Bank Mergers and the Public Interest

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Executive Summary

This report looks at the rules and legislation that govern mergers of large Canadian banks from the consumer point of view and assesses how large bank mergers would likely affect consumers in relation to issues of access, choice and price of banking services. Large bank mergers are permitted in Canada, subject to a series of reviews, with final approval by the Minister of Finance, but none have been approved in recent years.

This report was prompted by a public review, initiated in 2002 by the federal government, of some of the policies that govern bank mergers. The purpose of the review was to look at the public interest implications of large bank mergers and determine what public interest considerations should be taken into account by the Minister of Finance in making a decision concerning a bank merger proposal. Despite the subject matter of this consultation there was minimal representation from the general public or consumers to the legislative committees that were tasked with this matter in contrast to significant representation and input by banks.

The report outlines briefly the current rules and policies that govern large bank mergers. It then looks at why two large bank mergers were turned down in 1998 and whether the reasons given had changed by 2002. It looks briefly at bank merger experiences in other jurisdictions, outlines what the current financial services environment looks like for consumers, and then assesses how mergers might affect public interest issues of choice, access, and price in this context.

The report concludes that there is no persuasive evidence that consumer choice and access to banking services will be enhanced by large bank mergers and no evidence that the cost of banking services will be reduced under a bank merger. The dominance of Canada's major banks makes successful new entry of foreign banks or other domestic entities very difficult. The proposal that physical branches can be replaced by electronic banking does not begin to meet the range of banking needs of Canadians and small business. The reliance on electronic banking also exacerbates age and income divides. There is also no guarantee that banking costs will not increase with increased reliance on ATMs resulting from a bank merger.

The report also strongly supports the existence of public interest guidelines governing bank mergers and a public review process of individual merger applications by the legislative committees of the House of Commons and Senate.

Recommendations

With respect to the Finance Department Merger Review Guidelines:

- The reference in Bullet 3 of the Public Interest Impact Assessment to “the timing and socio-economic impact of branch closures” should be eliminated.

- Reference in Bullet 3 of the Public Interest Impact Assessment to alternative service delivery measures should restated to require applicants to demonstrate how alternative service delivery measures will be an acceptable replacement for branches and at no greater cost to consumers.

- Under Bullet 7 with reference to divestitures of bank branches, the provision should be amended to say that where federal consumer protection legislation is now applicable to Canadian deposit taking institutions, undertakings will be made with entities to which any branches have been divested to ensure that these provisions continue to apply as a condition of any contractual agreement.

With respect to the Competition Bureau’s merger enforcement guidelines and the *Competition Act*:

- The sections of the *Competition Act* that govern the Competition Bureau’s merger review process, specifically section 93, should be amended to make reference to the extent to which the proposed merger would ‘provide consumers with competitive prices and product choices.”

- The interpretation given to the term “public interest” by the guidelines is misleading. The fourth paragraph of Annex I to *The Merger Enforcement Guidelines as Applied to a Bank Merger* implies that the public interest is concerned only with the interests of the financial system. This paragraph should be eliminated.

Recommendations concerning choice, access and price of banking services:

- Reverse the trend of bank branch closures

- Remove legislative impediments to allow for a federally regulated national cooperative banking structure

- Banks be required, as a condition of any divestiture of bank branches under a merger, to enter into negotiations with credit unions to be prospective buyers of divested branches.

- Banks should reduce hold periods on cheques and offer lines of credit and overdraft protection to more customers.

- The Federal Department of Finance needs to devote research to understand why a growing sector of bank customers are turning to alternative financial services

- Banks need to provide more transparency about service fees and charges and substantive analysis as to how they can be justified as banks move to less costly electronic platforms.

"You merge for only one reason, in my view. There is one overwhelming reason that can be given to the Canadian people, which is the overall scale of our equity base. Why do you need the size? It is to grow and expand outside of Canada faster." *- Evidence of Peter Godsoe, CEO of the Bank of Nova Scotia, before the Standing Senate Committee on Banking, Trade and Commerce, November 25th, 2002*

"Bank mergers are about raising prices and reducing service to the public and concentrating economic power in the hands of the few." *- Evidence of Douglas Peters, former chief economist, Toronto-Dominion Bank, before the Standing Committee on Finance, February 4th, 2003*

Introduction

The possible merger of large banks has been an issue on the banking industry's agenda, following two failed attempts to merge by four of Canada's major banks in 1998. However, it has never been an issue that the general public has supported. Surveys have consistently shown that Canadians are very wary of the prospect of large bank mergers. Recently, the federal government has allowed the issue to be put back onto the public stage. It announced a public review, in 2002, of the public interest considerations that should by taken into account concerning a specific bank merger proposal. This review is to culminate in a further modification of those policies.[1]

The potential merger of two (or more) major banks in Canada would have significant and lasting effects on retail banking and therefore is an important issue for consumers. Consumers and organizations representing their interests, however, have had minimal input into the latest public review of bank mergers.

Even though the public interest implications of large bank mergers were the specific subject matter of the latest public consultation process, Canadian financial institutions' voices dominated the committees from both the House of Commons and Senate. The Senate Committee heard from or received submissions from 23 banks and only 2 public interest groups. The House of Commons Committee heard from or received submissions from 12 banks and 4 public interest groups.[2]

[1] At the time of this publication, the modifications to the merger review policies had not yet been revealed by the Minister of Finance.
[2] See list of witnesses and submissions in Canada, House of Commons, Standing Committee on Finance, "Large Bank Mergers in Canada: Safeguarding the Public Interest for Canadians and Canadian Businesses" (March 2003), Appendix C and D and Canada, The Senate, Standing Senate Committee on Banking, Trade and Commerce "Competition in the Public Interest: Large Bank Mergers in Canada" (December 2002), Appendix 4.

This analysis was prompted by a concern about the meagre representation from the public on this issue. There may be significant implications for consumers if large banks are allowed to merge, but these issues have received limited airing and almost no analysis in the public debate. Large bank mergers are once again on the federal government's agenda. Canadians therefore need to know more about how a large bank merger is approved in Canada and what is at stake for them in a large bank merger.

A large bank merger is permissible in Canada, under the *Bank Act*.[3] It is, however, subject to a review process. In 2001, the federal government formalized its framework for review of merger proposals between large banks with over $5 billion in equity. The review involves applications to and assessments by the Competition Bureau, the Office of the Superintendent of Financial Institutions (OSFI) and the Department of Finance, in addition to the preparation of a public interest impact assessment of the proposed merger by the applicants to the Department of Finance. The House of Commons Standing Committee on Finance and the Standing Senate Committee on Banking, Trade and Commerce conduct public hearings on the public interest aspects of the proposal. Final approval for a large bank merger rests with the Minister of Finance.

This paper examines the policies that govern mergers of large banks, from the consumer perspective. Of specific interest to consumers is the public interest impact assessment. This paper will focus on that standard.

The public interest issues that were specifically identified by the Minister of Finance in the latest review included an assessment of the implication of large bank mergers for: access to convenient and quality financial services and choice among financial service providers.[4] These are key issues for consumers. This report will assess whether and how the merger review guidelines engage or influence these issues as well as analysing how a possible merger might affect these issues.

Consumer views of bank mergers

Consumers have been quite consistent in recent years in their opposition to bank mergers. In 2003 PIAC engaged Ekos Research Associates to conduct a national survey of consumer attitudes to financial institutions and asked specific questions about bank mergers.[5] The survey found that nearly three quarters of Canadians viewed that there would be significant job losses and bank closures if mergers were to take place between large banks. Fifty-five percent of

[3] *Bank Act*, R.S.C. 1991, c. 46.
[4] Department of Finance, News Release, (24 October 2002).
[5] Ekos Research Associates Inc., *Consumers and Financial Institutions: A Public Perspective on the Industry. A survey of the Canadian public conducted on behalf of the Public Interest Advocacy Centre* (April 2003).

respondents believed that they would get much less personal service as a result of mergers.[6]

Ekos also contrasted these results with similar questions asked of Canadians in March and April of 1998. They found that Canadian attitudes have become more negative about the benefits of bank mergers since 1998. In 1998, 66% (compared to 73% in 2003) of Canadians thought there would be a significant number of bank closures if two larger Canadian banks merged. In 1998, 47% (compared to 55% in 2003) of Canadians thought they would get much less personal service if their bank merged with a large Canadian bank.[7]

The federal Department of Finance has also surveyed Canadians on the bank merger issue and found a majority opposed to bank mergers. Ipsos-Reid surveyed 1,000 Canadians in August 2004 and found that 60% of Canadians thought it would be in their best interest if Ottawa didn't allow bank mergers. A majority (56%) doubted that bank mergers were in the public interest generally.[8]

Bank – trust company mergers

Canada has not had a merger of its large banks for many years, but some consolidation among large financial institutions took place in 1997, followed by a rejected attempt at large bank mergers in 1998.

Consolidation among large financial institutions has been approved by the federal government, in the form of mergers between banks and trust companies.[9]

In 1993 Royal Trust became part of the Royal Bank of Canada. In 1997, the federal government approved the acquisition by Scotiabank of the National Trust and in 2000, the acquisition by the Toronto-Dominion Bank of Canada Trust.

The approval was also accompanied by a requirement to divest a number of branches. Submissions by parties either directly involved in or affected by that merger suggest that the divestment was not highly successful and did not increase the number of branches available to customers. Toronto-Dominion Bank was required to sell 13 branches, a number of which were in small towns and some of those that were acquired were eventually closed.

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[6] *Ibid.* at 61.
[7] *Ibid.* at 60.
[8] Sandra Cordon, "Bank mergers still unpopular with consumers" *Toronto Star* (26 December 2004), H7.
[9] A trust company is defined as a "financial institution that operates under either provincial or federal legislation and conducts the same activities as a bank. Like a bank, it operates through a network of branches. However, because of its fiduciary role, a trust company can administer estates, trusts, pension plans and agency contracts, which banks cannot do." (Source: Canada, Department of Finance website: http://www.fin.gc.ca/gloss/gloss-e.html)

In terms of cost of bank services, consumers appear to have been negatively affected immediately following one of the mergers. In the Toronto-Dominion-Canada Trust merger, the institutions agreed to freeze service charges during the year that they merged, but in 2001 changes to service charges were implemented. The Office of Consumer Affairs, which published an annual report of Financial Service Charges in 2001 and 2002, reported that generally for former Toronto-Dominion customers who were moved to the Canada Trust fee structure, the price of most individual transactions increased, due to the imposed new requirement for higher monthly account balances in order to waive monthly service transaction fees.[10]

The failed attempt at bank mergers

In 1998, four major banks in Canada attempted two mergers, which were ultimately rejected by the then Minister of Finance, Paul Martin. In January 1998, a merger was proposed between the Royal Bank of Canada and the Bank of Montreal and in April 1998, the Canadian Imperial Bank of Commerce and the Toronto-Dominion Bank announced plans to merge.

