



THE SENATE

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**COMPETITION IN THE  
PUBLIC INTEREST:  
LARGE BANK MERGERS IN CANADA**

**Report of the Standing Senate  
Committee on Banking, Trade and Commerce**

*Chair*

*The Honourable E. Leo Kolber*

*Deputy Chair*

*The Honourable David Tkachuk*

*December 2002*

Ce rapport est aussi disponible en français

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# Competition In The Public Interest: Large Bank Mergers In Canada

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# Membership

The Honourable E. Leo Kolber, *Chair*

The Honourable David Tkachuk, *Deputy Chair*

and

The Honourable Senators:

Angus	*Lynch-Staunton (or Kinsella)
*Carstairs, P.C. (or Robichaud, P.C.)	Meighen
Fitzpatrick	Oliver
Hervieux-Payette, P.C.	Poulin
Kelleher, P.C.	Prud'homme, P.C.
Kroft	Setlakwe

*\*Ex Officio Members*

*Note:* The Honourable Senators Banks, Cook, Day, Fraser, Hubley, Mahovlich and Stollery were members of the Committee at various stages during the course of this study.

*Staff from the Parliamentary Research Branch, Library of Parliament:*

Ms. June Dewetering, Acting Principal

*Staff from the Committees and Private Legislation Directorate:*

Denis Robert, Clerk of the Committee



## Order of reference

Extract from the *Journals of the Senate* of November 6, 2002:

*“Resuming debate on the motion of the Honourable Senator Kolber, seconded by the Honourable Senator Mahen:*

*That the Standing Senate Committee on Banking, Trade and Commerce be authorized to study the public interest implications for large bank mergers on:*

- Access for Canadians throughout the country to convenient and quality financial services;*
- The availability of financing for individuals and businesses, particularly small and mid-sized businesses;*
- The Canadian economy and the ability of Canadian business to compete internationally;*
- Communities and bank employees; and*
- Any other related issues;*

*That the Committee be empowered to permit coverage by electronic media of its public proceedings with the least possible disruption of its hearings; and*

*That the Committee submit its final report no later than March 31, 2003.*

*The question being put on the motion, it was adopted.”*

*Paul Bélisle  
Clerk of the Senate*





## Recommendations

The Minister of Finance, in determining the public interest, consider first the likely effect of a proposed merger by large banks on the prosperity and competitiveness of the national economy. Moreover, the Minister should contemplate the increased choice of competitively priced financial services for all Canadians in every region of the country and for Canadian businesses, particularly small and medium-sized enterprises, that could ultimately result from such a merger. (page 3)

Recognizing any terms and conditions that may be required by the Minister of Finance, the Minister permit, as being in the public interest, a merger that has been approved by – and meets conditions set out by – the Competition Bureau and the Office of the Superintendent of Financial Institutions, unless there are compelling reasons to believe otherwise. If a merger is denied, the Minister should make a statement to Parliament at the earliest opportunity to clarify the reasons for the denial. (page 4)

The Competition Bureau make specific recommendations about the branches of merging banks that should be divested, with a view to ensuring that the branches to be divested will foster the growth of existing and new competitors. (page 6)

The federal government undertake a review of barriers to entry into the financial services sector for both domestic and international competitors and take other actions – including tax changes – that would foster competition. A report on the actions to be taken by the government to promote competition should be tabled in Parliament no later than 30 June 2003. (page 7)

The federal government review the three-step review process applied to large bank mergers in Canada in order to ensure that the process is conducted with a minimum of duplication and as expeditiously as possible. (page 8)

The federal government immediately examine the bank merger review process in other countries and – if needed – introduce legislation to ensure consistency among the merger review process for large banks in Canada and the processes in other industrialized countries. Legislative change should occur no later than 30 June 2003. (page 9)

The federal government require that the banks which are party to a merger proposal undertake a risk analysis of the proposal and indicate the manner in which they plan to manage any risks. (page 9)

Parliamentary committee review of specific bank merger proposals no longer be required, since stakeholders will have clarity and assurance with respect to the competition, prudential and public interest issues related to large bank mergers. (page 10)

# Competition In The Public Interest: Large Bank Mergers In Canada

## Introduction

On 24 October 2002, the Honourable John Manley and the Honourable Maurizio Bevilacqua asked the Standing Senate Committee on Banking, Trade and Commerce to conduct public hearings into the broad public interest issues that are raised by bank merger proposals, including major considerations that should apply in determining the public interest (Appendix 1). While it was indicated that the Secretary of State would be available to work with us during the course of our deliberations, we invited him to appear and he declined. Consequently, we conducted our hearings without either the Minister or the Secretary of State addressing the Committee on the issue of large bank mergers.

The 2001 changes to the *Bank Act* as a result of Bill C-8 set out the review process for mergers between large banks in Canada (Appendix 3). The Committee is of the view that the law makes clear that a proposed bank merger may be in the public interest in the right circumstances. We believe that the fact that the *Bank Act* establishes a process for mergers creates the obvious implication that this is so. We also feel that the requirements of the existing Public Interest Impact Assessment are well defined, having been explicitly stated in our earlier report, *A Blueprint for Change*, and in the *Report of the Task Force on the Future of the Canadian Financial Services Sector*. Therefore, we believe that the Minister of Finance must clarify, at the earliest opportunity, whether a bank merger that has been approved by the Competition Bureau and the Office of the Superintendent of Financial Institutions (OSFI) will be viewed as being in the public interest.

The Committee has already made recommendations about the merger review process for large banks in the course of our legislative and other duties. Consequently, we have already expressed some of our ideas about the steps in the process, the discretion to be exercised by the Minister and the role to be played by Parliamentary committees. In our response to the *Report of the Task Force on the Future of the Canadian Financial Services Sector* in 1998, we concluded that, in order to avoid unnecessary politicization of the stewardship review process, any public hearing process adopted should involve hearings undertaken by Finance Canada officials following the work done by the Competition Bureau and the OSFI. In that event, the decision about whether to approve the merger would be made by the Minister of Finance following the completion of the public review process.

