjoyed operational autonomy.<sup>284</sup> Based on the evidence, for at least the first five years of business, CG Vita could not manage independently the services related to the management and production of insurance policies,

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<sup>275</sup> *Ibid*, paras 19, and 20.

<sup>276</sup> *Ibid*, paras 112, and 113.

<sup>277</sup> *Ibid*, para 118.

<sup>278</sup> *Ibid*, para 120.

<sup>279</sup> Case T-87/96 *Assicurazioni Generali SpA and Unicredit S.p.A. v Commission* [1999] ECR II-203.

<sup>280</sup> *Ibid*, para 23.

<sup>281</sup> *Ibid*, paras 35, and 36.

<sup>282</sup> *Ibid*, paras 47, and 48.

<sup>283</sup> *Ibid*, para 51.

<sup>284</sup> *Ibid*, paras 79-81, and 83.

settlement of insurance claims, and administrative tasks of the portfolio.<sup>285</sup> CG Vita could not qualify as ‘concentration’ due to the fact that the entity failed operational independence. Accordingly, this finding was adequate to affect the analysis of matters concerning the cooperation between the two entities.<sup>286</sup> Consequently, the Court dismissed the application.<sup>287</sup>

#### 4.4.1(e) BNP Paribas and Banca Nazionale del Lavoro v Commission

The *BNP Paribas and BNL v Commission*<sup>288</sup> case concerned State aid.

In 2010, BNP Paribas, a French bank, and Banca Nazionale del Lavoro (‘BNL’), an Italian bank, filed an action against the Commission before the General Court (Fifth Chamber) to seek an annulment of a decision by the Commission.<sup>289</sup> The decision established that a particular tax scheme pertinent to the banking industry created a ‘selective advantage’ that would have an effect on improving the competitiveness of particular financial institutions.<sup>290</sup> The Commission opined that the benefit was not warranted by the nature of the Italian tax system and amounted to a State aid, and, thus, incompatible with the common market.<sup>291</sup> The applicants argued that the Commission erred in finding the presence of State aid and that it impinged on its obligation to articulate specific reasons due to a factual error.<sup>292</sup>

The court dismissed the action, finding that the Commission was correct in utilizing the normal tax rates as a reference basis for determining whether there was an economic benefit.<sup>293</sup> The court, also, dismissed the assertion that the benefit was warranted due to the general structure of the tax system.<sup>294</sup>

In 2012, both banks appealed to the Court of Justice (Second Chamber), asserting, among others, that the lower court failed to exercise its review power to evaluate whether the

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<sup>285</sup> *Ibid*, para 77.

<sup>286</sup> *Ibid*, para 83.

<sup>287</sup> *Ibid*, para 84.

<sup>288</sup> C-452/10 P *BNP Paribas and BNL v Commission* [2012] EU:C:2012:366 (‘BNP Paribas 2012’).

<sup>289</sup> Case T-335/08 *BNP Paribas and BNL v Commission* [2010] ECR II-03323.

<sup>290</sup> *Ibid*, paras 201-202.

<sup>291</sup> *Ibid*, paras 30, and 32-35.

<sup>292</sup> *Ibid*, paras 61-62, 80, and 85.

<sup>293</sup> *Ibid*, paras 93-101.

<sup>294</sup> *Ibid*, paras 208, and 211-212.

tax scheme subject matter was warranted by the essence and overall structure of the Italian tax system.<sup>295</sup> The Court of Justice found that the lower court erred in its decision as a matter of law by failing to conduct a comprehensive examination as to whether or not the tax scheme in the matter arose within the meaning of the State aid EU compatibility provisions.<sup>296</sup> It subsequently found that the tax scheme was unwarranted by the essential reasoning of the Italian tax system and dismissed the appeal.<sup>297</sup>

The foregoing bank merger case laws before the European courts show the strict, and often, narrow interpretation of the EU competition provisions by these courts towards bank mergers. Frequently, these courts do not hesitate to annul decisions issued by the Commission on bank mergers, when such decisions are deemed to be defective and not fully supported by the law.

#### 4.4.2 Bank merger cases before the Commission

In addition to the aforementioned bank merger case law before the EU courts, there have been four important bank merger review cases before the Commission, which deserve consideration.

##### 4.4.2(a) Banque Nationale de Paris and Dresdner Bank AG-Austrian JV<sup>298</sup>

This case was one of the first cases heard by the Commission in late 1990's pertaining to bank mergers at the EU level.<sup>299</sup> The French bank of Banque Nationale de Paris ('BNP') and the German bank of Dresdner Bank AG ('Dresdner') proposed a concentration under EU laws.<sup>300</sup> This would give rise to a new joint venture creating a stock company under Austrian law.<sup>301</sup> Each bank would have an ownership of 50 per cent of the share capital and the joint control of the anticipated consolidated banking institution.<sup>302</sup> The new institution would operate as a

<sup>295</sup> *BNP Paribas 2012* (n288), paras 66-69.

<sup>296</sup> *Ibid*, paras 102-105.

<sup>297</sup> *Ibid*, paras 137-139.

<sup>298</sup> Case No. COMP/M.1340 *BNP/Dresdner Bank - Austrian JV* [1998] OJ C 36/16 ('BNP/Dresdner').

<sup>299</sup> R Whish and D Bailey, *Competition Law* (8<sup>th</sup> edns, New York: Oxford University Press 2015), p 652.

<sup>300</sup> *BNP/Dresdner* (n298), para 7.

<sup>301</sup> *Ibid*, para 4.

<sup>302</sup> *Ibid*.

financial holding company carrying out the banking joint ventures activity in the Central and Eastern Europe.<sup>303</sup>

The concentration between these two banks was considered to fall into the provisions of the ECMR.<sup>304</sup> Therefore, the Commission reviewed its compatibility with the Common Market.<sup>305</sup> The Commission, while holding the relevant products market to be the deposit taking, short and midterm loans, and processing of domestic and global payment transfers, it qualified these bank operations to constitute ‘the wholesale or corporate banking market’.<sup>306</sup>

The Commission determined that the aforementioned concentration neither established nor strengthened a dominant position.<sup>307</sup> In relation to the definition of the relevant geographic market, the Commission agreed with the merging banks that the relevant geographic market is within Austria.<sup>308</sup> Although, it was likely for the venture to carry out cross-border activities, the neighboring markets would merely be influenced indirectly.<sup>309</sup> The Commission noted that the wholesale banking market in Austria would not be influenced by the venture, considering that this market was distinguished by a weighty presence of national banking counterparts.<sup>310</sup>

The Commission concluded that the venture fell within the scope of the co-operation agreement exemption provisions under the EU Treaty.<sup>311</sup> The bank consolidation between BNP and Dresdner was, thus, granted.<sup>312</sup>

#### 4.4.2(b) BNP Paribas and Fortis

In the 2008 BNP Paribas and Fortis case,<sup>313</sup> BNP Paribas notified the Commission of its intention to take over the sole control of the Luxembourg and Belgian subsidiaries of Fortis

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<sup>303</sup> *Ibid*, para 5.

<sup>304</sup> *Ibid*, para 7.

<sup>305</sup> *Ibid*, paras 9, and 10.

<sup>306</sup> *Ibid*, para 9.

<sup>307</sup> *Ibid*.

<sup>308</sup> *Ibid*, para 10.

<sup>309</sup> *Ibid*.

<sup>310</sup> *Ibid*, para 11.

<sup>311</sup> *Ibid*, para 12.

<sup>312</sup> *Ibid*, para 13.

Holding (Fortise Banque Luxembourg, Fortis Bank Belgium and Fortis Insurance Belgium, respectively).<sup>314</sup> The combined global revenue of the players was assessed above €5 billion, and each undertaking sustained an EU-wide revenue above €250 million.<sup>315</sup> Therefore, the concentration met an EU dimension under the EU merger provisions.<sup>316</sup>

While the corporate banking and retail banking markets did not cause any issues, serious reservations were made about the credit cards issuing in Luxembourg and Belgium.<sup>317</sup> The merger would make BNP the biggest bank within these two countries market, therefore, diminishing customers' options for credit cards.<sup>318</sup> The Commission, upon individualizing the different kinds of cards, such as, debit cards, credit cards, and store cards, deemed it suitable to leave out debit cards from the relevant market.<sup>319</sup> This was because while the concerning banks overlapped in the charge and credit cards issuing, it was not the case in the debit cards issuing.<sup>320</sup> Although the Commission did not encounter any aspects of vertical effects in its competitive valuation, it noticed horizontal effects.<sup>321</sup>

The Commission set apart the overlaps that resulted in affected markets and those that did not.<sup>322</sup> Those that did not result in affected markets - such as, when the concerning banks' combined shares did not surpass 15 per cent - included the savings accounts and the personal current accounts in France, personal loans in Germany, Belgium, and Poland, and private banking in the UK, France, Italy, Belgium, Spain, and Luxembourg.<sup>323</sup> The overlaps that gave rise to affected markets - such as, when the concerning banks' combined shares did surpass 15 per cent - comprised the French leasing market (in aggregate market share of 20 per cent) and the Belgian leasing market (aggregate market share between 20 to 30 per cent), and the Belgian mortgages and retail banking (aggregate market share under 25 per cent).<sup>324</sup> Following the merger, the issuing of universal credit/charge cards would have reached 40 to

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<sup>313</sup> Case No. COMP/M.5384 *BNP Paribas/Fortis* [2008] OJ C 7/4.

<sup>314</sup> *Ibid*, para 1.

<sup>315</sup> *Ibid*, para 6.

<sup>316</sup> *Ibid*; see, also, *ECMR* (n3), art 1.2.

<sup>317</sup> *Ibid*, para 24.

<sup>318</sup> *Ibid*, para 105.

<sup>319</sup> *Ibid*, paras 23-25.

<sup>320</sup> *Ibid*, para 26.

<sup>321</sup> *Ibid*, paras 80-82.

<sup>322</sup> *Ibid*.

<sup>323</sup> *Ibid*, paras 81, and 94.

<sup>324</sup> *Ibid*, paras 75, 81, 83, 85, 89-90, and 93-95.

50 per cent of the market shares in the Belgian market and about 40 to 50 per cent in Luxembourg.<sup>325</sup>

In response to the Commission's concerns, BNP divested its entire Belgian credit card operation unit, namely the BNP Paribas Personal Finance Belgium SA/NV.<sup>326</sup> In consideration of such divestment, the Commission found that the merger did not create significant effect in competition within the EU territory.<sup>327</sup>

#### 4.4.2(c) Banco Santander and Bradford & Bingley Assets

*Santander and Bradford & Bingley Assets* case<sup>328</sup> concerned a 2008 concentration proposed by the Abbey, a UK bank wholly owned by the Spanish bank, Banco Santander, to acquire particular assets of Bradford & Bingley, another UK bank.<sup>329</sup> Both UK banks provided personal financial services of savings accounts, mortgages, loans, and financial planning.<sup>330</sup>

Upon determining that the precise product and geographic market definition could be left open, the Commission looked into the competitive valuation.<sup>331</sup> It noted that in relation to retail banking, notwithstanding the fact that there was some overlap in activities between the two banks, they did not provide a whole spectrum of services, but were only concentrated on mortgage and savings products.<sup>332</sup> Accordingly, the bank was not deemed to be a competitor over the primary banking relationship towards retail customers.<sup>333</sup>

As to the savings account products, the Commission determined that the proposed merger did not influence the UK market, provided that the new share would rise less than 5 per cent.<sup>334</sup> In relation to the retail mortgages operations, the Commission found that the HHI post-merger indicated that the acquisition did not give rise to concerns about its affinity with

<sup>325</sup> *Ibid*, paras 104, 122, and 149.

<sup>326</sup> *Ibid*, paras 144-147, and the commitments annexed to this decision.

<sup>327</sup> *Ibid*, paras 161-162.

<sup>328</sup> Case No. COMP/M.5363 *Santander/Bradford & Bingley Assets* [2008] OJ C 7/4.

<sup>329</sup> *Ibid*, para 1.

<sup>330</sup> *Ibid*, paras 2-4.

<sup>331</sup> *Ibid*, paras 12-18.

<sup>332</sup> *Ibid*, paras 19-20.

<sup>333</sup> *Ibid*, para 21.

<sup>334</sup> *Ibid*, paras 22-24.

the common market within the retail mortgage market in the UK.<sup>335</sup> Therefore, the Commission did not oppose the merger.<sup>336</sup>

#### 4.4.2(d) UniCredit S.p.A. and HypoVereinsbank

This 2006 case involved a merger between the Italian bank, UniCredit, and the German bank, HypoVereinsbank ('HVB').<sup>337</sup>

In 1999, UniCredit entered into a bidding process to acquire a majority interest in Pekao, a publicly owned bank that was undergoing privatization by the Polish Government.<sup>338</sup> Part of the deal included the prohibition of UniCredit to grow its position within the Polish banking market through acquiring other Polish or foreign banks in the same market.<sup>339</sup> Nevertheless, in 1998, UniCredit had already acquired another Polish bank, BPH, and HVB had executed a similar non-compete stipulation with the Polish Government at the time of this acquisition.<sup>340</sup>

In clearing the UniCredit/HVB bank merger, the Commission admitted that the effect of this deal would be on the Polish banking market due to the practical combination of Pekao and BPH.<sup>341</sup> Even though the merger would result in an increase in the assets market of the Pekao bank, and in an increase of the branch network market of BPH bank, the Commission noted that banking sector in Polish market showed a 'fairly low degree of concentration'.<sup>342</sup> In the end, the Commission decided not to oppose the *UniCredit/HVB* merger, and to declare it compatible with the common market.<sup>343</sup>

The Polish Government disagreed with the Commission's foregoing findings regarding the impact the merger would have on the credibility of the privatization process in

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<sup>335</sup> *Ibid*, paras 25-29.

<sup>336</sup> *Ibid*, para 37.

<sup>337</sup> Case No. COMP/M.3894 *UniCredit SpA/HypoVereinsbank* [2005] OJ C 235.

<sup>338</sup> *Ibid*, para 1.

<sup>339</sup> *Ibid*, para 5.

<sup>340</sup> *Ibid*, para 6.

<sup>341</sup> *Ibid*, paras 54.

<sup>342</sup> *Ibid*, para 55.

<sup>343</sup> *Ibid*, para 86.



Poland.<sup>344</sup> As a result, in 2006, the Polish Government sought *UniCredit/HVB* to divest the entire shares held in BPH bank.<sup>345</sup> It, also, launched an action against the Commission with the Court of First Instance, asserting that the Commission committed procedural and substantive errors in its *UniCredit/HVB* merger decision.<sup>346</sup> Especially, the Polish Government claimed that the Commission violated the duty of loyal co-operation in Article 10 of the EC (presently Article 4(3) of the Treaty on European Union) by failing to consider Poland's genuine interests in guaranteeing the application and implementation of the strategies of de-monopolization and privatization.<sup>347</sup>

The Commission immediately open an infringement proceeding against Poland, claiming the privatization agreements that UniCredit and HVB entered into with the Polish Government contravened the free movement of capital provisions of the EU Treaty<sup>348</sup>, and that the *ex post* intervention of the Polish Government aimed at implementing those agreements against the merged financial institution violated Article 21 of the ECMR.<sup>349</sup> Soon after, the Polish Government dropped its action before the Court of First Instance, and declared that it entered into an agreement with UniCredit/HVB, in which it agreed to permit the merger of the two Polish banks, conditional upon the divestment of about half of BPH's branches and an agreement not to eliminate jobs at the merged bank until early 2008, which was the year the HVB-BPH non-compete clause expired.<sup>350</sup>

The foregoing bank merger cases before the Commission's review show that the EU competition regulator analyses closely specific evidence, such as banking products market, geographic market, in order to determine the level of concentration that the proposed merger will have in the Common Market. Like its American and British counterparts, the Commission tends to resolve competition issues in a bank merger by the means of remedial action, *i.e.*, divestiture.

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<sup>344</sup> M Landler, 'Cross-Border Banking Offers Culture Lessons' (11 May, 2006) *New York Times*.

<sup>345</sup> J Cienski et al, 'UniCredit Strikes Deal Over BPH' (6 August, 2006) *Financial Times*.

<sup>346</sup> Case T-41/06 *Poland v Commission* [2008] EU:T:2008:103.

<sup>347</sup> *Ibid*, paras 4-8.

<sup>348</sup> Commission, 'Mergers: Commission Launches Procedure Against Poland for Preventing UniCredit/HVB Merger' (8 March, 2006) *Press Release IP/06/277*.

<sup>349</sup> Commission, 'Libre Circulation des Capitaux: La Commission Ouvre Une Procédure d'Infraction Contre la Pologne Dans le Cadre de la Concentration UniCredit/HBV' (8 March, 2006) *Press Release IP/06/276*.

<sup>350</sup> M Landler, 'Poland Averts Clash with Europe Over Italian Bank Deal' (6 April, 2006) *New York Times*.

## The role of the UK and EU State aids assessment in banking cases

State aid to the banking and financial sector can be offered in the form of guarantee, equity, bad bank, and nationalisation.<sup>351</sup>

Governments can *guarantee* bank deposits, banks bonds or all bank liabilities.<sup>352</sup> Because deposit guarantees schemes are structured for retail depositors and limited to a fixed maximum amount, they do not raise a State aid concern. However, when the deposit protection fund is utilized to bail out a bank, the EU's State aid rules apply.<sup>353</sup>

Member States can provide *equity* support to consolidate the capital base of banks.<sup>354</sup> In recapitalisation programmes, States provide funds to banks in return for direct equity, preferred shares or subordinated debt.<sup>355</sup>

A special form to absorb losses in the financial system is the formation of a *bad bank*, which applies where banks get a delay to reimburse their creditors until the financial system normalises, and assets recover.<sup>356</sup> Bad bank schemes raise fundamental competition policy issues pertaining to determination of the new book value of the impaired assets, tackling the distortions created by the schemes, and justifying the scheme to taxpayers, when public money is utilized to pay for bad assets to banks in trouble.<sup>357</sup>

The final form of State aid is the banks *nationalisation*, under which a large portion of or the whole assets are taken over by the state.<sup>358</sup> It is the capital injection in a bank in trouble, rather than a nationalisation per se, that forms state aid.<sup>359</sup>

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<sup>351</sup> M Ojo, 'Liquidity assistance and the provision of State aid to financial institutions' (2010) *IDEAS Working Paper Series* from RePEc.

<sup>352</sup> T Doleys, 'Managing State aid in a time of crisis: Commission crisis communications and the financial sector bailout' (2012) 34 *Journal of European Integration* 6, pp 549-65.

<sup>353</sup> *TFEU*, arts 107-109.

<sup>354</sup> R Vander Venet, 'Bank bailouts in Europe and bank performance' (2016) *Ghent University, Faculty of Economics and Business Administration*.

<sup>355</sup> T Buell, 'State aid for European bank is possibility' (29 September 2016) *Wall Street Journal*.

<sup>356</sup> H Dixon, 'Making the best of bad banks' (2 February 2009) *The New York Times*.

<sup>357</sup> T Geithner, 'My plan for bad bank assets; the private sector will set prices. Taxpayers will share in any upside' (23 March 2009) *Wall Street Journal*.

<sup>358</sup> H W Jenkins, Jr., 'Who owns the banks, round two? Bank nationalisation will soon be back on the agenda unless the economy picks up' (24 June 2009) *Wall Street Journal*.

<sup>359</sup> P Eavis, 'Nationalisation's many problems' (22 January 2009) *Wall Street Journal*.

The most relevant and applicable State aid assessments related to banking sector have been the ‘aid ... to remedy a serious disturbance in the economy of a Member State’<sup>360</sup> and ‘aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest’.<sup>361</sup>

The Commission was required to act under severe time limits.<sup>362</sup> The ‘effect’ that has created for continuing to deal with all banking State aid cases under ‘conventional’ EU State aid law has been for Member States’ notifications of proposed aid to be vetted by the Commission, sometimes within a short notice in order to preserve market stability. In most of the banking cases, the Commission approved such notifications, though on a provisional basis, categorising the measure(s) in issue as a ‘rescue’ aid and requiring the Member State to return to the Commission, at a specific time, with a plan for the bank’s restructuring, aimed at ensuring its long-term viability without additional aid.<sup>363</sup> Upon receipt of this plan, the Commission could issue a final decision approving the concerning aid, with or without conditions. The Commission decisions in banking cases such as KBC, ING and Lloyds were all taken on the basis of this ‘formula’.<sup>364</sup>

In the banking sectors, the Commission has acted autonomously, under its ‘classical’ position in the State aid area, pursuant to Articles 107-109 TFEU; developed its approach pragmatically through non-binding Communications, setting out (for the benefit of Member States and the banking sector) its intended approach under the fundamental EU Treaty provisions; and it made maximum use of the flexibility inherent in the Treaty, especially the ‘derogations’ permitted in Article 107(3) (a)-(c);<sup>365</sup> as well as it has successfully avoided

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<sup>360</sup> TFEU, art 107(3)(b).

<sup>361</sup> TFEU, art 107(3)(c).

<sup>362</sup> B Lyons and M Zhu, ‘Compensating competitors or restoring competition? EU regulation of State aid for banks during the financial crisis’ (2013) 13 *Journal of Industry, Competition and Trade* 1, pp 39-66.

<sup>363</sup> U Soltesz and C Von Kockritz, ‘From State aid control to the reputation of the European banking system – DG Comp and the restructuring of banks’ (2010) 6 *European Competition Journal* 1.

<sup>364</sup> Y Boudghene and S Maes, ‘Relieving banks from toxic or impaired assets: The EU State aid policy framework’ (2012) 3 *Journal of European Competition Law & Practice* 6.

<sup>365</sup> M Cini, ‘The soft law approach: Commission rule-making in the EU’s State aid regime’ (2011) 8 *Journal of European Public Policy* 2.

reaching decisions Member States and concerning financial institutions economic would have felt forced to refer to judicial review in the European Courts.<sup>366</sup>

The Commission has provided guidance to Member States and the financial sector by the way a several Communications<sup>367</sup> of a general and specific nature, dealing with matters such as, general principles of State aid law in the banking sector,<sup>368</sup> recapitalisation,<sup>369</sup> impaired assets<sup>370</sup> and restructuring aids.<sup>371</sup> These Communications<sup>372</sup> have provided an evolutionary and consistent response throughout the GFC.

There are however a number of *general themes* that characterise the Commission's approach in banking cases, especially during the GFC.<sup>373</sup> These include the need from the Commission to separate between 'good' and 'bad' banks; that all State aid is well-targeted, proportionate and minimise negative spill-over consequences on competitors; that State aid needs to be limited in minimum and the banking sector must contribute its fair share to restructuring ('burden-sharing'),<sup>374</sup> that State aid schemes should be limited in time with mandatory periodic reviews; that a clear difference is made between 'normal' liquidity provided by central banks in the form of general measures open to all comparable market players and support for specific banks; that all State aid measures and restructuring plans are aim to restore long-term viability, without the need for further injections of aid; and all State

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<sup>366</sup> C Buts et al, 'Determinants of the European Commission's State aid decisions' (2011) 11 *Journal of Industry, Competition and Trade* 4.

<sup>367</sup> E.g., Communication from the Commission on the application, from 1 August 2013, of State aid rules to support measures in favour of banks in the context of the financial crisis ('Banking Communication') OJ C 216/1, 30.7.2013.

<sup>368</sup> *Ibid.*

<sup>369</sup> Communication from the Commission – The recapitalisation of financial institutions in the current financial crisis: limitation of aid to the minimum necessary and safeguards against under distortions of competition, OJ C 10/2, 15.1.2009 ('Recapitalisation Communication').

<sup>370</sup> Communication from the Commission on the treatment of impaired assets in the Community banking sector, OJ C 72/1, 26.3.2009 ('Impaired Assets Communication').

<sup>371</sup> Commission communication on the return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the State aid rules, OJ C 195/9, 19.8.2009 ('Restructuring Communication').

<sup>372</sup> *Banking Communication* (n367); *Recapitalisation Communication* (n369); *Impaired Assets Communication* (n370); and *Restructuring Communication* (n371).

<sup>373</sup> L Evans, Deputy Director General, DG Competition, Commission 'State aid in perspective: Europe, UK and Wales – The European perspective on State aid control' (7 November 2008) Speech at the Welsh Assembly Government in conjunction with the Welsh local government association and the Law Society Office in Wales, available at [http://ec.europa.eu/competition/speeches/text/sp2008\\_10\\_en.pdf](http://ec.europa.eu/competition/speeches/text/sp2008_10_en.pdf).

<sup>374</sup> L Flynn, 'Sharing the burden – the new obligations imposed on banks seeking restructuring aid' (2014) 10 *Journal of European Competition Law & Practice* 5.

aid measures and decisions are aim to ensure a competitive EU banking industry in a global context.<sup>375</sup>

The Commission decisions in response to the State aids given from the Member States to their banks has shown transparency, comparability and consistency.<sup>376</sup>

The restructuring ordered by the Commission in the ING, KBC and Lloyds cases is radical by any standards, even if it is based on proposals worked out between the banks and the concerned Member States.<sup>377</sup> The Commission determined that almost all divestments were proposed by the concerning banks and there was sufficient market interest in the divested activities.<sup>378</sup> The Commission's approach went further by admitting that its restructuring Communication required a review of the structure of the market where the concerning banks operated. In the case of KBC, ING and Lloyds, the Commission found that in each of the three domestic markets involved, the top five banks occupy around 80 per cent of each market.<sup>379</sup> Therefore, the Commission concluded that the divestments in question created opportunities for new entrants or already present smaller competitors, and will therefore, remedy any distortions of competition caused by the State aid.<sup>380</sup>

The Commission asserted that the individual banks and the EU banking industry came out stronger from this process and is therefore, be better equipped to compete in global markets.

#### 4.5 Conclusion

Overall, the courts' involvement in the review process of bank merger in the UK has moved slowly and gradually towards the courts and other institutions specialized in the area of

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<sup>375</sup> B Thornhill, 'State aid's grey zone' (1 September 2016) *Global Capital* 5.

<sup>376</sup> A Gomes da Silva and M Sansom, 'Antitrust implications of the financial crisis: A UK and EU view' (2009) 23 *Antitrust American Bar Association* 24.

<sup>377</sup> H Sulis-Kwiecien et al, 'EU Banking Union: A framework for future financial crisis' 33 *American Bankruptcy Institute* 32.

<sup>378</sup> A Georgosouli, 'Regulatory incentive realignment and the EU legal framework of bank resolution' (2016) 10 *Brooklyn Journal of Corporate, Financial & Commercial Law* 343.

<sup>379</sup> R Smits, 'The crisis response in Europe's economic and monetary union: Overview of legal developments' (2015) 38 *Fordham International Law Journal* 1135.

<sup>380</sup> R M Lastra, 'Banking Union and Single Market: Conflict or Companionship?' 36 *Fordham International Law Journal* 1190.

competition regulatory matters. Unlike the US<sup>381</sup>, the UK courts have taken a backseat position in relation to their role in shaping competition aspects of the bank mergers. For example, as analyzed above, the Supreme Court's ruling in *Office of Fair Trading v Abbey National* was a setback to the consumer's protection rights and further consolidated the power of banks over their customers.

The contribution of the UK courts in shaping the competition aspects of bank mergers is modest. Perhaps this can be explained from the fact that any competition aspects of bank merger situations tend to be resolved at the stage of the competition and banking regulators' examination of the merger. Banks know that challenging a bank merger before the courts will be not only costly, but also will provide them with uncertainty with respect to the outcome of the case.

In the last two decades, and especially since the GFC, there has been an increasing involvement by the EU courts and the Commission in dealing with competition issues of bank mergers. However, the overall perception is that both the EU institutions and their UK counterparts have somewhat compromised the strict applicability of competition provisions in bank mergers in the post-GFC era. These mergers were largely dictated by the consequences of the crisis, which added to the political pressure from the governments of the UK or other EU Member States to approve them, despite evidence that these mergers would result in a substantial lessening of competition in the relevant markets. For example, the UK Government in the takeover of HBOS by Lloyds sidestepped competition concerns of the merger in the name of the financial stability preservation. The government's approach to the merger remains controversial because of the precedent established for future bank mergers.

The UK courts, like their US counterparts, should consider viewing banks as special institutions, which deserve particular special attention, especially when reviewing competition aspects of their mergers and acquisitions. In this respect, the Competition Appeal Tribunal, as a specialized competition court in the UK, and the General Court at the EU level that deals with bank merger cases of EU interest, play important roles. Courts and competition authorities show an increasing tendency to look at certain aspects of banking products and

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<sup>381</sup> For a discussion of the role of the US courts in reviewing antitrust aspects of some of the most important bank merger case laws, see chapters 8.0 to 8.2.2 in this thesis, pp 218-43.

services, such as, overdraft charges, credit/debit cards fees, and fees for switching bank accounts,<sup>382</sup> from a competition point of view. Instead, courts and competition authorities should take a broad look at the situation of competition in the banking system starting with preservation and enhancement of competition in bank consolidation cases in the UK.

In terms of the EU and UK State aid assessments in banking cases, State aid to the banking and financial sector is offered in the form of guarantee, equity, bad bank, and nationalisation. Governments can *guarantee* bank deposits, banks bonds or all bank liabilities. Because deposit guarantees schemes are structured for retail depositors and limited to a fixed maximum amount, they do not raise a State aid concern. However, when the deposit protection fund is utilized to bail out a bank, the EU's State aid rules apply. Member States can provide *equity* support to consolidate the capital base of banks. In recapitalisation programmes, States provide funds to banks in return for direct equity, preferred shares or subordinated debt. A special form to absorb losses in the financial system is the formation of a *bad bank*, which applies where banks get a delay to reimburse their creditors until the financial system normalises, and assets recover. The final form of State aid is the banks *nationalisation*, under which a large portion of or the whole assets are taken over by the state. It is the capital injection in a bank in trouble, rather than a nationalisation per se, that forms state aid.

In the banking sectors, the Commission has acted autonomously, under its 'classical' position in the State aid area, pursuant to Articles 107-109 TFEU; developed its approach pragmatically through non-binding Communications, setting out (for the benefit of Member States and the banking sector) its intended approach under the fundamental EU Treaty provisions; and it made maximum use of the flexibility inherent in the Treaty, especially the 'derogations' permitted in Article 107(3) (a)-(c); as well as it has successfully avoided reaching decisions Member States and concerning financial institutions economic would have felt forced to refer to judicial review in the European Courts.

The Commission decisions in response to the State aids given from the Member States to their banks has shown transparency, comparability and consistency.

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<sup>382</sup> *Director General of Fair Trading v First National Bank Plc* ([2000] CHANF/99/0974/A3).

The restructuring ordered by the Commission in the ING, KBC and Lloyds cases is radical by any standards, even if it is based on proposals worked out between the banks and the concerned Member States. The Commission determined that almost all divestments were proposed by the concerning banks and there was sufficient market interest in the divested activities. The Commission's approach went further by admitting that its restructuring Communication required a review of the structure of the market where the concerning banks operated. In the case of KBC, ING and Lloyds, the Commission found that in each of the three domestic markets involved, the top five banks occupy around 80 per cent of each market. Therefore, the Commission concluded that the divestments in question created opportunities for new entrants or already present smaller competitors, and will therefore, remedy any distortions of competition caused by the State aid.



## CHAPTER 5 - IMPLEMENTATION OF COMPETITION METHODOLOGIES AND POLICES IN BANK MERGERS IN UNITED KINGDOM

This chapter discusses competition methodologies applying to the UK and EU, focusing on markets, products, consumer issues and competition in relation to bank mergers.

The competition methodologies and policies of the UK and the EU competition authorities apply broadly and generally to any merger, being in banking or other sectors of the economy in the EU or the UK. In addition, the EU and the UK competition legislation, regulations, and guidelines generally regulate mergers from all sectors of the economy.

Notwithstanding the above, this chapter focuses its discussion only in the implementation of the foregoing competition methodologies, policies, including the competition legislation, regulations and guidelines, only in the context of a bank merger.

### 5.0 Markets, products, consumer issues and competitive analysis in relation to bank mergers

The UK competition regulators base their assessment processes on specific merger examination provisions under a set of merger guidance documents ('Merger Guidelines').<sup>1</sup> Pursuant to the Merger Guidelines, a bank (or other business) merger case is examined, based on whether the merger's anti-competitive consequences derive from the unilateral behaviour of the merged bank (or other business) or because of synchronized interaction between the existing competitors.<sup>2</sup> The guidelines, also, allow merging parties to better evaluate the competitive effect of the anticipated merger, in advance.

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<sup>1</sup> 'Mergers: Guidance on the CMA's Jurisdiction and Procedure' (2014) *CMA2* ('[UK Merger Jurisdiction and Procedure](#)'); see, also, 'Mergers: How to Notify the CMA of a Merger' (2015) *Detailed Guide* ('[UK Merger Notification](#)'); see, further, 'Merger Assessment Guidelines' (2010) *CC2/OFT1254* ('[UK Merger Assessment Guidelines](#)'); see, more, 'Quick Guide to UK Merger Assessment' (2014) *CMA18* ('[UK Quick Guide Merger Assessment](#)'); see, additionally, 'Disclosure of Information in CMA Work' (2013) *CC7* ('[UK Merger Disclosure Information](#)'); see, furthermore, 'Merger Remedies' (2008) *CC8* ('[UK Merger Remedies](#)'); see, finally, 'Mergers Exceptions to the Duty to Refer and Undertakings in Lieu' (2014) *OFT1122* ('[UK Merger Exceptions to the Duty to Refer and Undertakings in Lieu](#)'). All the above, hereinafter 'UK Merger Guidelines') available at [www.gov.uk/government/collections/cma-mergers-guidance](http://www.gov.uk/government/collections/cma-mergers-guidance).

<sup>2</sup> *UK Merger Assessment Guidelines* (n1), pp 13-16.

The Merger Guidelines provide that one-sided anti-competitive consequences may occur when, due to a merger, the merged party considers profitable to unilaterally raise prices, or decrease quality or productivity.<sup>3</sup> The guidelines identify several market specifications as suitable indicators of potential anti-competitive outcomes.<sup>4</sup> These consist of large post-merger market shares, the competitive likeness of the merging parties' services or products, considerable impediments to entry, and counterparts' difficulty in responding to variations in prices.<sup>5</sup> In situations where the chances of unilaterally imposed consequences are considerable, the bank (or other business) merger will be forbidden unless the merging parties can generally provide convincing reasons or put forward sufficient remedies to alleviate any concerns.<sup>6</sup>

The Merger Guidelines test puts significant pressure on the competition regulators to justify the possibility of post-merger co-ordination. As a result, this could improve the ability of merging participants to rebut the suggestion that the merger would lead to implicit post-merger collusion.<sup>7</sup>

In 2004, the EU enacted measures intended to enhance EU merger control provision. These measures included the revision of ECMR, a notice on the assessment of horizontal mergers, and best practice guidelines on the conduct of merger reviews. These measures improve the review process of a bank (or other business) merger by providing greater flexibility. They have improved the clarity of the Commission's merger scrutiny, and have increased prospects for merger review referral between the EU, UK or other EU Member States.<sup>8</sup>

Despite the improved provisions in the UK and EU, the proposed *Lloyds/Abbey* merger blocked by the UK Government may have created a 'psychological' impediment to future bank merger and acquisition deals. Apparently, the public interest purpose of blocking the bank

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<sup>3</sup> *Ibid*, pp 30-33.

<sup>4</sup> *Ibid*, pp 34-35.

<sup>5</sup> *Ibid*, pp 38-40, and 45.

<sup>6</sup> S S Megregian and A C Rosen, 'UK and EU Merger Reforms Increase Opportunity for Financial Institution Consolidation' (2003) 16 *Journal of Taxation and Financial Institutions* 31 ('Megregian'), pp 34-42.

<sup>7</sup> J Clarke, *International Merger Policy, Applying Domestic Law to International Markets* (Cheltenham: Edward Elgar 2014) ('Clarke'), p 72.

<sup>8</sup> I Kokkoris, *Merger Control in Europe: The Gap in the ECMR and National Merger Legislations* (New York: Routledge 2011), pp 27-34.

merger was that the merger increased the capacity of the four major banks in the financial market to implicitly coordinate their prices and reduced the competitive impact of smaller sized banks.

Nevertheless, the reform of EU competition merger control provided opportunity to sufficiently address the *Lloyds/Abbey* case competition concerns. For instance, clarification of the consequences of synchronization in the UK Merger Guidelines now permits banks (or other businesses) to get over implicit collusion issues. Even as the banking system remains vibrant, with new services and products being frequently offered, it may become more challenging for the competition regulators to satisfy the conditions set in the Merger Guidelines.<sup>9</sup>

The EU and UK merger guidelines include thorough narrative on practice and policy, as well as providing clear tests employed in merger reviews. There is a noticeable retreat from previous merger reviews that depended substantially on market shares. Presently, the competition regulators must apply vigorous economic scrutiny, based on a theory of probable harm. The EU and UK financial services reforms provide banks and other financial institutions with different options to make best use of the guidance laid out in these reforms.<sup>10</sup>

## 5.1 Markets

UK law is not applicable to foreign banks (or other foreign businesses) merging overseas, despite the existence of ramifications within the country.<sup>11</sup> In reality, for several years the UK position was that seizing jurisdiction in such cases would violate principles of international law.<sup>12</sup> Presently, in order for merging parties, *i.e.*, banks, to have significant involvement in a UK market, *i.e.*, the financial and banking market, they must satisfy a turnover threshold of £70 million and, also, meet the required share of supply test.<sup>13</sup> The relevant merging participants, *i.e.*, banks, do not have to become established in the UK or become in other

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<sup>9</sup> C S Rusu, *European Merger Control: The Challenges Raised by Twenty Years of Enforcement Experience* (Alphen aan den Rijn: Kluwer Law International 2010), ch 7.

<sup>10</sup> *Megregian* (n6), p 37.

<sup>11</sup> *Clarke* (n7), pp 135-56.

<sup>12</sup> L Collins, *Essays in International Litigation and the Conflict of Laws* (New York: Oxford University Press 1994), p 106.

<sup>13</sup> Enterprise Act 2002 (n11), c.40 ('EA02'), ss 23.3 and 23.4.

respects connected with the UK to be subject to its jurisdiction. In other words, if the jurisdictional requirements are fulfilled, participants could be subject to scrutiny by the UK authorities notwithstanding the fact that participants' primary business is carried out elsewhere.<sup>14</sup> Nonetheless, it can frequently be the case that such a merger would be subject to the exclusive jurisdiction of the EU merger system.

Securing a competitive market in the banking sector is the cornerstone objective of the UK regulators, marked by effectiveness, diversification and innovation.<sup>15</sup>

In relation to effectiveness, banks across the market remain constantly concentrated on attracting and retaining consumers. Banks carry this out by offering a complete suite of services and products which satisfy consumer essentials and comprise value for money.

With regard to diversification, consumers value the opportunity to utilize online services or go to a branch. Diverse management groups apply various methodologies so that banks display disparities in organizational structures, corporate governance, and business blueprints.

The innovation aspect translates into the market, which constantly brings step-by-step enhancements to banking services and products. Existing banks and new entrants experiment with extensive innovation, which may profoundly alter the nature of bank consolidation in particular, as well as the whole banking sector.<sup>16</sup>

Evidently, issues regarding concentration<sup>17</sup> in the banking and financial market, switching bank accounts and transparency continue to prove controversial, and require constant scrutiny from the UK competition and bank regulators.<sup>18</sup>

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<sup>14</sup> A Scott et al, *Merger Control in the United Kingdom* (New York: Oxford University Press 2006), p 22.

<sup>15</sup> HM Treasury, 'Maintaining the Financial Stability of UK Banks: Update on the Support Schemes' (15 December, 2010) *HC 676*, pp 19-24.

<sup>16</sup> House of Commons, 'Government Response to the Ninth Report from the Committee, Seventh Special Report of Session 2010-12' (2011) *HC 1408* ('Competition in Retail Banking'), pp 2-3, and 9.

<sup>17</sup> Concentration' arises when two or more banks merge, or when one or more merging banks directly or indirectly acquire control of the entire or part of one or more other merging banks. See, Council Regulation (EC) No 139/2004 of 20 January, 2004 on the control of concentrations between undertakings, *OJ L 24/1*, 29 January, 2004 ('*ECMR*'), art 3.

<sup>18</sup> British Bankers' Association, 'Letter to Independent Commission on Banking' (2010) *BBA*, available at: <http://>

The biggest banks and other financial institutions in the UK maintain a significant market share of the individual banking markets, as well as mid and small sized enterprise banking.<sup>19</sup>

There appear to be indications of obstacles to entry in retail banking as well as substantial difficulties for new banks attracting consumers, and increasing their market shares.<sup>20</sup> The largest obstacles arise from the challenge of attracting medium and small-sized business customers and individual customers because of their preference for financial institutions with a wide-ranging branch network, low rates for switching bank accounts, and robust brand loyalty. These obstacles discourage financial institutions entering the market in case they are unable to attract adequate amounts of customers to recuperate start-up costs, grow market share, and maintain a favourable place within the market.

An additional possible obstacle to entry is customer preference for financial institutions with branch networks. Nevertheless, this barrier is gradually decreased because of the growing use of internet banking.<sup>21</sup> Conversely, branch-related attributes remain top of consumers' reasons for preferring personal current account providers, which is not diminishing, based on changes to customers' interaction with their financial institution following their opening of an account.<sup>22</sup>

Share of new business is substantially intertwined with financial institutions' shares

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bankingcommission.independent.gov.UK/wp-content/uploads/2011/01/British-Bankers-Association-Issues-Paper-Response.pdf

<sup>19</sup> Independent Commission on Banking, 'Final Report' (September, 2011), London (the 'Vickers' Report'), pp 79, 116, and 335, available at [www.hm-treasury.gov.uk/d/ICB-Final-Report.pdf](http://www.hm-treasury.gov.uk/d/ICB-Final-Report.pdf).

<sup>20</sup> Competition and Markets Authority, 'Retail Banking Market Investigation: Retail Banking Financial Performance' (14 August, 2015) *CMA*, pp 21, and 29-30, available at [https://assets.digital.cabinet-office.gov.uk/media/55cdf857ed915d534600002d/Financial\\_performance\\_working\\_paper.pdf](https://assets.digital.cabinet-office.gov.uk/media/55cdf857ed915d534600002d/Financial_performance_working_paper.pdf); see, also, Competition and Markets Authority, 'Extension to CMA Retail Banking Market Investigation' (29 January, 2016), available at <https://www.gov.uk/government/news/extension-to-cma-retail-banking-market-investigation>; see, further, Competition and Markets Authority, 'Retail Banking Market Investigation: Summary of Provisional Findings Report' (22 October, 2015) ('Retail Banking Market Investigation: Summary of Provisional Findings Report'), pp 401-407, available at [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/470032/Banking\\_summary\\_of\\_PFs.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/470032/Banking_summary_of_PFs.pdf).

<sup>21</sup> Competition and Markets Authority, 'Retail Banking Market Investigation: Barriers to Entry and Expansion: Branches' (13 August, 2015), pp 30-36, available at [https://assets.digital.cabinet-office.gov.uk/media/55cdf841ed915d5343000038/Branches\\_working\\_paper\\_v2.pdf](https://assets.digital.cabinet-office.gov.uk/media/55cdf841ed915d5343000038/Branches_working_paper_v2.pdf).

<sup>22</sup> *Vickers' Report* (n19), pp 217, 266, 268, and 320.

throughout the network of national branches, providing additional quantitative evidence that branch networks remain a priority for consumers in choosing their financial institution. The number of customers using internet banking still continues to be moderate notwithstanding reduced prices and considering improved customer satisfaction levels from the branch services. Consumers continue to consider internet banking to be a complimentary service, rather than a substitute for traditional branch banking.<sup>23</sup>

In contrast to bigger financial institutions, small existing and new entrant banks are disproportionately influenced by regulation. Consequently, they form a regulatory obstacle to entry in the banking services market. The small and new entrant banks seem likely to be sanctioned because of insufficiently qualified management or inability to establish a record of performance. They would most likely need to possess extra capital to offset the effects of concentration in a particular geographical area or market. The risk placed on assets of these banks may be higher due to the applicability of a standardized analysis approach.<sup>24</sup>

At the European level, the Commission has applied a series of procedural variations in order to improve the process of merger examination.<sup>25</sup> Banks, or other merging parties, now have more control than before over the timing of the examination. The previous requirement that banks, or other merging parties, provide notification of merger cases at least seven days before achieving a binding agreement has been repealed in the 2004 reform.<sup>26</sup> The timing of notification is now left to the merging parties' judgment. This approach is similar to the practice in the US.<sup>27</sup> Nevertheless, notifiable merger cases should continue to obtain clearance before closing.

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<sup>23</sup> Competition Commission, 'Lloyds TSB Group plc and Abbey National plc: A Report on the Proposed Merger' (2001) Cm5208, para 5.8, available at [www.competitioncommission.org.UK/rep\\_pub/reports/2001/fulltext/458c5.pdf](http://www.competitioncommission.org.UK/rep_pub/reports/2001/fulltext/458c5.pdf).

<sup>24</sup> Organization for Economic Co-operation and Development, 'OECD Economic Surveys: United Kingdom' (2015), available at [http://dx.doi.org/10.1787/eco\\_surveys-gbr-2015-en](http://dx.doi.org/10.1787/eco_surveys-gbr-2015-en).

<sup>25</sup> Commission, 'Towards More Effective EU Merger Control' (25 June, 2013) *Commission Staff Working Document SWD 239 final*, pp 13-17, available at [http://ec.europa.eu/competition/consultations/2013\\_merger\\_control/merger\\_control\\_en.pdf](http://ec.europa.eu/competition/consultations/2013_merger_control/merger_control_en.pdf)

<sup>26</sup> *ECMR* (n17), art 4(1).

<sup>27</sup> 15 USC §18a(c)(7).

The Commission has, in addition, introduced several means to increase convenience during the review period in complex merger situations. A ‘stop-the-clock’ provision<sup>28</sup> allows the merging parties to seek a twenty-day extension to the review deadline in complex investigations.<sup>29</sup> This provides extra time to address any competition issues associated with the merger. Additional extensions may be predicted in those cases in which the merging parties present undertakings to address any European Commission concerns.<sup>30</sup>

Various mechanisms have been introduced to enhance the transparency of merger analysis. Merging parties may ask for ‘state-of-play’ meetings with the Commission, in which the latter outlines its issues and existing concerns. Further, merging parties are given the opportunity to address complainants in order to better understand their objections. These changes provide the merging participants banks with scope to refuse or resolve any issues potentially giving rise to a prohibition decision.<sup>31</sup>

#### 5.1.1 Horizontal bank mergers

In the event the acquiring party has ‘in-house’ distribution operations within the same relevant market(s) as the target party, an acquisition within the EU is potentially considered to be a ‘horizontal merger’.<sup>32</sup> The EU merger guidelines apply an analytical approach similar to the UK and US merger guidelines.<sup>33</sup> The Commission, normally, determines if the merger would create or increase a sole or concerted dominant position in the market.

Pursuant to the EU merger guidelines, there may be a greater possibility that mergers in concentrated markets could be depicted as product ‘differentiated’.<sup>34</sup> Traditionally, banking

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<sup>28</sup> *ECMR* (n17), art 10(3), para 2.

<sup>29</sup> *Ibid.*

<sup>30</sup> A Andreangeli, ‘Fairness and Timing in Merger Control Proceedings: Will the “Stop-the-Clock” Clause Work?’ (2005) 7 *European Competition Law Review* 26, pp 403-409.

<sup>31</sup> *Megregian* (n6), p 39.

<sup>32</sup> Commission, ‘Guidelines on the Assessment of Horizontal Mergers under the Council Regulation on the Control of Concentrations between Undertakings’ (5 February, 2004) *OJ C31/03* (‘EU Horizontal Merger Guidelines’), pp 5-18.

<sup>33</sup> See generally, *UK Merger Guidelines* (n1); also, for a discussion of the US merger guidelines, see chapter 9 in this thesis, pp 256-99.

<sup>34</sup> *EU Horizontal Merger Guidelines* (n32), fn 32 (‘Products may be differentiated in various ways. There may, for example, be differentiation in terms of geographic location, based on branch ... location; location matters for ... banks.’).

services and products are viewed as homogeneous. If merging parties, *i.e.*, banks, may effectively circumvent this depiction, this could mean that those parties may overcome prior market share assumptions. Presently, analysis does centre predominantly on market shares in homogeneous product markets. As for differentiated product markets, the Commission determines markets in a much narrower way, based on the established level of substitutability of the merging parties' products. Concerning differentiated product markets, the Commission aims to prevent a merger leading to a market share of more than the threshold percentage,<sup>35</sup> and in which the merging parties' services or products could be closely substituted. Therefore, merging parties may respond to such concerns by showing they are not direct competitors or that they can rearrange their products to compete more effectively with the products of the other merging party(-ies).

The merger assessment improves the likelihood of parties acquiring product varieties that fit with those parties' existing product portfolios. The competition regulators are steadily implementing approaches that narrow the scope of product market analysis, departing from conventional, broader market analysis that has prevailed throughout the retail banking, investment banking, corporate banking and financial markets. For instance, in the *Fortis/ABN AMRO Assets* merger case<sup>36</sup>, for analytical reasons, the Commission separated the retail banking market into four smaller markets.<sup>37</sup> These markets were deposits, lending, credit cards, and funds/additional types of asset management.<sup>38</sup> The identification of narrower markets permit merging banks to grow through acquiring businesses offering banking products and services businesses that do not overlap with pre-existing offerings within those narrower markets.<sup>39</sup> Similarly, this expands opportunities for permissible geographic market growth.

Removing political influence in the EU and UK bank mergers, also, would assist merging banks by providing greater certainty and lessening protectionism. In the UK,

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<sup>35</sup> The threshold is 30 per cent for vertical mergers (see Commission, 'Guidelines on the Assessment of Non-Horizontal Mergers under the Council Regulation on the Control of Concentrations Between Undertakings' (2008) *OJ C 265/6* ('EU Non-Horizontal Merger Guidelines'), para 25); and 20 per cent for horizontal mergers (see, *EU Horizontal Merger Guidelines* (n32)); see, also, 'Commission Cuts Red Tape for Businesses (5 December, 2013) IP/13/1214, available at [http://europa.eu/rapid/press-release\\_IP-13-1214\\_en.htm](http://europa.eu/rapid/press-release_IP-13-1214_en.htm).

<sup>36</sup> Case No. COMP/M.4844 *Fortis/ABN Assets* [2007] *OJ C 265/2*.

<sup>37</sup> *Ibid*, para 4.

<sup>38</sup> *Ibid*.

<sup>39</sup> *Ibid*, paras 11, 93, 130, 132, 177, and 245.



eliminating the SoS's role in approval of bank mergers strengthened certainty. The SoS can no longer influence complex bank merger situations. Merging banks would benefit from a clearer independent bank merger analysis, with less political involvement.<sup>40</sup>

In the EU, the Commission's increasing attempts to prevent EU Member States from affecting cross-border bank mergers should sustain a broader de-politicization agenda. For instance, in *Banco Santander Central Hispano Americano/A. Champalimaud*<sup>41</sup>, the Commission underlined that it was not prepared to acquiesce to Member States' attempts to safeguard domestic banks from foreign acquisition.<sup>42</sup> The constrained influence of Member States in controlling bank mergers assists in averting protectionist merger examinations by respective EU governments eager to override competition policy with industrial policy.<sup>43</sup> This de-politicization of bank merger control is constructive and essential in addressing cross-border situations, also motivating financial institutions to properly evaluate possible acquisitions.

Of continued importance are the 'efficiency' and 'entry' defences, which may result in an increase in banks' ability to effectively address competition issues associated with a proposed merger. For each defence, the UK and EU merger guidelines provide applicable elements, which require to be met.<sup>44</sup> Merging banks can assess the soundness of these defences at the initial stage of the process, prepare thorough arguments and submit evidence that the merger should be permitted to proceed. Furthermore, the merger guidelines define the hurdles that merging parties should overcome to evidence the available defences.<sup>45</sup>

During the Global Financial Crisis, banks in the UK had significant opportunities to acquire financially distressed competitors that faced complexity in restructuring and recapitalizing their operations.<sup>46</sup> Additionally, the UK Government had a reduced capacity to safeguard its national banks and other financial institutions, while the Commission tightened

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<sup>40</sup> J Vickers, 'Central Banks and Competition Authorities: Institutional Comparisons and New Concerns' (2010) *Bank for International Settlements, Working Papers, No 331*, available at <http://www.bis.org/publ/work331.pdf>.

<sup>41</sup> Case No. COMP/M.1616 *BSCCH/A. Champalimaud* [1999] OJ C 306/37 ('*BSCCH/A. Champalimaud*').

<sup>42</sup> *Ibid*, paras 26-28, and 46-67.

<sup>43</sup> *Ibid*, paras 68-70.

<sup>44</sup> *UK Merger Assessment Guidelines* (n1), paras 5.7 and 5.8.

<sup>45</sup> *Ibid*, for example, paras 2.7, 4.1, 4.2, 4.3, and 5.2.

<sup>46</sup> J K Jackson, 'The Financial Crisis: Impact on and Response by the European Union' (24 June, 2009) *Congressional Research Service 7-5700*, available at <https://www.fas.org/sgp/crs/misc/R40415.pdf>.

its scrutiny of EU Member States' attempts to provide State aid to failing financial institutions.<sup>47</sup> A merger could potentially be the only feasible alternative to a distressed bank going out of business. Banks could benefit from invoking the 'failing firm' defence. The merger guidelines in the UK and EU provide this defence together with the prerequisites for its application. Although banks looking to rely on this defence face considerable challenges, successful invocation of the same represents a route to taking over a distressed banking business.<sup>48</sup>

The EU's merger guidelines on the referral system ought to streamline the process of merger notification and could improve parties', *i.e.*, banks, capability to attain clearance. Merging banks would enhance their ability to influence the Commission to improve their chance of a merger success. For instance, the Commission's consistent position against protectionist EU Member States policies<sup>49</sup> could establish the Commission as the favoured alternative adjudicatory authority on cross-border bank acquisitions.

### 5.1.2 Vertical bank mergers

If the acquiring party (bank) does not have its own distribution system, but acquires one by means of the merger, the EU merger competition provisions typically define this situation to be a 'vertical merger'.<sup>50</sup>

A vertical merger is normally less likely to hamper competition than a horizontal merger, because a vertical merger does not lead to loss of direct competition between the merging parties' businesses.<sup>51</sup> Nonetheless, it may limit competition once it alters the market's

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<sup>47</sup> G Koopman, 'Stability and Competition in EU Banking during the Financial Crisis: The Role of State Aid Control' (2011) 7 *Competition Policy International* 8, pp10-2.

<sup>48</sup> A MacGregor, 'Failing Firm Defence in Merger Control: An Overview of EU and National Case Law' (2012) *e-Competitions* No 42408, p 1.

<sup>49</sup> G Babin, 'European Union Merger Control: The End of Member State Industrial Policy?' (14 April, 2015) 22 *Columbia Journal of European Law* 3, p 38.

<sup>50</sup> *EU Non-Horizontal Merger Guidelines* (n35), paras 6-25.

<sup>51</sup> P Maydell, 'Non-Horizontal Mergers under the EC Merger Regulation' (2012) *EU Law Working Papers, Transatlantic Technology Law Forum* No 3, pp 34-40, available at [http://law.stanford.edu/wp-content/uploads/sites/default/files/child-page/205024/doc/slspublic/maydell\\_eulawwp3.pdf](http://law.stanford.edu/wp-content/uploads/sites/default/files/child-page/205024/doc/slspublic/maydell_eulawwp3.pdf).

structure to such a degree that merging parties are better placed to synchronize their behaviour and prices or otherwise impair competition in a post-merger.<sup>52</sup>

Prior to declaring a proposed merger contrary to the EU Common Market, the Commission should determine that the merger would establish or consolidate a dominant position throughout the Common Market.<sup>53</sup> There is no clear-cut test to define dominance, therefore, making it less objective and subject to individual interpretation. Dominance is identified, based on a sliding scale, with there being various levels of dominance associated with market influence as well as capacity to act independently of competitors and consumers.<sup>54</sup>

In relation to a merger analysis, once it is established whether a concentration may create or increase a dominant position, the next step is to determine if the dominant position could harmfully impact the existence of competition. The Commission would disallow a proposed merger only in those cases in which the establishment or augmentation of a dominant position could create an important negative effect on competition, or considerably so across the Common Market.<sup>55</sup> It is possible that a merger could establish or increase a dominant position, which does not create negative competition consequences. It is, however, likely that a merger will result in a negative impact on competition. If such effect is regional or immaterial, there is no violation of the merger provisions.<sup>56</sup>

Competition regulations impose a high burden for the Commission to meet in order to refuse a merger application. This means that merging parties have a good chance of having their merger application granted. The regulations, while permitting the Commission to impose conditions, also, lower the chance of refusal.<sup>57</sup> A less strict analysis would permit fewer concessions and be harmful to merging parties, which would then have a negative result on competition in certain products or markets, due to the reduced likelihood of merger

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<sup>52</sup> S C Salop and D P Culley, 'Potential Competitive Effects of Vertical Mergers: A How-To Guide for Practitioners' (8 December, 2014) *Social Science Research Network (SSRN) 2684107*, available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2522179](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2522179).

<sup>53</sup> *EU Non-Horizontal Merger Guidelines* (n35), para 13.

<sup>54</sup> S Baches Opi, 'Merger Control in the United States and European Union: How Should the United States' Experience Influence the Enforcement of the Council Merger Regulation?' (1997) 6 *Journal of Transnational Law & Policy* 223, pp 271-8.

<sup>55</sup> *EU Non-Horizontal Merger Guidelines* (n35), para 15.

<sup>56</sup> L Ritter and W D Braun, *European Competition Law: A Practitioner's Guide* (3d edn, The Hague: Kluwer Law International 2005), pp 75-80.

<sup>57</sup> *ECMR* (n17), arts 6, and 8.

approval being granted. However, in many cases, it is possible through negotiations to arrive at a situation where the merger is permitted to go ahead.

The Commission, also, considers the likelihood of collective or joint dominance, when examining merger applications.<sup>58</sup> Some critics believe collective dominance to be a contentious theory, because it permits the Commission to determine that parties with smaller market shares have the collective (but not individual) capacity to dominate the market. The contention emerges as a result of the assumption that banks may conspire, instead of compete, with each other within the financial and banking market. Unlike the American approach that assumes that parties, i.e., banks, will conspire, if allowed,<sup>59</sup> the EU's position is that parties will not conspire to jointly dominate the market.<sup>60</sup> Therefore, the theory of 'abuse of collective dominant position'<sup>61</sup> is less assumed in the EU than the US to apply in practice.

The Commission uses a particular method of examination of mergers to establish impact on the market. The market is influenced, if a proposed horizontal merger dominates more than 20 per cent of the banking and financial market.<sup>62</sup> This modest threshold shows the Commission's particular concern regarding horizontal mergers because of their likely negative effect of competition in the Common Market.

The criterion for examination is more rigorous for a horizontal merger than for a vertical merger because of a greater probability that a horizontal merger would adversely influence competition than is the case with a vertical merger.

To narrow the number of vertical mergers being blocked, the EU courts' review process employs a *de minimis* criterion,<sup>63</sup> maintaining that a simple constraint on competition

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<sup>58</sup> Joined Cases C-68/94 and C-30/95 *France and Others v Commission* (1998) ECR I-1375.

<sup>59</sup> M Filippelli, *Collective Dominance and Collusion: Parallelism in EU and US Competition Law* (Cheltenham: Edward Elgar Publishing 2013), pp 48-50, 70, 89-91, 238-240, and 284-289.

<sup>60</sup> *Ibid*, pp 175-176, 192-194, and 238-240.

<sup>61</sup> Treaty on the Functioning of all European Union (Consolidated version 2012) OJ C326/01 P.0001-0390 ('TFEU'), art 102.

<sup>62</sup> See generally, *EU Horizontal Merger Guidelines* (n32); see, also, Commission, 'Commission Cuts Red Tape for Businesses' (5 December, 2013) IP/13/1214, available at [http://europa.eu/rapid/press-release\\_IP-13-1214\\_en.htm](http://europa.eu/rapid/press-release_IP-13-1214_en.htm).

<sup>63</sup> Commission, 'Notice on Agreements of Minor Importance, Which Do Not Appreciably Restrict Competition under Article 101(1) of the Treaty on the Functioning of the European Union (*De Minimis*) (2014) OJ C 291/01, pt 13.

is insufficient.<sup>64</sup> The constraint should be considerable. The Commission only has to prove that the merger has the capability to substantially affect competition. Under the *de minimis* criterion, the Commission excludes from Article 81 review a merger, which does not result in more than 10 per cent of total market share.<sup>65</sup> The Commission, often, issues block exemptions in specific vertical merger situations, basing its rationale on the fact that such vertical mergers won't restrict competition, thus, reducing the number of vertical merger applications and analyses.<sup>66</sup>

### 5.1.3 Conglomerate bank mergers

A conglomerate merger might encompass both vertical and horizontal competition issues, but cannot be purely categorized as a vertical or horizontal merger.<sup>67</sup> The filing of the parties with the Commission in the context of a determination of market affected by a proposed conglomerate merger differentiates only between vertical and horizontal mergers.<sup>68</sup>

A conglomerate merger does not result in the combining of competitors (like horizontal merger), nor does it render complimentary services to the market (like vertical merger).<sup>69</sup> Consequently, a conglomerate merger solely presents anti-competition concerns in respect of the vertical or horizontal characteristics of the merger. Conglomerate mergers are useful for banks and other financial institutions that wish to diversify and reduce their risk exposure in event of economic decline.<sup>70</sup>

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<sup>64</sup> Case 319/82 *Société de Vente de Ciments et Bétons de l'Est SA v Kerpen & Kerpen GmbH* [1985] 1 CMLR 511.

<sup>65</sup> More than five per cent of aggregate market shares are the threshold applied for conglomerate mergers. See, Treaty on European Union (Consolidated version 2012) *OJ C326/01 P.0001-0390* ('TEU'), art 81(1).

<sup>66</sup> Commission, 'Green Paper on Vertical Restraints in EC Competition Policy' (22 January, 1997) *COM (96) 721 final*, Brussels, 4 C.M.L.R. 519, 522; Communication from the Commission on Application of the Community Competition Rules to Vertical Restraints *COM (98)544 final* (1998) *OJ C365/3*, 4, 9, 12, 21.

<sup>67</sup> W J Kolasky, 'Conglomerate Mergers and Range Effects: It is a Long Way from Chicago to Brussels' (2002) 10 *George Mason University Law Review* 533.

<sup>68</sup> *EU Non-Horizontal Merger Guidelines* (n35), paras 3, 5, and 7.

<sup>69</sup> *Ibid*, para 5.

<sup>70</sup> J Church, 'The Impact of Vertical and Conglomerate Mergers on Competition' (September, 2004) *Directorate General for Competition, Directorate B Merger Task Force* (Commission), available at [http://europa.eu.int/comm/competition/mergers/others/merger\\_impact.pdf](http://europa.eu.int/comm/competition/mergers/others/merger_impact.pdf); see, also, EP and Council Directive 2002/87/EC of 16 December, 2002 on the supplementary of credit institutions, insurance undertakings and investment firms in a financial conglomerate and amending Council Directives 73/239/EEC, 79/267/EEC, 92/49/EEC, 92/96/EEC, 93/6/EEC and 93/22/EEC, and EP and Council Directives 98/78/EC and 2000/12/EC, 2002 (L 35) 1 ['Financial Conglomerates Directive'].

## 5.2 Products

Savings accounts, personal current accounts, credit cards, personal loans, and mortgages are the most important products in the banking market.<sup>71</sup> Broadly speaking, the markets in relation to such products are considered and examined from a UK-wide perspective.<sup>72</sup> Almost all retail-banking products appear to be accessible to consumers throughout the country, without particular differentiation in prices or other specifications. Specifically, the large financial institutions, such as Barclays Plc, Royal Bank of Scotland, and Lloyds Banking Group, have national branch networks, which make their banking products available across Britain.<sup>73</sup>

The largest financial institutions in the UK are the Royal Bank of Scotland, Lloyds Banking Group, HSBC, Santander (UK), and Barclays.<sup>74</sup> Combined, these banks have approximately an 85 per cent share of the personal current account products market within the UK. The market for small and medium-sized enterprises ('SMEs') liquidity services controlled by these financial institutions is about 80 per cent of the entire products market. In cases where the number of financial institution market participants is greater, such as, for other parts of the retail market, including loans and savings products, there appears to be less concentration.<sup>75</sup>

To date and notwithstanding a few encouraging improvements, the competition and bank regulators still find that competition remains ineffective in respect of the interests of SMEs. In particular, markets continue to be concentrated, with the biggest bank providers holding in excess of 85 per cent of business current accounts, as well as about 90 per cent of business loans. Presently, obstacles to entry and expansion for smaller, newer entrant financial institutions continue to be important including the need for branch banking network. Further, it appears to be an insignificant driver in the market shares of the biggest financial institutions, except as a result of mergers and acquisitions. In recent years, only a very few banks, *i.e.*,

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<sup>71</sup> *Retail Banking Market Investigation: Summary of Provisional Findings Report* (n20), pp 5-9.

<sup>72</sup> *Ibid.*

<sup>73</sup> R Adler, 'UK Banking Industry Structure 2014' (2015) *British Bankers Association*, available at [https://www.bba.org.uk/2014\\_UK\\_Banking\\_Industry\\_Structure\\_Abstract%20\(3\).pdf](https://www.bba.org.uk/2014_UK_Banking_Industry_Structure_Abstract%20(3).pdf).

<sup>74</sup> *Ibid.*

<sup>75</sup> *Competition in Retail Banking* (n16), pp 12-14.

Metro Bank, Tesco Bank, have newly entered into the full service SMEs sector.<sup>76</sup> Currently, about 4 per cent of SMEs switch bank provider each year because they see little or no differentiation among the largest financial institutions with respect to the services they provide. There is an indication of a significant limitation in market share gains over the last several years for those financial institutions with the highest levels of customer satisfaction. This is contrary to what may usually be anticipated in adequately functioning competitive markets.<sup>77</sup>

Market concentration in respect of supply is exceptionally problematic because of the weaknesses in demand, particularly regarding bank current accounts. Pricing structures remain compound and impervious. Also, customers have not demonstrated confidence in switching between bank account providers. As a matter of fact, the rates of switching bank accounts continue to be low, notwithstanding substantial variety in pricing in the current bank account market that does not appear to be explained by consumer satisfaction. Lack of transparency can cause the competition become mislead. In such situation, banking products are mis-sold, with consumers becoming subject to considerable and unforeseen charges for certain services.<sup>78</sup>

Products in the personal loan and credit card markets remain the most challenging. These markets appear to include the largest number of providers, and correspondingly a proportionately large number of financial institution market entrants in comparison to the size of the market. In addition, there appears to be a handful of new financial institution entrants in the bank savings account and mortgages markets. However, entry into these markets has been gradually reduced from the GFC. Several of the financial institution entrants within the markets for loans, mortgages, and credit cards provide a variety of products short of the whole span of personal banking products more broadly available to consumers. Usually, these financial institutions obtain a small share of the market.<sup>79</sup>

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<sup>76</sup> C Barrett et al, 'UK Banks Face Full Industry Inquiry' (18 July, 2014) *Financial Times*.

<sup>77</sup> CMA and FCA, 'Markets Study: Banking Services to Small and Medium-Sized Enterprises' (18 July, 2014), available at [www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/346931/SME-report\\_final.pdf](http://www.gov.uk/government/uploads/system/uploads/attachment_data/file/346931/SME-report_final.pdf).

<sup>78</sup> S Goff, 'Lloyds Looks to Ease Branch Disposal' (21 August, 2011) *Financial Times*.

<sup>79</sup> *Vickers' Report* (n19), pp 166-170.

There appears to be quite a small number of financial institution entrants<sup>80</sup> in the market for personal current bank account products, which approximately comprises 2 per cent of the broader market.<sup>81</sup> The insignificant levels of new financial institution entrants, as well as the minimal market shares captured by them shows that new financial institution entrants lack the capacity to make a substantial impression in any retail banking market, except for credit cards.<sup>82</sup>

### 5.3 Consumer Issues

One of the main competition objectives in bank consolidations remains to capitalize on the advantages to customers of banks and other financial institutions, which currently continues to be critical. The big financial institutions do poorly in several customer satisfaction surveys, when measured in proportion to other providers.<sup>83</sup> Customers expressed their unhappiness with the quality of services received from financial institutions, and the apparent lack of alternatives on offer in the marketplace. In an openly competitive market, banks and other financial institutions that render better service, prices or alternative products are projected to increase meaningful market share as compared with their rival banks and financial institutions. However, there is not much present indication that this is happening.<sup>84</sup>

Some undertakings are needed to advance competition within retail banking and to generate improved results for customers of banks and other financial institutions.<sup>85</sup> Poor customer satisfaction results can be addressed by reducing impediments to entry and expansion, encouraging better competition between existing financial institutions and to foster new financial institutions to enter the market. Tackling concentration without addressing these concerns is insufficient to stimulate a more competitive market.<sup>86</sup> By dealing with these concerns, new entrant banks or those that are in the process of expansion would succeed in

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<sup>80</sup> *Ibid*, pp 169, 182, and 191. About five bank providers between 2000 through 2012. See, *ibid*.

<sup>81</sup> *Ibid*, pp 174, and 320.

<sup>82</sup> *Ibid*, pp 171-178.

<sup>83</sup> M Scuffham, 'British Banks Spared Worst Outcomes in Competition Probe' (22 October, 2015) *Reuters*, available at <http://uk.reuters.com/article/uk-banks-competition-idUKKCN0SG0G720151022>.

<sup>84</sup> *Competition in Retail Banking* (n16), pp 15-16, 19, and 84.

<sup>85</sup> Competition and Markets Authority, 'CMA Proposes Better Deal for Bank Customers' (22 October, 2015) *Markets, Competition and Competition Law*, available at <https://www.gov.uk/government/news/cma-proposes-better-deal-for-bank-customers>

<sup>86</sup> M Colchester, 'UK Retail Banking Market Isn't Competitive Enough, Says Regulator' (22 October, 2015) *Wall Street Journal*.



development in important markets, like the current account and SME market.<sup>87</sup> Other barriers to expansion, that are principally associated with bank account switching and the lack of comparability and transparency, must also be fully addressed.

Competition in the retail-banking sector in the UK remains ineffective.<sup>88</sup> The markets for SMEs banking services, as well as for individual current accounts continue to be concentrated. As a result, those banks and other financial institutions that challenge the large sized market participants either ended up going out of business or are taken over by their larger counterparts. Consumer alternatives remain dissatisfying especially because of complexities in switching accounts between banks. There is exploitation of both customer knowledge gaps and the insufficiency of banking regulatory provisions. In addition, implied government assistance favours the largest financial institutions.<sup>89</sup>

Competition among banks is restricted due to apparent complications for consumers in identifying the right bank account for their necessities, in switching bank accounts, and through insufficient conditions providing customers with alternatives more generally. Financial institutions have few incentives to provide superior offers when their customers are unlikely to choose a different bank for their account and other financial needs.<sup>90</sup> Over the last decade, a substantial number of personal current account consumers believed that switching bank accounts between banks was risky and a complex undertaking. Consequently, the level of switching bank accounts remains relatively low.<sup>91</sup> A select, well-informed number of consumers do monitor products offered by other banking institutions. However, most of consumers are unacquainted with the important fees applying to their personal current bank

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<sup>87</sup> A Thomson, 'Time to Open Banking to New Entrants' (24 March, 2013) *Financial Times*.

<sup>88</sup> New City Agenda, 'Competition in Banking: A Collection of Essays' (2015) *New City Agenda*, available at <http://newcityagenda.co.uk/wp-content/uploads/2015/02/here.pdf>. This publication is composed of selected essays written by experts in the banking, and competition, sectors in the UK.

<sup>89</sup> J Vickers, 'How to Regulate the Capital and Corporate Structures of Bank?' (22 January, 2011) *London Business School and University of Chicago Booth School of Business*, available at <http://bankingcommission.independent.gov.uk/bankingcommission/wp-content/uploads/2011/01/John-Vickers-2201111.pdf>.

<sup>90</sup> Competition and Markets Authority, 'Personal Current Accounts and Banking Services to Small and Medium-Sized Enterprises: Decision on Market Investigation Reference' (6 November, 2014) *CMA* ('CMA Report on Personal Current Accounts and Banking Services to SMEs'), pp 26-27. available at [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/371407/Decision-MIR-Final\\_14.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/371407/Decision-MIR-Final_14.pdf).

<sup>91</sup> *Ibid*, pp 24-29.

accounts, and express difficulty in understanding and computing these fees.<sup>92</sup>

It is of significant competition concern that there is such a low rate of switching for both personal current bank accounts as well as business current bank accounts.<sup>93</sup> Moreover, this has established consequential obstacles for additional banking products that are linked to bank accounts.<sup>94</sup> For example, cross selling through personal current accounts has become more valuable than cross selling through other retail banking products.<sup>95</sup> In particular, small financial institutions are dependent on cross sales to sustain a presence in multiple markets.<sup>96</sup> Financial institutions that provide business current accounts have a considerable benefit over those institutions that do not provide the same, because the former institutions can collect transactional track records on consumers prior to providing an overdraft or loan. Most SME customers use one of the largest financial institutions in the UK, *i.e.*, Barclays, Lloyds TSB, Royal Bank of Scotland, and HSBC, as their primary banking services provider.<sup>97</sup> Therefore, unlike other market participants these institutions have an advantage in providing several business banking services.<sup>98</sup>

Presently, the banking markets in the UK remain considerably concentrated because many financial institutions have either consolidated into larger groups, or have exited the market. For example, the combined market shares in the main personal current account products market of the four biggest financial institutions (Barclays, HSBC, Lloyds TSB, and Royal Bank of Scotland) in the UK rose from about 64 per cent in 2008 to approximately 77 per cent in 2010.<sup>99</sup> The combined UK market shares of the four largest banks have been slightly decreasing since 2011, and in 2014 accounted for more than 70 per cent of UK main personal current accounts.<sup>100</sup> With the exception of new entrants like Metro Bank, Santander, and Tesco Bank, that between the period 2011 – 2014 each entrant has gained 1 to 2 per cent

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<sup>92</sup> *Ibid*, pp 49, and 52.

<sup>93</sup> *Ibid*, pp 24-25.

<sup>94</sup> *Ibid*.

<sup>95</sup> *Ibid*, pp 23, and 33.

<sup>96</sup> Office of Gas and Electricity Markets, 'The Retail Market Review – Findings and Initial Proposals' (2011) *Ofgem*, available at [www.ofgem.gov.UK/Markets/RetMkts/rmr/Documents1/RMR\\_FINAL.pdf](http://www.ofgem.gov.UK/Markets/RetMkts/rmr/Documents1/RMR_FINAL.pdf).

<sup>97</sup> *CMA Report on Personal Current Accounts and Banking Services to SMEs* (n90), p 8 (e.g., SMEs customers with the five largest banks in 2012 were about ninety per cent).

<sup>98</sup> *Retail Banking Market Investigation: Summary of Provisional Findings Report* (n20), pp 298-303.

<sup>99</sup> *Vickers' Report* (n19), p 16.

<sup>100</sup> *Retail Banking Market Investigation: Summary of Provisional Findings Report* (n20), pp 6-7.

of the total market of personal current accounts,<sup>101</sup> such market remains within the control of the four largest banks in the UK.<sup>102</sup>

As late as the 1970s, banks and other financial institutions in the UK rendered similar services to consumers, based on somewhat similar terms.<sup>103</sup> They maintained the same operational business hours, catering to satisfying the convenience of bankers instead of their customers. Banks looked upon their customers with arrogance and indifference. Remarkably, this strict oligopoly situation did not appear to be entire destructive. Those who were employed in financial institutions tended to be honest and these institutions did not go bust.<sup>104</sup>

Changes began to take place in 1971, with the publication from the Bank of England of a 'consultative document' called 'Competition and Credit Control'<sup>105</sup>, which was probably the first time there was a serious discussion on the competition effects of credit institutions. Thereafter, the UK went through the 1986 Big Bang deregulation and reregulation process, creation of universal banking and financial conglomerates as well as the globalization of financial system.<sup>106</sup> These gradual developments led to the transformation and improvement of the UK banking regime.

However, the expected results were not realized. In reality, banks and other financial institutions remain much the same to their retail customers.<sup>107</sup> This was proven recently by the case of the new entrants in the UK banking market, such as, Tesco Bank, Metro Bank, or Virgin Money.<sup>108</sup> Based on a survey, most bank account holders believed that switching bank accounts from their present bank to these new challenger banks would not matter much. Bank

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<sup>101</sup> *Ibid*, p 7.

<sup>102</sup> Competition and Markets Authority, 'Retail Banking Market Investigation: Barriers to Entry and Expansion: Branches' (13 August, 2015), pp 22, available at [https://assets.digital.cabinet-office.gov.uk/media/55cdf841ed915d5343000038/Branches\\_working\\_paper\\_v2.pdf](https://assets.digital.cabinet-office.gov.uk/media/55cdf841ed915d5343000038/Branches_working_paper_v2.pdf).

<sup>103</sup> J Kay, 'In Banking, Too Much Competition Is As Bad As Too Little' (22 July, 2014) *Financial Times*.

<sup>104</sup> G Lancaster and P Reynolds, *Management of Marketing* (New York: Routledge 2005), p 314.

<sup>105</sup> Bank of England, 'Competition and Credit Control' (14 May, 1971) *Consultation Document*, available at <http://www.bankofengland.co.uk/archive/Documents/historicpubs/qb/1971/qb71q2189193.pdf>.

<sup>106</sup> M Buckle and J Thompson, *The UK Financial System: Theory and Practice* (4th edn, Manchester: Manchester University Press 2004), p 53.

<sup>107</sup> *Retail Banking Market Investigation: Summary of Provisional Findings Report* (n20), pp 29-30.

<sup>108</sup> E Dunkley, 'Challenger' Banks Try to Shake Up Big Four' (4 January, 2015) *Financial Times*.

account holders did not think they could obtain better service or gain more value for money by switching their bank accounts to a new bank.<sup>109</sup>

There are several problems experienced to date, which appear to damage bank customers due to competitive pressure rather than its non-existence. For example, bank customers are urged to take out mortgages or obtain deposit products with unfavourable rates.<sup>110</sup> A large number of these customers will still take these products notwithstanding that introductory rates subsequently change to unappealing terms.<sup>111</sup> Even in those instances in which banks promise their customers to treat them fairly, history indicates that competition for new customers makes these banks abandon previous promises, when they notice the effect of their approaches on the banks' market share.<sup>112</sup>

The crucial issue in the banking market is the competitive pressure, which forces financial institutions to provide their customers with 'free' current account banking services.<sup>113</sup> However, such a thing does not, in reality, exist. Financial institutions obtain financial benefits from the current account relationship in other respects. They provide accounts wrapped in incentives, which are hardly worth what a customer would pay for them.<sup>114</sup> Banks introduce arbitrarily high charges for other banking services, unauthorized overdrafts, and foreign transactions. They, also, seek to cross-sell services to a customer that possibly does not need, and would, indeed, get less expensively services somewhere else.

The market for personal current accounts has comparatively few bank providers and banking products. The charges in this market remain multi-layered and complex, making the features of the products, and their associated costs, difficult to comprehend.<sup>115</sup>

Regarding competition in the cash savings market, savers appear to earn poorer returns than necessary from their bank accounts, especially the case for longstanding customers. As a

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<sup>109</sup> *Ibid.*

<sup>110</sup> R Dyson, 'Santander: "You Can't Afford Our Cheaper Mortgages"' (26 January, 2014) *Telegraph*.

<sup>111</sup> *Ibid.*

<sup>112</sup> E Dunkley, 'RBS Reneges on Promises to Safeguard "The Last Bank in Town"' (29 October, 2015) *Financial Times*.

<sup>113</sup> J Titcomb, 'You May Not Know It, But You Are Paying for Your Bank' (3 January, 2015) *Telegraph*.

<sup>114</sup> A Murray, 'The Best Bank Account Switching Offers' (11 February, 2016) *Telegraph*.

<sup>115</sup> *Kay* (n103).

result, whereas certain aspects of the cash savings market tend to function properly, competition does not generally seem to operate in the interests of most consumers.<sup>116</sup>

Most bank account holders are unable to take advantage of the best financial product offers available to them.

The four-dominant cash savings account financial institution providers (Royal Bank of Scotland, Lloyds Banking Group, Barclays, and HSBC) that hold approximately two-thirds of the market in the UK provide much lower rates of interest than smaller competitor financial institutions.<sup>117</sup>

For example, the median yearly interest rate that the leading personal current account financial institution renders on easy-access savings accounts opened between 2012 and 2014 was roughly 0.5 per cent.<sup>118</sup> The corresponding rate given by other providers for the same period was 1.2 per cent.<sup>119</sup>

Financial institutions are able to pay lower interest rates to existing customers than they offer on bank accounts opened more recently, because most customers fail to look around for better deals in the market.<sup>120</sup>

For instance, in early 2014, the average interest rate on easy-access bank accounts opened in the previous two years was approximately 0.8 per cent, as compared with 0.3 per cent for those bank accounts opened more than five years before that period.<sup>121</sup>

The dominance of established suppliers of current accounts and the unpopularity of bank account switching makes it hard for competing financial institutions to obtain a foothold in the UK savings market.<sup>122</sup>

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<sup>116</sup> Financial Conduct Authority, 'Cash Savings Market Study Report' (January, 2015) *FCA Market Study MS14/2.3*, pp 31-40, and 87-90, available at <https://www.fca.org.uk/static/documents/market-studies/cash-savings-market-study-final-findings.pdf>

<sup>117</sup> A Paleit, 'Savers Earn Poor Returns on Bank, Warns UK Regulator' (8 July, 2014) *Financial Times*.

<sup>118</sup> *Ibid.*

<sup>119</sup> *Ibid.*

<sup>120</sup> *FCA Cash Savings Market Study Report* (n116), pp 6, and 7.

<sup>121</sup> *Paleit* (n117).

Most consumers put their savings in accounts with their current account providers, notwithstanding that the dominant current account market players characteristically provide lower rates of interest than smaller rival bank.<sup>123</sup>

Nevertheless, some critics doubt whether regulatory investigations can provide any benefit to consumers. Persuading consumers to retain their savings in accounts overtaken by inflation remains a probing assessment of investor protection.<sup>124</sup> A possible alternative could be to inform savers that the best means to realize real profits would be to embrace investment risk and market exposure.