The Competition Bureau analysed both proposals under their existing merger review guidelines. In an appearance before the House of Commons Committee in 2002, a representative from the Competition Bureau summarized their findings:

> So what did we find in 1998? We found that the barriers to entry or expansion were high. There is a need for a large branch network. They represent large sunk investments. Customer inertia is high. Market share does not change very much except by acquisition. The banks built up significant brand names through decades of advertising, which was reinforced by large numbers of branches throughout the country. Technology is an important factor here, but we found that in some ways it was more of a complement than a substitute, and in some ways it can actually make changing banks a little more difficult…In terms of the effect of competition, at that time, given the four merging banks, what you had left was the Bank of Nova Scotia and some regional niche players, which were important to some parts of the country but not all. Foreign competition for the products we were most concerned about, personal banking and SME [Small & Medium-sized Enterprises] products, was minimal. Obviously, there was also the removal of two vigorous and effective competitors.[11]

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[10] Industry Canada, Office of Consumer Affairs, *Financial Service Charges Annual Report 2001, 2002*. online: <http://strategis.gc.ca/epic/internet/inoca-bc.nsf/en/ca01589e.html>
[11] House of Commons, Standing Committee on Finance, *Evidence* (December 10, 2002) evidence of Richard Annan, Major Case Director and Strategic Policy Advisor, Competition Bureau.

They concluded that both mergers would likely lead to “a substantial lessening or prevention of competition that would cause higher prices and lower levels of service and choice for several key banking services in Canada.”[12]

The Office of the Superintendent of Financial Institutions (OSFI) also assessed both proposals concerning the prudential aspects of the proposed mergers and concluded: “OSFI is not able to identify any prudential reasons, in and of the two merger proposals themselves, why you should not consider them.”[13] However, OSFI also indicated that they were unable to conclude that the merged banks arising out of the merger proposals would be financially stronger than their predecessors. The concern was also expressed that if a merged Canadian bank were to experience serious financial problems, it would be much more difficult to recapitalize, sell or restructure, given the relative size of the institution in relation to potential buyers and investors. [14]

On December 14, 1998, the Minister of Finance rejected both proposals on the basis of public interest considerations: “The mergers would lead to an unacceptable concentration of economic power in the hands of fewer, very large banks. They would result in a significant reduction of competition. And they would reduce the government’s policy flexibility to address potential future prudential concerns.”[15]

The current bank merger review process

The unsuccessful mergers in 1998 helped to ensure that that a formalized process for bank merger reviews was initiated. In the same year that some of the major banks were attempting to merge, a federal task force that been reviewing the financial services industry overall was reporting its recommendations.[16] Their recommendations resulted in legislation introduced in 2000 (and re-introduced in 2001) that proposed changes to financial services regulation, including a review process for bank mergers. Under Bill C-8 the *Competition Act*[17] was amended to bring in a public interest analysis. The Act states that the Competition Tribunal may not make an order prohibiting a merger where the Minister of Finance has determined that the proposed merger would be in the public interest.[18]

[12] Letter from the Competition Bureau to the CIBC and TD Bank and to the Royal Bank and Bank of Montreal (11 December 1998).
[13] Office of the Superintendent of Financial Institutions Canada, “Proposed Mergers between the Royal Bank of Canada and the Bank of Montreal, and the Canadian Imperial Bank of Commerce and the Toronto-Dominion Bank: Report to the Minister of Finance” (10 December 1998).
[14] *Ibid.*
[15] “Statement by The Honourable Paul Martin, Minister of Finance, on the Bank Merger Proposals” (14 December 1998).
[16] Canada, *Change, Challenge, Opportunity: Report of the Task Force on the Future of the Canadian Financial Services Sector,* (September 1998).
[17] *Competition Act*, R.S. 1985, c. C-34.
[18] *Ibid*., ss. 94. (b).

The Merger Review Guidelines are issued by the Department of Finance and set out the process for reviews of large banks.[19] The review consists of four parts: reviews by the Competition Bureau, OSFI, the Department of Finance and legislative overview.

Merger review guidelines

Under the Guidelines, the applicant banks must apply in writing to the Competition Bureau, the Office of the Superintendent of Financial Institutions, and to the Minister of Finance requesting permission to merge. They must also prepare a Public Interest Impact Assessment.

The Competition Bureau and OSFI review the proposed merger at the same time that the House of Commons Standing Committee on Finance and the Standing Senate Committee on Banking, Trade and Commerce are asked to conduct public hearings into the broader public interest issues raised by the merger proposal, using the Public Interest Impact Assessment as a guide.

The Competition Bureau and OSFI provide their views of the merger proposal to the applicants and to the Minister of Finance in writing. These documents are then released to both Committees and upon completion of the committee hearings, the committees report to the Minister on the broader public interest issues raised by the proposed merger.

Ultimately the Minister of Finance makes a decision as to whether the merger proposal will be approved or denied, based on the information received. If problems resulting from a merger that are raised by various parties are viewed as capable of being addressed, the merger review process will enter a negotiation of remedies stage:

> The Competition Bureau will negotiate the competition remedies and OSFI the prudential remedies with the merger applicants, and will work with the Department of Finance in co-ordinating an overall set of public interest remedies (including possible divestitures).[20]

Public interest impact assessment

The Public Interest Impact Assessment (PIIA) is the key document for consumers because it refers to issues of greatest concern to consumers under a proposed merger. The PIIA requires applicants to show, among other considerations:

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[19] Canada, Department of Finance, *Merger Review Guidelines*.
[20] *Ibid.* at para 11.

> [T]he possible costs and benefits to customers and small and medium-sized businesses, including the impact on branches, availability of financing, price, quality and availability of services;
>
> [T]he timing and socio-economic impact of any branch closures or alternative service delivery measures at the regional level, and any alternative service delivery measures that might mitigate the impact;
>
> [W]hat 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…[21]

The applicants must explain the rationale for the merger and the steps they could take to mitigate any potential costs or concerns.

Competition Bureau's role

The Competition Bureau is an independent law enforcement agency whose role is to promote and maintain fair competition in the marketplace. Mergers are a business transaction that may be reviewed for anti-competitive activity. Under section 92 of the *Competition Act*, the Competition Tribunal (a specialized court that hears applications under the Act) may make an order concerning a merger where the merger, in its view prevents or lessens, or is likely to prevent or lessen, competition substantially.

The bureau operates under merger review guidelines and a framework describing how the guidelines are specifically applied to a bank merger:[22] This framework document indicates consumer protection as the key objective:

> The main objective of the merger review process is to maintain and promote competition within the Canadian economy in order to provide consumers with a wide variety of high quality products that are competitively priced.[23]

The merger enforcement guidelines describe two ways that a merger can lessen competition: 1) where is it likely to enable the merged entity to unilaterally raise the price in any part of the market and 2) where it is likely to bring about a price increase as a result of the increased ability for all firms in a market (including those outside the merger) to engage in interdependent[24] behaviour or tacit collusion.[25]

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[21] *Ibid.*
[22] Competition Bureau, *The Merger Enforcement Guidelines as Applied to a Bank Merger* (January 2003).
[23] *Ibid.* at 2.
[24] Interdependent behaviour is defined as "explicit or implicit understandings among firms in the market to jointly exercise market power or limit competition on price, quality, service, or any other

The Competition Bureau's review begins by determining the relevant market(s) in which the merging parties operate. The bureau looks at the market for the product as well as the geographical aspects of a market. The product markets that are looked at that directly concern consumers are those found within the category of personal financial services: personal long-term investments, personal short-term savings, student loans, personal transaction accounts (chequing and savings accounts) and residential mortgages.[26]

Defining the boundaries of the "relevant" markets involves a hypothetical exercise of proposing a price increase by the merging parties and asking whether consumers are likely to switch to other products in sufficient numbers as to make the price increase unprofitable and therefore, unlikely.[27]

The geographic boundaries of the relevant market are determined in a similar way. The geographic market includes all areas where there are suppliers to which customers would likely turn in response to an attempt by the merging entities to exercise market power.[28] The issue of the importance of personal contact is looked at as part of the analysis:

> In particular, one needs to establish what is the need for personal contact between supplier and customer and what are the costs, in terms of time and transportation, of accessing more distant suppliers for the given product. It is the relative cost of personal contact that is important.[29]

The next stage in the analysis involves looking at what the post-merger market share of the merging parties would be. The Competition Bureau suggests that there are 'safe harbours' for acceptable market shares below which the Bureau will not investigate further. But even if market shares are greater than these values, a merger may still be found not to substantially limit competition.

> Generally, mergers will not be challenged on the basis of concerns relating to the unilateral exercise of market power where the post-merger market share of the merging parties would be less than 35 per cent, and mergers will not be challenged on the basis of concerns relating to the interdependent exercise of market power where the share of the market accounted for by the largest four firms in the market post-merger would be less than 65 per cent and the merging parties would hold less than 10 per cent of the market.[30]

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dimension." Source: "The Competition Bureau's Letter to the Royal Bank and Bank of Montreal, Appendix A – Glossary," *supra* note 12.

[25] *The Merger Enforcement Guidelines, supra* note 22 at para. 7.

[26] *Ibid.* at para. 8.

[27] *Ibid.* at para. 8-9.

[28] Market Power is defined as "the ability of firms to profitably influence price, quality, variety, service, advertising, innovation or other dimensions of competition." Source: *Ibid.* at para.18.

[29] *Ibid.* at para. 38.

[30] *Ibid.* at para. 11.

Examples of the way that banks could exercise market power include increases in service fees charged on deposits or credit cards, a decrease in interest earned on deposits or an increase in the interest rates on loans or mortgages. Market power could also be exercised by eliminating available products or reducing product or service quality.