Moreover, in the Committee's report on Bill C-8 in 2001, a minority of us indicated that the Minister of Finance's discretion should be removed from the merger process as a means of removing politics from the process. Instead, the process – as set out in the guidelines – should take place, with proper analysis by the bodies responsible. The minority also expressed the view that if Ministerial discretion were removed from the process, the merger should not be laid before either House of Parliament.

This report summarizes the testimony received by the Committee (Appendix 2), and provides our thoughts and recommendations about the “public interest” – or what prior reports by this Committee have referred to as “stewardship issues” – in the context of large bank mergers.

# The Effect of a Merger on the National Economy and Consumers of Financial Services

*In addition to (the banks) generating billions of dollars in tax revenues, individuals benefit from holding bank stocks. Bank stocks are widely held, but the holdings are indirect, the majority of bank shares being held by institutions. The two most prominent institutions are mutual funds and pension funds, both of which involve a large proportion of the Canadian public. (Dr. James McIntosh)*

In seeking to determine the “public interest” considerations of a proposed large bank merger, the Committee is convinced that the paramount consideration should be the prosperity and competitiveness of the national economy. We hold this view not only with respect to the financial services sector, but with respect to other sectors as well. We believe that a prosperous banking sector also benefits other sectors of the economy. Canadian businesses of all sizes are well served by banks that can grow and support their activities both domestically and abroad. As well, Canadians benefit financially, since a majority – either directly or indirectly – are shareholders of Canadian banks, and the large banks employed 226,094 Canadians in 2001; they are also significant taxpayers. From this perspective, the Committee recommends that:

**The Minister of Finance, in determining the public interest, consider first the likely effect of a proposed merger by large banks on the prosperity and competitiveness of the national economy. Moreover, the Minister should contemplate the increased choice of competitively priced financial services for all Canadians in every region of the country and for Canadian businesses, particularly small and medium-sized enterprises, that could ultimately result from such a merger.**

## Approval by the Competition Bureau and the Office of the Superintendent of Financial Institutions

*We applaud the existence of (the guidelines of the Department of Finance and the Competition Bureau) and we think they need to be reinforced, ... . The guidelines are good because they identify the important public interest considerations that affect consumers ... . (Public Interest Advocacy Centre)*

The Committee recognizes that there is a public interest consideration concerning large bank mergers. Nevertheless, once the Competition Bureau and the OSFI have completed their comprehensive reviews of a merger proposal and the parties to the merger have agreed to the commitments and undertakings required, there should be few remaining considerations related to the public interest. As a result, in the absence of compelling circumstances to the contrary, the Minister of Finance should approve the proposed merger as being in the public interest. For this reason, the Committee recommends that:

**Recognizing any terms and conditions that may be required by the Minister of Finance, the Minister permit, as being in the public interest, a merger that has been approved by – and meets conditions set out by – the Competition Bureau and the Office of the Superintendent of Financial Institutions, unless there are compelling reasons to believe otherwise. If a merger is denied, the Minister should make a statement to Parliament at the earliest opportunity to clarify the reasons for the denial.**

## Commitments and Undertakings by Merging Banks

*There is (an ongoing appetite in the credit union movement for the acquisition of viable branches). There are more bank branches in our country per population than anywhere. We have enjoyed a few good opportunities here in Canada to take advantage of the strength of the major banks by forming networks that are now cooperatively owned. (CS CO-OP)*

The Committee fully supports mergers as a legitimate business strategy. Although there may be some loss of access to financial services, the evidence presented to us shows that branch closures are occurring even in the absence of mergers between large banks in Canada. We believe that the effects can be mitigated through increased choice among financial service providers that is likely to result with healthy competition in the sector, as well as through undertakings and commitments required by the Competition Bureau and the OSFI.

In reality, properly regulated mergers can enhance competition. Existing market participants will grow, new competitors will emerge – including foreign and small Canadian banks, co-operatives and credit unions, and mono-line service providers – and the Canadian economy should prosper. These financial institutions will be able to fill any void created as a consequence of undertakings and commitments required by the Competition Bureau and the OSFI. Mergers must be seen as a business strategy that will contribute to growth and prosperity for Canada, which is clearly a key public interest consideration. Moreover, growth by large banks in Canada should make it easier for them to continue to provide access to all Canadians in all regions and to meet the needs of our businesses, particularly those of small and medium size. The federal government, however, must continue to ensure the correct policy, legislative and regulatory environments.

In the Committee's view, once the Competition Bureau and the OSFI have conducted their reviews and any necessary remedies have been determined, there will be an environment within which competition will ensure that all Canadians and Canadian businesses have access to a number of financial service providers giving convenient and quality financial services of all types.

The Committee shares a concern about the manner in which branch divestitures occur. There is the danger, for example, that should inadequate direction be given, a merged bank that is required to divest branches would choose to divest those that are the least advantageous, which would make it more difficult for existing and new competitors to grow and prosper. When divestiture occurs, the branches to



be divested should be distributed in such a way that they form a market that would facilitate this growth. Thus, the Committee recommends that:

**The Competition Bureau make specific recommendations about the branches of merging banks that should be divested, with a view to ensuring that the branches to be divested will foster the growth of existing and new competitors.**

## Promoting Competition in the Financial Services Sector

*(The public interest) should mean ... that there is enough competition in place to service the Canadian clients. ... What is the public interest? It is being served properly and having choices. (National Bank of Canada)*

Our banks must be provided with the instruments they need to be effective and internationally competitive. A merger is one instrument that can be used to achieve this end. As noted earlier, the federal government must ensure the existence of the proper policy, legislative and regulatory environments. Moreover, the Committee continues to believe that the federal government should promote a competitive environment by eliminating capital taxes, which are a barrier to new entrants. This change would ease the burden on new market entrants and enhance the competitiveness of existing financial institutions. Consequently, the Committee recommends that:

**The federal government undertake a review of barriers to entry into the financial services sector for both domestic and international competitors and take other actions – including tax changes – that would foster competition. A report on the actions to be taken by the government to promote competition should be tabled in Parliament no later than 30 June 2003.**

# The Current Merger Review Process for Large Banks

*If the merger process does not allow a Canadian bank to try to be a major player, that would be wrong. The Canadian banks have worthy aspirations. (HSBC Bank of Canada)*

There is still some question about how mergers should be reviewed in the event that a number of large banks wish to merge, and about the order in which the steps of the large bank merger review process should occur.