The banking and competition authorities maintain they intend to carry out additional studies, such as the Competition and Markets Authority's ongoing retail banking market investigation,<sup>125</sup> prior to deciding on implementation of any necessary intervention to safeguard operational competition in the banking market.

Any action taken will be measured to advance consumers' insight into the interest rates they are receiving, in comparison to rates available from other accounts. It would, moreover, scrutinize the improving of consumer awareness on the change of their rates over time, mostly for accounts that provide appealing introductory interest rates. Characteristically, banks offer 'teaser' rates to entice individuals and businesses to their savings products, with the publicized rate only continuing for a particular period before returning to a lower rate.<sup>126</sup> Often, these accounts are criticized by consumer groups that believe most consumers do not succeed to move their savings before the promotional rate comes to an end. Numerous providers utilize 'teaser' rates to inflate the notification rates on savings accounts, and this is not necessarily a negative thing when rates are reasonably low. However, when interest rates rapidly reduce on savings accounts, consumers are left in poorer financial situations.<sup>127</sup>

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<sup>122</sup> *FCA Cash Savings Market Study Report* (n116), pp 7-10.

<sup>123</sup> *Ibid*, pp 16, 29, and 109.

<sup>124</sup> *Ibid*, pp 70, and 113.

<sup>125</sup> For a discussion on the ongoing retail banking market investigation by the Competition and Markets Authority, see chapter 2.9 in this thesis, pp 30-31.

<sup>126</sup> *FCA Cash Savings Market Study Report* (n116), p 7.

<sup>127</sup> *Ibid*, pp 6-7.

The UK banking and competition regulators are, also, in the process of reviewing how to make it more convenient for consumers to switch their bank accounts.

New rules were introduced in 2013 to provide that it should only take seven business days, rather than thirty business days, for a consumer and/or a business to change bank account providers.<sup>128</sup> The rules are intended to enhance competition and persuade smaller financial institutions to challenge the dominance of the large banks.<sup>129</sup> Nevertheless, bank account switching levels between financial institutions continue to be at a low level.<sup>130</sup>

Banks' customers lose billions of pounds by holding their funds in poor value savings accounts, while banks provide inadequate services to assist their customers in receiving the best deals.

Despite the fact that the banking authorities do undertake investigations in this market,<sup>131</sup> financial institutions ought to be entirely transparent, when it comes to interest rates. These institutions need to inform consumers, when bonus interest rates expire, and make it more convenient for consumers to switch their savings accounts to other financial institutions.

#### 5.4 Competitive analysis

A relevant merger situation in the UK arises when at least two parties fulfil a three-step process.

First, the enterprises (i.e., banks) must cease to be distinct.<sup>132</sup> Secondly, the merger must have either not yet occurred or was consummated within four months prior to the reference to the competition authority, unless the merger occurred without public knowledge

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<sup>128</sup> UK Payments Council, 'Current Account Switch Service' (16 September, 2013), available at [www.paymentscouncil.org.UK/switch\\_service](http://www.paymentscouncil.org.UK/switch_service).

<sup>129</sup> HM Treasury, 'Bank Account Switching Service Set to Launch' (10 September, 2013) *News Story*, available at <https://www.gov.uk/government/news/bank-account-switching-service-set-to-launch>

<sup>130</sup> J Winch, 'Bank Account Switching Levels "Still Low"' (11 April, 2014) *Telegraph*.

<sup>131</sup> For example, *FCA Cash Savings Market Study Report* (n116); and *Retail Banking Market Investigation: Summary of Provisional Findings Report* (n20).

<sup>132</sup> *EA02* (n13), ss 23.1, and 23.2.

and the authority was not notified of the merger.<sup>133</sup> Thirdly, the UK turnover of the acquired enterprise must surpass £70 million (turnover test)<sup>134</sup> or the merger case forms or boosts a supplier's share of services or products of an exact specification in the UK to 25 per cent or higher (share of supply test).<sup>135</sup>

To ascertain if two or more enterprises cease to be distinct, the UK competition authority examines legal control, as well as factual control in a merger case in respect of the concerning enterprises.<sup>136</sup>

Notwithstanding the complexities the share of supply test presents for merging parties, it is only one of two possible jurisdictional size thresholds that may apply.<sup>137</sup> The share of supply test is met if the merger establishes or increases a 25 per cent market share of any products or services within the UK, or in a significant part of the country. The share of supply test, also, provides the competition authority with broad discretion regarding the geographical reference point.<sup>138</sup>

The competition authority ensures that the concerned market or markets are adequately importance to warrant a reference, *i.e.*, where their total yearly value in the UK exceeds £10 million. Where the yearly value of the market or markets is in sum total below £3 million, the Competition and Markets Authority ('CMA') normally will not contemplate a reference as long as there is not, in principle, a definite undertakings in lieu of reference solution available.<sup>139</sup> Where the total relevant annual value in the UK is between £3 million and £10 million, the CMA will look at whether the anticipated harm to customers arising from the merger is significantly above the median public cost of a reference from the CMA for further investigation (Phase 2).<sup>140</sup>

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<sup>133</sup> *Ibid*, ss 24.1, and 24.2.

<sup>134</sup> *Ibid*, s 28; see, also, *UK Merger Assessment Guidelines* (n1), pt 3; especially, paras 3.3.1 – 3.3.2.

<sup>135</sup> *EA02* (n13), s 23; see, also, *UK Merger Assessment Guidelines* (n1), pt 3; especially, paras 3.3.6 – 3.3.7.

<sup>136</sup> *UK Merger Assessment Guidelines* (n1), para 3.2.

<sup>137</sup> *EA02* (n13), s 23; see, also, *UK Merger Assessment Guidelines* (n1), paras 3.3.6 – 3.3.7.

<sup>138</sup> *Ibid*.

<sup>139</sup> The UK competition watchdog applies a *de minimis* rule in relation to markets of insufficient importance, which can be less than £10 million of the merger's yearly value of the affected market in the UK. For more information, see *Mergers Exceptions to the Duty to Refer and Undertakings in Lieu of Reference* (n1), pp 3-21.

<sup>140</sup> Presently, it is around £400,000 (see, *ibid*, pp 3, and 5).



The UK competition authority bases its analysis of likely customer harm on the size of the concerned market. This means that its view is based on the prospect that a ‘substantial lessening of competition’ (‘SLC’) shall materialize, its analysis of the extent of any competition that would be removed, and its view regarding the duration of that substantial reduction of competition.<sup>141</sup> It is more probable that the competition authority will refer the merger for ‘Phase 2’ investigation, where the merger is possibly replicable in a number of similar markets within a certain sector of the economy.<sup>142</sup>

The CMA does not implement the *de minimis* exception in the event straightforward undertakings in lieu could be put forward by the merging parties to address the identified competition concerns.<sup>143</sup> Even where the concerned markets are in context insignificant in size, the merging parties should still be motivated to proffer clear undertakings to resolve concerns or to structure their merger deal so as to avoid anti-competitive consequences.<sup>144</sup>

The merger analysis provisions embody the common principles that the UK competition authority and the responsible sector regulator(s) apply to assess the unilaterally imposed and synchronized consequences of horizontal or non-horizontal merger transactions.<sup>145</sup> These guidelines explain the SLC test and the significance of important consequence on competitiveness over time.<sup>146</sup>

They, also, consider a more ‘economics-built’ method to merger examination, especially in unilaterally imposed competition consequences situations.<sup>147</sup> For instance, as market definition remains pertinent to framing competitive analysis, it is presently deemed to be more of a valuable instrument and not essentially an end in itself.<sup>148</sup> This is principally the case in situations of unilaterally imposed consequences, where advanced application of profit margins, diversion ratios, and related quantitative evidence is more imperative.<sup>149</sup>

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<sup>141</sup> *UK Merger Assessment Guidelines* (n1), para 4.1.

<sup>142</sup> *UK Merger Jurisdiction and Procedure* (n1), pp 92-98.

<sup>143</sup> *UK Mergers Exceptions to the Duty to Refer and Undertakings in Lieu of Reference* (n1), pp 3-21.

<sup>144</sup> *Ibid.*

<sup>145</sup> *UK Merger Assessment Guidelines* (n1), paras 5.4 - 5.5, and 5.6.

<sup>146</sup> *Ibid.*, para 4.1.

<sup>147</sup> *Ibid.*, paras 1.6, and 1.16.

<sup>148</sup> *Ibid.*, see generally, pt 5.

<sup>149</sup> *Ibid.*

The retail banking market in UK is moderately concentrated, with a small number of large financial institutions and a sizeable peripheral corpus of small financial institutions.<sup>150</sup>

For most banking services, including mortgage lending, unsecured lending, and instant access deposits, the outcome of mergers on interest rate levels is not much more than zero. This appears to be true before and after the merger consummation.<sup>151</sup>

The consequences of bank mergers on notice deposit accounts, in comparison with other banking products, do seem to be statistically meaningful. For considerable quantities, between £5,000 and £50,000, invested in notice deposit accounts, a consistent negative change in interest rates provided on customers' accounts appears to occur. This happens, instantly, following the merger, and for a few years after that event.<sup>152</sup> Overall, the result is a rapid decrease in the level of interest for customers compared to those customers of banks that are not merging. This shows that merging banks compete much less aggressively in the UK market for the notice deposits accounts as compared with their non-merging counterparts.

Prior to a merger, targeted banks appear to price their notice deposit accounts for smaller amounts, between £500 and £5,000, reasonably competitively, and render considerably higher interest rates in the last few years prior to the merger.<sup>153</sup> Generally, a bank merger seems to correlate with a strategic reduction of competition in the notice deposit accounts market.

The UK merger assessment guidelines provide a thorough explanation of the 'defences' available to banks wishing to receive merger clearance.<sup>154</sup> An important factor is that the merger increases effectiveness.<sup>155</sup> A bank merger sometimes leads to a diversity of

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<sup>150</sup> S Heffernan, 'The Effect of UK Building Society Conversion on Pricing Behaviour' (2005) *Journal of Banking and Finance* 29, pp 79-97.

<sup>151</sup> *Ibid*, pp 87-110.

<sup>152</sup> J Ashton and K Pham, 'Efficiency and Price Effects of Horizontal Bank Mergers' (June, 2007) *CCP Working Paper* 07-09, available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=997995](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=997995).

<sup>153</sup> J Ashton and K Pham, 'Efficiency and Price Effects of Horizontal Bank Mergers' (June, 2007) *Centre for Competition Policy – Working Paper* 07-9, available at

<http://competitionpolicy.ac.uk/documents/8158338/8256114/CCP+Working+Paper+07-9.pdf>

<sup>154</sup> *UK Merger Assessment Guidelines* (n1), paras 4.3.8 - 4.3.18.

<sup>155</sup> *UK Merger Assessment Guidelines* (n1), paras 5.7.1 - 5.7.18.

efficiencies, like economies of scope and branch sharing, as well as back-office integration.<sup>156</sup> Banks' abilities to rely on effectiveness arguments are relatively narrow. The UK competition regulators acknowledge that effectiveness makes a difference, when it is considerable and the potential anti-competitive effect of the merger would be small. However, the merging banks need to demonstrate that the effectiveness could provide advantages to consumers.<sup>157</sup>

The merger case is eligible for assessment by UK competition authority when the share of supply test<sup>158</sup> or the turnover test<sup>159</sup> is met. Accordingly, a merger might be subject to more scrutiny when there appears to be no competitive overlap between the merging parties.

The turnover test is met where the annual value of the UK turnover of the party being taken over exceeds £70 million.<sup>160</sup> Generally, it will be straightforward to identify the acquired party business whose turnover should be considered. Particular rules apply in relation to joint ventures and partnership mergers.<sup>161</sup> The custom is to base turnover on the latest reported accounts, conditioned to reflect any substantial transactions completed after the most recent accounts were prepared.<sup>162</sup>

Regarding the share of supply test, there is broad discretion in determination of the relevant services or products, which might be exercised for the following reasons.<sup>163</sup> The share of supply test is, in many instances, loosely, yet erroneously, considered as a market share test. In fact, it is not an economic market share test. Therefore, there is no requirement

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<sup>156</sup> *Ibid.*

<sup>157</sup> *Ibid.*, paras 5.7.3, 5.7.9, 5.7.15 - 5.7.17, and 5.7.18.

<sup>158</sup> EA02 (n13), s 23; see, also, *UK Merger Assessment Guidelines* (n1), paras 3.3.6 – 3.3.7. The merging parties jointly account for at least twenty-five per cent of goods or services supplied in the UK.

<sup>159</sup> EA02 (n13), s 28; see, also, *UK Merger Assessment Guidelines* (n1), paras 3.3.1 – 3.3.2. The turnover of the target business exceeds £ 70 million.

<sup>160</sup> *UK Merger Assessment Guidelines* (n1), pt 3; especially, para 3.3.

<sup>161</sup> EA02 (n13), s 28(1)(b). Where none of the banks remain under the same ownership and control, for instance, following the formation of a joint venture or partnership, the value of the turnover of the financial institution being taken over shall be calculated as the sum of the turnovers of all of the financial institutions ceasing to be distinct, less the turnover of the financial institution with the highest turnover (*i.e.*, the lowest turnover is determinative).

<sup>162</sup> EA02 (n13) (Merger Fees and Determination of Turnover) Order 2003 (SI 2003/1370).

<sup>163</sup> *UK Jurisdiction and Procedure* (n1), paras 3.3.3 – 3.3.8.

to take a similar approach as could be taken to determine the market for the purposes of a substantial, competition examination.<sup>164</sup>

The competition authorities heed any sensible characterization of a set of products or services in order to decide, if the share of supply test is satisfied. For example, such a characterization may be based on value, price, cost, quantity or capacity of people employed.

Applicability of the supply share test can extend to the UK as a whole, or to a 'substantial' part of the country.<sup>165</sup> An area may be defined as 'substantial', when it is of such character, size, and significance to make it of worthwhile consideration for merger control reasons.<sup>166</sup>

If one of the merging parties possesses a 25 per cent share of supply, the share of supply test is satisfied provided that there is an increase in that share.<sup>167</sup>

The SLC standard allows consideration of a broad spectrum of competition concerns, while assessing vertical, horizontal, or conglomerate mergers.<sup>168</sup> A merger can be envisaged to give rise to a SLC, when such merger is anticipated to impair competitiveness to such a level that it would be harmful to customers.<sup>169</sup> This could occur, for instance, because of decreased product options, or as a result of the profitable increase in prices, a decrease in output, or a decrease in innovation or product quality.

Determination of the markets affected by a relevant merger provides the structure for the competition analysis. The merger assessment guidelines issued by the competition regulator concerning market determination<sup>170</sup> constitute the regulator's blueprint for dealing with merger situations and competition provisions. The foremost standard is on the suitability of products from the perspective of consumers and competing providers. The supposed

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<sup>164</sup> *Ibid*, para 4.3.

<sup>165</sup> *Ibid*, paras 3.3.6 – 3.3.7.

<sup>166</sup> *Regina v Monopolies and Mergers Commission, ex parte South Yorkshire Transport Ltd*, [1993] 1 WLR 23, [1993] 1 ALL ER 289.

<sup>167</sup> EA02 (n13), s 23; see, also, *UK Merger Assessment Guidelines* (n1), pt 3; especially, paras 3.3.6 – 3.3.7.

<sup>168</sup> *UK Merger Assessment Guidelines* (n1), pt 4; especially para 4.1.

<sup>169</sup> *Ibid*.

<sup>170</sup> *Ibid*, para 5.2.

monopolist test is a crucial one. This concerns profitability for a theoretical monopolist to apply a 5 per cent non-transitory increment in prices<sup>171</sup> relative to a specific product. The merger is considered for the existence of any short-term competitive restraints in the way of substituted products.

The geographic market is determined in line with the location of merging parties, which are perceived as competitive options for consumers within a specific area.<sup>172</sup>

Part of a merger review is assessment of the ‘counterfactual’ position,<sup>173</sup> which means the competition outlook in the absence of the merger.<sup>174</sup>

The ‘counterfactual’ position is of importance in a horizontal merger in which issues emerge regarding competitive overlapping between the merging parties.<sup>175</sup> These could involve coordinated<sup>176</sup> or non-coordinated (unilateral) consequences.<sup>177</sup> Coordinated results consist of competitors in the market place synchronizing their conduct in order to increase prices, lessen quality or curb yield.<sup>178</sup> Non-coordinated or unilateral consequences consist of situations where one party discovers it is profitable to increase prices or diminish yield or quality due to the market power of the merged parties.<sup>179</sup>

The competition examination centres on the merging parties’ market shares, their competitors’ market shares, obstacles to entry, any competitive weights (persuasions) on the merging parties’ business, the effects of prices and additional provision of products and services supply, as well as any offsetting buyer ability.<sup>180</sup> The degree of concentration in the

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<sup>171</sup> *Ibid*, para 5.2.12.

<sup>172</sup> *Ibid*, paras 5.2.5(b); 5.2.21 – 5.2.27.

<sup>173</sup> *Ibid*, para 4.3.

<sup>174</sup> *Ibid*.

<sup>175</sup> *Ibid*, paras 4.3.1 - 4.3.4.

<sup>176</sup> *Ibid*, para 5.5.

<sup>177</sup> *Ibid*, para 5.4.

<sup>178</sup> *Ibid*, paras 5.5.1 - 5.5.4.

<sup>179</sup> *Ibid*, paras 5.4.1 - 5.4.3.

<sup>180</sup> *Ibid*, para 5.1.

market is a robust indicator of any latent competition issues and can be counted, based on concentration ratios, market share, or the HHI.<sup>181</sup>

The potential issue that occurs in vertical mergers is the vertically combined businesses may encourage market foreclosure, either towards or in the opposite direction of the vertically combined business operation.<sup>182</sup> The merged parties' position in these markets is a significant factor.

A conglomerate merger hardly ever gives rise to a SLC. However, this could be an issue if the merger concerns products of a complementary nature and creates 'portfolio effects'.<sup>183</sup>

The EU competition provisions are applicable to banking (or other businesses) 'concentrations' transactions possessing an EU dimension. A merger has an EU dimension, if the grand total global turnover of the entire banks involved exceeds €5 billion, and the total Community-wide turnover of each, or at minimum two, of the banks involved exceeds €250 million.<sup>184</sup> However, this criterion will not be satisfied if each of the banks involved has more than two thirds of its grand total EU-wide turnover in one and the same member state.<sup>185</sup> In that case, the proposed bank merger is evaluated in accordance with that Member State's merger provisions.<sup>186</sup>

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<sup>181</sup> E Carletti, 'Competition, Concentration and Stability in the Banking Sector' [2010] *OECD Competition Committee Roundtable, Seminar on Competition, Concentration and Stability in the Banking Sector, DAF/COMP (2010) 9*, Paris, pp 13-37.

<sup>182</sup> *UK Merger Assessment Guidelines* (n1), para 5.6.

<sup>183</sup> *Ibid*, para 5.6.15; see, also, paras 4.1.4, 4.1.5, 5.6.1, 5.6.2, and 5.6.13; A 'portfolio effect' is the change in the value of a portfolio in response to a change in the value of one of the assets in the portfolio, weighted according to what percentage of the portfolio that asset represents. For instance, if shares of a certain stock that makes up half of a portfolio and the stock drops by 20 per cent, the portfolio effect is a value decrease of 10 per cent.

<sup>184</sup> *ECMR* (n17), art 1.2. These are called 'primary thresholds'. Another set would be the so-called 'alternative thresholds', subject to the *ECMR* concentration parameters. These situations include if the parties combined worldwide turnover exceeds €5 billion; and each of at least two parties has EU-wide turnover exceeding €250 million unless all of the parties generate at least two-thirds of their individual EU-wide turnover in one and the same Member State.

<sup>185</sup> *Ibid*. For a discussion of the *ECMR* (n17), see chapter 2.10.2 in this thesis, pp 33-7.

<sup>186</sup> *ECMR* (n17), art 1(2).

The above financial threshold of banks is computed, based on an income-related test, in which turnover includes the sum of interest and similar income, income from securities, commissions receivable, net profit on financial operations and other operating income.<sup>187</sup>

A bank merger subject to the EU merger provisions is evaluated to determine if the merger is compatible with the Common Market. If a bank merger causes a concentration that could notably hamper effectual competition, within the Common Market or in a considerable portion of it, especially due to the formation or consolidation of a dominant position, the merger would be held incompatible with the Common Market and consequently prohibited.<sup>188</sup> In the event that it does not present an incompatibility issue, at that juncture the merger should be permitted.

In relation to the application of State aid provisions to undertakings implemented by banks and other financial institutions in light of the Global Financial Crisis, the EU competition authority has identified numerous types of State aid situations.<sup>189</sup> These include guarantees of banks' liabilities, recapitalization of banks that should not have been allowed under the special aid provisions, administered bank winding up processes, and central bank provision of immediate and short-term liquidity backing that sometimes is not defined a State aid.<sup>190</sup>

The Commission provides twenty-four hours or over a weekend, if required, for an enhanced procedure to evaluate and grant State aid to banks.<sup>191</sup> Also, the normal time limitation of six months regarding emergency rescue aid is extended to two years.<sup>192</sup>

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<sup>187</sup> Council Directive 86/635/EEC on the annual accounts and consolidated accounts of banks and other financial institutions (1986) *OJ L372/1*, pp 1-17. The turnover of a credit or financial institution in the EU or in a Member State shall comprise the income items, as defined above, which are received by the branch or division of that institution established in the EU or in the Member State in question, as the case may be.

<sup>188</sup> *Ibid.*, art 2.

<sup>189</sup> Commission, 'The Application of the State Aid Rules to Measures Taken in Relation to Financial Institutions in the Context of the Current Global Financial Crisis' (2008) *Communication OJ C 270/02* ('Banking Communication 2008').

<sup>190</sup> *Ibid.*

<sup>191</sup> DG Competition, 'DG Competition's Review of Guarantee and Recapitalization Schemes in the Financial Sector in the Current Crisis' (7 August, 2009) *DG Comp*, p 2, available at [http://ec.europa.eu/competition/state\\_aid/legislation/review\\_of\\_schemes\\_en.pdf](http://ec.europa.eu/competition/state_aid/legislation/review_of_schemes_en.pdf).

<sup>192</sup> *Ibid.*

Retail deposit guarantees are normally designed to protect against any bank run situations.<sup>193</sup> Wholesale lending and additional kinds of guarantees are allowed in particular scenarios, especially on invigoration of the revival of interbank lending.<sup>194</sup>

For retail deposit guarantees, the basis to ensure adequate recompense from the beneficiary of the guarantee must be greater if the guarantee is requested. For recapitalization, the price of stock purchased by a Member State government is stemmed from a market-driven assessment, with elements like claw-back instruments or favoured stock being regarded positively.

In terms of guarantees and recapitalizations, several restrictions on the future conduct of the bank recipients are needed. These include a prohibition on advertising derived from the bank recipient's state-backed position, or regarding business operation expansion.

The reason behind the recapitalization relief for the EU Member States' actions, like the UK Government's recapitalization scheme and asset guarantee for Royal Bank of Scotland,<sup>195</sup> and Lloyds Banking Group,<sup>196</sup> is to restore financial stability of banks within the Member State, in order to ensure lending to the real economy and avoid system risk of possible insolvencies.<sup>197</sup>

The Commission adopted temporary approaches on State aid undertakings in order to support banks and other financial institutions' access to finance during the Global Financial Crisis.<sup>198</sup> The Commission's measures concerned aid to stimulate loan guarantees and

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<sup>193</sup> Directive 2014/49/EU of the European Parliament and of the Council of 16 April, 2014 on *Deposit Guarantee Schemes*, (12 June, 2014) *OJ L 173*.

<sup>194</sup> A Petrovic and R Tutsch, 'National Rescue Measures in Response to the Current Financial Crisis' (2009) *European Central Bank Legal Working Paper Series No 8*, available at [http://ssrn.com/abstract\\_id=1430489](http://ssrn.com/abstract_id=1430489).

<sup>195</sup> Commission, 'State Aid No. 422/2009 and N 621/2009 – United Kingdom Restructuring of Royal Bank of Scotland Following its Recapitalization by the State and Its Participation in the Asset Protection Scheme' (14 December, 2009) *C(2009) 10112 final*.

<sup>196</sup> Commission, 'State Aid No 428/2009 – United Kingdom: Restructuring of Lloyds Banking Group' (18 November, 2009) *C(2009)9087 final*.

<sup>197</sup> Commission, 'The Recapitalization of Financial Institutions in the Current Financial Crisis: Limitation of Aid to the Minimum Necessary and Safeguards against Undue Distortions of Competition' (2009) *C(2009)10/3*.

<sup>198</sup> Commission, 'Temporary Framework for State Aid Measures to Support Access to Finance in the Current Financial and Economic Crisis' (2009) *OJ C83/1*; see, also, Commission 'Return to Viability and the Assessment of Restructuring Measures in the Financial Sector in the Current Crisis under the State Aid Rule' ('Restructuring Communication') (2009) *OJ C195/9*.



subsidized loans, short-term export credit insurance, and risk capital investments in risk capital.<sup>199</sup>

Under the EU merger regulation, the general position is that a notifiable transaction cannot be implemented before clearance of the merger.<sup>200</sup> However, the merger regulation permits the Commission to grant derogations from this suspensory obligation.<sup>201</sup> In deciding whether to accept a derogation request, the Commission must consider the effects on the parties and third parties and the threat to competition posed by the transaction. Derogations are in practice very rarely granted. The derogation may be contingent on conditions and obligations in contemplation of warranting conditions for efficient competition. The derogation application can be filed at any time prior to notification or subsequent to the merger.<sup>202</sup>

Previously derogations were issued solely under extraordinary conditions.<sup>203</sup> Recently, the Commission has demonstrated an inclination to be more accommodating, finding extraordinary conditions more frequently than before. In 2008, the Commission granted derogation actions, giving the go-ahead to the Bradford & Bingley takeover by Santander, immediately, forming thereafter the Santander UK bank.<sup>204</sup>

Non-European bank acquirers, like US banks, need to adhere to the EU parameters for evaluating banking mergers.<sup>205</sup> These parameters require an analysis of the 'equivalence' of third country regulatory authority in the jurisdiction where the banking group is formed.<sup>206</sup>

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<sup>199</sup> Commission, 'Communication on the Application, from 1 January, 2011, of State Aid Rules to Support Measures in Favour of Banks in the Context of the Financial Crisis' (2011) *OJ C329/7*.

<sup>200</sup> *ECMR* (n17), art 6.1.

<sup>201</sup> *Ibid*, art 7.3; see, also, Council Regulation (EEC) No 4064/89 of 21 December, 1989 on the control of concentrations between undertakings [*OJ L 395* of 30 December, 1989]. Amended opinion: *OJ L 257* of 21 September, 1990. Amended by: Council Regulation (EC) No 1310/97 of 30 June, 1997 [*OJ L 180* of 9 July, 1997], art 7.4.

<sup>202</sup> *Ibid*; see, for a discussion of 'derogation' in merger cases, see chapter 3.3 in this thesis, pp 66-79.

<sup>203</sup> Case No. COMP/M.2621 *SEB/Moulinex* [2005] *OJ L138/18*; see, also, Case No. COMP/M.3209 *WPP/Cordiant* [2003] *OJ C 212/19*.

<sup>204</sup> For a discussion of the *Santander/Bradford & Bingley* case, see chapter 4.4.2(c) in this thesis, pp 126-7.

<sup>205</sup> Directive 2006/48/EC of the European Parliament and of the Council of 14 June, 2006 relating to the taking up and pursuit of the business of credit institutions (recast) [2006] *OJ L177/1*, arts 6-22; Council Directive 2006/48/EC of 14 June, 2006 relating to the taking up and pursuit of the business of credit institutions, *OJ L177/1* ('Credit Institutions Directive'), art 19.1; Council Directive 2006/49/EC of 14 June, 2006 on the capital adequacy of investment firms and credit institutions, *OJ L 177* ('Capital Adequacy Directive').

The Commission finds that cross-border bank mergers within the EU are less prevalent than in other areas of the economy. Market participants recognize a number of impediments to cross-border bank mergers.<sup>207</sup> One obstacle is that the banking and competition regulators that approve cross-border bank mergers are frequently utilized for national protectionist reasons.<sup>208</sup> The ability to examine the effects of a bank merger and approval on the basis of this examination is, in reality, granted to the pertinent authorities of the Member State in which the merger target bank is located.

When a UK bank merger has an EU dimension,<sup>209</sup> the UK regulators do not have authority to apply their own regulatory provisions to the merger.<sup>210</sup> However, under the EU provisions, UK competition authorities are permitted to apply suitable means to preserve 'legitimate interests' in the bank merger transaction.<sup>211</sup> The EU provisions recognize prudential provisions, like interests.<sup>212</sup>

#### 5.4.1 Ex-ante v ex-post notification control

The Commission's merger control analysis under the ECMR is carried out based on an *ex-ante* (pre-notification) control.<sup>213</sup> Under this approach, the Commission shall primarily aim to prevent merging parties from reinforcing or establishing a dominant position enabling them to exercise market power that could be harmful for the process of undisturbed competition.<sup>214</sup> Consequently, the most important purpose of merger policy is to avert formation of a market

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<sup>206</sup> Council Directive 2009/111/EC amending Directives 2006/48/EC, 2006/49/EC and 2007/64/EC as regards banks affiliated to central institutions, certain own funds items, large exposures, supervisory arrangements, and crisis management (2009) *OJ L 302/97*; Council Directive 2013/36/EU on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directive 2006/48/EC and 2006/49/EC (2013) *OJ L 176/338*.

<sup>207</sup> Commission, 'Cross-border Consolidation in the EU Financial Sector' (October, 2005) *Staff Working Document SEC 1398*, pp 25-30, available at [http://ec.europa.eu/internal\\_market/finances/docs/cross-sector/mergers/cross-border-consolidation\\_en.pdf](http://ec.europa.eu/internal_market/finances/docs/cross-sector/mergers/cross-border-consolidation_en.pdf).

<sup>208</sup> *Ibid.*

<sup>209</sup> *ECMR* (n17), arts 1.2, 1.3, and 5.3.

<sup>210</sup> *Ibid.*, art 21.3.

<sup>211</sup> *EA02* (n13), ss 42, 46A, 46B, and 46C.

<sup>212</sup> C M Borges, 'The Legitimate Interests of Member States in EC Merger Law' (2003) 9 *European Public Law* 345, pp 345-357.

<sup>213</sup> *ECMR* (n17), art 2(1).

<sup>214</sup> M Lorenz, *An Introduction to EU Competition Law* (Cambridge: Cambridge University Press 2013), pp 242-243.

structure that would significantly facilitate coordination of market behaviour between different market players. For example, in the *Deutsche Börse/NYSE-Euronext* merger<sup>215</sup>, the Commission banned *ex-ante* this planned merger to near monopoly on the European financial derivatives market, despite future substantial efficiency gains argued by the parties.

The inability of the Commission to review developments on post-mergers<sup>216</sup> influences the authority to implement more compromises than may otherwise be the case when carrying out its responsibilities.<sup>217</sup> The burdensome nature of action, in addition to the lack of a requirement that the EU competition authority justifies its findings with solid evidence, and the infrequent EU courts' findings of merger decisions, means that Commission's role is vulnerable to abuse.<sup>218</sup>

The examination of specific mergers may be particularly contentious as the merging parties concerned and the Commission along with the Member States are arguing on the basis of anticipated, rather than actual, results, and the scope of the transactions concerned is sometimes very substantial.<sup>219</sup>

Unlike the *ex-ante* merger control assessment, the anticompetitive agreements (cooperation) pursuant to Article 101 TFEU<sup>220</sup> and the control of abuse of dominance (unilateral conduct) under Article 102 TFEU<sup>221</sup> are examined by the Commission on *ex-post*-merger basis.<sup>222</sup>

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<sup>215</sup> Case No. COMP/M.6166 *Deutsche Borse/NYSE Euronext* [2013] OJ C199/9. In March, 2015 the General Court issued a judgment upholding the Commission's prohibition of the merger, see Case T-175/12 *Deutsche Börse v Commission* [2015] EU:T:2015:148.

<sup>216</sup> There is an ongoing discussion within the competition experts' whether the EU concentration control should move from hard-core a priori prevention to a lighter *ex-ante* scrutiny combined with *ex-post* consistent monitoring of the market. In order to improve the outcomes and functioning of the concentration control system, benefits may be drawn from the *ex-post* functional precision. This would create finding solutions of having the *ex-ante* and the *ex-post* methods of control cohabit under the roof of the same legal order. For more discussion, see C S Rusu, *European Merger Control: The Challenges Raised by Twenty Years of Enforcement Experience* (Netherlands: Wolters Kluwer 2010), ch 7.

<sup>217</sup> P Ormosi et al, 'A Review of Merger Decisions in the EU: What Can We Learn from Ex-Post Evaluations?' (July, 2015) *DG Competition report*, available at <http://ec.europa.eu/competition/publications/reports/kd0115715enn.pdf>

<sup>218</sup> *Ibid.*

<sup>219</sup> S M Colino, *Competition Law of the EU and UK* (7<sup>th</sup> edn, Oxford: Oxford University Press 2013), p 349.

<sup>220</sup> TFEU (n61), art 101, more particularly 101(1) and 101(3). For a discussion of art 101 TFEU, see chapter 2.10 in this thesis, pp 31-46.

<sup>221</sup> TFEU (n61), art 102. For a discussion of art 102 TFEU, see chapter 2.10 in this thesis, pp 31-46.

<sup>222</sup> *Ibid.*, arts 101, and 102.

The market analysis in cases assessed under Articles 101 and 102 TFEU and the ECMR is, notwithstanding the different wording of these provisions, not different under each rule, though the different time perspective of Articles 101(1) and 102 TFEU (*ex-post*) and merger control (*ex-ante*) could lead on occasion to different geographic markets being defined for the same products.<sup>223</sup> Notwithstanding this insignificant anomaly, the objective should be uniformity, or, failing that, at least compatibility among all the market definitions (both geographic and product) reach for the same product or service when applying the different rules.<sup>224</sup>

As for the UK and the US, bank merger notifications are not mandatory. Nevertheless, merging banks tend to notify the relevant regulators before consummation of merger in order to avoid any potential anticompetitive issues in post-merger condition.

#### 5.4.2 Significant impediment of effective competition ('SIEC') test

The Commission utilizes a specific test as a relevant criterion to examine mergers and to enhance the possibilities to refer mergers to Member States or the latter referring mergers to the Commission.<sup>225</sup> The test is called the 'Significant Impediment of Effective Competition' ('SIEC').<sup>226</sup> The SIEC test is defined as,

A concentration which would significantly impede effective competition, in particular by the creation or strengthening of a dominant position, in the Common Market or in a substantial part of it shall be declared incompatible with the Common Market.<sup>227</sup>

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<sup>223</sup> L O Blanco, *Market Power in EU Antitrust Law* (Oregon: Hart Publishing 2011), pp 13-14.

<sup>224</sup> *Ibid.* The ideal situation would be for the analysis of a situation under arts 101 and 102 and the merger control rules to produce identical results. This may be impossible to achieve because merger control analysis is more hypothetical; unlike analyses under arts 101 and 102, it is not based (or is based much less) on the actual facts, if only because the (past) conduct of undertakings and their manner of exercising (or not) their market power cannot be taken into account when assessing the future results of a concentration.

<sup>225</sup> N Levy, 'The EU's SIEC Test Five Years On: Has It Made a Difference?' (April, 2010) 6 *European Competition Journal* 1, pp 3-5.

<sup>226</sup> *ECMR* (n17), arts 2.2, and 2.3.

<sup>227</sup> *Ibid.*

The SIEC test includes not only *coordinated effects*, which are ‘creation or strengthening of a dominant position’,<sup>228</sup> but also *non-coordinated effects*, which is ‘significantly impede effective concentration’ in case of an oligopoly.<sup>229</sup>

In order to improve the transparency of its merger analysis, while implementing the SIEC test, the Commission has published two sets of guidelines providing a sound economic framework for the assessment of both horizontal<sup>230</sup> and non-horizontal (*i.e.*, vertical or conglomerate) mergers.<sup>231</sup> Besides the guidelines the Commission has adopted three other notices, on case allocation,<sup>232</sup> ancillary restrictions<sup>233</sup> and simplified procedures.<sup>234</sup>

The term ‘Significant Impediment of Effective Competition’ (‘SIEC’) is used to describe a situation in which the new business, *e.g.*, financial institution, deriving from a merger is the single strongest participant in the market and is capable to significantly hamper competition by creating unilateral effects.<sup>235</sup> This is the situation in which a merger removes a significant competitive constraint, especially because prior to the merger, the businesses being brought together were previously one another’s closest competitors.<sup>236</sup>

When evaluating the impact of a notified merger on competition, the Commission reviews whether the merger would substantially hamper effective competition in the internal market or a substantial part of it.<sup>237</sup> Especially, the Commission seeks to conclude whether the merger would establish or strengthen a dominant position.<sup>238</sup> For example, in the merger case of *Bank of New York / Royal Bank of Scotland*,<sup>239</sup> the Commission found that the proposed bank merger did not result in the ‘creation or strengthening of a dominant position’

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<sup>228</sup> *Ibid*, art 2.2.

<sup>229</sup> *Ibid*, art 2.3.

<sup>230</sup> Commission, ‘Guidelines on the Assessment of Horizontal Mergers under the Council Regulation on the Control of Concentration between Undertakings’ [2004] *OJ C 31/5*.

<sup>231</sup> Commission, ‘Guidelines on the Assessment of Non-Horizontal Mergers under the Council Regulation on the Control of Concentrations between Undertakings’ (2008) *OJ C 265/6*.

<sup>232</sup> Commission, ‘Notice on Case Referral in Respect of Concentrations’ (2005) *OJ C56/2*.

<sup>233</sup> Commission, ‘Notice on Restrictions Directly Related and Necessary to Concentrations’ (2005) *OJ C56/24*.

<sup>234</sup> Commission, ‘Notice on a Simplified Procedure for Treatment of Certain Concentrations’ (2005) *OJ C56/32*.

<sup>235</sup> *ECMR* (n17), arts 2.2, and 2.3.

<sup>236</sup> C S Rusu, *European Merger Control: The Challenge Rose by Twenty Years of Enforcement Experience* (The Netherlands: Wolters Kluwer 2010), p 46.

<sup>237</sup> *TFEU* (n61), arts 101(1), and 102.

<sup>238</sup> *Ibid*.

<sup>239</sup> Case No. COMP/IV/M.1618 *Bank of New York/Royal Bank of Scotland* [1999] *OJ C/16*. In this case Bank of New York acquired a subsidiary of Royal Bank of Scotland.

because the merger failed to distort effective competition in the EU market or a significant part of it.<sup>240</sup> Therefore, the Commission decided to not oppose the notified operation and to declare it compatible with the common market.<sup>241</sup>

The SIEC test eliminated a possible enforcement ‘gap’ created from the previous (dominance) test<sup>242</sup>, which did not clearly capture possible anti-competitive effects deriving from a merger of two businesses in an oligopolistic market, where the merged business would not have become dominant.<sup>243</sup> Therefore, the SIEC test has removed this uncertainty and permits the Commission to strengthen its economic analysis of complex mergers. The merger examination employs a series of combination of qualitative quantitative/empirical evidence.<sup>244</sup> For example, in *Fortis/ABN Assets* merger<sup>245</sup>, the Commission utilized the SIEC test identifying *non-coordinated effects* in spite of the fact that the merged bank’s market share was similar or even lower than its competitors.<sup>246</sup>

While the SIEC test is mostly common used in EU Member States, the UK and the US apply the ‘substantial lessening of competition’ (‘SLC’) test.<sup>247</sup> The SIEC and the SLC tests are potentially quite different. The SLC draws attention to the level of change the merger shall cause to existing levels of competition, while the SIEC test appears capable of capturing a broader range of conduct, where the merger in question hinders competition without substantially reducing existing market competition. Nevertheless, practically speaking, the analytical approach adopted by the UK, the US and the EU Member States applying either of these tests is very similar.

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<sup>240</sup> *Ibid.*

<sup>241</sup> *Ibid.*

<sup>242</sup> Council Regulation (EEC) No 4064/89 of 21 December, 1989 on the Control of Concentrations between Undertakings (30 December, 1989) *OJ L* 395. Amended opinion: *OJ L* 257 (21 September, 1990). Amended by: Council Regulation (EC) No 1310/97 of 30 June, 1997 [*OJ L* 180 of 9 July, 1997], art 2.

<sup>243</sup> *ECMR* (n17), recital 25.

<sup>244</sup> Case COMP/M.5978 *GDF Suez/International Power* (2011), [2011] *OJ C* 60/9

<sup>245</sup> Case No. COMP/M.4844 *Fortis/ABN Assets* [2007] *OJ C* 265/2 (‘Fortis/ABN’).

In this bank merger case the proposed merger was to combine the first and the fourth biggest financial institutions within the Dutch market that was already concentrated. The Commission expressed some concerns in relation to the banking markets for commercial customers within the Dutch market. The market investigation established the position of Fortis as an aggressive competitor, which wished to remain an active competitor by expanding its market share, notwithstanding substantial hurdles to entry and expansion. In the post-merger situation, Fortis would have been a market leader rather than a challenger.

<sup>246</sup> *Ibid.*

<sup>247</sup> *EA02* (n13), ss 22-23; also, 15 USC §§12-27, 29 USC §§52-53 (Clayton Act 1914), s 7.

### 5.4.3 Failing firm (exiting firm) defence

In relation to the analysis of obstacles to entry and the ‘failing firm (‘exiting firm’ is the British terminology) defence’, the UK competition authorities have adopted a coherent standard for ascertaining whether these defences may apply.<sup>248</sup> To establish the defence of possible entry, concerning undertakings should show market entry is of adequate scope and extent, and is timely in manner, such as, to offset the likely bettered competitive position of the merged bank. To determine a ‘failing firm’ (‘exiting firm’) situation, the CMA considers, ‘(1) whether the [bank] would have exited (through failure or otherwise); and, if so (b) whether there would have been an alternative purchaser for the [bank] or its assets to the acquirer under consideration; and (c) what would have happened to the sales of the [bank] in the event of its exit’.<sup>249</sup>

The UK competition authority’ approach in bank merger cases, *i.e.*, the takeover of HBOS by Lloyds, confirmed that the authority is not lightly persuaded by the ‘failing firm (‘exiting firm’) defence’.<sup>250</sup> In that case, the competition authority (then the Office of Fair Trading) deemed that the assets of the merged banks would not leave the UK financial market because the government guaranteed medium and short-term funding to these banks.<sup>251</sup> The competition authorities assess the prevailing market and economic situations, when weighing evidence presented by merging parties. These situations are predominantly relevant to an assessment of evidence regarding the predictability of a party departing the market, and the genuine readiness of an alternate acquirer for an existing party to make such acquisition.

The foregoing dynamics are similar to those factors considered by the US<sup>252</sup> and the EU<sup>253</sup> competition regulators.

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<sup>248</sup> *UK Merger Assessment Guidelines* (n1), para 4.3.8.

<sup>249</sup> *Ibid.*

<sup>250</sup> Decision by Lord Mandelson, the Secretary of State for Business, Not to Refer to the Competition Commission the Merger Between Lloyds TSB Group plc and HBOS plc under Section 45 of the Enterprise Act 2002 (31 October, 2008) *Department for Business, Enterprise & Regulatory Reform* (‘Lord Mandelson Decision’), paras 19-21, available at [www.berr.gov.uk/files/file48745.pdf](http://www.berr.gov.uk/files/file48745.pdf).

<sup>251</sup> Office of Fair Trading, ‘Report to the SoS for Business Enterprise and Regulatory Reform: Anticipated Acquisition by Lloyds TSB plc of HBOS plc’ (24 October, 2008) *OFT*, paras 59-60.

<sup>252</sup> Department of Justice, ‘Horizontal Merger Guidelines’ (2010) (‘US Horizontal Merger Guidelines’), paras 5.0, and 11, available at [www.justice.gov/atr/public/guidelines/hmg-2010.pdf](http://www.justice.gov/atr/public/guidelines/hmg-2010.pdf).

<sup>253</sup> *EU Horizontal Merger Guidelines* (n32). para 89; also, pp 5-18.

In the US, the ‘failing firm defence’<sup>254</sup> is established when (i) the allegedly ‘failing firm’ would be unable to meet its financial obligations in the near future;<sup>255</sup> (ii) it would not be able to reorganize successfully under Chapter 11 of Title 11 of the US Code (‘US Bankruptcy Code’);<sup>256</sup> (iii) it has made unsuccessful good-faith efforts to elicit reasonable alternative offers of acquisition of the assets of the ‘failing firm’ that would both keep its tangible and intangible assets in the relevant market and pose a less severe danger to competition than does the proposed merger; and absent the acquisition, the assets of the ‘failing firm’ would exit the relevant market.<sup>257</sup> In practical terms, a ‘failing firm’ defence would be unlikely used in the bank mergers market because those banks that are in dire financial situation are undesirable targets from other banks.

### Role of the ‘failing firm defence’ in EU merger analysis

Although the doctrine is not made explicit in the EUMR,<sup>258</sup> it is noted in paragraphs 89 to 91 in the Horizontal Merger Guidelines.<sup>259</sup> The rationale behind the ‘failing firm defence’ rule is the notion the deterioration of the competitive structure follows a merger cannot be caused by the merger.<sup>260</sup> This lack of a causality link between a merger and a subsequent decrease in competition is consistent with Article 2(3) EUMR,<sup>261</sup> in which a merger would significantly impede effective competition (‘SIEC’) should be prohibited or modified by the Commission. In the ‘failing firm defence’, though, because the lessening of competition occurs regardless of the merger, the merger cannot be the cause of any harm to competition, or it is at least “neutral”,<sup>262</sup> and thus, such merger should be approved.<sup>263</sup>

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<sup>254</sup> *Int’l Shoe v. FTC*, 280 U.S. 291 (1930); see, also, *Citizen Publ’g Co. v. United States*, 394 U.S. 131, 137 (1969).

<sup>255</sup> *US Horizontal Merger Guidelines* (n252), para 11. For a discussion of the US bank merger analysis, see chapter 7 in this thesis, pp 197-215.

<sup>256</sup> Pub. L. 114-38 (US Bankruptcy Code).

<sup>257</sup> *US Horizontal Merger Guidelines* (n252), para 11. For a discussion of the US bank merger analysis, see chapter 7 in this thesis, pp 197-215.

<sup>258</sup> Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings (the EC Merger Regulation) [2004] OJ L 24/1.

<sup>259</sup> Commission Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings [2004] OJ C 31/5 (‘HMG’).

<sup>260</sup> *Ibid*, para 89.

<sup>261</sup> *EUMR* (n1) art. 2(3).

<sup>262</sup> The principle of neutrality was stated in *Kali and Salz/MdK/Treuhand* (Case IV/M.308) [1994] OJ L 186/30; on appeal *Joined Cases C-68/94 French Republic v Commission* and *C-30/95 Societe Commerciale des Potasses et de l’Azote (SCPA) and Entreprise Miniere et Chimique (EMC) v Commission* [1998] ECR I-1375, para 116; *BASF/Eurodiol/Pantochim* (Case COMP/M.2314) Commission Decision 2002/365/EC [2002] OJ L 132/45, para 142.



Because the ‘failing firm defence’ is an exceptional test, the Commission applies it very narrowly.<sup>264</sup> The evidential hurdle in applying ‘failing firm defence’ comes from the fact that in order to succeed, merging banks must show something more than the lack of causality<sup>265</sup> and their claim would need to be accompanied by an efficiencies defence.<sup>266</sup> The Commission’s Guidelines consider three cumulative criteria in its evaluation of a bank’s application for ‘failing firm defence’: first, the failing bank shall exit the market in the foreseeable future due to its financial difficulties; secondly, there is no less anti-competitive alternative purchase that could occur in place of a merger; and thirdly, in the absence of a merger, the assets of the failing firm (bank) would inevitably exit the market.<sup>267</sup> The high burden of proving that the criteria are satisfied lies on the merging banks, which must show the proposed merger would lead to a less anti-competitive outcome than a counterfactual scenario in which the firm and its assets would exit the market.<sup>268</sup>

Even though the foregoing three criteria may not be rigorously met, the merger could still be accepted due a counterfactual analysis, considering the fragility of the bank in question, the financial market and the banking industry and, above all, consumer welfare.<sup>269</sup> In other words, rather than refining the defence, it may be more appropriate to focus on the substance of the causality test.<sup>270</sup> Indeed, the approach taken by the Commission concerning situations similar to a ‘failing firm’ scenario,<sup>271</sup> in which the Commission uses a counterfactual analysis, seems to confirm that the formalistic ‘failing firm’ test might no

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<sup>263</sup> V Baccaro, ‘Failing firm defence and lack of causality: doctrine and practice in Europe of two closely related concepts’ (2004) 25 *E.C.L.R.* 12.

<sup>264</sup> This narrowness is a subject of criticism in Lindsay and Berridge, *The EU merger regulation: Substantive issues* (4<sup>th</sup> ed, Sweet & Maxwell, 2012), pp 17-18.

<sup>265</sup> G P Kyprianides, ‘Assess the importance of the counterfactual in merger assessment with regards to the failing firm defence’ (2012) 576 *E.C.L.R.* 6.

<sup>266</sup> K Heyer and S Kimmel, ‘Merger review of firms in financial distress’ (2009) 5(2) *CPI* 110.

<sup>267</sup> *HMG* (n 259), para 90.

<sup>268</sup> OECD Roundtable on Failing Firm Defence (21 October 2009) *DAF/COMP* (2009) 38.

<sup>269</sup> T Mathews, ‘The failing firm defence: re-examining Canada’s approach to rescue mergers in light of the US and EU experiences’ (2013) *James H Bocking Memorial Award, University of Ottawa*, p 28.

<sup>270</sup> K Joergsen, ‘Andersen and the “failing firm”: the application of the “failing firm defence” in merger proceedings involving firms providing professional services’ (2003) 26(3) *World Competition* 363-80, 1.

<sup>271</sup> *Deloitte & Touche/Andersen (UK)* (Case COMP/M.2810) Commission Decision of 01/07/2002.

longer be appropriate, and indeed, a more pragmatic approach can be used when applying a broad counterfactual analysis in which the ‘failing firm defence’ is just a concrete example.<sup>272</sup>

The Commission’s thinking has developed gradually over time, leaving open the possibility of a wider analysis of the ‘failing firm defence’, although this should depend on the specific circumstances of each case.<sup>273</sup> Indeed, the Commission submitted at the OECD Roundtable that ‘while especially relevant, these factors [the three ‘failing firm defence’ criteria] are not exclusive and exhaustive in establishing that a merging party is a failing firm. Other factors may be equally relevant depending on the circumstances of the case’.<sup>274</sup>

The ‘failing firm defence’ does not follow the standard two-step merger review process. Instead, the ‘defence’ is structured around three cumulative criteria, as outlined above. This threefold test is problematic in that ‘a merger involving a failing firm may be blocked (or remedied) for not satisfying the above conditions [criteria], even when it represents the least anticompetitive solution for the failing firm’s financial problems’.<sup>275</sup> Instances of this could include a situation in which the failing firm’s assets are used by potential purchasers but inefficiently, or one in which the alternative buyer itself lacks the ability to compete effectively in the market.<sup>276</sup>

Under the first condition of the ‘failing firm’ test, the merging parties need to show the firm is unlikely to meet its financial obligations in the near future.<sup>277</sup> It is not necessary to demonstrate that the firm has entered into bankruptcy or liquidation proceedings, but only that it is a feasible prospect.<sup>278</sup> Sophisticated financial data comes into play in order to measure the firm’s financial health, together with the health of the industry at issue. Particularly, the Commission takes into account the firm’s balance sheet in terms of profitability, liquidity and

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<sup>272</sup> K Fountoukakos and L Geary, ‘Time to bid farewell to the failing firm defense? Some thoughts in the wake of Nynas/Olympic/Aegean’ (2013) *C.P.I. Europe Column* 11.

<sup>273</sup> A Fedele and M Tognoni, ‘Failing firm defence with entry deterrence’ (2010) 62(4) *Bulletin of Economic Research*, pp 365-6.

<sup>274</sup> J Bouckaert and P M Kort, ‘Merger incentives and the failing firm defense’ (2014) 3 *Journal of Industrial Economics* 62, pp 436-6.

<sup>275</sup> H Vasconcelos, ‘Can the failing firm defence rule be counterproductive?’ (2013) 2 *Oxford Economic Papers* 65, pp 567-93.

<sup>276</sup> D Myles, ‘EU’s new failing firm defence benchmark’ (Dec 2013/Jan 2014) *International Financial Law Review*.

<sup>277</sup> A Komninos and J Jeram, ‘Changing mind in changed circumstances: Aegean/Olympic II and the failing firm defence’ (2014) 9 *Journal of European Competition Law & Practice* 5, pp 605-15.

<sup>278</sup> G P Kyprianides, ‘Assess the importance of the counterfactual in merger assessment with regards to the failing firm defence’ (2012) 12 *European Competition Law Review* 33, pp 576-82.

solvency.<sup>279</sup> Although it is a highly demanding financial analysis, it is more certain than the other two criteria in which the counterfactual assessment is hypothetical in nature.<sup>280</sup>

In the second component of the test, the parties must demonstrate that there are no less harmful alternative purchasers for the firm than the proposed transaction. It implies a difficult scrutiny of other reasonable buyers, and whether they would lead to a better competitive outcome.<sup>281</sup> The merging parties need to show that the assets of the ‘failing firm’ would exit the market, if not for the merger. In essence, the parties have to provide evidence that the business in question, as an on-going concern, is less valuable than its liquidation price.<sup>282</sup> In the application of the ‘failing firm’ test, not only is the exit of the target firm a key issue but, also, the exit of the target firm’s specialised or productive assets. In a successful application of ‘failing firm defence’, the merger is justified on the basis that it is the only way of keeping the assets in the market.<sup>283</sup> Indeed, some commentators have even proposed referring to the ‘failing firm defence’ as an ‘exiting assets defence.’<sup>284</sup>

The establishment of comprehensive provisions for the ‘failing firm’ defence is, moreover, an important issue, as this could be useful in the acquisition of a distressed bank’s business. To apply, the target bank should be on the brink of being pushed out of the market. The acquirer bank must demonstrate that the acquisition will be an ultimate recourse for the failing bank, which would otherwise not survive.<sup>285</sup>

The Commission has demonstrated an inclination to be flexible regarding its standard requirement to hold back clearance of a bank merger in anticipation of closing.<sup>286</sup> In the event a rescue package needs to be put together quickly; the suspensory effect of the EU merger

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<sup>279</sup> L Persson, ‘The failing firm defence’ (2005) 2 *Journal of Industrial Economics* 53, pp 175-201.

<sup>280</sup> I Kokkoris, ‘Failing firm defence in the European Union: a panacea for mergers?’ (2006) 9 *European Competition Law Review* 27, pp 494-509.

<sup>281</sup> P Marsden and I Kokkoris, ‘The role of competition and state aid policy in financial and monetary law’ (2010) 3 *Journal of International Economic Law* 13, pp 875-92.

<sup>282</sup> L M Perpina, ‘Rescuing Icarus: the European Commission’s approach to dealing with failing firms and sectors in distress’ (2015) 101 *European Competition Journal* 11, pp 101-34.

<sup>283</sup> K Joergsen, ‘Andersen and the “failing firm”: the application of the “failing firm defence” in merger proceedings involving firms providing professional services’ (2003) 26(3) *World Competition* 363–80, p 1.

<sup>284</sup> E F Clark and C E Foss, ‘When the failing firm defence fails’ (2012) 3(4) *Journal of European Competition Law & Practice* 317–31, p 15.

<sup>285</sup> OECD, ‘Roundtable on Failing Firm Defence: Note by the Services of the European Commission, Directorate-General for Competition’ (21 October, 2009) OECD Competition Committee, available at [http://ec.europa.eu/competition/international/multilateral/ec\\_submission.pdf](http://ec.europa.eu/competition/international/multilateral/ec_submission.pdf).

<sup>286</sup> *ECMR* (n17), art 7(1).

provisions may prove to be an impediment. This would have been a serious issue in the Bradford & Bingley takeover, in which Santander bank came out as the primary bidder.<sup>287</sup> The Commission quickly issued a belittlement against the suspensory provisions to permit Santander bank to conclude the acquisition transaction, instantly.<sup>288</sup>

In bank merger cases, the EU, UK, and the US authorities show a great deal of scrutiny in order to permit merging banks to consummate a merger under a failing firm defence. As a result, such defence is rarely used by the banks.

## 5.5 Conclusion

In this chapter, competition methodologies applying to the UK, focusing on markets, products, consumer issues and competition in relation to bank mergers are described, explained and analysed.

As has been demonstrated, despite regulatory developments at domestic and EU levels, competition in this sector remains limited and problematic. A combination of the recent global financial crisis, effects of regulatory developments and consumer behaviours means that SMEs continue to find it challenging to enter the banking and finance market.

In evaluating a proposed bank merger, both UK and EU regulators seek to establish whether the proposed merger will establish or strengthen an existing dominant position, and further whether this will negatively impact competition in the market. Regarding markets, both product and geographical delimitations are relevant to the overall analysis. In addition to market share, which in itself has generally decreased in importance over time as the primary factor for consideration, barriers to entry now feature heavily in regulatory impact assessment. Jurisdictional rules determine whether a given merger may be evaluated by the UK or EU authorities, with legal developments in recent times having expanded the Commission's scope of competence. Commission has the power to review bank mergers with an EU dimension, to establish compatibility with the Common Market.

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<sup>287</sup> For a discussion of the Santander/Bradford & Bingley takeover, see chapter 4.4.2(c) in this thesis, pp 126-7.

<sup>288</sup> Commission, 'State Aid: Commission Approves UK Rescue Aid Package for Bradford & Bingley' (1 October, 2008) *Press Release IP/08/1437*.

In general, considerable challenges remain in terms of achieving the desired objective, being a competitive market for banking in the UK. At present the developments that have taken place have principally advantaged banks seeking to merge, through improved process transparency and flexibility, without any appreciable benefit to consumers. In fact, dominant market players exploit consumer ignorance, mis-sell products, and offer services that are inferior to those limited other options in the marketplace, but without negative consequence to their market shares. In reality, by one means or another, the majority of proposed bank mergers are permitted to proceed. There are both similarities and differences with the US experience, where, for example, timing issues are broadly the same but collective dominance has greater relevance.

The author has demonstrated that in the personal current account product market, there is particularly heavy concentration. Significant competition problems also exist in product markets where there are a greater number of participants, such as, personal loans and credit cards. Notwithstanding the obvious requirement for banks to be more transparent with their customers, it must be asked whether this alone will be sufficient to remedy consumer apathy towards switching bank accounts, a continued problem documented in this thesis.

In terms of competition analysis, merging banks are offered a number of alternative routes to approval, from undertakings in lieu of reference to avoid enhanced scrutiny, *de minimis* exceptions, increased effectiveness defences, and the failing firm defence. In the context of the underlying economic situation that has prevailed since at least the start of the GFC, in many ways orchestrated by large financial institutions themselves, there has been infinite motivation for competition regulators to approve bank merger transactions despite evidence that merging institutions generally compete less effectively than their non-merging counterparts. When all is said and done and whilst acknowledging laudable intentions in all of this, it is difficult to say that the cornerstone objective of providing for healthy competition in the market for banking products and services has been achieved.

While the EU looks at a merger in its ‘concentration’ with a ‘Community dimension’, in which two or more undertakings may cease to be distinct and the jurisdictional thresholds

of the 'Community dimension' are met, the UK investigates a merger based on 'relevant merger situations' that may exist where two or more enterprises cease to be distinct and the jurisdictional thresholds are satisfied.

The Commission's merger control analysis under the ECMR is carried out based on an *ex-ante* (pre-notification) control. Under this approach, the Commission shall primarily aim to prevent merging parties from reinforcing or establishing a dominant position enabling them to exercise market power that could be harmful for the process of undisturbed competition. As for the UK and the US, bank merger notifications are not mandatory. Nevertheless, merging banks tend to notify the relevant authorities before consummation of merger in order to avoid any potential anticompetitive issues in post-merger.

The Commission utilizes a specific test as a relevant criterion to examine mergers and to enhance the possibilities to refer mergers to Member States or the latter referring mergers to the Commission. The test is called the 'Significant Impediment of Effective Competition' ('SIEC'). The SIEC test is defined as concentration, which would significantly impede effective competition, in particular by the creation or strengthening of a dominant position, in the Common Market or in a substantial part of it shall be declared incompatible with the Common Market. Unlike the EU (SIEC) test, the UK and the US apply the 'substantial lessening of competition' ('SLC') test. The SIEC and the SLC tests are potentially quite different. The SLC draws attention to the level of change the merger shall cause to existing levels of competition, while the SIEC test appears capable of capturing a broader range of conduct, where the merger in question hinders competition without substantially reducing existing market competition. Nevertheless, practically speaking, the analytical approach adopted by the UK, the US and the EU Member States applying either of these tests is quite similar.

In relation to the analysis of obstacles to entry and the 'failing firm' ('exiting firm' is the British terminology) defence, the UK competition authority has adopted a coherent standard for ascertaining whether these defences may apply. To establish the defence of possible entry, concerning undertakings should show market entry is of adequate scope and extent, and is timely in manner, such as, to offset the likely bettered competitive position of the merged bank. To determine a 'failing firm' ('exiting firm') situation, the UK competition

authority CMA considers various factors, such as, whether the bank would have exited (through failure or otherwise); and, if so, whether there would have been an alternative purchaser for the bank or its assets to the acquirer under consideration; and what would have happened to the sales of the bank in the event of its exit.

The foregoing dynamics of failing firm' defence are similar to those factors considered by the US and the EU competition regulators. In bank merger cases, the EU, UK, and the US authorities show a great deal of scrutiny in order to permit merging banks to consummate a merger under a 'failing firm' defence. As a result, such defence is rarely used by the banks.

## CHAPTER 6 – ANTITRUST PROVISIONS OVER BANK MERGERS IN UNITED STATES

Banking in the US is regulated by both the federal and state governments. Depending on its type of federal or state charter and organizational structure, a banking organization may be subject to numerous federal and state banking regulations.

Preserving financial stability is a fundamental goal of bank regulation, and historically has been a specific goal of bank competition policy. Paradoxically, it was previously believed that bank consolidation promoted stability. In addition, when the US Government enforced antitrust law, the banking industry remained intact due to the fact that competition policy was perceived as subordinate to stability concerns.<sup>1</sup>

The competitive issues raised by bank mergers are subject to the Sherman Antitrust Act<sup>2</sup>, the Clayton Antitrust Act<sup>3</sup>, the Bank Merger Act<sup>4</sup>, the Bank Holding Company Act of 1956<sup>5</sup>, the Riegle-Neal Interstate Banking and Branching Efficiency Act<sup>6</sup>, the Change in Bank Control Act<sup>7</sup>, and the Dodd-Frank Wall Street Reform and Consumer Protection Act<sup>8</sup>. The aspects of these Acts as they relate to bank antitrust are discussed in this chapter.

### 6.0 Sherman Antitrust Act

In consideration of the increasing number of large-scale business enterprise in the post American civil war period, and the increasing number of trusts that utilized their power to oppress individuals, and injure the public, the US Congress passed the Sherman Antitrust

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<sup>1</sup> J R Macey and J P Holdcroft, Jr, 'Failure Is an Option: An Ersatz-Antitrust Approach to Financial Regulation' (2011) 120 *Yale Law Journal* 1368, p 1372.

<sup>2</sup> A federal anti-monopoly and antitrust statute, passed in 1890 as 15 USC §§1-7 and amended by the Clayton Act in 1914 that prohibits activities that restrict interstate commerce and competition in the marketplace ('Sherman').

<sup>3</sup> The Clayton Antitrust Act of 1914, passed in 1914 as 15 USC §§12-27, 29 USC §§52-53, and was a part of US antitrust law with the goal of adding further substance to the US antitrust law regime; the Clayton Act sought to prevent anticompetitive practices ('Clayton').

<sup>4</sup> 12 USC § 1828 ('BMA').

<sup>5</sup> Bank Holding Company Act of 1956 (12 USC 1841 *et seq*) ('BHCA').

<sup>6</sup> PL 103-328, 108 Stat. 2338 ('Riegle-Neal').

<sup>7</sup> 12 USC §1817(j) (2006 & Supp. 2010) ('Change in Bank Control Act' ('CBCA')).

<sup>8</sup> Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203; 124 Stat. 1391; codified to 12 USC 5301 note, effective 21 July, 2010 (*codified as amended in 12 U.S.C. §§ 5301–5641*) ('Dodd-Frank').



Act ('Sherman Act') on 2 July, 1890 to promote and preserve competition.<sup>9</sup> This law was perceived as the '*Magna Carta*'<sup>10</sup> of free enterprise.<sup>11</sup>

The Sherman Act prohibits 'every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce,'<sup>12</sup> and makes unlawful 'monopol[ies], or attempt to monopolize, or combine or conspire ... to monopolize.'<sup>13</sup> The breach of any of these provisions may result in criminal and civil penalties. The goal of the Sherman Act is not to protect businesses from competition, but to protect consumers from monopolies. The Act 'directs itself ... against conduct which unfairly tends to destroy competition itself.'<sup>14</sup>

Two sections of the Sherman Act carry out its goals. S 1 defines and prohibits specific types, such as, contracts, combinations, or conspiracies of anticompetitive conduct that restraint commerce or trade.<sup>15</sup> S 2 defines the concept of monopolization as an effort or actual action from one person to combine or to conspire with one or more persons to have or take complete control over any part of the commerce or trade in the US.<sup>16</sup>

## 6.1 Clayton Antitrust Act

In 1914, the US Congress passed the Clayton Antitrust Act ('Clayton Act') to augment the Sherman Act<sup>17</sup> and protect the public from mergers reduces competition. The Clayton Act forbids acquisition by 'one corporation of the stock of another corporation when such

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<sup>9</sup> J Drexel et al, *Competition Policy and the Economic Approach* (Cheltenham: Edward Elgar 2011), p 30.

<sup>10</sup> '*Magna Carta*' is a charter of liberties to which the English barons forced King John of England in 1215 to give his assent in June, 1215 at Runnymede, near Windsor. It was the first document to challenge the authority of the king, subjecting him to the rule of the law and protecting his people from feudal abuse. '*Magna Carta*' greatly influenced the formation of the American Constitution in 1787 that became and still is the supreme law of the land in the United States. For more information, see generally, P Linebaugh, *The Magna Carta Manifesto: Liberties and Commons for All* (Berkeley: University of California Press 2009).

<sup>11</sup> The Sherman Act has been called the '*Magna Carta*' of free enterprise by the US Supreme Court Justice Thurgood Marshall in *United States v Topco Assoc Inc* (1972) 405 US 596, p 610, and by Justice Antonin Scalia in *Verizon Communications Inc v Law Officers of Curtis V Trinko LLP* (2004) 540 US 398, p 415.

<sup>12</sup> *Sherman* (n2) § 1.

<sup>13</sup> *Ibid*, § 2.

<sup>14</sup> The basic purpose of the Sherman Act's enactment is the public's protection. The act aims to prevent restraints to free competition in business and commercial transactions that tend to restrict production, increase prices, or control the market to the detriment of purchasers or consumers of services and goods and services.

<sup>15</sup> *Sherman* (n2), § 1.

<sup>16</sup> *Ibid*, § 2.

<sup>17</sup> *Clayton* (n3) § 18.

acquisition would result in a [SLC],’ or seeks to create ‘a monopoly in any line of commerce.’<sup>18</sup>

S 7 of the Clayton Act<sup>19</sup> forbids mergers that ‘may ... substantially ... lessen competition, or tend to create a monopoly.’<sup>20</sup> The Act applies to bank mergers,<sup>21</sup> and the Justice Department has repeatedly opposed bank mergers under s 7.

S 7’s criteria are altered by simply forbidding mergers whose anticompetitive outcomes are evidently offset in the public interest by the apparent consequence of the merger case in meeting the convenience and prerequisite needs of the affected community.<sup>22</sup>

The goal of s 7 of the Clayton Act is to forbid mergers that could exercise market power by increasing prices and limiting the supply of goods or services.

Several US authorities, such as the Federal Reserve, Department of Justice,<sup>23</sup> share the responsibility of imposing statutory anti-monopoly provisions. These regulators implement s 7 of the Clayton Act throughout legal actions in federal court or agency proceedings. In this regard, US banking regulators and competition authority apply s 7 to challenge directly any bank merger in a court of law or within regulator’s administrative process.

However, the Clayton Act does not expressly prohibit merger by one bank of the assets of another bank.<sup>24</sup> The Act also does not seem to impede the purchase of stock in any bank but a direct competitor.<sup>25</sup> Indeed, the Clayton Act promotes financial holding companies by permitting the purchase of its competitor’s stock.

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<sup>18</sup> *Ibid.*

<sup>19</sup> *Ibid.*, §§ 12-27; see, also, 29 USC 29 §§52-53 (2000).

<sup>20</sup> *Ibid.*, §18.

<sup>21</sup> S 7 is applicable to bank mergers. See *Philadelphia Nat’l Bank*, 374 US at 354 (holding that ‘the Bank Merger Act of 1960 does not preclude application of s 7 of the Clayton Act to bank mergers’ and that s 7 of the Clayton Act is applicable to bank mergers). For a discussion of *Philadelphia Nat’l Bank* case, see chapter 8.1 in this thesis, pp 219-24.

<sup>22</sup> *BMA* (n4), §1828(c)(5).

<sup>23</sup> For a discussion of the competition and banking regulators, see chapter 7 in this thesis, pp 197-215.

<sup>24</sup> *Clayton* (n3), § 18.

<sup>25</sup> *Ibid.*

In order to consider any competitive impact of a proposed bank merger, bank regulators and the antitrust authority must consider the foregoing requirements provided under the Sherman and Clayton Acts. Regulators may not approve a merger that would result in a monopoly or substantially to lessen competition.<sup>26</sup> If the merger involves the acquisition of a nonbank by a bank holding company, the regulator should consider whether any possible adverse effects from the acquisition are outweighed by reasonably expected public benefits, such as, greater convenience, increased competition, or gains in efficiency.<sup>27</sup>

## 6.2 Bank Merger Act

The Bank Merger Act of 1960<sup>28</sup> ('BMA') pursues goals similar to the Clayton Act, but solely in the context of bank mergers.<sup>29</sup> Congress enacted the BMA after considering the impact of bank mergers on competition.<sup>30</sup> The BMA takes into account certain elements in bank merger situations.

The BMA requires regulatory approval of mergers, which is shared among the Federal Reserve, the Office of the Comptroller of the Currency ('OCC'), and the Federal Deposit Insurance Corporation ('FDIC'), based on the regulatory status of the institutions. In every proposed merger, the relevant regulator obtains advisory opinions about competition concerns from the other two regulators and the DOJ. The BMA provides that appropriate regulator must not approve any proposed merger that would result in a monopoly, or that 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 US.<sup>31</sup> The exception is if the anticompetitive outcomes of the proposed merger are outweighed by the consequence of the merger case in meeting the convenience and desideratum of the community to be attended.<sup>32</sup>

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<sup>26</sup> *Ibid.*

<sup>27</sup> *BMA* (n4), §1828(c)(5).

<sup>28</sup> *Ibid.*

<sup>29</sup> P Z Robert, 'The Bank Failure Crisis: Challenges in Enforcing Antitrust Regulation' (2009) 55 *Wayne Law Review* 1178, p 1182.

<sup>30</sup> B Shull and G A Hanweck, *Bank Mergers in a Deregulated Environment: Promise and Peril* (Westport: Quorum Books 2001), p 87.

<sup>31</sup> *BMA* (n4), §1828(c)(5)(A).

<sup>32</sup> *Ibid.*, §1828(c)(5)(B). Shortly after the Act was passed, Justice Douglas described the Bank Merger Act as 'the product of powerful contending forces' in *United States v First City National Bank of Houston* (1967) 386 US 361, p 367.

The BMA indeed exempted pending bank merger transactions from s 7 of the Clayton Act and s 1 of the Sherman Act.<sup>33</sup> Therefore, even if a merger were deemed anticompetitive, it would still be permitted.<sup>34</sup>

Under the BMA, bank merger applications are sent to the Attorney General who is required to report to the banking regulator on the intended merger's competitive results in thirty calendar days. The regulator can reduce this pre-approval time to ten days by informing the Attorney General that an emergency to prevent an institution's collapse demands immediate action. The regulator must inform the Attorney General in the event it approves a merger.<sup>35</sup> The BMA also contains a post-approval time requiring a bank merger not be completed before the thirtieth calendar day after the date of approval by the suitable banking regulator. The thirty-day period could, also, be reduced to a period of not less than fifteen days, with the Attorney General's approval, in the event the bank regulator has not received an adverse competitive consequences report from the Attorney General.<sup>36</sup>

Pursuant to the BMA,<sup>37</sup> in the event a suit to prevent the merger is not commenced within the applicable approval period the bank merger might be consummated and be exempt from a competition-based challenge except for under s 2 of the Sherman Act. This means that a bank merger approved instantly to avert a bank collapse may not be conditioned to competition challenge whatsoever. A lawsuit initiated within the indicated period leads into an automatic stay of the merger. A bank may defend against the stay by demonstrating that the merger's anticompetitive effects are outweighed by public benefits.<sup>38</sup>

### 6.3 Bank Holding Company Act

Before the enactment of Bank Holding Company Act ('BHCA') 1956,<sup>39</sup> bank holding companies were not subject to regulations that limited banks from engaging in commerce. A purpose of the BHCA was to prevent concentrations of economic power resulting from

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<sup>33</sup> BMA (n4), §1828(c).

<sup>34</sup> *Ibid*, §1828(c)(5)(B).

<sup>35</sup> *Ibid*, §1828(c)(4).

<sup>36</sup> *Ibid*.

<sup>37</sup> *Ibid*, §1828(c)(7)(A).

<sup>38</sup> *Ibid*.

<sup>39</sup> BHCA (n5).

companies, like Sears and Ford Motors, from operating in banking business.<sup>40</sup> Among other restrictions, the Act prohibits companies that own banks from engaging in ‘activities that are not closely related to banking’.<sup>41</sup>

S 3 of the BHCA<sup>42</sup> provides standards for the Federal Reserve to apply in deciding whether bank holding companies may acquire other bank holding companies, banks, or bank assets. The process is similar to merger applications under the BMA. The Federal Reserve must specifically determine ‘whether or not the effect of [a merger proposal] would be to expand the size or extent of the bank holding company system involved beyond limits consistent with ... the preservation of competition’.<sup>43</sup>

S 4 of the BHCA<sup>44</sup> applies to bank holding company mergers of a nonbank or thrift institutions. A significant change came about in 1999 with the Gramm-Leach-Bliley Act<sup>45</sup> amendment of the BHCA to recognize a class of financial holding companies. These companies are permitted to engage in a wide variety of financial services previously off-limits to bank holding companies, including securities and insurance underwriting.<sup>46</sup>

The standards of the BHCA are similar to those from s 2 of the Sherman Act and s 7 of the Clayton Act. The Act gives the Federal Reserve broad authority ‘to restrain the undue concentration of commercial banking resources and to prevent possible abuses related to the control of commercial credit’.<sup>47</sup> The Act, also, empowers the Federal Reserve to regulate ‘any company which has control over any bank’.<sup>48</sup> The BHCA, also, prohibits certain tying arrangements and exclusive dealing agreements with customers.<sup>49</sup> The statutory definition of ‘bank’ and ‘bank holding company’ under the BHCA has been amended several times.<sup>50</sup> Each

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<sup>40</sup> See generally, J E Trytek, ‘Nonbank Banks: A Legitimate Financial Intermediary Emerges from the Bank Holding Company Act Loophole’ (1986) 14 *Pepperdine Law Review* 1, pp 3-5.

<sup>41</sup> BHCA (n5), §1843.

<sup>42</sup> *Ibid*, §1842.

<sup>43</sup> *Ibid*, §1842(c); see, also, J William Via Jr, ‘The Administration of the Bank Merger and Holding Company Acts: Confusion Compounded’ (1965) 51 *Virginia Law Review* 1517, p 1519.

<sup>44</sup> *Ibid*, §1843.

<sup>45</sup> Gramm Leach Bliley Act, Pub. L. No. 106-102 (1999), codified 15 USC §6801 (‘GLB Act’).

<sup>46</sup> 12 USC § 1843(k)(4)(I); see, also, 12 CFR § 225.86(b)(3).

<sup>47</sup> 12 USC § 1841 et seq.

<sup>48</sup> 12 USC § 1841(a)(1).

<sup>49</sup> BHCA (n5), §§1971-78.

<sup>50</sup> C Felsenfeld and D L Glass, *Banking Regulation in the United States* (3rd edn, New York: Juris Publishing 2011), pp 214-215.

of these amendments was a significant step in the historical development of the banking statutory scheme, reflecting shifting policy priorities about interstate banking, the scope of permissible non-banking activities of banks' corporate parents, and the separation of banking and commerce.<sup>51</sup> Tracing the evolution of this key statutory definition helps to comprehend the broader political and economic dynamics, which have shaped bank holding company regulation since enactment of the BHCA in 1956 to date.

#### 6.4 Riegle-Neal Interstate Banking and Branching Efficiency Act

The Riegle-Neal Interstate Banking and Branching Efficiency Act ('Riegle-Neal Act')<sup>52</sup> permits both intra- and interstate branching by both federal and state chartered banks. For intrastate, it only requires a bank holding company to have one bank subsidiary to operate in states, which have opted in to the Act's interstate branching provision.<sup>53</sup> For interstate, it permits a bank to operate branches in any state nationwide so long as the 'home state' and 'host state' have opted into the Act.<sup>54</sup> Interstate branching may be accomplished by consolidation, taking over an existing bank or branch, or opening a new branch. The main exception in the Act is that it permits states to prohibit interstate branching. States were requested to either 'opt in'<sup>55</sup> or 'opt out'<sup>56</sup> of the Act's interstate branching provisions inside their borders until 1 June, 1997.<sup>57</sup> The Act, effectively, permits bank holding companies to merge their subsidiary banks into a sole bank subsidiary.

In 2011 Senate testimony, Professor Arthur Wilmarth noted the Act's shortcomings:<sup>58</sup>

Unfortunately, Riegle-Neal's nationwide and state-wide deposit caps contained three major loopholes. First, the deposit caps applied only to interstate bank acquisitions and interstate bank mergers, and the deposit caps therefore did not restrict combinations between banking organizations headquartered in the same state. Second,

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<sup>51</sup> *Ibid*, pp 232-240.

<sup>52</sup> *Riegle-Neal* (n6).

<sup>53</sup> *Ibid*, §1831u(a).

<sup>54</sup> *Ibid*, §103; see, also, 12 USC 36(g) (for national banks), and 12 USC 1828(d) (for state banks).

<sup>55</sup> 12 USC §215.

<sup>56</sup> 12 USC §1831u.

<sup>57</sup> T J Eifler, 'Kentucky Taxation of Banking Institutions (1802-1996): An Historical Overview' (2002) 90 *Kentucky Law Journal* 567, p 571.

<sup>58</sup> A E Wilmarth Jr, 'Regulation of Large Financial Institutions' (7 December, 2011) *Congressional Testimony before the Committee on Senate Banking, Housing and Urban Affairs & Subcommittee on Financial Institutions and Consumer Protection*.

the deposit caps did not apply to acquisitions of, or mergers with, thrift institutions and industrial banks, because those institutions were not treated as 'banks' under the Riegle-Neal Act. Third, the deposit caps did not apply to acquisitions of, or mergers with, banks that are 'in default or in danger of default' (the 'failing bank' exception).<sup>59</sup>

As a result of these loopholes, banks were able to surpass nationwide depository caps through the emergency government-backed mergers during the Global Financial Crisis.<sup>60</sup> These transactions included Bank of America's acquisition of Countrywide<sup>61</sup>, and Merrill Lynch<sup>62</sup>, JPMorgan Chase's acquisition of Washington Mutual,<sup>63</sup> Wells Fargo acquired Wachovia,<sup>64</sup> and Morgan Stanley acquired Bear Stearns.<sup>65</sup>

Enactment of Riegle-Neal ushered in a new wave of bank mergers and acquisitions. Riegle-Neal permitted state and federally chartered banks to engage in interstate mergers restricted only by previously interstate restrictions provisions of the so-called 'Douglas Amendment' under the BHCA.<sup>66</sup> Bank consolidation and the emergence of megabanks became the norm.<sup>67</sup> Riegle-Neal abolished geographic restrictions by allowing a single national bank headquartered in one state to open branches across the country.<sup>68</sup> The Act reflected Congressional recognition of the nationwide banking trend and made competition between state and federally chartered banks more equal.<sup>69</sup>

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<sup>59</sup> *Ibid.*

<sup>60</sup> S E Foster, 'Fire Sale: The Situational Ethics of Antitrust Law in an Economic Crisis' (2009) 78 *Mississippi Law Journal* 777, p 778.

<sup>61</sup> Federal Reserve, 'Order Approving Acquisition of Countrywide by Bank of America' (5 June, 2008) *FRB*, available at <http://www.federalreserve.gov/newsevents/press/orders/orders20080605a1.pdf>.

<sup>62</sup> Federal Reserve, 'Order Approving Acquisition of Merrill Lynch by Bank of America' (26 November, 2008) *FRB*, available at <http://www.federalreserve.gov/newsevents/press/orders/orders20081126a1.pdf>.

<sup>63</sup> Federal Reserve, 'Consent Order for Acquisition of Washington Mutual by JPMorgan Chase' (8 December, 2011) *FRB*, available at <http://www.federalreserve.gov/newsevents/press/enforcement/jpmc-plan-sect5-compliance.pdf>.

<sup>64</sup> Federal Reserve, 'Order Approving Acquisition of Wachovia by Wells Fargo' (21 October, 2008) *FRB*, available at <http://www.federalreserve.gov/newsevents/press/orders/orders20081021a1.pdf>.

<sup>65</sup> Federal Reserve, 'Bear Stearns, JPMorgan Chase, and Maiden Lane LLC' (March 2008) *FRB*, available at [http://www.federalreserve.gov/newsevents/reform\\_bearstearns.htm](http://www.federalreserve.gov/newsevents/reform_bearstearns.htm).

<sup>66</sup> *BHCA* (n345) §1842(d). National banks were absolutely prohibited from branching interstate, thereby ensuring their small size. State banks could branch interstate, but only if their home and host states consented. Banks could spread by the acquisition of other banks through a holding company system, but this was awkward and required the specific statutory approval of the host states.

