Testimony of

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Hearing on

"The Effects of Consolidation on the State of Competition

in the Financial Services Industry"

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Mr. Chairman and members of the Committee, Consumers Union(1) appreciates this opportunity to discuss our views and concerns about the recent wave of mergers in the financial services industry, the effects of those mergers on competition, and the impact on consumers. Given the rapid move by banks to merge over the last few years, and most notably in the last two months, Congressional review of the effects of consolidation in the financial services industry is warranted. This hearing is also timely, as H.R. 10, the Financial Services Modernization bill, passed last month, opens the door to new types of mergers. Even without legislation, the Federal Reserve Board is poised to permit Citicorp and Travelers to join, the largest merger on record.

Since the 1980's the U.S. banking industry has experienced extreme consolidation, with the number of banking organizations nationwide declining by more than 40 percent, from about 13,000 in 1988 to 9,000 in 1997. That number is expected to decline even further in the next decade. The decline in the number of banks has been accompanied by a substantial increase in the share of total banking assets controlled by the largest banking organizations. Nearly seventyfive percent of domestic banking assets are held by the 100 largest banks. The top five banks hold twenty-five percent of the assets, and the top ten banks hold thirty-three percent. The new BankAmerica will control 8 percent of all U.S. bank deposits.

Consolidation May Be Unhealthy for Consumers.

Competition should yield many benefits for consumers: lower prices, increased innovation, better service, quality, and variety. But failure to apply and enforce antitrust laws designed to promote competition would be devastating for consumers' pocketbooks. Consumers are already feeling "bounced" by the merger wave:[2]

- Bigger banks charge higher fees[3] and more of them[4]
- Large banks require higher minimum balances to avoid fees[5]
- Customers complain about dwindling services[6]
- The wide array of products and services being offered could lead to confusion for consumers and coercive practices. Consumers' life savings are at risk if they are not informed of the risks of products being sold, misled into believing a product is federally insured, or convinced to buy a product they don't need or can't afford.
- Nationwide consolidation of the banking industry also intensifies the risks borne by deposit insurance and ultimately by U.S. taxpayers, as the merged banks become "too big to fail." (i.e., allowing an enormous bank to fail would "cost" more for the economy than a taxpayer bailout of the bank).

Given consumer concerns about the impact mergers could have on fees, quality of service, and market power, the Federal Reserve Board (which has primary authority over approving mergers involving bank holding companies) should take strong action to ensure the public interest is served by the mergers and the convenience and needs of consumers are met, as required under the Bank Holding Company Act.[7]

Regulatory Interpretation of Antitrust Laws Lenient on Bank Mergers

Application of antitrust laws to bank mergers have been less than effective in addressing competitive and consumer fears. Consumers Union is concerned that overly permissive exceptions to traditional antitrust analysis are leading to a dangerous pattern of banking consolidation that could raise prices for consumers. These exceptions are contained in overly generous merger guidelines, relied on by the Board, and issued by the Justice Department.

The guidelines state that a banking merger resulting in an increase in the market concentration above a certain level (as measured by the Herfindahl-Hirschman Index (HHI)) in a given market may be subject to challenge on antitrust grounds. The levels for banking are more lenient than for other industries to account for competition from nonbank financial service providers, such as finance companies and credit unions. In addition, the Board includes 50 percent of the deposits held by nonbank thrift institutions in a market when making this calculation. Mergers violating these guidelines are frequently approved, often because of the presence of some other factor determined by the regulators, such as potential competition from other types of financial institutions. These tolerances have been criticized as going to far, and thereby potentially underestimating the market power of the merging institutions.[(8)]

The Bank Holding Company Act sets concentration limits for total amount of deposits of insured depository institutions at ten percent nationwide and thirty percent for a state. States are allowed to set limits on the percentage of the total amount of deposits of institutions in the state.[(9)]