Once the relevant markets have been defined and market shares have been determined, further evaluative criteria (from section 93 of the *Competition Act)* are applied. In each of the relevant markets where the merged entity's market share exceeds either the 35% threshold or the four-firm concentration level exceeds the 65% threshold and the merged firm holds more than 10% of the market, a number of factors are looked at to see whether the merging parties can sustain price increases for more than two years.

These criteria include:

- any barriers to entry into a market and the effect of the merger on such barriers;
- the extent to which foreign competition provides effective competition to the businesses of the parties to the merger;
- whether the business of a party to the merger is likely to fail;
- the availability of acceptable substitutes;
- whether effective competition remains or would a merger result in removal of a vigorous and effective competitor;
- the nature and extent of change and innovation in a relevant market.[31]

The issue of the availability of acceptable substitutes is further explained in the merger review guideline document in relation to electronic banking as a substitute:

> Although telephone banking services are available to most retail customers, other electronic banking services requiring a computer are not readily available to many households and small businesses at this time. Although the number of electronic-based transactions has increased substantially in the last decade and new products are continuously being introduced, customer acceptance may take longer than two years. As a result, these alternative means of delivering banking products may not represent a sufficiently widely available, acceptable substitute to the provision of the same banking products through branches such that they may not constrain a potential exercise of market power by the merging banks. This will be an important component of the Bureau's analysis of any bank merger.[32]

[31] *Ibid.* at para. 71-100.
[32] *Ibid.* at para. 75.

The issue of electronic banking is also raised in discussion of the evaluative criterion of change and innovation, suggesting that it may be viewed as a substitute for branch banking:

> For example, the rising importance of electronic delivery of banking services may reduce the importance of a bank's local branch presence, since buyers may readily access the services of more distant suppliers of financial services through electronic means. Electronically delivering traditional banking services is also a considerably less expensive means of distribution, and may allow for greater entry opportunities for firms not currently involved in Canadian financial services.[33]

Once the merger proposal has been examined from all these aspects, the Commissioner of Competition of the Competition Bureau makes a determination as to whether the merger would substantially limit or prevent competition.

The bank merger enforcement guidelines conclude by recognizing that the role of the Minister of Finance is determinative on the matter of allowing a merger. They also indicate that the process of interaction between the Commissioner of Competition and the Minister of Finance is not spelled out by any of the legislation that applies to bank mergers.

As a result, the Annex to the guidelines describes the procedure that has been adopted by the Commissioner in consultation with the Minister of Finance. After the analysis of the proposed merger is completed, the Commissioner provides to the parties and the Minister of Finance a letter setting out the Commissioner's views on the competitive aspects of the proposed merger. After receiving the Commissioner's letter and any public interest concerns expressed by the Minister of Finance, the parties to the merger are then able to determine if it is appropriate to explore potential remedies with the Bureau in relation to any anti-competitive concerns raised by the Commissioner. If remedies suggested are acceptable to the Commissioner, the remedies may still require the approval of the Competition Tribunal (as well as the ultimate approval by the Minister of Finance).[34]

Office of the Superintendent of Financial Institutions' role

OSFI is a federal agency established under the *Financial Institutions and Deposit Insurance System Amendment Act* to supervise all federally regulated financial institutions. This includes all banks, all federally incorporated or registered insurance, trust and loan companies, cooperative credit associations, and fraternal benefit societies. OSFI is also responsible for monitoring federally regulated pension plans.

[33] *Ibid.* at para. 93.
[34] *Ibid.* at Annex I.

OSFI's role in the bank merger review is to assess the prudential aspects of a proposed merger. That review consists of "identifying and examining any material issues that would have the potential to impact negatively on the risk profile of the merged entity." It would also include reviewing the implementation and integration plans, financial projections, potential changes to risk profiles and "the capacity of the institution's risk management systems…the extent to which the risk increases or decreases as a result of the merger, and the merged entity's ability to measure, monitor and manage those risks going forward."[35]

The 2002 public consultation

The issue of large bank mergers returned to the public agenda in late 2002, through the initiative of the Minister of Finance, for reasons that have never been publicly clarified. There was no known written application by any of the major banks to the Competition Bureau, OSFI or the Minister of Finance regarding a specific bank merger proposal.

In October 2002, the then Minister of Finance, John Manley, sent a letter to the Chairs of the House of Commons and Senate Committees, asking these committees to provide their views on the major considerations that should apply in determining the public interest in a review of a bank merger. The letter indicated that the Government agreed with the views of "some stakeholders" that the "public interest tests associated with a bank merger review need greater clarity."[36]

Widespread media speculation suggested that it was not likely that the "stakeholders" referred to were members of the general public. Various media suggested that a prospective bank merger was raised with the Finance Minister in 2002 by two of the major banks, but quashed by the Office of the Prime Minister:

> The issue was dormant for a few years, but flared up again in late 2002, after it was revealed that the office of the former Prime Minister, Jean Chrétien had quietly scuttled a planned marriage between BMO [Bank of Montreal] and Bank of Nova Scotia."[37]

[35] House of Commons, Standing Committee on Finance, *Evidence* (December 10, 2002) evidence of Julie Dickson, Assistant Superintendent, Regulation Sector, OFSI.
[36] Letter from The Honourable John Manley, P.C., M.P. and The Honourable Maurizio Bevilacqua, P.C., M.P. to Ms. Sue Barnes, M.P., Chair, Standing Committee on Finance and The Honourable Leo Kolber, Chairman, Standing Senate Committee on Banking, Trade and Commerce (24 October 2002).
[37] Sinclair Stewart, "Credit Unions push NDP" *The Globe and Mail* (10 April 2005) and see Terence Corcoran, "Finkleman's Escape from the Bank Merger" *National Post* (30 October 2002), Robert Fife, "Merger mess banks' fault, Ottawa says" *National Post* (1 November 2002) and Shawn McCarthy, "How the bank merger fell apart" *The Globe and Mail* (2 November 2002).

As indicated above, the 2002 public consultation process involved minimum input from the general public or organizations representing their interests and comprehensive input from a range of the financial services industry sector.

The process resulted in reports from both Committees of the House of Commons and Senate, with somewhat contrasting recommendations. The Senate Committee suggested that the public interest consideration by the Minister of Finance should primarily focus on the likely effect of a proposed merger on the prosperity and competitiveness of the national economy. It recommended that a merger that has been approved by and meets the conditions set out by the Competition Bureau and OSFI, should be permitted by the Minister of Finance as being in the public interest "unless there are compelling reasons to believe otherwise".[38] The Senate Committee also recommended that Parliamentary review of specific bank merger proposals no longer be required.[39]

The House of Commons Committee endorsed the public interest review requirements with some clarifications. It recommended retaining the list of items included in the Public Interest Impact Assessment found in the Merger Review Guidelines, indicating, that in its view, the "existing requirements...are quite comprehensive and we see no need to identify any additional areas that should be added."[40]

The Committee had specific recommendations related to issues of access and cost of banking services. It recommended "Merger applicants provide no less than an equivalent level and range of services to all Canadians before and after the merger" paying "particular attention to ensuring access for disabled Canadians, seniors, low-income individuals and Aboriginal Canadians".[41] It also recommended that merger applicants outline the way in which the merged entity would provide retail financial services "at a comparable or lower price, on balance, during a transition period of up to five years,"[42] and how the merged institution "would ensure service to rural and remote communities where they are providing financial services at the time of the merger application".[43]

The report also recommended keeping the review of a proposed bank merger by the Competition Bureau, OSFI and the House of Commons Standing Committee on Finance.

There was a dissenting opinion by the NDP member of the Committee that stated its opposition to large bank mergers as being contrary to the public interest, that the Finance Department's Merger Review Guidelines be left as they are, and that

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[38] Report of the Standing Senate Committee on Banking, Trade and Commerce, *supra* note 2 at ix.
[39] *Ibid.* at x.
[40] Report of the Standing Committee on Finance, *supra* note 2 at 7.
[41] *Ibid.* at 11.
[42] *Ibid.* at 14.
[43] *Ibid.* at 17.

large bank mergers should continue to be reviewed by the House of Commons committee, with final oversight by Parliamentary vote.[44] The Bloc Quebecois member submitted a supplementary opinion that made specific recommendations concerning public consultation and analysis of the impact of a large bank merger on the Canadian economy.[45]

The federal government responded to both reports in June of 2003.[46]

What emerges from both Committee reports and the Federal Government's response to those reports is a curious lack of analysis of how bank mergers and some of the public interest issues raised by bank mergers are connected. There is a clear recognition of the issues raised by bank mergers, including small business and consumer-related problems of access, choice and cost of banking services. What is missing is any substantive analysis of how a prospective merger might actually have an effect on these issues.

As a result, the unequivocal endorsement by the Senate committee of bank mergers and the endorsement by the House of Commons majority report of the existing public interest test, with "clarifications," ring hollow because they aren't rooted in any substantive analysis. The House of Commons committee report merely asks the banks to outline how they will address the public interest issues of access and choice if a merger is approved.

The federal government response has similar gaps. It also identifies issues of access and choice, but merely recommends that the Minister of Finance ensure that a merger proposal addresses these concerns. The problem with these reports is that consumers are left without any way of assessing how bank mergers might actually affect retail-banking services.

Despite the formal review process put in place in 2001, an analysis of the latest consultation concerning bank mergers reveals that the process does not appear to have been made any more transparent by the actions of the major banks leading up to this consultation. Instead of interested banks coming forward publicly with merger proposals, they exacerbated what they have indicated in their public submissions they see as a highly politicized process[47] by politicizing it even more. Private discussions with ministry officials in order to 'sound out' the prospect of a merger, prior to or to determine whether to submit an application,

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[44] *Ibid.* at 57-61.
[45] *Ibid.* at 53-55.
[46] Canada, Department of Finance, "Response of the Government to *Large Bank Mergers in Canada: Safeguarding the Public Interest for Canadians and Canadian Business* and *Competition in the Public Interest: Large Bank Mergers in Canada*" (23 June 2003).
[47] Evidence, Standing Senate Committee on Banking, Trade and Finance (25 November 2002), Mr. Peter Godsoe, Chairman and Chief Executive Officer, Scotiabank: "We should like to get the issue of mergers out of the political popularity contest."; Evidence, Standing Committee on Finance (6 February 2003) Mr. Edmund Clark, President and Chief Executive Office, TD Bank Financial Group: "We politicized the restructuring of this industry."

belies the public interest process that the government claims it is eager to protect and promote.