On the first issue, it is unclear to the Committee how the review process should proceed in the event that, after a particular proposal is made public, other large banks also indicate a desire to merge. We also wonder whether there should be limits placed on the number of large banks that may be a party to any particular merger proposal. For example, while a merger by two banks that would reduce the number of large banks in Canada to four might be acceptable given appropriate circumstances, and a merger that would reduce the number to three may be satisfactory, it could be the case that mergers resulting in a duopoly in Canada among large banks would be insupportable.

Regarding the second issue, the Committee is mindful that there may be very few public interest issues unresolved following the completion of the reviews by the Competition Bureau and the OSFI. We are concerned that analysis done by the various entities should be complementary, and should not be duplicated. Therefore, the Committee recommends that:

**The federal government review the three-step review process applied to large bank mergers in Canada in order to ensure that the process is conducted with a minimum of duplication and as expeditiously as possible.**

The place of Canada in the international marketplace is important. As trade barriers continue to fall and as the number of trade agreements continues to expand, the Committee believes that Canada must be a leader, and leadership should begin with – but not be limited to – the North American Free Trade Agreement (NAFTA) context. Global competition is a reality, and we feel that the federal government should do what it can to ensure the competitiveness of Canadian businesses. One element of this is the process by which mergers are approved in this country. We share the belief that the merger process in Canada should be consistent with that in other countries, and from this perspective recommend that:

**The federal government immediately examine the bank merger review process in other countries and – if needed – introduce legislation to ensure consistency among the merger review process for large banks in Canada and the processes in other industrialized countries. Legislative change should occur no later than 30 June 2003.**

Finally, while the Committee is reasonably confident that mergers by large banks would be successful, and would contribute to the prosperity of the national economy, it is possible that – for a variety of reasons – the result of the merger would not be as intended. We support the Public Interest Impact Assessment that is currently required, but feel that it should go further. In particular, we believe that the parties to a merger proposal should be required to include a risk analysis, with an indication of how they plan to manage any risks inherent in their plan. Thus, we recommend that:

**The federal government require that the banks which are party to a merger proposal undertake a risk analysis of the proposal and indicate the manner in which they plan to manage any risks.**

## The Role of Parliament in the Large Bank Merger Review Process

*(Whether the government is politically in favour of mergers or not) is the essence. We have confused the public interest review with the requirement. ... The population deserves to know where the Government of Canada stands on the issue (of bank mergers). (TD Bank Financial Group)*

The Committee believes that there are public interest issues concerning bank mergers and that the Minister of Finance has a role to play in assessing the public interest aspect of any specific merger proposal. Once the Competition Bureau and the OSFI have completed their reviews and the parties to the merger have agreed to the commitments and undertakings required, there should be few remaining issues related to the public interest. Consequently, the Minister of Finance's scope in assessing residual public interest concerns should be very narrow. As stated in our second recommendation, in the absence of compelling circumstances to the contrary and assuming that a merger has been approved by the Competition Bureau and the OSFI, the Minister of Finance should assume that a proposed merger by large banks in Canada is in the public interest, and approve it as quickly as possible.

The Committee feels that beyond our current study and the forthcoming study by the House of Commons Standing Committee on Finance, no further useful role would be served by requiring Parliamentary committees to undertake an analysis of the public interest issues related to a specific bank merger proposal. For this reason, the Committee recommends that:

**Parliamentary committee review of specific bank merger proposals no longer be required, since stakeholders will have clarity and assurance with respect to the competition, prudential and public interest issues related to large bank mergers.**

## In Conclusion

The Committee is of the opinion that bank mergers are a valid business strategy, and that they would contribute to Canadian growth and prosperity. We also believe that the Public Interest Impact Assessment, as well as the reviews by the Office of the Superintendent of Financial Institutions and, more particularly, the Competition Bureau – along with any needed undertakings and commitments – will ensure the competition in the financial services sector that is needed to protect the public interest. Canadian banks are strong now. They could be stronger in the North American marketplace and in world markets, provided that they are allowed to pursue appropriate business strategies while safeguarding the public interest.

## Appendix 1:

### Letter from the Minister of Finance and the Secretary of State (International Financial Institutions)

October 24, 2002

Ms. Sue Barnes, M.P.  
Chair, Standing Committee on Finance  
House of Commons  
Ottawa, Ontario  
K1A 0A6

The Honourable Leo Kolber  
Chairman  
Standing Senate Committee on  
Banking, Trade and Commerce  
The Senate of Canada  
Ottawa, Ontario  
K1A 0A4

Dear Ms. Barnes and Senator Kolber:

As you are aware, when the Government introduced legislation on February 7, 2001, to establish the new framework for the financial sector in Canada, it issued guidelines governing the review process for mergers among banks with more than \$5 billion in equity. That process includes three parts. The Competition Bureau reviews competition issues, the Office of the Superintendent of Financial Institutions reviews prudential issues and the Government assesses public interest issues. In this latter regard, the House of Commons Standing Committee on Finance and the Standing Senate Committee on Banking, Trade and Commerce would be asked to conduct public hearings into the broad public interest issues that are raised by a specific merger proposal.

Since the release of these guidelines, some stakeholders have stated that the public interest tests associated with a bank merger review need greater clarity. The Government agrees, and in this regard it would be most helpful if your committees would provide us with views on the major considerations that should apply in determining the public interest.