<sup>67</sup> C Felsenfeld, 'The Antitrust Aspects of Bank Mergers' (2008) 13 *Fordham Journal of Corporate & Financial Law* 4, p 508.

<sup>68</sup> M D Rollinger, 'Interstate Banking and Branching Under the Riegle-Neal Act of 1994' (1996) 33 *Harvard Journal on Legislation* 183, p 210.

<sup>69</sup> House of Representative 1306, 'The Riegle-Neal Clarification Act of 1997: Hearing before the Subcommittee on Financial Institutions and Consumer Credit of the Committee on Banking and Financial Services, House of Representatives' (30 April, 1997) 105<sup>th</sup> *US Congress*, 1<sup>st</sup> Session, Vol 4.

## 6.5 Change in Bank Control Act

The US Congress enacted the Change in Bank Control Act ('CBCA')<sup>70</sup> to regulate acquisitions of 'control' of commercial banks that is not subject to the BHCA and the BMA.<sup>71</sup> Parties who desire to acquire control of a federal bank by the way of the purchase, transfer, pledge, or other disposition of voting stock must notify the competent federal regulator regulator(s), such as, the Federal Reserve, Office of the Comptroller of the Currency ('OCC'), or the Federal Deposit Insurance Corporation ('FDIC'), and submit the necessary information application.<sup>72</sup>

Under the CBCA and the pertinent regulation of the authorized regulator, such as, the Federal Reserve, the OCC, or the FDIC, any party seeking to acquire the power to vote 25 per cent, or more, of a class of voting securities of a federally chartered bank must notify the regulator at least sixty days prior to the acquisition of commercial bank. In addition, persons wishing to acquire the power to vote 10 per cent or more of a class of voting securities are deemed to have acquired control in certain circumstances. This comprises situations when two or more persons simultaneously acquire equal percentages of 10 per cent or more of a federal bank's voting securities.<sup>73</sup>

## 6.6 Dodd-Frank Wall Street Reform and Consumer Protection Act

The Dodd-Frank Wall Street Reform and Consumer Protection Act ('Dodd-Frank Act')<sup>74</sup> has important, but yet indirect, consequences for bank competition and concentration. The Act does not add substantive competition rules. However, it does limit concentration in the financial sector to promote financial stability and reduce system risk. In so doing, the Act may

<sup>70</sup> *Change in Bank Control Act ('CBCA')* (n7), §1817(j).

<sup>71</sup> *Ibid*, §1817(j)(8)(B) (transactions subject under *BHCA* or *BMA* not subject to *CBCA*).

<sup>72</sup> For the purposes of the *CBCA* the term 'person' means 'an individual or a corporation, partnership, trust, association, joint venture, pool, syndicate, sole proprietorship, unincorporated organization, or any other form of entity not specifically listed herein', see *CBCA* (n7), §1817(j)(8)(A). The term 'insured bank' includes any 'bank holding company' as defined in the *BHCA*, and the 'appropriate Federal banking agency' in the case of a bank holding company is the Federal Reserve Board, see *CBCA* (n7), §1817(1).

<sup>73</sup> *CBCA* defines 'control' as 'the power, directly or indirectly, to direct the management or policies of an insured bank or to vote 25 per centum or more of any class of voting securities of an insured bank', see *CBCA* (n7), §1817(j)(8)(B).

<sup>74</sup> *Dodd-Frank* (n8).



prohibit a bank merger or acquisition that would reduce competition, except for the purpose of preserving stability in the banking or financial system.<sup>75</sup> The first interpretations of the Act's 'financial stability' factor<sup>76</sup> that the Federal Reserve considered were in acquisitions approvals of RBC Bank (USA) by The PNC Financial Services Group<sup>77</sup>, and ING Bank by Capital One Financial Corporation.<sup>78</sup>

The Dodd-Frank Act requires bank holding companies seeking to acquire an out of state bank to be well managed and well capitalized.<sup>79</sup> It, also, amended the BMA to demand that the surviving bank in an interstate merger be well managed and well capitalized.<sup>80</sup>

An important aspect of the Dodd-Frank Act is the fact that it provides overriding power to the applicability of the American antitrust laws in the event of any dispute between the latter laws and the Act, as long as such power is utilized by the banking regulators to preserve the stability of the banking or financial system.<sup>81</sup>

#### 6.6.1 Volcker Rule

Several provisions of the Dodd-Frank Act seek to improve the stability of the financial system beyond limiting bank size. For instance, s 165 of Dodd-Frank Act builds up prudential criteria for large, interrelated financial institutions, including qualifying nonbanks.<sup>82</sup> S 619 of Dodd-Frank Act (known as the 'Volcker Rule')<sup>83</sup> prohibits banking entities from engaging in proprietary trading (trading for profit on financial markets for its own account) or investing

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<sup>75</sup> *Ibid*, § 604(d) requires the Federal Reserve to take into consideration the extent to which a proposed bank merger 'would result in greater or more concentrated risks to the stability of the United States banking or financial system'. Similarly, for acquisitions by banking organizations of nonbanks, s 604(e) of the Act requires the Federal Reserve to consider whether a proposed transaction presents 'risk to the stability of the United States banking or financial system'.

<sup>76</sup> *BMA* (n4), § 1828(c)(5); *Dodd-Frank* (n8), § 604(f).

<sup>77</sup> Federal Reserve, 'Order Approving the Acquisition of *RBC Bank* (US) by *The PNC Financial Services Group*' (23 December, 2011) *FRB*, available at [www.federalreserve.gov/newsevents/press/orders/order20111223.pdf](http://www.federalreserve.gov/newsevents/press/orders/order20111223.pdf).

<sup>78</sup> Federal Reserve, 'Order Approving the Acquisition of *IGN Bank* by *Capital One Financial Corporation*' (14 February, 2012) *FRB*, available at [www.federalreserve.gov/newsevents/press/orders/order20120214.pdf](http://www.federalreserve.gov/newsevents/press/orders/order20120214.pdf).

<sup>79</sup> *Dodd-Frank* (n8), §§ 606, and 607.

<sup>80</sup> *Ibid*, §613.

<sup>81</sup> The statute states that, 'Nothing in this subtitle or the amendments made by this subtitle shall be construed to modify, impair or supersede the application of the antitrust laws. Any implied or actual conflict between this subtitle and any amendments to this subtitle and the antitrust laws shall be resolved in favour of the operation of the antitrust laws', see *Dodd-Frank* (n8), §541.

<sup>82</sup> *Ibid*, §165.

<sup>83</sup> *Ibid*, § 619 (codified 12 USC §1851) ('the Volcker Rule').

in hedge funds and private equity. The major exceptions for proprietary trading are hedging and market making.<sup>84</sup> However, compliance, implementation, and enforcement of the Volcker Rule depend crucially of how these activities are defined and carried out.<sup>85</sup>

The main idea behind the Volcker Rule is to protect the stability of the financial sector and the government safety net (tax payers) against risks stemming from opportunistic speculative activities.<sup>86</sup> It recognizes that banks can use their core banking activities, including the supporting government safety net, to support highly risky trading activities. The Volcker Rule intends to address the issue by separating trading from banking activities.<sup>87</sup> Whether this can be achieved effectively remains to be seen. Essentially, the implementation of the Dodd-Frank Act will take some time.<sup>88</sup>

The Volcker Rule, unlike the Vickers<sup>89</sup> and the Liikanen<sup>90</sup> reports, called for a complete separation solutions between deposit taking institutions and their incorporated non-deposit-taking affiliates from engaging in proprietary trading in certain financial institutions and from acquiring or retaining ownership interests in, sponsoring, or entering into certain lending and other covered transactions with related, hedge funds, private equity funds and many other vehicles ('covered funds').<sup>91</sup> Instead of a full separation solution of the foregoing activities, the Vickers and Liikanen reports do not require investment banking to be pushed

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<sup>84</sup> Ibid, § 619(d)(1). These include: (i) underwriting and market-making-related activities; (ii) risk-mitigating hedging activities; (iii) investments driven by customer demand; (iv) proprietary trading done outside the United States, and (v) such other activities as regulators determine by rule would promote safety and soundness of the banking system.

<sup>85</sup> J B Stewart, 'Volcker Rule, Once Simple, Now Boggles' (22 October, 2011) *New York Times*.

<sup>86</sup> S E Foster, 'Fire Sale: The Situational Ethics of Antitrust Law in an Economic Crisis' (2009) 78 *Mississippi Law Journal* 777, p 778.

<sup>87</sup> *Volcker Rule* (n83).

<sup>88</sup> Full implementation of *Dodd-Frank* is still incomplete. Lawyers guesstimate that only forty per cent of the legislation has been introduced; see, also, P Molyneux, *Structural Reform, Too-Big-To Fail and Banks as Public Utilities in Europe*, in S P Rossi et al (eds.), *Financial Crisis, Bank Behaviour and Credit Crunch* (Cham: Springer 2015), p 73.

<sup>89</sup> The Vickers' Report seeks to separate trading activities from commercial banking, but allows the two to co-exist within the same banking group, so long as they are in separately capitalized entities which may only transact with each other on an arm's length basis. It adds that the entity engaging in commercial banking activities are subject to higher capital. For a discussion of the Vickers' Report, see chapter 2.4 in this thesis, pp 18-24.

<sup>90</sup> The Liikanen Report recommends separation only if the activities form a major share of banks activities or pose a systemic stability threat. For a discussion of the Liikanen Report, see chapter 2.10.5 in this thesis, pp 42-5.

<sup>91</sup> *Dodd-Frank* (n8), § 619 (codified 12 USC §1851).

out of banking groups entirely, but only out of deposit-taking legal entities into separately capitalized non-bank affiliates.<sup>92</sup>

## 6.7 Regulation of thrifts' acquisition

Like banks, other forms of financial institutions, which provided banking services in the US, include savings and loan associations, also known as thrifts or thrift institutions. Thrifts are specialized in accepting deposits and making mortgages.<sup>93</sup> These institutions are similar to building societies and trustee savings banks in the UK. Their focus of activity is on mortgage and consumer loans, making them especially vulnerable to housing downturns, such as, the deep one the US has experienced during the GFC.<sup>94</sup>

The US Congress enacted legislation to regulate thrift institutions in response to their massive failures during the 1930's Great Depression and the savings and loans crisis of 1980's.<sup>95</sup> Congress established a regulatory regime for supervision of the thrifts activities, drawing a line between commercial banks and thrifts that focused on home mortgage lending, and did not engage in the general business of banking, such as, in commercial lending.<sup>96</sup>

### 6.7.1 Home Owners Loan Act

The 1933 Home Owners Loan Act ('HOLA')<sup>97</sup> governs acquisitions of control of savings associations, or savings and loan holding companies ('SLHCs')<sup>98</sup> including any company that directly or indirectly controls a savings association other than a bank holding company.

Pursuant to the HOLA provisions<sup>99</sup> and the relevant bank regulators' regulation,<sup>100</sup> any company that wishes to acquire control of a savings association or a SLHC must file an

<sup>92</sup> See *supra* 89 and 90 in this chapter.

<sup>93</sup> Garn-St. Germain Depository Institutions Act 1982, Pub. L. No. 97-320 (1982).

<sup>94</sup> M H Wolfson and G A Epstein, *The Political Economy of Financial Crises* in M H Wolfson *An Institutional Theory of Financial Crises* (Oxford: Oxford University Press 2013), pp 178-180.

<sup>95</sup> R D Brumbaugh Jr and R D Brumbaugh, *Thrifts under Siege: Restoring Order to American Banking* (Washington, D.C.: Beard Books 1999), pp 8-11.

<sup>96</sup> *Garn-St. Germain Depository Institutions Act 1982* (n93).

<sup>97</sup> 12 USC §1461 *et seq* ('HOLA').

<sup>98</sup> SLHC is a company that controls an insured association or other holding company.

<sup>99</sup> *HOLA* (n97), §1467 a (e).

<sup>100</sup> Federal Reserve's Regulation LL, 12 Code of Federal Regulations Part 238.

application with the relevant bank regulator before such company acquires control.

In approving request for acquisition of interest in savings association or an SLHC, the pertinent banking regulator should consider the effect the acquisition would have on competition, the managerial and financial resources and future prospects of the constituent thrifts. In addition, the regulator should consider the convenience and needs of the communities served by the constituent institutions, and these institutions' records of performance.<sup>101</sup>

Overall, the federal legislation governing the acquisition of thrift institutions provide for similar antitrust approach as applied to the banks. Such approach includes enhancement and preserving the competition in the banking system.<sup>102</sup> The pertinent bank regulatory agencies provide to the application of an interested party to acquire thrift institutions a similar review process like they apply in a bank merger process. The trend of the legislative process of the thrift acquisition process is towards closer harmonization, and almost making them similar to the legislation of the banks process. This is a result of the blurring separation line between the banks' and thrift's activities.<sup>103</sup>

## 6.8 Conclusion

The antitrust principles that ensure competition in the markets for most products and services, also, apply to financial institutions mergers and acquisitions. However, merging financial institutions face additional scrutiny under the federal banking statutes, such as, the BHCA and the BMA, which include provisions comparable to the antitrust laws.

S 7 of the Clayton Act prohibits acquisitions, mergers and consolidations whose effect 'may be substantially to lessen competition or to tend to create a monopoly'. Theoretically, mergers and acquisitions may also violate two sections of the Sherman Antitrust Act: S 1, which prohibits combinations in restraint of trade, and s 2, which proscribes monopolization

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<sup>101</sup> HOLA (n97), §1467a(e)(2)(B).

<sup>102</sup> A M Pollard and J P Daly, *Banking Law in the United States* (4<sup>th</sup> edn., New York: Juris Publishing 2014), pp 19.01 – 19.08.

<sup>103</sup> *Ibid.*

and attempts to monopolize. As a practical matter, though, s 7 of the Clayton Act is most relevant to mergers and acquisitions.

In addition to the Sherman Act and Clayton Act, five bank industry-specific laws may regulate financial institution mergers or acquisitions: the BHCA, the BMA, the CBCA, the Dodd-Frank, and the HOLA. The types of institutions involved in a transaction determine the bank-specific statute that applies.

No bank merger since 1994 has been derailed by an antitrust standard. Occasionally, local branches will overlap in an undesirable manner. The solution is to sell off a few bank branches and, thereby, resolve the problem. The antitrust laws are a bug to be brushed off, not a fundamental protection to our economic liberties. One sees the process continuing. Entities like Bank of America and JPMorgan Chase are gradually becoming the rule. How far we will go in the reduction of bank numbers and the growth in bank size is anybody's guess. Also unknown is the effect that this trend will have upon bank services including credit cards, real estate mortgages, and business financings.

## CHAPTER 7 - AMERICAN ANTITRUST AND BANKING AUTHORITIES: A COMPARATIVE STUDY

This chapter discusses the US antitrust and banking watchdogs' roles to oversee and regulate competition aspects in bank mergers in the US, as well as a comparative analysis of these watchdogs' approach to bank mergers' examination process.

### 7.0 Antitrust federal government authority

The antitrust federal government authority in charge of overseeing bank mergers and any antitrust aspects relating to them is the Department of Justice.

#### 7.0.1 Department of Justice ('DOJ')

Before the Bank Merger Act ('BMA') was enacted,<sup>1</sup> the Department of Justice ('DOJ') lacked the statutory authority to block bank mergers. Following *Philadelphia National Bank*,<sup>2</sup> bank mergers became subject to s 7 of the Clayton Act and as a result under DOJ jurisdiction.<sup>3</sup> The BMA and Bank Holding Company Act ('BHCA')<sup>4</sup> authorize the DOJ to review bank mergers in a process separate from the review performed by banking agencies. Under the BMA, bank authorities may request reports about competitive analysis from the DOJ.<sup>5</sup>

When the DOJ opposes a merger, the opposition involves filing a federal court lawsuit. The DOJ, typically, deals with competitive concerns about a prospective merger through divesting bank branches.<sup>6</sup>

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<sup>1</sup> 12 USC § 1828 ('BMA').

<sup>2</sup> For a discussion of *Philadelphia National Bank* case law, see chapter 8.1 in this thesis, pp 219-24.

<sup>3</sup> A federal anti-monopoly and antitrust statute, passed in 1890 as 15 USC §§1-7 and amended by the Clayton Act in 1914 that prohibits activities that restrict interstate commerce and competition in the marketplace ('Sherman'); The Clayton Antitrust Act of 1914, passed in 1914 as 15 USC §§12-27, 29 USC §§52-53, and was a part of US antitrust law with the goal of adding further substance to the US antitrust law regime; the Clayton Act sought to prevent anticompetitive practices ('Clayton'); and, *BMA* (n1) §1828(c)(8).

<sup>4</sup> Bank Holding Company Act of 1956 (12 USC 1841 *et seq*) ('BHCA').

<sup>5</sup> *BMA* (n1), §1828(c)(4).

<sup>6</sup> Department of Justice, 'Justice Department Reaches Agreement Requiring Divestitures In Merger of First Busey Corporation And Main Street Trust Inc' (12 June, 2007), available at [http://www.justice.gov/archive/atr/public/press\\_releases/2007/223869.htm](http://www.justice.gov/archive/atr/public/press_releases/2007/223869.htm)

Instead of relying on the competition analysis from *Philadelphia National Bank*,<sup>7</sup> the DOJ defines product and geographic markets, based on the specific nature and location of the services being offered.<sup>8</sup>

Bank regulators seek the DOJ's views on any proposed bank merger, after providing the DOJ with the merger application. Banks are advised to involve the DOJ early on in the process, if the proposed merger may have a substantial impact on competition. This can be accomplished by sending to the DOJ copies of the merger application filed with the relevant banking regulator, and contacting the DOJ about any specific competitive issues.

The DOJ reviews roughly 500 bank mergers per year,<sup>9</sup> and it 'challenges' hardly any of them. Even when it decides to 'challenge' any merger, such 'challenge' does not entail the filing of complaints in federal court. In fact, the DOJ has not filed a complaint against a bank merger since 1993.<sup>10</sup> Instead, the DOJ issues a press release, announcing that competitive concerns with a bank merger have been resolved though the divestiture of branches, along with associated deposits and outstanding loans.<sup>11</sup>

In addition to information supplied by the merging banks within a merger application, the DOJ may request they voluntarily deliver additional information. S 3(a) of the Antitrust Civil Process Act<sup>12</sup> enables the DOJ to issue civil investigative demands requesting documents and information concerning a bank merger. Demands are issued only to merging banks, but often may be issued to parties, such as, competitors with relevant market information.<sup>13</sup> Other methods of information gathering by the DOJ include telephone or in-

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<sup>7</sup> For a discussion of *Philadelphia National Bank* case law, see chapter 8.1 in this thesis, pp 219-24.

<sup>8</sup> A M Pollard and J P Daly, *Banking Law in the United States* (4th edn, New York: Juris Publishing 2014), pp 19.34 - 19.36.

<sup>9</sup> Department of Justice, 'Antitrust Division Workload Statistics Fiscal Year 2005-2014' (2015) p 13, available at <https://www.justice.gov/atr/file/630706/download>.

<sup>10</sup> *United States v Texas Commerce Bancshares, Inc.* 1993-2 Trade Cas. (CCH) P 70,326 (N.D. Tex. 1993) (challenging the acquisition of New First City Bank-Midland N.A.), and *United States v Texas Bancshares, Inc.*, 1993-2 Trade Cas. (CCH) P 70,363 (N.D. Tex. 1993) (challenging the acquisition of *New First City Bank/Beaumont N.A.*).

<sup>11</sup> See, e.g., Department of Justice, 'Justice Department Reaches Agreement Requiring Divestitures in *Merger of First Busey Corporation/Main Street Trust Inc*' (12 June, 2007) *Press Release*, available at [http://www.usdoj.gov/atr/public/press\\_releases/2007/223869.htm](http://www.usdoj.gov/atr/public/press_releases/2007/223869.htm).

<sup>12</sup> 15 USC §§ 1311-1314.

<sup>13</sup> K A Letzler and M B Mierzewski, 'Antitrust Policy Poses Greater Burdens for Bank Mergers and Acquisitions' (20 April, 1992) 11 *Banking Policy Report* No 8, pp 1-3.

person interviews of competitors, customers, and other entities or individuals.<sup>14</sup> The DOJ may, also, request interviews or depositions of staff and employees of the merging banks.<sup>15</sup>

In the course of its investigation process, the DOJ will send a report to a requesting bank regulator outlining its position on competitive issues raised by the proposed bank merger. If the DOJ has no concerns, it will determine that the proposed bank merger will not reduce competition in the relevant markets. If the DOJ perceives serious issues, it will note its concerns to the banks and their regulator, and may resolve the issues by seeking a divestiture or other solution(s).<sup>16</sup> If the issues are successfully resolved, the divestiture or other action may become conditions to the Federal Reserve's order to avoid the need for a consent decree.<sup>17</sup> If the DOJ has not found a resolution of its concerns, but the Federal Reserve approves the merger, the resolution process will require simultaneously filing a complaint and consent decree.<sup>18</sup> The DOJ may, also, bring a court action to stay the merger subject to the outcome of the litigation.<sup>19</sup> The DOJ must inform regulators of its conclusions including any divestiture proposals.

An important consideration for the DOJ is that it must act so as not to deter potential bidders showing an ability and willingness to act quickly and express the limits of the type of relief it may later demand. Otherwise, it runs the risk either preventing a highly beneficial merger, or doing nothing in the face of a merger that may significantly undermine competition.<sup>20</sup>

## 7.1 Federal banking agencies that oversee bank mergers

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<sup>14</sup> Department of Justice, 'Antitrust Division Manual' (5<sup>th</sup> edn., April, 2015) Chapter III (Investigation and Case Development), pp III-13, III-15, and III-17.

<sup>15</sup> *Ibid*, pp III-19, and III-30.

<sup>16</sup> *Ibid*, pp III-37, III-143-144.

<sup>17</sup> H R Cohen and C M Nathan, *Financial Institutions Mergers and Acquisitions: The New Era* (New York: Practising Law Institute 1997), pp 515-6.

<sup>18</sup> Federal Register, 'Notice of Proposed Final Judgment, Stipulation, and Competitive Impact Statement in *United States v Society Corporation*' (1992) 57 Federal Register 10,371.

<sup>19</sup> 12 USC §1849(b)(1); see, also, 12 USC §1828(c)(7)(A).

<sup>20</sup> J M Rich and T G Scriven, 'Bank Consolidation Caused by the Financial Crisis: How Should the Antitrust Division Review "Shotgun Marriages?"' (2008) 8-2 *American Bar Association: Antitrust Source* 2, available at [www.americanbar.org/content/dam/aba/publishing/antitrust\\_source/Dec08\\_Rich12\\_22f.authcheckdam.pdf](http://www.americanbar.org/content/dam/aba/publishing/antitrust_source/Dec08_Rich12_22f.authcheckdam.pdf).



Federal banking agencies that are in charge of overseeing bank mergers, and any related competition aspects to these transactions, are the Federal Reserve, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation.

### 7.1.1 Federal Reserve<sup>21</sup>

The Federal Reserve's review of bank merger cases begins with the filing of an application. As part of the application the merging parties must provide a discussion of competitive issues.<sup>22</sup> These issues are based on specified factors in relation to the proposed merger. The Federal Reserve comments on the merger application, typically, raise questions seeking clarification of the elements of a merger, and about competitive issues. Once the application responds to the comments and questions, Federal Reserve must act on the application within a given period of time.<sup>23</sup> The merger application may, also, engage in ongoing discussions and written presentations with the Federal Reserve's staff, and with one of the twelve regional banks of the Federal Reserve.<sup>24</sup> The regional Federal Reserve Bank is determined based on the geographical area where the merger will take place. The process is completed, when the regional bank and the Federal Reserve's staff present their decision to the Board of Governors of the Federal Reserve.

The bank merger review guidelines promulgated by the Federal Reserve, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and Department of Justice sought to harmonize their review of bank mergers.<sup>25</sup> The Department of Justice and banking authorities have nonetheless not implemented consistent standards.

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<sup>21</sup> Federal Reserve Act 1913, 12 USC ch 3. The Federal Reserve is the central bank of the US. It provides the nation with a safe, flexible, and stable monetary and financial system. For more information, go to [www.federalreserve.gov](http://www.federalreserve.gov).

<sup>22</sup> Federal Reserve's Regulation Y, 12 Code of Federal Regulations § 225.13, part 14; Form FR Y-2, 4 Federal Banking Law Reporter (CCH) P44, 051 (7 February, 1992).

<sup>23</sup> 12 Code of Federal Regulations §225.14(d)(2) (Federal Reserve typically has sixty-day approval period, which may be extended, but 'in no event' may the total approval time exceed ninety-one days).

<sup>24</sup> Federal Reserve, 'The Twelve Federal Reserve Districts' (2016) FRB, available at <http://www.federalreserve.gov/otherfrb.htm>.

<sup>25</sup> Department of Justice, 'Bank Merger Competitive Review - Introduction and Overview [current as of 9/2000] (1995) (updated 25 June, 2015)' ('[US Bank Merger Review Guidelines](#)'), available at [www.usdoj.gov/atr/public/guidelines/6472.pdf](http://www.usdoj.gov/atr/public/guidelines/6472.pdf). For a detailed discussion of the bank merger competitive analysis, geographic market, product market, and consumers' issues in the US, see chapter 9 of this thesis.

The Federal Reserve still applies the traditional *Philadelphia National Bank*<sup>26</sup> competition analysis, despite admitting its lack of confidence in the ‘cluster approach’.<sup>27</sup> The Federal Reserve defines the relevant geographic market locally for a bank merger proposal, notwithstanding the fact that its merger analysis in principle could involve a review of competitors spanning the entire country.<sup>28</sup> How a product or geographic market is defined, often, determines whether a proposed merger will be approved. An evolving and pragmatic merger analysis paradigm must exist to ensure effective competition policy. This is particularly true in a fast-changing and increasingly borderless market in financial services. Nonetheless, the Federal Reserve’s analysis remains unchanged.

### 7.1.2 Office of the Comptroller of the Currency<sup>29</sup>

The Office of the Comptroller of the Currency (‘OCC’) has been characterized as an agency that supports banks mergers. The OCC’s view is that the realities of the marketplace require that competition from thrift institutions be considered to define the appropriate product market, and to assess the competitive consequences of a commercial bank merger proposal.<sup>30</sup> The OCC’s position that thrifts compete directly with commercial banks grew from *dicta* in early decisions to specific findings that thrifts and commercial banks are engaged in the same line of commerce.<sup>31</sup>

Under the Bank Merger Act (‘BMA’),<sup>32</sup> the OCC is prohibited from approving a transaction that would have an anti-competitive effect. Under the BMA,<sup>33</sup> the OCC must consider the merging banks’ financial and managerial resources, future prospects and

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<sup>26</sup> *United States v Philadelphia National Bank* (1963) 374 US 321. For a detailed discussion of this case law, see chapter 8.1 of this thesis.

<sup>27</sup> R S Carnell *et al*, *The Law of Banking and Financial Institutions* (4th edn, New York: Wolters Kluwer 2009), pp 221-2.

<sup>28</sup> *Chemical Banking Corporation*, 82 Federal Reserve Bulletin 239, 239 (1996), p 240.

<sup>29</sup> The National Bank Act 1864, 12 Stat. 665. The OCC charters, regulates and supervises all national banks and federal savings associations, and federal branches and agencies of foreign banks. The OCC is an independent bureau of the US Department of the Treasury. For more information, see [www.occ.gov](http://www.occ.gov).

<sup>30</sup> R V Fitzgerald, ‘Thoughts on Antitrust Policy’ (23 September, 1982) *Speech before the Ninth Annual Conference on Legal Problems in Bank Regulation*, Washington, D.C., reprinted in 4 *Office of the Comptroller of the Currency Quarterly Journal* 27 (December, 1982).

<sup>31</sup> See generally R Kumar, *Strategies of Banks and Other Financial Institutions: Theories and Cases* (Oxford: Elsevier 2014).

<sup>32</sup> BMA (n1), § 1828(c) (as amended by s 604 of the Dodd-Frank Act).

<sup>33</sup> *Ibid*, §§ 1828(c)(5), and 1828(c)(11).

efficiency in combating money laundering, as well as the convenience and needs of the relevant community. The OCC must, also, consider any stability and risk that the proposed merger may pose in the US banking or financial system.<sup>34</sup>

The OCC approves a bank merger where the resulting financial institution is a federally chartered bank.<sup>35</sup> This includes mergers of banks and thrifts into national banks, consolidations of banks and thrifts with national banks, and the purchase by a national bank of the assets of other banks and thrifts.<sup>36</sup> The OCC is not required to approve acquisition by a federal bank of a financial institution that does not have federal deposit insurance. Nonetheless, any branches of federal bank created from the acquisition of an uninsured financial institution's assets are subject to the OCC approval.<sup>37</sup>

After a federally chartered bank applies to the OCC for approval of a bank merger, it forwards the application to the Department of Justice, the Federal Deposit Insurance Corporation, and the Federal Reserve for their respective comments.<sup>38</sup>

The OCC, also, seeks to promote the soundness of the federal banking system and competitive market structures. The OCC approves bank mergers not substantially adverse competition and beneficial to the public. The OCC identifies the relevant geographic market to determine the effects of a proposed bank merger on competition.<sup>39</sup> The OCC focuses on the territory in which most of the bank's customers reside and the effect of the bank merger on competition is immediate and direct. The OCC's identifies the competitors in a market and uses statistical measures of market concentration, such as, the Herfindahl indices.<sup>40</sup>

The OCC reviews a proposed merger under the BMA's criteria, and applicable OCC provisions and policies. The OCC evaluates the financial and managerial resources of the

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<sup>34</sup> *Ibid.*

<sup>35</sup> 12 USC §214(a).

<sup>36</sup> 12 USC §215(a).

<sup>37</sup> 12 USC §§214(a), and 215(a).

<sup>38</sup> See generally, *US Bank Merger Review Guidelines* (n25); see, also, The Office of Comptroller of the Currency, 'Business Combinations: Comptroller's Licensing Manual' (December, 2006), 'Summary' ('OCC Manual'), available at <http://www.occ.treas.gov/publications/publications-by-type/licensing-manuals/bizcombo.pdf>

<sup>39</sup> *US Bank Merger Review Guidelines* (n25), p 2; see, also, *OCC Manual* (n38), pp 13, 42-43, and 56-58.

<sup>40</sup> *US Bank Merger Review Guidelines* (n25), pp 1, 2, and 5; see, also, *OCC Manual* (p38), pp 13, 17, and 42.

banks, their future prospects, the convenience and needs of the communities to be served. Under the BMA, the OCC is required to consider ‘the effectiveness of any insured depository institution’ involved in the proposed merger transaction in fighting money laundering activities, including overseas branches.<sup>41</sup>

### 7.1.3 Federal Deposit Insurance Corporation<sup>42</sup>

The Federal Deposit Insurance Corporation (‘FDIC’)’s approach to bank merger competition analysis is contained in a 1989 policy statement<sup>43</sup> and other provisions.<sup>44</sup> The agency’s approach to geographic market determination remains unchanged despite an update the statement. The relevant geographic market is the territory where the target offices are located, and from where they derive the predominant portion of their loans, deposits, or other business.<sup>45</sup> It, also, includes the territories in which current and potential customers impacted by the proposed merger may turn for alternative sources of banking services. In identifying the relevant geographic market, the FDIC, also, considers the location of the acquiring bank’s offices.<sup>46</sup>

The FDIC’s approach is based on the banking ‘services area’ and ‘customer alternatives’.<sup>47</sup> Bank applicants have the ability to influence the agency’s definition of relevant market, including by using the Federal Reserve’s ‘economics markets’ definition.<sup>48</sup> In evaluating commercial bank mergers, the FDIC includes thrift market shares and the insertion of broad product lines in evaluating the competitive impact of bank merger cases.<sup>49</sup>

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<sup>41</sup> BMA (n1), §1828(c)(11).

<sup>42</sup> Banking Act 1933, 48 Stat. 162 (1933). The Federal Deposit Insurance Corporation (FDIC) is an independent agency authorized to insure bank deposits, examine and supervise banks for safety and soundness and consumer protection, and resolving and managing receiverships. For more information, see [www.fdic.gov](http://www.fdic.gov).

<sup>43</sup> FDIC, ‘Statement of Policy on Bank Merger Transactions’ (2008) 1 FDIC Law, Regulations, and Related Acts 5145 (‘FDIC Policy on Bank Merger Transactions’), available at <http://www.fdic.gov/regulations/laws/rules/5000-1200.htm>.

<sup>44</sup> 12 CFR Part 303, Subpart D (Merger Transactions).

<sup>45</sup> *FDIC Policy on Bank Merger Transactions* (n43), Part III (Evaluation of Merger Applications).

<sup>46</sup> *Ibid.*

<sup>47</sup> *Ibid.*, pt III (3) and (4).

<sup>48</sup> *US Bank Merger Review Guidelines* (n25), p 3.

<sup>49</sup> FDIC, ‘Policy Statement’ (12 October, 1988) 53 *Federal Register* 39,803.

The JPMorgan Chase acquisition of Washington Mutual, in 2008, fell under the FDIC's jurisdiction in part because the bank was in FDIC receivership.<sup>50</sup>

The FDIC defines the relevant market in relation to the banks that are merging.<sup>51</sup> By contrast, the Federal Reserve predefines markets for all bank mergers.<sup>52</sup> The FDIC is more willing than the Federal Reserve to modify its market definition in response to information contained in a merger application, due to not having invested significant resources in defining markets.

In addition to the role of the foregoing federal banking agencies, state banking authorities play a vital part in enforcement of antitrust issues related to bank mergers at the state level.

## 7.2 State banking authorities

The role of state attorney general<sup>53</sup> has become increasingly involved in analysing bank mergers due to increasing bank consolidation potentially impacting local economies.<sup>54</sup> The state attorney general's challenges on proposed bank mergers have matched the DOJ since 1990.<sup>55</sup> But despite their success, their authority has been challenged on jurisdictional grounds.<sup>56</sup> Critics argue<sup>57</sup> that the proper role for state law enforcement is merely participating in reviewing bank mergers initiated at the federal level. They argue that federal law governing

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<sup>50</sup> 12 USC § 1831o(a); see, also, FDIC 'JPMorgan Chase Acquires Banking Operations of Washington Mutual' (25 September, 2008), available at <https://www.fdic.gov/news/news/press/2008/pr08085.html>.

<sup>51</sup> *FDIC Policy on Bank Merger Transactions* (n43), pt III (1), (2), and (3).

<sup>52</sup> *US Bank Merger Review Guidelines* (n25), pp 2, and 4.

<sup>53</sup> The state attorney general in each of the fifty US states and territories is the chief legal advisor to the state government and the state's chief law enforcement officer.

<sup>54</sup> C James, 'Bank Merger Experts Offer Tips on Murky Scene for Acquisitions' (26 August, 1993) 65 *Antitrust and Trade Regulation Report* No 1629, p 294.

<sup>55</sup> Congressional Hearings before the House Committee on Banking, Finance and Urban Affairs, 'Antitrust Implications of Bank Mergers and the Role of Several States in Evaluating Recent Mergers' (1992) 102<sup>nd</sup> *US Congress*, 2<sup>nd</sup> Session 1.

<sup>56</sup> P E Greene and G A MacDonald, 'The Jurisdiction of State Attorneys General to Challenge Bank Mergers under the Antitrust Laws' (1993) 110 *Banking Law Journal* 500, pp 508-10.

<sup>57</sup> C Felsenfeld and D L Glass, *Banking Regulation in the United States* (3rd edn, New York: Juris Publishing 2011), pp 291-5.

bank mergers created a uniform system of merger review governed by federal banking agencies.<sup>58</sup>

State attorney general have the authority to challenge proposed bank mergers that are anticompetitive and have protected competition and local economies by enforcing state and federal competition laws. State enforcement of competition policy has been upheld by Federal Courts that have rejected challenges to state authority, based on the US Constitution's Supremacy Clause.<sup>59</sup> Federal bank regulation does not pre-empt state competition law, or undermine the ability of state attorneys general standing to enforce federal competition law.

The state attorney general is not limited to enforcing only state competition laws. They have *parens patriae* standing to enforce federal competition laws, a doctrine that has long been a basis for competition lawsuits by state attorney general.<sup>60</sup> States have used their authority to oppose proposed bank mergers with anticompetitive consequences. Some states have statutes, particularly, prohibiting anticompetitive mergers, and are the basis for opposition to such bank mergers. *Parens patriae* enforcement authority is the frequent basis opposing anticompetitive mergers. General policy considerations supporting state action preventing anticompetitive conduct that adversely affects a state's economy is directly applicable to anticompetitive bank mergers. The most significant impact of banking activities is on local communities.<sup>61</sup>

Federal courts have consistently held that federal law does not pre-empt more restrictive state competition provisions because such laws are not an obstacle to the federal goal of preserving competition. Indeed, the fact that the Sherman Act tolerates certain conduct does not mean that there is an affirmative federal policy encouraging such conduct. In other words, federal competition provisions do not encourage state bank mergers that are unlawful under state law. The majority of state competition provisions are interpreted and implemented

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<sup>58</sup> *Ibid.*

<sup>59</sup> US Constitution, article VI, clause 2.

<sup>60</sup> The doctrine of '*parens patriae*' allows the attorney general of a state to start legal action for the benefit of state residents for federal antitrust violations (15 USC §15(c)). This authority is aimed to further the public trust, protect the general and economic welfare of a state's residents, safeguard residents from unlawful practices, as well as ensure that the benefits of federal law are not denied to the general population.

<sup>61</sup> C Marquis et al, *Communities and Organizations* (Bingley: Emerald 2011), pp 177-88.

consistent with federal competition laws.<sup>62</sup> State enforcement of competition law does not require federal bank regulators to approve a state bank merger that the federal regulators concluded was anticompetitive.<sup>63</sup>

Instead of pre-empting state law, the US Congress integrated state competition laws through the Bank Merger Act providing that state actions pursuant to state law are grounds for objecting bank mergers approved by federal regulators.<sup>64</sup> The Bank Merger Act and the Bank Holding Company Act establish specific remedies and enforcement authority for state attorneys general that challenge proposed anticompetitive bank mergers. These include provisions allowing automatic stay of proposed bank mergers, state intervention in federal enforcement actions, and comment requirements in both statutes.

According to the Bank Merger Act,<sup>65</sup> state attorneys general may intervene in any competition action opposing a bank merger if initiated by a private party or the government. The Act provides that:

In any action brought under the antitrust laws arising out of [a merger transaction] approved by [a federal supervisory agency] . . . any [s]tate banking supervisory agency having jurisdiction within the state involved, may appear as a party of its own motion and as of right, and be represented by counsel.<sup>66</sup>

Under the Bank Holding Company Act,<sup>67</sup> the appropriate federal regulator must notify the ‘appropriate [s]tate supervisory authority’ of any proposed merger.<sup>68</sup> State attorneys general have utilized these procedures to block anticompetitive issues of a numerous proposed bank mergers, without opposing with legal action in a state or a federal court.<sup>69</sup> The increasing amount of bank mergers and concentration in the banking industry impacts states’ economies, businesses, and citizens. Enforcement of competition laws by state attorneys general protects

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<sup>62</sup> For instance, *Mercantile Texas Corp v Board of Governors of the Fed Reserve Sys*, 638 F.2d 1255, 1261 (5th Cir. 1981).

<sup>63</sup> *Ibid.*

<sup>64</sup> *BMA* (n1), §1828(c)(7)(A).

<sup>65</sup> *Ibid*, §1849(c).

<sup>66</sup> *Ibid.*

<sup>67</sup> *BHCA* (n4), §1842.

<sup>68</sup> *Ibid.*

<sup>69</sup> *United States v First City National Bank*, 386 US 361, 367-69 (1967); *Southwest Miss. Bank v FDIC*, 499 F. Supp. 1, 5-8 (S.D. Miss. 1979).

states' interests and is consistent with the well-established doctrine of dual federalism, a balanced power between federal and state authority.<sup>70</sup>

### 7.3 Coordination of efforts between antitrust and banking authorities pertaining to bank merger situations

The general task of the regulators is to ensure the resulting bank would have sufficient capital and other resources to operate in a safe and sound manner, and that the merger would not substantially lessen competition. Banking authorities and the Department of Justice screen proposed mergers.<sup>71</sup> They further scrutinize those mergers that appear to create anticompetitive effects.<sup>72</sup> Part of the regulators' analysis consists of looking at relevant geographical market.

The Federal Trade Commission ('FTC'),<sup>73</sup> a US competition regulator, does not review bank mergers because pursuant to s 7A(c)(8) of the Clayton Act<sup>74</sup> such mergers are exempted from Hart-Scott-Rodino Act of 1976 ('HSR')<sup>75</sup> pre-merger notification requirements.

Upon receipt of a merger application, banking regulator forwards it to the Department of Justice ('DOJ'), after which both authorities review the application for the proposed merger's anticompetitive effects.<sup>76</sup> The DOJ applies s 7 of the Clayton Act<sup>77</sup> in analysing a merger's competitive effects and the Federal Reserve adds to its analysis consideration of the bank's resources and needs of the community.<sup>78</sup> The Federal Reserve does not issue its own finding until the DOJ submits its own report. The analytic framework the banking authorities

<sup>70</sup> E.g., *McCulloch v Maryland* 17 US 316 (1819).

<sup>71</sup> *US Bank Merger Review Guidelines* (n25), pp 1-2.

<sup>72</sup> R P Zora, 'The Bank Failure Crisis: Challenges in Enforcing Antitrust Regulation' (2009) 55 *Wayne Law Review* 1175, p 1180.

<sup>73</sup> The Federal Trade Commission Act 1914, 15 USC §§ 41-58, as amended. The Federal Trade Commission is a federal agency authorized to promote consumer protection and to eliminate and to prevent anticompetitive business practices. For more information, go to [www.ftc.gov](http://www.ftc.gov).

<sup>74</sup> *Clayton* (n3), §18(a); 16 Code of Federal Regulations §802.6(a) (1992).

<sup>75</sup> 15 USC §18.

<sup>76</sup> Federal Reserve / Department of Justice, 'How Do the Federal Reserve and the DOJ, Antitrust Division, Analyze the Competitive Effects of Mergers and Acquisitions under the Bank Holding Company Act, the Bank Merger Act and the Home Owners' Loan Act?', FAQs' (October, 2014) ('[Fed/DOJ Competitive Effects of Mergers FAQs](http://www.justice.gov/sites/default/files/atr/legacy/2014/10/09/308893.pdf)'), paras 1-2, available at

<http://www.justice.gov/sites/default/files/atr/legacy/2014/10/09/308893.pdf>.

<sup>77</sup> *Clayton* (n3), §18.

<sup>78</sup> *BMA* (n1), §1828(c)(5)(B).



apply when they review possible competitive effects of a bank merger goes back to the *United States v Philadelphia National Bank* ('*Philadelphia National Bank*') case of 1963.<sup>79</sup>

The governmental authorities' review of a bank merger is based upon bank merger guidelines developed by the DOJ, the Federal Reserve, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation.<sup>80</sup> Under the guidelines, the so-called 1800/200 test applied to bank deposits. The Federal Reserve is unlikely to challenge the merger transaction, if it does not cause the HHI (Herfindahl-Hirschman Index) to exceed 1800 in total and more than 200 points in any relevant banking market.<sup>81</sup> If a merger exceeds those thresholds, the Federal Reserve will typically approve the transaction, subject to the resulting firm divesting branches so as to decrease the HHI change to less than 200 points as measured by bank deposits. The DOJ screens transactions, based on the 1800/200 standard and applies the horizontal merger guidelines<sup>82</sup> for transactions that exceed the threshold.

The Federal Reserve and the DOJ apply the 1800/200 test differently in identifying relevant geographic and product markets.<sup>83</sup> Banking authorities apply pre-determined market definitions (such as, 'traditional banking');<sup>84</sup> while the DOJ defines relevant markets under the horizontal merger guidelines in relation to consumer demand.<sup>85</sup>

From the DOJ's perspective, banking services to small and medium-sized enterprises ('SMEs') can comprise a relevant product market because those enterprises depend on a local bank that is, generally, one of the few banks in the area.<sup>86</sup>

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<sup>79</sup> *Philadelphia National Bank* (n26). For a discussion of this case law, see chapter 8.1 in this thesis, pp 219-24.

<sup>80</sup> *US Bank Merger Review Guidelines* (n25), pp 1-2.

<sup>81</sup> *Ibid.*

<sup>82</sup> Department of Justice, 'Horizontal Merger Guidelines' (2010) ('[US Horizontal Merger Guidelines](http://www.justice.gov/atr/public/guidelines/hmg-2010.pdf)'), para 5.3, available at [www.justice.gov/atr/public/guidelines/hmg-2010.pdf](http://www.justice.gov/atr/public/guidelines/hmg-2010.pdf). For a detailed discussion of bank merger competitive analysis, geographic market, product market, and the consumers' issues, see chapter 9 of this thesis.

<sup>83</sup> *Ibid.*, para 4.

<sup>84</sup> *Fed/DOJ Competitive Effects of Mergers FAQs* (n76), para 21.

<sup>85</sup> *US Horizontal Merger Guidelines* (n82), para 1.

<sup>86</sup> *Fed/DOJ Competitive Effects of Mergers FAQs* (n76), para 12.

According to the DOJ,<sup>87</sup> SMEs have fewer credit alternatives and options available than retail consumers or large businesses. Middle market consumers require expertise and services that small banks may not be able to provide (including payroll, collection, and disbursement services, and business expertise and advice), and that are unlikely to be provided by distant banks.<sup>88</sup>

If the Federal Reserve approves a transaction, which the DOJ concludes to be anticompetitive, the DOJ can challenge the transaction in federal district court.<sup>89</sup> Under the Bank Merger Act ('BMA'),<sup>90</sup> the court must automatically stay the transaction, giving the DOJ enormous leverage in settlement negotiations.

The BMA requires bank authorities to evaluate competitive effects before approving a proposed bank merger.<sup>91</sup>

These authorities are required to consider several factors, such as, financial history and condition of each of the banks involved, adequacy of its capital structure, future earnings prospects, general character of management, and convenience and needs of the community to be served.<sup>92</sup> Other factors include consistency of bank's corporate powers with the purposes of the federal deposit insurance provisions, and the effect of bank merger transaction on competition.<sup>93</sup>

Banking authorities may waive any concerns about adverse effects on competition, if they conclude that the transaction is in the public interest because factors unrelated to competition are more important.<sup>94</sup> The authorities may decide that the bank merger solves an immediate management succession problem, improves a bank's stability, provides important

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<sup>87</sup> Department of Justice, 'DOJ Requires Divestitures in Acquisition of *National City Corporation* by the *PNC Financial Services Group*' (11 December, 2008) *DOJ*, available at [www.usdoj.gov/atr/public/press\\_releases/2008/240315.htm](http://www.usdoj.gov/atr/public/press_releases/2008/240315.htm).

<sup>88</sup> *Ibid.*

<sup>89</sup> *BMA* (n1), §1828(c)(7)(A).

<sup>90</sup> *Ibid.*, § 1828(c)(7)(A).

<sup>91</sup> *Ibid.*, § 1828(c).

<sup>92</sup> See generally L L Broome and J W Markham, *Regulation of Bank Financial Services Activities: Cases and Materials* (3rd edn, New York: Thomson/West 2008).

<sup>93</sup> *Ibid.*

<sup>94</sup> S D Waxberg and S D Robinson, 'Chaos in Federal Regulation of Bank Mergers, A Need for Legislative Revision' (1965) 82 *Banking Law Journal* 377, p 379.

services to an underserved community, or allows a bank to a growing customer base.

Relevant authorities may approve only those proposed bank mergers that are consistent with the 'public interest' factor.<sup>95</sup>

A fundamental difference between bank mergers and the mergers of other businesses is that the DOJ divides jurisdiction with banking authorities.<sup>96</sup> A proposed bank merger must be filed for approval with the proper banking authority. The proper authority for federally chartered banks is the OCC;<sup>97</sup> for state member banks and bank and financial holding companies it is the Federal Reserve;<sup>98</sup> and for non-member insured banks it is the FDIC.<sup>99</sup> Upon receipt of the bank merger application, the proper banking authority sends a merger application to the DOJ upon receipt while both conduct their respective analyses.<sup>100</sup>

Different statutory standards are applied by the DOJ and banking authorities. Standards established by s 7 of the Clayton Act<sup>101</sup> are applied by the DOJ utilizes, while the BMA<sup>102</sup> guides the analysis of banking authorities. Banking authorities wait until the DOJ provides a report with its findings regarding the competitive effects of a merger before deciding whether to approve.

Bank regulators and the DOJ initiate their bank merger competition analysis, based on the bank merger review guidelines.<sup>103</sup> S 1 of the guidelines lists quantitative information for authorities to evaluate.<sup>104</sup> It also contains two separate screens (screen A and screen B) for analysing bank merger transaction.<sup>105</sup> S 2 outlines information that 'may be relevant to the banking agencies and DOJ when the quantitative results from Screen A and/or B signal potential antitrust concerns.'<sup>106</sup>

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<sup>95</sup> *BHCA* (n4), Chapter VII, Sec C (section 3(c)); see, also, *United States v First City of Nat'l Bank of Houston*, 386 US 361 (1967).

<sup>96</sup> *Rich and Scriven* (n20), pp 34-57.

<sup>97</sup> 12 USC § 1.

<sup>98</sup> 12 USC § 248

<sup>99</sup> 12 USC § 1811.

<sup>100</sup> *Fed/DOJ Competitive Effects of Mergers FAQs* (n76), paras 1-3.

<sup>101</sup> *Clayton* (n3), §18.

<sup>102</sup> *BMA* (n1), §1828(c).

<sup>103</sup> *US Bank Merger Review Guidelines* (n25).

<sup>104</sup> *Ibid*, pp 1-2.

<sup>105</sup> *Ibid*, pp 4-10.

<sup>106</sup> *Ibid*, pp 3-4.

After filing a bank merger application, the merging bank needs to complete a screen A HHI<sup>107</sup> calculation chart for three separate geographic markets: the Federal Reserve market,<sup>108</sup> the Rationally Metropolitan Area ('RMA') market,<sup>109</sup> and the county market. The DOJ and banking authorities implement the 1800/200 test for screen A.<sup>110</sup> However, banking authorities only apply the test to bank deposits, if, concerning deposits, a transaction does not cause the HHI to exceed 1800 and to increase more than 200 points in any relevant banking market.<sup>111</sup> If the foregoing thresholds are met, the Federal Reserve is unlikely to challenge the transaction.

Banking authorities do not utilize screen B.<sup>112</sup> Instead, they analyse the merger application under s 2 of the bank merger guidelines,<sup>113</sup> and focus on the enumerated qualitative factors. The guidelines provide merging banks with transparency. They are not intended to unify the competition analysis of banking authorities and the DOJ. The DOJ uses screen A to begin its analysis and often screen B as a backup method.<sup>114</sup> If the proposed merger exceeds the 1800/200 threshold of screen A, the DOJ suggests to the merging banks that they consider submitting calculations set forth in Screen B. Screen B has alternative geographic market definitions that focus solely on bank offices that make commercial loans in the relevant market.<sup>115</sup>

Even if a proposed merger would not exceed the screen A threshold, the DOJ may analyse it further under screen B, if screen A does not reflect entirely the competitive effects

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<sup>107</sup> *Ibid*, pp 4-8. The Herfindahl-Hirschman Index ('HHI') is a commonly accepted measure of market concentration, calculated by squaring the market share of each firm competing in a market and then summing the result numbers.

<sup>108</sup> The general definition of a Federal Reserve market is quite complex to articulate because each Federal Reserve Bank defines a Federal Reserve market differently. For more information on how each Federal Reserve defines its respective market(s); see, also, J V Disalvo, 'Federal Reserve Geographic Banking Market Definitions' (1999) *Federal Reserve Bank of Philadelphia*, available at [www.philadelphiafed.org/research-and-data/banking/third-district-markets/banking-market-definitions.pdf](http://www.philadelphiafed.org/research-and-data/banking/third-district-markets/banking-market-definitions.pdf).

<sup>109</sup> *US Bank Merger Review Guidelines* (n25), pp 2, 5, and 8. RMAs are defined by the Rand McNally Corporation utilizing commuting and population density data at the sub-county level. Three criteria must be met before a market is designated as an RMA: (1) an urbanized area with a population of about fifty thousand, (2) a population density of at minimum seventy per square mile, and (3) commutation of at minimum twenty per cent of the labour force to the central urban area.

<sup>110</sup> *US Bank Merger Review Guidelines* (n25), pp 4-7.

<sup>111</sup> *Ibid*.

<sup>112</sup> *Ibid*, pp 8-10.

<sup>113</sup> *US Horizontal Merger Guidelines* (n82), para 2.

<sup>114</sup> *US Bank Merger Review Guidelines* (n25), pp 4-10.

<sup>115</sup> *Ibid*, pp 8-9. For a discussion of the US bank merger guidelines, see chapter 9 in this thesis, pp 256-99.

of the transaction in all relevant markets, in particular lending to SMEs.<sup>116</sup> The DOJ is more likely to review a bank merger transaction, if the applicants compete in an area substantially larger than the area where lending to small business takes place. The DOJ's unique application of screen B to product and geographic markets may explain the increased concentration that has taken place in local markets. The DOJ's analysis of geographic and product markets is important, but does not receive sufficient attention because of the status of the DOJ as a 'junior partner' in the government's bank merger review process.<sup>117</sup>

Banking authorities use outdated definitions of product and geographic markets.<sup>118</sup> The Federal Reserve uses the cluster method, which defines the relevant product market as the 'cluster' of products *i.e.*, different kinds of credit and services *i.e.*, checking and debit accounts denoted by the term 'commercial banking'.<sup>119</sup> The FDIC views relevant product markets as particular banking services offered by the merging banks or those to be offered by the combined financial institution, and the functional equivalent of such services offered by potential competitors.<sup>120</sup>

Banking authorities may overlook concentrations in particular product lines and particular geographic areas because they define markets broadly.<sup>121</sup> The DOJ's approach is more sensitive to the operation of contemporary markets.<sup>122</sup> When analysing the product market, it uses a submarket or product-oriented approach. By focusing on transaction accounts and commercial lending to SMEs, the DOJ's method makes it more likely to find markets being overly concentrated or at risk of becoming so.<sup>123</sup>

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<sup>116</sup> *US Horizontal Merger Guidelines* (n82), para 2.

<sup>117</sup> A C Stine and E D Gorman, 'Fixing America: A Look at the Way Projects are Funded & Who Should be Regulating the Process: Ebbing the Tide of Local Bank Concentration: Granting Sole Authority to the Department of Justice to Review the Competitive Effects of Bank Mergers' (2012) 62 *Syracuse Law Review* 405, pp 407-9.

<sup>118</sup> *E.g.*, *United States v Philadelphia National Bank* (1963) 374 US 321. For a discussion of this case, see chapter 8.1 in this thesis, pp 219-24.

<sup>119</sup> *Ibid.*

<sup>120</sup> *FDIC Policy on Bank Merger Transactions* (n43), pt III, subpart 2.

<sup>121</sup> T McCarthy, 'Refining Product Market Definition in the Antitrust Analysis of Bank Mergers' (1997) 46 *Duke Law Journal* 865, p 888.

<sup>122</sup> E Pekarek and M Huth, 'Bank Merger Reform Takes an Extended Philadelphia National Bank Holiday' (2008) 13 *Fordham Journal of Corporate & Finance Law* 595, p 600.

<sup>123</sup> N Note, 'The Line of Commerce for Commercial Bank Mergers: A Product-Oriented Redefinition' (1983) 96 *Harvard Law Review* 907, pp 908-13.

Overall, banking authorities and the DOJ seem highly inclined to permit bank mergers to proceed without significant obstacles, proceeding according to the principle of not appearing overly concentrated. The approach from the foregoing regulators, so far, has been: the proposed merging banks dispose of a half-a-dozen branches in, for example, Cincinnati, and the merger will be okay.<sup>124</sup> Bank merger analysis by the agencies is fact-intensive. Accordingly, successfully defending a bank merger requires applicants to gather fact sufficient to demonstrate that a proposed merger would not substantially lessen competition.

The federal banking laws establish the standard applied to the analysis of bank mergers. It is essentially the same standard as s 7 of the Clayton Act.<sup>125</sup> That is, no bank merger may be approved, if it would result in a monopoly, would be in furtherance of any combination or conspiracy to monopolize or attempt to monopolize, or that would substantially lessen competition or restrain trade.<sup>126</sup> State law is generally not pre-empted by federal bank laws, which allows state attorneys general and agencies to review bank mergers for competition issues.<sup>127</sup>

#### 7.4 Conclusion

The general task of the Department of Justice ('DOJ'), Federal Reserve, the Office of the Comptroller of the Currency ('OCC'), and the Federal Deposit Insurance Corporation ('FDIC'), along with the state banking regulators, is to ensure the resulting bank would have sufficient capital other resources to operate in a safe and sound manner and that the merger would not substantially lessen competition.<sup>128</sup> The DOJ and the banking agencies screen submitted mergers and categorize them needing further scrutiny into anticompetitive consequences.

An important difference between bank mergers and the mergers in other industries is

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<sup>124</sup> See, generally, R S Carnell *et al*, 'Symposium the Future of Law and Financial Services: Panel III: The New Policy Agenda for Financial Services' (2001) 6 *Fordham Journal of Corporate & Finance Law* 113, p 114-5.

<sup>125</sup> *Clayton* (n3), §18.

<sup>126</sup> *BMA* (n1), §§1828(c) (5), and 1842(c).

<sup>127</sup> C Felsenfeld and G Bilali, 'Is There a Dual Banking System?' (2008) 2 *Journal of Business and Entrepreneurship and Law* 30, p 65.

<sup>128</sup> *E.g.*, Department of Justice, 'Protocol for Coordination in Merger Investigations between the Federal Enforcement Agencies and States Attorneys General' (11 March, 1998), available at <https://www.justice.gov/sites/default/files/atr/legacy/2011/12/21/1773.pdf>.

that the DOJ divides jurisdiction with banking regulators. A submitted bank merger must be filed for approval with the proper banking regulator, such as, the Federal Reserve, the OCC, or the FDIC. After receipt of the bank merger application, the proper banking agency sends a merger application to the DOJ upon receipt, while both carry out their respective examinations. Different statutory standards are applied by the DOJ and federal banking agencies. Standards established by s 7 of the Clayton Act are applied by the DOJ, while the Bank Merger Act guides the analysis of federal banking agencies. Banking agencies wait until the DOJ provides a report with its findings concerning the competitive consequences of a merger before deciding whether to approve.

The DOJ along with the federal banking agencies has developed certain guidelines, under 1800/200 test, based on which they review a bank merger. Under the guidelines, a bank merger can potentially be approved if the merger does not exceed 1800 in total and more than 200 points in any relevant market.

The DOJ and the federal agencies apply the 1800/200 test differently in identifying relevant geographic and product markets. DOJ defines relevant markets under the horizontal merger guidelines in relation to consumer demand, while the federal banking regulators apply pre-determined market definitions (such as, ‘traditional banking’).

The analytic framework the federal banking agencies apply when they review possible competitive consequences of a bank merger goes back to the *Philadelphia National Bank*. In examination of a bank merger, the federal banking agencies utilize outdated definitions of product and geographic markets, based on the cluster method that defines the relevant product market as the cluster of products (different kinds of credit) and services (*i.e.*, checking and debit accounts) denoted by the term ‘commercial banking.’

Banking regulators risk in overlooking concentrations especially in product lines and particular geographic areas because they define markets broadly. The DOJ’s approach is more sensitive to the operation of contemporary markets. When analysing the product market, the regulator uses a submarket or product-oriented approach. By focusing on transaction accounts and commercial lending to SMEs, the DOJ’s method makes it more likely to find markets

being overly concentrated or at risk of becoming so. The DOJ's competition examination identifies a specific area of competitive concern, such as, lending or credit card processing services or other business banking services for SMEs. On the other hand, the federal banking regulators inquiry whether a merger could result in the combined entity's share of deposits exceeding the regulator's statutory thresholds. Nonetheless, divestiture is often the proper measure to tackle competition concerns.

Banking regulators may waive any issues about adverse consequences on competition if they determine that the bank merger is in the public interest. Factors unrelated to competition are seemingly given more importance. The regulators may decide that the bank merger solves an immediate management succession problem, enhances a bank's stability, renders significant services to an underserved community, or permits a bank to a growing customer base. Relevant regulator may approve only those submitted bank mergers that it rules were consistent with the public interest.



## CHAPTER 8 – BANK MERGER CASES BEFORE AMERICAN COURTS AND REGULATORS

This chapter discusses the role of American courts in shaping bank merger competition policies, including analysis of several important case laws on the subject. This chapter, also, discusses significant bank merger transactions cleared by the US banking watchdogs, without courts intervention.

### 8.0 Role of American courts in shaping bank merger competition policies

The US judicial and banking systems are dual in nature. The duality of the judicial system consists of federal and state laws and courts, which adjudicate bank mergers, based on national or state level respectively. The duality of the banking system consists of nationally chartered banks and state chartered banks.<sup>1</sup> In view of the relevance and scope of this thesis, below is an overview of significant bank mergers cases decided by the federal courts (both the lower courts and the Supreme Court).

Interestingly, there has been an increase in the courts' adjudication of numerous bank mergers cases brought by the Department of Justice or banking regulators on behalf of the US Government from the early 1960s through to the late 1990s.<sup>2</sup> In particular, the 1960s and 1970s proved to be the period with the highest number of bank merger cases brought before the American courts.<sup>3</sup> This corresponded with a time in which the US Congress, along with the regulators, implemented and enhanced competition laws and regulations, coupled with an increase and strict compliance of the bank merger assessments from competition authorities and bank regulators.<sup>4</sup>

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<sup>1</sup> K E Scott, 'The Dual Banking System: A Model of Competition in Regulation' (1977) 30 *Stanford Law Review* 1, pp 12-16.

<sup>2</sup> C P Rogers III, 'The Antitrust Legacy of Justice William O. Douglas' (2008) 56 *Cleveland Saint Louis Law Review* 895, pp 899-903.

<sup>3</sup> P S Rose, *Bank Mergers: Current Issues and Perspectives* in B E Gup (ed.) (2nd edn, Boston: Kluwer Academic Publishers 2001), pp 3-5.

<sup>4</sup> E.g., in 1960, the Congress passed the Bank Merger Act 1960; and in 1966, it amended the Act, in the Bank Merger Act 1966 (12 USC § 1828(c)) ('Bank Merger Act' ('BMA')).

During the Global Financial Crisis, and immediately thereafter, there has been nearly no bank merger case challenged by either US banking and/or competition regulators, or interesting party before American courts.<sup>5</sup> This appears to be due to the lack of diligence or the manipulation of the rules on the part of the regulators.<sup>6</sup> Instead of closely scrutinizing bank mergers and bringing some of these mergers before the courts, the supervisory agencies have preferred to rely on emergency provisions contained in the competition legislation to approve bank mergers in the name of public interest *vis-à-vis* the protection of the consumers' deposits.<sup>7</sup> Often, in the course of such undertakings, responsible authorities have simply requested some divestiture actions on the part of the merging banks in order to meet an alleged minimum threshold of the lessening of competition aspect in the best interest of the public. Whether such approach has been, and still is, an appropriate measure in circumventing review by the courts remains an open question that deserves to be addressed by the US Congress and the public.<sup>8</sup>

In order to illustrate the United States courts role in shaping bank merger antitrust policies, several federal court cases with an important impact on the policies will be discussed, below. Considering the significant effect of the *United States v Philadelphia National Bank* in the bank merger examination policies, such case law is given a particular and separate discussion from the other federal case laws, below.

## 8.1 United States v Philadelphia National Bank

The landmark court case that sets the parameters of bank mergers regulations in the US and, in particular, products and services within the banking markets remains the 1963 case of *United States v Philadelphia National Bank*.<sup>9</sup>

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<sup>5</sup> D Zaring, 'Litigating the Financial Crisis' (2014) 100 *Virginia Law Review* 1405, pp 1407-9.

<sup>6</sup> OECD, 'Competition and the Financial Crisis' (17-18 February, 2009) *OECD Competition Committee*, p 23, available at <http://www.oecd.org/competition/sectors/42538399.pdf>.

<sup>7</sup> N J Michel, 'Improving Financial Institution Supervision Ending the Federal Reserve's Regulatory Role' (21 November, 2014) *Testimony before Committee on Banking, Housing and Urban Affairs, Financial Institutions and Consumer, Protection Subcommittee, US Senate*, available at <http://www.heritage.org/research/testimony/2014/12/step-one-for-improving-financial-institution-supervision-ending-the-federal-reserves-regulatory-role>.

<sup>8</sup> *Ibid.*

<sup>9</sup> *United States v Philadelphia National Bank* (1963) 374 US 321 ('Philadelphia National Bank').

In *Philadelphia National Bank*, the lower (federal district) court<sup>10</sup> dismissed the case, after concluding that the geographic market was clearly not restricted to the four-county metropolitan area in Philadelphia, State of Pennsylvania.<sup>11</sup> In the indicated area the merging banks obtained offices in consideration of the fact that bank customers would rely on supplier banks outside the area.<sup>12</sup> The US Supreme Court overruled the lower court's decision.<sup>13</sup>

Pursuant to its overview of the record, the Supreme Court restricted the market within the metropolitan area.<sup>14</sup> The court supported its findings, based on the incapability of small number of customers to engage in specific banking services at considerable distances.<sup>15</sup> The court, further, noted a number of factors that contributed to the argument that the smaller the number of the customers, the more restricted would be their banking market geographically.<sup>16</sup> Its factors included the elevated proportion of the defendants' business that emerged in the metropolitan area, and the relatively smaller proportion of business, which the merging businesses raked in outside Philadelphia.<sup>17</sup> Another factor was the fact that nearly the entire defendant's banking business was with well-built number of the corporate customers.<sup>18</sup>

The *Philadelphia National Bank* case was ground-breaking for the applicability of competition provisions to a bank merger, and the applicability of s 7 of the Clayton Act<sup>19</sup> to mergers, generally.<sup>20</sup> The Supreme Court noted that the element of inconvenience confines competition in banking as strictly as high costs of transportation in other sectors of the economy.<sup>21</sup> The court, moreover, stated that different bank customers carry out their banking activities in areas of differing geographic extent. Nevertheless, the court categorized all of them, and established that a four-county area bordering Philadelphia constituted a 'workable compromise' in relation to the geographic area where banks competed among themselves.<sup>22</sup>

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<sup>10</sup> *United States v Philadelphia National Bank*, 201 F. Supp. 348 (E.D. Pa. 1962).

<sup>11</sup> *Ibid*, p 363.

<sup>12</sup> *Ibid*, p 368.

<sup>13</sup> *United States v Philadelphia National Bank* (n9).

<sup>14</sup> *Ibid*, pp 357-362.

<sup>15</sup> *Ibid*, p 370.

<sup>16</sup> *Ibid*, pp 370-371.

<sup>17</sup> *Ibid*, p 371.

<sup>18</sup> *Ibid*, pp 335-349.

<sup>19</sup> Clayton Antitrust Act 1914, 15 USC §§12-27, 29 USC §§52-53 ('Clayton'), § 18.

<sup>20</sup> *Brown Shoe Co. v United States*, 370 U.S. 294, 325, 335 (1962) ('Brown Shoe').

<sup>21</sup> *United States v Philadelphia National Bank* (n9), p 370.

<sup>22</sup> *Ibid*, pp 3659-362.

The court based its finding of this area on the fact that the same area was mapped out as the pertinent market by the US banking authorities.<sup>23</sup>

This case was the leading case where the court was asked to deliberate on the applicability of competition provisions to the commercial banking sector.<sup>24</sup> Two foremost findings<sup>25</sup> were set out in the case, which would alter the configuration of competition legislation applicable to the banking sector. First, the court for the first-time interpreted s 7 of the Clayton Act to cover mergers by banks.<sup>26</sup> Second, the court spelled out the interaction between the Bank Merger Act ('BMA') and the Clayton Act.<sup>27</sup>

The Supreme Court examined the validity of a submitted merger Girard Trust Corn Exchange Bank/Philadelphia National Bank.<sup>28</sup> During the submitted merger, Girard Trust Corn Exchange Bank and Philadelphia National Bank were, respectively, the third and the second biggest banks of the forty-two commercial banks situated within the metropolitan area of Philadelphia.<sup>29</sup> If the proposed merger were authorized, the newly established bank would become the biggest financial institution within the metropolitan area of Philadelphia.<sup>30</sup> The new bank was to control nearly 36 per cent of deposits, about 36 per cent of the area banks' total assets, as well as approximately 34 per cent of net loans.<sup>31</sup>

The Supreme Court stated<sup>32</sup> that s 7 of the Clayton Act extends to regulate acquisitions of share capital or corporate stock of any business entity that participated in commerce. Nonetheless, in relation to acquisitions of corporate assets, s 7 of the Clayton Act only extends to regulate such acquisitions by business entities that are subject to the jurisdiction of the Federal Trade Commission ('FTC').<sup>33</sup> Consequently, the court noted that as the proposed bank merger transaction in the case fell within the scope of an assets acquisition by banks, which are business enterprises that are not subject to the jurisdiction of the FTC, it would not

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<sup>23</sup> *Ibid*, p 362.

<sup>24</sup> *Ibid*, pp 335-355

<sup>25</sup> *Ibid*, pp 335-349 (s 7 of the *Clayton Act* (n19)); and, *ibid*, pp 350-355 (*Bank Merger Act* (n4)).

<sup>26</sup> *Ibid*, pp 335-349.

<sup>27</sup> *Ibid*, pp 350-355.

<sup>28</sup> *Ibid*, pp 330-334.

<sup>29</sup> *Ibid*, p 330.

<sup>30</sup> *Ibid*.

<sup>31</sup> *Ibid*, p 331.

<sup>32</sup> *Ibid*, pp 335-349.

<sup>33</sup> *Ibid*; see, also, 15 USC §1521.

be subject to s 7 of the Clayton Act.<sup>34</sup> The court elaborated on the purpose and applicability of s 7, stating that when the Clayton Act was passed by the US Congress, s 7 appertained solely to acquisitions of share capital or corporate stock, and did not state anything concerning mergers, asset acquisitions, or consolidation transactions.<sup>35</sup>

Before the *Philadelphia National Bank* case, courts had determined that merger transactions were not covered by s 7 of the Clayton Act.<sup>36</sup> Even at the time bank mergers were used as an alternative to a genuine stock acquisition. Due to the ambiguity of the coverage and applicability of 7, in 1950 the US Congress amended s 7 to contain an assets-acquisition clause.<sup>37</sup> The Supreme Court analysed the legislative history and found that US Congress intended to include bank mergers within s 7 in order to close the ambiguity.<sup>38</sup> The court concluded<sup>39</sup> that the US Congress aimed to give s 7 a wide coverage to include a variety of ‘corporate amalgamations’, from genuine assets acquisitions to genuine stock acquisitions. The court found<sup>40</sup> that when the relevant provisions on assets acquisitions and stock-acquisitions are read together, merger transactions would be covered under s 7.

The court, further, pointed out<sup>41</sup> that any other construction of s 7 would fail to give effect to the evident congressional motive for amending s 7 of the Clayton Act; any other construction would only serve to create ambiguity in a law intended to resolve an ambiguity. The Supreme Court explained that it was undisputed that the stock-acquisition clause of s 7 would cover any enterprises involved in commerce, including banks.<sup>42</sup> The court maintained that the provision on the stock-acquisition incorporated all means of indirect and direct acquisition transactions, containing also consolidation and merger transactions.<sup>43</sup> The FTC has jurisdiction over such acquisition transactions. The court applied s 7 and, in so doing,

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<sup>34</sup> *Philadelphia National Bank* (n9), p 336.

<sup>35</sup> *Ibid*, p 337.

<sup>36</sup> *Ibid*, pp 338-339.

<sup>37</sup> *Ibid*, p 340.

<sup>38</sup> *Ibid*, pp 341-342.

<sup>39</sup> *Ibid*, pp 348-349.

<sup>40</sup> *Ibid*, p 349.

<sup>41</sup> *Ibid*, p 344.

<sup>42</sup> *Ibid*, p 345.

<sup>43</sup> *Ibid*, p 346.

rejected the argument that the stock acquisition provision in s 7 did not cover bank merger transactions.<sup>44</sup>

The US Supreme Court, also, noted the interaction between the BMA and the Clayton Act.<sup>45</sup> The Philadelphia National Bank and Girard Trust Corn Exchange Bank argued that the BMA authorized banking regulators to take into account competitive aspects prior to a bank merger being authorized, thus, immunizing authorized merger cases from oppositions pursuant to the American competition legislation.<sup>46</sup> The court dismissed this argument and affirmed that the BMA did not provide any express immunity.<sup>47</sup> Moreover, the court found that the BMA did not prevent the applicability of s 7 to a bank merger transaction.<sup>48</sup> Nonetheless, the court stated that the applicability of the Clayton Act did not reduce the scope or applicability of the BMA.<sup>49</sup> The court, too, clarified that the Clayton Act and the BMA complimented each other, and one was not the prerequisite of the application of the other.<sup>50</sup>

The court went on to discuss the implementation of s 7 of the Clayton Act,<sup>51</sup> analysing the pertinent market of the banks with a view to assess whether there was, in fact, a competitive overlapping, and whether such overlapping should cause a competitive effect within the market.<sup>52</sup> The US Supreme Court indicated<sup>53</sup> that an analysis of anti-competitive outcomes of a merger need not be an assessment of the instant effect of the merger on competition, but a forecast of its effect over competitive situations in the future. This is what was intended by the amended s 7 of the Clayton Act, which was meant to catch anti-competitive propensities concerning their 'incipiency'.<sup>54</sup> The US Supreme Court consequently concluded that a bank merger scrutinized closely in accordance with the spirit of s 7 of the Clayton Act, averting likely anti-competitive outcomes, when the bank merger is submitted and in consideration of any forthcoming consequences.<sup>55</sup> In the end, the Court reversed the

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<sup>44</sup> *Ibid*, pp 347-348.

<sup>45</sup> *Ibid*, p 350.

<sup>46</sup> *Ibid*, p 351.

<sup>47</sup> *Ibid*, p 352.

<sup>48</sup> *Ibid*, p 353.

<sup>49</sup> *Ibid*, p 354.

<sup>50</sup> *Ibid*, p 355.

<sup>51</sup> *Ibid*, pp 356-358.

<sup>52</sup> *Ibid*, pp 359-362.

<sup>53</sup> *Ibid*, pp 363-366.

<sup>54</sup> *Ibid*, pp 367-369.

<sup>55</sup> *Ibid*, pp 370-371.

lower court's judgment, and remanded the case with direction to enter judgment enjoining the proposed merger.<sup>56</sup>

The importance of the 1963 *Philadelphia National Bank* Supreme Court's ruling is that it held that banks are subject to the antitrust laws in their merger activities and that banking is essentially a local business.<sup>57</sup>

## 8.2 Other important Supreme Court and federal court case laws related to bank mergers

Following the *Philadelphia National Bank* ruling,<sup>58</sup> federal courts along with the US Supreme Court reviewed several bank merger cases that have important impact to antitrust policies in bank mergers. Some of these case law court decisions attempted to divert from the findings of the Supreme Court in *Philadelphia National Bank*. Below is a discussion of several of these case law court decisions.

### 8.2.1 Supreme Court case laws

#### a) *United States v First National Bank and Trust Co. of Lexington*

In 1962, the Department of Justice ('DOJ') filed a lawsuit against First National Bank and Trust Co of Lexington et al, in the federal court,<sup>59</sup> requesting from the court to prohibit the merger between banks (First National Bank and Trust Co. with Security Trust Co.) in Lexington, State of Kentucky pursuant to the Sherman Act due to issues concerning the application of s 7 towards a bank merger.<sup>60</sup> That legal action, *First National Bank & Trust Co. of Lexington*, went before the US Supreme Court<sup>61</sup> in the court's term subsequent to the *Philadelphia National Bank* decision.<sup>62</sup> The court did not hesitate to reverse the

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<sup>56</sup> *Ibid*, p 372.

<sup>57</sup> *Ibid*, p 325.

<sup>58</sup> *Philadelphia National Bank* (n9),

<sup>59</sup> *United States v First Nat'l Bank & Trust Co.* (1962) 208 F. Supp. 457 (E.D. Ky.).

<sup>60</sup> *Ibid*.

<sup>61</sup> *United States v First National Bank and Trust Co of Lexington et al* (1964) 376 US 665 ('First National Bank of Lexington').

<sup>62</sup> *Philadelphia National Bank* (n9), p 372.

federal (lower) court's ruling and vacated the bank merger pursuant to s 1 of the Sherman Act despite the lack of precautionary wording of the Clayton Act.<sup>63</sup>

The bank merger concerned the first and fourth biggest banks in Fayette County in the State of Kentucky that gave rise to a bank dominating approximately fifty-two per cent of the area's deposits and assets.<sup>64</sup> The court reviewed previous cases involving railroad and ruled pursuant to the Sherman Act in determining that the bank merger satisfied the prevention of trade criterion.<sup>65</sup> Among these previous cases, the Court put more analytical consideration on the *United States v Columbia Steel Co.* case.<sup>66</sup> Justice Douglas, for the majority of the court, dismissed the *Columbia Steel* case, which he had accordingly strongly dissented.<sup>67</sup> In particular, he noted that while the *Columbia Steel* decision should be narrowed to its particular facts, there was insufficient clarification in the judgment as to what those distinctive particulars were.<sup>68</sup> Alternatively, he extracted a number of components mentioned in the *Columbia Steel* case that supported an undue constraint of trade finding, and ruled that in the current case all those components evidently indicated the other way.<sup>69</sup>

The Supreme Court made clear that commercial banking would continue to be a relevant market.<sup>70</sup> Since the majority of the Court held that the merger concerned in the case was unlawful with the market so determined, the Court did not see the need to determine whether the services of the trust department constituted an additional relevant market.<sup>71</sup>

In 1966, on the aftermath of the *First National Bank and Trust Co. of Lexington* rulings, the US Congress showed its discontent with the court's ruling, and the Congress shed light on the Clayton Act's application to bank merger cases by amending the Bank Merger Act 1960.<sup>72</sup> The main effect of the Act was to relief actual bank mergers, covering even those

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<sup>63</sup> *First National Bank of Lexington* (n61), pp 672-673.

<sup>64</sup> *Ibid*, p 666.

<sup>65</sup> E.g., *United States v Columbia Steel Co.* (1948) 334 US 495 ('Columbia Steel Co'); *United States v Southern Pacific Company* (1922) 259 US 214; *United States v Reading Co.* (1920) 253 US 26.

<sup>66</sup> *First National Bank of Lexington* (n61), pp 669-673.

<sup>67</sup> *Ibid*, p 670.

<sup>68</sup> *Ibid*, p 671.

<sup>69</sup> *Ibid*, p 672.

<sup>70</sup> *Ibid*. pp 666-668.

<sup>71</sup> *Ibid*. pp 667.

<sup>72</sup> *Bank Merger Act* (n4).



bank mergers under pending government commenced lawsuits, from s 7 of the Clayton Act and s 1 of the Sherman Act.<sup>73</sup>

The Bank Merger Act 1960, as amended in 1966,<sup>74</sup> indicated that future bank mergers would be subject to the Clayton Act inquiry, except where the likely public interest resulting to the transaction clearly prevails over their anti-competitive outcomes in satisfying the needs of the community the bank serves.<sup>75</sup>

b) *United States v First City Bank of Houston*

While it appears that the Bank Merger Act,<sup>76</sup> may have given rise to a new defence for the advocates of a bank merger, the US Supreme Court led by Justice Douglas quickly reduced the scope and applicability of the defence. For instance, in the 1967 case, *United States v First City Bank of Houston*,<sup>77</sup> the Court determined the public interest arising out of the Bank Merger Act.<sup>78</sup> Writing for the Court, Justice Douglas opined that the burden of proof to establish the public interest defence rested on the banks intending to enter into merge.<sup>79</sup> Although the Bank Merger Act sought the Office of the Comptroller of the Currency to look the anti-competitive outcomes of a bank merger should be clearly offset by the likely public interest resulting from the merger undertaking in satisfying the needs and suitability of the community in which they render banking services, Justice Douglas concluded that the US Congress envisaged that review by the courts be *de novo*.<sup>80</sup> According to Justice Douglas, that meant an independent resolution of the points at issue by the reviewing court.<sup>81</sup>

Therefore, Justice Douglas rejected the reasoning that the judiciary should uphold an administrative decision by the regulator unless it is not supported by important evidence.<sup>82</sup>

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<sup>73</sup> E.g., *United States v Third National Bank in Nashville* (1968) 390 US 171, p 177.

<sup>74</sup> *Bank Merger Act* (n4).

<sup>75</sup> *Ibid*, §1828(c).

<sup>76</sup> *Bank Merger Act* (n4).

<sup>77</sup> *United States v First City National Bank of Houston* (1967) 386 US 361 ('First City Bank of Houston').

<sup>78</sup> *Ibid*, pp 363-366.

<sup>79</sup> *Ibid*, p 366.

<sup>80</sup> *Ibid*, pp 367-370.

<sup>81</sup> *Ibid*, pp 362, and 368.

<sup>82</sup> *Ibid*, pp 370-371.

c) *United States v Third National Bank in Nashville*

In the 1968 case, *United States v Third National Bank in Nashville*,<sup>83</sup> the court implemented the *de novo* review enumerated in the *First City Bank of Houston* case,<sup>84</sup> and overruled a district court decision<sup>85</sup> that endorsed the merger between the fourth and the second biggest banks in Nashville, the capital of the State of Tennessee.<sup>86</sup> The court affirmed that the purpose and objective of the legislators in passing the Bank Merger Act was to implement significant variations in the legislation appurtenant to bank mergers.<sup>87</sup> However, the court determined that it was unrestricted by an administrative specification about the suitability and prerequisites of the community.<sup>88</sup> Based on the court's findings, the defending bank needs to demonstrate that it cannot match the community's suitability and requires prerequisites in the absence of taking over with a competitor.<sup>89</sup>

The *Third National Bank in Nashville* case gave an occasion for the US Supreme Court to bring the Bank Merger Act in line and consistency with the *Philadelphia National Bank* decision. Absent further elaboration, the Supreme Court noted that commercial banking remained to be the relevant product market.<sup>90</sup> The court affirmed that the Bank Merger Act did not alter the criteria for resolving the issue about a merger whether or not is competitive.<sup>91</sup> Instead, the Act employed a 'convenience and needs'<sup>92</sup> assessment method while the authorities analyse competitive or non-competitive results of a bank merger.