Understanding how a merger might affect certain public interest criteria requires some initial analysis of what the Canadian banking system currently looks like and Canadians' banking habits. The next section attempts to draw a broad picture of what retail banking currently looks like.

The current banking system

Six major banks dominate

The most significant characteristic of the Canadian retail financial services sector is that six major banks dominate.[48] There are 13 smaller domestic banks, 49 foreign bank subsidiaries or foreign bank branches, 30 trust companies and approximately 1100 credit unions and caisse populaires in Canada.[49]

However, the six largest banks dominate the sector, holding over 90 per cent of banking assets.[50] This is demonstrated by the market share that the banks have in various financial services products. The six major banks have a 66% share of personal deposits, a 65.2% share of consumer loans and a 56.7% share of residential mortgages in Canada.[51] This is consistent with the results of a national survey of Canadians that the Public Interest Advocacy Centre (PIAC) conducted in 2003. The survey revealed that the six major banks have the largest share of banking customers (65%).[52]

The major banks continue to dominate, despite legislative changes in 2001 to encourage foreign bank entry into Canada. Previously, federally regulated Canadian banks were required to be widely held, which meant that no single shareholder or shareholders acting together could hold more than 10% of any class of bank shares. This law placed restrictions on the ability of foreign banks to fully enter into the Canadian financial services sector and compete with existing retail banking services. In recognition of this, the federal government implemented a new policy framework to encourage foreign competition in the banking sector.

Under the new framework the widely held rules have been changed according to the financial size of the bank. The major banks continue to be required to be

[48] Bank of Montreal, Scotiabank, CIBC, National Bank, Royal Bank and TD Canada Trust.
[49] Canadian Bankers Association, *The 2006 financial services legislation review: Improving the legislative framework for Canadian consumers* (1 June 2005) at 29.
[50] Canada, Department of Finance, "Canada's Banks" (August 2002) online: <http://www/fin.gc.ca/toce/2002/bank_e.html>
[51] Canadian Bankers Association, *supra* note 49 at 38.
[52] Public Interest Advocacy Centre and Ekos Research Associates, *Consumers and Financial Institutions: A Public Perspective on the Industry* (Spring 2003) at 9.

widely held, but the definition of “widely held’ has been expanded. A single individual may own *up to* 20% of the voting shares of a bank with equity greater than $5 billion or up to 30% of non-voting shares. Medium-sized banks with $1 billion to $5 billion in equity may be closely held, although a public float of 35% of voting shares is required. There are no ownership restrictions for banks with less than $1 billion in equity, except for a “fit and proper” test, which is the test to determine general suitability of prospective owners.[53]

The lack of significant change in the ‘big picture’ of Canadian financial services despite these legislative modifications inevitably raises questions about whether there are other barriers to entry into the Canadian financial services market. The Department of Finance acknowledged this in their consultation document accompanying their review of financial services legislation in 2006, but suggested that regulatory complexity was the problem:

> [T]he legislative framework has evolved into a complex set of rules that are broad in scope. The scope and complexity of the framework may impose an unintended regulatory burden on foreign banks seeking entry and has implications for the resources required to administer it.[54]

The issue of the entry of foreign banks to encourage bank competition under a possible bank merger scenario also introduces an important question about control over Canadian banking. Proponents of bank mergers argue for encouraging the entry of foreign banks as one means of ensuring competition in the financial services sector. But this also raises the issue of Canadian control of financial services. The McKay Task Force concluded that retaining Canadian control over the financial services sector should be a public policy objective.[55] If the federal government is considering further regulatory changes that may change the balance of ownership of the Canadian financial services sector, we would argue that it also requires an open and public debate with Canadians.

Canadians’ views on the issue of Canadian control of the banking sector support the impression that a larger public debate about changing the rules on who controls the banking sector is needed. An Ekos survey that was prepared for the Task Force found that an overwhelming 82% of Canadians felt that it was important to have Canadian control of domestic banks even if it meant slightly

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[53] *Bank Act* (1991, c. 46) ss. 370-400 and Library of Parliament, “Legislative Summary” *Bill C-8: An Act to Establish the Financial Consumer Agency of Canada and to Amend Certain Acts in Relation to Financial Institutions* (14 February 2001) at 4-9.
[54] Canada, Department of Finance *Budget 2005, Budget Plan Annex 6* “An Effective and Efficient Legislative Framework for the Canadian Financial Services Sector.”
[55] Task Force on the Future of the Canadian Financial Services Sector, *Competition, Competitiveness and the Public Interest: Background Paper #1* (September 1998) at 173. Canadian control means financial institutions managed by Canadian-based executives subject to Canadian governance requirements and not subject to the influence of a dominant foreign interest. (p. 172)

higher prices.[56] PIAC also surveyed Canadians on this issue in 2003 and found that a strong majority of Canadians thought that it was important to have domestic control in the financial sector. Sixty-two percent of Canadians said they would be willing to pay higher service fees in order to keep banks in Canadian hands, while nearly eight in ten respondents viewed that Canadian control of our banks is important in order to protect Canadian jobs.[57]

Decline of branch banking

Various sources have documented the decline of branch banking in Canada. A study by the C.D. Howe Institute affirms that the number of branches per 10,000 people has been declining since the 1920s (when there were 5.46 branches per 10,000 people) to the present figure of 2.8 branches per 10,000 people.[58]

The Financial Consumer Agency of Canada (FCAC), a government regulatory agency that monitors and enforces consumer protection provisions in federal banking legislation has reported on bank branch closures since 2002, based on information provided to it by the banks. Their statistics show a reduction in bank branches in all provinces and territories in Canada (except the Yukon) by a figure of 700 since 2002.[59]

It is important to note that banks have unrestricted authority to close branches. The FCAC is only empowered to monitor these closures and may act as an intermediary between the bank and a community with respect to any closures.[60]

A recent World Bank report that surveyed access to banking services in 99 countries, ranging from developed economies to economies in transition, adds further evidence that Canada's bank branch network is not extensive compared to other countries. It found that Canada ranked 74th in terms of the number of branches per 1,000 square kilometres and 7th in terms of number of branches per 100,000 people.[61]

The Canadian Bankers Association views that Canadians "are well-served by branches throughout Canada" based on a study that it commissioned on the status of banks in small communities. It reports that a branch of the five largest

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[56] Ekos Research Associates, *Public Opinion Research Relating to the Financial Services Sector.* Research Paper Prepared for the Task Force on the Future of the Canadian Financial Services Sector at 51.
[57] Ekos Research Associates, *Consumers and Financial Institutions, supra* note 5 at 67.
[58] David Bond, C.D. Howe Institute *Backgrounder: "*Bank Mergers. Why We Need Them, How to Get Them" (September 2003, No. 74) at 4.
[59] Financial Consumer Agency of Canada website: FCAC - Bank Branch Closures
[60] S.O.R./2002-104, ss. 3, 5.(g).
[61] T. Beck & A. Demirgue-Kunt, *Reaching out: Access to and use of banking services across countries* (World Bank: September 2005) at 31.

banks did not serve 79 municipalities across Canada in 2003 and 11 municipalities did not have a branch of a deposit-taking institution.[62]

The view of the banking community that these are positive statistics raises an important question about perspective on this issue. Certainly an argument can be made as to whether it is a sign that Canadians are being "well-served" by bank branches when there is *any* municipality that is without the physical presence of a bank, given the geographical isolation of some of Canada's rural communities and the fact that electronic banking does not replace the range of retail banking services required by individuals and small business.

Growth of electronic banking

Electronic banking has shown significant growth in Canada, but it is difficult to know whether this development is a cause or effect of the decline of branch banking in Canada.

In 2002 there were over 8,000 bank branches in Canada and approximately 18,000 bank-owned and operated automated banking machines (ABMs).[63] It is important to note that these figures are not static and have changed since 2002. For example, the number of bank ABMs in Canada has declined since 2002. In 2004 the Canadian Bankers Association website reported that that there were 16,160 bank ABMs in Canada.[64] At the same time that the number of bank ABMs have declined, the number of independently operated cash dispensers or "white-label" automatic teller machines (ATMs) has grown. In 2002 there were 23,450 independently operated ATMs in Canada and by 2003 that figure had grown to 26,149.[65]

The World Bank report that surveyed access to banking services, found that Canada was number one in terms of the number of ATMs per 100,000 people (135.23). The United States ranked third (120.94)[66]

Banks point to the changing nature of Canadians' banking habits as explanation for the reduction in branch banking. Surveys conducted by the industry and consumer organizations document the extent to which Canadians are adopting electronic means of conducting financial transactions. Canadians are the largest users of debit cards[67] in the world. A 2003 survey found that Canadians make

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[62] Canadian Bankers Association, *supra* note 49 at 35.
[63] Department of Finance, *supra* note 50.
[64] Canadian Bankers Association, "Quick Facts" online: <http://www.cba.ca/en/ViewDocument.asp?fl=3&sl=174&tl=&docid=413>
[65] Canadian Bankers Association, *fastfacts* "ABM Market in Canada" (May 2004) at 2. It is important to note that there are surcharges associated with independently operated ATMs that do not apply to bank-owned ATMs.
[66] *Reaching out: Access to and use of banking services across countries, supra* note 61 at 31-32.
[67] Through a service called Interac Direct Payment, consumers use their financial institution debit card at participating retailers, who automatically debit the payment from their bank account.

81.7 debit card transactions per year, compared with 70.6 in France and 63.4 in the United States.[68]

Canadians are also increasingly banking online. When PIAC surveyed Canadians in 2003 on this issue, 16% indicated they bank online, 18% indicated that they do personal banking over the phone and 15% indicated that they do both.[69] In a Canadian Bankers Association survey conducted in 2004, 23% of Canadians indicated that they primarily conduct their personal banking through the Internet.[70]

However, surveys also indicate that branches are still important to Canadians. Over 61% of Canadians indicated in 2003 that it was important for them to be able to do their personal banking at a branch.[71]

The changing culture of retail banking has shown a movement from in person banking at a bank branch to banking through more remote means such as telephone, automated banking machines and the Internet. However, it is difficult to know which of these shifts are ‘cause’ and which are ‘effect’. Have Canadians taken up electronic banking so significantly because bank branches are less available and accessible or have banks closed branches because consumers show an increasing preference to conduct their banking by electronic means?