In providing your advice, you may wish to consider the public interest implications of large bank mergers for:

- the access of Canadians in all regions to convenient and quality financial services, giving special attention to the disabled, low-income individuals and rural communities;
- the choice among financial service providers and the availability of financing for businesses, especially small businesses, and Canadians;
- the creation of long-term growth prospects for Canada through more effective Canadian-based internationally competitive institutions; and
- any adjustment or transition issues, including the treatment of employees.

The Secretary of State (International Financial Institutions) would be pleased to work with you during the course of your deliberations. It would be appreciated if you could provide your advice at your earliest convenience.

Yours sincerely,

The Honourable John Manley, P.C., M.P.

The Honourable Maurizio Bevilacqua, P.C., M.P.



## Appendix 2:

### Evidence about the Public Interest

A relatively consistent view expressed by the Committee's witnesses focussed not on the "public interest" *per se*, but rather on the uncertainty that currently exists in Canada about the possibility of large bank mergers. They told us that while legislation unambiguously supports the legitimacy of mergers within this country, it is far from clear that the political will exists to allow bank mergers at this time.

In particular, while sufficient clarity exists about the roles to be played – and the criteria to be used – by the Competition Bureau and the Office of the Superintendent of Financial Institutions regarding bank merger proposals, they argued for a clear indication from the federal government about the probability of bank mergers being approved in the near future, and for clear guidelines about the public interest requirements that would have to be met for approval of any particular proposal. In the view of many of the Committee's witnesses, uncertainty is unfair for employees, clients and shareholders, and limits the financial services sector's growth and prosperity. Other witnesses, however, suggested that there is certainty regarding the public interest, although political will seems unclear.

Witnesses commented not only on public interest issues related to bank mergers, but also on competition in the financial services sector as a contributor to the public interest. In their opinion, public interest cannot be divorced from competition issues. The Competition Bureau presented this notion to the Committee when we were told that "the public interest and competition matters are generally complementary with both trying to achieve an efficient market, low prices and high quality service to Canadian consumers." It was re-iterated by the HSBC Bank of Canada, which argued that "(a)s far as public policy issues are concerned, ... it is all about competition, competition, competition."

A number of witnesses commented on the Public Interest Impact Assessment that must be completed by banks involved in a merger proposal. While there was a general consensus among witnesses about the need for a Public Interest Impact Assessment, one witness – Peter Downing – suggested that a Public Accountability Statement should also be required. In his view, the statement should address the question of how the public interest would be better served by the merger under consideration.

## Access by Canadians in all Regions to Convenient and Quality Services

Consumers of financial services told the Committee that access to a range of services and service providers by residents of all regions of Canada should be considered in the context of any particular bank merger proposal. They stressed that convenience, quality and competitive pricing must be safeguarded, and noted that the convenience of electronic banking comes at additional cost and may not completely replace the need for personal interaction.

For example, the Retail Council of Canada informed us that “(r)etailers are regular and heavy users of local banking services. ... They are essential to the day-to-day operation of a retail business ... . In smaller communities the loss of a local branch would force retailers to travel substantial distances for financial services that can only be done face-to-face ... .” The Council also stressed the importance of a local bank presence in the community, and suggested that decisions about loans are increasingly made at the regional level with the result that decisions to lend money fail to reflect an understanding of either local realities or new opportunities. In its view, public consultation should occur not only on any specific merger proposal, but also on such issues as timeliness of financial institutions’ lending decisions, how potential merger participants will structure lending policies, and remedies negotiated by merger participants and the Competition Bureau.

In addressing the issue of access and choice, the RBC Financial Group indicated that all delivery channels and providers must be considered, with an examination of the contributions made by new technology and existing competitors. It informed the Committee that nearly 95% of transactions occur outside the branch network, although 70% of its clients visit a branch at least once every quarter for advice, for complex transactions or for issue resolution.

The particular needs of small and medium-sized businesses were highlighted by the Canadian Federation of Independent Business, which told the Committee that Canada currently has one of the most concentrated banking systems in the world. In its view, with reduced competition for financial services since 1998, the public interest would be best served by a greater degree of competition rather than by more consolidation.

Regarding disabled persons, low-income individuals and branch closures, the TD Bank Financial Group noted the existence of human rights legislation ensuring access to service for people with disabilities, the Memoranda of Understanding between the banks and the federal government regarding service for low-income Canadians, and regulations requiring appropriate notification to customers in circumstances of branch closure, including those that occur in rural communities. Other witnesses pointed out technological improvements in the financial services

sector that assist in meeting the needs of customers who reside in rural communities, who are disadvantaged, or who suffer from a disability. The Public Interest Advocacy Centre, however, noted that banks currently are not meeting the requirements of some consumers, including the need for short-term loans. These consumers are, as a result, turning to higher-cost alternatives. The Centre also noted the cost associated with the use of “white label” ATMs.

The BMO Financial Group commented on the public interest as it relates to rural communities when it told the Committee that “it is in the public interest for merging banks to outline their plans to serve the rural communities they already service individually, and to make a commitment to retain a branch presence in these communities for a reasonable period of time, which ... is about three years. ... (T)he bigger and more robust bank would be better able to maintain rural branches.” It also mentioned the impact of mergers on consumers of financial services, indicating that “it is in the public interest for merging banks to outline the role of personal and small business banking in their business mix and the impact of the merger on availability of credit. ... BMO has every intention of continuing its longstanding commitment to serve Canada’s small business community (and) would be prepared to allocate at least the same proportion of our overall capital to this sector as ... today.”

Finally, the Committee received testimony from Canaccord Capital, Canada’s largest independent, fully integrated investment dealer. The banks compete with independent investment dealers and provide credit to them. Among other recommendations, it suggested that there is a need for a guarantee that the banks will continue to provide credit to the independent investment community, and at competitive rates.