A study by Board staff concluded that "it does not appear that the antitrust laws are a significant impediment to consolidation in the banking industry" as currently implemented under the Department of Justice Merger Guidelines.[(10)] In fact, the banking system could theoretically have as few as six banks.[(11)] Yet, antitrust issues, such as market concentration, exercise of market power, and restrictions on entry, with resulting effects on competition, raise significant concerns.[(12)] It is not because there are no antitrust concerns, but because of the way the antitrust laws are interpreted under the Merger Guidelines, that antitrust laws may be less effective when it comes to bank mergers as opposed to other industries.[(13)]

The Merger Guidelines allow predicted efficiencies to be balanced against the anticompetitive effects of a merger. Yet, there is mixed evidence that any efficiencies exist at all.[(14)] Even where there is risk of monopoly, the Justice Department=s guidelines permit mergers that could have operating efficiencies. If, as the studies show, efficiencies do not exist, allowing a merger between two competitors to move forward may lead to a loss of competition. If efficiencies do not exist, there may be pressure from shareholders to make up for losses, resulting in higher fees charged to consumers. On the other hand, if efficiencies do exist, consumers should receive some significant benefit from the cost savings.[(15)]

One way to address the concern about inadequate antitrust enforcement is to reassess how mergers are analyzed. For example, perhaps the Board should be exploring why, instead of merging, these already large banks are not competing. Would the marketplace be better served if the merging firm entered by internal expansion or by a "toehold" acquisition of a small existing competitor in that market? An acquisition by the probable entrant of a leading firm in the market would diminish the chance of a future entry that might increase competition in the market. In the current merger climate, analysis of potential competition should be given greater weight in antitrust review.[(16)]

Consumers Can Be Harmed by Increasing Market Power.

The ability of firms to exercise market power by setting inflated prices harms consumers. Many banking markets are already highly concentrated, including both metropolitan and rural markets.[(17)]

A recent study examined the price effects of bank mergers that substantially increased local market concentration found that deposit rates declined after the merger by local market rivals.[(18)] The study concluded that there was evidence that these mergers led to increased market power.

There is also some research which suggests that there are barriers to entry in retail banking markets. That research also found that any possible public benefit from bank mergers in the aggregate may be offset by adverse effects on competition.[(19)]

Congress has Given the Board a Mandate to Act in the Public Interest and Ensure Mergers Meet the Convenience and Needs of Consumers.

In analyzing the competitive aspect of a merger, the Board is to consider the effect on the public interest. A merger is not to be approved unless the agency "finds that the anti-competitive effects of the proposed transaction are clearly outweighed in the public interest by the probable effect of the transaction in meeting the convenience and needs of the community to be served."[(20)]

The legislative history of the Act is clear in showing that Congress gave specific and unique authority to the Board "to measure whether each application should be granted or denied in the public interest"[(21)] Moreover, Congress specifically noted that:

The factors required to be taken into consideration by the Federal Reserve Board under this bill also require contemplation of the prevention of undue concentration of control in the banking field to the detriment of public interest and the encouragement of competition in banking. It is the lack of any effective requirement of this nature in present Federal laws which has led your committee to the conviction that legislation such as that contained in this bill is needed.[(22)]

The Board should reassert its role in rejecting mergers that are not in the public interest and that fail to meet the convenience and needs of the community. At a minimum, the Board can ensure that merging banks:

- o Meet the Financial Needs of Consumers and Communities: The Board must assess how merging banks serve the communities in which they operate or sell products. Greater commitment to communities should be a condition of any approval.

- o **Provide Affordable Bank Services:** Despite record profits in the banking industry, nearing $60 billion last year, banks continue to charge higher fees. Banks should be required to provide low-cost basic banking to all their customers throughout the country.

- o **Protect against abusive and deceptive sales practices:** While "one-stop shopping" and cross-selling are touted as the answer to consumers' financial needs, consumers may be in danger of being misled and deceived into losing their life savings or pressured into buying overpriced products they do not need or want. To help ensure consumers derive benefit from one-stop shopping, companies should be required to comply with a package of consumer protections, including: protections against confusion over products; privacy protections; suitability standards; protections against high pressure sales tactics; and a redress mechanism for people to recover losses.