It is important to note that the move to electronic banking represents a significant cost reduction for the financial services institution. Studies indicate that the cost to a bank of carrying out a transaction declines significantly when carried out electronically as compared to in a branch.[72] Some proponents of bank mergers have suggested that the desire to merge is partly driven by the desire to reduce branches and thus reduce costs: “Banks want to merge to rationalize the domestic market by reducing the number of branches and, inevitably, the number of employees.”[73]

Resistance to changing financial institutions

Retail banking behaviour also suggests some resistance to changing financial institutions. PIAC’s 2003 survey found that nearly one-third of Canadian banking

[68] Canadian Bankers Association, *taking a closer look: electronic banking* (May 2005).
[69] Ekos Research Associates Inc., *Consumers and Financial Institutions: A Public Perspective on the Industry. A survey of the Canadian public conducted on behalf of the Public Interest Advocacy Centre* (April 2003 at 14.
[70] Canadian Bankers Association, *supra* note 68.
[71] PIAC and Ekos, *supra* note 52 at 30.
[72] The cost varies from $1.07 (Branch), $0.52 (Telephone), $.27 (ATM), PC Banking $0.015, $0.01 (Internet banking) (source: Nicholas Bohm, Ian Brown, & Brian Gladman, *Electronic Commerce: Who Carries the Risk of Fraud?”* (Foundation for Information Policy Research: July, 2000) at para. 32.)
[73] C. D. Howe Institute, *Backgrounder, supra* note 58 at 5.

customers have been dealing with their primary financial institution for 21 years or more.[74] Canadians were also asked in the same survey, if they would be unlikely to change financial institutions even if they received bad service and almost four in ten agreed that they would be unlikely to change.[75] This is not surprising, considering that the number and complexity of a consumer's dealings with their financial institution may contribute to a built-in resistance to change.

This resistance may be exacerbated by the growth of electronic banking. A U.S. government study of bank mergers noted the effect of electronic banking on consumers switching banks. The study found that a short-term effect of the growth of electronic banking is that it has actually reduced competition between banks by raising the costs to customers of switching banks:

> Switching costs have risen because of the increased difficulty in, for example, stopping electronic relationships with one bank (for example, direct deposits and direct debits of bills, charitable contributions, and so forth) and switching them to another bank. In some cases, changing banks requires switching software. The benefits to banks of electronic banking with respect to switching costs have not gone unnoticed by bank analysts and presumably by banks. For example, in a summary of objectives and issues for online financial service providers, Hagel, Hewlin, and Hutchins noted in the *McKinsey Quarterly* that direct deposit, bill payment, and other switching barriers are "hooks for institutional customer retention." Similarly, *Moody's* noted in a report on the Internet and American banks that "switching bank accounts is difficult, time consuming, and disruptive – the financial equivalent of root-canal work."[76]

Growth of the alternative financial services sector

A more recent but developing characteristic of consumer practices with respect to financial services is the growth of the use of alternatives to banks and other traditional deposit taking financial institutions. A small but growing segment of bank customers are turning to high-cost alternatives such as cheque cashing and payday loan outlets to meet a need for small amounts of money when they can't access lines of credit, overdraft protection or endure the long hold periods placed on cheques by banks.[77]

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[74] *Consumers and Financial Institutions, supra* note 69 at 51.
[75] *Ibid.*
[76] Board of Governors of the Federal Reserve System, *Staff Study 174: Bank Mergers and Banking Structure in the United States, 1980-98* (August 2000) at 25-26.
[77] PIAC surveyed this trend in 2002 and found that 4.8% of the Canadian population or between 1.0 and 1.4 million Canadians had some experience using alternative financial services (Source: Public Interest Advocacy Centre, *Fringe Lending and "Alternative" Banking: The Consumer Experience* (November 2002) at 34-35. The Financial Consumer Agency of Canada surveyed this phenomenon in 2005 and found that 7% of Canadians have used alternative financial services such as cheque-cashing outlets or payday loan companies. (Source: Ipsos Reid, *Public Experience with Financial Services and Awareness of the FCAC* (March 24, 2005) at 10.

The concern raised by these alternative financial services is that they carry extremely high fees and charges and may place consumers at increased financial risk. Payday loans, a small, short-term loan extended over a few weeks with a personal cheque held for future deposit, are a particularly expensive and risky proposition for consumers.

Specific figures on the size of this sector in Canada do not exist. The industry association for the payday loan businesses that have physical outlets states that there were 1,000 stores in Canada in 2003.[78] However, this figure underestimates the size of the alternative financial services sector, as it only includes businesses that provide payday loans and also does not include the many payday loan companies that are solely Internet based.

This cursory analysis of the present state of retail financial services suggests that major banks are still very dominant and important in the retail financial services marketplace despite some changes in the culture of retail banking. Branch banking is declining and electronic banking is growing exponentially along with a small but significant rise in the use of alternative financial services. However the development of all of these phenomena have not significantly diminished the role of traditional banking institutions. Electronic banking has not replaced the need for physical bank branches and Canadians who are using alternative financial services still have a relationship with a traditional deposit-taking institution.

As indicated above, key issues for consumers resulting from large bank mergers are elements that directly impact retail banking such as choice of retail banking services, access to banking services and the cost of banking services. What follows then, is an attempt to link the issues for consumers of access, choice and cost of banking services, to the concept of a bank merger, given this framework of the consumer retail banking culture.

How mergers might affect banking services

Choice

An important issue for consumers is whether there will be sufficient financial institutions to offer Canadians a choice in banking services following a merger. The issue of choice also relates to the question of whether banking services will be competitive following a merger.

One of the arguments used by the banks in their submissions to the House of Commons and Senate committees was that if a merger has the effect of preventing or lessening competition, these effects would be eliminated or

[78] Ernst & Young, *The Cost of Providing Payday Loans in Canada. A Report Prepared for the Canadian Association of Community Financial Service Providers* (October 2004) at 4.

reduced by an order to divest assets or shares. Divestitures involve the selling off of branches to competitors.

Divestitures are a remedy that is mentioned in the rules and guidelines governing bank mergers. The Competition Tribunal may order a divestiture if it finds that competition has been substantially reduced or prevented as a result of a merger.[79] The Public Impact Assessment required by the Finance Department's Merger Review Guidelines also requires applicants to show

> [W]hat remedial or mitigating steps in respect of public interest concerns the banks are prepared to take, such as divestitures, service guarantees and other commitments…[80]

The question of whether divestitures would work as a remedy to the anti-competitive effects of a large bank merger can be assessed in relation to the bank-trust company mergers in the late 1990s. The acquisition of Canada Trust by the Toronto-Dominion Bank in late 1990s was subject to an order by the Competition Bureau to divest a number of bank branches to competitors.

Evidence before the Senate Committee about this experience was not persuasive about the success of divestitures increasing competition in the retail-banking sector. In its submissions before the Senate Committee, the Toronto-Dominion Bank did not produce convincing evidence that the required divestitures resulted in more choice for consumers:

> It is illustrative that when, as a condition of our merger approval, TD and Canada Trust had to sell 13 branches, some of them in small towns, there was no line of eager bidders anxious to snap up all of them. We found ourselves in certain situations where we were required to divest branches that we would have been happy to keep, and our customers would have been happy to stay with us.[81]

Despite that admission, the President and Chief Operating Officer of TD Bank Financial Group later asserted to the Committee that forced divestitures would result in replacement of the lost competitors. He advocated the introduction of competition rules that "force the development or replacement of the lost competitors."[82]

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[79] *The Competition Act, supra* note 17, s. 92.(1)(e)(ii).
[80] Department of Finance, *Merger Review Guidelines*, *supra* note 19.
[81] Senate of Canada, *Proceedings of the Standing Senate Committee on Banking, Trade and Commerce* (November 25, 2002). Evidence of Edmund Clark, President and Chief Operating Officer, TD Bank Financial Group.
[82] *Ibid.*

The Canadian Federation of Independent Business (CFIB) noted that the divestiture resulting from the consolidation of TD and Canada Trust had not increased competition:

> We could have taken that Canada Trust platform and allowed an outside bank or another institution to become another competitor in that marketplace. It is too bad that someone was not willing to pick up all those branches from Canada Trust so we would have had yet another major competitor in the market…by any standard, Canada has one of the most concentrated banking systems in the world, and I would submit the Americans would never stand for further consolidation of it. Since 1998 there has been less competition for financial services.[83]

Evidence was also weak on the likelihood of successful entry of foreign banks mitigating the anti-competitive effects of a merger. Bank witnesses before the Senate Committee also suggested that competition could be ensured under bank mergers by the emergent of new entrants, such as foreign banks. However, other witnesses challenged that view:

> There is one opportunity that is based so much on infrastructure and the costs of getting in. I live in Toronto. In the Yonge and Eglinton neighbourhood, Citibank came in and set up a retail branch that lasted only 18 months. The biggest bank in North America could not last longer than that because there is such a dominant position by the Canadian banks in the marketplace currently that, unless you are able to come in and buy infrastructure to get a toehold and have a chance, it is very hard to enter the market. The costs of entry are prohibitive.[84]

A representative from the Competition Bureau, appearing before the House of Commons Committee suggested that the lack of a significant presence of foreign banks in Canada 1998 had not changed by 2003.[85]

In his appearance before the House of Commons committee, a former chief bank economist argued that successful competition between the six major banks discourages foreign banks from entering the Canadian marketplace:

> We have a banking system where the service charges are 60%, I think, or something like two thirds of the service charges in the United States. We

[83] Senate of Canada, *Proceedings of the Standing Senate Committee on Banking, Trade and Commerce* (November 25, 2002). Evidence of Brien G. Gray, Senior Vice-President, Field Operations, Canadian Federation of Independent Business.
[84] *Ibid.*
[85] House of Commons, Standing Committee on Finance, *Evidence* (December 10, 2002). Evidence of Richard Annan, Major Case Director and Strategic Policy Advisor, Competition Bureau.