## Choice among Financial Service Providers and the Availability of Financing

Choice among financial service providers is another important consideration in the public interest debate. In the view of the Insurance Bureau of Canada, “(c)ustomer choice is the greatest guarantee of better service and product innovation.” A number of witnesses – including large banks and smaller competitors – indicated that a merger would create opportunities for existing competitors and future new entrants to the sector, particularly if divestiture of branches or business lines were required.

Witnesses made the point that concerns about the lack of choice could be addressed through undertakings and commitments, and through the growth of existing competitors and the emergence of new entrants. Citing credit unions, caisses populaires and such alternatives as PC Financial, HSBC Bank of Canada and Amex, ING Bank of Canada suggested to the Committee that “(o)ne cannot look at the merger of Canadian banks in isolation. There are alternative existing players that will ... step in and service the needs of consumers if the big banks drop services, and as well, there are prospective players who will see an opportunity.” Moreover, Credit Union Central of Ontario told the Committee that the credit union system “is working on a number of initiatives to strengthen the ability of individual credit unions to compete with the big banks.”

A concern was raised, however, about divestiture of branches. In the view of the National Bank of Canada, “(a) divestiture of local networks of service points to individuals and SMEs executed by selling scattered branches of either of the banks is not likely to promote the appearance of a new and credible source of competition nor to arouse serious interest from potential buyers.” It advocated two principles if divestiture is required as a consequence of a merger: for a given territory, divestiture should require the presence of groups of branches and SME loan offices of only one of the two banks, rather than the amalgamation of service points of either of the two banks, which may be the smaller or less profitable; and the territory covered must be relatively large.

Scotiabank informed the Committee that the Canadian financial services sector is experiencing a decrease in liquidity, which has implications for access to credit for large Canadian businesses, as well as for businesses of other sizes and individuals. In its view, “this situation cannot be solved by banning bank mergers, because the problem isn’t about competition among Canadian banks.” A similar point was made by ING Bank of Canada, which told us that the availability of financing is often a function of the market cycle, rather than the number of sources of available financing.

Witnesses also suggested that Canadian banks are currently too small to serve as lead banks in syndicated lending markets, with all large companies served by the “global giants.” A related comment was made by Mr. Joseph Polito, who suggested to the Committee that consortiums should be formed. In his view, “(i)f there were unusually large domestic loans ... financial institutions could parcel out the loan.”

## Long-term Growth Prospects through Effective, Internationally Competitive Institutions

Witnesses supported a strong and competitive financial sector in Canada and noted the importance of the sector to aid economic growth and prosperity in the country and for the success of firms in other sectors. They did, however, disagree about whether mergers are necessary in order to achieve growth. Some witnesses pointed out that mergers often enhance growth when they are successful, but not all mergers have the positive effects envisioned, since they encounter implementation problems, clashes of corporate culture or difficulties in remembering the importance of employees or customers. In their view, a safer strategy might be growing the business without a merger. Dr. Edwin Neave told the Committee that:

*(i)ncreasing concentration implies increasing size and that leads in turn to increasingly challenging management issues. Convergence creates new interdependencies among business units and thus also adds to the difficulty of managing the merged firm. Post-merger, firms can be subject to an increased risk of operating losses as management acquires the new skills needed to govern the new firm. These possibilities increase in importance if the combined firm conducts business in several different countries.*

This view received some support from the Consumers' Association of Canada, which was speaking about mergers generally – rather than bank mergers specifically – when it told the Committee that “(t)he evidence is in: most mergers do not pass the market test. For example, in a review of about a hundred big mergers, a recent *Business Week* analysis shows that 61% of buyers (of companies) destroyed shareholder wealth. ... There is a lot to be said for banks of the current size in Canada, or for a few more participants. Currently the banks offer impressive technological services and they are among the best of corporate participants investing in communities and in Canada's future.”

The argument was also made, however, that merger activity is a legitimate and valid business strategy that should be available to businesses which believe that a merger will enhance opportunities and growth. The Credit Union Central of Canada did not limit its support for mergers to large banks, telling the Committee that it “does not distinguish between mergers involving large institutions or small institutions” with respect to mergers being “a viable business strategy with potentially healthy outcomes ... .” Dr. Wendy Dobson told that Committee that “in the end it is the banks that must compete in the complex international marketplace. It is they, not policy-makers, who should decide their business strategies.”

In the view of many of the Committee's witnesses, size matters in the international financial services environment, and a number mentioned the North American Free Trade Agreement as an important element in the international context. As countries continue to lower trade barriers and negotiate trade agreements, it is important that Canadian banks be strong enough to compete with international banks, both within Canada and worldwide. Canadian "branding" is important, and Dr. Dobson told us that "(l)arge balance sheets are also necessary to build brand. And the well-known brands tend to do business with each other. In the global context, the average asset size of the top ten banks in the world is between three and four times the size of the largest Canadian bank." A number of witnesses noted that the absence of a Canadian bank within the top 50 financial institutions globally is surprising and of concern given our ranking among industrialized nations.

Those who support mergers suggested that increased scale is important for continued growth and prosperity in the financial services sector, both domestically and internationally and particularly in North America. In their view, Canadian consumers of financial services – and Canada more generally – would benefit from this increased scale, as would financial sector employees and shareholders. Dr. James McIntosh made the point that many Canadians would benefit from a prosperous banking sector through their direct or indirect ownership of bank shares.

Witnesses indicated that Canadian banks currently lack scale and capital, with the result that they are becoming less relevant globally. Mergers would allow banks to take advantage of larger scale and scope, with a broader array of products and services, lower unit costs and lower prices to consumers of financial services. Financial strength is seen as critical, since relative size affects investments, acquisitions and growth strategies.

One area in which larger size might be particularly important in the years ahead is with respect to innovation and technology, which are thought to be important for the long-term growth of Canada. From this perspective, it is thought that Canadian banks must continue to have the resources to fund leading-edge developments in this area, with positive effects on the number and quality of jobs in Canada. Similarly, the RBC Financial Group told the Committee that mergers should be examined in terms of their long-term impact on Canada's future prosperity and standard of living, and whether larger, more internationally competitive financial institutions would enhance economic growth. The logical consequence of this strength and growth, according to a number of witnesses, would be the employment of more workers in better jobs.