The courts, like in the *First City Bank of Houston* case<sup>93</sup> and the *Third National Bank in Nashville* case,<sup>94</sup> continued to employ the criteria set out by the Warren court in relation to the s 7 of the Clayton Act assessment to a bank merger, unaffected by the enactment of the

<sup>83</sup> *United States v Third National Bank in Nashville* (1968) 390 US 171 ('Third National Bank in Nashville').

<sup>84</sup> *First City Bank of Houston* (n77).

<sup>85</sup> *United States v Third National Bank of Nashville* (1966) 260 F. Supp. 869 (M.D. Tenn.).

<sup>86</sup> *Ibid*, pp 883-884.

<sup>87</sup> *Third National Bank in Nashville* (n83), p 177.

<sup>88</sup> *Ibid*, p 178.

<sup>89</sup> *Ibid*, pp 184-192.

<sup>90</sup> *Ibid*, p 183.

<sup>91</sup> *Ibid*, p 178.

<sup>92</sup> *Ibid*.

<sup>93</sup> *First City Bank of Houston* (n77).

<sup>94</sup> *Third National Bank in Nashville* (n83).

Bank Merger Act.<sup>95</sup> The court's reading of the suitability and prerequisites criteria, putting the burden of proof on the defendant to satisfy the criteria and indirectly requiring the administration to apply the criteria, did not cause any apparent change to the 'pure' competition enforcement of a bank merger pursuant to s 7 of the Clayton Act, regardless of the US congressional objective.<sup>96</sup> The court, consistent with the approach taken by the Warren court, clarified that it was not prepared to hand over the enforcement power of the Clayton Act to an administrative regulator without a clear authority from the US Congress.<sup>97</sup> In the end, the court reversed and remanded the case to the lower court, for the latter's reconsideration.<sup>98</sup>

d) *United States v Phillipsburg National Bank & Trust Co.*

In the 1970 case, *United States v Phillipsburg National Bank & Trust Co.*,<sup>99</sup> the US Supreme Court reaffirmed its position held in *Philadelphia National Bank*.<sup>100</sup>

In *Phillipsburg National Bank & Trust Co*, two small banks (Phillipsburg National Bank, and Second National Bank) in Phillipsburg, an inconsiderable industrial city in the State of New Jersey, intended to merge.<sup>101</sup> They filed a merger application and received approval from the Office of the Comptroller of the Currency.<sup>102</sup> In 1969 the Department of Justice filed a legal action against the foregoing merging banks, in the federal court, to admonish the bank merger for violating s 7 of the Clayton Act.<sup>103</sup>

The federal court followed an analysis, based on an arranged product market as in the courts in previous cases, such as, the *Provident National Bank* case.<sup>104</sup> However, the US Supreme Court held that this examination was flawed.<sup>105</sup> In an unusual brief and insufficiently

<sup>95</sup> E.g., *United States v Marine Bancorporation* (1973) 418 US 602.

<sup>96</sup> C P Rogers III et al, *Antitrust Law: Policy and Practice* (4th edn, Danvers: Matthew Bender 2008), p 533.

<sup>97</sup> *Third National Bank in Nashville* (n83), pp 190-192.

<sup>98</sup> *Ibid.*

<sup>99</sup> *United States v Phillipsburg National Bank & Trust Co* (1970) 399 US 350 ('Phillipsburg National Bank').

<sup>100</sup> *Ibid.*, pp 359-362; see, also, *Philadelphia National Bank* (n9), p 372.

<sup>101</sup> *Phillipsburg National Bank* (n99), p 354.

<sup>102</sup> *Ibid.*, pp 358-359.

<sup>103</sup> *United States v Phillipsburg National Bank & Trust Co* (1969) 306 F. Supp. 645 (D.N.J.) ('Phillipsburg National Bank, District Court'), p 646.

<sup>104</sup> *Ibid.*, pp 655-656.

<sup>105</sup> *Phillipsburg National Bank* (n99), pp 369-372.

articulated discussion on this particularly significant issue, the Court capriciously followed its approach taken in the *Philadelphia National Bank* case.<sup>106</sup>

Setting out the relevant circumstances of the merger case, the US Supreme Court noted that although lower (federal) courts deal with cases involving smaller banks as the subject of the merger, these banks supplied a vast spectrum of products and services accessible at the level of commercial banks.<sup>107</sup> These products and services comprise of savings deposits, demand deposits, industrial and commercial loans, consumer loans, safe deposit boxes, and real estate mortgages.<sup>108</sup>

The lower court concluded that the banks in question were functionally more similar to savings and loan associations than large commercial banks.<sup>109</sup> Therefore, the court adopted an approach that looked at submarkets in a broad product market.<sup>110</sup> In its ‘submarkets’ analysis the court included banks, savings and loan associations, mutual funds, pension funds, and insurance companies and focused on the submarket concerning to thrifts.<sup>111</sup>

The submitted merger banks have an area of focus in real estate and mortgage loans. They had a little portion of demand to entire deposits, and were directed to small borrowers and depositors.<sup>112</sup> The merging banks seemed to be closer to thrift institutions instead of big banks.<sup>113</sup>

Notwithstanding the foregoing characteristic, the US Supreme Court found that a ‘submarket’ review was flawed.<sup>114</sup> The Court noted that banking continued to sustain an important part of the economy with the numerous services and products concerned.<sup>115</sup> The Court failed to emphasize the position of demand deposit accounts, which was a significant

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<sup>106</sup> *Ibid*, pp 359-362.

<sup>107</sup> *Ibid*, p 360.

<sup>108</sup> *Ibid*, p 361.

<sup>109</sup> *Phillipsburg National Bank, District Court* (n103), pp 649-650.

<sup>110</sup> *Ibid*, p 646.

<sup>111</sup> *Ibid*.

<sup>112</sup> *Ibid*, p 648.

<sup>113</sup> *Ibid*, p 650.

<sup>114</sup> *Phillipsburg National Bank* (n99), p 370.

<sup>115</sup> *Ibid*, pp 360-362.

piece of fact in the *Philadelphia National Bank* case.<sup>116</sup> Nevertheless, it observed a superseding economic importance in the suitability of ‘one-stop shop’ effect in banking.<sup>117</sup> The Court left open the question of whether or not a customer who lacks resources possessed a better opportunity to succeed to get quicker and easier a loan from a bank instead of a non-bank financial institution.<sup>118</sup>

Chief Justice Burger and Justice Harlan differed in part from the majority and were strongly scathing over the majority’s oversimplified and convenient setting forth of *Philadelphia National Bank*.<sup>119</sup>

The minority justices opined that the current court shunned the whole review of the configuration of the services and products presented by merging banks.<sup>120</sup> As a result, the majority overlooked entirely how competition from mutual savings banks, savings and loan entities, and other financial institutions that are not commercial banks influence the market strength of the merging banks.<sup>121</sup>

In the end, the US Supreme Court reversed the lower court’s judgement in favour of the defendants, as well as remanded the case for consideration to the lower court to decide whether the public interest factors outweighed the adverse competitive effects.<sup>122</sup>

e) *United States v Connecticut National Bank*

The 1973 federal court case in *United States v Connecticut National Bank*<sup>123</sup> did not follow the *Phillipsburg National Bank & Trust Co*<sup>124</sup> with the financial and economic situation within the State of Connecticut or with the US Supreme Court’s nonbanking rulings.<sup>125</sup> In reviewing the decision in *Phillipsburg National Bank*, the federal court noted that the Supreme Court’s

<sup>116</sup> *Philadelphia National Bank* (n9), pp 356-357.

<sup>117</sup> *Phillipsburg National Bank* (n99), p 369.

<sup>118</sup> *Ibid*, p 367.

<sup>119</sup> *Ibid*, pp 373-378.

<sup>120</sup> *Ibid*, pp 379-381.

<sup>121</sup> *Ibid*, pp 381-382.

<sup>122</sup> *Ibid*, p 373.

<sup>123</sup> *United States v Connecticut National Bank* (1973) 362 F. Supp. 240 (D. Conn.) (‘Connecticut National Bank, (District Ct)’).

<sup>124</sup> *Phillipsburg National Bank* (n99).

<sup>125</sup> *Connecticut National Bank (District Ct)* (n123), pp 246-247, and 279-280.

assertions in *Philadelphia National Bank* and *Phillipsburg National Bank* were not meant to be stagnant, firm and quick rules that required later courts to ignore the reality of competition in any given situation.<sup>126</sup>

In *Connecticut National Bank*, five commercial banks, a savings bank, the federal banking regulators along with the State Banking Commission of Connecticut concurred that savings banks had become competitors of commercial banks.<sup>127</sup> Even the DOJ, during the trial, admitted that competition between savings and commercial banks had increased steadily from the time of the *Philadelphia National Bank* ruling.<sup>128</sup> The federal court took note of the then latest legislative changes that showed a national tendency to more similar controls between thrift institutions and banks.<sup>129</sup> The evidence presented at trial revealed the undisputable reality that commercial and savings banks were competing in full extent of at minimum five product lines, namely, real estate mortgages, IPC deposits,<sup>130</sup> personal checking, personal loans and commercial loans.<sup>131</sup> In the end, the district court agreed that savings banks (defendants) should be included in the consideration of the lines of commerce and upheld the submitted bank merger transaction.<sup>132</sup>

During the plaintiff's appeal, the US Supreme Court rejected the lower court's findings in relation to the line of commerce.<sup>133</sup> The majority acknowledged some of the loopholes left unresolved in the *Phillipsburg National Bank* decision.<sup>134</sup> The Court, also, acknowledged a remark initially made in a footnote in the decision of *Third National Bank in Nashville*.<sup>135</sup> For the first time, the court expressly found that the lack of any line of commerce definition under the Bank Merger Act did not affect criteria set out in s 7 of the Clayton Act in relation to the characterization of a product market.<sup>136</sup> The court found that reality of the banking field within the State of Connecticut did not clearly distinguish between commercial and savings banks and, thus, the only conclusion that could be drawn from the banking reality

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<sup>126</sup> *Ibid*, pp 280-281.

<sup>127</sup> *Ibid*, pp 242-244.

<sup>128</sup> *Ibid*, pp 244, 250, and 269.

<sup>129</sup> *Ibid*, pp 246-248.

<sup>130</sup> The 'IPC deposits' is an acronym for deposits of individuals, partnerships, and corporations.

<sup>131</sup> *Connecticut National Bank (District Ct)* (n123), p 280.

<sup>132</sup> *Ibid*, pp 285, and 288.

<sup>133</sup> *United States v Connecticut National Bank* (1974) 418 US 656 ('Connecticut National Bank (Sup Ct)').

<sup>134</sup> *Ibid*, pp 660-666.

<sup>135</sup> *Third National Bank in Nashville* (n548), pp 182, and fn 15.

<sup>136</sup> *Connecticut National Bank (Sup Ct)* (n133), p 663.

would be commercial banking being the line of commerce.<sup>137</sup> In arriving at such conclusion, the Supreme Court was left with no choice but to unbundle its own cluster of product market in commercial banking.<sup>138</sup>

In Connecticut, the savings banks provided most aspects of the banking cluster.<sup>139</sup> However, the US Supreme Court was unconvinced that these savings banks epitomized significant competition since they offered fairly limited short-term enterprise loans.<sup>140</sup> Moreover, the savings banks did not issue or render loans for securities purchases, investment services, credit cards, and letters of credit. The failure to provide these products and services was considered important. However, not every commercial bank within the State of Connecticut provided the whole gamut of characteristic products of commercial banking. While the US Supreme Court rejected the inclusion of thrift institutions in the commerce's line in *Connecticut National Bank*, the court left open the possibility of including thrift institutions in future cases.<sup>141</sup>

In the end, the Court vacated the judgment of the lower court, in favour of the plaintiff, as well as remanded the case to the lower court for further consideration consistent with the Supreme Court's opinion.<sup>142</sup>

### 8.2.2 Federal district court case laws

Besides the Supreme Court's decisions on the antitrust aspects of bank merger case laws, some of which are discussed in the foregoing subchapter, the federal district courts have, also, played an important role in shaping the antitrust policies in bank mergers. Below is a discussion of some important case law rulings made by the federal courts pertaining to bank merger antitrust issues.

#### a) *United States v Manufacturers Hanover Trust Co.*

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<sup>137</sup> *Ibid*, p 664.

<sup>138</sup> *Ibid*, pp 665-666.

<sup>139</sup> *Ibid*, p 667.

<sup>140</sup> *Ibid*, p 668.

<sup>141</sup> *Ibid*, pp 669-670.

<sup>142</sup> *Ibid*, p 673.

In the 1965 case, *United States v Manufacturers Hanover Trust Co.*,<sup>143</sup> the Department of Justice brought a legal action seeking divestiture subsequent to the merger of the *Hanover Bank*, a wholesale bank, and *Manufacturers Trust Company*, a retail bank.<sup>144</sup> The district court relied on the ruling in *Philadelphia National Bank*<sup>145</sup> that, in order to preclude the competitive effect of a bank merger, there should be a definite comprehension of the relevant market's structure.<sup>146</sup>

The district court denied the Department of Justice's assertion that seven specific banking services should be regarded as submarkets.<sup>147</sup> Instead, it embraced a bit refined reading of the *Philadelphia National Bank* cluster approach.<sup>148</sup>

The district court in the end inferred that while favouring the easy direction, draining the hard work, complicated, evasive and piecemeal the evidence, seeking intelligible tests, or facing considerable pressure for speedy resolution and bulk production,<sup>149</sup> it needs to closely look through the distinctiveness of commercial banking in New York City.<sup>150</sup> Once the court employed this approach, it discovered that retail and wholesale banking appeared seamlessly in upright boundaries of commerce<sup>151</sup> and that both were within the limits of *Philadelphia National Bank*. The district court, however, did not address a point raised in the *Philadelphia National Bank* case that non-bank competition would not need to be considered when reviewing a bank merger.<sup>152</sup>

b) *United States v Croker-Anglo National Bank*

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<sup>143</sup> *United States v Manufacturers Hanover Trust Co.* (1965) 240 F. Supp. 867 (S.D.N.Y.).

<sup>144</sup> *Ibid*, pp 876-877.

<sup>145</sup> *Philadelphia National Bank* (n9), p 372.

<sup>146</sup> *Ibid*, p 887.

<sup>147</sup> *Ibid*, p 895.

<sup>148</sup> *Ibid*, p 896.

<sup>149</sup> *Ibid*, p 899.

<sup>150</sup> *Ibid*, pp 900-901.

<sup>151</sup> *Ibid*, pp 933-940.

<sup>152</sup> *Ibid*, p 956.



In the 1967 case, *United States v Crocker-Anglo National Bank*,<sup>153</sup> while relying on the letter and spirit of the Bank Merger Act,<sup>154</sup> a federal district court overruled the standard set in the *Philadelphia National Bank* case.<sup>155</sup>

The district court noted that the Bank Merger Act demanded a broader test due to the fact that the legislation did not include the catchphrase in ‘any line of commerce’.<sup>156</sup> It, also, acknowledged that members of the US Congress who advocated forcefully in favour of the Bank Merger Act maintained that the courts and the banking regulators are not allowed to handpick handful single, perhaps minor, facet of the banks’ business and claim that, since there is some decreasing of competition in this particular component of the business, the rise in the overall competition throughout the whole sector of banking and in the larger sector of financial institutions remain immaterial and would not be counted.<sup>157</sup>

The federal district court recognized that demand deposits, which are distinctive to the business of banking, were simply the kind of ‘minor aspect’ for which the aforementioned group of congressional members referred to.<sup>158</sup>

The district court, likewise, noted the viewpoints or positions expressed by other US congressional members that commercial banks face severe competition from other financial institutions, like mutual savings banks, savings and loan associations, finance companies, and insurance companies.<sup>159</sup> If the competition and banking regulators, and the courts, would neglect any one of these characteristics of competition, it would be highly impractical and could potentially reduce financial competition.<sup>160</sup>

The corroboration in the present action supported a finding that nonbank financial competitors rendered ‘effective economic substitutes’<sup>161</sup> throughout the rightfully distinctive

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<sup>153</sup> *United States v Crocker-Anglo National Bank* (1967) 277 F. Supp.133 (N.D.Cal.) (‘Crocker-Anglo National Bank’).

<sup>154</sup> *Bank Merger Act* (n4), §1828(c).

<sup>155</sup> See generally, *Philadelphia National Bank* (n9).

<sup>156</sup> *Crocker-Anglo National Bank* (n153), pp 154-155.

<sup>157</sup> *Ibid*, p 155.

<sup>158</sup> *Ibid*.

<sup>159</sup> *Ibid*, p 156.

<sup>160</sup> *Ibid*.

<sup>161</sup> *Ibid*, Note 12.

service of demand deposit from banks. The federal district court affirmed that the cluster approach was precisely what the Bank Merger Act intended to remedy, and thus, overruled it.<sup>162</sup>

Nonetheless, viewing the California financial market as a whole, the district court closely considered the services of credit unions, savings and loan associations, insurance companies, and finance companies to be part of the same market.<sup>163</sup> The eventual decision in the present legal action depended on the lack of any opposing result on concrete or possible competition in banking sector.

c) *United States v Provident National Bank*

In the 1968 case, *United States v Provident National Bank*,<sup>164</sup> two banks (the Provident National Bank and the Central-Penn National Bank) in Philadelphia, State of Pennsylvania, planned to merge with each other.<sup>165</sup> Apart from the usual advantages that the merger could provide to Philadelphia and its banking and business environment, the federal district court opposed the bank merger, finding it to violate the antitrust laws *i.e.*, the Bank Merger Act.<sup>166</sup> While rejecting the proposed merger transaction,<sup>167</sup> the Court concurred with the US Supreme Court's examination of the product market under the Bank Merger Act in the *Third National Bank in Nashville* case.<sup>168</sup>

The federal district court indicated that particularly in the concentrated market in Philadelphia, the financial services sector had sustained major transformations, since the ruling of the *Philadelphia National Bank* case.<sup>169</sup> In particular, the figures showed that it was no longer correct that commercial banks benefited from a resolved consumer inclination about their savings sums.<sup>170</sup> The Court saw sensible evocative and interchange ability competition for the consumers' savings sums and mortgage loans between commercial banks and thrift

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<sup>162</sup> *Ibid*, p 200.

<sup>163</sup> *Ibid*, pp 174-175.

<sup>164</sup> *United States v Provident National Bank* (1968) 280 F. Supp. 1 (E.D. Pa.) ('Provident National Bank').

<sup>165</sup> *Ibid*, p 4.

<sup>166</sup> *Ibid*, pp 24-26.

<sup>167</sup> *Ibid*, p 26.

<sup>168</sup> *Ibid*, pp 20-21.

<sup>169</sup> *Ibid*, pp 6, 11, 14, and 16.

<sup>170</sup> *Ibid*, pp 14-15.

institutions.<sup>171</sup> In the end, the Court noted that thrift institutions had to be included in the examination.<sup>172</sup> Meanwhile, the same court overruled competition from finance enterprises, insurance enterprises, and the similar due to the fact that they appeared to be too different from the business of banking.<sup>173</sup>

The position taken by the federal district court in the *Provident National Bank* case was that the distinctiveness of the banking sector was specifically the very fact that had made the *Philadelphia National Bank* approach one-dimensional.<sup>174</sup>

d) *United States v Chelsea Savings Bank*

The issue submitted in the 1969 case of *United States v Chelsea Savings Bank*<sup>175</sup> was whether s 7 of the Clayton Act is applicable to non-stock mutual savings banks.<sup>176</sup>

The *Chelsea Savings Bank* and the *Dime Savings Bank*, both mutual savings banks, located in the City of Norwich, and state (Connecticut) chartered, executed a consolidation agreement.<sup>177</sup> The Federal Deposit Insurance Corporation and the Banking Commission of the State of Connecticut authorized the submitted consolidation.<sup>178</sup>

The US Government (plaintiff) moved to reverse the submitted consolidation on the basis that the merger deemed to violate s 7 of the Clayton Act and s 1 of the Sherman Act.<sup>179</sup>

The Court held that the US Congress intended s 7 of the Clayton Act to cover mergers and, thus, resolve any ambiguity in the section.<sup>180</sup> The US Congress intended that the amendment in the Clayton Act would clarify the scope of applicability of s 7, such that it would cover the whole variety of corporate amalgamations, from acquisitions of stocks to

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<sup>171</sup> *Ibid*, p 14.

<sup>172</sup> *Ibid*, p 15.

<sup>173</sup> *Ibid*, p 9.

<sup>174</sup> *Ibid*, pp 10-12.

<sup>175</sup> *United States v Chelsea Savings Bank* (1969) 300 F. Supp. 721 (D. Conn.) ('Chelsea Savings Bank').

<sup>176</sup> *Ibid*, p 722.

<sup>177</sup> *Ibid*.

<sup>178</sup> *Ibid*, p 723.

<sup>179</sup> *Ibid*, p 722.

<sup>180</sup> *Ibid*.

acquisitions of assets. Therefore, the assets and stocks acquisitions provisions respectively should be read together and catch merger transactions that do not fall squarely into the category of assets acquisitions or stocks acquisitions.<sup>181</sup>

The Court disagreed with the defendant banks' claim, which sought to limit the ruling in the *Philadelphia National Bank* case to mergers concerning stock enterprises. The defendants, further, contended that the statutory consolidation of non-stock corporations, like the one in the present action, is outside the reach of s 7 of the Clayton Act.<sup>182</sup> In disagreeing with these assertions from the defendants, the court indicated that it was correct that the *Philadelphia National Bank* case concerned the merger of two commercial banks.<sup>183</sup> However, nothing would support a ruling that restricted the applicability of the decision to amalgamations of banks that issue stock. The court, specifically, cautioned against any elusive corporate ploys aimed at circumventing s 7 of the Clayton Act. In this regard, it noted that it is correct that an exchange of its stock for assets could attain the acquiring bank's goals.<sup>184</sup>

The Court looked at the fact that the ensuing bank, the Chelsea-Dime Savings Bank, intended to carry on operations in a way that the Chelsea bank's facility would become its principal office and the Dime banks' would be its branch office, including one board of directors in charge to manage the business operations of the new bank.<sup>185</sup> The foregoing led the court to rule that the consolidation deemed to be equal in its results to a merger.<sup>186</sup> Therefore, the merger needs to be assessed with the criteria set out in s 7 of the Clayton Act.<sup>187</sup>

The Court, also, looked at the differences between a mutual savings bank and a stock bank. It found that any different corporate structure between the forgoing institutions would be relevant within the meaning of s 7 of the Clayton Act. A savings bank accepts monies in

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<sup>181</sup> *Ibid.*

<sup>182</sup> *Ibid.*, p 723.

<sup>183</sup> *Ibid.*

<sup>184</sup> *Ibid.*

<sup>185</sup> *Ibid.*, p 724.

<sup>186</sup> *Ibid.*

<sup>187</sup> *Ibid.*

trust, and the deposit holders are positioned in the similar rapport to the bank like the stockholders in an ordinary bank.<sup>188</sup>

The Court, further, noted that the competitive effects of the proposed merger should be subject to an analysis under s 7 of the Clayton Act because the defendant banks intended to acquire the ‘share capital’ of each other that has the same effect as a merger.<sup>189</sup>

In the end, the Court concluded that the present action like any other bank merger ought to be subject to coherent antitrust conduct pursuant to s 7 of the Clayton Act, regardless of whether the banks involved issue stock.<sup>190</sup>

e) United States v Idaho First National Bank

The federal court, in the 1970 case, *United States v Idaho First National Bank*,<sup>191</sup> favoured the argument of the ‘many additional so-called lines of commerce’ that the US Supreme Court in *Philadelphia National Bank* deemed undesirable.<sup>192</sup>

The federal court argued that the preceding cases appeared to be particular on their facts.<sup>193</sup> Those cases dealt with banking operations in highly inhabited metropolitan parts instead of what the present case concerned, namely the rural atmosphere of Twin Falls city and the Magic Valley region in the State of Idaho.<sup>194</sup> The court engaged in what it defined as a practical bottom line examination<sup>195</sup> and took a submarket approach in order to determine the relevant product market.<sup>196</sup> The court, also, noted that demand deposits remained constantly an adequate line of commerce.<sup>197</sup> Moreover, the court, also, found<sup>198</sup> that banks in the relevant market area compete among themselves to provide products and services, except for demand

<sup>188</sup> *Lippitt v Ashley* (1915) 89 Conn. 451, 488, 94 A. 995, 1016.

<sup>189</sup> *United States v Chelsea Savings Bank* (n175), p 724.

<sup>190</sup> *Ibid.*

<sup>191</sup> *United States v Idaho First National Bank* (1970) 315 F. Supp. 261 (D. Idaho) (‘Idaho First National Bank’).

<sup>192</sup> *Ibid.*, p 266; *Philadelphia National Bank* (n9), p 363.

<sup>193</sup> *Idaho First National Bank* (n191), p 266.

<sup>194</sup> *Ibid.*, pp 263-264.

<sup>195</sup> *Ibid.*, p 268.

<sup>196</sup> *Ibid.*

<sup>197</sup> *Ibid.*, pp 267-268.

<sup>198</sup> *Ibid.*

deposits. There is cross-elasticity of demand for such products and services. Every product or service where banks would compete is also a proper line of commerce.<sup>199</sup>

The federal court acknowledged that commercial banks in the city of Twin Falls market faced competition from a series of nonbank suppliers of financial services and products.<sup>200</sup> Some of these services and products included interest held deposits, commercial and residential real estate loans, farm real estate and farming production loans, education loans, and additional consumer loans.<sup>201</sup> The court did not find any evidence that the merger would tend to substantially lessen competition in any line of commerce in any geographic area relevant to this case.<sup>202</sup> As a result, the action was dismissed and the merger was allowed to be consummated.<sup>203</sup>

f) *United States v First National Bancorporation*<sup>204</sup>

In 1971 case *United States v First National Bancorporation*,<sup>205</sup> the district court embraced the cluster as articulated by the court in *Philadelphia National Bank*.<sup>206</sup> It defended the cluster method with evidence on the presence of nonbank financial institution competitors in the City of Greeley, State of Colorado, market.<sup>207</sup> The Department of Justice sought a possible line of commerce, specifically; correspondent banking that was within the sphere of commercial banking. The court reviewed cases involving nonbanking institutions, namely, *Du Pont*<sup>208</sup> and *Brown Shoe*<sup>209</sup>, in reviewing the hypothetical alternative of banking submarkets.<sup>210</sup> However, the court found the foregoing nonbanking related cases unhelpful due to the fact that the bundle of services defined as ‘correspondent banking’ depended vastly from bank to bank.<sup>211</sup>

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<sup>199</sup> *Ibid*, p 267.

<sup>200</sup> *Ibid*, pp 268 - 269

<sup>201</sup> *Ibid*, pp 269-271

<sup>202</sup> *Ibid*, pp 272-273

<sup>203</sup> *Ibid*, p 274.

<sup>204</sup> This case involved potential, not direct, competition, and arose under the *BMA* (n4).

<sup>205</sup> *United States v First National Bancorporation* (1971) 329 F. Supp. 1003 (D. Col.) (‘First National Bancorporation’).

<sup>206</sup> *Ibid*, pp 1011-1013.

<sup>207</sup> *Ibid*, p 1012.

<sup>208</sup> *United States v El DuPont de Nemours & Co*, (1956) 351 US 377.

<sup>209</sup> *Brown Shoe* (n20).

<sup>210</sup> *First National Bancorporation* (n205), pp 1016-1017.

<sup>211</sup> *Ibid*, pp 1016-1017.

In the end, the district court did not reach a conclusion on whether to consider the commercial banking bundle or the concurrent banking submarket remained the line of commerce.<sup>212</sup> It maintained that the submitted bank merger was not significantly reducing competition nor aimed at forming a monopoly provided under s 7 of the Clayton Act.<sup>213</sup> Thereafter, following the plaintiff's appeal to the Supreme Court, an evenly split Supreme Court<sup>214</sup> asserted its decision *per curiam*.<sup>215</sup> As a result, the ruling of the district (lower) court was upheld.

g) *United States v First National State Bancorporation*

In the 1980 bank merger case of *United States v First National State Bancorporation*<sup>216</sup>, in its analysis, the Court perceived a potential competition concern in the merger.<sup>217</sup> However, the Court found that there was a considerable group of likely banking entry participants within the relevant markets.<sup>218</sup> Therefore, the court added, such entry would erase any competition concern.<sup>219</sup> As a result, the loss of Bancorporation was going to be an inconsequential competitive happening.<sup>220</sup> The court eventually dismissed the bank merger dispute mainly due to competition boosting divestitures that was sought by the Office of the Comptroller of the Currency ('OCC'), as a prerequisite to the merger approval from the banking regulator (OCC).<sup>221</sup>

h) *United States v Central State Bank*

The DOJ's drive to transform bank merger regulation seems to have influenced its change in approach in the 1987 case *United States v Central State Bank*.<sup>222</sup> The change could be understood in relation to the facts. The two biggest banks (Central State Bank and State Savings Bank) in rural Benzie County in Michigan merged in order to hold over 60 per cent of

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<sup>212</sup> *Ibid*, p 1020.

<sup>213</sup> *Ibid*.

<sup>214</sup> Justice Powell took no part in the consideration or decision of this case.

<sup>215</sup> *United States v First National Bancorporation* (1973) 410 US 577.

<sup>216</sup> *United States v First National State Bancorporation* (1980) 499 F. Supp. 793 (D.N.J.).

<sup>217</sup> *Ibid*, pp 812-814.

<sup>218</sup> *Ibid*, pp 815-816.

<sup>219</sup> *Ibid*, p 816

<sup>220</sup> *Ibid*, p 817.

<sup>221</sup> *Ibid*, pp 797, 815, and 817.

<sup>222</sup> *United States v Central State Bank* (1985) 621 F. Supp. 1276 (W.D. Mich.).

the overall deposits.<sup>223</sup> Even though the defendants at first contended that non-depository and thrift institutions should be incorporated within the market,<sup>224</sup> it is doubtful that this argument had any bearing on the result because Benzie County did not have any thrift institutions; it only had two credit unions that were less than influential.<sup>225</sup> The only tenable argument that the defendants could put forward was to expand the geographic market to contain at minimum a second county, Grand Traverse County, comprising, as the specified location, Traverse City, a regional centre 40 miles off from one bank, and 32 miles off from the other bank. Between the two banks and Traverse City rests predominantly farm land.<sup>226</sup>

The issue before the District Court was whether the geography of one county would render reasonable to support a one-county market.<sup>227</sup> As separate issue were whether a customer would travel for about 45 minutes to carry out his or her banking needs, while alternate means were available.<sup>228</sup>

In the end, the Court entered a judgment in favour of the defendants,<sup>229</sup> holding that the geographic market comprised of Grand Traverse County.<sup>230</sup>

In arriving to its conclusion, the Court relied on three pieces of evidence.<sup>231</sup> First, a 1980 survey revealed that 17.2 per cent of Benzie County's inhabitants were employed in Grand Traverse County.<sup>232</sup> Second, a market census consisted of a poll of 400 individuals financed by the Traverse City newspaper revealed that nearly 30 per cent of Benzie County residents relied on a Grand Traverse supermarket as their only or main food place origin.<sup>233</sup> A further 27 per cent relied on it as an unimportant food place origin, and a considerable minority of Benzie County inhabitants had made their last clothing purchase in Traverse City.<sup>234</sup> Third, banks located in Grand Traverse County maintained 15.03 per cent of the

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<sup>223</sup> *Ibid*, pp 1280, and 1286.

<sup>224</sup> *Ibid*, defendants' trial brief, p 16.

<sup>225</sup> *Ibid*, plaintiff's appeal brief, p 5.

<sup>226</sup> *Ibid*, defendants' trial brief, pp 18-19.

<sup>227</sup> *Ibid*, pp 1289.

<sup>228</sup> *Ibid*.

<sup>229</sup> *Ibid*, p 1296.

<sup>230</sup> *Ibid*, pp 1294-1295.

<sup>231</sup> *Ibid*, pp 1292-1294.

<sup>232</sup> *Ibid*, p 1293.

<sup>233</sup> *Ibid*, pp 1280, and 1289.

<sup>234</sup> *Ibid*, p 1282.



deposits of Benzie County inhabitants.<sup>235</sup> Based on the foregoing, the court found that there was a possibility that Benzie inhabitants would visit the banks in Grand Traverse for banking products and services.<sup>236</sup>

From the foregoing case laws dealt by the Federal District Courts, it is determined that notwithstanding some efforts from the Courts to ‘divert’ from the *Philadelphia National Bank* ruling on the ‘cluster’ of banking products and services within a commercial banking line of commerce, and the applicability of antitrust laws to bank mergers, the Courts’ application of the *Philadelphia National Bank* in bank merger case laws remains unchanged.

### **8.3 Important bank merger transactions cleared by federal banking regulators**

The US antitrust and banking regulators review numerous bank merger cases that are eventually approved or denied. In the course of their review, regulators contribute in shaping the US bank merger policy regime. Some of the most important bank merger reviews that were cleared by the regulators, and without the US courts involvement, are discussed, below.

#### **a) Bankers Trust/Public Loan Co.**

In 1973, the Bankers Trust New York Corporation (‘Bankers Trust’),<sup>237</sup> a commercial bank, submitted an application with the Federal Reserve in order to purchase Public Loan Company, a sales and consumer finance enterprise.<sup>238</sup> The deal aimed at phasing out actual competition between the targeted finance enterprise and the applicant’s subsidiary. The Federal Reserve recognized the existence of two product submarkets, namely the direct consumer payment loans and personal loans no higher than \$1,400.<sup>239</sup> The Federal Reserve noted that consumer finance enterprises were a substitute basis for personal loans, loans to finance home improvements and buying automobiles, and additional loans conventionally offered by

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<sup>235</sup> *Ibid*, p 1293.

<sup>236</sup> *Ibid*, pp 1294-1295.

<sup>237</sup> *Public Loan Company*, 38 Federal Register 21822 (1973) (‘Fed Reg’73’).

<sup>238</sup> *Ibid*.

<sup>239</sup> Board of Governors of the Federal Reserve System (4 August, 1973) *H. 2 1973 No 31*, p 12, available at [https://fraser.stlouisfed.org/docs/releases/h2/h2\\_19730804.pdf](https://fraser.stlouisfed.org/docs/releases/h2/h2_19730804.pdf).

commercial banks.<sup>240</sup> The Federal Reserve, further, observed other granters of these loans include credit unions.<sup>241</sup>

The Federal Reserve did not support the position that finance entities remained entirely sheltered from bank competition because finance companies apportioned elevated-risk customers. As a result, the Federal Reserve rejected the takeover of Public Loan Company by Bankers Trust.<sup>242</sup>

b) *American Fletcher Corporation/Southwest S&L*

In 1974, in reviewing the applications for nonbank mergers by bank holding companies, the Federal Reserve, consistently, relied fully on the decision of *Phillipsburg National Bank Trust & Co.*<sup>243</sup> In the merger case of *American Fletcher Corporation/Southwest S&L*<sup>244</sup> the Federal Reserve rejected the merger of a savings and loan association for reasons not concerning competition. The regulator observed that banks and saving and loan associations are no longer as clearly distinguishable.<sup>245</sup>

The Federal Reserve, also, noted that the savings and loan associations and commercial banks historically became involved in financing of sales, purchases and housing construction along with additional real estate related transactions.<sup>246</sup>

c) *Chase-Manhattan/Chemical*

Viewed as a merger deal of equal participants; both Chase Manhattan Banking Corporation ('Chase Manhattan') and Chemical Banking Corporation ('Chemical') carried an affluent history of preceding acquisitions and mergers undertakings.<sup>247</sup> At the time of the merger, Chase Manhattan had become the sixth biggest financial institution in the US, and Chemical

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<sup>240</sup> *Ibid.*

<sup>241</sup> *Bankers Trust Corp*, 59 Federal Reserve Bulletin 694-95 (1973) ('FRB'73').

<sup>242</sup> *Fed Reg* '73 (n237) & *FRB* '73 (n241).

<sup>243</sup> *Phillipsburg National Bank* (n99).

<sup>244</sup> *American Fletcher Corp*, 60 Federal Reserve Bulletin 868 (1974).

<sup>245</sup> *Ibid*, p 869.

<sup>246</sup> *Ibid*, p 870.

<sup>247</sup> S Hansell, 'Banking's New Giant: The Deal; Chase and Chemical Agree to Merge in \$10 Billion Deal Creating Largest U.S. Bank' (29 August, 1995) *New York Times* ('Hansell').

bank had become the fourth biggest banking institution in the country.<sup>248</sup>

In 1996, the Chemical bank and Chase Manhattan entered into a merger, emerging as the biggest bank in the nation.<sup>249</sup> The consolidation was undertaken as a measure to enable both banks to maintain competitiveness in the international financial market.

Notwithstanding the resulted enormous concentration of assets, the *Chemical/Chase Manhattan* merger did not encounter any impediments from US competition and banking authorities.<sup>250</sup> To a certain extent, the only opposition arose from the community and consumer groups that raised their opposition to the fact the bank merger would precipitate in excessive costs in relation to bank services. They similarly opposed to the massive layoff due to the consolidation of networks and branches throughout the US. As a result, the community and consumer groups filed a court action against the Federal Trade Commission, the Federal Reserve, as well as the two banks and their holding companies on a likely violation of competitive provisions in one of the territories in which the merger bank was situated.<sup>251</sup>

Moreover, the community and consumer groups explicitly complained that the Federal Reserve had misconstrued the effect of the bank merger in its entirety.<sup>252</sup>

A relevant aspect in a bank merger review is to find out the market definition, extent, and concentration of the new bank subsequent to the submitted merger. Pursuant to the merger guidelines of the US competition and banking authorities, the target of measuring and determining the market is to equip a suitable review of the merger's possible concentration of market and the likely dominant results such concentration could create.<sup>253</sup> With the bank merger, the new Chase Manhattan was provided with an overwhelming global and domestic

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<sup>248</sup> Commission Notification, '*Chase Manhattan/Chemical Banking; Investigating Competitive Effects of a Merger between Chase Manhattan and Chemical Banking and Concluding that the Merger Did Not Pose Significant Impediments to Competition*' (1996) *No 33/05 OJ C33/7*.

<sup>249</sup> S Lipin, 'Joining Fortunes: Chemical and Chase Set \$ 10 Billion Merger, Forming Biggest Bank' (28 August, 1995) *Wall Street Journal*.

<sup>250</sup> C R Geisst, *Deals of the Century: Wall Street, Mergers, and the Makin of Modern America* (New Jersey: Wiley & Sons 2004), pp 288-90.

<sup>251</sup> *Lee v Board of Governors of the Fed. Reserve Sys.* (1997) 118 F.3d 905 (2d Cir.) ('Lee v Federal Reserve').

<sup>252</sup> *Ibid*, p 917.

<sup>253</sup> *BMA* (n1) §1828(c); see, also, generally, Department of Justice, 'Bank Merger Competitive Review - Introduction and Overview [current as of 9/2000] (1995) (updated 25 June, 2015)' ('US Bank Merger Review Guidelines'), available at [www.usdoj.gov/atr/public/guidelines/6472.pdf](http://www.usdoj.gov/atr/public/guidelines/6472.pdf).

presence in fifty-one nations and thirty-nine states across the US. Both Chase Manhattan and Chemical bank were engaged in similar-businesses - credit cards, mortgages, securities trading, small business lending, global banking, and corporate banking.<sup>254</sup> As a consequence of the merger transaction, the new Chase Manhattan turned into a major lender to big corporations and a front runner in securities processing, and became the biggest trading revenue in the US.<sup>255</sup> The new bank similarly grew to become the fourth-biggest supplier of credit cards, the third-biggest maker of new mortgages, and the leading provider of remaining mortgages.<sup>256</sup> Apart from its domination across the country, the new bank similarly attained control through possessing most consumer deposits in New York and came to be the prominent lender to medium-sized enterprises in the state.<sup>257</sup>

Notwithstanding the power amassment across the country and state-wide domination as a result of the bank merger, competition authorities authorized the merger transaction.<sup>258</sup> This authorization showed that the market concentration supremacy examination went off on a tangent from the time of *Philadelphia National Bank*.<sup>259</sup> In the *Philadelphia National Bank* case, the court recognized that, in the setting of the pertinent product market as well as the prospective for concentration, the effect on competition that a merger could cause locally, regionally, and nationally needs to be considered.<sup>260</sup> The *Chase Manhattan/Chemical* merger would not have passed the criteria established in *Philadelphia National Bank*, which overruled a bank merger that could have triggered a 30 per cent dominance of commercial bank business within the four-county Philadelphia area, for the reason that such merger culminated in the new bank getting product market control in several regions, particularly in New York.<sup>261</sup>

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<sup>254</sup> *Lee v Federal Reserve* (n251), pp 918-919.

<sup>255</sup> C Derber, *Corporation Nation: How Corporations Are Taking over Our Lives -- and What We Can Do about It* (New York: St. Martin's Press 2014), pp 74-5.

<sup>256</sup> *Hansell* (n247).

<sup>257</sup> R E Grosse, *The Future of Global Financial Services* (New York: John & Wiley & Sons, 2009), pp 117-118.

<sup>258</sup> Federal Reserve, 'Order Approving the Acquisition of Chase Manhattan/Chemical' (1997) *FRB*, available at <http://www.federalreserve.gov/boarddocs/press/bhc/1997/199709292/#fn26>.

<sup>259</sup> *Philadelphia National Bank* (n9).

<sup>260</sup> *Ibid*, pp 364.

<sup>261</sup> *Ibid*, pp 362-367.

Also, due to the fact that the merger *Chemical/Chase Manhattan* culminated in control in several aspects at the regional, state, and country level, the bank merger concluded in a considerable concentration that would hamper competition in banking.<sup>262</sup>

Entry examination is a relevant factor used in a bank merger examination. The question is whether the entry of new bank competitors will probably dissuade an anti-competitive merger at the outset, or dissuade or offset the competitive consequences. The new Chase Manhattan bank did not permit presence of other bank competitors rendering the same kind of services as the new bank, averting them from participating fairly and openly for products and services to customers in the market. Due to the level of the new bank merger's considerable concentration in the banking market, it culminated in a restriction of trade and deterrence the entry of additional bank competitors.<sup>263</sup>

d) *Citicorp/Travelers Group*

In 1998 one significant merger in the financial services industry was the \$70 billion-merger transaction of *Citigroup/Travelers Group*. Citigroup, with gross assets of about \$331 billion, had grown to become the third biggest commercial bank in the US.<sup>264</sup> Travelers Group, a varied financial services institution with gross assets of about \$420 billion, partook in several activities in the areas included insurance, securities, lending, and additional financial operations domestically and abroad.<sup>265</sup>

The merger formed the biggest commercial banking institution worldwide with gross assets of about \$751 billion.<sup>266</sup> In the course of the merger analysis, the competition and banking agencies received several complaints that Citigroup would have an unwarranted accumulation of resources as the merger transaction would establish a financial group too big

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<sup>262</sup> Case No IV/M. 642 *Chase Manhattan/Chemical Banking Corporation* (1995) OJ C 33/7, para 20.

<sup>263</sup> H P Nesvold, 'Communication Breakdown: Developing an Antitrust Model for Multimedia Mergers and Acquisitions' (1996) 6 *Fordham Intellectual Property Media & Entertainment Law Journal* 781, pp 780-2.

<sup>264</sup> Travelers Group, 84 Federal Reserve Bulletin 985 (23 September, 1998) (Federal Reserve's Order to Approve the *Citigroup/Travelers Group* Merger) ('Federal Reserve Order'), p 4.

<sup>265</sup> *Ibid*, p 2.

<sup>266</sup> *Ibid*, p 4.

to be permitted to fail.<sup>267</sup> Nonetheless, the Department of Justice regarded this as predominantly a regulatory matter to be taken into consideration by the Federal Reserve.

The Federal Reserve sidestepped competition issues posed in Citigroup (a commercial bank) and Travelers Group (insurance institution) merger. The merger clearly violated provisions of the Glass-Steagall Act 1933<sup>268</sup> for the separation of the business of commercial banking, investment banking and insurance activities. Under the Act,<sup>269</sup> a commercial bank was not allowed to enter into an insurance activity, or an investment activity. Citigroup was a commercial bank and Travelers Group was an insurance institution. Powerful groups of interest lobbied upon the Federal Reserve to put on hold the review of the proposal until and unless the Congress amends the Glass-Steagall Act 1933<sup>270</sup> to cover unrestricted combinations that would catch banking, securities and insurance activities under the same financial institution umbrella.<sup>271</sup> Critics noted that the *Citigroup/Travelers Group* merger would cause an unwarranted concentration of resources and a financial institution which is both ‘too large to supervise’ and ‘too large to fail’.<sup>272</sup>

In allowing the merger, the Federal Reserve noted that the markets where the merging banks competed were not concentrated.<sup>273</sup> The regulator found that in any market in which one bank had an important presence, the other bank has a comparatively insignificant market share.<sup>274</sup> The Federal Reserve projected that the *Citigroup/Travelers Group* merger was going to have a *de minimis* consequence on competition.<sup>275</sup> The Federal Reserve rejected the argument that the relative or absolute dimension of Citigroup would unfavourably sway the market structure. It opined that there was insufficient evidence to assert that the scope or scale of Citigroup’s operations would permit it to alter or control any relevant market.<sup>276</sup>

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<sup>267</sup> R Kramer, ‘“Mega-Mergers” in the Banking Industry’ (14 April, 1999) *American Bar Association* (Washington D.C.), available at <http://www.justice.gov/atr/speech/mega-mergers-banking-industry>.

<sup>268</sup> Glass-Steagall 1933, 12 USC §§ 24, 78, 377 (repealed 1999) (‘Glass-Steagall’).

<sup>269</sup> *Ibid.*, §§ 20, 24, and 32.

<sup>270</sup> *Glass-Steagall* (n268), §§ 20, 24, and 32; see, also, The Gramm-Leach-Bliley Act (‘GLBA’) 1999, Pub. L. 106-102, 113 Stat. 1338, enacted 12 November, 1999) repealed the Glass-Steagall Act 1933.

<sup>271</sup> J G Madrick, *Age of Greed: The Triumph of Finance and the Decline of America, 1970 to the Present* (New York: Vintage Books 2012), pp 315-316.

<sup>272</sup> J A Tatom, *Financial Market Regulation: Legislation and Implications* in J Tatom (ed.) (New York: Springer 2011), pp 7-8.

<sup>273</sup> *Federal Reserve Order* (n264), p 85.

<sup>274</sup> *Ibid.*, p 75.

<sup>275</sup> *Ibid.*, pp 75-76.

<sup>276</sup> *Ibid.*, pp 85-86.

In the Global Financial Crisis, almost a decade after the merger consummation, Citigroup and other large banks and financial institutions were on the verge of collapse. They were saved thanks to the US Government financial bailouts in which Citigroup obtained \$45 billion emergency funding and \$301 billion of government asset insurance.<sup>277</sup> This is, to date, the largest US bailout of any US bank.<sup>278</sup>

e) Wells Fargo/Wachovia & PNC Financial Services/National City

In the bank mergers, *Wells Fargo/Wachovia*,<sup>279</sup> and *PNC Financial Services/National City*,<sup>280</sup> both in 2008, the Federal Reserve and the Department of Justice<sup>281</sup> harmonized and accelerated their analysis on the bank merger.

The Federal Reserve granted the *Wells Fargo/Wachovia* merger in merely over a week's time from receiving its submissions.<sup>282</sup> After over a month of review, both, the Federal Reserve and the Department of Justice, allowed the takeover of National City by PNC Financial Services notwithstanding relevant unresolved competitive concerns.<sup>283</sup>

Unlike expedited review for non-emergency bank mergers, under which the Department of Justice and the Federal Reserve may require from merging parties to find purchasers for their required divestitures within a certain time, upon the entry of a consent

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<sup>277</sup> Financial Crisis Inquiry Commission, 'The Financial Crisis Inquiry Report: Final Report: Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States' (2011) *US Congress* ('Financial Crisis Inquiry Report'), p 380-382, available at [www.gpo.gov/fdsys/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf](http://www.gpo.gov/fdsys/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf).

<sup>278</sup> *Ibid*, p 381.

<sup>279</sup> Federal Reserve Board, 'Order Approving the Merger by Wells Fargo & Company of Acquire Wachovia Corporation' (12 October, 2008) *FRB*, available at [www.federalreserve.gov/newsevents/press/orders/20081012a.htm](http://www.federalreserve.gov/newsevents/press/orders/20081012a.htm).

<sup>280</sup> Federal Reserve Board, 'Order Approving the Merger by PNC Financial Services Group of National City Corporation' (15 December, 2008) *FRB*, available at <http://www.federalreserve.gov/newsevents/press/orders/orders20081215a1.pdf>.

<sup>281</sup> Department of Justice, 'Justice Department Requires Divestitures in Acquisition of National City Corporation by the PNC Financial Services Group' (11 December, 2008) *DOJ*, available at [www.justice.gov/archive/atr/public/press\\_releases/2008/240315.htm](http://www.justice.gov/archive/atr/public/press_releases/2008/240315.htm).

<sup>282</sup> S G Alvarez, 'The Acquisition of Wachovia Corporation by Wells Fargo & Company' (1 September, 2010) *Testimony Before the Financial Crisis Inquiry Commission, Washington, D.C.*, available at <http://www.federalreserve.gov/newsevents/testimony/alvarez20100901a.htm>.

<sup>283</sup> J W Markham Jr, 'Lessons for Competition Law From the Economic Crisis: The Prospect for Antitrust Responses to the "Too-Big-To-Fail" Phenomenon' (2011) 16 *Fordham Journal of Corporate and Financial Law* 261, pp 263-6.

decision, the Department of Justice and Federal Reserve exercised their discretionary power in the mergers *Wells Fargo/Wachovia* and *PNC Financial Services/National City* in order to permit both mergers to become consummating before accomplished divestitures.<sup>284</sup>

The exercise of the regulators' discretionary powers in the quick merger processing and the timing of divestitures of the two mergers, *Wells Fargo/Wachovia*,<sup>285</sup> and *PNC Financial Services/National City*, demonstrate how the regulators that oversee bank mergers meet the needs of the reality of distressed capital markets at a time of financial crisis.

## 8.4 Conclusion

In conclusion, this chapter has provided a comprehensive overview of the US courts' decisions in reviewing bank merger cases, together with an analysis of the methodologies employed and reasoning given by the courts to scrutinize these mergers.

As the legal cases demonstrate, a central issue in considering the legitimacy of bank mergers is the identification of the relevant product and geographic markets. Realizing that the first point of reference in the regulation of bank mergers is the relevant legislation, courts have at an early stage clarified the relationship between s 7 of the Clayton Act and the Bank Merger Act. In particular, courts have emphasized that the two acts are complimentary of each other, and rejected the argument that the applicability of one is the prerequisite of the applicability of the other. Unfortunately, it appears that courts have not been able to come to a solid conclusion regarding the scope and application of the 'cluster' or 'line of commerce' approach. Courts have often seen themselves adopting different interpretation and, at times added their own remarks, to landmark rulings, such as, the *Philadelphia National Bank* case<sup>286</sup> and the *Phillipsburg National Bank & Trust, Co.* case.<sup>287</sup> It was also common to see courts

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<sup>284</sup> J M Rich and T G Scriven, 'Bank Consolidation Caused by the Financial Crisis: How Should the Antitrust Division Review "Shotgun Marriages"?' (December, 2008) *Antitrust Source*, p 6, available at <http://www.abanet.org/antitrust/at-source/08/12/Dec08-Rich12-22f.pdf>.

<sup>285</sup> Federal Reserve Board, 'Order Approving the Merger by *Wells Fargo & Company* of Acquire *Wachovia Corporation*' (12 October, 2008) *FRB*, available at [www.federalreserve.gov/newsevents/press/orders/20081012a.htm](http://www.federalreserve.gov/newsevents/press/orders/20081012a.htm).

<sup>286</sup> *Philadelphia National Bank* (n9).

<sup>287</sup> *Phillipsburg National Bank* (n99).



taking different factors and considerations into account when determining the outcome of a case.

Much of the confusing and at times contradictory rulings by the courts were a result and reflective of the undisputable fact that the banking industry has been experiencing substantial changes over the years since the *Philadelphia National Bank* decision was handed down. The services and products provided by banks and other financial institutions have expanded both vertically and horizontally. New services and products have emerged. The services and products traditionally provided by one type of financial institutions have begun to be available at other types of financial institutions.

The issue of whether or not the US Supreme Court has reached a well-founded ruling in deciding that commercial banking was a particular line of commerce in the cases of *Philadelphia National Bank*, *Phillipsburg National Bank & Trust*, and *Connecticut National Bank*<sup>288</sup> is essentially inconsequential. Situations in the banking industry is uninterruptedly changing substantially since these rulings such that it has called into question the notion of the continuing recognition of commercial banking as a precise line of commerce. Market forces, stricter banking regulations, and legislative amendments in the US have added an additional layer of ambiguity to the already troubled cluster argument in commercial banking. Perhaps only the firmest advocate to the notion of *stare decisis* could draw a conclusion that commercial banking is pertinent in a competition perspective. Fortunately, the banking and financial markets, unlike US courts, do not rely on precedents.

Essentially, the peculiar conclusion that could be drawn, particularly, from the cases of *Philadelphia National Bank*<sup>289</sup> and *Phillipsburg National Bank*,<sup>290</sup> is that while non-bank financial services enterprises were found not to be competing with commercial banks, commercial banks were found to be competing with non-bank financial services enterprises.

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<sup>288</sup> *Connecticut National Bank* (n133).

<sup>289</sup> *Philadelphia National Bank* (n9).

<sup>290</sup> *Phillipsburg National Bank* (n99).

The *Connecticut National Bank* ruling,<sup>291</sup> nevertheless, partially deviated from previous rulings by indicating that the courts in the present case and the cases of *Phillipsburg National Bank* and *Philadelphia National Bank* did not reject the possibility of finding that commercial banks and savings banks function within the same line of commerce if there are similarities in their services and economic conduct.<sup>292</sup> The court further added that at some point in time of the progress of savings banks, it would become impractical to differentiate savings banks from commercial banks for reasons of the Clayton Act.<sup>293</sup>

To the deviation mechanism set out in *Connecticut National Bank*, it is apparent that the financial services sector has changed quite substantially such that it is unreasonable to differentiate between services rendered by banks and additional financial service providers.<sup>294</sup>

After the *Philadelphia National Bank* case, the US district courts scrambled to exert its lessons learnt in several bank merger situations. Several courts imprudently or absent of necessary clarification acknowledged the commercial banking bundle of products and services as the external boundary of the line of commerce. Some district courts tried to limit the application of the *Philadelphia National Bank* ruling to its uncharacteristic facts and circumstances.

To remain as a key player in the field, courts must, thus, strike a balance between upholding the spirit of precedents and recognizing the ever-evolving circumstances in the modern financial world.

The Federal Reserve and the Department of Justice might have failed to notice the anti-competitive effect of the merger *Chemical/Chase Manhattan* and *Citi/Travelers*, in their entirety. The extent of banking and financial market dominance in both the country and the state of New York should have revealed serious issues for the competition agencies and banking regulators. The negligence to completely disregard the concerns raised by the community and consumer groups demonstrates the failure of the current competition

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<sup>291</sup> *Connecticut National Bank* (n133), pp 672-673.

<sup>292</sup> *Ibid*, pp 660-666.

<sup>293</sup> *Ibid*.

<sup>294</sup> For a discussion of the evolution of banking products and services, since the *Philadelphia National Bank*, and the need for a revisit of this case from the competent courts, see chapter 11.2 in this thesis, pp 361-91.

provisions to involve the community and consumer involvement in the competition law system. The *Chase Manhattan/Chemical*, *Citi/Travelers* bank mergers show tendencies in the competition law application and implementation process in the US.

The foregoing demonstrates the increasing tolerance (forbearance) in bank merger standards; the failure about consumer focal point concerning the competition law application and enforcement process, as well as it illustrates the extent about the bank merger guidelines that neglect to consider the social costs in merger transactions.

## CHAPTER 9 – ANTITRUST METHODOLOGIES AND POLICIES APPLIED IN BANK MERGERS IN UNITED STATES

In this chapter, antitrust methodologies and policies applied from the US competition authority and banking regulators to bank mergers are examined. Below, discussion is focused on the specific aspects of markets, products, consumer issues and competitive analysis in relation to bank mergers. In addition, below, is a discussion of the examination approach from the foregoing regulators towards bank merger applications.

### 9.0 Markets, products, consumer issues and competitive analysis in relation to bank mergers

Due to the unique framework of competition review, regulators employ special methods addressing issues regarding the relevant product markets under which the competitive issues of a bank merger are reviewed.<sup>1</sup> Regulators, also, look to the geographic markets within which the merging banks would provide banking products after the proposed merger, any competition consequences associated with the bank merger in the geographic and product markets, whether there are any mitigating circumstances. Regulators, further, look to whether there is any possibility that the merging banks may negate any anticompetitive results.<sup>2</sup>

Despite the fact the foregoing competition analysis methods applied to bank mergers have remained largely unchanged over time, the resources applied to each method has not been equal. The trend in methods of competition analysis has, from the early 1960s until now, gradually moved from looking at the product markets and geographic markets and the effect of a bank merger on competition, to increased scrutiny of market performance in the event of a bank merger being consummated.<sup>3</sup>

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<sup>1</sup> *First Union Corp.* (1997) 83 Federal Reserve Bulletin 1012.

<sup>2</sup> A V Nanni, *Consolidation in the Banking Industry: An Antitrust Perspective* in Y Amihud & G Miller (eds.) *Bank Mergers & Acquisitions* (Boston: Kluwer 2013), pp 191-5.

<sup>3</sup> B Shull and G A Hanweck, *Bank Mergers in a Deregulated Environment: Promise and Peril* (Westport: Quorum Books 2001), pp 184-5.

The Federal Reserve and the Department of Justice ('DOJ')'s analytical methods appear to be basically similar in most aspects.<sup>4</sup> Both these agencies review the relevant product and geographic markets, the level of concentration in the relevant markets, and the increase in concentration resulting from the merger.<sup>5</sup> In addition, these agencies examine the convenience of and opportunity for market entry by new participants, and efficiencies brought by the bank merger.<sup>6</sup>

The DOJ reviews the possible competitive effects that might derive from the bank merger.<sup>7</sup> This is not an internal component of the Federal Reserve's review, but a distinct procedure. The latter regulator examines if any anticompetitive concerns are dominated by a particular community's needs and convenience in markets in which the merging banks would provide services.<sup>8</sup>

Notwithstanding the foregoing, each, the Federal Reserve, and the DOJ, looks closely at several of these distinct analytical factors very differently. The different approaches applied are reasonably clear in relation to determining the geographic and product markets, as well as the concentration inquiry.<sup>9</sup> Their positions on entry examination are alike.<sup>10</sup> However, even on this issue the factual reviews and indications may vary.

## 9.1 Markets

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<sup>4</sup> Federal Reserve/Department of Justice, 'How Do the Federal Reserve and the DOJ, Antitrust Division, Analyze the Competitive Effects of Mergers and Acquisitions under the Bank Holding Company Act, the Bank Merger Act and the Home Owners' Loan Act?', FAQs' (October, 2014) ('[Fed/DOJ Competitive Effects of Mergers FAQs](http://www.justice.gov/sites/default/files/atr/legacy/2014/10/09/308893.pdf)'), paras 1-2, available at <http://www.justice.gov/sites/default/files/atr/legacy/2014/10/09/308893.pdf>; see, also, Department of Justice, 'Bank Merger Competitive Review - Introduction and Overview [current as of 9/2000] (1995) (updated 25 June, 2015)' ('[US Bank Merger Review Guidelines](http://www.usdoj.gov/atr/public/guidelines/6472.pdf)'), p 1, available at [www.usdoj.gov/atr/public/guidelines/6472.pdf](http://www.usdoj.gov/atr/public/guidelines/6472.pdf); Department of Justice, 'Horizontal Merger Guidelines' (2010) ('[US Horizontal Merger Guidelines](http://www.justice.gov/atr/public/guidelines/hmg-2010.pdf)'), para 1, available at [www.justice.gov/atr/public/guidelines/hmg-2010.pdf](http://www.justice.gov/atr/public/guidelines/hmg-2010.pdf).

<sup>5</sup> *Fed/DOJ Competitive Effects of Mergers FAQs* (n4), paras 3, and 8-10.

<sup>6</sup> *Ibid*, para 22; see, also, *US Bank Merger Review Guidelines* (n4), p 3.

<sup>7</sup> *Fed/DOJ Competitive Effects of Mergers FAQs* (n4), paras 28-30; see, also, *US Bank Merger Review Guidelines* (n4), p 1.

<sup>8</sup> *Fed/DOJ Competitive Effects of Mergers FAQs* (n4), paras 14, and 22.

<sup>9</sup> *Ibid*, paras 3, 18, and 30; see, also, *US Bank Merger Review Guidelines* (n4), p 4.

<sup>10</sup> *Fed/DOJ Competitive Effects of Mergers FAQs* (n4), para 22; see, also, *US Bank Merger Review Guidelines* (n4), p 3.

The definition and application of the geographic market used in a bank merger review, as well as approaches taken by the antitrust and banking agencies in determining such market, are discussed below.

### 9.1.1 Geographic market

Courts have defined a geographic market as the ‘area of effective competition ... in which the seller operates and to which the purchaser can practically turn for supplies.’<sup>11</sup> In relation to a bank merger, the US Supreme Court in the *Philadelphia National Bank* case described the geographic market as being local in nature.<sup>12</sup> In that regard, the court stated:

The proper question to be asked in this case is not where the parties ... do business or even where they compete, but where, within the area of competitive overlap, the effect ... on competition will be direct and immediate. ... This depends upon ‘the geographic structure of supplier-customer relations’. ... The factor of inconvenience localizes banking competition as effectively as high transportation costs in other industries.<sup>13</sup>

In this case, the court’s review of the geographic market now appears to be unrealistic, considering that banks have expanded their activities beyond commercial banking, into investment banking and insurance activities.<sup>14</sup> In addition, the US banking industry has expanded both across the country and internationally.

In retrospect, the highest court in the US appears to have foreseen the evolution that has taken place in relation to local geographic banking markets by acknowledging that precedent would not bind the lower courts to become ‘blind ... to economic realities’.<sup>15</sup> Banks arrange their business across the country; they are regulated at national or state level.<sup>16</sup> Under these circumstances, the geographic market appears to expand not only locally (within the US), but also internationally due to the operations of financial institutions throughout the

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<sup>11</sup> *Tampa Elec. Co. v Nashville Coal Co.* (1961) 365 US 320, p 327.

<sup>12</sup> *United States v Philadelphia National Bank* (1963) 374 US 321 (‘Philadelphia National Bank’), pp 356-357.

<sup>13</sup> *Ibid*, pp 356-359.

<sup>14</sup> E Pekarek and M Huth, ‘Bank Merger Reform Takes an Extended Philadelphia National Bank Holiday’ (2008)13 *Fordham Journal of Corporate & Finance Law* 595, pp 637-646.

<sup>15</sup> *United States v Connecticut National Bank* (1974) 418 US 656, p 662.

<sup>16</sup> *United States v Grinnell Corp.* (1966) 384 US 563, pp 575-576.

global financial markets.<sup>17</sup> Certainly, the application of this reasoning does depend on the given bank or financial institution. Most systemic banking institutions in the US hold most of their assets within the US, instead of overseas.<sup>18</sup>

Nevertheless, expansion of the geographic market from local to national weakens dominant (*i.e.*, monopoly) influence.<sup>19</sup> While the scope of the geographic market continues to enlarge, the number of prospective market players also increases, which lessens market influence in a market-share review. This lessening along with the difficulty in determining the product market shows that a systemic banking institution would not attain dominant influence, based on standard market-share investigation. Indeed, a new method is needed to identify dominant influence of a systemic banking institution.<sup>20</sup>

### 9.1.2 Department of Justice approach to defining geographic markets

The Department of Justice ('DOJ'), along with the Federal Trade Commission,<sup>21</sup> produced the 2010 Horizontal Merger Guidelines<sup>22</sup> (the 'DOJ Guidelines') to outline the procedure used for reviewing the competition effects of a horizontal merger.<sup>23</sup> In a merger case law, the Guidelines are not binding from the courts to be implemented. However, due to the fact that American courts have traditionally considered in the past previous guidelines implemented by the DOJ,<sup>24</sup> and since DOJ tends to resolve any competitive issues on a bank merger at its review process, the Guidelines take an important role.

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<sup>17</sup> Federal Reserve Board, 'Insured US Chartered Commercial Banks That Have Consolidated Assets of \$300 Million or More, Ranked by Consolidated Assets' (31 March, 2015) *FRB*, available at [www.federalreserve.gov/releases/lbr/current/](http://www.federalreserve.gov/releases/lbr/current/).

<sup>18</sup> *Ibid.*

<sup>19</sup> C Felsenfeld, 'The Antitrust Aspects of Bank Mergers' (2008) 13 *Fordham Journal of Corporate & Financial Law* 4 ('Felsenfeld'), p 508.

<sup>20</sup> M M Polski, *The Invisible Hands of U.S. Commercial Banking Reform* (New York: Springer Science & Business Media 2012), pp 89-91.

<sup>21</sup> The Federal Trade Commission Act 1914, 15 USC §§ 41-58, as amended. The Federal Trade Commission is a federal agency authorized to promote consumer protection and to eliminate and to prevent anticompetitive business practices. It does not regulate competition aspects of bank mergers. For more information, go to [www.ftc.gov](http://www.ftc.gov).

<sup>22</sup> See, generally, *US Horizontal Merger Guidelines* (n4).

<sup>23</sup> *Ibid.*, para 1.

<sup>24</sup> *Chi. Bridge & Iron Co. v. FTC*, 534 F.3d 410, 431 n 11(5th Cir. 2008).

Provisions of the DOJ Guidelines explain the practice that the DOJ applies to determine the relevant geographic market.<sup>25</sup> In substance, the purpose of the method is to identify the geographic territory where a supposed monopolist may gainfully inflict a minor but noteworthy and non-transitory price increase. The US competition authority begins to analyse whether there is any overlapping of service areas of the merging parties within a given territory.<sup>26</sup> Thereafter, it decides if a monopolist within that territory would increase prices. In the event that it does not, this is due to the fact that the monopolist in that small area encounters competition from banks situated in a somehow expanded area. By ongoing expansion of the geographic market until it contains all banks that, in reality, would actually compete within an area, the DOJ arrives at an identified geographic market, which is the economic market for these purposes. An important factor to define the geographic market is transportation costs.<sup>27</sup> In addition the DOJ Guidelines cite ‘language, regulation, tariff and non-tariff trade barriers, custom and familiarity, reputation, and service availability’ as relevant to the quality of long distance transactions.<sup>28</sup> Further, a bank’s ability to price discriminate, based on customer location may justify the recognition of smaller markets. Under the DOJ Guidelines,<sup>29</sup> the DOJ implements the hypothetical monopolist test, dividing its analysis into two parts.<sup>30</sup> The first part is the market delineation, based on the supplier location.<sup>31</sup> The second part is the market delineation, based on the customer location.<sup>32</sup> The separate consideration of customer location from supplier location is due to the possibility that the financial institutions would be able to price discriminate against ‘targeted’ customers identified by geography.<sup>33</sup> This may happen when the suppliers deliver products to customers.

Notwithstanding the above, there may be one important variation between the economic markets determined by the DOJ and the Federal Reserve. The geographic market is closely linked to the product market considering that it seeks to identify an area in which

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<sup>25</sup> *US Horizontal Merger Guidelines* (n4), para 4.2.

<sup>26</sup> *Ibid*, para 4.2.1.

<sup>27</sup> *Ibid*, para 4.2.2.

<sup>28</sup> *Ibid*, para 4.2, subpar 2.

<sup>29</sup> *Ibid*, para 4.1.

<sup>30</sup> *Ibid*, para 4.1.1.

<sup>31</sup> *Ibid*, para 4.2.1.

<sup>32</sup> *Ibid*, para 4.2.2.

<sup>33</sup> *Ibid*, para 4.1.4.



competition for that product would be impacted by the bank merger.<sup>34</sup> According to the banking regulators' position, the pertinent product market for a financial institution merger is the cluster of services under the commercial banking umbrella.<sup>35</sup> The DOJ has broken up this cluster into a number of essential parts. The DOJ begins by taking into consideration a distinct product market for commercial banking and retail banking services, respectively. The DOJ defines its product market to include the existing products provided by the merging banks and other financial institutions within the local area.<sup>36</sup>

The reason for geographic market determination is to ascertain the likely customers of the merging banks that would be impacted by the merger transaction. The DOJ has concluded that small companies are locally bound to the sources of their own credit.<sup>37</sup> As a result, when the DOJ looks into issues in the small business market, the agency often discovers the relevant geographic market would be smaller than the market identified by the Federal Reserve. The latter market analysis is determined on the basis of the cluster of commercial banking services in the guise of the relevant product market.

The different approaches taken by the DOJ and banking regulators sometimes create disparate bank merger examination results. If two financial institutions are placed within the same geographic market, and such market is defined to be smaller, the result of the bank merger would be to lessen the number of competitors and to raise the impact of the bank merger on competition.<sup>38</sup> For instance, a relevant case is the merger *Society Corporation/Ameritrust Corporation* in 1992.<sup>39</sup> The Federal Reserve granted the merger application upon review of the merger's effect on ten markets in the state of Ohio, including the market of Cleveland. The Federal Reserve demanded substantial divestitures in numerous markets. During this process, the Federal Reserve concluded that in the Cleveland market, determined to comprise eight counties in the metropolitan area of Cleveland, there was no

<sup>34</sup> *Ibid*, para 4.2; see, also, *Fed/DOJ Competitive Effects of Mergers FAQs* (n4), paras 10, and 13-14; *US Bank Merger Review Guidelines* (n4), pp 2-4.

<sup>35</sup> *Philadelphia National Bank* (n12), pp 356-357.

<sup>36</sup> *US Horizontal Merger Guidelines* (n4), paras 4.1, and 4.1.3; see, also, *Fed/DOJ Competitive Effects of Mergers FAQs* (n4), paras 28, and 29; see, further, *US Bank Merger Guidelines* (n4), pp 2-4.

<sup>37</sup> *US Bank Merger Guidelines* (n4), p 2.

<sup>38</sup> S G Alvarez, 'Statement, General Counsel, Board of Governors of the Federal Reserve System, before the Antitrust Modernization Commission' (5 December, 2005) *US Congress*, available at [http://www.amc.gov/commission/hearings/pdf/Alvarez Statement.pdf](http://www.amc.gov/commission/hearings/pdf/Alvarez%20Statement.pdf).

<sup>39</sup> G M Killian, 'Bank Mergers and the Department of Justice's Horizontal Merger Guidelines: A Critique and Proposal' (1994) 69 *Notre Dame Law Review* 857, pp 858-9.

need for divestiture undertakings.<sup>40</sup> The DOJ looked at the small commercial loan market, determining these borrowers were restricted, within the terms of geographic market, as where they could get loans. Therefore, the DOJ did not find a ‘Cleveland market’ to exist, and determined geographic markets, based upon a county-by-county approach. The DOJ found relevant anticompetitive concerns in two of the eight counties identified by the Federal Reserve. As a result, it demanded divestitures in these markets.<sup>41</sup>

The DOJ sees the relevant geographic markets for bank merger cases in the same way as it views the geographic markets in other areas of the economy.<sup>42</sup> Particularly, the competition authority assumes several market dimensions, starting with a small geographic market. It presumes that a monopolist provides banking services in that area of the geographic market.<sup>43</sup> Afterwards, it looks at whether customers would pursue suppliers located outside of that area of the geographic market. Concerning the presumed geographic markets, if the DOJ determines that businesses and individuals in the market would divert to suppliers outside the market, the authority broadens the geographic market to include areas that these enterprises and individuals could move into so that all of these areas are considered to be within the relevant market.<sup>44</sup>

The US banking sector has shown a readiness to oppose the DOJ in cases the agency identifies anticompetitive concerns, based upon fragmenting the product market and smaller geographic market, which the product market often indicates. In almost all bank merger cases, the divestiture of a few added offices composing a small percentage of the assets bought by the concerning bank has been sufficient to appease the DOJ.<sup>45</sup>

However, the banking sector continues to believe that bank mergers that the DOJ opposes should be allowed. The sector supports this belief by arguing that there are dozens of non-bank opportunities for banking service providers, and small enterprises are not as locally

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<sup>40</sup> *Society Corp.* (1992) 78 Federal Reserve Bulletin 302.

<sup>41</sup> *United States v Society Corp. and Ameritrust Corp.* (1992) 57 Federal Register 10,371, 10,380.

<sup>42</sup> *US Horizontal Merger Guidelines* (n4) para 4.2; see, also, *Fed/DOJ Competitive Effects of Mergers FAQs* (n4), para 29.

<sup>43</sup> J Keyte & K B Schwartz, ‘Tally -Ho!: UPP and the 2010 Horizontal Merger Guidelines’ (2011) 77(2) *Antitrust Law Journal* 587, pp 592-597.

<sup>44</sup> *US Horizontal Merger Guidelines* (n4), para 4.2.2.

<sup>45</sup> J R Walter and P E Wescott, ‘Antitrust Analysis in Banking: Goals, Methods, and Justifications in a Changed Environment’ (2008) 94 *Economic Quarterly* 1, pp 42–44.

restricted as claimed by the DOJ. The facts gathered by the Federal Reserve justify as well as undermine the banking sector's claim that small enterprises are not locally restricted.<sup>46</sup> These findings also indicate a significant amount of out-of-market lending institutions provide loans to local companies. The Federal Reserve conclusions further indicate that on average the percentage of every business seeking loan(s) from out-of-market lending institutions is an extremely small percentage of such business's aggregate borrowings.<sup>47</sup>

### 9.1.3 Federal Reserve's method in determining geographic markets

The Federal Reserve openly falls within the 'economic market'<sup>48</sup> approach. All regional offices of the Federal Reserve<sup>49</sup> have predetermined banking markets across the US. These markets do not change, regardless of the specifics of merging financial institutions and the services provided thereby.<sup>50</sup>

In determining these markets, the Federal Reserve conducts censuses and analyses data regarding labour commuting trends, as well as additional indications of economic evolution and integration of competitive factors within banks and other financial institutions. In addition, the Federal Reserve's data contains information on consumers, shopping, owners of small businesses, and studies from bankers.<sup>51</sup>

Based on the Federal Reserve's factual evidence, the pre-determined economic market is defined as territory in which the economic factors of banks are systematically interlinked. Although merging banks may submit evidence showing a different 'economic market', the Federal Reserve is not likely to alter the market definition.<sup>52</sup>

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<sup>46</sup> Federal Reserve Board, 'New Information on Lending to Small Businesses and Small Firms: The 1996 CRA Data' (1998) 84 *Federal Reserve Bulletin* 1.

<sup>47</sup> L Brainard, 'Community Banks, Small Business Credit, and Online Lending' (30 September, 2015) *Speech at the Community Banking in the 21<sup>st</sup> Century, The Third Annual Community Banking Research and Policy Conference*, available at <http://www.federalreserve.gov/newsevents/speech/brainard20150930a.htm>.

<sup>48</sup> The 'economic market' definition looks for the area within which economic forces are transmitted freely; see *Fed/DOJ Competitive Effects of Mergers FAQs* (n4), paras 10, 12, and 14.

<sup>49</sup> Federal Reserve has twelve regional offices across the US, available at <http://www.federalreserve.gov/otherfrb.htm>.

<sup>50</sup> Federal Reserve defines the relevant product market as the cluster of services known as commercial banking, and they draw the relevant market to fit this product. See *Philadelphia National Bank* (n12), pp 356-357.

<sup>51</sup> *BancSecurity Corp.* (1997) 83 *Federal Reserve Bulletin* 122.

<sup>52</sup> *Hawkeye Bancorporation* (1978) 64 *Federal Reserve Bulletin* 974.

Clearly, the Federal Reserve and the DOJ take different analytical positions concerning their respective determination of the pertinent geographic market. As a result, those financial institutions that are merger participants need to prepare separate presentations for each agency's review in order to support the suggested geographic market. In that case, each of the agencies often arrives at substantially diverse findings regarding the appropriateness of the suggested relevant geographic market.<sup>53</sup>

The Federal Reserve's regional offices establish and provide definitions of pertinent geographic markets, while they review a bank merger within the territory over which the office has authority. Each office aims to determine the pertinent market, which 'reflect[s] commercial and banking realities and [that] consist[s] of the local area ... where local customers can practicably turn for alternatives'.<sup>54</sup> Therefore, the Federal Reserve's regional offices attempt to define the extent of the geographic area as comprising a contiguous economic area with all fragments connected to each other or to a joint centre city. Traditionally, the review aims to define the geographic zone within which a certain town or city is of particular concern or interest, and within which that zone there are separate areas for shopping, employment, medical or other services.<sup>55</sup>

Notwithstanding that established methods for determining a geographic market may vary in application from one area to another,<sup>56</sup> the Federal Reserve normally analyses local commerce and trade trends, the geographic dispersal of loans and deposits, labour force movements and concentration, and data on highway traffic, as well as figures for newsprint circulation and radio and television transmission. The Federal Reserve, mainly, looks at overall commuting indicators and the presence of roads linking certain geographic zones to determine whether that zone operates as a distinct economic component.<sup>57</sup> Generally, incoming commuting levels of 15 to 20 per cent of the total workforce is an adequate

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<sup>53</sup> Though proponents of mergers involving two in-market banks often benefit from the broadest possible market definition, in cases where it can be argued, for instance, that the two banks are not in the same geographic market, narrow geographic markets eliminate any perceived competitive overlap between the two banks. See, *Fed/DOJ Competitive Effects of Mergers FAQs* (n4), paras 12 -14.

<sup>54</sup> *Alice Bank of Texas* (1993) 79 Federal Reserve Bulletin 362, p 263.

<sup>55</sup> *Fed/DOJ Competitive Effects of Mergers FAQs* (n4), paras 10, 12, and 14.

<sup>56</sup> *United States v Marine Bancorporation* (1973) 418 US 602, pp 618-619.

<sup>57</sup> *Wyoming Bancorporation v Board of Governors Federal Reserve System*, (1984) 729 F.2d 687 (10th Cir.), p 690.

indication of an area being an integrated part of the same market as the areas from which such commuting occurs.<sup>58</sup> Furthermore, the ability to reach the centre city within reasonable times and distances would also indicate that an area is contained within the geographic market.<sup>59</sup>

The Federal Reserve considers whether a centre city is an economic destination in terms of offering substantial job prospects, as well as being a commercial business, sports, cultural and entertainment venue for people living in the areas that may be contained within the geographic market. To achieve this, the Federal Reserve analyses evidence in relation to the reasonable location and number of significant employers. The regulator, also, examines the prevalence of retailers' advertisements within the centre city, and the utilization levels of medical or other such services located within the metropolis.<sup>60</sup>

The Federal Reserve's focus appears to be on the external boundaries of the prospective geographic market, for the purposes of deciding if residents and enterprises there are to a substantial level concentrated in and financially connected to the metropolis or the market centre.<sup>61</sup> Otherwise, the market is reduced until foregoing threshold is reached. The Federal Reserve's perspective on the geographical market looks from the suburban areas towards the centre city, as part of one economic unit. Conversely, the DOJ looks from the centre city outwards to the suburban areas.<sup>62</sup>

In addition, the Federal Reserve determines a sole geographic market and utilizes this for all reviews, whereas the DOJ identifies more than one geographic market for the purposes of reviewing the competition consequences of a bank merger transaction. The agencies' different angles for analysing the geographic market reflect their different approaches to determining the product market.<sup>63</sup> The Federal Reserve includes banking and other financial services within one product market, and considers this to be a sole geographic market. The

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<sup>58</sup> *CB Financial Corp.* (1993) 79 Federal Reserve Bulletin 118.

<sup>59</sup> *Central Wisconsin Bankshares, Inc.* (1985) 71 Federal Reserve Bulletin 895, p 896.

<sup>60</sup> *Compare Sunwest Financial Services, Inc.* (1987) 73 Federal Reserve Bulletin 463, p 464.

<sup>61</sup> *Fed/DOJ Competitive Effects of Mergers FAQs* (n4), paras 10, 12, and 14.

<sup>62</sup> *First American Bank Corporation* (2014) 79 Federal Register 26758.

<sup>63</sup> *Norwest Corporation* (1998) 84 Federal Reserve Bulletin 1088, p 1089.

DOJ's review of a bank merger presumes the existence of numerous product markets. As a result, it tends to identify different geographic markets for specific products.<sup>64</sup>

#### 9.1.4 Specific geographic market

The existence of a relevant argument is crucial to persuading the DOJ or the Federal Reserve to select a certain geographic market when reviewing the competition consequences of a financial institution merger case. Gathering of significant statistics and the preparation of maps to reveal that a given area is a sole economic compartment is essential.

The statistics that most commonly demonstrate a relevant geographic market may fluctuate. This depends on market conditions. Gathering of statistics on local commerce and trade, such as, highway traffic and commuting of labour are vital in the final determination made by the Federal Reserve regarding the geographic market.<sup>65</sup> Other important considerations are the degree to which residents travel to nearby geographic locations for work, leisure or shopping. These considerations are of interest to the US courts and the Federal Reserve in arriving at conclusions on geographic markets.<sup>66</sup> The Federal Reserve and the courts rely on numerous sources, such as, local and state transport and labour data, as well as commuter surveys and highway traffic use statistics.

Also, relevant to the Federal Reserve are the interested banks' surveys on geographic markets. In this sense, banks involved in the merger often carry out zip code reviews throughout the areas where they render banking services to retail and business customers.<sup>67</sup> This approach allows the merging banks to argue that locations in the market they serve are used by a meaningful number of customers, and, thus, is/are located within the geographic market defined from the Federal Reserve.

Other important data used to define the proposed geographic market in the centre city is gathered from malls and shopping centres in respect of their customers, medical facilities

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<sup>64</sup> R P Zora, 'The Bank Failure Crisis: Challenges in Enforcing Antitrust Regulation' (2009) 55 *Wayne Law Review* 1175, p 1180.

<sup>65</sup> *Fed/DO Competitive Effects of Mergers FAQs* (n4), paras 12-14, and 29.

<sup>66</sup> *Pikeville National Corporation* (1985) 71 Federal Reserve Bulletin 240-241.