> have a banking system where the interest rate spreads[86] are narrower than they are in the United States. So why on earth would a U.S. bank want to come into Canada and develop its business here when they look at service charges that are a fraction and interest rate spreads that are considerably narrower?
>
> There's the main reason we haven't had many international banks come in here or look for a niche market. It's because we have a highly competitive banking system with half a dozen major banks. That's the importance, that we should keep those half a dozen major banks and keep them competing.[87]

Despite this evidence before the Senate Committee, and their acknowledgment of the potential problems arising from divestitures, that the least profitable branches may be divested, which would not facilitate new entrants or increase competition,[88] the Committee's report strongly endorsed large bank mergers and asserted that any loss of competition that might result from a bank merger would be offset by divestitures of branches of merging banks to other financial institutions and non-deposit-taking institutions and by the entry of international banks. The Committee simply made a recommendation exhorting the Competition Bureau to ensure that divestitures foster competition.[89]

The House of Commons Standing Committee on Finance similarly acknowledged the difficulties of fostering competition in the financial services sector, followed by an exhortation to the federal government to foster competition. The Committee noted the barriers to entry into the financial services sector and the uncertainties of successful divestitures under a merger. They also acknowledged the comments of the number of witnesses that "While the recent amendments to the Bank Act made modifications to the rules governing closely held banks, access to the payments systems and foreign entry…little competition has resulted." They further acknowledged comments by the Competition Bureau that technological innovations would not replace the need for the physical presence of financial services in the next five to ten years.[90]

The Standing Committee did make a very useful recommendation for encouraging competition and greater choice in the banking sector that has been supported by other interested parties. They suggested that competitors would emerge if the federal government allows for a federally regulated national

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[86] This refers to the difference between the interest earned on loans and the interest paid on deposits.
[87] House of Commons, Standing Committee on Finance, *Evidence* (February 4, 2003) evidence of Douglas Peters, Economist.
[88] Report of the Standing Senate Committee on Banking, Trade and Commerce, *supra* note 2 at 5.
[89] *Ibid.* at 6: "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 exiting and new competitors."
[90] Report of the Standing Committee on Finance, *supra* note 2 at 20-21.

banking structure that could provide some competition to banks and recommended that the federal government remove barriers to the emergence and growth of credit unions in Canada.[91]

The national association for credit unions and the New Democratic Party have also called on the federal government to make legislative changes to allow for a national cooperative bank structure.[92] Credit unions have also proposed that they play a larger role in any divestitures of bank branches that may be required if a merger were to take place as a way of ensuring that banking services remain in communities.[93]

The evidence is not very convincing that choice in banking services will be enhanced following a merger given the dominance of the major banks and the weakness of current rules in place to encourage the entrance of other competitors. However, measures to boost the development of a cooperative banking sector and ensure their participation in any divestitures entered into by the large banks are very useful and concrete proposals that would benefit consumers in terms of increased choice in banking services, with or without bank mergers.

Access to banking services

Access to banking services is one of the criteria that must be considered under the Finance Department Merger Review Guidelines. It was also flagged in the Minister's letter to the legislative committees concerning the public interest criteria. As implied by the Minister's letter, access means not just geographical access but substantive access.[94]

The issue of access to banking services under a prospective merger raises the question of the current state of Canadians' access to banking services. This is a particularly important issue for low income, disabled, and rural customers. The McKay Task Force Report identified problems with access to basic banking services by low-income Canadians as a serious concern.[95] Basic banking services include standard low-cost bank accounts; the ability to cash federal government issued cheques, lines of credit, overdraft protection and short-term loans at reasonable rates of interest.

[91] *Ibid.*
[92] Credit Union Central of Canada Submission in Response to Finance Canada's Large Bank Mergers in Canada (20 January 2004) online: http://www.fin.gc.ca/consultresp/mergersRespns_27e.html and letter from Judy Wasylycia-Leis, M.P. to Hon. Ralph Goodale (12 August 2005).
[93] Credit Union Central, *Ibid.*
[94] Letter from the Honourable John Manley, *supra* note 36.
[95] Task Force on the Future of the Canadian Financial Services Sector, *Change, Challenge and Opportunity: Report of the Task Force*, (Ottawa: Queen's Printer, September 1998) at 59.

PIAC's recent work in the area of alternative financial services indicates that banks are not currently providing effective basic banking services to some of their customers, beyond some movement to offer low-cost accounts and new federal laws requiring banks to cash federal government issued cheques and criteria governing the opening of retail deposit accounts.[96] As discussed above, a growing segment of bank customers are turning to high-cost alternatives such as cheque cashing and payday loan outlets. These services appear to be utilized by moderate income Canadians and a growing number of younger Canadians.[97]

The concern raised by alternative financial services is that customers who can least afford it are paying much higher fees and service charges for services than they would pay for the same services at mainstream financial institutions, such as fees to cash cheques. Payday loans, a small, short-term loan, are a particularly expensive and risky proposition for those who cannot access overdraft protection or lines of credit.[98]

A prospective bank merger or mergers raises the question whether access to banking services would be improved, given the likelihood of a less competitive marketplace providing even less incentive for banks to improve access to basic banking services to their low volume customers.

There also appears to be some relationship between reduction in branch banking which would likely result from a bank merger and the rise of alternative financial services. Research conducted in a low-income community in the north end of Winnipeg showed a direct relationship between the reduction in bank branches and the rise of more expensive alternative financial services:

> From one pawnshop in 1980, by 2002 there were at least 19 fringe financial service outlets…In 1980, there were 20 mainstream bank branches in the North End. The number dropped to 15 by 1997 and then plummeted to only five in 2003.[99]

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[96] SOR/2003-184.

[97] PIAC surveyed Canadians on their use of alternative financial services in 2002 and found that the users fit the demographic characteristic of the average Canadian in terms of income and education. (See PIAC publication *Fringe Lending and "Alternative" Banking: The Consumer Experience, supra* note 77). However, the Financial Consumer Agency of Canada surveyed Canadians on their use of these services in 2005 and found that the users are characterized by those with lower household incomes and younger Canadians (between 18-34 years of age). Ipsos Reid, *Public Experience with Financial Services and Awareness of the FCAC, supra* note 77 at 10.

[98] See PIAC publications *Fringe Lending and "Alternative" Banking: The Consumer Experience* (November 2002) and *Pragmatic Solutions to Payday Lending: Regulating Fringe Lending and "Alternative" Banking* (November 2003) available on the PIAC website http://www.piac.ca/

[99] Jerry Buckland and Thibault Martin, *Fringe Banking in Winnipeg's North End* (March 2005) at 15-16.

A low-income advocacy group called ACORN Canada researched the geography of bank branch closures and the sites of payday lenders. Their research demonstrated a link between branch closures and the rise of alternative financial services in the cities of Toronto and Vancouver:

> In general, bank branch closures have been concentrated in lower-income neighbourhoods. And payday lenders are moving aggressively into this competitive vacuum. The location and distribution of payday lending operations is closely, although not perfectly, related to significant concentrations of low-income families.[100]

As discussed above, according to the FCAC's database of bank closures, by January 2005 more than 700 Canadian bank branches had closed across the country since February 2002.[101]

The other concern for consumers is the argument put forward by proponents of bank mergers that access to banking services could effectively be protected by ATMs in place of branch closures resulting from a merger. In his appearance before the Senate committee, the Chairman and CEO of Scotiabank addressed the issue of access posed by bank mergers by suggesting that Automatic Bank Machine (ABM) access could replace branch closures and that rural bank branches might be kept open only "when it is for the economic viability of the towns."[102]

As discussed above, the Competition Bureau's Merger Enforcement Guidelines suggest that electronic banking may be an acceptable substitute for the loss of a physical bank branch.[103]

One significant problem in posing electronic banking as an acceptable substitute for the physical presence of a bank branch is that it exacerbates the existing divide between rich and poor in terms of access to banking services. The McKay Task Force Report identified problems with access to basic banking services to low-income Canadians as a serious concern.[104]

PIAC's own survey research has found that although many consumers are embracing the electronic environment in banking, there is a growing income gap in attitudes and practices concerning in-person and electronic banking. Almost twice as many people with incomes of less than $20,000 compared to those with incomes over $100,000 (64% compared to 35%) say that it is important for them

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[100] ACORN Canada, *Protecting Canadians' Interest: Reining in the Payday Lending Industry* (Vancouver: November 2004) at 15..
[101] See FCAC website FCAC - Bank Branch Closures
[102] Senate of Canada, *Proceedings of the Standing Senate Committee on Banking, Trade and Commerce*. 37th Parliament, 2nd Session. No. 5 (25 November 2002).
[103] See discussion of Competition Bureau *supra,* note 33.
[104] McKay Task Force Report, s*upra*, note 16 at 59.

personally to be able to bank in-person.[105] Correspondingly, the greater one's income, the more likely one is to use ATMs or the Internet for banking. When surveyed in 2003, only 14% of those in the lowest income bracket indicated that they had used the Internet for banking in the previous month, compared to more than half of those in the highest income bracket. Those in the lowest income bracket also exhibit the lowest use of debit cards and the highest incidence of in-person banking.[106]

Electronic banking also introduces another demographic divide in terms of age, which must be taken into account when electronic banking is flagged as an alternative or mitigating factor in bank merger discussions. PIAC's research has shown that there is a significant difference in use of electronic banking by age group. Not surprisingly, the importance of in-person banking increases with age. Over 86% of respondents 65 years and older said it was important for them personally to be able to do their banking in person at a branch. Surprisingly, respondents under 25 were the next highest age group indicating the importance of in-person banking (60%).[107]

A further concern is that divestitures of core or branch banking services to other entities such as foreign-owned or non-deposit-taking institutions will mean that any federal legislation protecting consumers may not apply to such institutions. Canada has regulations attached to the *Bank Act* that ensure access to basic banking services such as opening a personal banking account and that govern requirements for cashing federal government cheques. These are important protections for moderate and low income Canadians and their non-applicability to institutions that are not federally regulated banks is a concern.

The other concern is that ATMs are simply not a substitute for the range of services and products that can only be performed by bank branches. An ATM can't negotiate a mortgage or consider a personal or business loan.

Although not the subject of this report, it is clear from submissions to the committees by the small business sector, that the prospect of bank mergers do not alleviate their concerns about existing provision of services to small and medium sized businesses. There was very little discussion by bank chairs of how existing difficulties for small and medium sized business accessing critical banking services such as credit financing would be improved under a bank merger. An increase in the number of ATMs or increased functionality of ATMs is clearly not a solution for small and medium businesses that need the full range of services provided by branch banking.