- o **Pass on Cost Savings to Consumers:** A share of the cost savings generated through any of the touted efficiencies should be passed on to consumers through lower fees or at least a moratorium on increasing fees charged by banks.

- o **Investing in Communities:** Merging banks should help meet the financial services needs of communities. The bank affiliates should make Community Reinvestment Act (CRA) commitments involving specific programs and dollar goals to the communities. Just as banks must comply with the CRA, the insurance and securities business should be responsible to the communities in which they operate.

Other Issues:

FTC Jurisdiction: H.R. 10 retained most of the existing structure related to the antitrust review of bank mergers. The bill clarifies that the Federal Trade Commission (FTC) has jurisdiction over bank and nonbank mergers. Bank regulators are required to notify and share data on mergers involving nonbank activities.[(23)] The FTC should have this authority to assess, investigate and take action when there are unfair and deceptive practices in any affiliate. As banks consolidate with other financial services entities the risk for consumers from anti-competitive practices is great. This is important because the FTC has the authority to address "anti-competitive" practices harmful to consumers that may not otherwise be covered by antitrust laws.

Ensure Competition and Access for All Bank Services: The Department of Justice is investigating certain exclusionary practices that involve the credit card industry. Rules imposed by VISA and MasterCard on financial institutions that limit their ability to issue other cards may create serious barriers to competition and cause harm to consumers.[(24)] Congress should ensure that mergers involving major banks such as Citicorp, or BancOne, major issuers of VISA and MasterCard, in no way harms the expansion of competition in the credit card business. Concerns have also been raised about the effect of the mergers on the control of the ATM network.

Too Big To Fail: Regulators have indicated that they would take extraordinary steps in response to the failure of a very large bank, including full protection for uninsured depositors, creditors, and suppliers of funds to the bank's holding company, even shareholders, without regard to the cost to the FDIC. This practice became known as "too-big-to-fail." There is a fear that the large institutions created by these mergers will exacerbate the "too big to fail" doctrine, should one of the merged companies fail, prompting a bailout.[(25)] Additionally, there is concern that too much government protection encourages banks to shift funds into riskier practices.[(26)]

Banking and Commerce: Permitting banking and industrial firms to merge could lead to a huge concentration of economic power. Rather than promoting increased competition, this would allow consolidation across markets. Such economic consolidation is likely to lead to inflated prices and diminished innovation. Concentration of economic power could have a disastrous impact on the economy if decisions affecting banks were made by a few commercial entities or if the financial condition of those entities weakened. Many argue that the "basket approach" will prevent excessive concentration of economic power.

Mixing banking and commerce also give banks that extend credit an incentive to make credit decisions based on what is good for affiliated businesses rather than what is creditworthy. Banks could deny credit to competitor of their commercial entities, hoping to gain an advantage in the market. For consumers and small businesses, this may make it difficult for them to get loans if they are not part of the bank's overall business strategy. Moreover, consumers may feel the effects when businesses in their areas close and concentration of ownership increases, forcing consumers to pay higher prices or limiting consumer choice in the marketplace.

Conclusion

The rapid changes and ongoing consolidation in the financial services industry gives cause for concern if banking regulators fail to adequately assess the effect that consolidation will have on consumers. Failure to fully assess how a merger impacts competition may allow firms to gain market power. Congress should ensure, in the face of the changing financial marketplace, that consumers are protected.

1. Consumers Union is a nonprofit membership organization chartered in 1936 under the laws of the State of New York to provide consumers with information, education and counsel about goods, services, health, and personal finance; and to initiate and cooperate with individual and group efforts to maintain and enhance the quality of life for consumers. Consumers Union's income is solely derived form the sale of Consumer Reports, its other publications and form noncommercial contributions, grants and fees. In addition to reports on Consumers Union's own product testing, Consumer Reports, with approximately 4.5 million paid circulation, regularly carries articles on health, product safety, marketplace economics and legislative, judicial and regulatory actions which affect consumer welfare. Consumers Union's publications carry no advertising and receive no commercial support.