<sup>67</sup> *US Bank Merger Review Guidelines* (n4), p 3.

regarding their patients, and the number of individuals who watch television or listen to radio stations in that centre city.<sup>68</sup>

The DOJ analyses cases in which financial services buyers located in a certain part of the suggested geographic market commute to other part of the market to receive such services; or situations in which banks in one part of the market provide necessary services to consumers and enterprises situated in another part of the market.<sup>69</sup> Gathering the relevant information can be a complex exercise because the DOJ reviews are based on statistics on present use of or readiness to utilize banks in other parts of the geographic market.

Examining the location of customers and enterprises using the branches of banks involved in a merger shows whether customers in one portion of the market utilize banks in another part of the suggested geographic market. Surveys, such as, a Uniform Commercial Code ('UCC')<sup>70</sup> filing carried out by organizations providing loans to individuals and enterprises placed in the suggested geographic market may show that customers placed on one side of the market use banks located on the other side of the market, or simply situated wholly outside the market.<sup>71</sup> Such data may show that banks throughout the suggested geographic market may be considered to be relevant options for businesses and consumers situated in various other segments of the market.

#### 9.1.5 Position of the Office of the Comptroller of the Currency in determining geographic markets

The Office of the Comptroller of the Currency ('OCC') applies effective, advanced methods when reviewing a bank merger, with the principal focus of delivering continuous advantages for consumers. As a result, the OCC support almost all bank mergers, which are cleared by

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<sup>68</sup> Federal Reserve Bank of Boston, 'Elements of Antitrust Analysis: Other Factors' (2015) *FRBB*, available at <http://www.bostonfed.org/bankinfo/struct/antitrst.htm>.

<sup>69</sup> *US Horizontal Merger Guidelines* (n4), para 2.0.

<sup>70</sup> The Uniform Commercial Code is a uniform acts regulating the law of sales and other commercial transactions in the US. The Code was drafted in 1952, in a joint project of the National Conference of Commissioners on Uniform State Laws and the American Law Institute.

<sup>71</sup> *US Bank Merger Review Guidelines* (n4), p 4.

the Department of Justice.<sup>72</sup> The OCC tends to apply any geographic market determination that permits a bank merger to proceed, along with application of a *de minimis* rule<sup>73</sup> for approving a bank merger that seemingly raises competition concerns.

The OCC assumes the service areas of financial institutions involved in a merger consistent with the Federal Reserve's economic market stance.<sup>74</sup> However, in cases where the Federal Reserve has identified considerable anticompetitive outcomes within its demarked market, the OCC has used other approaches to justify its approval of the merger. The OCC utilizes the service area method in order to determine the relevant market in cases in which that approach alone would lead to the regulator approving the bank merger.<sup>75</sup>

It appears that there is credible evidence justifying the use of the OCC's *de minimis* approach. A case in point is the bank merger *National Bank and Trust Company of Norwich/National Bank of Oxford*<sup>76</sup> in 1983. The OCC accepted the merger because the pertinent geographic market was too insignificant to become a 'section of the country'.<sup>77</sup> The agency did not clarify the exact meaning of insignificance, which traditionally may be considered a county population of around 10,000 or less individuals.<sup>78</sup>

The OCC's *de minimis* theory is based upon the agency's reading of the Bank Merger Act<sup>79</sup> and on the assumption that the Department of Justice is unlikely to expend resources opposing an insignificant bank merger.

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<sup>72</sup> E.g., Justice Department, 'DOJ Approves NBT Bancorp/BSB Bancorp Merger After Parties Agree to a Divestiture' (15 August, 2000) *DOJ*, available at [https://www.justice.gov/archive/atr/public/press\\_releases/2000/6197.htm](https://www.justice.gov/archive/atr/public/press_releases/2000/6197.htm).

<sup>73</sup> Office of the Comptroller of the Currency, 'Order for Prior Authorization for American National Bank to merge with First National Bank of Union Springs' (11 March, 1997) *OCC Decision #97-11*, pp 1-2, available at [www.occ.gov/static/interpretations-and-precedents/Fmar97/Fcd97-11.pdf](http://www.occ.gov/static/interpretations-and-precedents/Fmar97/Fcd97-11.pdf).

<sup>74</sup> Office of the Comptroller of the Currency, 'Decision in the Bank Merger Application of Zions First Nat'l Bank, Salt Lake City, Utah, with Certain Branch Offices of Wells Fargo Bank in Utah' (September, 1997) *OCC Decision N. 97-82*, available at <http://www.occ.gov/static/interpretations-and-precedents/aug97/cd97-73.pdf>.

<sup>75</sup> S M A Greenspan, 'Geographic Markets in Bank Mergers: A Potpourri of Issues' (1998) 2 *North Carolina Banking Institute* 1, pp 10-13.

<sup>76</sup> Office of the Comptroller of the Currency, 'Decision on the Bank Merge Application between The National Bank and Trust Company of Norwich with National Bank of Oxford' (April, 1983) *OCC Decision N. 56-75* ('National Bank & Trust/National Bank of Oxford'), available at <http://www.occ.gov/static/interpretations-and-precedents/aug97/cd97-73.pdf>.

<sup>77</sup> *Ibid*, pp 1-2.

<sup>78</sup> *Ibid*, p 2.

<sup>79</sup> *United States v County National Bank of Bennington* (1972) 339 F. Supp. 85 (D. Vt.).



### 9.1.6 Federal Deposit Insurance Corporation's method on geographic markets

The Federal Deposit Insurance Corporation ('FDIC')'s position regarding competition impact assessment of a bank merger is included in the agency's merger assessment provisions.<sup>80</sup> Notwithstanding many revisions in its provisions, the FDIC's approach on geographic market definition remains unchanged.<sup>81</sup>

According to the FDIC,<sup>82</sup> a relevant geographic market includes the areas where the banking business that is to be acquired is located, as well as the areas in which that banking business generates the most loans, deposits or other banking products and services. In addition, the relevant geographic market contains the areas to which current and possible customers impacted by the proposed bank merger would actually go to access alternative banking products and services. In characterizing the relevant geographic market, the FDIC takes into account the location of the acquiring bank's offices with reference to the offices to be taken over.<sup>83</sup>

The FDIC's merger policy statement describes a method, which is somewhat 'service area' based and, to a certain degree, 'customer alternatives' based.<sup>84</sup> In reality, the agency appears to appreciate merging banks' positions concerning the relevant market. Frequently, the FDIC also applies the Federal Reserve's 'economics markets' approach.<sup>85</sup>

While the Federal Reserve predetermines markets for all bank mergers, the FDIC defines the market with respect to the particular banks that are merging. Considering that the FDIC does not invest substantial resources in market determination or pre-determination, the

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<sup>80</sup> FDIC, 'Statement of Policy on Bank Merger Transactions' (2008) *1 FDIC Law, Regulations, and Related Acts 5145*, available at <http://www.fdic.gov/regulations/laws/rules/5000-1200.htm> ('FDIC Policy on Bank Merger Transactions'); see, also, 12 CFR Part 303, Subpart D ('Merger Transactions'); see, further, FDIC, 'Interagency Bank Merger Act Application' (effective to 2017), OMB No. for FDIC 3064-0015, available at [www.fdic.gov%2Fformsdocuments%2Fbma-fapp.pdf](http://www.fdic.gov%2Fformsdocuments%2Fbma-fapp.pdf).

<sup>81</sup> *FDIC Policy on Bank Merger Transactions* (n80), para III (1).

<sup>82</sup> *Ibid*, paras III (2), and (3).

<sup>83</sup> *Ibid*, para III (3).

<sup>84</sup> *Ibid*, paras III (1), (2), and (3).

<sup>85</sup> B E Gup, *Bank Mergers: Current Issues and Perspectives* in R J Rogowski and D G Simonson (ed.) *Bank Merger Pricing Premiums and Interstate Bidding* (Boston: Kluwer Academic Publishers 2012), p 88.

agency has greater flexible than the Federal Reserve in altering its market determination<sup>86</sup> following information submitted by the merging bank.

## 9.2 Products

The financial services product market has evolved in recent decades. At the outset, the Glass-Steagall Act 1933<sup>87</sup> brought division between commercial and investment banking.<sup>88</sup> Following this demarcation, the US Supreme Court, in *Philadelphia National Bank*, defined 'product market' for commercial banking as 'various kinds of credit ... and services'.<sup>89</sup>

Since the *Philadelphia National Bank* ruling, the product market has transformed substantially due, in part, to the rescission of the Glass-Steagall Act in 1999.<sup>90</sup> Banks are now permitted to carry out both investment and commercial banking. This signifies a more flexible product market in which customers are no longer restricted to commercial banks for commercial services and to investment banks for investment services. Besides this important development, the *Philadelphia National Bank* case product-market definition continues to be the same. However, the *Philadelphia National Bank* decision permits adjustments to reflect the actualities of trade. The Court emphasized that commercial banking is an adequately comprehensive market so as to be material in relation to trade.<sup>91</sup> Economic events have impacted the ratio of the *Philadelphia Bank* decision, and it is clear that the 'cluster' of services and products provided only by commercial banks in 1963 are rendered by a diversity of financial-service institutions today.<sup>92</sup> Therefore, the product market needs to be identified with this in mind, rather than on the basis of separation between investment and commercial banking.

### 9.2.1 Banking regulators' approach to the product market

<sup>86</sup> *FDIC Policy on Bank Merger Transactions* (n80), paras III (2), and (3).

<sup>87</sup> 12 USC §24 (Seventh), 78, 377, and 378 (1999).

<sup>88</sup> S A Wagman, 'Laws Separating Commercial Banking Security Activities as an Impediment to Free Trade in Financial Services: A Comparative Study of Competitiveness in the International Market for Financial Services' (1994) 15 *Michigan Law Review* 999, pp 105-11.

<sup>89</sup> *Philadelphia National Bank* (n12), p 356.

<sup>90</sup> The Gramm-Leach-Bliley Act ('GLBA') 1999, Pub. L. 106-102, 113 Stat. 1338, enacted 12 November, 1999) repealed the Glass-Steagall Act 1933.

<sup>91</sup> 374 US at 357 (quoting *Crown Zellerbach Corp. v FTC* (1961) 296 F.2d 800, 811 (9th Cir.)).

<sup>92</sup> S J Pilloff, *The Banking Industry* in Brock (ed.), *The Structure of American Industry* (12th edn, Illinois: Waveland Press 2013), ch 10.

The banking authorities continue to rely on outdated banking products determination method. The Federal Reserve applies a conventional method, based on the ‘cluster’ of banking products and services that define the market as a bundle of specific products (e.g., various types of credit) and services (e.g., checking accounts) identified as ‘commercial banking’.<sup>93</sup>

In respect of product market determination, the Federal Reserve has conventionally found that the suitable product market to examine a bank merger is the ‘cluster’ of services and products provided by financial institutions.<sup>94</sup> Therefore, the Federal Reserve is inclined to include within the product market all products provided by banks, disregarding differences between commercial products for enterprises and retail products for consumers. Furthermore, the Federal Reserve, typically, ignores differences among the categories of products or services offered, such as, transaction accounts, credit, and cash management services.<sup>95</sup>

The Federal Reserve has complied with the ruling in the *Philadelphia National Bank* case, which concerned the inclusion of entire financial services and products utilized by businesses and consumers within one market.<sup>96</sup> However, the Federal Reserve has not complied with *Philadelphia National Bank*’s assertion that only those competitors that produce the whole ‘cluster’ ought to be included within the market.<sup>97</sup> For a considerable amount of time, the Federal Reserve acknowledged other competitors, especially in those situations when a sufficient actual showing of competitive effect is established.<sup>98</sup>

The Federal Reserve applies thresholds to analyse HHI (Herfindahl-Hirschman Index) levels, which surpass those utilized for other sectors of economy.<sup>99</sup> The federal banking regulator approach is such that conventional deposit-based HHI computations would not show a broad range of limited-cluster, non-bank competitors.

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<sup>93</sup> R S Carnell *et al*, ‘Symposium the Future of Law and Financial Services: Panel III: The New Policy Agenda for Financial Services’ (2001) 6 *Fordham Journal of Corporate & Finance Law* 113, pp 119-125.

<sup>94</sup> *Philadelphia National Bank* (n12), p 321.

<sup>95</sup> *BankAmerica Corporation* (1993) 79 Federal Reserve Bulletin 148.

<sup>96</sup> *Fed/DOJ Competitive Effects of Mergers FAQs* (n4), paras 8-9; see, also, *US Bank Merger Review Guidelines* (n4), p 2.

<sup>97</sup> J E Mason, *The Transformation of Commercial Banking in the United States, 1956-1991* (New York: Routledge 2013), pp 30-32.

<sup>98</sup> *Fed/DOJ Competitive Effects of Mergers FAQs* (n4), paras 22-23, and 30.

<sup>99</sup> *Ibid*, paras 16, 18-19, and 31-32; see, also, chapters 7.1.1 and 9.1.3 in this thesis, pp 200-02, and 263-66.

In its analysis, the Federal Reserve acknowledges the presence and effect of additional competitors. However, the regulator still does not include other competitors in its numeral HHI concentration computations. Indeed, the Federal Reserve takes account of the influence of other competitors as a supplementary element if HHI measures are not in any other way within the standards of safe harbour.<sup>100</sup>

The Federal Reserve treats thrift institutions as bank competitors.<sup>101</sup> However, in reality, the agency continues to consider thrift institutions as partial competitors by discounting their deposits by 50 per cent when computing the HHI levels.<sup>102</sup> In the case a thrift institution conducts activities closer in nature to those more typically carried out by a bank than a thrift institution; the Federal Reserve considers such institutions to be in complete competition with banks. In this case, the agency weighs the thrift institution's deposits at more than 50 per cent in computing HHI measures.<sup>103</sup> To be considered in complete competition with banks, a thrift institution needs to obtain commercial and consumer loan-to-asset ratios that are higher than the national median for thrift institutions.<sup>104</sup>

The Federal Reserve acknowledges competition from other non-bank financial services suppliers as a supplemental consideration in deciding whether a bank merger will be authorized in relation to the HHI measures, which surpass the parameters utilized by the Federal Reserve.<sup>105</sup> The federal regulator reviews the existence of considerable credit union competition especially if the percentage of market deposits by the credit unions is higher than the medium figure for credit unions across the country.<sup>106</sup> The Federal Reserve, also, acknowledges the competitive significance of non-depository institutions, especially regarding commercial and consumer finance businesses, and 'other non-depository providers of financial services.'<sup>107</sup>

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<sup>100</sup> Federal Reserve Bank of Kansas, 'Understanding Antitrust Considerations in Banking Proposals' (1992) *FRBK Paper*, available at

<https://www.kansascityfed.org/publicat/banking/bankerresources/UnderstandingAntitrustAnalysisv3.pdf>.

<sup>101</sup> *Fed/DOJ Competitive Effects of Mergers FAQs* (n4), para 31.

<sup>102</sup> *Ibid*, para 5.

<sup>103</sup> *NCNB Corporation* (1992) 78 Federal Reserve Bulletin 141.

<sup>104</sup> *Fed/DOJ Competitive Effects of Mergers FAQs* (n4), paras 4-5.

<sup>105</sup> *Ibid*, paras 7, and 16; see, also, *US Bank Merger Review Guidelines* (n4), pp 1-4.

<sup>106</sup> *Barnett Banks, Inc.* (1993) 79 Federal Reserve Bulletin 44.

<sup>107</sup> *First Bank System, Inc.* (1993) 79 Federal Reserve Bulletin 50.

The Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency adopt an expanded approach by looking at the pertinent product market<sup>108</sup> as comprising those products that are specifically provided by the amalgamating banking services providers, or are to be provided by the post-merger bank with the practical counterpart of such services provided by other kinds of competitors, such as, additional depository institutions, finance companies, and securities firms. For instance, the negotiable order of withdrawal ('NOW') accounts<sup>109</sup> provided by savings institutions are in some aspects the practical counterpart of demand deposit checking accounts.<sup>110</sup>

The banking authorities take a broad-minded approach to determination of the geographic market.<sup>111</sup> Consequently, the authorities may often fail to identify important clusters in specific product lines and geographic locations.

#### 9.2.2. Department of Justice's approach to product market

Pursuant to the DOJ Guidelines, the competition authority provides that defining a relevant market is useful 'to the extent it illuminates [a] merger's likely competitive effects' but nevertheless the relevant market 'is not an end in itself.'<sup>112</sup> Accordingly, the DOJ Guidelines indicate that the DOJ would 'normally' but not always define a relevant market in merger challenges.<sup>113</sup> Evidently, the DOJ has departed from its previous position, which was, in order

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<sup>108</sup> *FDIC Policy on Bank Merger Transactions* (n80), part III(2); see, also, generally, *US Bank Merger Review Guidelines* (n4); see, also, Office of Comptroller of the Currency, 'Business Combinations: Comptroller's Licensing Manual' (December, 2006), 'Summary' ('OCC Manual'), pp 10, and 56, available at <http://www.occ.treas.gov/publications/publications-by-type/licensing-manuals/bizcombo.pdf>.

<sup>109</sup> NOW account is a checking account with earning interest on the money deposited in the account.

<sup>110</sup> *Fed/DOJ Competitive Effects of Mergers FAQs* (n4), paras 4, and 16.

<sup>111</sup> *E.g.*, the FDIC takes the following stance on the geographic market:

The FDIC will view the relevant geographic market as consisting of those areas in which offices of the merging institutions are located and from which the institutions derive the predominant portion of their loan, deposit or other business and where existing and potential customers of the merging and resulting institutions may reasonably be expected to find alternative sources of banking services. See, A C Stine and E D Gorman, 'Fixing America: A Look at the Way Projects are Funded & Who should be Regulating the Process: Ebbing the Tide of Local Bank Concentration: Granting Sole Authority to the Department of Justice to Review the Competitive Effects of Bank Mergers' (2012) 62 *Syracuse Law Review* 405, pp 407-9.

<sup>112</sup> *US Horizontal Merger Guidelines* (n4), para 4.

<sup>113</sup> *Ibid.*

to review the prospective merger the competition regulator would define first the relevant product market.<sup>114</sup>

The DOJ Guidelines employ the ‘hypothetical monopolist’ test<sup>115</sup> for determining whether a group of products constitutes a relevant product market.

Specifically, the test requires that a hypothetical profit-maximizing firm, not subject to price regulation, that was the only present and future seller of those products (‘hypothetical monopolist’) likely would impose at least a ‘small but significant and non-transitory increase in price’ (‘SSNIP’)<sup>116</sup> on at least one product in the market, including at least one product sold by one of the merging firms.<sup>117</sup> For the purpose of analysing this issue, the terms of sale of products outside the candidate market are held constant. The SSNIP is employed solely as a methodological tool for performing the hypothetical monopolist test; it is not a tolerance level for price increases resulting from a merger.<sup>118</sup>

In order to measure the SSNIP, or ‘small but significant and non-transitory increase in price’, the DOJ normally begins with prevailing prices, or the prices that are deemed to prevail absent the merger. This will ‘most often’ be an increase of five percent. However, that number could differ depending on nature of the industry and the relative positions of the merging parties.<sup>119</sup> The DOJ then implements econometric techniques to ascertain whether such a price increase would be profitable by estimating the number of sales, which would be lost due to such a price increase. In making this estimate the DOJ would look at historical evidence, like how customers have shifted their purchases in the past due to a price change, information from buyers, objective information in relation to the costs of switching for various types of consumers and products.<sup>120</sup>

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<sup>114</sup> *Ibid*, para 1.1.

<sup>115</sup> *Ibid*, para 4.1.1.

<sup>116</sup> *Ibid*.

<sup>117</sup> *Ibid*, para 4.1.2; see, also, J D Harkrider, ‘Operationalizing the Hypothetical Monopolist Test’ (25 June, 2015), available at [www.justice.gov/atr/operationalizing-hypothetical-monopolist-test](http://www.justice.gov/atr/operationalizing-hypothetical-monopolist-test).

<sup>118</sup> C Shapiro, ‘The 2010 Horizontal Merger Guidelines: From Hedgehog to Fox in Forty Years’ (2010) 77 *Antitrust Law Journal* 1, pp 12-23.

<sup>119</sup> *US Horizontal Merger Guidelines* (n4), para 4.1.2.

<sup>120</sup> *Ibid*, para 4.1.3.

The DOJ Guidelines, also, discuss the likelihood of a narrower market in the event there is a recognizable subset of ‘targeted customers’ who could be mainly vulnerable to a price increase.<sup>121</sup> In other words, the Guidelines define a smaller relevant market in situations when the seller is able to price discriminate.

Clearly, the DOJ’s product market definition does not conform to the *Philadelphia National Bank* ‘cluster’ determination.<sup>122</sup> The competition regulator, also, does not include all financial services and products within the same product market, nor does it consequently contain even certain complete cluster producers in certain product markets. The DOJ separates the ‘cluster’ of financial services and products between at least a market for services and financial products used by consumers, and another market for financial services and products used by enterprises.<sup>123</sup>

The DOJ does not use the Federal Reserve’s ‘cluster of services’ product definition. Instead, the competition authority focuses on the markets for retail banking services and for small enterprise services. The DOJ maintains the position that small enterprise customers are usually more limited geographically in where they can turn for banking services and normally can receive those services only from commercial banks and not thrift institutions or credit unions. Accordingly, thrift deposits are weighted at 100 per cent in the retail banking analysis but given no weight in the small enterprise analysis.<sup>124</sup> Credit union deposits are normally given no weight too in the small enterprise market analysis, though the presence of credit unions with active commercial lending businesses could be deemed a mitigating factor.<sup>125</sup> Moreover, the DOJ looks at information on small enterprise lending in the relevant markets, such as, business loans booked at the merging banks’ branches, small enterprise loan originations reported under the Community Reinvestment Act 1977 (‘CRA’),<sup>126</sup> and market surveys conducted by the merging banks. Since information on small enterprise lending is not reported for all market banks at a branch level for their deposit data information, collecting

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<sup>121</sup> *Ibid*, para 4.1.4.

<sup>122</sup> *Ibid*, para 4.1; see, also, *Philadelphia National Bank* (n12), pp 356-357.

<sup>123</sup> *US Horizontal Merger Guidelines* (n4), para 4.1; see, also, *Fed/DOJ Competitive Effects of Mergers FAQs* (n4), paras 29, and 31.

<sup>124</sup> *Fed/DOJ Competitive Effects of Mergers FAQs* (n4), paras 5, and 31. Except for thrifts that are active in commercial lending, including having two per cent or more of their total assets invested in commercial and industrial loans.

<sup>125</sup> *Ibid*, para 21.

<sup>126</sup> Community Reinvestment Act 1977, 12 USC §§2901-08.

market share data on small enterprise lending can be difficult. Accordingly, a DOJ investigation of a bank merger would include document requests from the merging banks, such as, pricing surveys, and lost business reports, and interviews with customers and competitors.<sup>127</sup> Often, the DOJ also investigates the effect of bank mergers on middle market banking that presents similar information gathering difficulties.<sup>128</sup>

### 9.3 Consumer issues

Another important facet of a bank merger situation is its impact on consumers and their choice of products.<sup>129</sup> The concern is particularly stark in the merger of small and medium-sized financial institutions and resultant formation of large financial institutions. Moreover, small and medium-sized financial institutions are pressed by the federal government or the FDIC to protect their deposit accounts by consenting to acquisition by the largest financial institutions. Under these circumstances, customers would have fewer alternatives in the marketplace and likely higher fees for products.<sup>130</sup>

Outcomes creating negative effects on consumers are exactly what the competition provisions are intended to prevent. Consumer impact is the main focus in preventing monopolistic or anticompetitive conduct. In the event of major consolidation that erases small or medium-sized banks from the range of options available to consumers, the larger financial institutions, with their market power, can use this to raise the price of their products.<sup>131</sup>

Banks contend that amalgamation generates market efficiencies and economies of scale, which eventually benefit consumers in terms of better services and fewer fees.<sup>132</sup> Expansion of the bank branching outside the bank's home state may provide more flexibility to enterprises located across the country and to individuals that travel or commute through

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<sup>127</sup> *Fed/DOJ Competitive Effects of Mergers FAQs* (n4), paras 30, and 33.

<sup>128</sup> *Ibid*; see, also, M E Stucke, 'The Goals of Antitrust: Should Competition Policy Promote Happiness?' (2013) 81 *Fordham Law Review* 257, pp 258-62.

<sup>129</sup> *Fed/DOJ Competitive Effects of Mergers FAQs* (n4), paras 8, and 11; see, also, *US Horizontal Merger Guidelines* (n4), paras 1, and 2.2.2.

<sup>130</sup> R P Zora, 'The Bank Failure Crisis: Challenges in Enforcing Antitrust Regulation' (2009) 55 *Wayne Law Review* 1175 ('Zora'), p 1180.

<sup>131</sup> *Ibid*, p 1186.

<sup>132</sup> A E Wilmarth Jr, 'The Transformation of the US Financial Services Industry, 1975-2000: Competition, Consolidation, and Increased Risks' (2002) *University of Illinois Law Review* 215, pp 219-20.



different states. Nevertheless, this substantially increases service costs to bank customers.<sup>133</sup> The rapid increase in service fees charged by larger financial institutions on their deposit accounts in recent years indicates that market consolidation benefits large financial institutions in terms of imposing uncompetitive prices. For instance, a study in 2012 revealed that the average monthly fee for noninterest bearing checking accounts increased by 25 per cent since 2011, and the minimum balance for free-checking services during the same period increased by 23 per cent.<sup>134</sup> According to study in 2015, fees for utilizing out-of-network cash machines increased 6.5 per cent from 2014, marking the tenth year in a row of increases for this fee.<sup>135</sup>

The abovementioned studies demonstrate that large financial institutions in concentrated markets are capable of wielding sufficient market power to impose uncompetitive prices on deposit accounts.<sup>136</sup> Furthermore, several big financial institutions have indicated that they would prefer customers with small balances in their deposit accounts take their business elsewhere, due to the high cost of maintaining these accounts.<sup>137</sup>

Because of this less than friendly stance of several large financial institutions to consumers with small accounts, it is not surprising that consumers normally favour the customized service provided by community-based banks.<sup>138</sup> However, in some urban banking markets, a considerable number of local banks are taken over from big out-of-area financial institutions. As a result, customers have relatively few community-based options for banking services.<sup>139</sup>

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<sup>133</sup> S Zhen, 'How Are You Affected by a Bank Merger or Failure?' (4 November, 2013) *Huffington Post*, available at [http://www.huffingtonpost.com/mybanktracker/how-are-you-affected-by-a\\_b\\_3862487.html](http://www.huffingtonpost.com/mybanktracker/how-are-you-affected-by-a_b_3862487.html).

<sup>134</sup> Z Wang, 'Debit Card Interchange Fee Regulation: Some Assessments and Considerations' (2012) 3 *Economic Quarterly* 98, pp 159-83.

<sup>135</sup> See Bankrate.com, *Checking Survey 2015* (2015), available at [www.bankrate.com/finance/checking/checking-account-fees-surge-to-new-highs-1.aspx](http://www.bankrate.com/finance/checking/checking-account-fees-surge-to-new-highs-1.aspx).

<sup>136</sup> M Burton et al, *An Introduction to Financial Markets and Institutions* (2nd edn, New York: Routledge 2015), p 359.

<sup>137</sup> S Garon, *Beyond Our Means: Why America Spends While the World Saves* (New Jersey: Princeton University Press 2012), pp 373-5.

<sup>138</sup> T D Marsh, 'Reforming the Regulation of Community Banks after Dodd-Frank' (2014) 90 *Indiana Law Journal* 181, pp 184-9.

<sup>139</sup> *Ibid.*

Not all customers are habitually supportive of bank mergers. For instance, a survey in 2011 showed that the possibility of customers switching banks increases three times when their bank merges with or is absorbed by another financial institution. Generally speaking, customers of acquired banks view acquiring banks as much less concerned with customer needs and personal service, as compared to their previous banking institution.<sup>140</sup>

Movement of customers between banks in these circumstances tends to occur within the first few months of the merger taking place.

While comparing pre-merger customer satisfaction with subsequent attitudes and prospects for improvement following a bank merger situation, insight may be derived from the study of acquisitions, such as, *Wells Fargo/Wachovia*,<sup>141</sup> *JPMorganChase/Washington Mutual*,<sup>142</sup> *Capital One/ING*,<sup>143</sup> and *PNC Financial Services/National City*.<sup>144</sup> Customers' dissatisfaction regarding a bank merger tends to be due to bad publicity, changes to local personal banking staff, or failure of adequate prior notification of the merger.<sup>145</sup>

Consumer protection advocates argue that any increased costs in banking services have led to higher fees for consumers, increased bank mergers and market consolidation, and a shortage of new bank charters. Consequently, advocates believe such developments to be anti-competitive and restrictive on consumer choice.<sup>146</sup>

In the event of a bank merger, and in contrast to bank loan terms, consumers have limited rights regarding the terms of their credit cards. Banks may change consumers' terms at

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<sup>140</sup> B Shemelagian, 'Bank Transition Nearly Complete' (October, 2011) 26 *Las Vegas Business Press* 43, p P5.

<sup>141</sup> Federal Reserve Board, 'Order Approving the Merger by Wells Fargo & Company of Acquire Wachovia Corporation' (12 October, 2008) *FRB*, available at [www.federalreserve.gov/newsevents/press/orders/20081012a.htm](http://www.federalreserve.gov/newsevents/press/orders/20081012a.htm).

<sup>142</sup> Federal Reserve, 'Consent Order for Acquisition of Washington Mutual by JPMorgan Chase' (8 December, 2011) *FRB*, available at <http://www.federalreserve.gov/newsevents/press/enforcement/jpmc-plan-sect5-compliance.pdf>.

<sup>143</sup> Federal Reserve Board, 'Order Approving the Acquisition ING Direct by Capital One Financial Corp' (14 February, 2012) *FRB*, available at <http://www.federalreserve.gov/newsevents/press/orders/order20120214.pdf>.

<sup>144</sup> Federal Reserve Board, 'Order Approving the Merger by PNC Financial Services Group of National City Corporation' (15 December, 2008) *FRB*, available <http://www.federalreserve.gov/newsevents/press/orders/orders20081215a1.pdf>.

<sup>145</sup> P L Felton, 'Too Big to Manage: A Case for Stricter Bank Merger Regulation' (2012) 52 *Santa Clara Law Review* 1081, pp 1083-89.

<sup>146</sup> E D Cavanagh, 'Antitrust Law and Economic Theory: Finding a Balance' (2013) 45 *Loyola University Chicago Law Journal* 123, pp 124-32.

any time, so long as consumers are notified of any such changes. Consumers possess little power in these situations. In the event that a consumer refuses to accept the revised terms of credit, his only option is to pay off the remaining balance and close the account. In these circumstances, consumers tend to look for better credit card interest offerings, particularly those consumers with good credit scores.<sup>147</sup>

The glut of bank mergers in the US has made it easier for new banking giants to charge customers higher interest rates on credit cards and mortgages, and competition regulators have shown an inability to prevent this happening. The wave of mergers during the period from 2006 to 2008 established four large financial institutions, namely JP Morgan Chase, Bank of America, Citigroup and Wells Fargo.<sup>148</sup> Combined, these institutions service approximately 54.4 per cent of the mortgage market in the US.<sup>149</sup>

As the top tier financial institutions become smaller in number but larger in capital and scope, it has become easier for them to track prices charged by their competitors. This makes it easier for financial institutions to raise fees and interest rates charged to consumers, who paid approximately \$700 billion to rescue banks during the GFC.<sup>150</sup>

Banking and competition authorities ought to revisit their strategies and give future merger transactions greater scrutiny than was the case during recent financial crises.

After the Global Financial Crisis, the US Congress created the Consumer Financial Protection Bureau ('CFPB')<sup>151</sup> in order to better safeguard consumers' rights in relation to services and products provided by banks and other financial institutions. The purpose of the bureau's activities is to inform consumers on risks and enhance their understanding of

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<sup>147</sup> H Cho, 'Card Crunch: Limit Consumers' Options - And Can Affect Their Bottom Lines' (26 April, 2009) *Baltimore Sun*, p 18A.

<sup>148</sup> M N Bailey et al, 'The Big Four Banks: The Evolution of the Financial Sector' (26 May, 2015) *Brookings Research Papers*, available at <http://www.brookings.edu/research/papers/2015/05/26-big-four-banks-mergers-asset-share-baily>.

<sup>149</sup> D Bartz, 'Higher Rates Foreseen as Banks Merge' (30 October, 2008) *International Herald Tribune*.

<sup>150</sup> *Ibid*.

<sup>151</sup> Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203; 124 Stat. 1391; codified to 12 USC 5301 note, effective 21 July, 2010 (*codified as amended in 12 U.S.C. §§ 5301-5641*) ('Dodd-Frank'), Title X (The Consumer Financial Protection Bureau ('CFPB')). For more information of the CFPB, available at [www.consumerfinance.gov/](http://www.consumerfinance.gov/).

financial transactions.<sup>152</sup> Furthermore, the bureau seeks to shield consumers from abusive, deceptive or unfair practices and discriminatory conduct, reduce obsolete, redundant or excessively onerous regulations, and endorses fair competition by applying the consumer protection provisions under the Dodd-Frank Act.<sup>153</sup> The bureau, also, seeks to encourage evolution in the market for consumer financial services and products, to ensure as much as possible that these function to facilitate entry and modernization.<sup>154</sup>

Although the CFPB is still a nascent institution, its positive impact in improvement and protection of consumers' rights with respect to banking products and services has been appreciable.<sup>155</sup> Lobbyists and other interest groups representing the banking sector, and in particular the largest banks, are encouraging the US Congress, especially Republican party members, to disband the Consumer Financial Protection Bureau, or at very least take away or narrow its substantial consumer protection powers.<sup>156</sup>

Competition provisions provide that banks and other financial institutions are prevented from conspiring to fix prices or blocking competitors and, thus, control or dominate a substantial part or the entire banking market. These provisions also ensure that each bank, notwithstanding its size and scope in the relevant territory, has an opportunity to compete and innovate. The competition provisions further ensure that consumers retain options. The ability of consumers to make choices creates an optimum environment for competition to flourish.<sup>157</sup> Those banking services and products that consumers prefer most, and which are most reasonably priced, will be successful. Those banking services and products that are not as good, or are highly priced, will perform less well.<sup>158</sup>

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<sup>152</sup> 12 USC §§ 5511, 5513 (Dodd-Frank §§ 1021, 1023).

<sup>153</sup> 12 USC §§ 5562-65 (Dodd-Frank §§ 1052-55).

<sup>154</sup> 12 USC § 5514 (Dodd-Frank § 1024); see, also, 12 USC § 5515 (Dodd-Frank § 1025); see, more, 12 USC § 5516 (Dodd-Frank § 1026).

<sup>155</sup> T Ziwick, 'Striking the Right Balance: Investor and Consumer Protection in the New Financial Market Place. The Consumer Financial Protection Bureau: Saviour or Menace?' (2013) 81 *Georgetown Washington Law Review* 856, p 858.

<sup>156</sup> J Henry, 'Some House Republicans Dig in Against the Consumer Financial Protection Bureau and Auto Loan Measures' (29 June, 2013) *Forbes Magazine*, available at <http://www.forbes.com/sites/jimhenry/2013/06/29/some-house-republicans-dig-in-against-the-consumer-financial-protection-bureau-and-auto-loan-measures/#3d2d123234c3>.

<sup>157</sup> E Warren, 'Testimony before the Subcommittee on TARP, Financial Services, and Bailouts of Public and Private Programs' (24 May, 2011) *Committee on Oversight and Government Reform, House of Representatives* (US Congress).

<sup>158</sup> *Ibid.*

## 9.4 Competitive analysis

The banking authorities have the power to grant or prevent a bank merger. The Department of Justice ('DOJ') advises the authorities on the possible competition consequences of such mergers. As a result, the agency has to carry out its own competition examination. The review of bank merger cases is different than in other industries principally in the quantity and kind of information considered and the means the competition regulators used in analysing this information.<sup>159</sup>

The DOJ utilizes a different competitive analysis for the mergers in banking and financial sector from the analysis it implements for other sectors of the economy.<sup>160</sup>

A bank merger examination process starts with the acquiring bank filing an application with its primary banking authority,<sup>161</sup> which then forwards a copy of the merger application to the DOJ.<sup>162</sup> The DOJ analyses the merger application using a 'screening process'.<sup>163</sup> The agency screens about 1,000 bank merger applications each year.<sup>164</sup> The screening process is explained in detail in a 1995 document prepared and adopted by the federal banking agencies (the Federal Reserve, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation) and the DOJ named 'Bank Merger Competitive Review – Introduction and Overview' (the 'US Bank Merger Review Guidelines'),<sup>165</sup> and the document co-prepared by the Federal Reserve and the DOJ and titled 'Frequently Asked Questions regarding applications filed with the Board of Governors of the Federal Reserve System' (the 'FAQs on Antitrust Review of Bank Mergers') of 9 October, 2014.<sup>166</sup> These two documents provide practical information relating to antitrust reviews of bank mergers. Generally, they reflect

<sup>159</sup> Organization for Economic Co-operation and Development, 'Roundtable on Competition and Regulation in Retail Banking - United States' (16 October, 2006) 2 *Competition and Regulation [OECD]* 60, available at [www.ftc.gov/bc/international/docs/Banking\\_US.pdf](http://www.ftc.gov/bc/international/docs/Banking_US.pdf).

<sup>160</sup> *Fed/DOJ Competitive Effects of Mergers FAQs* (n4), paras 28-29.

<sup>161</sup> BHCA Bank Holding Company Act of 1956 (12 USC 1841 *et seq*) ('BHCA') §§ 3(a)(1)-3(a)(5); and 4(c)(8); see, also, 12 USC Sec 1828 ('BMA'), § 18(c).

<sup>162</sup> 15 USC §18(a).

<sup>163</sup> *Fed/DOJ Competitive Effects of Mergers FAQs* (n4), para 29.

<sup>164</sup> Department of Justice, 'Antitrust Division Workload Statistics Fiscal Year 2005-2014' (2015), p 13, available at <https://www.justice.gov/atr/file/630706/download>.

<sup>165</sup> *US Bank Merger Review Guidelines* (n4).

<sup>166</sup> *Fed/DOJ Competitive Effects of Mergers FAQs* (n4).

longstanding administrative policies and practices of the competition and banking agencies and are a useful compilation of their respective views, including areas where the approaches taken by them diverge.

Based on the foregoing documents, there are two screening processes, known as Screen A and Screen B, implemented by the banking regulators and the DOJ, respectively, in order to review antitrust issues of a bank merger.<sup>167</sup>

The US banking agencies rely largely on Screen A that looks at competition in predefined markets that are developed by the Federal Reserve.<sup>168</sup> If the calculation provided in Screen A does not result in a post-merger HHI over 1800 and an increase of more than 200, the banking regulators would be unlikely to carry out further examination the competitive results of a bank merger.<sup>169</sup> If the result of the calculation indicated in Screen A surpasses the 1800/200 threshold, merging banks may consider supplying additional information.<sup>170</sup>

When filing for merger approval, bank participants are measured against a Screen A HHI calculation chart<sup>171</sup> in relation to three distinct geographic markets, respectively the Federal Reserve market, the Ranally Metropolitan Area (RMA) market,<sup>172</sup> and the county market.<sup>173</sup>

DOJ initially examines merger transactions utilizing data from the banking agencies' screen, Screen A.<sup>174</sup> If a proposed bank merger exceeds the 1800/200 threshold in Screen A, merging banks should consider submitting the calculations set out in Screen B.<sup>175</sup> In some cases, the DOJ may further review bank merger cases that do not exceed the 1800/200

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<sup>167</sup> *US Bank Merger Review Guidelines* (n4), pp 1–10.

<sup>168</sup> *Ibid*, pp 4-7;

<sup>169</sup> *Ibid*, pp 1-3.

<sup>170</sup> *Ibid*.

<sup>171</sup> *Ibid*, pp 5-7.

<sup>172</sup> *Ibid*, p 5. RMAs are defined by the Rand McNally Corporation utilizing commuting and population density data at the sub-county level. Three criteria must be met before a market is designated as an RMA: (1) an urbanized area with a population of about fifty thousand; (2) a population density of at minimum seventy per square mile; and (3) commutation of at minimum twenty per cent of the labour force to the central urban area.

<sup>173</sup> *US Bank Merger Review Guidelines* (n4).

<sup>174</sup> *Ibid*, pp 1-2.

<sup>175</sup> *Ibid*, p 3.

threshold in Screen A.<sup>176</sup> This is most probable when Screen A does not show completely the competitive consequences of the merger case in all relevant markets, especially lending to SMEs. For instance, the DOJ is more probable to review a merger case concerning two commercial banks, if the post-merger HHI approaches 1800 and the HHI increase approaches 200, and screen A includes thrift institutions that are not actively involved in commercial lending.<sup>177</sup> The DOJ is, also, more probably to examine a merger case if the predefined market where the merging banks compete is notably larger than the area where small enterprise lending competition may exist. In such a case, merging banks should consider providing the calculations set out in Screen B.<sup>178</sup>

Frequently, the DOJ upon analysing the information in Screen B finds no need for further examination of the proposed merger. If the calculation specified in Screen B results in an HHI over 1800 and an increase of over 200, bank mergers may consider providing additional information.<sup>179</sup> In some particular situations, the DOJ may review a merger case in more details even though Screens A and B do not identify anticompetitive issues.<sup>180</sup> This is most probably to happen, if it appears that the Screens' market area does not fit the transaction. Occasionally the geographic market utilized in the Screens might not be a suitable choice for examination of the particular bank merger. For instance, the Screens' market area is a county, and one merging bank is at the west end of one county and the other merging bank is at the east end of the adjacent county. Indeed, the banks could be each other's most significant competitors, nonetheless, the screens does not reflect that fact. Or the Screens' market area is too large; nevertheless, the merger involves two banks at the centre of the market. Banks at the market area's periphery might be very unlikely substitutes for the competition that would be lost in the merger transaction. Therefore, the transaction needs to be scrutinized in a narrower area in order to ensure consideration of the relevant geographic market.<sup>181</sup>

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<sup>176</sup> *Ibid*, p 4.

<sup>177</sup> *Ibid*, pp 5-10.

<sup>178</sup> J R Walter and P E Wescott, 'Antitrust Analysis in Banking: Goals, Methods, and Justifications in a Changed Environment' (2008) Federal Reserve Bank of Richmond, 94 *Economic Quarterly* 1, pp 45-72.

<sup>179</sup> *US Bank Merger Review Guidelines* (n4), p 2.

<sup>180</sup> G M Killian, 'Bank Mergers and the Department of Justice's Horizontal Merger Guidelines: A Critique and Proposal' (1994) 69 *Notre Dame Law Review* 857, pp 858-9.

<sup>181</sup> *Fed/DOJ Competitive Effects of Mergers FAQs* (n4), para 30.

From time to time, the merging banks are competitors for a specialized product and few of the banks included in the Screens compete in offering that product.<sup>182</sup> For instance, the Screens likely might not identify a concentrated market for working capital loans to medium-sized enterprise customers. In the event the market area has many banks nonetheless the merging banks are two of only a few banks capable to compete for such business. In such situations, merging banks might desire to provide additional information, as discussed in the following paragraphs.

The banking regulators and the DOJ are likely to review a bank merger in more detail, if it surpasses the 1800/200 threshold in Screen A.<sup>183</sup> The DOJ is, also, likely to review the effect of a proposed merger on competition for commercial loans, in the event the merger case surpasses the 1800/200 threshold in Screen B.<sup>184</sup> In situations in which a screen highlights a merger transaction for further examination, the merging banks may provide additional information that is not considered in the screen. In situations in which Screen A or Screen B highlights a merger case for further scrutiny, additional information may provide further clarification of competitive realities in the market. Additional information would be evidence that the merging banks do not significantly compete with each other, or evidence that rapid economic change has resulted in an obsolete geographic market definition, and as a result another market is more appropriate.<sup>185</sup> Other information would be evidence that market shares are not an adequate indicator of the extent of competition in the market *e.g.*, evidence that banks in the market would be probably to expand present levels of commercial lending.<sup>186</sup>

Further additional information would be evidence about current loan-to-deposit ratios, recent hiring of new commercial loan officers, pending branch applications or important out-of-market resources that would be shifted into the market in response to new loan opportunities.<sup>187</sup> Or evidence that a particular institution's market share overstates or understates its competitive significance; or evidence about entry conditions, evidence of

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<sup>182</sup> *US Bank Merger Review Guidelines* (n4), pp 5-10.

<sup>183</sup> *Ibid*, p 3.

<sup>184</sup> *Ibid*.

<sup>185</sup> M Mierzewski *et al.*, 'FTC and DOJ Release Proposed Revisions to Horizontal Merger Guidelines: Implications for Bank Mergers' (October, 2010) 127 *Banking Law Journal* 9, p 869.

<sup>186</sup> *Ibid*, p 870.

<sup>187</sup> A M Zaretsky, 'Bank Consolidation: Regulators Always Have the Power to Pull the Plug' (January, 2004) *Regional Economist, Federal Reserve Bank of Saint Louis*, pp 3-5.



potential entry within the next two years, and expectations concerning likely entry by banks not presently in the market area and the reasons for such expectations. In providing the necessary information to such a market share table, merging banks could estimate another bank's commercial lending in a certain market by multiplying the bank's overall ratio of commercial loans to deposits by its deposits in the relevant market, if market-specific information concerning that bank is not available.<sup>188</sup>

In instances in which Screen B highlights a bank merger for further scrutiny, merging banks could consider preparing an HHI (Herfindahl-Hirschman Index) worksheet for the market area using, instead of deposits, data from the relevant reports on commercial loans under \$250,000, and between \$250,000 and \$1,000,000.<sup>189</sup> Such information can be a productive assessment of actual competition for small business lending. Additional information that could be pertinent is evidence of competition from sources not included in Screen B, or evidence that a credit union has such membership restrictions, or failure of restrictions, and offers such services to commercial customers that it should be considered to be in the market. Other information could be evidence of actual competition by out-of-market banks for commercial customers, especially competition for loans for business start-up or working capital purposes. Further evidence could be actual competition by non-bank institutions for commercial customers, especially competition for loans for business start-up or working capital purposes.<sup>190</sup>

When the bank mergers deem that Screen B does not correctly reflect competitive realities and market concentration in a specific area, they may render additional information to support their argument. Their supporting argument should comprise an HHI worksheet that shows the geographical area, which should be covered, the banks to be included, the calculation method of the market share of each bank *e.g.*, deposits, branches, loans, as well as the arguments to base the assertion that this information is preferable to the information submitted in Screen B. Inclusion of banks outside the areas identified in Screen B should be supported by evidence of actual competition by these banks.<sup>191</sup>

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<sup>188</sup> *Ibid.*

<sup>189</sup> *US Bank Merger Review Guidelines* (n4), p4.

<sup>190</sup> *Ibid.*, pp 8-10.

<sup>191</sup> *Ibid.*, pp 9-10.

Pursuant to the FAQs on Antitrust Review of Bank Mergers, the Federal Reserve carries out an initial screening for each pre-defined banking market where bank deposits are weighted at 100 per cent, and thrift deposits are weighted at 50 per cent.<sup>192</sup> If in any overlapping market the resulting HHI increases by less than 200 points due to the merger or the post-merger HHI is less than 1,800, and the post-merger entity does not have a higher than 35 per cent market share, then the merger will pass the initial screening and be eligible for approval by the Federal Reserve.<sup>193</sup> Any bank merger situation, which exceeds these thresholds must be examined by Federal Reserve. Nonetheless, such merger may still be approved by the Federal Reserve, based on a closer examination of the markets, and the presence of mitigating factors.<sup>194</sup>

In reference to the DOJ's initial screening review, the FAQ on Antitrust Review of Bank Mergers<sup>195</sup> clarifies that the competition authority's initial screening analysis is, also, done utilizing deposit data. However, the authority does not necessarily use the Federal Reserve's pre-defined geographic banking markets. While the DOJ's decision about geographic markets is made on a case-by-case basis, the FAQs note that merging banks 'may wish' to also perform HHI calculations for each county in which the applicants have overlapping operations. Since the Federal Reserve's geographic markets normally are based on Metropolitan Statistical Areas ('MSAs')<sup>196</sup> that normally include multiple counties, concentration levels for individual counties can often be higher than for the MSA or Federal Reserve's banking market as a whole. In addition, unlike the Federal Reserve, the DOJ screens for two different product markets, retail banking and small business banking, and thrift deposits are given different weights in those markets.<sup>197</sup>

In relation to the deposit data adjustments for thrift institutions and the credit unions, the Federal Reserve initially weights commercial bank deposits at 100 per cent and thrift

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<sup>192</sup> *Fed/DOJ Competitive Effects of Mergers FAQs* (n4), para 5.

<sup>193</sup> *US Bank Merger Review Guidelines* (n4), footnote 1.

<sup>194</sup> *Fed/DOJ Competitive Effects of Mergers FAQs* (n4), para 4.

<sup>195</sup> *Ibid*, para 29.

<sup>196</sup> *Ibid*, para 13. 'Many geographic markets follow . . . MSA . . . definitions or rural county lines, but some markets comprise multiple MSAs/counties or parts of MSAs/counties, reflecting that economic activity does not always track political boundaries'.

<sup>197</sup> *Fed/DOJ Competitive Effects of Mergers FAQs* (n4), para 17.

deposits (other than thrifts owned by bank holding companies) at 50 per cent.<sup>198</sup> Federal Reserve staff will, usually, agree to give 100 per cent weight to deposits of thrifts that are actively engaged in commercial lending (often indicated by commercial and industrial loans being more than 5 per cent of total assets).<sup>199</sup> Federal Reserve will, also, include a credit union's deposits at a 50 per cent weighting, if the credit union has broad field of membership requirements that include most or all of a market's population and has branches that are easily accessible to the public.<sup>200</sup> In very rare circumstances, the Federal Reserve will give a 100 per cent deposit weighting to a credit union with significant commercial lending business.<sup>201</sup>

On occasion, one of the merging banks may have a branch in an overlapping market, which is utilized to book deposits from out-of-market sources *e.g.*, national escrow deposits, which distorts its market share. The Federal Reserve has in the past made adjustments to exclude such deposits where the bank applicant can show both the out-of-market nature of such deposits and that similar adjustments need not be made to branch deposits of other market participants.<sup>202</sup> Since detailed information on deposit source is normally not available publicly, obtaining such information for other market participants can be difficult. Significant government deposits booked in a particular branch can be addressed in the same manner.

Certain types of specialized depository institutions that source their deposits from broader markets, like credit card, Internet banks, and trust companies are normally excluded from the Federal Reserve's screening examination.<sup>203</sup>

The FAQs on Antitrust Review of Bank Mergers provides clarification about the remedies for bank mergers that present important antitrust concerns even after considering mitigating factors and any approved deposit adjustments. The typical remedy to obtain approval of the bank merger application is a commitment to sell branches in the concentrated markets. The Federal Reserve, normally, permits the merging banks to select a package of

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<sup>198</sup> *Ibid*, para 5.

<sup>199</sup> *US Bank Merger Review Guidelines* (n4), p 7.

<sup>200</sup> *Fed/DOJ Competitive Effects of Mergers FAQs* (n4), para 18.

<sup>201</sup> *E.g.*, *M&T Bank Corporation/Hudson City* (30 September, 2015) Federal Reserve Board Order No 2015-27, available at [www.federalreserve.gov/newsevents/press/orders/orders20150930a1.pdf](http://www.federalreserve.gov/newsevents/press/orders/orders20150930a1.pdf).

<sup>202</sup> *First Horizon/TrustAtlantic*, (17 September, 2015) Federal Reserve Board Order N 2015-24, available at <http://www.federalreserve.gov/newsevents/press/orders/orders20150917a1.pdf>.

<sup>203</sup> *Fed/DOJ Competitive Effects of Mergers FAQs* (n4), para 25.

branches to be sold that will reduce the HHI below the 200/1,800 thresholds and a 35 per cent market share.<sup>204</sup> Practically speaking, due to mitigating factors, the Federal Reserve has often accepted smaller divestiture packages. The FAQs document does not address the range of permissible market concentrations. Instead, it notes that ‘there are no general guidelines for determining the level of divestiture that would be necessary to allow the [Federal Reserve] to approve a potentially anticompetitive application.’<sup>205</sup> The DOJ follows a similar approach to remedies. However, it has more stringent requirements for several aspects of proposed divestitures. Its divestitures include the sale of the total customer relationship of the divested branch (deposits and loans), and only target bank (not acquirer) branches may be used to meet the divestiture requirements. The DOJ must approve each of the divested branches for sale, as well as the proposed purchaser (that must be ‘competitively suitable’), and the package of divested branches must permit the buyer to ‘compete effectively’ in the market.<sup>206</sup>

Generally speaking, there is no perfect mechanism to review concentration in the banking services and products sector. Many concentration measurement methods fail to properly quantify the productivity or capacity of several ‘bundles’ of financial services and products. The concentration methods, also, fail to quantify the competitive influence of competitors providing financial services and products.

A concentration of banks’ deposits, based on a specific geographic market, does not include data for all possible competitors. Depending on such data for concentration analysis ignores the competitive impacts from out-of-market banks, brokerage firms, credit unions, leasing companies, insurance companies, and others who take deposits, issue loans, or otherwise compete with banks and thrift institutions.<sup>207</sup>

The DOJ and the Federal Reserve use the HHI market concentration method to review the level of concentration in the relevant markets and the increase in concentration that would transpire as a result of the bank merger.<sup>208</sup> Considering that concentration examination is intimately linked to market definition, the differences between the DOJ and the Federal

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<sup>204</sup> *Ibid*, para 27.

<sup>205</sup> *Ibid*, para 27.

<sup>206</sup> *Ibid*, para 34.

<sup>207</sup> *Ibid*, paras 10, and 12-15.

<sup>208</sup> *BankAmerica Corporation* (1992) 78 Federal Reserve Bulletin 338, p 340.

Reserve positions on market definition logically results in different stances on concentration examination. Their respective searches for an appropriate method of concentration analysis are determined differently.<sup>209</sup>

Even when the 1800/200 safe harbour rule is breached, the Federal Reserve may, nevertheless, approve a bank merger, based on other conditions that neutralize any adverse competition consequences derived from the merger. These conditions may include quantity and strength of competitors, the existence of credit unions representing a larger percentage of market deposits than the US average, the presence of robust non-depository competitors, and a market, which is appealing to entry and likely to encourage entry.<sup>210</sup>

As for the DOJ's approach to market determination, the agency does not rely on a single HHI or solely on deposit-based HHIs. The DOJ reviews concentration, based on separate examinations for services and products provided to individual consumers and enterprises. The competition enforcement agency also considers consumer and commercial loans, number of branch offices, as well as other criteria indicating capacity to produce and groups of financial services and products that the DOJ deems to be distinctive product markets.<sup>211</sup>

Notwithstanding the intrinsic fallibility of various degrees of concentration measurement in financial services and products markets, it is possible to adopt a concentration examination for a specific bank merger that mitigates these imperfections. This is achieved by improving on the traditionally reported deposit-based HHI calculations and by using HHI calculations, based on other kinds of data, which may reflect the competitive environment for other financial services and products, particularly loans.

One consideration included addressing the deficiencies intrinsic in the bank and thrift reported deposit-based HHI calculations are deposits in credit unions that may be considerable

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<sup>209</sup> D D Sokol, *What Drives Merger Control? How Government Sets the Rules and Play* in T K Cheng et al (eds.) *Competition and the State: Global Competition Law and Economics* (Stanford: Stanford University Press 2014), pp 103-4.

<sup>210</sup> *Colorado National Bank Acquisition* (1993) 79 Federal Reserve Bulletin 534, p 535.

<sup>211</sup> G J Werden, 'Perceptions of the Future of Bank Merger Antitrust: Local Areas Will Remain Relevant Markets' (2008) 13 *Fordham Journal of Corporate & Finance Law* 581, p 584.

in several markets. Credit unions report data on loans and deposits to the National Credit Union Administration<sup>212</sup> in a comparable way to call reports used by banks and thrift institutions to provide data to the FDIC.<sup>213</sup>

Non-depository competitors can indirectly impact a deposit-based HHI calculation because the same is meant to function as a substitution for the whole bundle of services and products rendered by financial institutions.<sup>214</sup>

The estimated necessary share of non-depository competitors are grounded in nationwide statistics, on such competitors' share of the supply of financial services and products, or based on specific geographic market survey information.<sup>215</sup> This needs to reflect the competition impact of out-of-market financial institutions, which would not be shown in deposit data gathered exclusively from branches of banks and thrift institutions in the market.

The goal of concentration examination is to identify the potential market power and position of the merging financial institutions *vis-à-vis* businesses and consumers in that specific geographic market. If the analysis includes deposits related to a global, national or regional market, their inclusion may distort the examination of market power with respect to those businesses and consumers present only in the local market. This could be a serious issue for large banks with nationwide and overseas operations.

The above issue may be addressed by adjusting reported deposits in order to produce 'core deposits' *i.e.*, not including deposits, which are booked at locations within the pertinent local market but originated from a global, national or regional market, such as, brokered deposits, large in-market corporate demand deposits, sizeable certificates of deposit, and foreign deposits. Pursuant to available data on the call reports of in-market banks and thrift institutions and examination of the location and nature of the users and sources of merging

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<sup>212</sup> National Credit Union Administration ('NCUA') is an independent federal agency that charters and supervises federal credit unions and insures savings in federal and most state-chartered credit unions in the US, available at [www.ncua.gov/](http://www.ncua.gov/).

<sup>213</sup> 12 USC, § 1817 ('banks'), § 741.13 ('credit unions') (hereinafter 'Banks stat' & 'Credit unions stat').

<sup>214</sup> *Federal Reserve Bank of Boston - Elements of Antitrust Analysis* (n68).

<sup>215</sup> D C Wheelock, 'Banking Industry Consolidation and Market Structure: Impact of the Financial Crisis and Recession' (2011) *Federal Reserve Bank of St. Louis Review*, available at <https://www.stlouisfed.org/publications/review/11/11/419-438Wheelock.pdf>.

financial institutions' deposits,<sup>216</sup> an adequate estimate of the 'core deposits' of banks and thrift institutions within the market may be identified.

The legal foundation of the 'core deposits' examination approach was initially discussed in *Philadelphia National Bank*,<sup>217</sup> when recognizing the presence of 'regional' and 'national' banking markets as well as local customers' participation in these markets. The court found that due to the presence of a national market, the reported deposit-related market shares of the merging financial institutions could substantially exaggerate their current share of the local banking business. Consequently, this could exaggerate the merging institutions' power in the local market. As a result, the court decreased the deposit-based market shares of the individual merging financial institutions by 6 percentage points (which decreased the then existing market share by 16 2/3 per cent) to arrive at 'core deposits' more precisely estimating market concentration.<sup>218</sup> The 'core deposits' examination approach was then discussed and applied in significant bank merger cases like *US v Provident National Bank*,<sup>219</sup> *US v Crocker-Anglo National Bank*,<sup>220</sup> and *US v Manufacturers Hanover Trust Co.*<sup>221</sup> Banking authorities also recognize and implement the 'core deposits' examination method in the course of bank merger case reviews.<sup>222</sup>

Since the DOJ examines the effect of the bank merger on overall lending to enterprises and in various specific sectors, it seems logical that merging financial institutions would carry out their own concentration examination for commercial lending. Such action ensures that the competition authorities receive relevant facts on commercial lending competition, as well as on competition from out-of-market banks, insurance businesses, and finance companies.

The competition and banking regulators agree that prospects for market entry are a significant relevant factor for reviewing the possible competition consequences of a bank merger. Furthermore, there is consensus that showing entry to be straight forwarded, likely,

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<sup>216</sup> Federal Deposit Insurance Corporation, 'Bank Data and Statistics' (2015) *FDIC*, available at <https://www.fdic.gov/bank/statistical/>.

<sup>217</sup> *Philadelphia National Bank* (n12), p 321.

<sup>218</sup> *Ibid*, p 326.

<sup>219</sup> *United States v Provident National Bank* (1968) 280 F. Supp. 1 (E.D. Pa.), pp 6-8.

<sup>220</sup> *United States v Crocker-Anglo National Bank* (1967) 277 F. Supp.133 (N.D.Cal.), pp 154-155.

<sup>221</sup> *United States v Manufacturers Hanover Trust Co.* (1965) 240 F. Supp. 867 (S.D.N.Y.), pp 933-940.

<sup>222</sup> *Laredo Nat'l Bancshares, Inc.* (1992) 78 Federal Reserve Bulletin 139.

and quickly achievable may neutralize any other issues that would be beyond the safe harbour provisions.<sup>223</sup> However, the nature of the information requested by the DOJ and the Federal Reserve differs here.

Various areas of market entry examination are of specific interest to both the Federal Reserve and DOJ. These include the presence or absence of legal or regulatory impediments to entry or market share enlargement, the market's entry appeal, the history, if any, of entry, and accessibility for likely entrants.<sup>224</sup>

Traditionally, there have been limitations in the capability of financial institutions to enter new markets, specifically entry across state lines. Problems have also been encountered in establishing supplementary branches within a particular state or market. Any entry examination must address the existence or lack of any such obstacles and the practical effect of current constraints.<sup>225</sup>

The attractiveness of the market for entry is of particular interest to the Federal Reserve. Data showing a greater than average increase in market deposit rates, greater than average increase in population rates in the market, higher than average capital income, and higher than average individuals to banking office ratios.<sup>226</sup> Any economic or demographic data, which shows an increase in and a large market for consumer and business customers is relevant to the Federal Reserve and DOJ examinations. The DOJ and the Federal Reserve examine evidence of recent market entry that involves acquisition of in-market financial institutions by out-of-market financial institutions, as well as *de novo* entry and expansion.<sup>227</sup>

The DOJ's method of product market definition in a bank merger case, when combined with more comprehensive review, requires the development of additional data to ensure that the probability, timing, and prospects of entry are sufficiently demonstrated.

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<sup>223</sup> E.g., the HHI safe harbour provisions, *US Bank Merger Review Guidelines* (n4), pp 1-2; see, also, *Fed/DOJ Competitive Effects of Mergers FAQs* (n4), paras 4, and 16.

<sup>224</sup> *PNC Financial Services Group, Inc.* (2014) 100 Federal Reserve Bulletin 10.

<sup>225</sup> *Merchants & Farmers Bancshares* (3 August, 2015) 101 Federal Reserve Bulletin 3.

<sup>226</sup> *Old National Bancorp* (5 November, 2014) 100 Federal Reserve Bulletin 5.

<sup>227</sup> *Five Star Bank*, (December, 2012) 98 Federal Reserve Bulletin 8, p 18.



The Federal Reserve concentrates broadly on the market entry of financial institutions offering a full spectrum of products, while the DOJ reviews various kinds of entry for potential relevance.<sup>228</sup> Therefore, it is sufficient to establish facts on past and future probability, timeframe, and adequacy of market entry by newly formed financial institutions, entry by out-of-market banks or thrift institutions and the acquisition of in-market banks by out-of-market banks. The DOJ, also, considers entry prospects for out-of-market financial institutions to provide specific products like certificates of deposit, business lending, and additional services. In addition, the DOJ considers the entry prospects of out-of-market banks offering local loan production, and the expanded presence of new in-market finance company.<sup>229</sup>

In relation to entry examination, it is crucial to show that in-market banks would become larger following the merger to provide new products or serve new customers.<sup>230</sup> For example, banks providing services to small enterprises would be enabled to expand in order to render services to larger, medium-sized enterprises. Therefore, it is helpful to show that such smaller banks will acquire not only the means to expand their activities, but, also, that they will begin providing more complex cash management services and additional products that the DOJ would deem most likely to be used by medium market enterprises. This information could be significant in persuading the DOJ that there are no adverse competition consequences associated with a given bank merger.

Prior to showing that there is no negative unilateral competition effect caused by a bank merger, it must be clear that the post-merger market situation does not provide the merged banks with an opportunity to increase prices and decrease customer services.<sup>231</sup> The particular factual situation varies market to market. It is vital to show that the market share of the merged bank in the pertinent product market is not so large to allow it to wield market power.

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<sup>228</sup> *Fed/DOJ Competitive Effects of Mergers FAQs* (n4), paras 22, and 28.

<sup>229</sup> *US Bank Merger Review Guidelines* (n4), pp 3-4.

<sup>230</sup> *Ibid*, p 6.

<sup>231</sup> *Fed/DOJ Competitive Effects of Mergers FAQs* (n4), para 27.

An important consideration remains the existence of facts demonstrating the ability of other market competitors to increase supply (productivity) in response to any attempt made by the newly merged bank to either increase prices or decrease supply. In this regard, it is important to show that the financial products or services of the merged banks are not unique, and these products or services can be carried out by competitors within the market.<sup>232</sup> In addition those competitors are in a position to increase capacity and supply of products and services analogous to those offered by the merged institution.

The possible adverse competition consequences of concern to the DOJ are the likelihood of a bank merger making it easier and more probable for banks to collude to increase prices and decrease supply (productivity).<sup>233</sup> To show the DOJ that no such outcomes would result from the bank merger, it is necessary to gather facts on a series of considerations that provide banks with the incentive and capability to coordinate their efforts within the market.

The DOJ may need to look closely at specific products or product markets posing particular competition concerns in order to identify potential coordination among financial institutions. Some of the issues, which the DOJ need to focus on are: (i) whether there are such a number of competitors in the given market that coordination is challenging and improbable; (ii) whether there is a small cluster of prominent banks, which could efficiently coordinate activities, notwithstanding other competitors; (iii) whether the market is likely to encourage entry that is sufficiently simple so that prospective entrants would effectively combat any coordination among actual competitors; (iv) whether competitors can increase supply (productivity) to counteract any coordination by other competitors in the marketplace, including the existence of any nonconformist institutions that are seeking to expand quickly; and (v) whether excess volume in the marketplace, in broad terms or for specific competitors, provides an incentive to broaden rather than diminish supply (productivity).<sup>234</sup>

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<sup>232</sup> A Kline, 'KeyCorp: 'Numerous Bank Competitors' Will Remain in Western New York After First Niagara Acquisition' (11 January, 2016) *Buffalo Business News*, available at [http://www.bizjournals.com/buffalo/blog/morning\\_roundup/2016/01/keycorp-numerous-bank-competitors-will-remain-in.html](http://www.bizjournals.com/buffalo/blog/morning_roundup/2016/01/keycorp-numerous-bank-competitors-will-remain-in.html).

<sup>233</sup> T Calvani and W T Miller, 'Antitrust Analysis of Bank Mergers: Recent Developments' (July, 1993) 9 *The Review of Banking & Financial Services* 13, pp 132-5.

<sup>234</sup> See generally, R P McAfee and M A Williams, 'The Department of Justice Merger Guidelines: A Critique and a Proposed Improvement' (1990) 16 *Pepperdine Law Review* 4.

Nevertheless, it remains challenging to assume what are the most insightful means to show the absence of any potential opposing competitive concerns in a certain bank merger. It is likely that any examination of prospective adverse competition concerns in the retail product market would rely principally on evidence regarding the number of competitors and expansion magnitude. However, there is less possibility of showing that such products are diverse or that information on pricing and additional product terms is, broadly speaking, unavailable to competitors, considering that retail prices and products are generally uniform.

A comprehensive development of the relevant facts is without a doubt essential to the Federal Reserve endorsing a bank merger and the DOJ not opposing it. Merging banks are required to prepare extensively for the examination of proposed mergers by developing widespread evidence in relation to an extensive array of competitors and geographic and product markets in any specific merger transaction.

## **9.5 Conclusion**

In this chapter, a comprehensive overview of the agencies involved in the review of bank merger cases in the US has been provided, together with an analysis of the methodologies employed by those agencies to scrutinize these mergers. As has been explained, crucial to consideration of bank merger cases is the identification of the relevant geographic and product markets. Beyond these fundamental considerations, agencies now look deeper at the potential for mitigation of competition consequences that may otherwise prohibit approval of the merger, and the likely post-merger landscape.

As the two principally concerned government agencies, the Federal Reserve and Department of Justice ('DOJ') adopt similar yet different approaches to the review of bank merger cases. Specifically, the approach taken to the identification of the pertinent geographic market diverges, with the Federal Reserve adopting a fixed approach and the DOJ incorporating greater flexibility to suit particular circumstances. Disparate approaches taken by the agencies, which may lead to contrary analysis results, make the task of preparing for

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prospective merger scrutiny all the more challenging for the relevant banks. In any case, it is vital that the institutions, which propose to merge, adhere to the requirements of the DOJ, Federal Reserve, and other concerned agencies in terms of providing evidence that the merger will not give rise to anti-competitive consequences. The location of customers and branches, and particular the preservation of a marketplace in which consumers have a choice between competitor banking service providers, are critical considerations.

In the initial screening of the bank applications, similar to the Federal Reserve, the DOJ performs HHI analysis. Nonetheless, unlike the Federal Reserve, the DOJ does not have pre-defined geographic markets for screening bank applications, and it examines the competitive consequences of each bank merger on a case-by-case basis. The DOJ may use the Federal Reserve's pre-defined banking markets in its initial review, but it is not bound by those banking markets. The DOJ normally examines the competitive consequences of a proposed merger in each of two product markets: (i) retail banking products and services, and (ii) small business banking products and services. The geographic area where a retail banking customer is willing to travel for banking services may differ from that of a small business customer. The DOJ has found that retail banking customers usually prefer to bank where they live or where they work, but small business customers may be geographically more limited. Unlike the geographic market for retail banking customers, the geographic market for small business banking may be smaller than the Federal Reserve's pre-defined banking markets. Consequently, a transaction that satisfies the Federal Reserve's HHI delegation threshold still may raise concerns in the DOJ's examination.

With respect to competition analysis, the Federal Reserve and DOJ both evaluate the proposed merger with reference to jointly created merger guidelines, thus, providing some level of synergy in the broader process despite the tests applied being different. Whereas various factors form part of the respective evaluations, fundamentally the agencies are looking to ensure that the market will remain easily accessible to new entrants, if the merger is approved. Different forms of organizations both within and beyond the particular markets, including thrift institutions and bodies not offering deposit account services, may be considered as relevant competitors, in the right circumstances. Ultimately, the DOJ is empowered to proceed to litigation in order to prohibit the merger, if it has not been possible

for the relevant parties to reach an agreement with respect to measures that may sufficiently ameliorate any adverse competition consequences.

## CHAPTER 10 – GLOBAL FINANCIAL CRISIS AND COMPETITION IN BANKING

This chapter discusses competition aspects of bank mergers in the UK and US as a result of the Global Financial Crisis, and whether ‘too-big-too-fail’ (‘TBTF’) status of systemically important financial institution(s) in the UK and US creates special competition concerns in banking.

### 10.0 Effect and role of the global financial crisis in bank mergers activities

In early 2008, as several of the largest financial institutions in the US confronted impending failure,<sup>1</sup> the American financial sector completed a series of consolidations different from any it had previously experienced.<sup>2</sup> In order to thwart a systemic collapse and allow the banking system to regain its footing, bank mergers between industry heavyweights were being encouraged and expedited by regulators, with little concern for antitrust implications.<sup>3</sup>

Under the increasing risk of a major financial crisis, the American banking agencies and the DOJ started giving their blessing to ‘quick-fix’ bank mergers.<sup>4</sup> Bank of America acquired Merrill Lynch and Countrywide, JPMorgan Chase acquired Bear Stearns<sup>5</sup> and Washington Mutual, and Wells Fargo purchased Wachovia,<sup>6</sup> all on seemingly accelerated timelines of regulatory review. Such unprecedented consolidation among the largest financial institutions raised a clear concern for market domination.

The banking and financial industry has a unique place in the global economic structure due to the key role it plays in directing capital and facilitating transactions. However, the role,

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<sup>1</sup> L Story and E L Andrews, ‘Change Arrives, with a Sense That Wall St.’s Boom Times Are Over’ (15 September, 2008) *New York Times*.

<sup>2</sup> H A Shelanski, ‘Enforcing Competition During an Economic Crisis, Symposium: The Effect of Economic Crises on Antitrust Policy’ (2010) 77 *Antitrust Law Journal* 229, pp 230-35.

<sup>3</sup> A Foer, ‘Preserving Competition After the Banking Meltdown’ (December, 2008) *American Antitrust Institute, Global Competition Policy*, available at [http://www.antitrustinstitute.org/files/bank%20meltdown%20article%2012-16-08\\_121520082145.pdf](http://www.antitrustinstitute.org/files/bank%20meltdown%20article%2012-16-08_121520082145.pdf).

<sup>4</sup> D Gross, *Dumb Money: How Our Greatest Financial Minds Bankrupted the Nation* (New York: Free Press 2009), p 88.

<sup>5</sup> Federal Reserve, ‘Bear Stearns, JPMorgan Chase, and Maiden Lane LLC’ (March 2008) FRB (‘Bear Stearns’), available at [http://www.federalreserve.gov/newsevents/reform\\_bearstearns.htm](http://www.federalreserve.gov/newsevents/reform_bearstearns.htm).

<sup>6</sup> J M Rosenberg, *The Concise Encyclopaedia of The Great Recession 2007-2012* (Lanham: Scarecrow Press 2012), p 405.

as it exists today, exposes the industry to the significant interest-rate risk between long-term assets and short-term liabilities, as well as the inter-connection amongst financial institutions within the interbank market and the payment system. These risks, along with the crises they have created, have led banks and financial institutions to be categorized as ‘special’, in that they garner heightened public suspicion and blame and heightened governmental intervention in times of panic.<sup>7</sup>

The idea that financial institutions are essentially unlike other types of businesses may unusually vindicate governmental involvement in their operations, including mergers and acquisitions. The financial sector can create heightened risks of contagion and economic collapse compared with other industries. The failure of a single financial institution can cause a waterfall of runs on other financial institutions. Unlike manufacturing enterprises that work through inventories and diminish production over weeks and months, substantial liquidity can be drained from the financial system in a matter of days - exemplified by the downfall of Lehman Brothers in 2008.<sup>8</sup>

The Global Financial Crisis (‘GFC’) emerged from the unscrupulous underwriting of mortgages, the assignment of inflated credit ratings to mortgage-backed securities, financial institutions’ inadequate risk management systems, and an insufficient and enabling regulatory environment. But the enormous global fall-out from these events indicates that the complications spurring from subprime mortgages are only a sign instead of the root of the crisis.<sup>9</sup>

The notions of ‘too-big-too-fail’ (‘TBTF’) and ‘systemic risk’ emerged as key concerns for the banking and financial system. The question was whether by supporting the ‘quick-fix’ bank mergers, banking regulators increased the future risks posed by TBTF institutions.<sup>10</sup> By empowering the nation’s largest financial institutions to combine and

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<sup>7</sup> M N Baily et al, ‘The Origins of the Financial Crisis’ (November 2008) *Brookings Research Papers*, available at <http://www.brookings.edu/research/papers/2008/11/origins-crisis-baily-litan>.

<sup>8</sup> A D Halm-Addo, *The 2008 Financial Crisis: The Death of an Ideology* (Pittsburgh: Dorrance Publishing 2010), pp 10-11.

<sup>9</sup> G K Zestos, *The Global Financial Crisis: From US Subprime Mortgages to European Sovereign Debt* (New York: Routledge 2015), chap 2.

<sup>10</sup> N Kocherlakota, ‘Too-Big-to-Fail: The Role of Metrics’ (18 September, 2013) *FRBM*, available at [www.minneapolisfed.org/news-and-events/presidents-speeches/toobigtofail-the-role-of-metrics](http://www.minneapolisfed.org/news-and-events/presidents-speeches/toobigtofail-the-role-of-metrics).

achieve unprecedented scale, questions were raised whether the US Government had bypassed the requirements of the Bank Merger Act<sup>11</sup> and the Clayton Act,<sup>12</sup> which otherwise may have prevented many of these mergers from taking place.<sup>13</sup>

The monetary strategies of the Bank of England in the UK and the Federal Reserve in the US, among other countries, were excessively lax and overemphasized consumer price increases to the neglect of asset price increases. The Asian financial crisis of 1997 and the strategies that the International Monetary Fund ('IMF') applied to it instilled in Asian governments a more conservative and responsible fiscal policy.<sup>14</sup> These differences in fiscal policy led to significant worldwide distortions, which ultimately accelerated the bursting of the bubble. The popping of the toxic mortgage bubble generated massive ambiguity within the capital markets.<sup>15</sup> The uncertainty and volatility during the financial crisis brought into question whether government backing was justified and in what way antitrust concerns should be upheld and enforced.

The UK and the US faced difficulties in various business sectors as the recession took hold. Strains on lenders stemming from capital evaporating from toxic assets forced them to tighten lending standards, which in turn created challenges for borrowers trying to obtain credit at suitable rates. The severe tumble in consumer demand reduced sales, leading retailers to cut inventory, and manufacturers to lose orders and scale back production. Indeed, the complications faced by individual banks spread to undermine the entire economy.<sup>16</sup>

In the financial sector, UK and the US antitrust authorities slackened enforcement in the name of economic stability. Proponents of saving the banks defied antitrust adherents' beliefs that competition remained part of the answer to benefitting consumers and ultimately

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<sup>11</sup> 12 USC § 1828 ('Bank Merger Act' ('BMA')).

<sup>12</sup> Clayton Antitrust Act 1914, 15 USC §§12-27, 29 USC §§52-53 ('Clayton'), § 18 (section 7).

<sup>13</sup> R P Zora, 'The Bank Failure Crisis: Challenges in Enforcing Antitrust Regulation' (2009) 55 *Wayne Law Review* 1175 ('Zora'), p 1180.

<sup>14</sup> See generally S D Sharma, *The Asian Financial Crisis: Crisis, Reform and Recovery* (Manchester: Manchester University Press 2003).

<sup>15</sup> Financial Crisis Inquiry Commission, 'The Financial Crisis Inquiry Report: Final Report: Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States' (2011) *US Congress*, p 371, available at [www.gpo.gov/fdsys/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf](http://www.gpo.gov/fdsys/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf).

<sup>16</sup> S Nayak, *The Global Financial Crisis: Genesis, Policy Response and Road Ahead* (New York: Springer Science 2013), p 56.



stimulating and salvaging the economy.<sup>17</sup>

During the GFC, it was suggested that a less strict implementation of antitrust oversight was necessary and suitable. Both American antitrust and the UK competition regulators were burdened by political pressure to limit competition oversight in the financial industry to prop up banks struggling with eroding capital. This pressure included efforts to ease considerations of market control and market domination by banks and their acquisitions so that they could benefit from decreased competition and greater pricing power. Industry friendly policies were developed toward the largest financial institutions. For instance, national banks that already controlled significant deposit market-share were permitted to merger large competitors.<sup>18</sup>

One significant drawback of the adoption and application of anticompetitive attitudes is that they can delay economic recovery from the damage caused by banks and other financial institutions. Economic analysis demonstrates that the interruption of antitrust rules in the US in the 1930s prolonged the Great Depression.<sup>19</sup> Analogously, studies demonstrate that when the UK Parliament constrained competition during the GFC, one result was a continuation of the recession in the UK.<sup>20</sup> One of the key contributing factors to these results appears to be that financial meltdowns should generate long-term benefits by easing the exit of ineffective banks and enabling the entry of innovative and effective competitors. Allowing failing banks to fail can provide a cascade of lasting advantages for a national economy. It ultimately allows new entrants in the marketplace, which in turn continue to provide credit and other financial services to consumers and producers who demand and require them.

It remains uncertain whether a moderate method toward market influence can be adopted in the banking sector. The supposition that strength concerns supersede competition

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<sup>17</sup> I Hasan and M Marinč, 'Should Competition Policy in Banking Be Amended During Crises? Lessons from the EU' (May, 2013) *European Journal of Law and Economics*, pp 8-13, available at [http://www.ef.uni-lj.si/docs/osebnestrani/hasanmarinc\\_competitionpolicyinafinancia.pdf](http://www.ef.uni-lj.si/docs/osebnestrani/hasanmarinc_competitionpolicyinafinancia.pdf).

<sup>18</sup> T F Geithner, *Stress Test: Reflections on Financial Crises* (New York: Crown Publishers 2014), ch 7; see, also, D Judge et al, *Surveying Institutions in Crisis* in D Richards et al (eds.) *Institutional Crisis in 21st-Century Britain* (Hampshire: Palgrave Macmillan 2014), pp 81-117.

<sup>19</sup> C W Calomiris, *The Political Lessons of Depression-era Banking Reform* in N Crafts et al (eds.) *The Great Depression of the 1930s: Lessons for Today* (Oxford: Oxford University Press 2013), p 178.

<sup>20</sup> J Fingleton, 'Competition Policy in Troubled Times' (20 January, 2009), available at [www.ofc.gov.UK/shared\\_ofc/speeches/2009/spe0109.pdf](http://www.ofc.gov.UK/shared_ofc/speeches/2009/spe0109.pdf).

concerns is staunchly adhered to. The extent to which stability concerns affect policy considerations toward market competitiveness needs to be determined. In light of the GFC, it is important to consider whether previous and current competition policy assumes uniform and typical market conditions. It is, also, important to consider whether a given policy is being implemented to address the anti-competitive outcomes of individual bank mergers, or to establish a broader agenda toward bank consolidations throughout the industry as a whole.<sup>21</sup>

The UK and American antitrust regulators were confronted with an enormous involvement of political and administrative influence on the financial system. A series of actions were undertaken to assist the financial system, such as, steep drops in central bank interest rates, modifications to liquidity accounting standards and modifications of collateral needs, as well as additional quantitative easing asset purchases, and guarantee arrangements sheltering banks' liabilities and dealings in the interbank marketplace.<sup>22</sup>

Authorities in the UK and the US were integral to rescue operations, such as, those of Northern Rock, West LB, Bear Stearns, AIG, and Merrill Lynch.<sup>23</sup> These undertakings were products of uncertainty about contagion and fear of a systemic catastrophe emanating from a loss of confidence in the banking system as a whole. In the UK, the lines of customers seeking to withdraw their savings from Northern Rock branches in September, 2007<sup>24</sup> provided an early sign of the impending financial meltdown. For a financial institution, Northern Rock was uncommonly reliant upon *ad interim* capitalization from institutional investors instead of individual depositors.<sup>25</sup> Instead of its loan book deteriorating, it was the shutting off of its short-term funding mechanisms that caused Northern Rock to become insolvent. Northern Rock was vulnerable and ultimately succumbed to systemic deleveraging as the UK and

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<sup>21</sup> S Claessens and L Kodres, 'The Regulatory Responses to the Global Financial Crisis: Some Uncomfortable Questions' (March, 2014) *IMF Working Paper 14/46*, pp 4-5, and 30, available at <https://www.imf.org/external/pubs/ft/wp/2014/wp1446.pdf>.