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[105] Public Interest Advocacy Centre and Ekos Research Associates Inc., *supra* note 52 at 35.
[106] *Consumers and Financial Institutions, supra* note 5 at 19.
[107] Ekos Research Associates, *Data Tables – Main Demographics* (Fieldwork: January 7th to January 14th 2003) at 2 (Notes with the author.)

Small business is also sceptical about the current level of competition for their services between the major banks. The results of a Canadian Federation of Independent Business (CFIB) banking survey (October 2003) showed small business not seeing any improvement in banking competition in past three years regarding servicing small business clientele. The study indicated that the amount of small business debt financing has remained flat since the late 1980s.[108]

There is no clear evidence that mergers will improve access to retail banking services. The suggestion that access could be protected by the replacement of branch banking with ATMs (not necessarily bank-owned or operated) is not a solution to ensuring access. Electronic banking services don't provide a full range of banking services and they aren't an option for many Canadians, who by reason of income or age do not have access to electronic banking.

Cost of banking services

There are indicators that bank mergers will not reduce banking costs overall for consumers, given the alternatives put forward by merger proponents to mitigate the reduction in bank branches that would likely result from a merger. The evidence from the merger of a major bank with a trust company in 1998 was that the cost of most individual transactions increased. As described above, former Toronto-Dominion customers were moved to the Canada Trust fee structure and as a result the price of most individual transactions increased.[109]

There is also an argument that introducing ABMs to respond to the likely reductions in the number of bank branches resulting from a merger, will not result in an overall decrease in the cost of banking services. Bank representatives before the Senate Committee suggested that increasing the number of ABMs could respond to likely reductions in the number of bank branches resulting from mergers.[110] However, there are increased costs associated with using ABMs that do not belong to a customer's financial institution or ABMs operated by private companies.

A 1996 decision by the Competition Tribunal to open up the ABM market to private companies, in order to increase the number of competitors in the marketplace, has produced a proliferation of no-name or "white-label" ATMs, in addition to bank ATMs, but not lower costs. Consumers may now be charged three tiers of fees to use "white-label" ATMs.

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[108] CFIB Research, *Banking on Competition: Results of CFIB Banking Survey* (October 2003) at 10-12.
[109] See earlier section on Bank-trust company mergers.
[110] Senate of Canada, *Proceedings of the Standing Senate Committee on Banking, Trade and Commerce* (November 25, 2002). Evidence of Mr. Peter Godsoe, Chairman and Chief Executive Officer, Scotiabank: "In the case of mergers, the issues can be easily resolved with undertakings and commitments if gaps exist to protect the public interest. Rural branches could be kept open, where necessary, when it is for the economic viability of the towns. ABM access could be offered."

Some of the major banks are now charging the surcharge, normally applicable only to the “no name” ATMs, to non-customer’s using that bank’s own ATMs.[111] A more recent development is banks entering into the no name market through wholly owned subsidiaries. This reduces competition as banks replace their branch ATMs with the subsidiary ATMs.

Analysts suggest that ABM fees increase the costs of banking overall. A study of bank service fees by the Financial Consumer Agency of Canada showed an overall decrease in banking service fees in Canada from 2001 to 2004. However, the authors pointed out that had the survey included the increase in ABM fees charged to consumers using ABMs that do not belong to their financial institution, the study results could have be the reverse:

> The study did not take into account the increase in ABM fees charged to consumers for using ABMs that do not belong to their financial institution to withdraw funds. The inclusion of these fees in the study would have had a significant impact on the results and could have inverted the trend, resulting in an overall increase in service fees.[112]

The amount of bank fees and charges are already unregulated. It is difficult to see how mergers would create competition, choice and thus protect consumers from further price increases if ATMs are seen as appropriate replacements for bank branches.

Peter Godsoe, Chair and CEO of Scotiabank in his appearance before the Senate Committee, described ABM fees and bank service charges as “irritants”:

> The banks could come forward with a viable merger, answering the various public interest impact concerns. There are not that many concerns. We all know about service charges, credit card charges and ABM charges. There are numerous irritants out there, but the real issues are small business, availability and competition.[113]

Bank service charges, credit card fees and ATM fees may be “irritants” for Mr. Godsoe; for many Canadians, these charges and fees are not. They describe Canadians’ daily experience of bank transactions and are the source of much confusion and frustration with Canada’s banking system.

There is no persuasive evidence that bank mergers will improve access, choice and price of retail banking services for consumers. We are more concerned that banks appear indifferent to the concerns of their retail banking customers,

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[111] See the FCAC website for a full description of ABM fees: <http://www.fcac-acfc.gc.ca/eng/consumers/abmfees10_02_e.asp>

[112] Financial Consumer Agency of Canada, *Bank Service Fee Monitoring* (14 March 2005) at 10.

[113] *Proceedings of the Standing Senate Committee on Banking, Trade and Commerce, supra* note 110.

whether that concern is banking services generally or the bleeding off of part of their customer base for retail services to alternative financial services.

When PIAC surveyed Canadians in 2003, a significant percentage was sceptical about the return on the service fees they pay. Nearly half of Canadians surveyed did not think that they get a lot of value for the service fees they pay to their financial institutions, while only one-third felt they get a lot of value for the service fees they pay.[114] PIAC also asked about serious problems Canadians may have experienced with their financial institution. Although only a small percentage indicated they had had a serious problem, a surprisingly large percentage indicated that the problem had not been resolved (32%) and the most common response (four in ten) as to the nature of the problem was described as a problem with services.[115]

One effect of general dissatisfaction with banking services is gravitation away from banks to alternative financial services. Low-volume customers of mainstream banks seem to be increasingly turning to non-bank outlets like cheque-cashing and payday loans businesses. We raised concerns about these businesses due their high-costs and financially risky practices for consumers in two previous reports.[116] In 2002, we found that an incidence rate of utilization of this sector by Canadians was 4.8% or approximately 1.0 to 1.4 million Canadians had used this sector in the last three years when surveyed.

Disturbingly, the rate of usage of alternative financial services appears to be growing. In 2005, the Financial Consumer Agency of Canada surveyed Canadians on their use of cheque-cashing outlets and payday loan companies and found that 7% of have used one of these services.[117] When asked why they had used these services, the most common reasons given were service related. Twenty-five percent indicated that these services were faster, more efficient and provided the money immediately. Eighteen percent stated that these services had more convenient hours and were open evenings and weekends.[118]

There are a number of concerns for consumers raised by the growth of these businesses, already documented by PIAC, but there is also an important question as to why banks seem willing to ignore this segment of their customer base, since the users of these services also have bank accounts at traditional banking institutions. PIAC found that over 80% of users of alternative financial services had bank accounts.[119]

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[114] *Consumers and Financial Institutions*, *supra* note 5 at 11.
[115] *Ibid.* at 23-25.
[116] PIAC publications, *supra* note 98.
[117] Ipsos Reid, *Public Experience with Financial Services and Awareness of the FCAC*. submitted to: Financial Consumer Agency of Canada (March 24, 2005) at 10.
[118] *Ibid.* at 11.
[119] *Fringe Lending and "Alternative" Banking: The Consumer Experience, supra* note 77 at 41.

One possible reason that banks have allowed these customers to disappear to alternative financial services is that these customers do not represent a source of income for banks, since they may lack the resources to buy a range of retail bank products. However, there is research that suggests that banks are ignoring a potentially profitable segment of the market. A 2002 report produced in the United States by the Brookings Institution, an independent economic think tank, found that households with annual incomes of less than $25,000 are estimated to have $175 billion in financial assets and that “unbanked” customers spend at least $4 billion on cheque cashing and bill payment services annually.[120]

We also know that retail banking operations represent a stable and significant source of bank profits, which have been at record highs. Non-interest income (which includes fees for services such as mutual fund and wealth management, brokerage transactions, cheque processing, ABM transactions, credit card transactions and payment and deposit services) accounted for over 50 percent of growth revenue of the six major banks in 2001.[121]

The six major banks have seen all of their shares performing better than the market with record levels of profitability since 2002 in the range of 14 –16 percent and higher[122] and share increases over the last five years from 155% (National Bank) to 169% Bank of Nova Scotia) to 175% (Bank of Montreal). Analysts have described Canada’s major banks as being second only to Japanese banks in terms of their overall performance.[123]

Banks should acknowledge the sector that has been the source of much of this profitability by a demonstrated commitment to improving its retail banking relationships and services rather than seeking ways to merge at the expense of retail banking services. This means improving access to a range of banking products and services to all its customers and reducing the appeal of alternative financial services.

Bank mergers in other jurisdictions

It is useful to look at the results of bank mergers in some other jurisdictions such as the United States and Australia, to see if there are points of comparison or lessons to be learned for Canada.

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[120] R. Weissbourd, *Banking on Technology: Expanding Financial Markets and Economic Opportunity* (June 2002) at 8.
[121] Canada, Department of Finance *Canada’s Banks* (August 2002). Online: <http://www.fin.gc.ca/toce/2002/bank_e.html>
[122] Canada, Department of Finance *The Canadian Financial Services Sector* (June 2005) online: http://www.fin.gc.ca/toce/2005/fact-cfsse.html
[123] Keith Woolhouse “Bank on it: more massive profits for the big six” *Ottawa Citizen* (27 February 2005) D1.

The United States

The United States has a much more heterogeneous and diffuse banking system, than Canada; therefore its experience with bank mergers may be even more cautionary for us. If that experience is negative, this may be significant, given that the United States banking system is not nearly as concentrated as Canada.