An argument was also made for a merger review process that is consistent and competitive with that which exists in other countries, and that is characterized by clarity, transparency, predictability and a reasonable timeframe. In the view of some of the Committee's witnesses, as much clarity as possible must be provided in order that banks do not invest the time and money involved in a merger proposal only to find that their efforts are not successful. In fact, the Canadian Imperial Bank of

Commerce told the Committee that it “would not wish to put (its) employees ... (its) customers ... or (its) shareholders through another merger attempt ... unless we can design a process that is timely ... and has reasonably predictable outcomes. Predictability is of paramount importance.”

In the view of the large banks, they must be able to assess realistically the likelihood of success in advance. It was suggested that any discussion of remedies occur in advance of the public interest assessment, since remedies are integral to addressing public interest concerns. The Canadian Imperial Bank of Commerce thought that the review process should be changed so that it takes no more than 100 days. Moreover, the TD Bank Financial Group indicated that, in the event of a merger proposal coming forward, all other interested banks should be considered at the same time.

On the issue of international competitiveness, Scotiabank stated the view held by a number of banks when it said:

*You merge for one reason and one reason only – to increase overall scale – our equity and capital base – to diversify and grow outside Canada, especially in the U.S. and, in Scotiabank’s case, Mexico and elsewhere, including Latin America, the Caribbean and in the Far East. Could we do this without merging? The short answer is yes, but not at the same level, and not as quickly.*



## Transition Issues

A number of witnesses spoke about transition issues in the event of a bank merger, and urged a consideration of both the short-term and long-term implications of mergers, and of the effect on both the number and the quality of jobs in Canada. In addition to job dislocation, service disruption, the effect on communities and head office reductions are also concerns. Some witnesses told the Committee that these adjustments could be managed in the public interest, bearing in mind the long-term benefits of a strengthened financial services sector. As is the case in other industries that suffer job losses, normal job turnover can be used to reduce the impact. Moreover, witnesses provided examples of how branch rationalization has already occurred in Canada, without significant employee or other problems, and mentioned the protections provided by employment standards legislation, which are generally exceeded by the banks.

As mentioned earlier, divestiture of branches – as well as of business lines – by merging banks can create growth opportunities for others. CS CO-OP, for example, informed the Committee that it is “well positioned to obtain additional customers and acquire new assets. ... (T)here may well be some customers of a newly merged bank wanting to move their business to a credit union. ... (C)redit unions offer more personal service at the local community level ... . Opportunities for (credit unions) to acquire branches or other business operations from merging banks might also arise.” As noted earlier, access to local presence was a concern identified by the Retail Council of Canada.

Furthermore, a number of witnesses – including ING Bank of Canada – told us that “Canada ... is over banked. ... (T)here are too many branches, ABMs and staff ... .” From this perspective, branch rationalization and the efficiencies that would occur through a merger could be somewhat beneficial. Moreover, the Canadian Western Bank informed the Committee that, in the event of large bank mergers, small banks should be permitted to fill any void. In its view, in order to fill the void the small banks must be supported, and a way should be found to “convert many of Canada’s larger credit unions into community or regional banks. ... (A) common Federal regulator, standard capital requirements, structure so capital markets can be accessed to add capital and standardize deposit insurance through CDIC (would be needed).”

Scotiabank characterized such issues as access, low cost accounts, rural branches, the branch closure regime, access for persons with disabilities and access through new technologies as “important considerations,” and shared the view that “undertakings and commitments will be able to solve any concerns around these issues – to protect the public interest – by selling branches if local market concentration is too high, by keeping rural branches open where necessary, by

ensuring ongoing service in the poorer areas of cities, by protecting ABM access and so on.”

Finally, the BMO Financial Group also indicated that “it is in the public interest for merging banks to outline how they will make full use of attrition, retraining and redeployment to mitigate job losses in those cases where there is some short-term overlap or duplication; and to specify the number of positions that will be lost in the short term and the principles under which severance packages will be made available to those who are affected.”

## Appendix 3:

# The Merger Review Process for Large Banks in Canada

## The Process

The guidelines governing the review process for mergers by banks with more than \$5 billion in equity provide for a three-part review:

- the Competition Bureau reviews issues related to competition;
- the Office of the Superintendent of Financial Institutions reviews prudential issues; and
- the federal government reviews public interest issues, with the Standing Senate Committee on Banking, Trade and Commerce and the House of Commons Standing Committee on Finance asked to conduct public hearings into the broad public interest issues raised by a specific merger proposal, using the Public Interest Impact Assessment as a key input and with the benefit of input by the Competition Bureau and the Office of the Superintendent of Financial Institutions.

The decision stage of the review is to be completed within five months after receiving a complete application and adequate supporting documentation from the parties to a merger proposal. The decision stage may be followed by a remedies stage, if required.

## Review by the Competition Bureau

In July 1998, the Competition Bureau released its Merger Enforcement Guidelines as Applied to a Bank Merger, also known as the Bank Merger Enforcement Guidelines (BMEGs). As noted by the Bureau at that time,

*(t)he main objective of the merger review process is to maintain and promote competition ... in order to provide consumers with a wide variety of high quality products that are competitively priced. ... (T)he Competition Tribunal may order remedies when a merger prevents or lessens, or is likely to prevent or lessen competition substantially. An efficiency exception to otherwise anti-competitive mergers is provided, however, when there are sufficient cost savings to outweigh the competitive harm likely to arise as a result of the merger and these savings would not be realized without the merger.*

The Competition Bureau pointed out to the Committee that “the analytical framework used in evaluating bank mergers is basically the same as for any other merger review. It is fact based and must take into account the current structure and operations of the parties in question.” Key elements of the analysis are:

- market definition (the product markets and closeness of substitutes as well as geographic markets and customer behaviour);
- market share/concentration factors;
- key competition factors (including barriers to entry, foreign competition, the effectiveness of remaining competition, change and innovation, and removal of a vigorous competitor); and
- efficiencies (which are a possible defence to otherwise anti-competitive mergers but must not be likely obtainable by means other than the merger).