<sup>22</sup> B Gökay, 'Mapping the Faultlines: A Historical Perspective on the 2008-2009 World Economic Crisis' (15 February, 2009) *Centre for Research on Globalization*, available at <http://www.globalresearch.ca/the-2008-world-economic-crisis-global-shifts-and-faultlines/12283>.

<sup>23</sup> B S Bernanke, 'Reflections on a Year of Crisis' (21 August, 2009) *Federal Reserve Bank of Kansas City's Annual Economic Symposium*, Jackson Hole, Wyoming, available at <http://www.federalreserve.gov/newsevents/speech/bernanke20090821a.htm>.

<sup>24</sup> H S Shin, 'Reflections on Northern Rock: The Bank Run that Heralded the Global Financial Crisis' (2009) 23 *Journal of Economic Perspectives* 101, p 102.

<sup>25</sup> *Ibid*, pp 110-116.

American banks looked to reduce vulnerabilities on their balance sheet.<sup>26</sup>

The distress had commenced before Northern Rock's failure, as demonstrated by August, 2007's sizable expansion of money market spreads.<sup>27</sup> Increasingly, events like the Federal Reserve's easing of the federal funds rate in September, 2007 indicated a distinctly intensified awareness of credit risks throughout the financial system. Such developments accelerated throughout 2008, with Bear Stearns being bought by JPMorgan Chase in March,<sup>28</sup> Lehman Brothers failing in September,<sup>29</sup> and before long turmoil in the markets for mortgage backed securities, credit default swaps, repurchase agreements, money market funds, auction rate securities, and short-term credit was threatening the entire financial system. The collapse of asset prices and distressed deleveraging processes was a far-reaching event, with grave repercussions for the financial system. Ultimately it transformed a private debt watershed into an economic emergency, which would last for years to come.<sup>30</sup>

The complexity of the GFC and the magnitude of 'public' intervention by the UK and American regulators were nearly unparalleled. Competition regulators were compelled to partake in the industry consolidations and rubber-stamp mergers of major industry players. Certain practices of 'public' involvement and encouragement of financial industry health could be justified considering the special circumstances.<sup>31</sup> However, the extent to which industry consolidation ought to be employed as a means of renewing economic confidence must be earnestly scrutinized.

Several experts have contended that competition enforcement should have been deferred during the financial meltdown in order to permit authorities to concentrate

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<sup>26</sup> *Ibid*, pp 117-119.

<sup>27</sup> N Cassola and C Morana, 'Euro Money Market Spreads During the 2007-? Financial Crisis' (May, 2012) *European Central Bank, Working Paper Series No 1437*, pp 2-4, available at <https://www.ecb.europa.eu/pub/pdf/scpwps/ecbwp1437.pdf?9de0bd09c7ab66b693b7e1b34e60290c>.

<sup>28</sup> *Bear Stearns* (n5).

<sup>29</sup> US Congress, 'The Effect of the Lehman Brothers Bankruptcy on State and Local Governments' (5 May, 2009) *Hearing before the Committee on Financial Services, US House of Representatives*, 111<sup>th</sup> Congress, 1<sup>st</sup> Session.

<sup>30</sup> L Hernandez Jr, *Too Small to Fail: How the Financial Industry Crisis Changed the World's Perceptions* (Bloomington: Author-House 2010), ch 2.

<sup>31</sup> J R Bisignano and W C Hunter, *Global Financial Crises: Lessons From Recent Events* (Massachusetts: Kluwer Publisher 2000), pp 272-276.

exclusively on the task of preserving the strength of the financial system.<sup>32</sup> This perspective brings into question the role and value of industry competition during times of systemic stress. Other commenters have emphasized the significance of upholding rigorous competition provisions during the financial crises to guarantee an equal application of the rules and consistent response to the financial crisis, and also to prevent a wasteful subsidy contest between the UK and US.<sup>33</sup>

Various characteristics of competition strategy, like the ‘failing firm’ principal in bank merger assessment, can aid in understanding the importance of regulatory rigor in the face of economic instability. In terms of enabling the dialogue surrounding competition strategy and public involvement, the European Commission issued several communications on state support of banks during the GFC meltdown (the ‘Banking Communication’).<sup>34</sup> The Communication offered specific guidelines for the compatibility of State aid with Article 107(3)(b) TFEU.<sup>35</sup> Each of the communications has been a continuation of the response to the GFC. They have served as an indefinite and temporary mechanism from the EU, until the Commission establishes a permanent statutory regulation for state support of struggling financial institutions. They also provide a regulatory framework for coordinated measures in support of the banking sector, while lessening distortions of competition between financial institutions in single markets and across Member States.<sup>36</sup>

While acknowledging the aberrant nature of the GFC, the Banking Communication identified components of the public support that caused unwarranted alterations of competition among banks.<sup>37</sup> The Communication delineated between structures in support of

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<sup>32</sup> T Beck, ‘Bank Competition and Financial Stability’ (June, 2008) *Working Paper before the G20 Seminar on Competition in the Financial Sector*, p 20, available at

<http://siteresources.worldbank.org/INTFR/Resources/BeckBankCompetitionandFinancialStability.pdf>.

<sup>33</sup> *Ibid.*

<sup>34</sup> Presently the valid ‘*Banking Communication*’ is communication from the Commission on the application from 1 August, 2013 of State aid rules to support measures in favour of banks in the context of the financial crisis (‘*Banking Communication*’), 2013/C 216/01, C 216/1, 30.7.2013 (‘*Banking Communication 2013*’); Communication from the Commission, The application of the State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis (2008/C 270/02) (‘*Banking Communication 2008*’); Communication from the Commission, Community guidelines on State aid for rescuing and restructuring firms in difficulty, OJ 2004 C 244/2 (‘*Banking Communication 2004*’).

<sup>35</sup> P Marsden and I Kokkoris ‘The Role of Competition and State Aid Policy in Financial and Monetary Law’ (2010) 13 *Journal of International Economic Law* 875, pp 876-92.

<sup>36</sup> See generally *Banking Communication 2013* (n36), and *Banking Communication 2008* (n36).

<sup>37</sup> *Banking Communication 2013* (n36), paras 4, and 28.

specific banks, particularly those of systemic importance, and structures intended to support the industry as a whole.<sup>38</sup> Together the structures in Article 107 TFEU<sup>39</sup> and the overall rules on State aid<sup>40</sup> for salvaging and reorganizing banks and other financial institutions form a useful regulatory framework. Ultimately, these structures explain what State aid is permitted to resolve a severe disruption in the economy of a Member State (*i.e.* UK).

Concerning states backing specific financial institutions, the Banking Communication distinguishes between banks with complications stemming from broad marketplace events that have affected capital and liquidity industry-wide, from banks that are distressed due to their own internal banking practices, business choices, and risk management.<sup>41</sup> Arrangements sustaining the first category are preferable, because they are less likely to generate moral hazard and produce negative externalities on society. Such arrangements can recapitalize and sustain banks that would be sound under normal conditions, while not encouraging excessive risk taking by other industry participants.<sup>42</sup>

While the regulatory position toward all banks in a particular market ought to maintain the standards of competition within that market, one concern is the extent to which actions in one state will adversely affect markets abroad. Provided the size and worldwide interconnectedness of contemporary financial institutions, it is hard to curb the competitive consequences of guarantee structures within a given country's boundaries. In terms of limiting the shifting of competition standards, the Banking Communication includes broad guarantee arrangements and the possibility of recapitalization for all banks in a given Member State (including the domestic subsidiaries of foreign financial institutions).<sup>43</sup> The Communication requires that the guarantees only cover critical liabilities.<sup>44</sup> To preserve certainty in the financial system, retail and, to a degree, wholesale deposits would be safeguarded. However, subordinated debt and other types of borrowings are not protected.<sup>45</sup>

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<sup>38</sup> *Ibid*, paras 10-11, and 80.

<sup>39</sup> Treaty on the Functioning of all European Union (Consolidated version 2012) *OJ C 326/01* ('TFEU'), art 107.

<sup>40</sup> Commission, 'Guidelines on State aid for rescuing and restructuring firms in difficulty' (2004) *OJ C 244*, 1.10.2004 ('State Aid Guidelines').

<sup>41</sup> *Banking Communication 2013* (n36), paras 65-67,

<sup>42</sup> *Ibid*, paras 22, 23, 24, and 28-31.

<sup>43</sup> *Ibid*, paras 56-61.

<sup>44</sup> *Ibid*, para 59.

<sup>45</sup> *Ibid*, para 77.

The enactment of EU banking communication in 2008 that preceded the present Banking Communication was the first concrete measure taken by the Commission, which recognized that Article 107 TFEU<sup>46</sup> allows financial relief to resolve a ‘serious disturbance’ within the financial system of an EU Member State.<sup>47</sup> The Communication embraces many different kinds of aid, including guarantees of banks’ liabilities, recapitalization of banks that were not subject or entitled to the rescue and restructuring aid provisions, the controlled shuttering of banks, and central banks’ provision of certain temporary liquidity supports that are not considered State aid.<sup>48</sup>

The Commission differentiates between good and bad banks, specifically, those that are ‘illiquid’ but otherwise primarily sound and those facing challenges from inefficiency or ‘excessive risk-taking’.<sup>49</sup> This difference might not be easy to distinguish in specific situations. However, it can have significant implications. The banks that are categorized in the second group would normally be required to endure heightened scrutiny to qualify for rescue and reorganization provisions, while banks in the first group would benefit from a more expedited process of qualifying for assistance.<sup>50</sup>

Although the standards set forth in the Banking Communication show the Commission’s conventional view toward State aid, the Communication presents important novel components. One new component is a short timetable - limited to twenty-four hours or a single weekend – for the Commission to evaluate and grant aid to banks needing liquidity. Another new component of the Communication is its restriction on the lifespan of aid. The standard threshold of six months for emergency financial relief is commonly protracted to two years, with biannual assessments to determine if the aid is still essential.<sup>51</sup>

In late 2008 and early 2009, the Commission endorsed numerous financial recovery packages according to the Banking Communication, with the UK executing recapitalization

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<sup>46</sup> TFEU (n41), art 107.

<sup>47</sup> *Banking Communication 2008* (n36), paras 7-9, and 12.

<sup>48</sup> *Ibid*, paras 51-53.

<sup>49</sup> *Banking Communication 2013* (n36), para 9.

<sup>50</sup> *Ibid*, para 62.

<sup>51</sup> *Ibid*, paras 36, and 57.

arrangements with HBOS, Royal Bank of Scotland, and Lloyds Banking Group.<sup>52</sup> Other EU Member State's imposed similar liquidity injection operations.<sup>53</sup> However, state ownership of financial institutions is not a remedy with respect to competitiveness and efficiency. Although a public system has the benefit of not facing liquidity crises of its power to tax, issue sovereign debt, and print money, it also presents a greater risk of complacency and inefficiency.<sup>54</sup> This might slow any recovery, or alternatively, encourage excessive risk taking. State ownership of financial institutions can limit competition and impede prosperity. State-owned financial institutions tend to be motivated by political interests and influence rather than commercial and mercantile incentives. Businesses receiving loans from state-owned financial institutions incur lower borrowing costs than businesses seeking loans from the private sector. However, state-owned institutions tend to be less profitable and can create more systemic risk.<sup>55</sup>

The early phases of the GFC were defined by diverse government initiatives by the UK and the US intended to sustain their domestic financial markets.<sup>56</sup> The necessity of a harmonized response was quite clear, and was quickly acknowledged by national and EU competition authorities.<sup>57</sup> However, in its efforts to bolster its domestic financial sector, the UK adopted competition strategies that could put the international financial markets at risk.<sup>58</sup>

The Commission succeeded in adhering to set competition policies and provisions, while permitting flexibility in their enforcement during the financial crisis. The Commission's approach received approval from the UK competition watchdog that emphasized that

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<sup>52</sup> Case N 507/2008 – Financial Support Measures to the Banking Industry in the UK (13 October, 2008) *Commission decision*, paras 9, 13, and 69.

<sup>53</sup> For example, the Dutch Government bailout package for ING in 2008, and the Danish Government rescue scheme for Roskilde Bank in 2008. See, Commission, 'State Aid: Overview of National Rescue Measures and Deposit Guarantee Schemes' (14 October, 2008) *Memo/08/619*.

<sup>54</sup> J C Rochet and J Tirole 'Controlling Risk in Payment System' (1996) *Journal of Money, Credit and Banking* 28, pp 823-60.

<sup>55</sup> L Porta et al, 'Government Ownership of Banks' (2002) *Journal of Finance* 57, pp 265-301.

<sup>56</sup> A G da Silva et al, 'Antitrust Implications of the Financial Crisis: A UK and EU View' (Spring 2009) *Antitrust Journal*, p 31.

<sup>57</sup> N Kroes, 'The Thin Line between Regulation and Competition Law: The Interface between Regulation and Competition Law' (28 April, 2009) *Bunderskartellamt Conference on Dominant Companies*, p 3, available at [http://europa.eu/rapid/press-release\\_SPEECH-09-202\\_en.htm?locale=en](http://europa.eu/rapid/press-release_SPEECH-09-202_en.htm?locale=en).

<sup>58</sup> M Reynolds et al, 'EU Competition Policy in the Financial Crisis: Extraordinary Measures' (2010) 33 *Fordham International Law Journal* 1670, pp 1671-78.

competition was just as important in difficult economic times as it is in the good times, and adding that UK aspired to be a stabilizing force throughout the financial crisis.<sup>59</sup>

In 2009, the European Commissioner for Internal Market and Services stated that, ‘the [Global Financial Crisis] has required substantial state intervention in financial institutions in many Member States’.<sup>60</sup> While this may be true, the Commission appeared to lack effectiveness in enforcing EU provisions, especially concerning competition and public aid to banks. It, also, failed to show the assertiveness necessary to establish calm in the financial industry and temper the effect of systemic hazards.

Although there was an overall reduction in bank mergers during the GFC, the mergers that did occur faced less examination review from the Commission. The Commission claimed that there was ‘special treatment’ given to banks that viewed mergers as a solution for financial concerns.<sup>61</sup> The Commission did not see any reason to permit formation of additional banks deemed TBTF.<sup>62</sup> During the GFC, few bank merger cases came under the Commission’s jurisdiction, as the bulk of cases were domestic and not cross-border transactions.<sup>63</sup> Nevertheless, the Commission acknowledged that certain bank mergers within Member States raised potential competition concerns. However, it vowed not to create unreasonable hurdles. In the end, the Commission decided it was better to not block cross-border bank mergers for competition purposes over the course of the GFC.<sup>64</sup>

From October, 2008 through October, 2011, the Commission granted State aid to the financial services industry in the sum of €4.5 trillion, which represented about 36.7 per cent of

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<sup>59</sup> P Freeman, ‘Competition Advocacy in Time of Recession: The UK CC’s Approach’ (15 April, 2009) the *2009 International Competition Forum* (Warsaw), available at [www.competitionforum.uokik.gov.pl/download/freeman\\_warsaw\\_150409.pdf](http://www.competitionforum.uokik.gov.pl/download/freeman_warsaw_150409.pdf).

<sup>60</sup> C McCreevy, ‘Financial Markets and Economic Recovery - Restoring Confidence and Responding to Public Concerns’ (27 January, 2009), available at [http://europa.eu/rapid/press-release\\_SPEECH-09-23\\_en.htm](http://europa.eu/rapid/press-release_SPEECH-09-23_en.htm).

<sup>61</sup> Commission, ‘The Effects of Temporary State Aid Rules Adopted in the Context of the Financial and Economic Crisis’ (5 October, 2011) *SEC 1126 final* (‘State Aid Rules in the Financial Crisis’), available at [http://ec.europa.eu/competition/publications/reports/working\\_paper\\_en.pdf](http://ec.europa.eu/competition/publications/reports/working_paper_en.pdf).

<sup>62</sup> N Kroes, ‘Time for Banks to Shoulder Their Responsibilities’ (14 March, 2009) *Deutsche Bank Conference*, p 5, available at [http://europa.eu/rapid/press-release\\_SPEECH-09-266\\_en.htm?locale=en](http://europa.eu/rapid/press-release_SPEECH-09-266_en.htm?locale=en).

<sup>63</sup> D Gerard, ‘EC Competition Law Enforcement at Grips with the Financial Crisis: Flexibility on the Means, Consistency in the Principles, in Concurrences’ (2009) *Institute of Competition Law Issue* No 1, p 55.

<sup>64</sup> N Kroes, ‘Competition and Regulation in Retail Banking and Payment Markets’ (25 May, 2009) *ECB-DNB Retail Payments Conference*, available at [http://europa.eu/rapid/press-release\\_SPEECH-09-266\\_en.htm?locale=en](http://europa.eu/rapid/press-release_SPEECH-09-266_en.htm?locale=en).



EU GDP.<sup>65</sup> During the GFC the Commission applied competition policies accommodatingly and with sensitivity to the financial environment. A prime example is the bank takeover of Alliance & Leicester ('A&L') by the Santander Group ('Santander').<sup>66</sup> That takeover was made public on 14 July, 2008,<sup>67</sup> was reported to the Commission on August 8<sup>th</sup>, and was cleared on the 15<sup>th</sup> of September.<sup>68</sup> The Commission noted that the takeover combined the sixth (Santander) and eighth (A&L) largest financial institutions in the UK.<sup>69</sup> It, also, noted that both banks had concentrations in wholesale banking, corporate customer services, insurance, and credit cards. However, within each of these areas, the banks' combined market share was less than fifteen percent.<sup>70</sup> As a result, the merged entity would encounter significant market competition from a number of UK financial institutions including HBOS, Barclays, Lloyds, HSBC, RBS/NatWest, and Nationwide. The Commission added that, A&L was active in cash management and cash sales, while Santander was inactive. Considering the limited market shares of A&L and Santander and the lack of concentration in any single line of business, the Commission determined that the merger did not raise any competition concerns.<sup>71</sup>

Another bank takeover of interest to the Commission during the GFC was Bradford & Bingley (B&B) by Abbey in 2008. Following the B&B's nationalization due to its failure, Abbey, a subsidiary of the Santander Group (BSCH), acquired the deposit book and accompanying assets of B&B.<sup>72</sup> Upon approval of the public bailout of the B&B by the Commission under the EU State aid rules,<sup>73</sup> the Commission looked into the proposed acquisition.<sup>74</sup>

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<sup>65</sup> Commission, 'Competition Policy and Economic Recovery: Tackling the Financial Crisis' (2012), available at [http://ec.europa.eu/competition/recovery/financial\\_sector.html](http://ec.europa.eu/competition/recovery/financial_sector.html).

<sup>66</sup> Commission Decision, Case No. COMP/M.5293, slip op. (European Commission 16 September, 2008), cited in 2009 OJ C 26/3, p 8 ('Santander/Alliance & Leicester').

<sup>67</sup> House of Commons, 'Banking Crisis: Dealing with the Failure of the UK Banks' (21 April, 2009) *HC Session 2008-2009*, p 29.

<sup>68</sup> *Santander/Alliance & Leicester*, (n68), pp 1, and 2.

<sup>69</sup> Commission, 'Mergers: Commission Approves Proposed Acquisition of Alliance & Leicester by Banco Santander' (16 September, 2008) *Press Release IP/08/1325*.

<sup>70</sup> *Ibid.*

<sup>71</sup> *Ibid.*

<sup>72</sup> HM Treasury, 'Bradford & Bingley plc' (29 September, 2008) *Newsroom & Speeches 97/08*, available at [http://webarchive.nationalarchives.gov.uk/+http://www.hm-treasury.gov.uk/press\\_97\\_08.htm](http://webarchive.nationalarchives.gov.uk/+http://www.hm-treasury.gov.uk/press_97_08.htm).

<sup>73</sup> Commission, 'Mergers: Commission approves acquisition of Bradford & Bingley Assets by Banco Santander subsidiary Abbey' (18 December, 2008) *Press Release IP/08/2012*.

<sup>74</sup> Case No. COMP/M.5363 *Santander/Bradford & Bingley Assets* [2008] OJ C 7/4.

The Commission noted that Abbey purchased all of B&B's wholesale savings account deposits, bank branches, and additional key business assets.<sup>75</sup> Importantly, B&B's mortgage lending business had already been transferred to the UK Government.<sup>76</sup>

The Commission noted also that because B&B did not offer a complete variety of wholesale banking services prior to the takeover, the acquisition was unlikely to have a substantial effect on Abbey's pricing power in the wholesale banking business.<sup>77</sup> The Commission based its examination on the supposition that Abbey could re-establish the pre-takeover position of B&B if it wanted to.<sup>78</sup> Indeed, B&B's established customer relationships allowed Abbey to maintain a mortgage lending business comparable to what it pre-takeover had. Under these circumstances, the merged bank's market share of UK mortgage lending stayed below twenty percent, with only a slight increase attributable to the takeover.<sup>79</sup> Considering that Abbey would continue to encounter competition from several major banks within the mortgage marketplace, the Commission found the takeover of B&B by Abbey did not raise significant competition concerns.<sup>80</sup> In the end, the Commission approved the takeover.<sup>81</sup>

Although the UK competition authorities maintain that the GFC did not disturb the bank merger review standard<sup>82</sup> there were significant modifications to merger examination processes. The general idea from the competition authorities was that past market structures and standards may no longer provide a suitable basis for review.<sup>83</sup>

Governments in the UK and US reacted to the financial crunch by underwriting their respective banking systems in order to safeguard depositors' monies and quell the destruction of banks challenged by rapidly evaporating liquidity. In the EU, most of the rescue measures

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<sup>75</sup> *Ibid*, para 5.

<sup>76</sup> *Ibid*, para 7.

<sup>77</sup> *Ibid*, paras 22-24.

<sup>78</sup> *Ibid*, para 29.

<sup>79</sup> *Ibid*, para 27.

<sup>80</sup> *Ibid*, para 29.

<sup>81</sup> *Ibid*, para 37.

<sup>82</sup> C Pouncey and K Fountoukakos, 'Mergers in Times of Crisis: Business as Usual?' (2010) *European Antitrust Review*, pp 22-23.

<sup>83</sup> *Ibid*, p 26.

involved some form of State aid under Article 107 TFEU.<sup>84</sup> However, such aid is unlawful in the event the Commission does not approve it. Under normal circumstances, the approval process takes at least a couple of months, but due to the urgency and gravity of the financial crisis, government actions were quickly taken without Commission approval. This decisive but unapproved action raised the risk that competition between the UK banks and other Member State banks would be distorted.<sup>85</sup>

Government measures including: take overs, extensions of deposit insurance, recapitalizations, loans below market rates, and the repurchase of distressed assets could be considered illegal without the blessing of the Commission.<sup>86</sup> The Commission reacted to these government initiatives by lowering the requirements for granting approval of such State aid. These changes in the standards of administrative review came under the auspices of ‘severe instabilities’ in the financial markets. However, such changes could have major consequences for the implementation of EU competition enforcement going forward.<sup>87</sup>

In response to the GFC, the Commission presented a novel and more relaxed evaluation and implementation process to allow governmental bailout provisions. Such policy shifts can be considered a direct consequence of political pressure to place a moratorium on such provisions entirely. From the inception of the GFC, the Commission had in certain instances moved swiftly, utilizing its State aid authority. For instance, the Commission approved the UK bailout of Bradford & Bingley within a day.<sup>88</sup> The Commission acted with the same speed in approving other Member States’ bank merger applications, as well.<sup>89</sup> On one hand the Commission’s accelerated approvals show how its processes had changed. On the

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<sup>84</sup> TFEU (n41), art 107; see, also, *State Aid Guidelines* (n42).

<sup>85</sup> *State Aid Rules in the Financial Crisis* (n63); see, also, C Quigley, ‘Review of the Temporary State Aid Rules Adopted in the Context of the Financial and Economic Crisis’ (2010) 3 *Journal of European Competition Law & Practice* 237, pp 240-243.

<sup>86</sup> J J Piernas López, *The Concept of State Aid under EU Law: From Internal Market to Competition and Beyond* (Oxford: Oxford University Press 2015), pp 224-226.

<sup>87</sup> E Szyszczak, *Research Handbook on European State Aid Law* in C Ahlborn and D Piccinin (eds.) *The Great Recession and Other Mishaps: The Commission’s Policy of Restructuring Aid in a Time of Crisis* (Cheltenham: Edward Elgar Publishing 2011), p 154.

<sup>88</sup> Commission, ‘State aid: Commission approves UK rescue aid package for *Bradford & Bingley*’ (1 October, 2008) *IP/08/1437*.

<sup>89</sup> Commission, ‘Announcing approval of German rescue of Hypo Real Estate’ (2 October, 2008) *IP/08/1453*; see, also, Commission, ‘Announcing approval of Belgian rescue of Fortis’ (20 November, 2008) *IP/08/1746*.

other hand, the Commission's actions reveal its importance, which had been increasing with its involvement in dealing with the meltdown of financial markets.

The Brexit referendum result of 2016 has thrown the UK towards uncharted waters in terms of the future relationship between the UK and the EU, including implementation of EU provisions and the UK's access in the EU market. However, the foregoing is not part of the analysis in this thesis, notwithstanding its importance.

## 10.1 Response to the 'too-big-to-fail' concern

Financial stability decisions are not 'political' in itself without separate interference. Banking markets are naturally, oligopolistic, which cannot be prevented with the objective being to ensure that these operate in a safe and stable manner. Consumers have a right of choice and can say no with competition authorities not being entitled to force competition on them. International competition is also relevant with countries having a legitimate interest to ensure that they have one or more large banks that can compete globally.<sup>90</sup> The 'too-big-to-fail' ('TBTF') was a problem following the Global Financial Crisis ('GFC'), although a large number of important steps have been taken to correct this since. To address these criticism, the author analyses the responses to the TBTF problem in light of the actions taken by the international bodies and national authorities, respectively.<sup>91</sup>

One of the key issues addressed by the international financial system was the matter of systemically important financial institutions ('SIFIs'), or institutions that are TBTF. Inadequate systemic risk control had an important role in the GFC.<sup>92</sup> Dealing with SIFIs and the moral hazard associated with them was a key priority of the group of the most industrialized countries (so-called the 'G20').<sup>93</sup>

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<sup>90</sup> A E Wilmarth, Jr., 'Narrow banking as a structural remedy for the problem of systemic risk: A comment on professor Schwarcz's ring-fencing' (2014) 88 *Southern California Law Review* 1.

<sup>91</sup> E.g., Report, 'Progress and next steps towards ending 'Too-Big-To-Fail' (TBTF)', Financial Stability Board, 2 September 2013.

<sup>92</sup> R Lastra, 'Systemic Risk, SIFIs and Financial Stability', 6 *Capital Markets Law Journal* (2011) 197.

<sup>93</sup> G20, *Summit Leaders' Declaration (Seoul, South Korea)*, 11-12 November 2010, para 30.

At the Pittsburgh Summit in 2009, G20 leaders called on the Financial Stability Board ('FSB') to propose measures to address the systemic and moral hazard risks associated with SIFIs.<sup>94</sup> The TBTF issue occurs, when the threatened failure of a SIFI provides public authorities, with the sole choice of bailing it out, utilizing public funds to avoid financial instability and economic damage.<sup>95</sup> This public assistance encourages SIFIs to take unwarranted risks and signifies a large implied public subsidy of private financial institutions.

At London Summit, in 2009, the G20 Summit set out priorities of restoring the economy that included strengthening financial supervision and regulation and to extend regulation and oversight to all systemically important financial institutions.<sup>96</sup>

In 2010, the FSB released a series of recommendations and time lines on reducing the moral hazard posed by systemically important financial institutions.<sup>97</sup> It seeks to improve the ability of national regulators to resolve SIFIs in an orderly manner, while allowing these institutions to fulfil their key functions in the economy. The FSB recommends that SIFIs have a higher loss absorbency capacity than Basel III requirements, and that SIFIs are subject to more intensive supervision and resolution planning.<sup>98</sup>

At Seoul Summit, in 2010, the G20 leaders reaffirmed their view that no financial institution should be too big or too complicated to fail and that taxpayers should not bear the costs of resolution.<sup>99</sup> The FSB, at the request of the G20, publishes an annually updated list of financial institutions deemed to be globally systemically important financial institutions ('G-SIFIs').<sup>100</sup> They are defined as financial institutions, whose distress or failure 'because of their size, complexity and systemic interconnectedness, would cause significant disruption to

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<sup>94</sup> SIFIs are institutions of such size, market importance and interconnectedness that their distress or failure would cause significant dislocation in the financial system and adverse economic consequences.

<sup>95</sup> S Yadin, 'Too small to fail: State bailouts and capture by market underdogs' (2015) 43 *Capital University Law Review* 889.

<sup>96</sup> G-20, *Summit leaders' declaration (London, UK)*, 2 April 2009, point 15.

<sup>97</sup> FSB, *Progress and next steps towards ending 'Too-Big-To-Fail' (Report of the Financial Stability Board to the G-20)*, 2 September 2013, at 23.

<sup>98</sup> *Ibid.*

<sup>99</sup> G-20, *Summit leaders' declaration (Seoul, South Korea)*, 11-12 November 2010, para 30.

<sup>100</sup> FSB, *Update of group of global systemically important banks (G-SIBs)* (2013), available at [www.financialstabilityboard.org/publications/r\\_131111.pdf](http://www.financialstabilityboard.org/publications/r_131111.pdf).

the wider financial system and economic activity'.<sup>101</sup> They are determined with reference to methodology determined by the Basel Committee on Banking Supervision ('BCBS').<sup>102</sup>

It is precisely due to their global and inter-connected nature that G-SIFIs are difficult to deal with at the national level. It has been argued that finding 'common ground' in relation to significant cross-border bank insolvencies could be one of the most difficult missions the global financial community may need to achieve in the future.<sup>103</sup> Concerns remain in areas such as, the definition of SIFIs, their regulation and supervision, as well as issues pertaining to their resolution in periods of crisis.<sup>104</sup>

The G20 has endorsed a 'multi-pronged' framework for dealing with the TBTF concern. First, this involves establishing a framework, so that banks may be resolved quickly, safely, and without destabilizing the wider financial system.<sup>105</sup> SIFIs should, also, have a higher loss absorbency capacity, reflective of the risks they pose to the global financial system. G-SIFIs should, also, be subject to more intensive supervisory oversight. This policy framework should include 'robust core financial market infrastructure to reduce contagion risk from individual failures'.<sup>106</sup> This approach acknowledges that G-SIFIs, due to the risk they pose to the global financial system, should be subject to specialized rules. For instance, national insolvency rules have been deemed inadequate for the resolution of globally important financial institutions, requiring a *lex specialis* resolution regime.<sup>107</sup>

Substantial progress is made in implementation of the framework to reduce the moral hazard posed by SIFIs.<sup>108</sup> For instance, methodologies for assessing the global systemic importance of banks (G-SIBs) and insurers (G-SIIs) have been issued, and to date, there are

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<sup>101</sup> FSB, 'Policy measures to address systemically important financial institutions' (4 November 2011), para 3.

<sup>102</sup> Basel Committee on Banking Supervision, 'Global systemically important banks: Assessment methodology and the additional loss absorbency requirement' (2011), available at [www.bis.org/publ/bcbs255.pdf](http://www.bis.org/publ/bcbs255.pdf).

<sup>103</sup> E Avgouleas and J Cullen, 'Excessive leverage and bankers' pay: Governance and financial stability costs of a symbiotic relationship' (2014) 21 *Columbia Journal of European Law* 1.

<sup>104</sup> L Weber, 'Multi-layered governance in international financial regulation and supervision' (2010), 13 *Journal of International Economic Law* 697.

<sup>105</sup> A C Eernisse, 'Banking on cooperation: The role of the G-20 in improving the international financial architecture' (2012) 22 *Duke Journal of Comparative & International Law* 239.

<sup>106</sup> A E Wilmarth, Jr. 'A two-tiered system of regulation is needed to preserve the viability of community banks and reduce the risks of megabanks' (2015) *Michigan State Law Review* 249.

<sup>107</sup> FSB, 'Reducing the moral hazard posed by systemically important financial institutions' (2011), *Recommendations and timelines*, available at [www.financialstabilityboard.org/publications/r\\_101111a.pdf](http://www.financialstabilityboard.org/publications/r_101111a.pdf).

<sup>108</sup> T C W Lin, 'The new financial industry' (2013) 65 *Alabama Law Review* 567.

designated twenty-eight G-SIBs and nine G-SIIs. Higher loss-absorption capacity, more intensive supervision and resolution planning requirements apply to all the foregoing financial institutions.<sup>109</sup>

A new strengthened capital regime requiring additional going-concern loss absorption capacity for the G-SIBs are has finalized, and in many cases, the G-SIBs have built the extra capital ahead of schedule imposed by regulators.<sup>110</sup> Starting from 2010, the G-SIBs have increased their common equity capital by about USD 500 billion, which represents three per cent of their risk weighted assets.<sup>111</sup>

Recommendations for enhanced supervision and heightened supervisory expectations for risk management, risk aggregation and risk reporting are already developed, and are now being implemented.<sup>112</sup>

In 2011, the G20 endorsed a report<sup>113</sup> - '*Key attributes of effective resolution regimes for financial institutions*' - as a new international standard. Since then, guidance papers have been issued on resolution strategies for G-SIBs.<sup>114</sup> Approaches for dealing with the resolution of financial market infrastructure ('FMI') and insurers, as well as the protection of client assets in resolution are already finalized.<sup>115</sup>

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<sup>109</sup> E Avgouleas, 'The future of financial and securities markets; the fourth annual symposium of the Adolf A. Berle, Jr. Center on Corporations, Law & Society: Rationales and designs to implement an institutional big bang in the governance of global finance' (2013) 36 *Seattle University Law Review* 321.

<sup>110</sup> A E Wilmarth, Jr., 'Reforming financial regulation to address the too-big-to-fail problem' (2010) 35 *Brooklyn Journal of International Law* 707.

<sup>111</sup> A W Wilmarth, Jr., 'Reflections and projections: The political economy of financial regulation: The financial industry's plan for resolving failed megabanks will ensure future bailouts for Wall street' (2015) 50 *Georgia Law Review* 43.

<sup>112</sup> *Ibid.*

<sup>113</sup> Communiqué' G20 leaders' summit – Cannes – 3-4 November 2011, Section 13.

<sup>114</sup> Financial Stability Board, 'Guiding principles on the temporary funding needed to support the orderly resolution of a global systemically important bank ('G-SIB')' (18 August 2016), available at [www.fsb.org/wp-content/uploads/Guiding-principles-on-the-temporary-funding-needed-to-support-the-orderly-resolution-of-a-global-systemically-important-bank-“G-SIB”-pdf](http://www.fsb.org/wp-content/uploads/Guiding-principles-on-the-temporary-funding-needed-to-support-the-orderly-resolution-of-a-global-systemically-important-bank-“G-SIB”-pdf).

<sup>115</sup> Financial Stability Board, 'Guidance on resolution of non-bank financial institutions' (15 October 2014) [www.fsb.org/wp-content/uploads/FSB-Publishes-Guidance-and-Resolution-of-Non-Bank-Financial-Institutions.pdf](http://www.fsb.org/wp-content/uploads/FSB-Publishes-Guidance-and-Resolution-of-Non-Bank-Financial-Institutions.pdf)

Good progress is, also, made in strengthening core financial market infrastructure, such as, central counterparties ('CCPs'), to address risks of contagion through the financial system.<sup>116</sup>

Financial institutions and markets are adjusting to regulators' determination to end the TBTF concern. Where effective resolution regimes are now in place, rating agencies give less credit for taxpayer support, and there are signs of financial markets revising down their assessment of the implicit TBTF subsidy.<sup>117</sup> Market prices of credit default swaps for banks have become more highly correlated with equity prices, suggesting a greater expectation amongst participants that holders of debt will, if necessary, bear losses.<sup>118</sup>

In 2013, the FSB published its report,<sup>119</sup> '*Progress and next steps towards ending "Too-Big-To-Fail"*' (the '2013 report'). While the FSB acknowledges that progress has already taken place in putting together an international policy framework, detailed technical works are required to further consolidate policies' application to individual SIFIs.<sup>120</sup>

The G20 pushed for the nations' commitment to the necessary legislative reforms to implement the recommendations made in the 2013 report for all parts of the financial sector that could cause systemic problems.<sup>121</sup>

Reforms in several jurisdictions, including the UK<sup>122</sup> and the US<sup>123</sup>, demonstrate that substantive progress has already been made in the implementation of the 2013 report recommendations across the FSB jurisdictions.

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<sup>116</sup> Bank for International Settlements, Financial Stability Board, 'Progress report on the CCP workplan' (16 August 2016), available at [www.fsb.org/wp-content/uploads/Progress-Report-on-the-CCP-Workplan.pdf](http://www.fsb.org/wp-content/uploads/Progress-Report-on-the-CCP-Workplan.pdf).

<sup>117</sup> M Labonte, 'Systemically important or "too big too fail" financial institutions' (30 June 2015), *Paper in the Congressional Research Service*, available at <https://fas.org/sgp/crs/misc/R42150.pdf>.

<sup>118</sup> I Mevorach, 'Beyond the search for certainty: Addressing the cross-border resolution gap' (2015) 10 *Brooklyn Journal of Corporate, Financial & Commercial Law* 183.

<sup>119</sup> Financial Stability Board, 'Progress and next steps towards ending "too-big-too-fail" (TBTF): Report of the Financial Stability Board to the G-20' (2 September 2013) ('the FSB 2013 Report'), available at [www.fsb.org/wp-content/uploads/r\\_130902.pdf?page\\_moved=1](http://www.fsb.org/wp-content/uploads/r_130902.pdf?page_moved=1).

<sup>120</sup> Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/30/EU, and 2013/36/EU, and Regulations (EU) 1093/2010 and (EU) 648/2012, of the European Parliament and of the Council Text with EEA relevance, OJ 2014 L 173/190.

<sup>121</sup> *FSB 2013 Report* (n121).



In the EU, the Bank Recovery and Resolution Directive (BRRD),<sup>124</sup> which established a common approach within the EU to the recovery and resolution of banks and investment firms to ensure that the EU effectively addresses the risks posed by the banking system, has already in the course of being implemented in the UK.<sup>125</sup> Its implementation, within a year of adoption, is an important step towards implementation of the 2013 report's recommendations throughout the EU Member States.<sup>126</sup>

For G-SIFIs, meaningful cross-border co-operation agreements for supervisors and resolution authorities are being adopted. The G20 has empowered domestic authorities that regulate G-SIFIs to cooperate among each-others, and to commit to legislative action as necessary.<sup>127</sup> Resolution strategies for G-SIFIs are coalescing around single-point-of-entry resolution for globally integrated firms and multiple-point-of-entry resolution for firms with multiple national or regional subsidiaries.<sup>128</sup> In order to make these strategies operational, jurisdictions, including the UK and the US, have put in place the powers and arrangements for cross-border cooperation and for the recognition of foreign resolution measures.<sup>129</sup>

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<sup>122</sup> Financial Stability Board, 'Resilience through resolvability – moving from policy design to implementation: 5<sup>th</sup> report to the G20 on progress in resolution' (18 August 2016) ('FSB 5<sup>th</sup> report'), available at [www.fsb.org/wp-content/uploads/Resilience-through-resolvability—moving-from-policy-design-to-implementation.pdf](http://www.fsb.org/wp-content/uploads/Resilience-through-resolvability—moving-from-policy-design-to-implementation.pdf); see, also, Bank of England, 'Consultation paper on the Bank of England's approach to setting MREL' (December 2015), available at [www.bankofengland.co.uk/publications/Pages/news/2015/098.aspx](http://www.bankofengland.co.uk/publications/Pages/news/2015/098.aspx)

<sup>123</sup> *FSB 5<sup>th</sup> Report* (n124); see, also, Federal Reserve Board, 'Notice of proposed rulemaking (NPR) on TLAC, Long-Term Debt, and Clean Holding Company Requirements for Systemically Important US Bank Holding Companies and Intermediate Holding Companies of Systemically Important Foreign Banking Organizations' (October 2015), available at [www.federalregister.gov/documents/2015/11/30/2015-29740/total-loss-absorbing-capacity-long-term-debt-and-clean-holding-company-requirements-for-systemically](http://www.federalregister.gov/documents/2015/11/30/2015-29740/total-loss-absorbing-capacity-long-term-debt-and-clean-holding-company-requirements-for-systemically).

<sup>124</sup> Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council, OJ L 173/190, 12.6.2014.

<sup>125</sup> E.g., in UK, BRRD has been implemented into UK law by 'Statutory Instrument 2014 No 3329: The Bank Recovery and Resolution Order 2014' and 'Statutory Instrument 2014 No 3348: The Bank Recovery and Resolution (No. 2) Order 2014'.

<sup>126</sup> *FSB 2013 Report* (n121).

<sup>127</sup> *FSB 5<sup>th</sup> Report* (n124);

<sup>128</sup> *Ibid.*

<sup>129</sup> International Monetary Fund, 'Cross-border bank resolution: recent development' (2 June 2014), IMF staff report, available at [www.imf.org/external/np/pp/eng/2014/060214.pdf](http://www.imf.org/external/np/pp/eng/2014/060214.pdf)

Authorities with responsibility for resolution are already sharing firm-specific information, both within jurisdictions and cross-border.<sup>130</sup>

Impediments to resolvability, also, arise from complexities in firms' legal, financial and operational structures. National regulators have already entered into a dialogue with financial institutions about changes required to their structures and operations to ensure their preferred (single- or multiple-point-of-entry) resolution strategy is a realistic strategy for the institution. The resolvability of each G-SIFI is assessed at the national regulatory level within the Resolvability Assessment Process (RAP) that the FSB launched in 2015.<sup>131</sup>

As the SIFI framework recognised, 'structural measures could reduce the risks or externalities that a G-SIFI poses', structural reform measures, containing the separation of activities, intra-group exposure limits, local capital and liquidity requirements, seek to put restraints on excessive risk-taking by SIFIs, and so assist promoting financial stability.<sup>132</sup> They can, also, contribute to enhance the resolvability of SIFIs at a country level, therefore, lessening the moral hazard of TBTF. There is a risk that diverging structural measures imposed by national regulators could have an impact on integration across national or regional markets. Therefore, these regulators need to monitor the potential cross-border spill-over results, which may arise from different approaches. The same regulators should take account the progress on cross-border cooperation, and seek to avoid unnecessary constraints on the integration of the global financial system or the creation of incentives for regulatory arbitrage.<sup>133</sup>

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<sup>130</sup> *Ibid.*

<sup>131</sup> Financial Stability Board, 'Removing remaining obstacles to resolvability' (2015), available at [www.fsb.org/wp-content/uploads/Report-to-the-G20-on-Progress-in-Resolution-for-publication-national.pdf](http://www.fsb.org/wp-content/uploads/Report-to-the-G20-on-Progress-in-Resolution-for-publication-national.pdf).

<sup>132</sup> S P Massman, 'Developing a new resolution regime for failed systemically important financial institutions: An assessment of the orderly liquidation authority' (2015) 89 *American Bankruptcy Law Journal* 625.

<sup>133</sup> F Lupo-Pasini and R P Buckley, 'Global systemic risk and international regulatory coordination: Squaring sovereignty and financial stability' (2015) 30 *American University International Law Review* 665.

The FSB, in collaboration with the IMF and OECD, have assessed the cross-border consistency and global financial stability implications of these measures, taking into account country-specific circumstances.<sup>134</sup>

The TBTF problem existed not only for global firms. The SIFI framework, therefore, also, extends to domestic SIFIs ('D-SIBs'). The framework for D-SIBs developed by the Basel Committee on Banking Supervision ('BCBS') allows for appropriate discretion at jurisdictional level to accommodate structural characteristics of domestic financial systems.<sup>135</sup> Implementation in each jurisdiction is subject to an international peer review program to ensure appropriate adherence to the principles of the framework. The BCBS along with the FSB have developed a programme for such a peer review, started in 2015.<sup>136</sup>

Effective resolution planning requires financial institutions to enable to produce accurate information on time. It, also, requires efficient processes for sharing that information, both within crisis management groups ('CMGs') and with authorities in host jurisdictions not represented on CMGs, where the local operations of a G-SIFI are systemic. Furthermore, coordinated risk assessment requires banking regulators to share more information on the key risks facing G-SIFIs.<sup>137</sup>

The FSB has developed recommendations for consistent and comparable firm-specific information for resolution planning purposes.<sup>138</sup> The FSB, also, has developed proposals on how to strengthen information sharing within CMGs and, in consultation with standard-setting

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<sup>134</sup> Financial Stability Board, 'Structural banking reforms: Cross-border consistencies and global financial stability implications: Report to G20 leaders for the November 2014 summit' (27 October 2014), available at [www.fsb.org/wp-content/uploads/r\\_141027.pdf](http://www.fsb.org/wp-content/uploads/r_141027.pdf).

<sup>135</sup> Basel Committee on Banking Supervision, 'A framework for dealing with domestic systemically important banks' (October 2012), available at [www.bis.org/publ/bcbs233.pdf](http://www.bis.org/publ/bcbs233.pdf).

<sup>136</sup> Financial Stability Board, '2015 update of list of global and domestic systemically important banks (G-SIBs and D-SIBs) (3 November 2015), available at [www.fsb.org/wp-content/uploads/2015-update-of-list-of-global-systemically-important-banks-G-SIBs.pdf](http://www.fsb.org/wp-content/uploads/2015-update-of-list-of-global-systemically-important-banks-G-SIBs.pdf).

<sup>137</sup> Financial Stability Board, 'Guidance on cooperation and information sharing with host authorities of jurisdictions where a G-SIFI has a systemic presence that are not represented on its CMG' (3 November 2015), available at [www.fsb.org/wp-content/uploads/Guidance-on-cooperation-with-non-CMG-hosts.pdf](http://www.fsb.org/wp-content/uploads/Guidance-on-cooperation-with-non-CMG-hosts.pdf).

<sup>138</sup> Financial Stability Board, 'Towards full implementation of the FSB key attributes of effective resolution regimes for financial institutions' (12 November 2014), available at [www.fsb.org/wp-content/uploads/Resolution-Progress-Report-to-G20.pdf](http://www.fsb.org/wp-content/uploads/Resolution-Progress-Report-to-G20.pdf).

bodies, within core supervisory colleges.<sup>139</sup> The FSB has, further, developed recommendations for cooperation and sharing information with authorities in G-SIFI host jurisdictions that are not represented on the CMG, but where a G-SIFI's local operations are systemic.<sup>140</sup>

To avoid the need for a bail-out with public funds, a SIFI needs to have sufficient resources to absorb losses in resolution ('total loss absorbing capacity' or 'TLAC').<sup>141</sup> An adequate amount of TLAC already facilitates the implementation of a resolution strategy with a recapitalisation at a level that promotes market confidence and, at a minimum, meets going-concern regulatory capital requirements. The foregoing is based on the FSB's recommendations on the nature, amount, location within the group structure, and possible disclosure of TLAC.<sup>142</sup>

G-SIIs is subject to policy measures comprising effective resolution planning, enhanced group-wide supervision and higher loss absorbency ('HLA'), consistent with the requirements of the SIFI Framework.<sup>143</sup> The International Association of Insurance Supervisors (IAIS) has developed implementation details for higher loss absorbency requirements, which are built on straightforward, backstop capital requirements applying to all group activities, including non-insurance subsidiaries.<sup>144</sup>

The UK and the US have already carried out policy initiatives in light of the continued growth of many TBTF firms in relation to the size of the financial system; concerns of

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<sup>139</sup> Financial Stability Board, 'Global shadow banking monitoring report 2014' (30 October 2014), available at [www.fsb.org/wp-content/uploads/r\\_141030.pdf](http://www.fsb.org/wp-content/uploads/r_141030.pdf).

<sup>140</sup> Financial Stability Board, 'Guidance on supervisory interaction with financial institutions on risk culture – a framework for assessing risk culture' (2014).

<sup>141</sup> TLAC is closely related (but different from) the term Minimum Requirement for Own Funds and Eligible Liabilities (MREL) used in the European Bank Recovery and Resolution Directive 2014. External TLAC applies to each resolution entity in a bank group. Internal TLAC applies to subsidiaries of a resolution entity not being resolved in the entity's home jurisdiction and can include for example collateralised guarantees provided from the parent.

<sup>142</sup> Financial Stability Board, 'Adequacy of loss-absorbing capacity of global systemically important banks in resolution' (10 November 2014), *Consultative Paper*, available at [www.fsb.org/wp-content/uploads/TLAC-Condoc-6-Nov-2014-FINAL.pdf](http://www.fsb.org/wp-content/uploads/TLAC-Condoc-6-Nov-2014-FINAL.pdf)

<sup>143</sup> Financial Stability Board, 'Reducing the moral hazard posed by systemically important financial institutions' (20 October 2010), available at [www.fsb.org/wp-content/uploads/r\\_101111a.pdf](http://www.fsb.org/wp-content/uploads/r_101111a.pdf).

<sup>144</sup> International Association of Insurance Supervisors, 'Higher loss absorbency requirement for global systemically important insurers (G-SIIs)' (5 October 2015), available at [www.iaisweb.org/page/supervisory-material/financial-stability-and-macroprudential-policy-and-surveillance#](http://www.iaisweb.org/page/supervisory-material/financial-stability-and-macroprudential-policy-and-surveillance#).

dependence on short-term wholesale funding and increased secured borrowing at banks and non-banks; and the adoption or planned adoption of structural measures e.g., separation of activities into different legal entities, intra-group exposure limits, increased local capital and liquidity requirements etc.<sup>145</sup>

Several models for structural reforms have emerged. In the US, the Volcker Rule in s 619 of the Dodd-Frank Act,<sup>146</sup> places an outright ban on specific combinations of financial activity. Alternative approaches, associated with the UK's 'Independent Commission on Banking' ('ICB' or 'Vickers report'),<sup>147</sup> the 'High-level expert group on reforming the structure of the EU banking sector' headed by Liikanen,<sup>148</sup> emphasise, instead, a requirement for different types of financial activity to be carried out by separately capitalised subsidiaries. Approaches for structural regulation differ in scope and content reflecting the different institutional characteristics of the jurisdictions for which they have been developed.<sup>149</sup>

Upon implementation of the financial services reforms in order to tackle the TBTF concern, another step to end the TBTF was the ongoing development of a new failure resolution regime, including the so-called orderly liquidation authority ('OLA'), created by the Dodd-Frank Act<sup>150</sup> in the US. The OLA directly attacks the TBTF concern by giving the US regulators the legal required tools to resolve a systemically important financial institution on the brink of failure, in a way that involves no taxpayer funding (shareholders and creditors bear all losses), and which mitigates the spill-overs to the broader financial system and the economy.<sup>151</sup> Resolving a complex financial institution, especially in a condition where the financial system is in chaos, poses substantial challenges. However, a great deal has already been accomplished. The single most important development has probably been the enunciation by the regulators of the so-called 'single-point-of-entry' strategy,<sup>152</sup> which

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<sup>145</sup> *FSB 5<sup>th</sup> Report* (n124).

<sup>146</sup> Pub. L. 111-203, 124 Stat. 1376 – 2223 (Dodd-Frank Act).

<sup>147</sup> Independent Commission on Banking (the 'Vickers Commission') (2011) Final recommendations, available at <http://bankingcommission.independent.gov.uk>

<sup>148</sup> Report of the European Commission's High Level Expert Group on Bank Structural Reform ('Liikanen Report') (2012), European Commission, p 23.

<sup>149</sup> R F Weber, 'Structural regulation as antidote to complexity capture' (2012) 49 *American Business Law Journal* 643.

<sup>150</sup> *Dodd-Frank Act* (n148), Title II (Orderly Liquidation Authority).

<sup>151</sup> *Ibid.*

<sup>152</sup> Federal Deposit Insurance Corporation, 'Notice and request for comments, resolution of systemically important financial institutions: The single point of entry strategy' (18 December 2013) 77 *Fed. Reg.* 76614.

simplifies and makes more predictable any intervention in a failing financial institution. Other key elements include the extensive planning taking place at the banking regulator level; requirements that banks supplement their equity capital with long-term debt, which can be converted to equity when needed ('bail-in-able debt');<sup>153</sup> protections for short-term creditors and other measures to forestall runs; and the requirement that banks present plans for their own resolutions - so-called 'living wills'<sup>154</sup> - that must be approved by the banking authorities. In order to receive approval of living wills, banks have already made structural changes to enhance their resolvability - simplification of legal structures, for example - and more such changes are likely.<sup>155</sup>

The policy response to end TBTF was necessary. The international and national regulators have made great progress to put the overall international policy framework in place.<sup>156</sup> The application of policies to individual SIFIs, and financial institutions have undertaken restructuring necessary in order to make the foregoing institutions resolvable.<sup>157</sup>

The FSB works with standard-setting bodies to agree the necessary refinements to regulatory policies, as well as the FSB rigorously monitors implementation to ensure that national authorities meet their commitments, including the consistency of national responsive measures with agreed international policies towards the TBTF issue.<sup>158</sup>

In conclusion, sufficient action has been taken to remove the worst threats that arise with TBTF.

Antitrust is quintessentially addressed to the optimum organization of the nation's economy, even if it does not purport to address all aspects of it. The main issue of competition law is economic power and its potential to be misused. Vast aggregations of

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<sup>153</sup> Commission, 'European Commission specifies criteria for banks to hold easily 'bail-in-able' instruments in case of resolution' (23 May 2016) Press Release.

<sup>154</sup> Regulators around the globe have been demanding so-called living wills to be drawn up by banks. A living will for a bank denotes a contingency plan that is on the shelf in case that bank becomes insolvent and needs to be closed, sold or broken up.

<sup>155</sup> *FSB 5<sup>th</sup> Report* (n124).

<sup>156</sup> C D Block, 'A continuum approach to systemic risk and too-big-to-fail' (2012) 6 *Brooklyn Journal of Corporate, Financial & Commercial Law* 289.

<sup>157</sup> *Ibid.*

<sup>158</sup> C W Murdock, 'The big banks: Background, deregulation, financial innovation, and "too big to fail"' (2012) 90 *Denver University Law Review* 505.

economic power in convergence with other phenomena caused TBTF crises.<sup>159</sup> It, therefore, stands to reason that competition ought to be concerned with some aspects of the TBTF problem, at least, insofar as the problem stems from aggregated economic size and power. Since the TBTF problem is complex, it is unsurprising that competition by itself is not and cannot the cure. However, the competition law could make a difference by controlling certain forms of conduct that lead to financial institutions becoming excessively large.<sup>160</sup>

The foregoing considerations lead to a few conclusions and proposals for bringing competition into the public policy discussion of preventing or limiting the need for public rescues of private financial institutions that are too big, too interconnected and, perhaps, too powerful to be permitted to collapse.

## **10.2 Whether ‘too-big-to-fail’ status of systemically important financial institutions creates special competition concerns**

Many antitrust experts claim that competition provisions were not rigorously applied throughout the GFC, which ultimately exacerbated ‘too-big-to-fail’ (‘TBTF’) issue. In approving mergers of large banks and other financial institutions, both the UK and American regulators managed to increase systemic risk in the long-term, while attempting to battle it in the short-term.

The GFC revealed a number of significant regulatory and central bank failures in the US, UK, EU and elsewhere and especially in terms of defective regulation, supervision, resolution, support and macro prudential oversight. A substantial amount of work has been undertaken to correct all of these. It is arguable that sufficient action has been taken to remove the worst threats that arise with TBTF.

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<sup>159</sup> C Evans, ‘The Dodd-Frank Wall Street Reform and Consumer Protection Act: A missed opportunity to rein in too-big-to-fail banks’ (2011) 12 *Duquesne Business Law Journal* 43.

<sup>160</sup> C Hurley, ‘Paying the price for too big to fail’ (2010) 4 *Entrepreneurial Business Law Journal* 351.

The Financial Stability Board ('FSB'),<sup>161</sup> alongside the International Monetary Fund ('IMF')<sup>162</sup> and the Bank for International Settlements ('BIS'),<sup>163</sup> recognized important distinctions of systemic organizations, including: size, lack of substitutability and interconnectedness. Furthermore, the FSB has identified a series of essential factors – discussed in the previous section of this thesis - which complement size, lack of substitutability, and interconnectedness. Such factors include leverage, solvency, asset quality and the stability of short-term funding mechanisms, each of which can exacerbate external stresses. Jointly, these characteristics are used to determine the systemic importance of a given financial institution.<sup>164</sup>

The FSB suggests that the degree of systemic risk is a product of individual institutional characteristics combined with macroeconomic considerations of interconnectedness and the system-wide potential for contagion. The FSB's standards concerning systemic financial risk result from an evaluation of the central banks in the UK, US and other developed economies. Indeed, the FSB standards are similar to the standards outlined in the by UK and US financial oversight reform efforts.<sup>165</sup> These standards comply with the characteristics leading experts have identified for systemic financial institutions. Ultimately, the FSB's standards represent wide-ranging considerations of the fundamental characteristics of systemic risks and the organizations that produce them.<sup>166</sup>

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<sup>161</sup> Financial Stability Board, Charter arts.1, and 4, available at [www.financialstabilityboard.org/publications/r\\_090925d.pdf](http://www.financialstabilityboard.org/publications/r_090925d.pdf).

<sup>162</sup> The International Monetary Fund ('IMF') is an international organization, formed in 1844 at the Bretton Woods Conference; it came into existence in 1945. Its goals is to preserve global monetary cooperation, secure financial stability, facilitate international trade, promote high employment and sustainable economic growth, and reduce poverty around the world. For more information, available at <http://www.imf.org/external/index.htm>.

<sup>163</sup> The Bank for International Settlements ('BIS') was formed in 1930 by an intergovernmental agreement between Germany, Belgium, France, the UK, Italy, Japan, the US, and Switzerland. The bank's purpose is to preserve international monetary and financial cooperation and serves as a bank for central banks. For more information, available at <http://www.bis.org/>.

<sup>164</sup> Financial Stability Board, International Monetary Fund, Bank for International Settlements, 'Guidance to Assess the Systematic Importance of Financial Institutions, Markets and Instruments: Initial Considerations' (2009), available at <https://www.imf.org/external/np/g20/pdf/100109.pdf>.

<sup>165</sup> M Carney, 'The Future of Financial Reform' (17 November, 2014) *2014 Monetary Authority of Singapore Lecture*, available at <http://www.bankofengland.co.uk/publications/Documents/speeches/2014/speech775.pdf>.

<sup>166</sup> L C Backer, 'Private Actors and Public Governance beyond the State: The Multinational Corporation, the Financial Stability Board, and the Global Governance Order' (2011) 18 *Indiana Journal of Global Legal Studies* 751, pp 792-3.



Competition provisions should aim to prevent dominant market behaviour through bank mergers. Although the Clayton Act in the US aimed to curb mergers that result in significantly increased market control,<sup>167</sup> there is no regulation specific to banks and financial organizations.<sup>168</sup> Deprived of adequate legislation, competition regulators are restricted in terms of what they can do to address TBTF banks.

Prior to the GFC there were numerous financial institutions that could be considered TBTF.<sup>169</sup> The loosening of competition provisions for specific bank mergers during the crisis increased the concentration, dominance, and influence of a handful of institutions. The US Treasury Department's Troubled Asset Relief Program ('TARP')<sup>170</sup> in 2006 evidenced the fact that many American banks had become TBTF.<sup>171</sup> The Treasury saved several large and dominant financial institutions by spending \$700 billion to bail them out.<sup>172</sup> In doing so, the US Government tacitly acknowledged that, by needing enormous capital injections to remain solvent, enable lending and facilitate transactions throughout the economy, several domestic banks were TBTF.

The large bank mergers and mergers were granted fast-tracked approval due to the belief that by mingling a deteriorating bank with a larger, healthier bank, systemic risk would be mitigated. Nonetheless, several of these bank mergers were seen as merely capitulating to prevailing popular and political concerns. Some experts went further, concluding that the TBTF issue has grown into an even 'too-bigger-to-fail' concern. They, also, predicted that the bank mergers, which occurred throughout the GFC, heightened the risk that the US will have to rescue even bigger banks at a later time.<sup>173</sup>

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<sup>167</sup> *Clayton* (n12) § 18 (section 7).

<sup>168</sup> L J White, 'Financial Regulation and the Current Crisis: A Guide for the Antitrust Community in C Compton et al (eds.) *Competition as Public Policy*' (2010) *American Bar Association Section of Antitrust Law* 65.

<sup>169</sup> See generally A R Sorkin, *Too Big To Fail: The Inside Story of How Wall Street and Washington Fought to Save the Financial System and Themselves* (New York: Penguin 2010).

<sup>170</sup> US Department of the Treasury, 'TARP Transaction Report' (24 March, 2011) ('TARP'), available at <http://www.treasury.gov/initiatives/financial-satbility/briefing-room/reports/tarp-transactions/Pages/default.aspx>.

<sup>171</sup> See generally N Barofsky, *Bailout: How Washington Abandoned Main Street While Rescuing Wall Street* (New York: Simon & Shuster 2013).

<sup>172</sup> *Zora* (n13), p 1188.

<sup>173</sup> M Weiss, 'Roubini Says 2008 Bank Deals Created "Too Bigger to Fail" Risk' (30 September, 2010) *Bloomberg News*.

An important issue surrounding the bank mergers of the GFC is the consequence they will have on consumers.<sup>174</sup> The high number of bank mergers in the UK and US has been felt by consumers through the pricing and availability of financial products. One problem is that small and middle-sized financial institutions have been absorbed by the larger competitors. They were persuaded and sometimes forced by regulators to protect deposits by assenting to be acquired by larger financial institutions.<sup>175</sup> As a result of bank consolidation, customers were confronted with fewer alternatives and the possibility of higher interest rates, charges, and fees for financial products. Such outcomes, wherein consumers face fewer options and higher costs, are exactly what the competition provisions are intended to prevent.

Many specialists in the banking sector advocate amending the competition provisions to include TBTF considerations.<sup>176</sup> Competition provisions can certainly be used to constrain the size of a bank. However, contemporary competition concerns don't focus on the size of a bank, but primarily consider market share and correlating pricing power. Implementing several alternatives of a 'size cap' on the largest financial institutions would limit the 'systemic risk' one big financial institution would pose to the entire economy. A size cap - whether on deposits or market share - would constrain the TBTF risk.<sup>177</sup>

Constraining the possible power and scale of banks would protect not only the financial marketplace, but consumers and the economy as a whole. Restricting the power and size of banks *via* a TBTF examination would limit the systemic threat of individual financial institutions and prevent market dominance by any single or small group of competitors.<sup>178</sup> Without such processes, the continued occurrence of mergers among large financial institutions would continue to substantially lessening of competition.

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<sup>174</sup> Organization for Economic Co-operation and Development, 'Competition and the Financial Crisis' (17-18 February, 2009) *OECD Competition Committee*, p 23, available at <http://www.oecd.org/competition/sectors/42538399.pdf>.

<sup>175</sup> K C Chakrabarty, 'Impact of Global Financial Crisis on Financial Consumers – Global Perspective on Need For Consumer Protection – Role of Ombudsmen' (21 September, 2011) *Speech at the Annual Conference of the International Network of Financial Services Ombudsman Schemes – INFO 2011*, Vancouver, pp 1-3, available at <http://www.bis.org/review/r110923b.pdf>.

<sup>176</sup> J W Markham Jr, 'Lessons for Competition Law From the Economic Crisis: The Prospect for Antitrust Responses to the "Too-Big-To-Fail" Phenomenon' (2011) 16 *Fordham Journal of Corporate and Financial Law* 261, pp 263-6.

<sup>177</sup> R F Weber, 'Structural Regulation as Antidote to Complexity Capture' (2012) 49 *American Business Law Journal* 643, pp 644-8.

<sup>178</sup> A J Levitin, 'In Defence of Bailouts' (2011) 99 *Georgetown Law Journal* 435, pp 435-40.

The US tried to address the issue of mega-bank merger review in the Dodd-Frank Act. That legislation sought to provide bank regulators the authority to consider and constrain the scale of financial institutions. Under the Act, the Federal Reserve is granted the authority to intervene in any merger for a bank holding company that has more than \$50 billion in assets, or for a nonbank financial institution that is found to pose a ‘grave threat to the financial stability’ of the US.<sup>179</sup> In the event a bank presents a risk to the financial strength of the economy, the Federal Reserve can undertake certain measures to constrain its influence.

The Dodd-Frank Act provides US authorities with tools to constrain the influence of large financial institutions, and if necessary, to split them up in the event they pose a significant threat to financial stability.<sup>180</sup> Empowering authorities with the ability to break up large financial institutions limits the institutions’ incentive to become TBTF. However, the Act does not allow for assistance to specific financial institutions until they are determined to have become distressed.<sup>181</sup> By the time such weaknesses emerge, it may be too late for the Federal Reserve to undertake the necessary measures to protect the rest of the financial sector.

In consideration of the transformations that occurred throughout the financial sector during the GFC, the competition enforcement authorities in the UK and US must bring a new perspective to the banking sector. The collapses of Northern Rock in the UK,<sup>182</sup> and Bear Stearns<sup>183</sup> and Lehman Brothers<sup>184</sup> in the US, as well as major bank consolidation in these countries, have altered the distribution of market share and competition within the sector. How these transformations have affected the consumer is an essential measure of whether more rigorous competition enforcement is required to constrain further consolidation.

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<sup>179</sup> Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203; 124 Stat. 1391; codified to 12 USC 5301 note, effective 21 July, 2010 (*codified as amended in 12 U.S.C. §§ 5301–5641*) (‘Dodd-Frank’), § 121.

<sup>180</sup> *Dodd-Frank* (n110), Title I, Subtitle A (*e.g.*, s 123), and Title VI (*e.g.*, s 622).

<sup>181</sup> *Ibid*; see, also, A E Wilmarth Jr, ‘The Dodd-Frank Act: A Flawed and Inadequate Response to the Too-Big-to-Fail Problem’ (2011) 89 *Oregon Law Review* 951, pp 952-63.

<sup>182</sup> House of Commons, ‘HM Treasury: The Creation and Sale of Northern Rock Plc’ (5 November, 2012) *Committee of Public Accounts HC 552*, p 7.

<sup>183</sup> *Bear Stearns* (n5).

<sup>184</sup> US Congress, ‘The Effect of the Lehman Brothers Bankruptcy on State and Local Governments’ (5 May, 2009) *Hearing before the Committee on Financial Services, US House of Representatives*, 111<sup>th</sup> Congress, 1<sup>st</sup> Session.

Some studies have shown that bank mergers can have adverse effects in the short-term on the consumer's access to credit and the interest rates on loans and deposits, but that such effects appear to diminish in the longer-term.<sup>185</sup> However, such outcomes might be overly optimistic. Most of the bank mergers studied in support of that thesis happened within 'normal' market situations instead of during financial crisis conditions. Consequently, such data may not be properly suitable to reach conclusions concerning the impacts of giant bank mergers in financial crisis conditions like those in 2007-2009.<sup>186</sup>

Mammoth mergers are seldom the sole alternative to support distressed banks and confront market-wide instability. Notably, direct public funding can serve as a complement or replacement for large-scale mergers. During the GFC, the bank acquisitions of Bear Stearns by JPMorgan Chase,<sup>187</sup> and Merrill Lynch by Bank of America<sup>188</sup> involved huge sums of public financial support in the form of guarantees. Other bank takeovers involved the acquisition of shares by the government, causing the resulting entity to be partially nationalized. For instance, in the new Lloyds Banking Group (following the takeover of HBOS by Lloyds) and Royal Bank of Scotland, the UK Government effectively assumed an 84 per cent interest in Royal Bank of Scotland and a 43 per cent interest in Lloyds Banking Group.<sup>189</sup> The effects of these mixed-responses (such as, mergers with partial government purchases) are unclear in terms of how they limit competition in the marketplace. Much would depend on the government's level of involvement and activism in the management and ownership of a bank.

It is worth recalling the action taken by the SoS regarding the intended merger *Lloyds/Abbey* in 2001.<sup>190</sup> That deal was ultimately rejected because of anticipated

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<sup>185</sup> Bank for International Settlement, 'Report on Consolidation in the Financial Sector' (January, 2001) *Group of Ten*, pp 29, 317, and 320, available at <http://www.bis.org/publ/gten05.pdf>; see, also, J M Rich and T G Scriven, 'Bank Consolidation Caused by the Financial Crisis: How Should the Antitrust Division Review "Shotgun Marriages?"' (2008) 8-2 *American Bar Association: Antitrust Source* 2, available at [www.americanbar.org/content/dam/aba/publishing/antitrust\\_source/Dec08\\_Rich12\\_22f.authcheckdam.pdf](http://www.americanbar.org/content/dam/aba/publishing/antitrust_source/Dec08_Rich12_22f.authcheckdam.pdf).

<sup>186</sup> A E Wilmarth Jr, 'Reforming Financial Regulation to Address the Too-Big-To-Fail Problem' (2010) 35 *Brooklyn Journal International Law* 707, pp 734-742.

<sup>187</sup> Federal Reserve, 'Bear Stearns, JPMorgan Chase, and Maiden Lane LLC' (March 2008) *FRB*, available at [http://www.federalreserve.gov/newsevents/reform\\_bearstearns.htm](http://www.federalreserve.gov/newsevents/reform_bearstearns.htm).

<sup>188</sup> Federal Reserve, 'Order Approving Acquisition of Merrill Lynch by Bank of America' (26 November, 2008) *FRB*, available at <http://www.federalreserve.gov/newsevents/press/orders/orders20081126a1.pdf>.

<sup>189</sup> House of Commons, 'Banking in Scotland 2009-10' (2010) *HC 70-I*, p 10; see, also, UK Fin. Invs. Ltd, *Updates of UFKI Market Investments* 8 (March, 2010), available at [www.ukfi.co.uk/publications](http://www.ukfi.co.uk/publications).

<sup>190</sup> For a discussion of the *Lloyds/Abbey* merger, see chapter 4.3.2(b) in this thesis, pp 107-8.

anticompetitive results arising from the merger. That result starkly contrasts with the takeover of HBOS by Lloyds, which showed regulators' remarkable concern for immediate economic challenges and corresponding neglect of competition issues in favour of stability interests in the short term.<sup>191</sup>

Financial institutions are distinct from other areas of the economy due to their exposure to interest rate risks and their control of vast amounts of wealth kept in the form of deposits.<sup>192</sup> Risks can arise from liabilities that are susceptible to runs (primarily demand deposits) and systemic crunches (*i.e.*, counter-party risks). Risks can also arise from a bank's assets, particularly unforeseen risks arising from over-concentration, high leverage, and general impairment due to poor risk management. Such risks are often exacerbated by moral hazard arising from deposit insurance or expectations of government bailouts.<sup>193</sup>

Unnerving situations arise when bank customers lose confidence in their bank and begin withdrawing deposits. Under normal conditions, only customers needing funds for actual consumption withdraw deposits. However, in the event that customers fear a bank's liquidity is endangered, depositors a rush to obtain funds before the bank runs out of cash entirely, stops honouring demand deposit requests, or simply decides to close its doors.<sup>194</sup> When financial institutions' returns are low, as in a recession, customers are more wary of market difficulties and more prone to withdraw deposits with little or no notice. As a result, basic bank runs are a reaction to interrelated economic conditions, and can accelerate the forced liquidation of distressed assets.<sup>195</sup>

Systemic risk and the safeguarding of depositors are the primary reasons for deposit insurance and lender of last resort government safety nets. Deposit insurance can forestall runs by retail depositors, but is not a failsafe protection against contagion, because not all

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<sup>191</sup> T Cottier et al, *International Law in Financial Regulation and Monetary Affairs* (Oxford: Oxford University Press 2012), p 325.

<sup>192</sup> E Carletti, *Competition and Regulation in Banking* in A V Thakor et al (eds.) in *Handbook of Financial Intermediation and Banking* (Amsterdam: Elsevier 2008), pp 449-51.

<sup>193</sup> J Crawford, 'The Moral Hazard Paradox of Financial Safety Nets' (2015) 25 *Cornell Journal of Law and Public Policy* 95, pp 101-102, 116-117, and 138.

<sup>194</sup> R M Lastra, 'Northern Rock, UK Bank Insolvency and Cross-Border Bank Insolvency' (2008) 9 *Journal Banking Regulation* 165, p 166.

<sup>195</sup> F Lupo-Pasini and R P Buckley, 'Global Systemic Risk and International Regulatory Coordination: Squaring Sovereignty and Financial Stability' (2015) 30 *American University International Law Review* 665, pp 666-71.

bank liabilities are insured. Lender of last resort responses are more comprehensive, in that the Bank of England in the UK and the Federal Reserve in the US extend capital to banks, which can be used to address a host of liquidity issues.<sup>196</sup> Although there is an ongoing discussion of the optimum form and role of the lender of last resort, there is broad consensus that the mechanism should not be utilized in specific bank failure situations, as with the actions undertaken by the US in TARP with an overall \$700 billion budget.<sup>197</sup> The TARP was a cram down, which required nearly all financial institutions, such as, Bank of America took \$45 billion, Citigroup received \$45 billion, and JPMorgan Chase took \$25 billion, to accept the US Government's monies, even though, had they had the choice, they wouldn't have.<sup>198</sup> As a matter of fact, banks that received the government's billions through the TARP lent less money on average to customers than few banks that did not receive any funds through the TARP program.<sup>199</sup> Similar to the TARP program, the UK Government spent £130 billion of taxpayers' monies to bail out Lloyds, RBS, Northern Rock, and Bradford & Bingley during the Global Financial Crisis.<sup>200</sup>

Under these public bailout situations, central banks in the UK and US would only lend monies to distressed banks at favourable rates, against suitable collateral, in times of significant external economic challenges. However, practically speaking, it is not easy for the Bank of England and the Federal Reserve to differentiate illiquidity from insolvency. Financial institutions in need of emergency aid are generally at risk of insolvency due to failures or challenges in raising funds from the capital markets.<sup>201</sup>

Temporary State aid initiatives implemented by the Commission helped UK and other EU Member States' banks recapitalize throughout the Global Financial Crisis ('GFC').<sup>202</sup> The

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<sup>196</sup> P Tucker, 'The Lender of Last Resort and Modern Central Banking: Principles and Reconstruction' (September, 2014) *BIS Papers No 79*, pp 10-13, and 33.

<sup>197</sup> US Department of the Treasury, 'TARP Programs' (2008) *Treasury*, available at <https://www.treasury.gov/initiatives/financial-stability/TARP-Programs/Pages/default.aspx#>.

<sup>198</sup> Centre for Responsive Politics, 'TARP Recipients Paid-Out \$ 114 Million for Politicking Last Year' (4 February, 2009), available at <http://www.opensecrets.org/news/2009/02/tarp-recipients-paid-out-114-m.html>.

<sup>199</sup> B Appelbaum, 'Despite Federal Aid, Many Banks Fail to Revive Lending' (3 February, 2009) *Washington Post*.

<sup>200</sup> A Ross et al, 'Europe's Banks Slog to Exit Bailouts' (20 September, 2013) *Financial Times*.

<sup>201</sup> F Allen and E Carletti, 'The Role of Liquidity in Financial Crises' (4 September, 2008) the 2008 Jackson Hole Symposium on Maintaining Stability in a Changing Financial System, available at <http://www.kc.frb.org/publicat/sympos/2008/AllenandCarletti.09.14.08.pdf>.

<sup>202</sup> Commission, 'Temporary Framework for State Aid Measures to Support Access to Finance in the Current Financial and Economic Crisis' (2009) *OJ C83/1*.

Commission failed to mention anything with respect to longer-term consequences for businesses or industries that obtain State aid.<sup>203</sup> But it is clear that the Commission's review of the restructuring procedures could have serious implications for industry competition in the banking sector going forward. Beneficiary banks of state guarantee and recapitalizations are prone to restrictions on their ongoing commercial conduct. Such restrictions can include bans on advertising touting the government's support, restrictions on pricing, constraints on market share within certain business lines, and possibly limitations on stock options or cash bonuses for bank management staff and employees.<sup>204</sup>

Nationalized financial institutions are generally required to remain under predetermined market share caps devised to preclude them from using the public's support and subsidy to undercut competitors. In the State aid recapitalization of the UK banks Lloyds, Royal Bank of Scotland, and HBOS, the beneficiaries were obligated to assent to a series of requirements, including: reinstating lending to pre-credit GFC levels, and limiting the bonuses of the banks' executives and upper management.<sup>205</sup> Such requirements could assist in preventing unfair competition from banks with government support.

However, bailouts can cause adverse outcomes. In the event that a salvaged financial institution is obligated to lower deposit interest rates or raise mortgage rates, it may produce distortions and imbalances in the marketplace and hurt consumers and competitors. The issue is more complex where financial rescues take place on an industry-wide level, such as, with the TARP situation.<sup>206</sup> In the event that several financial institutions in a given market obtain financial relief and are subjected to market share caps, there could be an amplified risk of cooperation and coordination between those firms.<sup>207</sup> Therefore, the restrictive measures imposed on bailed out banks by the UK and American authorities, especially those of large size, can be more damaging than letting the market guide their behaviour.

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<sup>203</sup> G Koopman, 'Stability and Competition in EU Banking during the Financial Crisis: The Role of State Aid Control' (2011) 7 *Competition Policy International* 8, pp 10-2.

<sup>204</sup> *Ibid*, p 12.

<sup>205</sup> HM Treasury, 'Treasury Statement on Financial Support to the Banking Industry' (13 October, 2008) *Speeches & Newsroom 105/08*, available at [www.hm-treasury.gov.UK/press\\_105\\_08.htm](http://www.hm-treasury.gov.UK/press_105_08.htm).

<sup>206</sup> TARP (n101).

<sup>207</sup> A E Wilmarth Jr, 'The Dark Side of Universal Banking: Financial Conglomerates and the Origins of the Subprime Financial Crisis' (2009) 41 *Connecticut Law Review* 963, pp 995-6.

Competition provisions would not have prevented the GFC, or eliminated TBTF, because they are not made with the essential tools to avoid the occurrence of financial crises.<sup>208</sup> Modern competition provisions are not in place to homogenize the size of banks and other financial institutions. They are applied only to forbid dominant conduct, and to stop bank mergers in the event of heightened pricing power and market influence.

The method and structure of large bank bailouts employed by the UK and American regulators, along with other banking authorities and the Commission, has had consequences across the UK and US financial industries. The GFC required extreme measures by banking regulators in order to save big banks and other transactional and lending institutions underpinning the economy. Many of the actions taken by the authorities have proven contentious, with some experts arguing against government intervention.<sup>209</sup>

Permitting large financial institutions to become larger only increased the future risk of contagion and the threat posed to the economy by individual institutions.<sup>210</sup> For instance, by permitting Bank of America to acquire Countrywide and Merrill Lynch, the US Government allowed a much larger institution to emerge from three that had already contributed to the stresses on the banking system.<sup>211</sup>

Through the Dodd-Frank Act,<sup>212</sup> US lawmakers endeavoured to create a more regulated banking and financial sector, establish stability and transparency, and put an end to TBTF.<sup>213</sup> S 121 of the Act granted banking authorities the power to prevent big bank mergers.<sup>214</sup> It, also, granted them the ability to split up banks considered to present systemic

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<sup>208</sup> J E. Stiglitz, *Freefall: America, Free Markets, and the Sinking of the World Economy* (New York: W. W. Norton & Co. 2010), pp 83, 114, and 165.

<sup>209</sup> A Graham, 'Bringing to Heel the Elephants in the Economy: The Case for Ending "Too Big To Fail"' (2010) 8 *Pierce Law Review* 117, p 142.

<sup>210</sup> K A Pisarcik, 'Antitrust and Bank Regulation: Was the Clayton Act on Hold during a Time of Crisis?' (2011) 14 *Duquesne Business Law Journal* 47, pp 48-52.

<sup>211</sup> M W Boyer, 'Financial Regulatory Reform: A New Foundation or More of the Same?' (2009) 22 *Loyola Consumer Law Review* 233, pp 234-9.

<sup>212</sup> *Dodd-Frank* (n110).

<sup>213</sup> *Ibid*, §§201-17 (codified at 12 U.S.C. § 5381-94); § 619 (codified at 12 U.S.C. § 1851); §§112(a)(2), 115(b), and 165(b) (codified at 12 U.S.C. §§5322, 5325, and 5365).

<sup>214</sup> *Ibid*, §121 (codified at 12 USC §5331).



risks to financial stability.<sup>215</sup> US regulators have, also, recognized the value of incorporating systemic risk considerations in competition legislation.<sup>216</sup>

Some nonbank financial institutions in the US,<sup>217</sup> have defied the US Government's legislative and regulatory reaction to the financial meltdown. For example, MetLife, one of the largest US nonbank financial institutions by assets, sued the US Government<sup>218</sup> for designating it as a 'systemically important financial institution' ('SIFI').<sup>219</sup> Once a nonbank financial institution is classified as a SIFI, the US banking agencies, including the Federal Reserve can exercise authority over it, along with the nonbanking regulatory structures that already supervise it.<sup>220</sup>

MetLife has been a forceful challenger of SIFI classification, claiming that the classification could place it at an unfair disadvantage to competitors.<sup>221</sup> Its legal action is the first test of the Financial Stability Oversight Council ('FSOC'), established by the Dodd-Frank Act,<sup>222</sup> it consists of the US Treasury Secretary, the Chairman of the Federal Reserve and the Chairman of the SEC. Other US nonbank financial institutions, including: Prudential Financial, General Electric Capital and AIG, have previously been classified as SIFIs by the FSOC, and are presently supervised by the Federal Reserve.<sup>223</sup> Among these institutions, only

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<sup>215</sup> *Ibid*, §121(a) (codified at 12 USC §5331(a)).

<sup>216</sup> D K Tarullo, 'Industrial Organization and Systemic Risk: An Agenda for Further Research' (15 September, 2011) *Speech at the Conference on the Regulation of Systemic Risk*, Federal Reserve Board, Washington, D.C., available at <http://www.federalreserve.gov/newsevents/speech/tarullo20110915a.htm>.

<sup>217</sup> D J Elliott, 'Regulating Systematically Important Financial Institutions That Are Not Banks' (9 May, 2013) *Brookings Paper*, available at <http://www.brookings.edu/research/papers/2013/05/09-regulating-financial-institutions-elliott>.

<sup>218</sup> *MetLife, Inc. v FSOC* [2015] No. 1:15-cv-45 (D.D.C. filed 13 January, 2015).

<sup>219</sup> A 'systematically important financial institution' ('SIFI') is a bank or other financial institution, whose failure may trigger a financial crisis, available at [https://en.wikipedia.org/wiki/Systemically\\_important\\_financial\\_institution](https://en.wikipedia.org/wiki/Systemically_important_financial_institution).