2. "Customers Say Bank Mergers Deal Them Out," Washington Post, pg. A 1, April 19, 1998.

3. Big Banks, Bigger Fees: 1997 PIRG Bank Fee Survey, USPIRG, July 1997.

4. "How Good is Your Bank," Consumer Reports, March 1996.

5. "Fees for Checking Accounts Vary Widely," NY Times, December 25, 1997.

6. "Will Deals Deliver Better Services," WSJ, April 14, 1998.

7. Section 3(c)(1)(B)(C) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841 et seq.)

8. Thomas G. Krattenmaker & Robert Pitofsky, *Antitrust Merger Policy and the Reagan Administration,* 33 Antitrust Bull. 211 (1988).

9. Section 3(d)(2) of the Bank Holding Company Act.

10. Stephen Rhoades, *Consolidation of the Banking Industry and the Merger Guidelines*, 37 Antitrust Bulletin 689 (1992).

11. Rhoades, *Consolidation of the Banking Industry and the Merger Guidelines*, 37 Antitrust Bulletin 689 (1992).

12. Steven Rhoades, *Have Barriers to Entry in Retail Commercial Banking Disappeared?,* 43 Antitrust Bulletin 997 (1997).

13. The Merger Guidelines have been described as "astonishingly cavalier" in their disregard for the legislative purposes underlying Section 7 of the Clayton Act. For example, they fail to consider as a factor working against a merger whether it would occur in a market that has recently experienced a trend toward increased concentration. The legislative history behind Section 7 leaves no doubt that Congress meant to apply harsher merger standards to such industries. Thomas G. Krattenmaker & Robert Pitofsky, *Antitrust Merger Policy and the Reagan Administration*, 33 Antitrust Bull. 211 (1988), citing Derek Bok, *Section 7 of the Clayton Act and the Merging of Law and Economics*, 74 Harv. L. Rev. 226 (1960).

14. Governor Laurence Meyer, of the Federal Reserve Board, testified that Board staff recently examined nine bank mergers that seemed most likely to yield efficiency gains, but only found efficiency gains in four. Furthermore, even Governor Meyer admits that evidence on the relative efficiency of mergers is mixed. See, Testimony of Governor Laurence Meyer before the Committee on Banking and Financial Services, U.S. House of Representatives, April 29, 1998.

15. Joseph Brodley, *Proof of Efficiencies in Mergers and Joint Ventures*, 64 Antitrust L.J. 575 (1996).

16. Joseph Brodley, *Limiting Conglomerate Mergers: the Need for Legislation*, 40 Ohio St.L.J. 867 (1979).

17. Steven Rhoades, *Competition and Bank Mergers: Directions for Analysis from Available Evidence*, 41 Antitrust Bulletin 339 (1996).

18. Prager & Hannan, *Do Substantial Horizontal Mergers Generate Significant Price Effects? Evidence from the Banking Industry*, Journal of Industrial Economics (forthcoming).

19. Steven Rhoades, *Have Barriers to Entry in Retail Commercial Banking Disappeared?*, 43 Antitrust Bulletin 997 (1997).

20. Section 3(c)(1) of the Bank Holding Company Act.

21. S.Rep. 1095, 84th Cong. 1st Sess., on the Bank Holding Company Act of 1956 (July 25, 1955).

22. S.Rep. 1095, 84th Cong. 1st Sess., on the Bank Holding Company Act of 1956 (July 25, 1955).

23. Section 141, amending Section 11(b)(1) of the Bank Holding Company Act of 1956, 12 U.S.C. 1849(b)(1).

24. See, March 18, 1997 letter from Consumers Union and Consumer Federation of America to Attorney General Janet Reno.

25. See, Fixing FDICIA: A Plan to Address the Too-Big-To-Fail Problem, Federal Reserve Bank of Minneapolis (1997).

26. This is of particular concern as banks and other institutions target the “subprime” market with offers of easy credit and a multitude of credit card solicitations. At the same time, those same institutions are seeking to keep families facing financial crisis from declaring bankruptcy.