## Review by the Office of the Superintendent of Financial Institutions

Although the Office of the Superintendent of Financial Institutions (OSFI) has not issued guidelines in the same manner as has the Competition Bureau, the report made by the OSFI to former Minister of Finance Paul Martin in 1998 when it considered the prudential aspects of two merger proposals (one from the Royal Bank of Canada and the Bank of Montreal and the second from the Canadian Imperial Bank of Commerce and the Toronto-Dominion Bank) has been made public.

At that time, the OSFI sought to answer two questions in advising the Minister of Finance on these two merger proposals:

- if the merger proposals were to be allowed, would there be circumstances or issues which would be likely to have a material, adverse impact on the financial viability of either merged bank going forward, or would there be other material concerns as to the safety and soundness of either merged bank? and
- if the merger proposals were to be allowed and one of the merged banks were to experience serious financial problems, would the resolution of these problems be more difficult than would be the case if any one of the predecessor banks experienced such problems?

In seeking answers to these questions, the OSFI analyzed the financial condition and risk profile of each of the merging banks, considered literature on mergers, consulted with other regulators, worked with the banks to review and analyze several issues, and sought the views of several banks and federal government agencies.

## An Element of the Public Interest: The Public Interest Impact Assessment

The Public Interest Impact Assessment is to include the following eight elements:

- the business case and objectives of the merger;
- the possible costs and benefits to customers and small and medium-sized businesses, including the impact on branches, availability of financing, price, quality and the availability of services;
- the timing and socio-economic impact of any branch closures or alternative service delivery measures that might mitigate the impact;
- how the proposal would contribute to the international competitiveness of the financial services sector;
- how the proposal would affect direct and indirect employment and the quality of jobs in the sector, distinguishing between transitional and permanent effects;
- how the proposal would increase the banks' ability to develop and adopt new technologies;
- what remedial or mitigating steps in respect of public interest concerns the banks are prepared to take, such as divestitures, service guarantees and other commitments, and what measures to ensure fair treatment of those whose jobs are affected; and
- the impact that the transaction may have on the overall structure of the industry.

Any additional issues required by the Minister of Finance or deemed relevant by the parties might also be included. In essence, the Impact Assessment requires the parties to a merger proposal to explain the rationale for their proposal and the steps that could be taken to reduce any potential costs or concerns. The Committee notes that various elements of the Impact Assessment are expressed in the four areas for exploration presented to us by the Minister of Finance and the Secretary of State (International Financial Institutions).

## Appendix 2:

### Witnesses and Submissions

**Richard Annan**, Major Case Director and Strategic Policy Advisor, Mergers Branch, Competition Bureau (Monday, November 25, 2002)

**Rhoda Attwood**, General Counsel, General Legal Services, Department of Finance (Monday, November 25, 2002)

**Colleen Barnes**, Chief, Competition Issues and Transactions, Financial Institutions Division, Department of Finance (Monday, November 25, 2002)

**Paul Bedbrook**, President and Chief Executive Officer, ING Bank of Canada (Tuesday, November 26, 2002)

**Elisabetta Bigsby**, Senior Executive Vice-President, Human Resources and Public Affairs, RBC Financial Group (Monday, November 25, 2002)

**Gerry Birks**, Senior Competition Law Officer, Mergers Branch, Competition Bureau (Monday, November 25, 2002)

**BMO Financial Group** (Wednesday, November 27, 2002)

- Tony Comper, Chairman and Chief Executive Officer
- Karen Maidment, Executive Vice-President and Chief Financial Officer
- Tim O'Neill, Executive Vice-President and Chief Economist

**Madeleine Brilliant**, Manager, Corporate Growth, CS CO-OP (Tuesday, November 26, 2002)

**Diane J. Brisebois**, President and Chief Executive Officer, Retail Council of Canada (Thursday, November 28, 2002)

**Canaccord Capital** (Wednesday, November 27, 2002)

- Michael G. Greenwood, President and Chief Operating Officer

**Canadian Federation of Independent Business** (Monday, November 25, 2002)

- Garth Whyte, Executive Vice-President
- Brien G. Gray, Senior Vice-President, Field Operations)

**Canadian Imperial Bank of Commerce** (Monday, November 25, 2002)

- John Hunkin, Chairman and Chief Executive Officer

**Canadian Labour Congress** (submission)

**Canadian Western Bank** (Thursday, November 28, 2002)

- Larry M. Pollock, President and Chief Executive Officer (by videoconference from Edmonton)

**Jean-Paul Caron**, Vice-President, General Affairs, National Bank of Canada (Tuesday, November 26, 2002)

**Edmund Clark**, President and Chief Operating Officer, TD Bank Financial Group (Monday, November 25, 2002)

**Tony Comper**, Chairman and Chief Executive Officer, BMO Financial Group (Wednesday, November 27, 2002)

**Competition Bureau** (Monday, November 25, 2002)

- Gaston Jorré, Senior Deputy Commissioner of Competition, Mergers Branch
- Richard Annan, Major Case Director and Strategic Policy Advisor, Mergers Branch
- Gerry Birks, Senior Competition Law Officer, Mergers Branch

**Consumers' Association of Canada** (Thursday, November 28, 2002)

- Robert R. Kerton, Dean, Faculty of Arts, University of Waterloo (by videoconference from Waterloo)

**Credit Union Central of Canada** (Wednesday, December 4, 2002)

- Joanne DeLaurentiis, President and Chief Executive Officer
- David Phillips, Vice-President, General Counsel and Corporate Secretary