<sup>220</sup> Financial Stability Oversight Council, 'Basis for the Financial Stability Oversight Council's Final Determination Regarding MetLife, Inc' (18 December, 2014), available at [www.treasury.gov/initiatives/fsoc/designations/Documents/MetLife%20Public%20Basis.pdf](http://www.treasury.gov/initiatives/fsoc/designations/Documents/MetLife%20Public%20Basis.pdf).

<sup>221</sup> *MetLife v FSOC* (n153).

<sup>222</sup> *Dodd-Frank Act* (n110).

<sup>223</sup> 12 CFR Part 1310 ('Financial Stability Oversight Council, Authority To Require Supervision and Regulation of Certain No-bank Financial Companies'), available at <https://www.treasury.gov/initiatives/fsoc/rulemaking/Documents/Authority%20to%20Require%20Supervision%20and%20Regulation%20of%20Certain%20Nonbank%20Financial%20Companies.pdf>; see, also, US Treasury Department, 'Financial Stability Oversight Council Supplemental Procedures Relating to Nonbank Financial Company Determination' (4 February, 2015), available at <https://www.treasury.gov/initiatives/fsoc/designations/Documents/Supplemental%20Procedures%20Related%20to%20Nonbank%20Financial%20Company%20Determinations%20-%20February%202015.pdf>.

Prudential Financial appealed the FSOC's decision.<sup>224</sup> However, Prudential only pursued administrative appeal and did not file suit in federal court.<sup>225</sup>

Unlike US financial reform legislation, which did not employ competition provisions to tackle systemic risk, the UK, through the EU financial reform, argued for considering competition implications during any merger evaluation. Similarly, the TFEU acknowledged that State aid could influence markets by granting an unjust advantage to recipients.<sup>226</sup> The Treaty also highlighted the inconsistent undertakings used to tackle the GFC, like the mergers between big banks and direct State aid intervention.<sup>227</sup>

During the GFC, the Commission acknowledged that the bank bailouts could be viewed as both a solution and a problem.<sup>228</sup> The Commission admitted that were it not for the financial rescue provisions, there was a risk that EU governments would have undertaken an exorbitant and harmful funding contest, spending billions of taxpayer monies on domestic efforts rather than coordinating their funding wherever it was most required.<sup>229</sup> Going forward, the Commission required that large banks present restructuring proposals as a prerequisite to receiving public funds.<sup>230</sup> Requiring such proposals is important for the improvement of competition within the financial industry. Such proposed restructurings of large banks may include divestments of assets and broad undertakings to minimize barriers to entry. However, the beneficial effects of bank generated restructuring proposal are yet to be seen.

The GFC carried new challenges for competition provisions, the banks that are accountable to them and the regulators that enforce them. The UK Government's remarkable

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<sup>224</sup> D Douglas, 'Prudential Enters Unchartered Legal Realm by Appealing Its Regulatory Label' (3 July, 2013) *Washington Post*.

<sup>225</sup> D Schwarcz and S L Schwarcz, 'Regulating Systemic Risk in Insurance' (2014) 81 *University of Chicago Law Review* 1569, pp 1570-5.

<sup>226</sup> TFEU (n41), arts 107(1), and 107(3)(c).

<sup>227</sup> *Ibid*, art 107(2)(b).

<sup>228</sup> Commission, 'Bank Recovery and Resolution Proposal: FAQs' (6 June, 2012) *MEMO*, available at [http://europa.eu/rapid/press-release\\_MEMO-12-416\\_en.htm](http://europa.eu/rapid/press-release_MEMO-12-416_en.htm).

<sup>229</sup> H Ungerer, 'State Aids 2008/2009-Twelve Months of Crisis Management and Reforms' (14 May, 2009) *Keynote Address at the 7<sup>th</sup> Experts' Forum on New Developments in European State Aid Law*, available at [http://ec.europa.eu/competition/speeches/text/sp2009\\_05\\_en.pdf](http://ec.europa.eu/competition/speeches/text/sp2009_05_en.pdf).

<sup>230</sup> Commission, 'State aid: Commission presents guidelines on restructuring aid to banks' (23 July, 2009) *Press Release IP/09/1180*.

measures in the *HBOS/Lloyds*<sup>231</sup> bailout reveal how competition law can be disregarded for broader considerations of financial stability, systemic stress, and economic peril. In that instance, the competition and banking authorities' attention was narrowly focused on immediate systemic considerations instead of the long-term concerns arising from the formation of a new UK banking giant.<sup>232</sup> Such setting aside of competition considerations during the financial crisis might have raised the importance of competition analysis in the banking industry going forward.

The Brexit referendum result of 2016 has thrown the UK towards uncharted waters in terms of the future relationship between the UK and the EU, including implementation of EU provisions and the UK's access in the EU market. However, the foregoing is not part of the analysis in this thesis, notwithstanding its importance.

In conclusion, the UK, US, and other national and international bodies implemented various initiatives to address the GFC, TBTF concerns, and the systemic risk of contagion. The GFC revealed a number of significant regulatory and central bank failures in terms of defective regulation, supervision, resolution, support and macro prudential oversight. A substantial amount of work has been undertaken to correct all of these. It is arguable that sufficient action has been taken to remove the worst threats that arise with TBTF.

## 10.2 Conclusion

The notions of TBTF and 'systemic risk' emerged as key concerns for the banking and financial system. The question was whether by supporting the 'quick-fix' bank mergers, the UK and the US regulators increased the future risks posed by TBTF institutions. By empowering the Anglo-American countries' largest financial institutions to combine and achieve unprecedented scale, questions were raised whether the governments in the UK and

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<sup>231</sup> HM Treasury, 'Treasury Statement on Financial Support to the Banking Industry' (13 October, 2008) *Press Notice 105/08*, available at [http://www.hm-treasury.gov.uk/press\\_105\\_08.htm](http://www.hm-treasury.gov.uk/press_105_08.htm); see, also, HM Treasury, 'Guidance on HMT Treasury Credit Guarantee Scheme and Bank Recapitalisation Fund' (2008), available at [http://www.hm-treasury.gov.uk/fin\\_stab\\_credit\\_guarantee\\_scheme.htm](http://www.hm-treasury.gov.uk/fin_stab_credit_guarantee_scheme.htm).

<sup>232</sup> D Maddox, 'HBOS-Lloyds Bank Merger A Mistake, Says Osborne' (3 April, 2014) *Scotsman*; see, also, A Stephan, 'Did Lloyds/HBOS Mark the Failure of an Enduring Economics based System of Merger Regulation?' (2011) 62 *Northern Ireland Legal Quarter* 539, pp 540-5.

the US had bypassed the requirements of competition provisions, which otherwise may have prevented many of these mergers from taking place.

During the GFC it was suggested that a less strict implementation of antitrust oversight was necessary. Both the UK competition and American antitrust regulators were burdened by avoiding collapse of the financial system in order to limit competition oversight in the financial industry to prop up banks struggling with eroding capital. The foregoing measure included efforts to ease considerations of market control and market domination by banks and their acquisitions so that they could benefit from decreased competition and greater pricing power. Industry friendly policies were developed toward the largest financial institutions. For instance, the largest banks in the UK and the US that already controlled significant deposit market-share were permitted to merger large competitors.

Competition provisions were not rigorously applied throughout the GFC that eventually, among others, exacerbated TBTF issue. In approving mergers of large banks and other financial institutions, both the UK and American regulators managed to avoid the spread of the systemic risk throughout the economy.

The collapses of Northern Rock in the UK, and Bear Stearns and Lehman Brothers in the US, as well as major bank consolidation in both countries, have transformed the distribution of market share and competition within the industry. How these transformations have affected the consumer is an essential undertaking of whether more rigorous competition enforcement is required to constrain further consolidation.

The post GFC enactments of the modernization of financial services legislations in the UK and the US, respectively, provided banking and competition regulators with the power to prevent big bank mergers. It, also, granted them the ability to split up banks considered to present systemic risks to financial stability. Regulators have, also, recognized the value of incorporating systemic risk considerations in competition legislation.

The GFC carried new challenges for competition provisions, the banks that are accountable to them and the regulators that enforce them. The UK Government's

remarkable undertakings in the takeover of HBOS by Lloyds reveal how competition law can be disregarded for broader considerations of financial stability, systemic stress, and economic peril. In that instance, the competition and banking authorities' attention was narrowly focused on immediate systemic considerations instead of the long-term concerns arising from the formation of a new UK banking giant. Such setting aside of competition considerations during the GFC might have raised the importance of competition examination in the banking industry going forward.

Competition provisions would not have prevented the GFC, or eliminated TBTF, because they are not made with the essential tools to avoid the occurrence of financial crises. Modern competition provisions are not in place to homogenize the size of banks and other financial institutions. They are applied only to forbid dominant conduct, and to stop bank mergers in the event of heightened pricing power and market influence.

In relation to the response to the TBTF concern, banking markets are naturally, oligopolistic that cannot be prevented with the objective being to ensure that these operate in a safe and stable manner. Consumers have a right of choice and can say no with competition authorities not being entitled to force competition on them. International competition is also relevant with countries having a legitimate interest to ensure that they have one or more large banks that can compete globally. The TBTF was a problem following the GFC, although a large number of important steps have been taken to correct this since. To address these criticisms, the author analyses the responses to the TBTF problem in light of the actions taken by the international bodies and national authorities, respectively.

Post the GFC, the national and, especially, international bodies released a series of recommendations and time lines on reducing the moral hazard posed by systemically important financial institutions. These recommendations seek to improve the ability of national regulators to resolve SIFIs in an orderly manner, while allowing these institutions to fulfil their key functions in the economy. SIFIs have now a higher loss absorbency capacity than the Basel III requirements, and that SIFIs are subject to more intensive supervision and resolution planning.

International regulators have reaffirmed their view that no financial institution should be too big or too complicated to fail and that taxpayers should not bear the costs of resolution.

The policy response to end TBTF was necessary. The international and national regulators have made great progress to put the overall international policy framework in place. The application of policies to individual SIFIs, and financial institutions have undertaken restructuring necessary in order to make the foregoing institutions resolvable.

Sufficient action has been taken to remove the worst threats that arise with TBTF.

Antitrust is quintessentially addressed to the optimum organization of the nation's economy, even if it does not purport to address all aspects of it. The main issue of competition law is economic power and its potential to be misused. Vast aggregations of economic power in convergence with other phenomena caused TBTF crises. It, therefore, stands to reason that competition ought to be concerned with some aspects of the TBTF problem, at least, insofar as the problem stems from aggregated economic size and power. Since the TBTF problem is complex, it is unsurprising that competition by itself is not and cannot the cure. However, the competition law could make a difference by controlling certain forms of conduct that lead to financial institutions becoming excessively large.

## CHAPTER 11 - DIFFERENCES AND RECOMMENDATION IN ANGLO-AMERICAN BANK MERGER COMPETITION ASPECTS

This chapter discusses competition considerations confining Anglo-American bank mergers; approaches taken by the UK and US to tackle competition matters arising in bank mergers; and what is necessary to be improved, changed, or adopted in the UK and US competition systems affecting bank merger situations.

### 11.0 Competition concerns surrounding Anglo-American bank mergers

Bank mergers policies in relation to competition in the UK and the US have evolved in time.

In the US, the ruling that governs the business of banking as pronounced by the court in the *Philadelphia National Bank* case<sup>1</sup> is no longer practically applicable to the financial services market, which banks and other (non-bank) financial institutions participate nowadays. The *Philadelphia National Bank* case's reliance on demand deposits to differentiate commercial banks from other financial entities<sup>2</sup> is, consequently, a relic in the existent banking and financial system in the US.

'Non-bank financial institutions' ('NBFIs'),<sup>3</sup> like the insurance companies, credit unions, have already entered into other product markets previously controlled by commercial banks. In the event of credit needs, enterprises could simply reach out to finance companies, trade credit, leasing companies, and commercial mortgage entities.<sup>4</sup> Similarly, individuals could contact thrift institutions, commercial finance companies, credit unions and credit cards for their credit needs.<sup>5</sup>

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<sup>1</sup> *United States v Philadelphia National Bank* (1963) 374 US 321 ('Philadelphia National Bank').

<sup>2</sup> *Ibid*, pp 356-357.

<sup>3</sup> A 'non-bank financial institution' ('NBFI') is a financial institution that does not have a full banking license or is not supervised by a national or international banking regulatory authority. For more information, available at [https://en.wikipedia.org/wiki/Non-bank\\_financial\\_institution](https://en.wikipedia.org/wiki/Non-bank_financial_institution).

<sup>4</sup> C Felsenfeld and G Bilali, 'Business Divisions from the Perspective of the US Banking System' (2003) 3 *Houston Business & Tax Law Journal* 66, pp 68-75.

<sup>5</sup> R Kumar, *Strategies of Banks and Other Financial Institutions: Theories and Cases* (Oxford: Elsevier 2014), pp 202-03.

Since the *Philadelphia National Bank* case, in 1963, non-bank competitors have moved into markets previously exclusively dominated by banks, and banks have entered into markets in which they did not have a prior presence.<sup>6</sup> In addition, banks are providing brokerage services and money market funds, which are not a core commercial banking business.<sup>7</sup>

Taking a reposition from local markets approach, banks during the pre-*Philadelphia National Bank* era marketed a variety of their traditional products throughout US state borders. In the post-*Philadelphia National Bank* era, lending services units started to permit banks to offer loans in geographic territories where banks could not take bank account deposits.<sup>8</sup> In the mid to late 1990s, the liberalization of intrastate bank branching and the repeal of the essential parts of the Glass-Steagall Act<sup>9</sup> by the Gramm-Leach-Bliley Act<sup>10</sup> removed the boundaries in the market among the business of banking, securities, and insurance. As result, banks formed financial holding companies where they began to offer banking, securities, and insurance products and services beyond their local territory. Taking part in the countrywide credit card system permitted a bank to expand consumer credit past its local market.<sup>11</sup>

The foregoing developments undermine the conventional view that commercial banks are cloistered from competition as they are the exclusive providers of specific products. At present, businesses and consumers can at their liberty elect to engage either banks or non-bank financial institutions in markets that were previously exclusive to banks and markets in which banks did not have a prior presence either because they were prohibited from participating or simply overlooked by banks.<sup>12</sup>

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<sup>6</sup> M W Olson, 'Don't Call Them Shadow Banks – Call Them Competitors' (14 April, 2014) *American Banker*; see, also, L Ratnovski, 'Competition Policy for Modern Banks' (May, 2013) *IMF Working Paper WP/13/126*, pp 13-15, available at <http://www.imf.org/external/pubs/ft/wp/2013/wp13126.pdf>.

<sup>7</sup> *Garn-St. Germain Depository Institutions Act of 1982*, Pub. L. No. 97-320, 96 Stat. 14 (1982) (codified in various sections of 12 U.S.C.); see, also, A H Meltzer, *A History of the Federal Reserve, Volume II, Book Two, 1970-1986* (Chicago: University of Chicago Press 2010), p 1068.

<sup>8</sup> M Baradaran, 'Reconsidering the Separation of Banking and Commerce' (2012) 80 *Georgetown Washington Law Review* 385, pp 340-7.

<sup>9</sup> Glass-Steagall 1933, 12 USC §§ 24, 78, 377 (repealed 1999) ('Glass-Steagall').

<sup>10</sup> Gramm-Leach-Bliley Act ('GLBA') 1999, Pub. L. 106-102, 113 Stat. 1338, enacted 12 November, 1999).

<sup>11</sup> *Ibid.*

<sup>12</sup> W Busch and J P Moreno, 'Banks' New Competitors: Starbucks, Google, and Alibaba' (20 February, 2014) *Harvard Business Review*, available at <https://hbr.org/2014/02/banks-new-competitors-starbucks-google-and-alibaba>.



Therefore, the *Philadelphia National Bank* approach,<sup>13</sup> which continues to be taken by the US banking and competition agencies, is outdated due to legislative changes that permit both banks and other financial institutions to offer banking products and services. Moreover, the rapid expansion of electronic (online) banking, following the rapid and continuous development of software and online technology innovation, have facilitated banks and non-bank financial institutions to provide online banking products and services not only to local markets, but also across the US and worldwide.<sup>14</sup>

Under these circumstances, the US needs to review its current standard as set out in the *Philadelphia National Bank* case to bring the competition parameters of bank mergers in line with the reality in the financial market. The responsibility to set out the new standard should be borne by the US courts.

In the UK, issues related to competition in bank mergers have evolved as time progresses and in particular with the opening up of the banking industry during the Big Bang reform under the bank deregulation undertaken by the Government of Prime Minister Thatcher in the 1980's.<sup>15</sup> At that time, large banks acquired smaller financial institutions in order to consolidate their position in the market and increase their profits. However, the Government and the banking and competition authorities, including its EU counterparts, failed to take measures necessary to address the anticompetitive effects that these acquisitions imposed on the financial markets and consumers.<sup>16</sup> As a result, the operations and size of these banks have expanded to a scale that the UK Government and the relevant authorities were unable to monitor their activities adequately. The danger of these banks being 'too-big-too-fail' ('TBTF') was exposed in the Global Financial Crisis ('GFC'). The crisis compelled the UK banking and competition authorities to undermine competition laws, with the support of the EU competition enforcer, and allow large UK banks to merge with other UK banks that

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<sup>13</sup> *Philadelphia National Bank* (n1), pp 356-357.

<sup>14</sup> A M Pollard and J P Daly, *Banking Law in the United States* (4th edn, New York: Juris Publishing 2014), pp 3-12.

<sup>15</sup> A Yarrow, 'The Challenges Facing Investment Banking in the UK, in Big Bang 20 Years On: New Challenges Facing the Financial Services Sector' (2006) *Centre for Policy Studies* 42-50, p 45.

<sup>16</sup> P N Hablutzel, 'British Bank's Role in UK Capital Markets since the Big Bang' (December, 1992) 68 *Chicago-Kent Law Review* 365, p 368.

had gone or were on the verge of being insolvent.<sup>17</sup> By rendering special treatment to certain bank mergers in the UK in the name of avoiding a complete meltdown of the financial market, despite knowing that these mergers would give rise to anticompetitive concerns in the banking and financial industry, the UK Government and the relevant UK and EU authorities have established a potentially dangerous precedent for the future treatment of bank mergers.<sup>18</sup>

The current situation in the UK demonstrates that permitting bank mergers despite obvious competition concerns was not the proper measure to enhance the competitiveness in the banking sector.<sup>19</sup> Other attempts have been taken to lessen the effect of the crisis, such as, the bank regulators increasing the leverage ratio to big UK banks in order to minimize the systemic risk in difficult financial situations; however, they do not tackle the anticompetitive issues in the UK that were brought by the special treatment to large bank mergers. As a result of these anticompetitive concerns, the confidence of the British population in banks have decreased as recorded by the British Social Attitudes Survey where some 90 per cent of voters in 1983 thought banks were well-run institutions, but by 2012 the level of trust had fallen to 19 per cent.<sup>20</sup>

The Brexit referendum result of 2016 has thrown the UK towards uncharted waters in terms of the future relationship between the UK and the EU, including implementation of EU provisions and the UK's access in the EU market. However, the foregoing is not part of the analysis in this thesis, notwithstanding its importance.

### **11.1 Approaches taken by the United Kingdom and United States to address competition issues arising in bank mergers**

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<sup>17</sup> M Goldstein and N Véron, 'Too Big To Fail: The Transatlantic Debate' (March, 2011) *Bruegel Working Paper*, pp 20-22, available at [http://bruegel.org/wp-content/uploads/imported/publications/Nicolas\\_Veron\\_WP\\_Too\\_big\\_to\\_fail\\_2011\\_03.pdf](http://bruegel.org/wp-content/uploads/imported/publications/Nicolas_Veron_WP_Too_big_to_fail_2011_03.pdf).

<sup>18</sup> V V Acharya, *Ring-fencing is Good, but no Panacea* in T Beck (ed.) *The Future of Banking* (London: Centre for Economic Policy Research 2012), ch 9.

<sup>19</sup> I Kokkoris, 'Merging Banks in Time of Crisis' (2014) 15 *Journal of Banking Regulation* 3/4, pp 313-324; see, also, I Kokkoris, 'Competition vs. Financial Stability in the Aftermath of the Crisis in the EU and UK' (2014) 59 *Antitrust Bulletin* 1, pp 31-8.

<sup>20</sup> P Stephens, 'The End of the British Establishment' (24 February, 2015) *Financial Times*.

In the US, the courts are the primary organ to interpret anticompetitive rules that are applicable to bank mergers.<sup>21</sup> The relevant authorities and private claimants may bring proceedings to the courts; indeed, most cases have been brought by private claimants. Unlike the UK, which has barely any recorded cases on bank mergers before the courts and the Competition Appeal Tribunal,<sup>22</sup> the US has established a long and rich history of judicial proceedings in which bank mergers have gone under close scrutiny. The American federal district courts along with the Supreme Court, over the last five decades, have dealt with a number of competition cases involving bank mergers.<sup>23</sup>

The last two decades following the *Philadelphia National Bank* court ruling<sup>24</sup> saw the most active period of the American courts' review of bank definition and its local scope of products and services provider in the context of a bank merger.<sup>25</sup> Thereafter, the number of reviews by the judiciary has dropped.<sup>26</sup> The banks that wished to engage in a merger were discouraged by the stringent interpretation of the standard of review by the courts. In particular, it became clear to the banks that there was little room to challenge any merger decision averse to the banks' wishes. As a result, rather than bringing a case to the court, the merging parties turned to the competition authorities and banking regulators to reach a preliminary compromise and then proceeded to merge. A market practice was developed: the merging parties would first divest some of their operations in order to meet the required threshold that the merger would not give rise to anticompetitive concerns, and then move ahead with the merger.<sup>27</sup>

In UK, the Competition and Markets Authority ('CMA')<sup>28</sup>, in close cooperation with the banking regulators, is responsible for bank merger decisions, which are then subject to

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<sup>21</sup> For a discussion of the role of the US courts in bank merger cases, see chapter 8 in this thesis, pp 218-52.

<sup>22</sup> For a discussion of the role of the UK courts in bank merger cases, see chapters 4.0 – 4.3 in this thesis, pp 81-116.

<sup>23</sup> C P Rogers III, 'The Antitrust Legacy of Justice William O. Douglas' (2008) 56 *Cleveland State Law Review* 895, pp 896-9.

<sup>24</sup> *Philadelphia National Bank* (n1), pp 356-357.

<sup>25</sup> E.g., Supreme Court *United States v First Nat'l Bank & Trust Co.* (1962) 208 F. Supp. 457 (E.D. Ky.); *United States v Phillipsburg National Bank & Trust Co* (1970) 399 US 350.

<sup>26</sup> B Shull and G A Hanweck, *Bank Mergers in a Deregulated Environment: Promise and Peril* (Westport: Quorum Books 2001) ('Shull and Hanweck'), pp 181-6.

<sup>27</sup> B Shull, 'Bank Merger Policy in a Too-Big-To-Fail Environment' (2011), pp 2-3, available at [www.levyinstitute.org/pubs/conf\\_april10/19th\\_Minsky\\_Shull\\_dft.pdf](http://www.levyinstitute.org/pubs/conf_april10/19th_Minsky_Shull_dft.pdf).

<sup>28</sup> For a discussion of the role of the Competition and Markets Authority in review of bank mergers, see chapter 3.1.1 in this thesis, pp 51-7.

appeal to the courts, such as the Competition Appeal Tribunal, and the relevant appeal court.<sup>29</sup> However, relatively fewer cases to date have been private actions. Banks in the UK generate considerable profits from the provision of services to their corporate and individual customers. One of the major concerns in relation to the banking markets is their exclusivity and concentration, particularly for small and medium-sized enterprises ('SMEs') banking. There appears to be a failure to provide relevant information to individual customers and SMEs. Customers face substantial obstacles to switching current accounts.<sup>30</sup> In addition, banks are largely in charge of the money transmission. Another issue concerns banking services such as, producing barriers to entry, dissatisfactory service standards, excessive charges, and innovation failure.<sup>31</sup> While the competition and banking regulators and the UK Government recognize these issues and attempts have been made to address them,<sup>32</sup> there have been no substantial improvement and the issues remain unresolved. Similar problems continue to arise and increase in many banking markets. These problems comprise of concentrated markets in which both new entry and increase in market shares by contenders proved to be difficult; compound and impervious pricing and small degrees of bank account switching, as well as payment systems, remain dominated by the banks' and failure in innovation.<sup>33</sup>

With respect to the issue of concentrated markets, the largest four UK financial institutions (Barclays, HSBC, Lloyds Banking Group, and Royal Bank of Scotland) possess a robust and embedded place within the market.<sup>34</sup> Market researches indicate that in the past decade the respective market shares of these established institutions and the 'challenger' banks remain almost unchanged.<sup>35</sup> In particular, two important observations emerged in the bank mergers throughout the GFC, especially the takeover of HBOS by Lloyds.<sup>36</sup> The first concern was in relation to the HBOS losing a key position of competition in the market.<sup>37</sup>

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<sup>29</sup> For a discussion of the Competition Appeal Tribunal and other British courts, see chapter 4.1 in this thesis, pp 81-3.

<sup>30</sup> Competition and Markets Authority, 'Retail Banking Market Investigation: Summary of Provisional Findings Report' (22 October, 2015) ('Retail Banking Market Investigation'), pp 219-224, available at [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/470032/Banking\\_summary\\_of\\_PFS.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/470032/Banking_summary_of_PFS.pdf).

<sup>31</sup> *Ibid*, p 378.

<sup>32</sup> *Ibid*, pp 7-9.

<sup>33</sup> *Ibid*, pp 401-407.

<sup>34</sup> *Ibid*, pp 10-11.

<sup>35</sup> *Ibid*, pp 122, 162, and 399.

<sup>36</sup> For a discussion of the HBOS takeover by Lloyds Group, see chapter 4.3.2(e) in this thesis, pp 110-6.

<sup>37</sup> Competition and Markets Authority, 'Retail Banking Market Investigation: Summary of Provisional Findings Report' (22 October, 2015) ('Retail Banking Market Investigation'), pp 397-98, available at

The second related to Lloyds' larger share of the market, which could encourage the bank to concentrate on growing margins from current customers instead of obtaining new customers.<sup>38</sup> This has, by now, resulted in a vastly concentrated and non-dynamic market.<sup>39</sup>

On bank account switching, annual switching rates remain quite low in the personal current account market and higher for small and medium size banking and savings accounts.<sup>40</sup> While they were a lot higher for mortgages and credit cards, there has been a considerable drop in mortgage switching after 2008.<sup>41</sup> In relation to the personal current account market, the competition and banking regulators have acknowledged issues to the switching process of these accounts.<sup>42</sup> Regulators agree that the bank account switching service process requires further enhancement to make it function more efficiently and become less costly for consumers.<sup>43</sup> It is insufficient to simply make it convenient to switch accounts. Customers in addition require the right stimulations in order to carry out their choice of bank provider. Consumers within banking markets often encounter problems in comprehending the factual cost of managing their bank accounts and paralleling offer packages from other bank providers.<sup>44</sup> It can be frequently observed that financial institutions do not provide sufficient care for their consumers in sectors where these institutions generate great revenues. This largely reflects the reality in the personal current account market. Large financial institutions may continue to generate revenues from present customers instead of offering appealing packages of banking products or services to new active customers.<sup>45</sup>

A concern, also, exists in relation to payment systems.<sup>46</sup> Payment systems continue to remain in banks' control. Barriers to entry continue to exist due to access to payment

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[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/470032/Banking\\_summary\\_of\\_PFS.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/470032/Banking_summary_of_PFS.pdf).

<sup>38</sup> *Ibid*, pp 22, and 237.

<sup>39</sup> M Chalabi, 'UK Banks: How Powerful Are They?' (17 January, 2014) *Guardian*.

<sup>40</sup> *Retail Banking Market Investigation* (n37), pp 22, 260, 286, and 295.

<sup>41</sup> *Ibid*, pp 256, and 286-287.

<sup>42</sup> *Ibid*, pp 219-224.

<sup>43</sup> *Ibid*, pp 225-227.

<sup>44</sup> *Ibid*, pp 235, and 237.

<sup>45</sup> E Dunkley, 'Free Banking Model Stifles UK Competition, Warns Virgin Money' (2 February, 2015) *Financial Times*.

<sup>46</sup> HM Treasury, 'Opening Up UK Payments' (March, 2013), pp 6-10, available at [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/221903/consult\\_opening\\_up\\_uk\\_payments.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/221903/consult_opening_up_uk_payments.pdf).

systems.<sup>47</sup> The UK regulators failed to take an active role in addressing the entry issue. It would be fair to question whether the existing UK regulation on overseeing payments would remain suitable for payments involving more advanced technology, such as, mobile payments.<sup>48</sup>

The structures of the regime monitoring and overseeing bank mergers in the US and the UK differ. First, the US has an established multi-tiered process for reviewing bank mergers by the relevant competition authorities and bank regulators. The competition authorities and the bank regulators, however, are independent of each other.<sup>49</sup> The UK, on the other hand, has a more flexible reviewing process that allows room for more discretion on the part of the relevant authorities.<sup>50</sup> Moreover, in relation to competition authorities, the federal competition authorities in the US hold the highest regulatory power subject to review of the courts,<sup>51</sup> while their UK counterparts are, in addition to review by the courts, subject to the decisions of the Commission.<sup>52</sup> The competition authority and bank regulators in the US may utilize the public interest standard when analysing a bank merger,<sup>53</sup> while in the UK only the UK Government, through the Secretary of State for Business, Innovation and Skills, may raise such standard.<sup>54</sup> Second, the judicial structures involved in bank mergers decisions in the two nations also differ. In the US, generally courts are the ultimate independent competition authorities, where any relevant party could lodge an appeal in court on the decision of the federal competition authorities.<sup>55</sup> In the UK, the equivalent judicial counterpart is the Competition Appeal Tribunal, whose decisions are rarely appealed to higher court.<sup>56</sup> Third, the US has in place specific laws governing bank mergers,<sup>57</sup> while in the UK the broader

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<sup>47</sup> *Retail Banking Market Investigation* (n37), pp 355-357, and 362; see, also, Competition and Markets Authority, 'Barriers to Entry and Expansion: Capital Requirements, IT and Payment Systems' (14 July, 2015), pp 3-7, available at [http://www.chapsco.co.uk/sites/default/files/barriers\\_to\\_entry\\_payment\\_systems.pdf](http://www.chapsco.co.uk/sites/default/files/barriers_to_entry_payment_systems.pdf).

<sup>48</sup> B L Reed, 'Mobilizing Payments: Behind the Screen of the Latest Payment Trend' (2014) 14 *Journal of High Technology Law* 451, pp 453-4.

<sup>49</sup> For a discussion of the role of the US antitrust and banking regulators in examination of bank mergers, see chapter 7 in this thesis, pp 197-215.

<sup>50</sup> For a discussion of the role of the UK competition and banking authorities in bank mergers, see chapter 3 in this thesis, pp 50-79.

<sup>51</sup> See *supra* (n49).

<sup>52</sup> See *supra* (n50).

<sup>53</sup> 12 U.S.C. § 1843(j)(2); see, also, 12 USC § 1842(c)(7).

<sup>54</sup> The Enterprise Act 2002 (Specification of Additional Section 58 Consideration) Order 2008 SI 2008/2645.

<sup>55</sup> For a discussion of the US courts role in reviewing bank merger case laws, see chapter 8 in this thesis, pp 218-52.

<sup>56</sup> For a discussion about the role of the Competition Appeal Tribunal, see chapter 4.1 in this thesis, pp 81-3.

<sup>57</sup> *E.g.*, Bank Merger Act 1960, amended 1966, 12 USC § 1828; also, see, chapter 6 in this thesis, pp 181-95.

merger provisions apply to bank mergers, and to other business sectors of the economy.<sup>58</sup> Under the US law, bank mergers are analysed based on local geographic territory where the ‘cluster’ of banking products are provided,<sup>59</sup> while in the UK, the competition watchdog, often, applies a somehow broader relevant geographic territory based on a ‘relevant merger situations’ factors.<sup>60</sup> As a result, there are currently no discussions in the US concerning the reform of competition policies in relation to bank mergers. On the other hand, there is an on-going effort in the UK to reform the same in the financial services sector.<sup>61</sup> However, the results of the effort to reform remain unclear.<sup>62</sup>

In the US, laws have been passed after the financial crisis as an attempt to prevent systemic risk in future financial crisis.<sup>63</sup> These laws consist of measures that, among others, tighten the oversight of banking activities to ensure a better and more organized banking market, as well as measures that aim to prevent future bail-outs from the taxpayers’ monies.<sup>64</sup> However, these measures did not generate the expected results. Banks operate in a scale larger than what they were previously and continue to find ways to enter into high risk operations, at times even through a concerted effort among themselves to generate more profits without regard to the competition provisions. For instance, the latest initiative from numerous congressmen in the US Congress to revise the Dodd-Frank Act<sup>65</sup> was quickly rejected by their majority colleagues in the Congress.<sup>66</sup> In this initiative, the Republicans put forward numerous changes comprising of the release of up to 30 banks from strict Federal Reserve supervision; enhancing the regulators’ responsibility towards systemic risk exposures; easing up on rules about mortgage lending; as well as amplifying the openness of Federal Reserve

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<sup>58</sup> E.g., Competition Act 1998, c.41; Enterprise Act of 2002, 2002 c. 40. For a discussion of the UK laws applicable to competition aspects of bank mergers, see chapter 2 in this thesis, pp 10-47.

<sup>59</sup> For a discussion of the competitive analysis of a bank merger in the US, see chapters 9.1-9.2 and 9.4 in this thesis, pp 258-75, and 283-99.

<sup>60</sup> For a discussion of the UK competition methodologies and policies implementation in bank mergers, see chapter 5 in this thesis, pp 132-77.

<sup>61</sup> E.g., Independent Commission on Banking, ‘Final Report’ (September, 2011), available at [www.hm-treasury.gov.uk/d/ICB-Final-Report.pdf](http://www.hm-treasury.gov.uk/d/ICB-Final-Report.pdf); see, also, The Financial Services (Banking Reform) Act 2013; see, further, Financial Services (Banking Reform) Act 2013, c.33.

<sup>62</sup> See generally M Wolf, *The Shifts and the Shocks: What We’ve Learned – and Have Still to Learn – From the Financial Crisis* (London: Penguin 2014).

<sup>63</sup> E.g., Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203; 124 Stat. 1391; codified to 12 USC 5301 note, effective 21 July, 2010 (*codified as amended in 12 U.S.C. §§ 5301–5641*) (‘Dodd-Frank’), s 604(d) and (f) (codified as 12 USC §1842(c)(7); and 12 USC § 1828(c)(5)).

<sup>64</sup> M Waters, ‘How to Prevent Another Financial Crisis’ (19 September, 2013) *American Banker*, available at <http://www.americanbanker.com/bankthink/how-to-prevent-another-financial-crisis-1062243-1.html>.

<sup>65</sup> *Dodd-Frank* (n63).

<sup>66</sup> B Jopson, ‘Republican Assault on Dodd-Frank Act Intensifies’ (14 January, 2015), *Financial Times*.

monetary policy.<sup>67</sup> On the other hand, the Democrats supported amendments that could dilute regulations concerning small community banks and improve the authority of the Consumer Financial Protection Bureau, which is an agency established after the Global Financial Crisis charged with the responsibility of guarding consumers' rights in the banking and financial system operations.<sup>68</sup>

Notwithstanding the foregoing, any substantial reforms of the existing laws do not seem to be plausible in the foreseeable future. Moreover, banks in the UK and the US, especially the large ones, continue to circumvent competition provisions.<sup>69</sup> In some cases, these banks have even cooperated among themselves to generate profits illegally, including through the use of avenues, such as, the banking businesses of the foreign exchange markets and the interbank lending rates, also known as the London Inter-Bank Offer Rate ('LIBOR')<sup>70</sup> rates. In 2015, six worldwide financial institutions paid approximately \$5.6bn in order to resolve claims that these institutions rigged the markets of foreign exchange that implicated criminality to a large extent.<sup>71</sup> This situation was deemed to be one of the largest instances of misconduct in the banking industry from the time of the GFC.<sup>72</sup>

During the period 2007 through 2013, traders at Royal Bank of Scotland, Barclays, JPMorgan Chase, Citigroup, and UBS AG - labelling themselves as 'the Cartel' - made use of an exclusive online chatroom and a set of secret code in an attempt to influence the benchmark exchange rates with the aim to make more profits.<sup>73</sup> The US competition authorities, led by the Department of Justice, imposed fines on the banks involved and considered such fines would be sufficient to deter market players from advancing their own interests while disregarding compliance with the relevant laws or consumers' interest.<sup>74</sup> However, these measures do not bring about the expected deterrence effect. It is clear from

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<sup>67</sup> B Jopson, 'Dodd-Frank Senate Reform Tussle Ends in Stalemate' (21 May, 2015) *Financial Times*.

<sup>68</sup> *Ibid.*

<sup>69</sup> S Gandel, 'The Big Banks of the Fortune 500 That Keep Getting Bigger' (16 June, 2015) *Fortune Magazine*, available at <http://fortune.com/2015/06/16/fortune-500-fastest-growing-banks/>.

<sup>70</sup> The London Inter-Bank Offer Rate ('LIBOR') is a benchmark rate that some of the world's leading banks charge each other for short-term loans. For more information, see <http://www.investopedia.com/terms/l/libor.asp>.

<sup>71</sup> C Binham, 'Bank Fines Credited for Culture Shift' (21 May 2015) *Financial Times*.

<sup>72</sup> *Ibid.*

<sup>73</sup> Department of Justice, 'Five Major Banks Agree to Parent-Level Guilty Pleas' (20 May, 2015) Release ('DOJ Fines'), available at <https://www.justice.gov/opa/pr/five-major-banks-agree-parent-level-guilty-pleas>.

<sup>74</sup> *Ibid.*



established precedent that as soon as a bank pays a fine or penalty for engaging in wrongful or unlawful activity, it could continue engaging in such activity without further penalization. It is, thus, evident that the US approach is counterproductive, especially towards the applicability of fairness and lawfulness of competition in the banking system.

The total settlement fines and criminal penalties paid by major UK and US banks to the relevant authorities from 2008 to date amounted to approximately \$160bn, a staggering sum of monies.<sup>75</sup> For example, in 2015 Royal Bank of Scotland, Barclays, Citigroup, JPMorgan Chase, Bank of America and UBS paid billions of pounds and dollars to resolve claims that their traders attempted to rig interbank lending rates.<sup>76</sup> These banks paid to the regulators over \$10bn with respect to the foreign exchange manipulative activities (the so-called 'forex scandal'), surpassing the \$9bn paid by them to settle the LIBOR rigging allegations.<sup>77</sup> Barclays alone paid to the authorities roughly \$2.3bn since 2008, rendering it the largest penalty paying bank in the UK. Indeed, the FCA fined Barclays £4284m, which is to date the highest fine imposed by the relatively young supervisory body.<sup>78</sup>

The lack of deterrent effect by the imposition of fine is also evident in the UK. In 2015, in response to the increased scrutiny and stricter regulations imposed by the UK banking and competition authorities, the British Bankers' Association ('BBA'), pressured by major UK financial institutions, appointed an independent team of expert to review the competitiveness of UK banks on behalf of the sector.<sup>79</sup> This step was also taken in response to anticipated further tightening of the regulatory and fiscal clampdown from the re-elected conservative government in the May, 2015 election.<sup>80</sup> The appointment was made upon warning from UK banks that they have begun shifting their investment and assets outside the UK as a result of the tightening of the UK banking regulatory regime and higher bank levy. The major UK banks along with the BBA opined that UK has gone ahead of other nations to implement restrictive measures in order to guarantee to the British people that they would not

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<sup>75</sup> L Fortado, 'British Banks Pay £12bn in Penalties' (31 May, 2015) *Financial Times*.

<sup>76</sup> *DOJ Fines* (n73).

<sup>77</sup> G Chon et al, 'Six Banks Fined \$5.6bn Over Rigging of Foreign Exchange Markets' (20 May, 2015) *Financial Times*.

<sup>78</sup> *Ibid*.

<sup>79</sup> T Young, 'UK: Hector Sants to Lead Review of Competitiveness in UK Banking Sector' (20 May, 2015) *Mondaq Business Briefing*.

<sup>80</sup> P Jenkins, 'Banker-Bashing Makes a Comeback in General Election Campaign' (7 May, 2015) *Financial Times*.

be required to bail out banks and other financial institutions again.<sup>81</sup> Moreover, the UK banks complained that the latest increase in the bank levy as a punitive measure has made it more strenuous to compete in international markets.<sup>82</sup> As a result, some leading UK banks with a global operation are considering to move activities out of the UK or to stop investing in the country. After the release of the Budget in 2015, where the HM Treasury increased the rate of the bank levy for the ninth time since 2011 to a historic high of 0.21 per cent of worldwide balance sheet liabilities, banks have accelerated their review for alternatives to moving their activities overseas.<sup>83</sup>

The independent review commissioned by the BBA was focused on the issue of whether the UK banking industry has lost its edge due to the UK Government tightening regulation of the banking business since the GFC. The independent commission released a report in late 2015, issuing recommendation for reconsideration of the government's present position of escalating measures that restrict banks operations.<sup>84</sup> Other than corporate and personal taxation issues, the report looked into regulation governing other aspects of banks operations, such as, the requirement for banks to ring-fence their retail activities from other operations, and the uncertainties related to the projected referendum in 2016 of the British people to exit the EU.<sup>85</sup> The report found that the UK Government needs to act urgently to address issues about its regulatory and tax environment if London is to remain a global financial centre and if banks located in the UK are to remain competitive internationally.<sup>86</sup> The report noted that regulatory overhauls put in place after the Global Financial Crisis had reduced banking returns globally, and that policy and regulatory decisions in the UK, especially, had 'begun to reduce the attractiveness of the UK as a location for international banking and hinder UK wholesale banks' ability to compete internationally'.<sup>87</sup> According to the report, the total amount of banking assets in the UK had dropped 12 per cent since 2011,

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<sup>81</sup> S Morris and B Stupples, 'Osborne Reins in British Bank Levy Following HSBC Pressure' (8 July, 2015) *Bloomberg*, available at <http://www.bloomberg.com/news/articles/2015-07-08/osborne-to-cut-u-k-bank-levy-won-t-apply-it-to-global-assets>.

<sup>82</sup> *Ibid*.

<sup>83</sup> M Arnold, 'UK Banks Appoint Sants to Lead Review of Competitiveness' (18 May, 2015) *Financial Times*.

<sup>84</sup> British Banker's Association, 'Winning the Global Race: The Competitiveness of the UK as a Centre for International Banking' (November, 2015) *BBA Report*, available at [www.bba.org.uk/news/reports/winning-the-global-race/#.Vk4cK3arTIX](http://www.bba.org.uk/news/reports/winning-the-global-race/#.Vk4cK3arTIX).

<sup>85</sup> *Ibid*, pp 12-23.

<sup>86</sup> *Ibid*, pp 24-29.

<sup>87</sup> *Ibid*, pp 30-39.

but that it had increased 12 per cent in the US, in the same period.<sup>88</sup> The report found that the UK Government should carry out a review of the recent financial reform regulations to identify ‘unintended consequences and areas where objectives are not effectively met’, ensuring that the threshold for ring fencing is ‘inflation-proof’, so that smaller banks are not stifled by having to comply with the new rules.<sup>89</sup>

In the 1960s, like in the US, where banking was contingent on the competition law, in the EU, the Commission, around the same time, took the necessary steps to regulate mergers, national protectionism, price agreements, State aid, and dominant abusive conduct.<sup>90</sup> In relation to the competition aspects of bank mergers, the Commission has contributed to the control of the distortions formed by public bailout due to its unique position, within the EU national competition authorities, that enables it to contain State aid.<sup>91</sup>

Prior to the GFC, the EU State aid control in relation to banking was mainly based on two incidents. One case involved *Crédit Lyonnais* in France concerning costs up to 2.5 per cent of the gross domestic product<sup>92</sup>, and the second case was on the state guarantees in Germany for the *Landesbanken* and saving banks concerning the compliance with capital requirements.<sup>93</sup>

Upon the occurrence of the GFC, the Commission has handled several banking aid cases. For instance, during the year of 2008 the competition authority took twenty-two decisions, and by the end of 2009 it took eighty-one decisions out of which seventy-five of these cases were agreed to without objection.<sup>94</sup>

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<sup>88</sup> *Ibid*, pp 40-52

<sup>89</sup> *Ibid*, p 53.

<sup>90</sup> E Carletti and X Vives, *Regulation and Competition Policy in the Banking Sector* in X Vives (ed.) *Fifty Years of the Treaty of Rome: Assessment and Perspectives of Competition Policy in Europe* (Oxford: Oxford University Press 2008) (‘Carletti and Vives’), pp 260-83.

<sup>91</sup> Commission, ‘The Effects of Temporary State Aid Rules Adopted in the Context of the Financial and Economic Crisis’ (October, 2011) *Staff Working Paper*, available at [http://ec.europa.eu/competition/publications/reports/working\\_paper\\_en.pdf](http://ec.europa.eu/competition/publications/reports/working_paper_en.pdf).

<sup>92</sup> *Credit Lyonnais I* Commission Decision 95/547/EC of 26.07.1995 giving conditional approval to the aid granted by France to the bank Credit Lyonnais, *OJ 1995 L308*, pp 92-119.

<sup>93</sup> Commission, ‘Commission Requests Germany to Bring State Guarantees for Public Banks into Line with EC Law’ (8 May, 2011) *Press release IP/01/665*.

<sup>94</sup> X Vives, ‘Competition Policy in Banking’ (2011) 27 *Oxford Review of Economic Policy* 3 (‘Vives’), pp 479-97.

The EU competition authority imposes conditions for the recapitalization or guarantees from the state: non-discriminatory entry to state assistance in order to maintain an equal opportunity among financial institutions and banking sectors; assistance needs to be restricted in time and scope with handouts from the private sector; and suitable market-designed remuneration for recapitalization or support.<sup>95</sup> In addition, beneficiary financial institutions must comply with specific conduct rules.<sup>96</sup> Enticements must be provided for eventual termination of the state capital injection. A differentiation needs to be drawn between banks that have a solid presence but possibly distressed due to contagion on the one hand, and other distressed banks with recapitalizations solely for financial institutions that have a solid presence, on the other.<sup>97</sup> The conditions are realistic because they attempt to lessen the distortions brought together by public assistance, especially for financial institutions that do not have a solid presence.

The regulatory instruments utilized are of a structural nature given the divestitures and balance sheet cutbacks. These instruments are also of a behavioural nature given the limitations on pricing, publicity, or staff and employees' compensation. For instance, Northern Rock bank was compelled to distinguish between a 'good' bank that had an opening balance sheet of about 20 per cent of the pre-GFC level and a continuation of taking deposits and mortgage lending, and a 'bad' bank that held most of the aftermath mortgage loans of Northern Rock bank.<sup>98</sup> Northern Rock was not permitted to carry out price leadership or to publicize any public assistance.<sup>99</sup> At another instance, the Royal Bank of Scotland was directed to sell its operations in some retail activities, commodity-trading, and insurance.<sup>100</sup> It is worth noting that the EU competition authority expressed concern over concentration in retail and corporate banking for SMEs to the Royal Bank of Scotland, and, with regard to

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<sup>95</sup> Commission, 'The Application of State Aid Rules to Government Guarantee Schemes Covering Bank Debt' (30 April, 2010) *DG Competition Staff Working Document*, available at [http://ec.europa.eu/competition/state\\_aid/studies\\_reports/phase\\_out\\_bank\\_guarantees.pdf](http://ec.europa.eu/competition/state_aid/studies_reports/phase_out_bank_guarantees.pdf).

<sup>96</sup> Commission, 'State Aid: Commission Adapts Crisis Rules for Banks – FAQs' (15 October, 2013) *MEMO*, available at [http://europa.eu/rapid/press-release\\_MEMO-13-886\\_en.htm](http://europa.eu/rapid/press-release_MEMO-13-886_en.htm); see, also, Commission, 'State Aid: Commission Adapts Crisis Rules for Banks' (2012) *Press Release IP/13/672*.

<sup>97</sup> A Lista, *EU Competition Law and the Financial Services Sector* (Oxon: Routledge 2013), p 332.

<sup>98</sup> G A Walker, 'Financial Crisis-UK Policy and Regulatory Response' (2010) 44 *International Law* 751, pp 753-4.

<sup>99</sup> National Audit Office, *Her Majesty's Treasury: The Nationalization of Northern Rock* (20 March, 2009), available at [www.nao.org.uk/publications/0809/northern\\_rock.aspx](http://www.nao.org.uk/publications/0809/northern_rock.aspx).

<sup>100</sup> Editor, 'Scots on the Rocks' (25 February, 2010) *Economist*.

commodity-trading and insurance activity, the authority stated the benefits of the divestments in curbing moral hazard.<sup>101</sup>

Various courses of actions undertaken by the Commission could be seen as efforts to reduce competitive distortions of the Member State assistance, and others to examine moral hazard in the foreseeable future.<sup>102</sup> In essence, the goal of the EU, the UK, and the US competition authorities should be to sustain competition, instead of curbing moral hazard, which is the role of the banking regulators. A significant consideration for maintaining the separation of roles is that even the measures directed solely at competitive distortions would cause an effect on expected incentives because a bank would be aware of the fact that, in event of trouble, aid would arrive with the imposition of particular restrictions. This is relevant to institutions being TBTF due to the fact that the notion of competitive distortion could include competition contingent on the advantage of the institution being TBTF. The limitations on the boundaries of operations outside the regulated basic banking activities could arise even though to some extent they go outside the typical competition considerations and concerns.<sup>103</sup>

A significant benefit of the State aid control is the restrictions on the bankers' incentives to undertake unwarranted risk in the anticipation of a bailout in the event that anything goes wrong. More specifically, it tackles the TBTF concern. Competition authorities in the UK, US, and the EU should take into consideration the fact that a failing bank receiving help could potentially distort competition. Restricting the integral size of a bank after it obtains public aid extends the breadth of competition policy.<sup>104</sup>

The engagement of the EU competition authority raises the issue of competitive balance with US banks that were recapitalized from the government without divestiture undertakings. This could become particularly important in the banking business involving

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<sup>101</sup> Commission, 'State Aid: Commission Approves Impaired Asset Relief Measure and Restructuring Plan of Royal Bank of Scotland' (14 November, 2009) *Press release IP/09/1915*; see, also, Commission, 'State Aid: Commission Approves of Liquidation of Bradford & Bingley' (25 January, 2010) *Press release IP/10/47*.

<sup>102</sup> C Quigley, *European State Aid Law and Policy* (3<sup>rd</sup> edn, Oxford: Hart Publishing 2015), p 406.

<sup>103</sup> L Ratnovski, 'Competition Policy for Modern Banks' (May, 2013) *IMF Working Paper WP/13/126* ('Ratnovski'), pp 13-15, available at <http://www.imf.org/external/pubs/ft/wp/2013/wp13126.pdf>.

<sup>104</sup> E Faia et al, *Financial Regulation: A Transatlantic Perspective* in L Enriques and G Hertig Shadow (eds.) *Resolutions as a No-No in a Sound Banking Union* (Cambridge: Cambridge University Press 2015), p 164.

global competition. The US Government advocated restrictions on the size and scope mainly with regard to the proprietary trading activities carried out by banks in order to avert the TBTF issue and controlling risk taking.<sup>105</sup>

The difference in approach between the US, on one hand, and the UK and EU, on the other hand, is that while the UK and the EU competition authorities attempted to resolve the issues through State aid control, their US counterpart opted to deal with the matter by regulations.

The US is pursuing another course in which the TBTF issue is not tackled directly as an antitrust issue. The 2010 Dodd-Frank Act<sup>106</sup> presented a moderate variant of the restrictions on proprietary trading activities (the Volcker Rule)<sup>107</sup> carried out by banks and reinforced some restrictions on size by extending the Riegle-Neal Act 1994.<sup>108</sup> This forbids any bank merger or acquisition that could lead to the combined banking organization controlling above ten per cent of domestic deposits in the US of all kinds of depository institutions.<sup>109</sup> It also introduces a restriction of concentration towards any consolidation of financial institutions of ten per cent of financial sector liabilities.<sup>110</sup>

Size and scope limitations are direct instruments to address the TBTF matter. Controls on size can become complex due to the fact that interconnectedness and line of business specialty are deemed more significant than size of the institution for systemic risk. As for the scope of the operations of banking institution, conflict of interest results in possible market failure and can be the basis for potential scope restrictions. Greater capital and insurance fees for systemically important financial institutions along with effectual resolution procedures could be a preferable method of confronting with the problem. This needs to be coupled with careful consideration of conflicts of interest in financial conglomerates. Considering the restrictions of behavioural regulation, structural limitations become warranted. The result is

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<sup>105</sup> The White House, 'President Obama Calls for New Restrictions on Size and Scope of Financial Institutions to Rein in Excesses and Protect Taxpayers' (21 January, 2010), available at [www.whitehouse.gov/the-press-office/president-obama-calls-new-restrictions-size-and-scope-financial-institutions-rein-e](http://www.whitehouse.gov/the-press-office/president-obama-calls-new-restrictions-size-and-scope-financial-institutions-rein-e).

<sup>106</sup> *Dodd-Frank Act* (n63).

<sup>107</sup> *Ibid*, § 619 (codified 12 USC §1851). For a discussion of the Volcker Rule, see chapter 6.6.1 in this thesis, pp 192-3.

<sup>108</sup> Riegle-Neal Act 1994, PL 103-328, 108 Stat. 2338; see, also, chapter 6.4 in this thesis, pp 188-90.

<sup>109</sup> *Dodd-Frank* (n63), § 623.

<sup>110</sup> *Ibid*, § 622.

that the UK and the US competition authorities, fulfilling their task of regulating competition, should have a part to play in the TBTF matter. Their initiatives need to be harmonized with the banking regulators in their respective countries. The prospect of competition policy to commit to tackle concerns surrounding institutions that are TBTF should not be dismissed.<sup>111</sup>

The move from the US Government seems to be resonant of the 19<sup>th</sup>-Century competition practice of distrusting big banks and other financial institutions due to the power concentration, often exercised in an imprudent manner, they can sustain.<sup>112</sup> Competition policy later progressed towards market power in a specific market in which size was not deemed an offense. The impact that the investment banks created on the financial intermediaries' deregulation and the safeguarding of vast rise in leverage culminating with the GFC has backfired in the last decade. Currently, the banking markets are situated within the territory of political economy and the challenge consists of finding the proper instrument to curtail excessive power concentrations in a democratic society.<sup>113</sup>

Bank mergers have followed two particular trends in the UK and the US, one through voluntary mergers and the other through mergers arranged by the respective governments to resolve the assets and liabilities of banks in distressed financial conditions. Voluntary bank mergers peaked in the late 1980's until the mid-1990s when economies in the UK and the US enjoyed steady and strong economic growth, high interest rates, and deregulation.<sup>114</sup> Thereafter, they declined to negligible numbers in the 2000's, soaring during the GFC.<sup>115</sup>

In relation to the consequences of boosted more dynamic bank dimension and concentration for numerous characteristics of sector performance, banks grow bigger and engage in a broader span of operations across those, which have traditionally been left with

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<sup>111</sup> J Harrison, 'The Protection of Foreign Investment: United Kingdom National Report' (2010) *XVIII International Congress of Comparative Law*, Washington ('Harrison'), pp 69-73.

<sup>112</sup> W M Gray, *Experiment in Liberty: The First 500 Years of Freedom in America* (Manhattan ks: Sunflower University Press 1998), p 256.

<sup>113</sup> *Shull and Hanweck* (n26), pp 181-6.

<sup>114</sup> F M Scherer, 'Financial Mergers and Their Consequences' (June, 2013) *Harvard John F. Kennedy School of Government, Research Working Paper Series 13-019*.

<sup>115</sup> *Ibid.*

other financial institutions.<sup>116</sup> Moreover, systemic risk, such as, the prospect that adverse economic situations would have a ripple effect of reactions with grave consequences on the economy may grow quickly and uncontrollably. Those banks that grow as TBTF need financial assistance from their supervisory institutions under the orchestration of the government, which is inconsistent with the notion of a free market. The outcry from the public that followed the US Government's TARP in 2008 and 2009 was a clear example of the reaction to government aid granted to large banks.<sup>117</sup> Although the US Government marketed the aid as a temporary relief warranted under the extraordinary circumstances in the financial market, the government's intervention created substantial moral hazard risks, indirectly allowing banks to become less prudent of the investments they undertake and, for this reason, exasperating the danger of future financial crises.<sup>118</sup> Offering risk reduction to the failing large banks, while not offering the same level of protection to small banks, creates unfair and unequal treatment the small banks. Such treatment could also lead to reduced borrowing cost for large bank in comparison to the borrowing costs for small banks. This cost advantage could potentially lead to the concentration of banking assets in the large financial institutions.<sup>119</sup>

It is also likely that the foregoing approach could increase the prominence of the largest banks to attain elevated profits and prices as a result of the economic power sustained. The increase of concentration of the banking markets through bank mergers may potentially lead to a rise in profitability to the merged institution(s). Consequently, and ultimately, such concentration and profitability could create a monopoly in favour of these merged institutions in the banking and financial markets. This should not be allowed to happen. Competition authorities along with the banking regulators in the UK and US must coordinate their efforts

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<sup>116</sup> E Carletti, 'Competition, Concentration and Stability in the Banking Sector' (2010) *OECD Competition Committee Roundtable, Seminar on Competition, Concentration and Stability in the Banking Sector*, DAF/COMP (2010) 9, Paris ('OECD Competition and Stability in Banking Sector'), pp 13-37.

<sup>117</sup> D T Riley, 'Roll Up the Constitution and Unfurl the Tarp: How Spending Conditions in the Troubled Asset Relief Program Violate the Constitution' (2010) 98 *Kentucky Law Journal* 595, pp 597-605.

<sup>118</sup> M Gertler *et al*, 'Financial Crises, Bank Risk Exposure and Government Financial Policy' (May, 2011) *New York University Working Paper*, pp 2-3, available at <https://www.princeton.edu/~iyoaki/papers/GertlerkiyotakiQueraltoJune7wp.pdf>.

<sup>119</sup> A E Wilmarth Jr, 'Turning a Blind Eye: Why Washington Keeps Giving in to Wall Street' (2013) 81 *University of Cincinnati Law Review* 1283, pp 1328-1345.



to prevent banks from merging in a way that would create absolute sizes within the banking markets. The absolute sizes of bank mergers are and should be absolutely prevented.<sup>120</sup>

The GFC compelled the occurrence of numerous bank mergers in the UK and the US that were backed by guarantees or subsidies from the respective governments.<sup>121</sup>

In the UK, the takeover of HBOS by Lloyds<sup>122</sup> was rubber-stamped against the competition authority's recommendation regardless of a 30 per cent market share of the merged institution in mortgages and the current accounts, as well as competition issues with regard to the SMEs banking services in Scotland.<sup>123</sup> Ironically, in 2001, the UK Government, following the advice from the then competition authorities that the deal was to operate against the public interest, did not permit Lloyds to take over Abbey.<sup>124</sup> Lloyds negotiated with the Commission some divestment measures due to the fact that in the merger process the bank received from the UK Government a State aid.<sup>125</sup> It appears that the UK Government used a broad interpretation of the 'failing firm' (or 'exiting firm') defence doctrine.<sup>126</sup> Under this doctrine, a merger with a failed firm cannot produce competition concerns since the assets of the entity would depart the market in the event of failure, to permit anticompetitive mergers to strengthen the financial system.<sup>127</sup>

In the US, due to several consolidation transactions during and after the GFC, Bank of America, JPMorgan Chase, and Wells Fargo combined to date counted for over 30 per cent of

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<sup>120</sup> D Biggar and A Heimler, 'An Increasing Role for Competition in the Regulation of Banks' (June, 2005) *International Competition Network Antitrust Enforcement in Regulated Sectors Subgroup 1*, Germany, pp 22-28, available at <http://www.internationalcompetitionnetwork.org/uploads/library/doc382.pdf>.

<sup>121</sup> E.g., US Department of the Treasury, 'TARP Transaction Report' (24 March, 2011) ('TARP'), available at <http://www.treasury.gov/initiatives/financial-stability/briefing-room/reports/tarp-transactions/Pages/default.aspx>; see, also, HM Treasury, 'Review of HM Treasury's Management Response to the Financial Crisis' (March, 2012), pp 23-30, available at [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/220506/review\\_fin\\_crisis\\_response\\_290312.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/220506/review_fin_crisis_response_290312.pdf).

<sup>122</sup> For a discussion of the HBOS' takeover by Lloyds Group, see chapter 4.3.2(e) in this thesis, pp 110-6.

<sup>123</sup> M Reynolds, 'EU Competition Policy in the Financial Crisis: Extraordinary Measures' (2010) 33 *Fordham International Law Journal* 1670, p 1718.

<sup>124</sup> S Kapner, 'Lloyds TSB Bids Again for Abbey' (1 February, 2001) *New York Times*.

<sup>125</sup> Commission, 'State Aid: United Kingdom Restructuring of Lloyds Banking Group' (18 November, 2009) *Press release IP 428/2009*.

<sup>126</sup> For a discussion of the failing firm (exiting firm) defence, see chapter 5.4.3 in this thesis, pp 174-7.

<sup>127</sup> Competition and Markets Authority, '[UK] Merger Assessment Guidelines' (1 September, 2010)

CC2/OFT1254, paras 4.3.8 – 4.3.18, available at

[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/284449/OFT1254.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/284449/OFT1254.pdf).

the national market share deposits in the country.<sup>128</sup> This created a serious concentration of the market share deposits in selected major banks. Such concentration created potential effects towards the lessening of the competition in the market share deposits with the likelihood of a negative impact on consumers' costs and the quality of banking services.<sup>129</sup>

Large banking groups have grown market power and sustained a lower cost of capital due to the public bailout and the fact that they are TBTF. Bank merger policy impacts the level of competition and effective incentives. The merger of a failed financial institution could potentially remunerate an incumbent with temporary monopoly sway. The risk would be that the incumbents could grow their market power and other (smaller) financial institutions could be shielded from entry.<sup>130</sup>

A merger competition policy throughout the banking sector needs to be drawn in consideration of a long-term view. All the more in a financial crisis condition, like the GFC, such policy must facilitate the most favourable level of concentration in the sector, compelling incentives for foresight of incumbents, and the ease of entry. The consolidation of the banking sector as a result of the GFC would less likely be seen as problematic if the grown market power of the merger banks were a temporary benefit for previous prudent conduct that would likely disappear with new entry. However, in the event that the market power is consolidated due to the obstacles to entry into banking, investors and consumers would suffer the consequences. At that point, an active competition policy would be required.<sup>131</sup>

In the EU, there is an additional latent contradiction between financial stability and merger control. The EU would demand any pertinent information and documentation from the UK and other national competition and banking authorities in bank mergers in the banking

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<sup>128</sup> Federal Deposit Insurance Corporation, 'Deposits of all FDIC-Insured Institutions, Top 50 Bank Holding Companies by Total Domestic Deposits' (30 June, 2015) *FDIC*, available at [www5.fdic.gov/sod/sodSumReport.asp?barItem=3&sInfoAsOf=2015](http://www5.fdic.gov/sod/sodSumReport.asp?barItem=3&sInfoAsOf=2015); see, also, L Arnold, 'Bank Market Share by Deposits and Assets' (2014) *CardHub Studies*, available at [www.cardhub.com/edu/bank-market-share-by-deposits](http://www.cardhub.com/edu/bank-market-share-by-deposits).

<sup>129</sup> *Vives* (n94), pp 482-490.

<sup>130</sup> I Hasan and M Marinč, 'Should Competition Policy in Banking Be Amended During Crises? Lessons from the EU' (May, 2013) *European Journal of Law and Economics*, pp 8-13, available at [http://www.ef.uni-lj.si/docs/osebnestrani/hasanmarinc\\_competitionpolicyinafinancia.pdf](http://www.ef.uni-lj.si/docs/osebnestrani/hasanmarinc_competitionpolicyinafinancia.pdf).

<sup>131</sup> E C Chaffee, 'The Dodd-Frank Wall Street Reform and Consumer Protection Act: A Failed Vision for Increasing Consumer Protection and Heightening Corporate Responsibility in International Financial Transactions' (2011) 60 *American University Law Review* 1431, pp 1439-45.

industry of the EU dimension. However, pursuant to the ECMR, Member States have the right or the 'legitimate interest' to block a merger in order to safeguard financial stability within the domestic market.<sup>132</sup> Unlike the UK competition and banking authorities, their EU national counterparts have utilized the merger regulation to keep at bay foreign banks.<sup>133</sup> This raises the issue of whether individual Member States need to be permitted to put into action this exception that allows countries to preserve their leading national banks and other financial institutions.

The Brexit referendum result of 2016 has thrown the UK towards uncharted waters in terms of the future relationship between the UK and the EU, including implementation of EU provisions and the UK's access in the EU market. However, the foregoing is not part of the analysis in this thesis, notwithstanding its importance.

Merger activity was a key contributor to the increase in combined concentration in the US banking sector, especially from the mid-1980s until the time of occurrence of the GFC.<sup>134</sup> For example, between 1985 and 2010, the share of assets controlled by the ten largest US banks grew from between 2.5 to 2.9 per cent to between 46 and 53 per cent.<sup>135</sup>

Broadly speaking, advising on the financial characteristics of mergers is oligopolistic. Meanwhile, various banks cooperate among themselves to render the desired advice. There appears to be indications that banks work together instead of at distance, separately and autonomously. In instances when banks cooperate in a significant and profitable activity, like the merger advice, they develop cooperative approaches concerning the pricing of their services. This is a fundamental element for resolving the oligopoly pricing issue, which produces supra-normal profits.<sup>136</sup> Overwhelming evidence of cooperation on pricing issues

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<sup>132</sup> Council Regulation (EC) No 139/2004 of 20 January, 2004 on the control of concentrations between undertakings, *OJ L 24/1*, 29 January, 2004 ('ECMR'), art 21(3).

<sup>133</sup> This has been the case, for example, in Italy (bank mergers Case No. COMP/M.3537 *BBVA/BNL* [2004] OJ C 233/2; and Case No. COMP/M.3768 [2005] OJ C 135/2; Case No. COMP/M.3780 *ABN Amro/Antonveneta* [2005] Press Release IP/05/498; *Unicredito/HVB* [2005] COMP/M.3894). This contrasts with the attitude of the UK in the merger *Santander/Abbey* in 2004 (Case No. COMP/M.3547 *Banco Santander/Abbey National* [2004] OJ C 255/7).

<sup>134</sup> Federal Deposit Insurance Corporation, 'Statistics at a Glance: Historical Trends as of 31 December, 2013' (2016) *FDIC*, available at <https://www.fdic.gov/bank/statistical/stats/2013dec/fdic.html>.

<sup>135</sup> Scherer (n114), p 3.

<sup>136</sup> P Molyneux and E Vallelado, *Frontiers of Banks in a Global World: Studies in Banking and Financial Institutions* (Hampshire: Palgrave Macmillan 2008), p 49.

was revealed by the combined action of banks to influence the LIBOR rate and the foreign exchange markets.<sup>137</sup>

The market share - oligopoly perceptions are supported by following facts. The major credit rating agencies, like Moody's, Standard & Poor's, and Fitch, control the business of rating securities in the UK, US, and globally. Five US banks appear to write about 97 per cent of credit default swaps.<sup>138</sup> The four prominent US banks covered approximately 91 per cent of the conceptual nominal value of derivatives outstanding in 2012.<sup>139</sup> Five banks appear to control American and European trading in over the-counter derivatives.<sup>140</sup> The four biggest US banks issue nearly two-thirds of all credit cards in the country.<sup>141</sup> Four banks account for approximately two-thirds of mutual fund holdings in the US.<sup>142</sup> Four financial institutions originated closely half of corporate debt issues in the US.<sup>143</sup> The picture in the UK is similar to the US. The 'oligopoly' of established players as Barclays, HSBC, Lloyds and Royal Bank of Scotland remains an unchallenged and worrisome reality.<sup>144</sup> These banks still provide more than 75 per cent of current accounts and a higher proportion of small business loans market in the UK.<sup>145</sup>

Evidence of tight oligopoly can be found in the fragments of the banking sector, served largely by the biggest banks and other financial institutions. However, systematic information about specified financial services market structures is incomplete. The public remains embroiled in an information vacuum that is similar to the situation at the beginning of the 20<sup>th</sup> Century.<sup>146</sup> US President Theodore Roosevelt, who undertook the initiative to fix the vacuum, remarked to the Congress that,

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<sup>137</sup> S Bair, 'The Fed Dropped the Ball during the LIBOR Scandal. Could it Happen Again?' (3 September, 2012) *Fortune Magazine*, p 46.

<sup>138</sup> Bloomberg News, 'Projecting the Impact of Default on US Banks' (13 November, 2011) *Bloomberg Business Week*, p 44.

<sup>139</sup> Bloomberg News, 'Dimonfreude' (21 May, 2012) *Bloomberg Business Week*, p 7.

<sup>140</sup> The Economist, 'At the Sharp End' (17 November, 2012) *Economist*, p 71.

<sup>141</sup> Bloomberg News, 'The End of Wall Street' (19 April, 2010) *Bloomberg Business Week*, p 42.

<sup>142</sup> Bloomberg News, 'A Look at JPMorgan Chase' Line-up' (25 March, 2012) *Bloomberg Business Week*, p 60.

<sup>143</sup> G Bowley, 'Foreign Banks See Opportunity in US Financial Turmoil' (17 June, 2009) *New York Times*.

<sup>144</sup> E Dunkley, 'Virgin Money Chief Jayne-Anne Gadhia Targets Banks' "Oligopoly" (28 August, 2015) *Financial Times*.

<sup>145</sup> M Arnold and S Goff, 'Banks Face Full-Scale Competition Inquiry' (9 July, 2014) *Financial Times*.

<sup>146</sup> T Roosevelt, *Addresses and Presidential Messages of Theodore Roosevelt, 1902-1904* (New York: G. P. Putnam's Sons 1904), pp 295-6.

[t]he first requisite [for tackling the antitrust issue] is knowledge, full and complete - knowledge which may be made public to the world.<sup>147</sup>

A research conducted during the period 1985 through 2010 found that 10,321 commercial bank mergers were registered in the US.<sup>148</sup> During this period, no anti-merger cases were reported for 22 years; in other words, no merger transactions were challenged by consent settlement or review by the judiciary.<sup>149</sup> In the seven reported bank merger consent decisions, of which two related to debit card or cash machine network combinations instead of bank branches,<sup>150</sup> a total of 46 units were demanded to undertake divestitures.<sup>151</sup> This apparent lack of formal litigation is due to the lack of room for a different interpretation of the rules laid down by the US Supreme Court in *Philadelphia National Bank* case.<sup>152</sup> In the event of litigation, the risk of deal-breaking will be delayed by an automatic stay and a temporary injunction against a bank merger, and the merger parties would often bring their merger plans to their regulators beforehand. In this situation, the merger parties and the regulators would negotiate voluntary settlements in order to avoid the federal or state competition authorities filing a formal complaint with the appropriate court. In fact, the Department of Justice has not filed a complaint with the courts against a bank merger since 1993.<sup>153</sup>

Under normal situation, nearly all bank merger reviews in the UK and US are concluded with proposals for divestiture of one or more branches of the merger banks.<sup>154</sup> The existing evidence shows that the competition authorities in these jurisdictions remain in a

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<sup>147</sup> *Ibid*, p 294.

<sup>148</sup> *Scherer* (n114), pp 3-5.

<sup>149</sup> *Ibid*.

<sup>150</sup> Two exception cases to a focus on local commercial banking concerned *Visa USA* and *Master Card International*, as well as *First Data Corp.* and *Concord EFS*. For more details about these two cases see *United States v. Visa U.S.A. Inc. and MasterCard Int'l, Inc.*, No. 98 CV 7076 (MP) S.D.N.Y. 7 October, 1998), and *United States, et al. v. First Data Corporation and Concord EFS, Inc.*, No. 1:03 CV 02169, 2003 WL 23194271 (D.D.C. 15 December, 2003).

<sup>151</sup> *Scherer* (n114), pp 3-5.

<sup>152</sup> *Philadelphia National Bank* (n1), pp 356-7.

<sup>153</sup> G J Werden, 'Perceptions of the Future of Bank Merger Antitrust: Local Areas Will Remain Relevant Markets' (2008) 13 *Fordham Journal of Corporate & Finance Law* 581, p 584.

<sup>154</sup> *E.g.*, Federal Reserve Order, *M&T Bank/Hudson City* (30 September, 2015), available at <http://www.federalreserve.gov/newsevents/press/orders/orders20150930a1.pdf>; *NationsBank Corp./Bank of America Corp.*, 84 Fed. Res. Bull 858, 862 (1998); *Banc One Corp./First Chicago NBD Corp.*, 84 Fed. Res. Bull. 961 (1998); *HBOS/Lloyds* takeover (chapter 4.3.2(e) in this thesis, pp 110-6); *TSB Banking Group/Banco de Sabadell* (2015); Commission, 'Competition: Commission approves acquisition of TSB by Sabadell; major step in restructuring plan of Lloyds Banking Group' (2015) *Press Release*, available at [http://europa.eu/rapid/press-release\\_IP-15-4993\\_en.htm](http://europa.eu/rapid/press-release_IP-15-4993_en.htm).

powerful bargaining position due to the government's powerful (decision making) voice in the UK and the judicial precedents in the US. The Anglo-American regulators have made use of their leverage to negotiate the divestiture of particular branches that present risks to competition from merging banks, which tend to have a more overwhelming influence in the merger and hold a considerably larger number of branches. In the process of conducting research for this paper, there are only a modest number of publications that demonstrate a clear understanding on how the bargaining process between the regulator and the merging banks functions. It can, thus, be fair to assume that would-be merger banks negotiate with the government and attempt to do everything possible to keep their branches divestitures, which surrenders minimal competitive advantage.

## **11.2 What needs to be improved, changed, or adopted in the Anglo-American competition systems towards bank mergers and consolidations?**

Going beyond emergency measures to stabilise the financial markets, the GFC revealed the need to reconsider the purpose of competition policy and Anglo-American competition authorities in these markets in the medium and long run. Improvements in regulations and institutions would also be welcomed in order to ensure adequate enforcement of merger and competition provisions following consolidations and nationalisations in the banking industry.<sup>155</sup> Any possible changes to the framework of competition policy in order to enhance the resolution of crisis conditions would require a thorough analysis of the roots of the financial meltdown, including an overview of its competitive outcomes in the medium and long run.<sup>156</sup> A substantial amount of work has been undertaken to correct all of the deficiencies that occurred during the GFC. However, it is arguable that sufficient action has been taken to remove the worst threats that arise with TBTF.

Since the late 1980s and early 1990s, competition policy in the UK and the US has

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<sup>155</sup> S Battilossi and Y Cassis, *European Banks and the American Challenge: Competition and Cooperation in International Banking* in R Sylla (eds.) *United States Banks and Europe: Strategy and Attitudes* (Oxford: Oxford University Press 2002), pp 60-73.

<sup>156</sup> J Vickers, 'Central Banks and Competition Authorities: Institutional Comparisons and New Concerns' (2010) *Bank for International Settlements, Working Papers, No 331*, available at <http://www.bis.org/publ/work331.pdf>; R Rajan, 'Competition in the Banking Sector – Opportunities and Challenges' (20 May, 2014), available at <https://www.ccilindia.com/Documents/Rakshitra/2014/jul/speeches.pdf>.

shifted towards a more effective implementation in the banking industry.<sup>157</sup> This echoed the shift in the theoretical foundation that competition is no longer seen as being necessarily disadvantageous to stability, and that banking regulators could obtain additional tools to monitor bank stability, for instance, the rules about the capital requirements under the Bank for International Settlement's Basel accord ('Basel III').<sup>158</sup> To a certain extent, the consolidation of competition supervision in the financial industry has been positive when comparing anticompetitive conducts and possible anticompetitive bank merger situations.<sup>159</sup>

Notwithstanding this approach, Anglo-American systems allow for significant exemptions from the framework of the competition provisions that regulate the banking industry and of the regulators responsible to implementing them. The assessment of a bank merger case by the competent agencies may be halted or an adverse ruling could be inverted by reason of stability disquiets. The 'stability' justification could be raised by the Secretary of State for Business, Innovation and Skills, in UK, and the Federal Reserve, in the US.<sup>160</sup>

The starting point is that the rapport between financial stability and competition is to be assessed on a case-by-case basis, or, better still; concerns with regard to competition are to be conditioned to the goal of achieving financial stability, when in conflict. In general, a government regulator should form a balanced and objective view, and make a decision based on the particular situation in relation to a banking regulator. However, the assessment can be convoluted and can depend on the reputation of the banks concerned and the stages of responsibility, or regulatory enforcement. In respect of the UK structure, the financial stability specification would be applied through a supra-national institution rather than the UK authorities, provided that the depth of assimilation of financial markets and the supra-national concerns a bank merger reviewed by the Commission. This relates to whether an EU banking authority is required to step in, which in turn depends on whether the UK and other Member States have made use of the stability factor to create artificial barriers to the integration of the

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<sup>157</sup> *OECD Competition and Stability in Banking Sector* (n116), p 27.

<sup>158</sup> Basel Committee on Banking Supervision ('BCBS'), 'Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems, Bank for International Settlements' (December, 2010) *BCBS 69*, available at [www.bis.org/publ/bcbs189.pdf](http://www.bis.org/publ/bcbs189.pdf).

<sup>159</sup> H Degryse, 'On the Interaction between Vertical and Horizontal Product Differentiation: An Application to Banking' (1996) 44 *Journal of Industrial Economics* 2, pp 169-82.

<sup>160</sup> The Enterprise Act 2002 (Specification of Additional Section 58 Consideration) Order 2008 (SI 2008/2645); *Dodd-Frank* (n63), s 604(d) and (f) (both codified as 12 USC §1842(c)(7), and 12 USC §1828(c)(5)).

financial system.<sup>161</sup>

Some important observations can be made after a closer look at these specifications concerning the financial stability. Assuming that certain restrictions in the enforcement of competition provisions imposed on the banking industry are necessitated, the crux of the matter is whether more systematic effort and positive steps must be taken in order to prevent financial meltdowns, rather than merely using exceptions in mechanisms, which are more traditionally utilized in crisis administration like a bank mergers and the public backing. It would be advisable to narrow down unwarranted competition through, for instance, effective regulation. The risks of so doing would be the facilitation of protectionism and tolerance with market power.<sup>162</sup>

In relation to the broader goals of the competition policy in bank merger, the issue is whether the competition review should pay attention particularly to consumer prosperity, or to follow additional goals, such as, systemic stability and the broad economic progress. Different approaches could be taken. One way could be to specifically integrate goals other than consumer prosperity in the institutional structure of competition review. Another possibility would be to allow competition agencies to focus on consumer prosperity and allow another agency or governmental authority to assess and address the detrimental effect of consumer prosperity on other issues in the event it is required.<sup>163</sup>

It is difficult to determine, which approach is better suited and more practical in extending the goals of competition policy in the banking and financial industry. However, the financial stability and preventing systemic risk should take priority towards any competition concerns. Expanding the goals of competition agencies outside of the consumers' wellbeing has the advantage of maintaining probable rapport between competition issues and additional issues within the same financial institution, with the benefit that financial stability, as shown

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<sup>161</sup> G A Walker, 'U.K. Regulatory Revision – A New Blueprint for Reform' (2012) 46 *International Law* 787, pp 790-98.

<sup>162</sup> R A Posner, *Antitrust Law* (2nd ed, Chicago: University of Chicago Press 2009), at pp 259-65; see, also, R F Weber, 'Structural Regulation as Antidote to Complexity Capture' (2012) 49 *American Business Law Journal* 643, pp 649-58.

<sup>163</sup> *Posner* (n162), pp 24-42.



from the events of the GC, has a higher priority.<sup>164</sup> Competition agencies may not be in the best place to judge the macro-economic consequences of a concentration, a collusive agreement, or proper understanding. As a result, there is a need for a certain kind of collaboration between banking regulators and competition agencies.<sup>165</sup>

A relevant concern relates to the need for competition agencies to constantly familiarize themselves with the ever-changing and evolving banking and financial markets. Financial modernization and other novelties within the framework of markets have not been always taken into consideration in previous actions and decisions. For example, in a bank merger the matter of control between the merging banks remains rather concentrated on the consequences of consolidation in retail banking and, in particular, about deposits and providing loans to SMEs.<sup>166</sup> Although this is reasonable because of the existence of switching costs and relationship lending, it is also important to acknowledge the increasing prominence of the online and electronic banking and other types of modernization, which might alter the framework of retail banking. In this regard, it would be likely for competition policy to aim and influence the structure of the banking and financial systems by, for instance, eradicating impediments to entry or making easier the switching of depositors. Nevertheless, one related concern would be that the increase in convenience of switching could create considerable instability. This is because depositors would be motivated to take out their monies by the convenience, and, thus, would likely trigger illiquidity concerns of banks and other financial institutions.<sup>167</sup>

Another concern relates to competition regulators placing more emphasis on the risks perceived by banks, particularly during the GFC. Taking into consideration the characteristics of financial services, prices might not be a distinctive feature of the competitive circumstances

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<sup>164</sup> Competition and Markets Authority, 'New Competition Authority to Make Markets Work Well for Consumers, Business and the Economy' (1 April, 2014) *CMA*, available at <https://www.gov.uk/government/news/new-competition-authority-to-make-markets-work-well-for-consumers-business-and-the-economy>.

<sup>165</sup> A Dombret, 'International Coordination to Enforce Regulatory Reform' (16 August, 2012) *Salzburg Global Seminar 'Financial Regulation – Bridging Global Differences'*, available at <http://www.bis.org/review/r120820c.pdf>; D K Tarullo, 'International Cooperation and Financial Regulatory Modernisation' (20 July, 2010) *Subcommittee on Security and International Trade and Finance, Committee on Banking, Housing, and Urban Affairs, US Senate*.

<sup>166</sup> *Retail Banking Market Investigation* (n37), pp 32-34.