**Credit Union Central of Ontario** (Wednesday, December 4, 2002)

- Jonathan Guss, President and Chief Executive Officer

**CS CO-OP** (Tuesday, November 26, 2002)

- Gary Seveny, President and Chief Executive Officer
- José Gallant, Vice-President, Finance and Chief Financial Officer
- Madeleine Brilliant, Manager, Corporate Growth

**Peter W. Currie**, Vice Chairman and Chief Financial Officer, RBC Financial Group (Monday, November 25, 2002)

**Joanne DeLaurentiis**, President and Chief Executive Officer, Credit Union Central of Canada (Wednesday, December 4, 2002)

**Wendy K. Dobson**, Rotman School of Management, University of Toronto (Thursday, November 28, 2002)

**Peter R. Downing**, President, TG International Management Consultants (Thursday, November 28, 2002)



**Department of Finance..**(Monday, November 25, 2002)

- Gerry Salembier, Director, Financial Institutions Division, Financial Sector Policy Branch
- Colleen Barnes, Chief, Competition Issues and Transactions, Financial Institutions Division
- Rhoda Attwood, General Counsel, General Legal Services

**José Gallant**, Vice-President, Finance and Chief Financial Officer, CS CO-OP (Tuesday, November 26, 2002)

**Raymond Garneau** (submission)

**Martin J.G. Glynn**, President and Chief Executive Officer (by videoconference from Vancouver) (Tuesday, November 26, 2002)

**Peter Godsoe**, Chairman and Chief Executive Officer, Scotiabank (Monday, November 25, 2002)

**Brien G. Gray**, Senior Vice-President, Field Operations, Canadian Federation of Independent Business (Monday, November 25, 2002)

**Michael G. Greenwood**, President and Chief Operating Officer, Canaccord Capital (Wednesday, November 27, 2002)

**Jonathan Guss**, President and Chief Executive Officer, Credit Union Central of Ontario (Wednesday, December 4, 2002)

**Robin A. Hamilton Harding** (submission)

**Jean Houde**, Senior Vice-President, Corporate Affairs, National Bank of Canada (Tuesday, November 26, 2002)

**HSBC Bank of Canada** (Tuesday, November 26, 2002)

- Martin J.G. Glynn, President and Chief Executive Officer (by videoconference from Vancouver)

**John Hunkin**, Chairman and Chief Executive Officer, Canadian Imperial Bank of Commerce (Monday, November 25, 2002)

**ING Bank of Canada** (Tuesday, November 26, 2002)

- Paul Bedbrook, President and Chief Executive Officer
- Andrew D. Ross, Director of Communications, ING Direct

**Insurance Bureau of Canada** (submission)

**Interac Association** (submission)

**Gaston Jorré**, Senior Deputy Commissioner of Competition, Mergers Branch, Competition Bureau (Monday, November 25, 2002)

**Robert R. Kerton**, Dean, Faculty of Arts, University of Waterloo, Consumers' Association of Canada (by videoconference from Waterloo) (Thursday, November 28, 2002)

**Sue Lott**, Counsel, Public Interest Advocacy Centre (Tuesday, November 26, 2002)

**Karen Maidment**, Executive Vice-President and Chief Financial Officer, BMO Financial Group (Wednesday, November 27, 2002)

**James McIntosh**, Professor of Economics, Economics Department, Concordia University (Wednesday, November 27, 2002)

**Ken J. Morrison**, Banking and Payments Services Consultant, Retail Council of Canada (Thursday, November 28, 2002)

**Mouvement des caisses Desjardins** (submission)

**National Bank of Canada** (Tuesday, November 26, 2002)

- Réal Raymond, President and Chief Executive Officer
- Jean Houde, Senior Vice-President, Corporate Affairs
- Jean-Paul Caron, Vice-President, General Affairs

**Edwin (Ted) Neave**, Professor of Finance, School of Business, Queen's University (Tuesday, November 26, 2002)

**Gordon M. Nixon**, President and Chief Executive Officer, RBC Financial Group (Monday, November 25, 2002)

**Tim O'Neill**, Executive Vice-President and Chief Economist, BMO Financial Group (Wednesday, November 27, 2002)

**David Phillips**, Vice-President, General Counsel and Corporate Secretary, Credit Union Central of Canada (Wednesday, December 4, 2002)

**Larry M. Pollock**, President and Chief Executive Officer, Canadian Western Bank (by videoconference from Edmonton) (Thursday, November 28, 2002)

**Public Interest Advocacy Centre** (Tuesday, November 26, 2002)

- Sue Lott, Counsel

**Réal Raymond**, President and Chief Executive Officer, National Bank of Canada (Tuesday, November 26, 2002)

**RBC Financial Group** (Monday, November 25, 2002)

- Gordon M. Nixon, President and Chief Executive Officer
- Peter W. Currie, Vice Chairman and Chief Financial Officer
- Elisabetta Bigsby, Senior Executive Vice-President, Human Resources and Public Affairs

**Retail Council of Canada** (Thursday, November 28, 2002)

- Diane J. Brisebois, President and Chief Executive Officer
- Ken J. Morrison, Banking and Payments Services Consultant

**Andrew D. Ross**, Director of Communications, ING Direct, ING Bank of Canada  
(Tuesday, November 26, 2002)

**Gerry Salembier**, Director, Financial Institutions Division, Financial Sector Policy Branch,  
Department of Finance (Monday, November 25, 2002)

**Scotiabank** (Monday, November 25, 2002)

- Peter Godsoe, Chairman and Chief Executive Officer

**Gary Seveny**, President and Chief Executive Officer, CS CO-OP (Tuesday, November 26,  
2002)

**TD Bank Financial Group** (Monday, November 25, 2002)

- Edmund Clark, President and Chief Operating Officer

**TG International Management Consultants** (Thursday, November 28, 2002)

- Peter R. Downing, President

**Garth Whyte**, Executive Vice-President, Canadian Federation of Independent Business  
(Monday, November 25, 2002)

**Tom Wood** (submission)