<sup>167</sup> R Rajagopal, *Butterfly Effect in Competitive Markets: Driving Small Changes for Large Differences* (Hampshire: Palgrave Macmillan 2015), ch I.

in the financial markets when placed in isolation. A bank rendering high deposit rates, low lending rates, or easy option to credit ought to undertake significant risks about its assets, which could hamper instead of fostering competition in the long and medium run.<sup>168</sup>

Apart from the financial services reforms taken in the UK and the US, it is also important to look into plans to depart from competition's alterations, which arose during the GFC.<sup>169</sup>

Extraordinary situations call for extraordinary actions. Nevertheless, while the financial markets attain stability, extraordinary actions to maintain liquidity in the markets and to preserve solvency of financial institutions will no longer be required in order to meet important initiatives taken by the UK and the US governments. These governments would thereafter turn their attention to remove anti-competitive practices, which was what might have happened throughout the GFC.<sup>170</sup>

Without such exit strategies or stimulus, banks might, in reality, become accustomed to the UK and US government bailouts, and competitive distortions might be compound in the near future. In the event that the UK or the US government aid is valued under a just market rate, including situations of markets equilibrium, banks would likely forge ahead to ask for public bailout. As a consequence, banks might receive an unjust competitive edge. Exit plans are required to avert competitive perversions and bolster suitable market operation.<sup>171</sup>

At times bank mergers that likely harmed competition happened with the blessing of the UK or American government. Instances are mega bank mergers, where banks with more sound balance sheets were amalgamated with weaker banks. It is worth looking into the analysing and crafting of the exit policies with regard to anti-competitive mega bank mergers,

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<sup>168</sup> S Corvoisier, 'Bank Concentration and Retail Interest Rates' (July, 2001) *European Central Bank, Working Paper No 72*, pp 23-26, available at

<https://www.ecb.europa.eu/pub/pdf/scpwps/ecbwp72.pdf?9a66c6493abd792fe1ac0f0b233b1ac3>.

<sup>169</sup> N Kroes, 'Competition Policy and the Crisis – the Commission's Approach to Banking and Beyond' (2010) *Competition Policy Newsletter 1*, pp 3-6, available at

[http://ec.europa.eu/competition/publications/cpn/2010\\_1\\_1.pdf](http://ec.europa.eu/competition/publications/cpn/2010_1_1.pdf).

<sup>170</sup> Vickers, *Central Banks and Competition Authorities* (n156); see, also, *Posner* (n162), p 263.

<sup>171</sup> A Chisholm, 'The Role of Competition in Banking Markets' (4 December, 2014) *Speech at Pinnars Hall, London*, available at <https://www.gov.uk/government/speeches/alex-chisholm-on-the-role-of-competition-in-banking-markets>.

considering that they are better structured than other configurations of financial crisis undertaking.<sup>172</sup> On this subject, nationalizations are desirable to super bank mergers due to the fact that they establish less market power and render a firmer solvency guarantee. Nevertheless, nationalizations are designed to disproportionate government course throughout operational conclusions of banks and may become burdensome on the government's balance sheet.<sup>173</sup>

It is perhaps inadvisable to build policies that would clearly and directly render for exit from anticompetitive bank mergers. The most unswerving undertakings, such as, fragmentation in the event of mega bank merger(s), could bring unsettling result about other more beneficial financial institution mergers. Competition authorities in the UK and the US are generally unwilling to assume reflective confronts towards bank mergers due to these unsettling results and the apprehension that it is unjust to contest bank mergers, which have previously been effectuated, especially considering that the competition authority has endorsed the merger prior to its contesting.<sup>174</sup> Previously, financial institutions were permitted to collaborate more freely or to take on behaviour that would constraint entry or expansion by new financial institutions as part of efforts to act upon the systemic crises. However, permitting financial institutions to take on anticompetitive behaviour, like the abuse of dominance in financial markets, could cause sudden harmful results towards consumers and the economy as a whole. Consumers would miss opportunities of better and more products at more reasonable prices.<sup>175</sup> The economy would not benefit with regard to development and long-standing productivity. The UK and the US governments ought to remain rightly unswerving to the prosperity of competition.

In the preeminent conditions, exit policies should be considered in the course of rehabilitation and rescue operations. A series of pro-competitive exit policies deserve consideration. Some were previously implemented in the actions taken during or post GFC.<sup>176</sup>

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<sup>172</sup> *Ibid.*

<sup>173</sup> S Gjedrem, 'Financial Crisis – Lessons from the Nordic Experience, *Financial Times*' (3 February, 2009) *Bank of Norway Publications*; M R King, 'Time to Buy or Just Buying Time? The Market Reaction to Bank Rescue Packages' (September, 2009) *Bank for International Settlements Working Papers N 288*.

<sup>174</sup> M Wolf, 'Reform of British Banking Needs to Go Further' (20 June, 2013) *Financial Times*.

<sup>175</sup> Ratnovski (n103), p 15.

<sup>176</sup> The World Bank, 'The Role of the State in Promoting Bank Competition' (2013) *Global Financial Development Report 2013*, pp 98-99, available at

However, their implementation is less than comprehensive and the means utilized, such as, pricing interferences, depend substantially on the UK and the US, forming probable comprehensive distortions in competition, which deserve additional review. A policy that has failed to bring sufficient attention and review relates to the safeguarding of competition in a domestic financial market by favouring across the border mergers of weak domestic financial institutions.<sup>177</sup>

There are a number of exit policies that promote competition.

In relation to the exit from the UK and US governments' measures, one option is the sale of public stakes in nationalized banks and other financial institutions for a period of time, which is realistic, clear, and predictable to restrict the time where there are possibilities of competition distortions. The sale should be in line with competition provisions to guarantee that government divestments would not lessen market competition. The sale should also warrant that any structural competition concerns existent, such as, from excessive market power, are eradicated before or in the course of privatization.<sup>178</sup>

The exit strategy of both governments' actions should be for granting capital or other specific bailout monies that are considered suitable, whilst offering incentives, especially financial benefits, which would motivate the benefitting banks to favour private funds. Governments should also frequently reassess the necessity of public guarantees and funding, including whether public guarantees and funding are delaying a prompt return to ordinary market situations.

In addition, these governments should subject the bailout monies to non-financial businesses on restructuring to warrant a sustainable future business strategy. They should limit the degree, which the UK and US governments' subsidies would be utilized for reasons that

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<https://openknowledge.worldbank.org/bitstream/handle/10986/11848/Global%20Financial%20Development%20Report%202013.pdf?sequence=1>.

<sup>177</sup> T F Geithner, 'Reducing Systemic Risk in a Dynamic Financial System' (9 June, 2008) *Economic Club of New York*, available at <https://www.newyorkfed.org/newsevents/speeches/2008/tfg080609.html>.

<sup>178</sup> J Nicolaisen, 'Should Banks Be Bailed Out?' (14 April, 2015) *Norwegian Academy of Science and Letters*, Oslo; T C W Lin, 'The New Financial Industry' (2013) 65 *Alabama Law Review* 567, pp 568-75.

were not intended by the respective governments.<sup>179</sup> An important aspect is the curbing of the function of the respective governments in daily business aspects of the supported financial institutions, and to ensure that financial incentives are available for the banks obtaining sustenance to redeem public loans or investments.<sup>180</sup>

The UK and American governments should decrease anticipation of capital or other particular backing for the banks and other financial institutions in the event that the systemic distresses could be less existent, banks have more liquidity and are solvent, and loaning monies to the economy has gotten back to *status quo*.

Both jurisdictions across the Atlantic should also undergo an evaluation process of the financial market policies and regulatory configurations in relation to eliminate existing inadvertent or unwarranted constraints on competition in banking system.<sup>181</sup>

Exit strategies from anticompetitive private measures should be in place in order to evade anticompetitive business frameworks by favouring transnational bank acquisitions of domestic banks in which domestic acquisitions threaten mounting market force.

To the extent that anti-competitive extra-large bank mergers have taken place, facilitating new entry would lessen competitive issues of such bank mergers by diminishing regulatory obstacles to entry to banking in formal practice and regulation. Another option would be to raise the availability of credit-rating information obtainable of the SMEs and individual consumers. A policy could also be in place to warrant that switching costs of bank accounts are at some degree of limitation, for instance, by effectuating a system that decreases the switching costs of banks.<sup>182</sup>

The UK and their American counterparts should consider, at a transnationally or

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<sup>179</sup> This may happen, when institutions find a way to borrow at below normal market rates in one jurisdiction and move funds for activities in another jurisdiction.

<sup>180</sup> A Prüm, 'The European Union Crisis Responses and the Efficient Capital Markets Hypothesis' (2013) 20 *Columbia Journal of European Law* 1, pp 5-13.

<sup>181</sup> In order to promote rigor in this review process, governments can use pro-competitive regulatory guidance, such as, that contained in the OECD's 'Competition Assessment Toolkit', available at [www.oecd.org/competition/toolkit](http://www.oecd.org/competition/toolkit).

<sup>182</sup> A M Mateus, 'Antitrust, State Aid, and Financial Regulation: Banking Regulatory Reform: "Too Big To Fail" and What Still Needs to Be Done' (2011) 7 *Competition Policy International* 22, pp 23-28.

bilateral synchronized level, whether structural separation would be compulsory for investment banking activities, which are positioned in a bank or within a financial holding institution. In the event that no structural fence is placed, investment banking could most probably obtain entry to low cost lines of credit provided by the Bank of England in the UK and the Federal Reserve in the US. In addition, the same investment banking could gain access to guarantees absent to independent banks and other financial institutions.

Permitting investment banks to function within a bank in order to profit from a bank's low interest rates largely alters competition with independent investment banking and produces a possibly ambiguous motivation for precarious undertakings to be concealed and lacking in transparency within bigger, less hazardous entities.

One probable measure in order to prevent the formation of a 'Glass-Steagall'<sup>183</sup> on both sides of the Atlantic could be an endorsement of a non-operating holding company configuration. Under this company structure, the divisions of financial institutions involving investment banking and commercial banking operations are subsidiaries of a non-operating parent and would borrow capital under their name with no remedy to the parent or other arms of the group.

Following the recent enactment of the financial services legislative reforms (including implementation of the Vickers' Report)<sup>184</sup> and investigation inquiries taken by the regulators, the UK is proceeding to tackle concerns about the market concentration of banks and other financial institutions. In the US, the Dodd-Frank legislation<sup>185</sup> forbids a financial institution from acquiring or merging with alternative business if it results in an institution in excess of 10 per cent of the total consolidated liabilities of entire financial institutions throughout the domestic market.<sup>186</sup>

Evaluating competition concerns in the banking industry remains a multifaceted process. In general, the support of competition is founded on cost reduction and apportioned

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<sup>183</sup> *Glass-Steagall* (n9).

<sup>184</sup> For a discussion of the financial services reforms in the UK, see chapters 2.4 - 2.8 in this thesis, pp 18-30.

<sup>185</sup> *Dodd-Frank* (n63), s 622 (codified as 12 USC §1852).

<sup>186</sup> *Ibid.*

efficiency in the banking sector. Nevertheless, the standard competitive threshold might not function completely due to reasons including unbalanced data and information in corporate interactions, switching costs, as well as in retail banking networks.<sup>187</sup> The most noticeable effect could be that competition does not constantly uphold effectiveness in financial markets.

In relation to the asymmetric information, one of the principal functions of financial institutions is to monitor and screen investment projects. This establishes significant informational unbalances among financial institutions and possible borrowers and financial institutions. Competition impacts these informational unbalances, thus, altering the group of borrower's banks issue loans. For instance, when borrowers vary in quality, competition in the credit markets would aggravate the 'winner's curse' problem due to higher loan rates leaning towards the exacerbation of the quality of businesses taken on the loan, thereby lowering the quality of borrower. Raising the loan rate above that of the competitor could cause two opposite consequences on the profit of the deviating bank. Its profit would peak throughout the typical price aftermath, while it exacerbates the quality of businesses that receive the loan and thereby cutting down its profit. The business receiving a loan from a bank that provides a higher loan rate has low credit ability on average. This establishes impediment to entry, which in turn creates an oligopolistic<sup>188</sup> build-up of the industry, and could throw light upon the fact that the market for SMEs continues to be local.<sup>189</sup>

Credit ratings could assist the finding of a solution regarding the issue of unbalanced data and information. They hold an important position in consumer lending, SMEs lending, asset-backed securities and corporate debt problems. In the UK and the US, limited credit rating data is accessible for SMEs and consumers. One outcome is that financial institutions would face the issue of opposing selection. Consumers and SMEs, which allow their home bank and other financial institutions to seek for credit elsewhere, might have been initially denied credit by their home bank and other financial institutions that obtain the most itemized data about the client's credit ability. Other banks would for that reason be cautious of new customers and would justly set a credit premium for such customers. Guaranteeing that fine-

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<sup>187</sup> Carletti and Vives (n90), pp 275-283.

<sup>188</sup> Oligopolistic is the market situation that exists when few sellers who control prices and other factors are.

<sup>189</sup> D G Ariccia, 'Asymmetric Information and the Structure of the Banking Industry' (2001) 45 *European Economic Review*, pp 1957-80.

grained credit rating data about SMEs and consumers would largely be accessible could boost to surmount this asymmetric data issue and step up the readiness of financial institutions to go after customers of other financial institutions.<sup>190</sup>

For securities ratings, like asset-backed securities and corporate debt, globally acknowledged credit rating organizations remain a central role. Competition regulators have examined certain business practices of credit rating institutions.<sup>191</sup> Competition between credit rating organizations frequently does not function in the interest of rendering balanced and precise ratings. As the credit rating institutions compete actively among themselves for the business of securities issuers, such competition could drop the quality of ratings from the investor's viewpoint by functioning as competition to inferior parameters and forming a financial favouritism in favour of over-high ratings. The US prerequisite that credit rating organizations become nationally acknowledged statistical rating agencies created a considerable obstacle to entry for new credit rating organizations in the US.<sup>192</sup> From the time of modification in the regulatory method in 2007, more credit rating organizations have been able to attain the status of nationally recognized statistical rating organizations ('NRSROs') status<sup>193</sup> in the US, which receive payment merely from investors. Nevertheless, persuading investors to obtain ratings from smaller agencies is not an easy task. It can also be a challenge to sway issuers to offer information to credit rating organizations agencies, which are not compensated by the issuer as issuers purportedly prefer maintaining a client rapport with credit rating organizations.

In the US, the SEC has spoken openly in favour of competition<sup>194</sup> by suggesting the removal of some regulations that provide the applicability of ratings by an authorized agency,

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<sup>190</sup> See, generally, H Degryse and S Ongena, *Competition and Regulation in the Banking Sector: A Review of the Empirical Evidence on the Sources of Bank Rents* in A V Thakor and A Boot (eds.) *Handbook of Financial Intermediation and Banking* (Amsterdam: Elsevier 2008).

<sup>191</sup> D A Maas, 'Policing the Ratings Agencies: The Case for Stronger Criminal Disincentives in the Credit Rating Market' (2011) 101 *Journal of Criminal Law & Criminology* 1005, pp 1006-13.

<sup>192</sup> A J Ceresney et al, 'Regulatory Investigations and the Credit Crisis: The Search for Villains' (2009) 46 *American Criminal Law Review* 225, pp 226-35.

<sup>193</sup> A credit rating agency assesses the creditworthiness of an obligor as an entity or with respect to specific securities or money market instruments. A credit rating agency may apply to the Security and Exchange Commission ('SEC') for registration as a nationally recognized statistical rating organization ('NRSRO'). The SEC's Office of Credit Ratings administers the SEC's rules relating to NRSROs, in addition to performing various other functions with respect to NRSROs.

<sup>194</sup> M S Piwowar, 'Remarks at ABS Vegas 2016' (1 March, 2016) *Speech in Las Vegas*, available at <https://www.sec.gov/news/speech/speech-piwowar-03012016.html>.



considering that more attention in implementing ratings reassures better outcomes from competition among credit rating organizations. The EU Commission has set forth several propositions.<sup>195</sup> However, these proposed measures would be inadequate to facilitate new entry and would vigorously impair new entry by outlawing unsolicited ratings as well as possibly introducing a prominent criterion about registration of credit rating organizations as the measures undertaken by the SEC in the US.<sup>196</sup>

In relation to the issue of switching costs, customer mobility and option are fundamental to encouraging competition in retail banking. In spite of this, the amount of customer mobility is small, while the durability of customer and bank interactions remains extensive. One factor, which could justify the limited level of the current accounts' switching, is the fact that both the economic and non-economic costs of switching remain relatively substantial. In transferring from one bank to another, consumers sustain costs related to the actual move of accounts, allocations of bill payments, or failure of data. Similarly, mental and predetermined contractual costs could play a significant role.<sup>197</sup>

Switching costs, thus, represents a pivotal basis of market control in the area of retail banking.<sup>198</sup> There are two main characteristics in the competitive aspect of switching costs. First, the switching costs facilitate the exercise of market control after financial institutions have ascertained a customer base that continues to be confined. Second, the switching costs create tough competition to expand the customer base. On this subject, there is a robust characteristic of competition *for* the market. Hence, switching costs would prompt financial institutions to provide high deposit rates primarily to entice customers, and to decrease them once consumers are locked in. This arrangement is consistent with pragmatic approaches and

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<sup>195</sup> The proposals to ban involvement of analysts who establish a rating for a security in the creation of that product or the sale of that product are attractive on its surface. However, there is little evidence that separation of tasks will create incentives for analysts to be more rigorous in the rating of new and existing securities issues. See, Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16.09.2009 on credit rating agencies (CRA I), as amended by CRA II (Regulation 513/2011) and CRA III (Regulation 462/2013); see, also, L Bai, 'Performance Disclosures of Credit Rating Agencies: Are They Effective Reputational Sanctions?' (2010) 7 *New York University Journal of Law and Business* 47.

<sup>196</sup> U G Schroeter, *Credit Ratings and Credit Agencies* in E Caprio et al (eds.) *Handbook of Key Global Financial Markets, Institutions, and Infrastructure* (Oxford: Academic Press 2012), pp 387-90.

<sup>197</sup> Independent Commission on Banking, 'Final Report' (September, 2011), London (the 'Vickers' Report'), pp 16-18, available at [www.hm-treasury.gov.uk/d/ICB-Final-Report.pdf](http://www.hm-treasury.gov.uk/d/ICB-Final-Report.pdf).

<sup>198</sup> T Hannan, 'Consumer Switching Costs and Firm Pricing: Evidence from Bank Pricing of Deposit Accounts' (12 May, 2008) *Working Paper, Federal Reserve Board*, pp 27-28, available at <http://www.federalreserve.gov/pubs/feds/2008/200832/200832pap.pdf>.

conventional facts.<sup>199</sup>

Legislators in the UK and the US could enable switching costs in several respects. First, they could assist the endorsing of better financial knowledge and consumer education with regard to financial options by, for instance, providing more information concerning prices and accountability. Second, they could promote the implementation of a self-regulatory coordination among financial institutions for the implementation of ‘switching packs’.<sup>200</sup> This aims to streamline the administrative stages for switching, and, therefore, would lessen the costs. Third, legislators could uphold the usage of account number portability, while this has, until now, created a series of issues in relation to the likelihood of high installation costs, the failure of non-discriminatory entrance to the payment system, and the possibility of losing the aptitude to detect financial institutions throughout the account numbers.

Concerning the contribution of electronic payments networks, it similarly influences the level of competition as it presents components of non-price competition in the dealings among financial institutions. For instance, the prospect of financial institutions to take part in cashpoint networks could be used as a strategic variable to influence price competition concerning the deposit market and dissuade latent entry.<sup>201</sup> Competition in networks is likewise linked to competition in markets on both sides. For instance, in the milieu of credit cards, merchants would make use of card acceptance to foster customer base and reduce price competition. This, however, is subject to the condition that the system has to draw two aspects of the market, namely the acquirers and issuers or consumers and merchants.<sup>202</sup>

Competition in banking is characteristically inadequate and several resistances and obstacles to entry would cause concentration of the market within a selective number of large

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<sup>199</sup> L Haim, ‘Rethinking Consumer Protection Policy in Financial Markets’ (2013) 32 *Journal of Law & Competition* 23, pp 28-34.

<sup>200</sup> Organization for Economic Co-operation and Development, ‘Competition and Regulation in Retail Banking: Switching Packs’ (5 June, 2009) *Report, DAF/COMP (2006)33/ADD1*, pp 14-15, available at [http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=DAF/COMP\(2006\)33/ADD1&docLanguage=En](http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=DAF/COMP(2006)33/ADD1&docLanguage=En).

<sup>201</sup> V Dinger, ‘Bank Mergers and Deposit Interest Rate Rigidity’ (2011) *Federal Reserve Bank of Cleveland, Working Paper* No 11-31.

<sup>202</sup> B T Petursson and A P Morriss, ‘Global Economies, Regulatory Failure, and Loose Money: Lessons for Regulating the Finance Sector from Iceland’s Financial Crisis’ (2012) 63 *Alabama Law Review* 691, pp 697-704.

banks.<sup>203</sup> This would, in turn, bring potential distort of an efficient banking system and the unreasonable costs of the banking services to fall on the consumers. In corporate banking, formed lending dealings and uneven data provide a bank with handful market power regarding both businesses and investors. Electronic banking also challenges the traditional lines of the banking business. However, it is as well conditioned to external and internal switching costs.<sup>204</sup>

An imperative, and relatively unsettled, issue relates to the connection between stability and competition. Before the 1990s, the predominant view among academic writings and policies was that competition had a negative impact on stability.<sup>205</sup> Specifically, concentrated competition was alleged to support disproportionate risk bearing and hence resulting in a higher risk of the collapse of a financial institution, and regulation was perceived to alleviate the impact of competition on such risk. The basis was that, by minimizing financial institutions' charter values; better competition would raise the desirability of perilous projects.<sup>206</sup>

Recently, the matter concerning a latent trade-off between stability and competition has moved towards the direction of equilibrium. Research demonstrates that panic runs tends to happen separately on the level of competition in the market, while by increasing deposit rates, more competition could worsen the harmonization within depositors<sup>207</sup> and upsurge the likelihood of runs.<sup>208</sup> Additionally, the adverse rapport about competition and stability does not need to be vigorous, when the option of the risk of the investment undertakings is examined more closely. For instance, once entrepreneurs, and not financial institutions, select the risk of the investment project, higher competition in the loan market decreases business' motivations to take risks, thus, suggesting sounder portfolios for banks.<sup>209</sup> Ample empirical

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<sup>203</sup> *Ibid*, pp 701-704.

<sup>204</sup> T Williams, 'Who Wants to Watch? A Comment on the New International Paradigm of Financial Consumer Market Regulation' (2013) 36 *Seattle University Law Review* 1217, pp 1220-34.

<sup>205</sup> T Hellman et al, 'Liberalization, Moral Hazard in Banking, and Prudential Regulation: Are Capital Requirements Enough?' (2000) *American Economic Review* 90, pp 147-165.

<sup>206</sup> T C Harker, 'Bailment Ailment: An Analysis of the Legal Status of Ordinary Demand Deposits in the Shadow of the Financial Crisis of 2008' (2014) 19 *Fordham Journal of Corporate & Finance Law* 543, p 548.

<sup>207</sup> C K Whitehead, 'Reframing Financial Regulation' (2010) 90 *Boston University Law Review* 1, pp 4-16.

<sup>208</sup> Z J Gubler, 'Regulating in the Shadows: Systemic Moral Hazard and the Problem of the Twenty-First Century Bank Run' (2012) 63 *Alabama Law Review* 221, pp 227-34.

<sup>209</sup> A W Hartlage, 'Europe's Failure to Prepare for the Next Financial Crisis Affects Us All' (2013) 44 *Georgetown Journal of International Law* 847, pp 852-68.

findings show that less regulatory constraints, namely lower barriers to bank entry and less boundaries about bank operations that nurture competition, creates a reduced amount of banking instability.

It appears conceivable to anticipate that while a particular threshold is attained, a rise in the degree of competition would likely increase motivation of risk-taking and the likelihood of bank collapse. This propensity would be confined by reputational effect, the existence of private costs of fiasco for managers, and / or by regulation. Nonetheless, the focus of the discussion continues to be the level of market power that should be permitted in banking and the competition policy that should be adopted in banking, considering the particularity of the industry. Moreover, it is significant to address the degree of competition, which could have been a factor contributing the formation of a bubble in housing prices and the enormous expansion of loans to subprime borrowers during the GFC, and more generally the aggressive quest by financial institutions for higher monetary prospects for example, securitization and structured products.

In the EU level, the Commission of the Financial Stability, Financial Services and Capital Markets Union<sup>210</sup> along with the Commission have contributed in diminishing protectionism arisen from bank mergers, especially in certain cross-border mergers.<sup>211</sup>

In the EU Member States, like the UK, the pattern of competition strategy in banking sector is considerably developed and various exceptions are taken out.<sup>212</sup> For instance, since 2005 the competition strategy in banking system in Italy is no longer regulated by the Central Bank of Italy.<sup>213</sup> Rather, it is regulated by a competition agency,<sup>214</sup> which also enforces

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<sup>210</sup> The main role of the Commission of the Financial Stability, Financial Services and Capital Markets Union is to ensure that financial markets within the Common Market are properly regulated and supervised so that they are stable, competitive and transparent, at the service of jobs and growth.

<sup>211</sup> See for example, bank mergers of *BSCH/A. Champalimaud (n580)*; *ABN-Amro/Antonveneta*; *BBVA/BNL*; see, also, Case No. COMP/M.3547 *Banco Santander/Abbey National* [2004] OJ C 255/7. For a detailed discussion of these bank mergers, see A Nourry and N Jung, 'Protectionism in the European Union: EU State Measures against Foreign Takeovers: "Economic Patriotism" in All But Name' (2012) 8 *Competition Policy International* 10.

<sup>212</sup> Commission, 'Europe 2020: A Strategy for Smart, Sustainable and Inclusive Growth' (3 March, 2010) *COM (2010) 2020*, pp 5-7, and 22-24.

<sup>213</sup> Italian Law No. 262 (28 December, 2005).

<sup>214</sup> Italian Competition Authority ('Autorita' Garante della Concorrenza e del Mercato'), available at [www.agcm.it/en/](http://www.agcm.it/en/).

competition concerns in other areas of the economy besides banking. In the Netherlands, since 2013 the competition aspects in banking are regulated under its national competition watchdog.<sup>215</sup> Also, in France, in 2003 as a result of a ruling from the *Conseil d'Etat* (French Supreme Court for administrative justice) on the bank merger case *Credit Agricole/Credit Lyonnais*, the banking industry, like other sectors of the economy, is subject to merger control legislation.<sup>216</sup>

Notwithstanding these changes, several significant particularities about the rapport between competition and stability persist in the institutional pattern of competition strategy in banking. As provided in Article 21(4) of the ECMR,

Member States may take appropriate measures to protect legitimate interests other than those taken into consideration by the EC[MR] (...). Public security, plurality of the media and prudential rules shall be regarded as legitimate interests (...).<sup>217</sup>

This clause indicates that, at least in merger control, concerns over stability could override competition. In the UK and US, a merger of banks might not be subject to the competition requirements if the Secretary of State for Business, Innovation and Skills in the case of the UK and the Federal Reserve in the case of the US certify that it is in the best national interest to preserve stability of the banking or financial system.<sup>218</sup>

The UK competition watchdog has the authority to examine a pertinent merger case and evaluate if it has or could predictably be ensued in a significant diminishing of competition in the financial market. In spite of the continuous discussion of the qualified values of the voluntary system, UK merger control provisions to date do not maintain a prerequisite to request or attain merger approval prior to the consumption of the merger transaction.<sup>219</sup>

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<sup>215</sup> Authority for Consumers and Markets ('Autoriteit Consument & Markt'), available at [www.acm.nl/en/](http://www.acm.nl/en/).

<sup>216</sup> Conseil d'Etat (16 May, 2003) *Bulletin Rapide de Droit des Affaires* 2003/10, p 9; see, also, E Carletti et al, 'The Economic Impact of Merger Control Legislation' (2008) *FDIC Centre for Financial Research Working Paper* No 2008-12 .

<sup>217</sup> *ECMR* (n132), art 21(4).

<sup>218</sup> *Dodd-Frank* (n63), ss 604(d) & (e); see, also, Enterprise Act 2002, c.40 ('EA02'), s 58.

<sup>219</sup> Competition and Markets Authority, 'Mergers Guidance: How to Notify the CMA of a Merger' (15 April, 2015) *CMA*, available at <https://www.gov.uk/guidance/mergers-how-to-notify-the-cma-of-a-merger>.

The UK competition authority maintains the authority to inspect non-notified qualifying bank mergers<sup>220</sup> and would bar transactions or enforce remedies comparable to the various compulsory-filing systems globally. This presents a supplemental aspect into UK merger control advice for customers, such as, whether to advise review of the bank merger cases for clearance before consummation, or to undertake the risk that the competition agency might thereafter examine and unroll the transaction or issue considerable remedies.<sup>221</sup>

There is a continuous initiative from the UK Government to meliorate the switching system with respect to redirection for small and individual business bank accounts.<sup>222</sup> This measure could offer consumers with a unified switching service free of charge and without risk. This should be accompanied by undertakings to improve limpidity, such as, allowing the consumers to make educated selections concerning the banking services, which would best suit their necessities.

The UK is in the process of implementation a robust and flexible ‘ring-fence’ division between the retail and investment banking.<sup>223</sup> A ‘ring-fenced’ financial institution would be able to supply the main domestic retail banking services of taking deposits from consumers and SMEs and offering these customers with overdrafts.<sup>224</sup> ‘Ring-fenced’ financial institutions would not be able to get into the business of trading, derivatives besides hedging retail risks, markets business, supply services to international customers, services besides the payments services, which would bring in vulnerability to financial companies. Bank activities like lending to large domestic non-financial businesses would be permitted each side of the ‘fence’.<sup>225</sup> Implementation of the ‘ring-fence’ provisions are expected to be a challenge. Regulators should prepare for an eventual backlash that would probably be expressed through political channels.

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<sup>220</sup> Competition and Markets Authority, ‘Mergers: Guidance on the CMA’s Jurisdiction and Procedure’ (2014) *CMA2*, paras 6.9 – 6.14; and 6.20 – 6.21.

<sup>221</sup> See generally, Competition and Markets Authority, ‘Remedies: Guidance on the CMA’s Approach to the Variation and Termination of Merger, Monopoly and Market Undertakings and Orders’ (January, 2014, revised August, 2015) *CMA11*, available at [www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/453150/CMA11\\_Remedies\\_Guidance\\_revised\\_August\\_2015.pdf](http://www.gov.uk/government/uploads/system/uploads/attachment_data/file/453150/CMA11_Remedies_Guidance_revised_August_2015.pdf).

<sup>222</sup> *Retail Banking Market Investigation* (n37), p 26.

<sup>223</sup> Financial Services (Banking Reform) Act 2013, s 4 (Part 9B (ss 142A – 142Z1) into the Financial Services and Markets Act 2000 (‘FSMA 2000’)).

<sup>224</sup> *Ibid*, s 4 (Part 9B (s 142C)).

<sup>225</sup> *Ibid*, s 4 (Part 9B (s 142B)).

As a part of the enhancement of their rapport of collaboration, the UK and the US authorities and the representatives from major banks in the two countries, in October, 2014, organized the first transatlantic simulation of a financial crunch about big sized financial institutions.<sup>226</sup> It is an indication of a growing conviction among the regulators in both countries to prepare themselves in addressing the failure of big financial institutions.<sup>227</sup> All the principal and participating banks in the 2014 stimulation program that could be involved in the collapse of a financial institution, namely the Bank of America, HSBC, Barclays or Goldman Sachs, got together to ensure these financial institutions would know the measures to be taken, who to contact, and in what way they could apprise the public.<sup>228</sup>

The move is another indicator that the regulators are moving close to cracking the TBTF issue, even for cross-border financial institutions, outside an all-out system-broad predicament.

The simulation did not imitate any specific bank. Instead, the UK and the US regulators went through the procedures they could pursue in the event a big sized UK bank with activities in the US collapsed and those situations for a considerable US bank with operations in the UK.<sup>229</sup> This is in response to a lesson learnt in the GFC. During the latter, the UK and American regulators fell out about Lehman Brothers,<sup>230</sup> both before it collapsed and thereafter throughout the messy bankruptcy situation that resulted. During the foregoing crisis, the rapport within the UK and US governments and authorities did not work adequately and efficiently.

During the period 2008 to 2009, taxpayers in the UK spent 10.5 per cent of national income in order to sustain the banking sector.<sup>231</sup> Consequently, the taxpayers have recuperated

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<sup>226</sup> R Palmer and D Miedema, 'U.S. and UK to Test Big Bank Collapse in Joint Model Run' (10 October, 2014) *Reuters*.

<sup>227</sup> *Ibid*.

<sup>228</sup> L Elliott, 'Six Years after Lehman's Crash, US and UK Play Out Next Financial Crisis' (10 October, 2014) *Guardian*.

<sup>229</sup> *Ibid*.

<sup>230</sup> US Congress, 'The Effect of the Lehman Brothers Bankruptcy on State and Local Governments' (5 May, 2009) *Hearing before the Committee on Financial Services, US House of Representatives, 111<sup>th</sup> Congress, 1<sup>st</sup> Session*.

<sup>231</sup> C Giles, 'US and UK to Play Financial "War Game"' (10 October, 2014) *Financial Times*.

approximately a quarter of that money. In comparison, the American's support summed to 4.5 per cent of the country's gross domestic product, while it has recovered the lot.<sup>232</sup> There should be a race-against-time approach that would shield the UK and US taxpayers from bearing the costs of the collapse of systemically significant banks. It requires the banking regulators, competition authorities, and the relevant government institutions in both countries to press for a well-capitalized financial institution in order to acquire the troubling business by a decided bank merger. This mechanism of financial crisis management would no longer be applied, levitating issues concerning the Anglo-American regulators and governments' ability to stabilise the financial system in a financial crisis.

This is demonstrated by the fact, for example, that Bank of America paid \$16.7 billion in 2014 to settle claims that it misled investors in its mortgage-backed securities.<sup>233</sup> This was a peculiar type of justice. The claims stemmed mainly from the activities of Merrill Lynch and Countrywide that Bank of America took over in 2008.<sup>234</sup> Unquestionably, in the event the rules of the game were established by the US banking and competition authorities, these pre-merger wrongdoings would not have been disciplined – this would, in turn, raise different questions concerning justice or its failure. Considering that the US authorities had the opportunity to place their regulatory power in this possibly profitable holder, the rules adhered to a different rationale. The message to the banking industry – similar to the disciplining of JPMorgan Chase for the misconduct of Washington Mutual prior to being acquired by the larger financial institution in 2008<sup>235</sup> – is that proper thoroughness on a crisis merger would now take a long time to be feasible.

The same pertains in the UK, nevertheless for different purposes. The experience with Lloyds' takeover of HBOS<sup>236</sup> demonstrated how the hastened merger with a weak financial

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<sup>232</sup> *Ibid.*

<sup>233</sup> Department of Justice, 'Bank of America to Pay \$16.65 Billion in Historic Justice Department Settlement for Financial Fraud Leading up to and During the Financial Crisis' (21 August, 2014) *DOJ*, available at <http://www.justice.gov/opa/pr/bank-america-pay-1665-billion-historic-justice-department-settlement-financial-fraud-leading>.

<sup>234</sup> *Ibid.*

<sup>235</sup> Federal Deposit Insurance Corporation, 'JPMorgan Chase Acquires Banking Operations of Washington Mutual' (28 September, 2008) *FDIC Press Release*, available at <https://www.fdic.gov/news/news/press/2008/pr08085.html>.

<sup>236</sup> For a discussion of the takeover of HBOS by Lloyds, see chapter 4.3.2(e) in this thesis, pp 110-6.



institution would obliterate a robust acquirer. Royal Bank of Scotland was likewise impaired by its takeover of parts of ABN AMRO.<sup>237</sup>

Similarly, significant is the concern about financial institutions that are not TBTF, but rather too big to salvage due to their liabilities are so large that the UK and the US governments would have shortage of the fiscal ability to support them. The damage produced by extra-large financial institution in the UK and US present a blunt warning.<sup>238</sup>

Big bank mergers in the UK and the US are dead. Subsequent to the downfall of Lehman Brothers in 2008,<sup>239</sup> the negative effects of banks insolvency to the financial markets have been altogether apparent. In the US, the Dodd-Frank Act<sup>240</sup> has nearly forbidden government bailouts. Therefore, alternative types of finance have to be created in order to recapitalize systemically significant financial institutions that are in distress.<sup>241</sup>

In the event governments in the UK and US would worry about a financial crunch accelerating a depression, they would create means of restoring to previous public aid practices.

The present compromise is that this would originate from 'bailing in' creditors who consequently partake about the losses, though methods for arranged resolution or winding down are set in order. The creditors who would confront larger risk could claim a greater return or put funds with financial institutions by way of deposits so as to be protected from the bail-in. To thwart this, regulators in the UK and US would likely permit banks to hold a necessary cushion of loss-soaking up capital in excess of and beyond their equity. Clearly, the issue would be what could occur if the cushion of loss-soaking up debt is exhausted.

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<sup>237</sup> Financial Services Authority, 'The Failure of the Royal Bank of Scotland' (December, 2011) *Financial Services Authority Board Report*, pp 159-187, available at <http://www.fsa.gov.uk/pubs/other/rbs.pdf>.

<sup>238</sup> A Demircuc-Kunt and H Huizinga, 'Are Banks Too Big to Fail or Too Big to Save?' (2010) *World Bank Policy Research Working Paper* No 5360.

<sup>239</sup> US Congress, 'The Effect of the Lehman Brothers Bankruptcy on State and Local Governments' (5 May, 2009) *Hearing before the Committee on Financial Services, US House of Representatives*, 111<sup>th</sup> Congress, 1<sup>st</sup> Session.

<sup>240</sup> *Dodd-Frank* (n63), Title II ('Orderly Liquidation Authority').

<sup>241</sup> D Lin, 'Bank Recapitalizations: A Comparative Perspective' (2013) 50 *Harvard Journal on Legislation* 513, p 514.

Empowered by the post GFC legislations, the UK and the US banking regulators have refused as insufficient the ‘living wills’<sup>242</sup> of the largest and qualified UK and US financial institutions that carry out activities in respective countries.<sup>243</sup> These would be an essential instrument concerning the methodical resolution of financial institutions that do not survive in a financial crisis. Notwithstanding the EU’s effort to head towards a banking union, its resolution instrument provides extensive saying to UK regulators.

An irony at the core of this method to systemic crises is the fact that bailing in creditors would likely cause across-the-board results considering that, contrary to a bailout, it could shift losses to other systemically significant banks. The Dodd-Frank Act<sup>244</sup> demands the banking sector to satisfy any losses in addition to its equity and debt, and to have the ability to soak up. This will likely be a formula for panic.

If the governments in the UK and the US are concerned that a systemic crisis might trigger a depression, they could seek alternatives to come back to the previous bailout behaviours. During the GFC, that proved to be chaotic. However, the futility of the arranged bank mergers in the UK and the US and the untested regulatory framework indicates that crisis management would be even more chaotic, if that happens.<sup>245</sup>

The UK and the US authorities and central banks are creating the world’s first actual plans to safeguard the comprehensive financial system in the case that any of the largest cross-border financial institutions were to fail. Regulators in both sides of the Atlantic have worked on ‘resolution plans’ with the main focus on ‘top-down bail-in’ actions. These would see the regulators in both countries taking control of a failing financial holding company and forcing

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<sup>242</sup> *Dodd-Frank* (n63), s 165 (codified 12 USC §5365). The Act requires that certain banks and nonbank financial companies with total assets of \$50 billion periodically submit resolution plans to the Federal Reserve and the FDIC. Each plan, commonly known as a ‘living will’, must describe a bank (non-bank)’s strategy for rapid and orderly resolution in case of its material financial distress or failure; see, also, Federal Reserve ‘Agencies Provide Feedback on Second Round Resolution Plans of ‘First-Wave’ Filers’ (5 August, 2014) *FRB*, available at <http://www.federalreserve.gov/newsevents/press/bcreg/20140805a.htm>.

<sup>243</sup> J Heltman, ‘Regulators Rebuke Living Wills of Three More Banks’ (23 March, 2015) *American Banker*; see, also, B Jopson and B McLannahan, ‘Bank Living Wills Reveal Wall St Victims’ (6 June, 2015) *Financial Times*; see, further, E Avgouleas, ‘Living Wills as a Catalyst of Action’ (June, 2010) *International Financial and Monetary Law Conference, Benjamin Cardozo School of Law, New York*.

<sup>244</sup> *Dodd-Frank Act* (n63), s 165 (codified 12 USC §5365).

<sup>245</sup> J Plender, ‘Financial Reforms Will Make the Next Crisis Even Messier’ (1 September, 2014) *Financial Times*.

its shareholders and bondholders to absorb losses despite the maintaining of critical operations within the group open. These regulators argue that if they can come up with resolution strategies for financial institutions in their respective jurisdictions, this may persuade other authorities that take a more graduate approach to responding to do the same.<sup>246</sup>

The purpose of the top-down bail-in would be to prevent a recurrence of the 2008 collapse of Lehman Brothers,<sup>247</sup> in which the sudden failure of the American parent left the UK operating division completely broke and incapable to remunerate employees and cover essential costs. Even the Bank of England admits that top down bail-in could render a sustainable approach for the resolution of multifaceted large banks or big financial institutions, which cross numerous markets, currencies, and jurisdictions.<sup>248</sup> The bank cooperates jointly with other authorities in the UK and in the US in order to ensure in what way to make that approach effective.<sup>249</sup>

The pilot project, according to the UK and the US regulators, is based on the 'living wills' prepared by the financial institutions.<sup>250</sup> Moreover, it includes a step-by-step and thorough examination of the respective means, consecutive actions, or measures to be taken by the UK and US governments, which could unfold (finish) realistically and legally on both shores of the Atlantic.<sup>251</sup>

This may assist to define the changes necessary to take place in financial institution structures, contracts, and possibly the UK and American laws.

However, UK and the US authorities are more eager than their counterparts in other nations to show that it would work to the cynics in Europe and elsewhere. In 2015, the

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<sup>246</sup> B Masters and S Nasiripour, 'USA and UK Eye Reaction to Bank Failure' (20 May, 2012) *Financial Times*.

<sup>247</sup> See generally, L G McDonald and P Robinson, *A Colossal Failure of Common Sense: The Inside Story of the Collapse of Lehman Brothers* (New York: Crown Publishing 2010).

<sup>248</sup> Bank of England, 'Detailed Answers from Bank of England Response to the European Commission Call for Evidence on the EU Regulatory Framework for Financial Services' (January, 2016) *BoE*, pp 6-8, available at <http://www.bankofengland.co.uk/financialstability/Documents/regframework/detailedanswers010216.pdf>.

<sup>249</sup> Federal Deposit Insurance Corporation & Bank of England, 'Resolving Globally Active, Systemically Important, Financial Institutions' (10 December, 2012) *Joint Paper*, pp 1-14, available at <http://www.bankofengland.co.uk/publications/Documents/news/2012/nr156.pdf>.

<sup>250</sup> M Otto, *Living Wills – The In-House Perspective* in A Dombret and P S Kenadjian (eds.) *The Bank Recovery and Resolution Directive: Europe's Solution for 'Too Big To Fail'* (Berlin: Walter de Gruyter 2013), p 103.

<sup>251</sup> *Ibid*, p 104.

Financial Stability Board ('FSB'),<sup>252</sup> a global financial regulator, issued the final 'total loss-absorbing capacity' ('TLAC') standard for 'global systemically important banks' ('G-SIBs').<sup>253</sup> The TLAC standard is designed for failing G-SIBs to have sufficient loss-absorbing and recapitalization capacity available in resolution for authorities to implement an orderly resolution that minimises impacts on financial stability, maintains the continuity of critical functions, and ensure that the cost of a giant bank's failure will be borne by its investors, not taxpayers.<sup>254</sup> Under the plan, large lenders will have by early 2019 to hold a financial cushion of at least 16 per cent of their risk-weighted assets in equity and debt that can be written off.<sup>255</sup> The minimum total loss absorption capacity requirement will gradually increase, reaching 18 per cent of assets weighted by risk by 2022.<sup>256</sup>

Like in the US, the UK political and business governing classes have been for decades rotten to the bones by greed and hypocrisy. Their patriotism and sense of responsibility are strictly driven by their personal ambitions for power and money.<sup>257</sup> The competition in the Anglo-American banking sector is not functioning in favour of the consumers. The sector is at a critical moment. There are two significant derivations of possible weight for a more eloquent response to the tenacious competition concerns. These hails from prospects for new competition approach in retail banking and arising out of a new reach to regulation.

In connection with new competition, there have already been the entries of new banks as a result of the acquisition transactions. Also, major banks' divestment process projected to

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<sup>252</sup> The Financial Stability Board (FSB) was formed in 2009 by the G-20 major economies. It is an international body, which monitors and makes recommendations concerning the global financial system. For more information about the role and activities of the FSB, go to [www.fsb.org](http://www.fsb.org).

<sup>253</sup> *Ibid.* Financial Stability Board has identified thirty worldwide banks that are G-SIFIs, out of which eight are US based financial institutions and four banks are headquartered in the UK.

<sup>254</sup> Financial Stability Board, 'Summary of Findings from the TLAC Impact Assessment Studies' (9 November, 2015) *FSB*, available at <http://www.fsb.org/wp-content/uploads/TLAC-Summary-of-Findings-from-the-Impact-Assessment-Studies-for-publication-final.pdf>.

<sup>255</sup> Financial Stability Board, 'Total Loss-Absorbing Capacity Standard for Global Systemically Important Banks' (9 November, 2015) *FSB*, available at <http://www.fsb.org/wp-content/uploads/20151106-TLAC-Press-Release.pdf>; see, also, Financial Stability Board, 'Total Loss-Absorbing Capacity (TLAC) Principles and Term Sheet' (9 November, 2015) *FSB* ('[TLAC Term Sheet](http://www.financialstabilityboard.org/wp-content/uploads/TLAC-Principles-and-Term-Sheet-for-publication-final.pdf)'), available at [www.financialstabilityboard.org/wp-content/uploads/TLAC-Principles-and-Term-Sheet-for-publication-final.pdf](http://www.financialstabilityboard.org/wp-content/uploads/TLAC-Principles-and-Term-Sheet-for-publication-final.pdf).

<sup>256</sup> *TLAC Term Sheet* (n258).

<sup>257</sup> C W Calomiris and S H Haber, *Fragile by Design: The Political Origins of Banking Crises and Scarce Credit* (New Jersey: Princetown University Press 2014) pp 132-151; and 256-269.

establish actual ‘challenger’ financial institutions.<sup>258</sup> More profoundly, new technology could render scope for augmented competition arising out of outside the customary banking pattern, for instance, through the on-line and mobile payments or additional technological innovation.<sup>259</sup>

The new bank competitors confront effective challengers in order to become prosperous. The largest hurdle to entry and expansion is likely to be consumer inaction, for the most part in the essential current bank account market.<sup>260</sup> The automatic redirection service should take note of a progress in dropping issues from the switching of business and personal bank accounts. In this regard, more should be done to stimulate accountability.<sup>261</sup> For instance, downloadable online access of bank account transaction histories could allow more customized comparisons and information on interest relinquishment could turn out to be more significant as interest rates rise.<sup>262</sup>

Nevertheless, customers are required to become more proactive with services and products offered by their banks. In the event that the customers continue to identify their banking as free, or to use a different charging pattern when the ‘free if in credit’ model<sup>263</sup> succeeds across the sector, it would be challenging for new bank entrants to draw customers from existing providers.<sup>264</sup>

It is also imperative that regulatory practices in the UK and the US do not function as obstacles to entry. Competition and banking regulators must show commitment for examination of the application of prudential prerequisites in order to safeguard that new

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<sup>258</sup> HM Treasury, ‘Banking for the 21st Century: Driving Competition and Choice’ (March, 2015), p 27, available at [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/416097/Banking\\_for\\_the\\_21st\\_Century\\_17.03\\_19\\_40\\_FINAL.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/416097/Banking_for_the_21st_Century_17.03_19_40_FINAL.pdf).

<sup>259</sup> J A DiVanna, *The Future of Retail Banking: Delivering Value to Global Customers* (New York: Springer 2016), pp 100-120.

<sup>260</sup> E Dunkley, ‘Capital Rules Choke Challenger Banks’ Ability to Compete’ (24 November, 2015) *Financial Times*.

<sup>261</sup> *Vickers’ Report* (n199), pp16-18.

<sup>262</sup> S Samudrala, *Retail Banking Technology: The Smart Way to Serve Customers* (Mumbai: Jaico Publishing House 2015), ch 4.

<sup>263</sup> ‘Free-if-in-credit’ model consists of free banking services in personal current accounts, *i.e.*, cash withdrawal, and transfer money.

<sup>264</sup> Competition and Markets Authority, ‘CMA Proposes Better Deal for Bank Customers’ (22 October, 2015) *CMA: Markets, Competition and Competition Law*, available at <https://www.gov.uk/government/news/cma-proposes-better-deal-for-bank-customers>.

entrants and smaller banks would not be unreasonably adversely affected, such as, provisions to keep more capital than present (larger) banks. Competition from outside the conventional banking pattern could likewise lead to the questioning of the process of issuing authorization. It is vital that competition and banking authorities on both sides of the Atlantic do not unjustly inhibit competition by taking the business pattern of existing and conventional financial institutions as the base for the model of new rules in means, which could place innovative financial institution providers and new technologies at a disadvantage.<sup>265</sup>

In terms of regulation, a likely basis of change in the banking industry is the role of competition and banking regulators in the UK and the US establishing different methods from the past in relation to the regulation of the behaviour of banks and other financial institutions. It remains crucial for these regulators to have an exceptional goal to stimulate competition and to make use of their influence to facilitate a properly functioned market for consumers. It is also crucial to ensure that regulation of financial institutions does not establish rules that constrain stagnant or vigorous regulation, and that the authorities do not look at banking incumbency safeguard or weaker competitiveness as means to attain financial stability. Competition and financial stability can coexist, on condition that there is suitable regulation to address disproportionate risk-taking.<sup>266</sup>

Several problems that competition and banking regulators in the UK and the US confront originate from a failure of ‘customer focus’ on the part of the providers.<sup>267</sup> Placing the customer experience at the centre of regulation and considering the benefits of potent market change over competition provides an opportunity for the regulators to use its rule-making power and influence to take on the enduring issues in the market.

New competition and a readjusted direction and focus to regulation would result in a new direction in banking. This would signify change on the bank providers’ side.

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<sup>265</sup> D Singh, *Banking Regulation of UK and US Financial Markets* (Hampshire: Ashgate 2012) (‘Singh’), pp 24-25.

<sup>266</sup> *Harrison* (n111), pp 71-3.

<sup>267</sup> M Neumann and J Weigand, *International Handbook of Competition* (Cheltenham: Edward Elgar 2004), pp 143-145.

Competition and regulation are required as catalysts for a more ‘customer focused’ way from bank and other financial institutions.<sup>268</sup>

Previously banks would only announce initiatives to address any existing problems if the competition and banking authorities put pressure on them. These initiatives should by now be carried out by banks. It does not require a major complaint for banks to supply coherent information to consumers on apparent matters like the interest rate paid over the saving account or the charges consumers pay upon utilizing their cards overseas.<sup>269</sup>

In the event banks and other financial institutions do not make concrete changes, a more fundamental reformatory method must be considered. There cannot be a continuation of working with business on cumulative change, in case this will not deliver any satisfactory outcome. The UK and US banking and competition regulators can take a fresh and comprehensive approach at a market, having certain structural and conduct remedies at its disposition, not excluding any break-up action towards existing banks.

The UK competition authorities should consider two basic criteria, which must be satisfied in making a market investigation reference in Phase 2 in relation to a bank merger examination. The first criterion focuses on the need for a sensible basis to suspect that ‘characteristics’ of the market thwart, curb, or alter competition.<sup>270</sup> Traditional concerns of concentrated markets, low degrees of switching, and accountability and failure of innovation normally direct *vis-à-vis* such characteristics. The second criterion involves the fact that the authorities must appropriately exercise their discretion in order to make a bank merger reference for Phase 2 examination,<sup>271</sup> taking into account the possibility that characteristics will carry on and the undertaking by other regulators.

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<sup>268</sup> Singh (n268), pp 23-5.

<sup>269</sup> A Ottow, *Market and Competition Authorities: Good Agency Principles* (Oxford: Oxford University Press 2015), pp 241-50.

<sup>270</sup> The Comptroller and Auditor General, ‘UK Competition Authorities: The UK Competition Regime’ (5 February, 2016) *Report, Session 2015-16, HC 737*, pp 37-39, available at <https://www.nao.org.uk/wp-content/uploads/2016/02/The-UK-Competition-regime.pdf>.

<sup>271</sup> A Coscelli and A Horrocks, ‘Making Markets Work Well: The UK Market Investigations Regime’ (2014) 10 *Competition Policy International* 1, pp 50-52.

Changes are materializing and designed to upturn bank accounts switching and decreasing entry hurdles, along with State aid divestments, new entry, and a fresh look to regulation by the UK authorities. Banks must expect these changes instead of responding to them unprepared. The regulators must sustain and encourage the banks to implement these changes, making use of rules and regulations if necessary, which would avert a race to the bottom.<sup>272</sup>

The Brexit referendum result of 2016 has thrown the UK towards uncharted waters in terms of the future relationship between the UK and the EU, including implementation of EU provisions and the UK's access in the EU market. However, the foregoing is not part of the analysis in this thesis, notwithstanding its importance.

The bank sector needs to change. There is yet to be seen any evidence that would show the market underlying forces of entry and that consumers benefit from better and cheaper banking services and products providers, bringing more resilient customer-concerned competition. Without this, the apparent issue remains whether the concentrated market configuration of the banking could be the problem. The best approach to examine this issue is a proper reference to the regulators and courts in the UK and the US, respectively.

### 11.3 Conclusion

This chapter engages in an analysis of competition-related problems faced by the UK and the US and examines possible ways to solve the problems. In the US, the traditional approach laid down in the *Philadelphia National Bank* case<sup>273</sup> is no longer applicable to the current situation in the financial market. Banks and financial institutions have ventured into new spheres of operations and begun providing services beyond their local territories as technology advances. In the UK, banks have acquired other financial institutions to consolidate their positions in the market since the 1980s when bank deregulations were undertaken by the UK Government. As a result of the failure to address the anticompetitive effects brought about by these mergers,

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<sup>272</sup> R Wandhöfer, *Transaction Banking and the Impact of Regulatory Change: Basel III and Other Challenges for the Global Economy* (London: Palgrave Macmillan 2014), ch 7.

<sup>273</sup> *Philadelphia National Bank* (n1), pp 356-7.



the operations and sizes of these banks have expanded to a scale that was too large for the government to adequately monitor.

While the UK and the US have in place respective systems to monitor and address issues related to competition, the problems became full-blown during the GFC. In particular, the crisis highlighted the problem of these banks being TBTF. Many large banks were on the verge of insolvency and, as emergency measures, the governments took steps to save the banks through, among others, approving mergers in order to prevent a total collapse in the economy. These measures, however, aggravated the oligopoly situation in banking system.

Notwithstanding the oligopolistic structure of banking system, such structure does not necessarily mean that it does not lead to competitive outcomes.

Competition provisions would not have prevented the GFC, or eliminated TBTF, because they are not made with the essential tools to avoid the occurrence of financial crises. Modern competition provisions are not in place to homogenize the size of banks and other financial institutions. They are applied only to forbid dominant conduct, and to stop bank mergers in the event of heightened pricing power and market influence.

Banks and other financial institutions are required to adopt the changes and financial reforms undertaken from their regulators in post-GFC, and they (banks) should take initiatives to comply with the relevant policies and regulations in place. Ultimately, a healthy and competitive financial market can only be established and maintained with the cooperation among the relevant authorities, regulators, and market players.

The bank sector needs to change. There is yet to be seen any evidence that would show the market underlying forces of entry and that consumers benefit from better and cheaper banking services and products providers, bringing more resilient customer-concerned competition. Without this, the apparent issue remains whether the concentrated market configuration of the banking could be the problem. The best approach to examine this issue is a proper reference to the regulators and courts in the UK and the US, respectively.

The GFC presented a series of significant regulatory and central bank failures in the US, UK, EU and elsewhere and especially in relation to defective regulation, supervision, resolution, support and macro prudential oversight. A substantial amount of work has been done to correct all of the foregoing. However, it is arguable that sufficient action has been taken to remove the worst threats that arise with TBTF. The GFC has reminded us that regulatory and supervisory frameworks need constant updating as new products, markets and interlinkages emerge.

## CHAPTER 12 - CONCLUSION

The scope of this thesis is a comparative analysis of the competition law system regulating bank mergers in the UK and the US, identifying what needs to be improved in each or both of these jurisdictions in order to enhance the Anglo-American bank merger regime.

The thesis is principally structured in four parts.

The first part of this thesis, chapters two through five, focused on the competition aspects of bank mergers in the UK, including applicability and implementation of EU relevant provisions to UK related bank mergers.

The present UK legislation, including the recent reforms on the financial services do not necessarily alter the substance of competition law in its application to banks, notwithstanding institutional changes to the enforcement of competition law, and the promotion of competition in the UK banking industry.

Having more UK regulatory bodies enforcing competition law in the banking industry and requiring them to give specific consideration to applying competition law may increase the number of competition investigations and scrutiny in bank merger applications. However, unanswered questions remain as to whether this will lead to an increase in the imposition of competition law enforcement orders. Civil fines would depend on whether the industry takes notice of the warnings inherent in the changes made in the regulation of the banking and financial services, ensuring compliance with competition law.

An open question remains whether UK banking regulators are expected to have much greater knowledge of the banking and financial industry than competition authorities. So far, in essence, the newly created competition and financial watchdogs in the UK appear to be a continuation of their predecessor institutions. Their recent initiatives in investigating competition in banking sector do not seem to go deep enough, notwithstanding some signs of improvements made in the retail banking activities for SMEs, and bank account's switching process.

There are both structural and result related similarities between the UK national and EU mechanisms for reviewing competition concerns associated with bank mergers. In both cases, there appears to be a considerable improvement in cooperation and coordination of their efforts in assessment of banking cases. Yet, more work remains to improve synergize between the UK and EU regulators in cases that give rise to issues that can properly be divided and addressed together without unnecessarily duplicating work.

The Brexit referendum result of 2016 has thrown the UK towards uncharted waters in terms of the future relationship between the UK and the EU, including implementation of EU provisions and the UK's access in the EU internal market. However, the foregoing is not part of the analysis in this thesis, notwithstanding its importance.

The courts' involvement in the review process of bank merger in the UK has been nearly nonexistent. With the exception of a few case laws dealing with certain aspects of banking, the courts, unlike their US counterparts, have not played an active and leading role in enhancement of the completion in bank mergers. However, slowly but steadily, the courts and watchdogs specialized in the area of competition regulatory matters have taken up on issues related to competition in banks. UK courts should consider viewing banks as special institutions, especially when reviewing competition aspects of their mergers and acquisitions. There is an increasing tendency by the courts and competition authorities to look at certain aspects of banking products and services, such as, overdraft charges, credit/debit cards fees, and fees for switching bank accounts, or other banking issues from a competition point of view, rather than taking a broad and complete look at the situation of competition in the banking system starting with preservation and enhancement of competition in bank consolidation cases in the UK. Courts ought to play a better and more proactive role to preserve competition in bank merger situations.

The GFC saw an increasing and active involvement by the EU courts and the European Commission in dealing with competition issues of bank mergers in the UK, and across the EU territory. However, the overall perception is that both the Commission and the UK competition watchdog have somewhat compromised the strict applicability of competition

provisions in bank mergers during the financial crisis. These mergers were largely dictated by the consequences of the systemic risk threats and the financial collapse, despite evidence that several of these mergers would have likely resulted in a substantially lessening of competition in the relevant markets.

During the GFC, the Commission managed to assist Member States, including the UK, avert a banking meltdown, and to avoid significant distortions of competition in the Internal Market, while sustaining the State aid rules in place. The Commission's central position was substantially reinforced by the Member States' realization that traditional national protectionist policies could be extremely dangerous in the present level of economic integration.

In the banking sectors, the Commission has acted autonomously, under its 'classical' position in the State aid area, pursuant to Articles 107-109 TFEU; developed its approach pragmatically through non-binding Communications, setting out its intended approach under the fundamental EU Treaty provisions; and it made maximum use of the flexibility inherent in the Treaty, especially the 'derogations' permitted in Article 107(3) (a)-(c); as well as it has successfully avoided reaching decisions Member States and concerning financial institutions economic would have felt forced to refer to judicial review in the European Courts. The Commission decisions in response to the State aids given from the Member States to their banks has shown transparency, comparability and consistency.

The Commission considers certain criteria in its evaluation of a bank's application for 'failing firm defence' such as, the failing bank shall exit the market in the foreseeable future due to its financial difficulties; there is no less anti-competitive alternative purchase that could occur in place of a merger; and in the absence of a merger, the assets of the failing firm (bank) would inevitably exit the market. The high burden of proving that the foregoing criteria are satisfied lies on the merging banks, which must show the proposed merger would lead to a less anti-competitive outcome than a counterfactual scenario in which the firm and its assets would exit the market.

Despite regulatory improvements and harmonization at the UK and EU levels, competition problems still remain in the banking sector. A combination of the GFC, effects of regulatory developments and consumer behaviours means that SMEs find it still challenging to enter the banking and finance market, notwithstanding recent initiatives and concrete actions to improve the situation. Challenges remain in terms of achieving the desired objective, being a competitive market for banking in the UK. Developments that have taken place have principally advantaged banks seeking to merge, through improved process transparency and flexibility, without full attention to consumers' benefits. In fact, dominant market players exploit consumer ignorance, mis-sell products, and offer services that are inferior to those limited other options in the marketplace, but without negative consequence to their market shares.

Generally speaking, banking system presents oligopolistic fabric. However, it does not, necessarily, mean such system do not lead to competitive results. Some of the broadest approaches that define and evaluate competition in banking are the structure-conduct-performance model; contestability - centres on conduct dependent on latent entry; and price responsiveness to cost shifts.

The UK Government has acknowledged the fact that competition in banking was harmed during the GFC in the name of preservation of the financial stability. A substantial amount of work has been undertaken to correct all of the deficiencies occurred during the crisis. However, it is arguable that sufficient action has been taken to remove the worst threats that arise with TBTF.

The personal account market in the UK is found particularly concentrated, notwithstanding latest initiatives to tackle such concern. Significant competition problems, also, exist in product markets, where there are a greater number of participants, such as, personal loans and credit cards. Notwithstanding the obvious requirement for banks to be more transparent with their customers, it must be asked whether this alone will be sufficient to remedy consumer apathy towards switching bank accounts, a continued problem. Apart from the UK competition watchdog investigation into the foregoing issues, its conclusive recommendations have been a small step forward but not transformational.

When all is said, and done, and whilst acknowledging laudable intentions in all of this, it is difficult to say that the cornerstone objective of providing for healthy competition in the market for banking products and services in the UK has been fully achieved.

The second part of this thesis, chapters six through nine, dealt with the competition aspects of the bank mergers in the US.

The analytic framework that the US banking and competition regulators apply when they review possible competitive effects of a bank merger goes back to the *Philadelphia National Bank* in 1963.<sup>1</sup> This case law utilized product and geographic markets, based on the ‘cluster’ method that defines the relevant product market as the ‘cluster’ of products (different kinds of credit) and services (checking and debit accounts) denoted by the term ‘commercial banking’ in a local market.<sup>2</sup> Such method is outdated due to expansion of numerous banking products and services, for instance, credit/debit cards, mortgage financing, real estate financing. The services and products provided by banks and other financial institutions have expanded both vertically and horizontally: not only have new services and products emerged, the services and products traditionally provided by one type of financial institutions have begun to be available at other types of financial institutions. Banking regulators risk in overlooking concentrations especially in product lines and particular geographic areas because they define markets locally. The common remedy in allowing bank merger applications has been divestiture of certain products or services from the merging bank(s) in a local banking market.

There is a long due need to further enhance and harmonize the bank merger review policies in the US. A step in the right direction would be for the US Supreme Court to revisit its decision in *Philadelphia National Bank*<sup>3</sup> to look at factors arising after its ruling. Such factors include broader market locations that exceed the local market of ‘clusters’ of banking products, inclusion of non-bank activities in banking, and the entrance of new banking products and services due to technological innovation.

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<sup>1</sup> *United States v Philadelphia National Bank* (1963) 374 US 321.

<sup>2</sup> *Ibid*, pp 355-357.

<sup>3</sup> *Ibid*, pp 370-372.

Nevertheless, whatever the future analytical framework for evaluating proposed bank mergers might be, the last thing it should be is dutiful devotion to *stare decisis* merely for the sake of not offending a half-century of established doctrine. To remain as a key player in the field, courts must, thus, strike a balance between upholding the spirit of precedents and recognizing the ever-evolving circumstances in the modern financial world. The US Congress and the regulators can play an important role in this striking this balance as well.

Perception of the future on bank merger antitrust enforcement is understandably difficult to make. However, before peering into the future, the foundation is laid by considering past and present bank merger enforcement in the US. In this regard, the approach in the US antitrust of bank mergers is expected to alter very little in that the geographic scope of the relevant market for important banking services is and appears to remain local for the foreseeable future.

The third part of this thesis, chapter ten, concluded that the UK and the US authorities took bank consolidation actions arguably necessary and perfectly justifiable on regulatory and financial stability grounds.

The GFC revealed a number of significant regulatory and central bank failures in the UK, US, EU and elsewhere, and especially in terms of defective regulation, supervision, resolution, support and macro prudential oversight. A substantial amount of work has been done to correct all of these. It is arguable that sufficient action has been taken to remove the worst threats that arise with TBTF.

During the GFC, a less strict implementation of antitrust oversight was necessary and suitable. Both the UK and American regulators were burdened by the spread of systemic risk and financial collapse to prop up banks struggling with eroding capital. In approving mergers of large banks and other financial institutions, both the UK and American regulators managed to control systemic risk. The large bank mergers in the UK and US were granted fast-tracked approval due to the fact that by mingling a deteriorating bank with a larger, healthier bank, systemic risk would be mitigated.



Competition provisions would not have prevented the GFC, or eliminated TBTF, because they are not made with the tools required to avoid financial crises. Modern competition provisions are not in place to homogenize the size of banks and other financial institutions. They are applied only to forbid anticompetitive conduct, and to stop bank mergers in the event of heightened pricing power and market influence.

In relation to the response to the TBTF concern, banking markets are naturally, oligopolistic, which cannot be prevented with the objective being to ensure that these operate in a safe and stable manner. Consumers have a right of choice and can say no with competition authorities not being entitled to force competition on them. International competition is, also, relevant with countries having a legitimate interest to ensure that they have one or more large banks that can compete globally. The TBTF was a problem following the GFC, although a large number of important steps have been taken to correct this since. To address these criticism, the international bodies and national authorities, including the UK and US, took actions to better regulate TBTF concern.

The policy response to end TBTF was necessary. The international and national regulators have made great progress to put the overall international policy framework in place. The application of policies to individual SIFIs, and financial institutions have undertaken restructuring necessary in order to make the foregoing institutions resolvable.

Antitrust is quintessentially addressed to the optimum organization of the nation's economy, even if it does not purport to address all aspects of it. The main issue of competition law is economic power and its potential to be misused. Vast aggregations of economic power in convergence with other phenomena caused TBTF crises. It, therefore, stands to reason that competition ought to be concerned with some aspects of the TBTF problem, at least, insofar as the problem stems from aggregated economic size and power. Since the TBTF problem is complex, it is unsurprising that competition by itself is not and cannot the cure. However, the competition law could make a difference by controlling certain forms of conduct that lead to financial institutions becoming excessively large.

The fourth (last) part of this thesis, chapter eleven, concluded that while the UK and the US have in place different systems to monitor and address issues related to competition, problems remain in both countries, and became full-blown during the GFC. In particular, the crisis highlighted the problem of these banks being TBTF. Many large banks were on the verge of insolvency and, as emergency measures, the governments took steps to save the banks through, among others, approving mergers in order to prevent a total collapse in the economy.

Large banking groups have grown market power and sustained a lower cost of capital due to the public bailout and the fact that they are TBTF. The financial reforms legislation in the UK (such as, the Vickers' Report,<sup>4</sup> Financial Services (Banking Reform) Act 2013<sup>5</sup>), the EU (such as, the Liikanen Report,<sup>6</sup> the European Banking Union directives<sup>7</sup>), and US (like, the Volcker Rule,<sup>8</sup> the Dodd-Frank Act<sup>9</sup>) have also met opposition from political parties and market participants. These statutes are very long, highly complex, and most likely will ever be fully implemented.

A lesson learnt from the GFC is that pro-competitive exit policies should be considered in the course of rehabilitation and rescue operations. There is also a need for the relevant competition authorities and banking regulators to step up their effort and make use of their respective power and influence over banks and other financial institutions. Ultimately, a healthy and competitive financial market can only be established and maintained with the cooperation among the relevant authorities, regulators, and market players.

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<sup>4</sup> Independent Commission on Banking, 'Final Report' (September, 2011) (the Vickers' Report), London, available at [www.hm-treasury.gov.uk/d/ICB-Final-Report.pdf](http://www.hm-treasury.gov.uk/d/ICB-Final-Report.pdf).

<sup>5</sup> Financial Services (Banking Reform) Act 2013, c. 33.

<sup>6</sup> Report High Level Expert Group on Reforming the Structure of the EU Banking Sector, Final Report (2 October, 2012) (the Liikanen Report), available at [http://ec.europa.eu/internal\\_market/bank/docs/high-level\\_expert\\_group/report\\_en.pdf](http://ec.europa.eu/internal_market/bank/docs/high-level_expert_group/report_en.pdf).

<sup>7</sup> European Banking Union directives European Council, European Council Conclusions 28/29 June, 2012, EUCO 76/12 ('Banking Union'), available at [http://www.consilium.europa.eu/uedocs/cms\\_data/docs/pressdata/en/ec/131388.pdf](http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/131388.pdf).

<sup>8</sup> Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203; 124 Stat. 1391; codified to 12 USC 5301 note, effective 21 July, 2010 (*codified as amended in 12 U.S.C. §§ 5301–5641*) ('Dodd-Frank Act'), § 619 (codified 12 USC §1851) (the Volcker Rule).

<sup>9</sup> *Dodd-Frank Act* (n8).

The post-GFC interest in looking at competition in the banking industry is not an unexpected turn of events. Governments and legislators have shown similar interest in the past, especially during international and national financial crisis. Under such extraordinary financial situations, regulators approved bank mergers in the name of financial stability, superseding, therefore, any competition concern.

The GFC presented a series of significant regulatory and central bank failures in the US, UK, EU and elsewhere, and especially, in relation to defective regulation, supervision, resolution, support and macro prudential oversight. A substantial amount of work has been done to correct all of the foregoing. However, it is arguable that sufficient action has been taken to remove the worst threats that arise with TBTF.

The GFC has reminded us that regulatory and supervisory frameworks need constant updating as new products, markets and interlinkages emerge.

The policy response to end TBTF was necessary. The international and national regulators have made great progress to put the overall international policy framework in place. The application of policies to individual SIFIs, and financial institutions have undertaken restructuring necessary in order to make the foregoing institutions resolvable.

Prospects for independent and adequate regulatory review of the merger situations in banking and competition policies will continue to depend on preservation of financial stability and markets free from threats to the competitive process; while the competition laws will be influenced by fundamental protection to people's economic liberties.

## APPENDIX 1: TABLE OF LEGISLATION

### European Union

**Commission Consolidated Jurisdictional Notice under Council Regulation (EC) No 139/2004** on the control of concentrations between undertakings, *OJ C 95*, 16 April, 2008

**Commission Proposal** for a Regulation of the European Parliament and of the Council Establishing Uniform Rules and a Uniform Procedure for the Resolution of Credit Institutions and Certain Investment Firms in the Framework of a Single Resolution Mechanism and a Single Bank Resolution Fund and Amending Regulation N 1093/2010 of the European Parliament and of the Council (2013) COM ('Second Pillar')

**Commission Regulation (EC) No 773/2004** of 7 April, 2004 relating to the conduct of competition proceedings by the Commission pursuant to Articles 81 and 82 of the EC Treaty; Commission Staff Working Document SWD (2014) 231 – Enhancing competition enforcement by the Member States' competition authorities: institutional and procedural issues (SWD (2014) 231/2, 9.7.2014)

**Commission Regulation (EC) No 802/2004** of 7 April, 2004 implementing Council Regulation (EC) No 139/2004 (published in OJ L 133, 30.04.2004) amended by Commission Regulation (EC) No 1033/2008 of 20 October, 2008 (published in OJ L 279, 22.10.2008) – Consolidated version of 23 October, 2008; Annex I: Form CO relating to the notification of a concentration pursuant to Regulation (EC) No 139/2004, consolidated with amendments introduced by Commission Regulation (EC) No 1033/2008 – Consolidated version of 23 October, 2008; Annex II: Short Form CO for the notification of a concentration pursuant to Regulation (EC) No 139/2004, consolidated with amendments introduced by Commission Regulation (EC) No 1033/2008 – Consolidated version of 23 October, 2008; Annex III: Form RS Reasoned Submission (Form RS), Regulation (EC) No 139/2004, consolidated with amendments introduced by Commission Regulation (EC) No 1033/2008 – Consolidated version of 23 October, 2008; Annex IV: Form RM relating to the information concerning commitments submitted pursuant to article 6(2) and article 8(2) of Regulation (EC) No 139/2004, introduced by Commission Regulation (EC) No 1033/2008 – Consolidated version of 23 October, 2008 ('Implementing Regulation')

**Commission Regulation (EU) No 1269/2013** of 5 December, 2013 (OJ L336, 14.12.2013)

**Council Directive 1986/635/EEC** on the annual accounts and consolidated accounts of banks and other financial institutions [1986] OJ L372/1

**Council Directive 2002/87/EC** of 16 December, 2002 on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate and amending Council Directives 73/239/EEC, 79/267/EEC, 92/49/EEC, 92/96/EEC, 93/6/EEC and 93/22/EEC, and EP and Council Directives 98/78/EC and 2000/12/EC, 2002 (L 35) 1 [‘Financial Conglomerates Directive’]

**Council Directive 2006/48/EC** of 14 June, 2006 relating to the taking up and pursuit of the business of credit institutions, OJ L177/1

**Council Directive 2006/49/EC** of 14 June, 2006 on the capital adequacy of investment firms and credit institutions, OJ L 177

**Council Directive 2007/44/EC** of 5 September, 2007 amending Council Directive 92/79/EEC and Directives 2002/83/EC, 2004/39/EC, 2005/68/EC and 2006/48/EC as regards procedural rules and evaluation criteria for the prudential assessment of acquisitions and increase in shareholdings in the financial sector, OJ 2007 L 247/1

**Council Directive 2009/111/EC** amending Directives 2006/48/EC, 2006/49/EC and 2007/64/EC as regards banks affiliated to central institutions, certain own funds items, large exposures, supervisory arrangements, and crisis management (2009) OJ L 302/97

**Council Directive 2013/36/EU** on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directive 2006/48/EC and 2006/49/EC (2013) OJ L 176/338

**Council Directive 2014/59/EU** of the European Parliament and of the Council of 15 May, 2014 Establishing a Framework for the Recovery and Resolution of Credit Institutions and Investment Firms and Amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No. 1093/2010 and (EU) No. 648/2012, of the European Parliament and of the Council, (2014) OJ L173/190 (‘Bank Recovery and Resolution Directive’)

**Council Regulation (EC) No 1/2003** of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty (2003) OJ L 1/1, as amended by Council Regulation (EC) No 411/2004 of 26 February 2004 repealing Regulation (EEC) No 3975/87 and amending Regulations (EEC) No 3976/87 and (EC) No 1/2003, in

connection with air transport between the Community and third countries (2004) OJ L 68/1 and Council Regulation (EC) No 1419/2006 of 25 September 2006 repealing Regulation (EEC) No 4056/86 laying down detailed rules for the application of Articles 85 and 86 of the Treaty to maritime transport, and amending Regulation (EC) No 1/2003 as regards the extension of its scope to include international tramp services (2006) OJ L 269/1 ('Regulation 1/2003')

**Council Regulation (EC) No 659/1999** of 22 March, 1999 laying down detailed rules for the application of [Article 108 TFEU] OJ L 83, 27.3.1999, p 1 ('State aids Regulation'), as amended by Council Regulation (EC) No 1791/2006 of 20 November, 2006, OJ L 363, 20.12.2006, p 1 and the Act concerning the conditions of accession of the Czech Republic, the Republic of Estonia, the Republic of Cyprus, the Republic of Latvia, the Republic of Lithuania, the Republic of Hungary, the Republic of Malta, the Republic of Poland, the Republic of Slovenia and the Slovak Republic and the adjustments of the Treaties on which the European Union is founded, OJ L 236, 23.9.2003

**Council Regulation (EEC) No 4064/89** of 21 December, 1989 on the control of concentrations between undertakings [OJ L 395 of 30 December, 1989]. Amended opinion: OJ L 257 of 21 September, 1990. Amended by: Council Regulation (EC) No 1310/97 of 30 June, 1997 [OJ L 180 of 9 July, 1997]

**Council Regulation 1093/2010**, 'Establishing a European Supervisory Authority' ('European Banking Authority') (2010) OJ L331/12

**Council Regulation 1094/2010**, 'Establishing a European Supervisory Authority' ('European Insurance and Occupational Pensions Authority') (2010) OJ L331/48

**Council Regulation 1095/2010**, 'Establishing a European Advisory Authority' ('European Banking Authority') (2010) OJ L331/84

**Regulation (EC) No. 1060/2009** of the European Parliament and of the Council of 16.09.2009 on credit rating agencies (CRA I), as amended by CRA II (Regulation 513/2011) and CRA III (Regulation 462/2013)

**Regulation (EU) No. 1022/2013** of the European Parliament and of the Council of 22 October, 2013 Amending Regulation N 1093/2010 Establishing a European Supervisory Authority (European Banking Authority) as Regards the Conferral of Specific Tasks on the European Central Bank Pursuant to Council Regulation N 1024/2013, (2013) OJ L287/5 ('First Pillar')

**Regulation (EU) No. 1024/2013** of the European Parliament and of the Council of 15 October, 2013 Conferring Specific Tasks on the European Central Bank Concerning Policies Relating to the Prudential Supervision of Credit Institutions (2013) OJ L287/ 63

**Statute of the Court of Justice of the European Union** (Consolidated version 2015) , as amended by Regulation (EU, Euratom) No 741/2012 of the European Parliament and of the Council of 11 August, 2012 (OJ L 228, 23.8.2012, p 1), by Article 9 of the act concerning the conditions of accession to the European Union of the Republic of Croatia and the adjustments to the Treaty on European Union, the Treaty on the Functioning of the European Union and the Treaty establishing the European Atomic Energy Community (OJ L 112, 24.4.2012, p 21) and by Regulation (EU, Euratom) 2015/2422 of the European Parliament and of the Council of 16 December, 2015 (OJ L 341, 24.12.2015, p 14) ('Statute')

**Treaty of Amsterdam** (*Official Journal C 340, 10/11/1997 P. 0001-0144*)

**Treaty on the Functioning of the European Union** (Consolidated Version 2012) *OJ C326/01 P. 0001-0390*

### **United Kingdom**

**Bank of England Act 1694**, (5 & 6 Will. & Mar. c. 20)

**Bank of England Act 1998**, c. 11

**Banking (Special Provisions) Act 2008**, c. 2

**Banking Act 2009**, c. 1

**Competition Act 1998**, c.41

**Enterprise Act of 2002**, c. 40

**Enterprise and Regulatory Reform Act of 2013**, c. 24

**Fair Trading Act of 1973**, c. 41

**Financial Services (Banking Reform) Act 2013**, c. 33

**Financial Services Act 2012**, c. 21

**Industry Act 1975**, c. 68

**Unfair Terms in Consumer Contracts Regulations** [1999] S.I. 1999/2083

## United States

**Bank Holding Company Act 1956**, 12 U.S.C. 1841 *et seq*

**Bank Merger Act 1960**, amended 1966, 12 U.S.C. Sec 1828

**Banking Act 1933**, 48 Stat. 162 (1933)

**Celler-Kefauver Act**, ch 1184, 64 Stat. 1125 (1950) (current version at 15 USC §§ 18, 21 [2000])

**Change in Bank Control Act**, 12 U.S.C. §1817(j) (2006 & Supp. 2010)

**Clayton Antitrust Act**, 15 U.S.C. §§12-27, 29 U.S.C. §§52-53

**Community Reinvestment Act of 1977**, 12 USC §§2901-08

**Dodd-Frank Act**, Pub. L. No. 111-203; 124 Stat. 1391; codified to 12 USC 5301 note, effective 21 July, 2010

**Federal Home Loan Bank Act**, 47 Stat. 725, 12 USC 1421-1449

**Federal Reserve Act 1913**, 12 USC ch 3

**Garn-St. Germain Depository Institutions Act**, Pub. L. No. 97-320, 96 Stat. 14 (1982) (codified in various sections of 12 U.S.C.)

**Glass-Steagall Act**, 12 USC §§ 24, 78, 377 (repealed 1999)

**Gramm Leach Bliley Act**, Pub. L. No. 106-102 (1999), codified 15 USC §6801 *et seq*

**Home Owners' Loan Act**, 12 USC §1461 *et seq*

**National Bank Act 1864**, 12 Stat. 665

**Riegle-Neal Interstate Banking and Branching Efficiency Act**, PL 103-328, 108 Stat. 2338

**Sherman Antitrust Act**, 15 U.S.C. §§1-7 and amended by the Clayton Act in 1914

**US Constitution**, article VI, clause 2



## **International Provisions**

**Bank for International Settlement**, ‘Report on Consolidation in the Financial Sector’ (January, 2001) *Group of Ten*, available at <http://www.bis.org/publ/gten05.pdf>

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**EU-US Statement of Co-operation** on the Exchange of Information for the Purposes of Consolidated Supervision, 17 September, 1999, available at [http://ec.europa.eu/internal\\_market/bank/docs/archives/eu-us-coop\\_en.pdf](http://ec.europa.eu/internal_market/bank/docs/archives/eu-us-coop_en.pdf)

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**Organization for Economic Co-operation and Development**, ‘Competition and Regulation in Retail Banking: Switching Packs’ (5 June, 2009) Report, DAF/COMP (2006)33/ADD1, available at [http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=DAF/COMP\(2006\)33/ADD1&docLanguage=En](http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=DAF/COMP(2006)33/ADD1&docLanguage=En)

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## APPENDIX 2: TABLE OF ADMINISTRATIVE ACTS

(Notices, Reports, Communications, Guidelines, Orders, Decisions, and Hearings)

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