The United States underwent an unprecedented level of bank mergers during the period from 1980 to 1998, the largest number of bank mergers in its history. During that period there were approximately 8,000 mergers, involving $2.4 trillion in acquired assets. Research conducted by the Federal Reserve showed that mergers reduced the number of banks overall, that ATMs have proliferated but have been found not to be a substitute for the actual physical presence of a bank and that retail electronic banking has, in the short run, actually reduced rather than increased competition.[124]

During the merger period, the number of banks in the United States declined from 14,381 in 1984, to 8,697 banks in 1998. However, the study noted that the number of banking offices did not decline but increased during this period, reflecting a consistent and ongoing demand for local offices by customers:

> These date are strong indicators that, from the supply side of the banking industry, local market representation is generally important, if not mandatory, if a bank is to be a viable competitor. Survey data for households and small businesses, from the demand side of the market, are strongly consistent with the relevance of local banking markets.[125]

The study also noted that the rise of retail electronic banking has not been the beginning of the end of brick-and-mortar banking. Despite the proliferation of ATMs during this period, the number of banking offices continued to increase. Also, despite the growth in the use of electronic transfers, the volume of physical cheques almost doubled during this period, leading the researchers to conclude that ATMs are not a substitute for the physical presence of a bank.[126]

As noted earlier, the authors also found that a short-term effect of the growth of electronic banking is that it has actually reduced competition between banks by raising the costs to customers of switching banks.

[124] Board of Governors of the Federal Reserve System, *Staff Study 174: Bank Mergers and Banking Structure in the United States, 1980-98* (August 2000).
[125] *Ibid.* at 25.
[126] *Ibid.*

Australia

Australia's banking system has had some experience with bank mergers, which may be instructive for Canada, given the similarity of its banking structure to Canada. Like Canada, Australia has a two-tiered banking system, in which a small number of major banks (four) dominate, followed by a second tier of regional banks, credit unions and building societies. It also has a similar merger review process, with approvals required by the prudential regulatory authority, the competition commission and the federal government, through the federal treasurer's reserve powers.[127]

In 2000 a merger between two major banks in Australia was approved, despite an existing policy prohibiting mergers between the four largest banks. This merger has been controversial; with critics pointing out that the merger left one region of the country with a 'near monopoly' by one of the major banks.[128]

Observers and critics have also expressed concerns about mergers having reduced competition and increased levels of bank closures, increases in bank fees and service charges, and the lack of the adequacy of electronic service delivery as a substitute for branch banking.[129] A recent media report on Commonwealth Bank, the bank that acquired the assets of the Colonial State Bank when they merged in 2000, found that customers were dissatisfied with the bank, citing high fees and charges and the bank's disinterest in customers.[130]

An important difference in the merger review process in Australia at the time of the merger was that there was no transparent public review or public interest test applied to a bank merger. As a result, the federal government proposed amendments to its financial sector legislation in late 2000, to incorporate great public scrutiny over bank mergers. One opposition party attacked the proposal as providing insufficient public consultation.[131]

The experience of bank mergers in the United States and Australia does not provide much assurance about the consumer benefits of large bank mergers. Given the likely negative impact of bank mergers on consumer issues of access, choice and cost of banking services, how effective is the current bank merger review process in protecting consumer interests? The next section examines the

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[127] Australian Graduate School of Management, *Four pillars debate needs refining: AFR Economic Briefing* (22 August 2005).
[128] Australian Democrats, Press Release, "Bank Merger leave Tasmania with a 'near' banking monopoly" (24 November 2005).
[129] Financial Services Consumer Policy Centre, University of New South Wales, *Financial Services and Social* Exclusion (March 2001) at 33-34, Woodstock Institute online: http://www.woodstockinst.org/program_areas/global/australia and Australian Labour Party, *National Platform and Constitution, Chapter Thirteen – Stronger Urban and Regional Communities*
[130] George Kekakis, "Service slides at CBA" *Herald Sun* (23 November 2005).
[131] Australian Democrats, Speeches, "Senator Ridgeway speaks to the Financial Sector Legislation Amendment Bill (No. 1) 2000: Second Reading (31 October 2000).

existing rules, guidelines and legislative review process in terms of the consumer component of the public interest.

Bank merger review process and consumers

The aspects of the bank merger review process that directly affect consumers are the Finance Department's merger review guidelines, the Competition Bureau's analytical document accompanying the merger enforcement guidelines and the legislative review process.

The Competition Bureau's bank merger enforcement guidelines document makes a very strong initial statement that the goal of ensuring competition is to protect consumer interests:

> The main objective of the merger review process is to maintain and promote competition w/in the Canadian economy in order to provide consumers with a wide variety of high quality products that are competitively priced.[132]

However, the actual provisions of the *Competition Act* that govern the Competition Bureau's merger review process make no specific reference to the competitive interests of consumers under mergers. Under section 92 of the *Competition Act*, the Competition Tribunal may prohibit a merger if it prevents or lessens, or is likely to prevent or lessen competition, substantially. Section 93 lists a number of factors to which the Tribunal may look at in determining whether a merger prevents or lessens competition. None of these factors references consumers.

Section 94 specifically references a merger under the *Bank Act* and makes a reference to the "public interest" but this term is not defined in the Act. It states that the Tribunal shall *not* make an order to prohibit a merger where the Minister of Finance has certified to the Commissioner that the merger is in the public interest.

Where the term "public interest" from section 94 is explained, the interpretation is misleading. The Competition Bureau's Merger Enforcement Guidelines interpret section 94 as:

> …the Minister of Finance also has the unique authority under section 94 of the *Competition Act* to prevent the Competition Tribunal from issuing any order in those circumstances where he has certified that a transaction among banks is desirable in the interest of the financial system.[133]

It is an odd interpretation of the term "public interest" to suggest it is only concerned with the "interest of the financial system." This interpretation is also

[132] *The Merger Enforcement Guidelines, supra* note 22 at para. 5.
[133] *Ibid.* at Annex I.

inconsistent with the stated consumer thrust of the merger review guidelines and it is inconsistent with other guidelines that apply to the bank merger review process. The Finance Department's own Merger Review Guidelines affirm the fact that the "public interest" in a bank merger consists of a wide range of factors: costs and benefits to customers and small and medium-sized businesses, availability, price and quality of banking services, impact of branch closures, the effect of mergers on employment, to name just a few elements in the Public Interest Impact Assessment (PIIA) outlined in the guidelines.[134]

The Finance Department's *Merger Review Guidelines* contain important broad statements about the potential impact of bank mergers on consumer services. We strongly support the continued existence of these Guidelines with some qualifications about areas of vagueness or inconsistency.

The Public Interest Impact Assessment refers to the issue of branch closures, but the stated assumption is that branch closures are a given, and the focus should only be on the timing and impact of such closures and the existence of "alternative service delivery measures." The term "alternative service delivery measures" is also not defined. Does this mean a full-service financial institution or an ATM? Obviously, the difference is significant. If the assumption is that an ATM is an "alternative service delivery" mechanism, where is the evidence for making the broad assumption that this could replace the physical presence of a bank branch? It is clear from the analysis of the two proposed mergers conducted in 1998 by the Competition Bureau, and their submissions to the House of Commons and Senate Committees in 2002-3 that alternative service delivery measures are yet a viable alternative to full-service branches.

The assumption that branch closures are a 'given' also appears to contradict the previous condition, which refers to "the possible costs and benefits to customers and small and medium-sized businesses, including the impact on branches…"

There is some vagueness in language and internal inconsistency between legislation and guidelines, but both documents describe important public interest protections that must be maintained and strengthened.

Both committees and the federal government also considered the issue of parliamentary oversight of large bank mergers. The House of Commons Committee recommended maintaining House of Commons committee oversight of the public interest considerations of a proposed bank merger. It was silent on the Senate committee's role stating "it should determine the nature of its involvement in the public interest assessment hearings within the large bank merger review process."[135]

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[134] *Merger Review Guidelines, supra* note 19 at para. 8.
[135] Report of the Standing Committee on Finance, *supra* note 11 at 35.

The Senate Committee report recommended that the Minister permit as being in the public interest, a merger that has been approved by and meets the conditions set out by the Competition Bureau and the OSFI. The Senate Committee's recommendation would remove all parliamentary committee review of bank mergers.

We disagree strongly with the Senate Committee's recommendation to remove legislative oversight of large bank mergers. The Committee's report and recommendations are premised on the assumption of the "public interest" being defined simply by macroeconomic issues. In our view the "public interest" by definition includes the interests of the public at large as well as other broad policy considerations, including macroeconomic concerns. Where is the opportunity for citizens and their elected representatives to have input in this important public policy decision, if not through legislative oversight of Parliamentary committees?

The central importance and influence of banks on the Canadian economy also necessitates a thorough public review process, as the federal government itself affirmed:

> [M]ergers involving large banks in Canada are not like mergers in other industries. They raise special concerns that justify a broader public interest test. This is especially true given the degree of existing concentration in the Canadian banking industry and the possibility of multiple merger applications, which have the potential to significantly alter the landscape of the financial sector in Canada.[136]

The federal government's response to the reports of both committees was to affirm the importance of the public interest review of bank mergers, beyond the reviews by OSFI and the Competition Bureau. The federal government recommended continued oversight by both committees of the House of Commons and Senate and affirmed the Minister of Finance's role as the "steward of the public interest".[137] The federal government also recommended that the Minister of Finance consider five public interest criteria: access, choice, international competitiveness and long-term growth prospects, capital markets and transition (of displaced employees).[138]

The fact that the merger review process is ultimately subject to political approval by the Minister of Finance was most strongly criticized by banks during 2002 consultation as politicizing the process. That this decision is ultimately in the hands of a minister certainly politicizes the process. However, banks have contributed to politicizing the process by having access to government officials to 'sound out' potential mergers.

[136] *Ibid.* at 6.
[137] Canada, Department of Finance, *supra* note 46 at 6.
[138] *Ibid.* at 7-10.

Our concern is about ensuring that there is a transparent public process, a balance of views concerning what constitutes the public interest and a grounded analysis of the potential impact of a bank merger concerning all the public interest criteria outlined in the public interest impact assessment.

The 2002 public review process failed on all these counts: its inception was not transparent, there was not a balance of views put forward during the public consultation and the assessments of the public interest aspects failed to thoroughly examine the connection between a bank merger and its potential impact on issues that most affect consumers – access, choice and cost of banking services.

Conclusion

What appears to be driving a renewed desire on the part of the large banks to merge is the desire to grow and expand outside of Canada. However, banks still provide retail-banking services to millions of individual Canadians. Our concern is that the case for large bank mergers has not been made. The evidence suggests that large bank mergers will mean fewer banks, fewer bank branches, an increase in non-bank and ATM delivery of bank services – at greater cost, with less Canadian control, therefore less protection for consumers. This, in our view, does not meet key elements of the public interest test.

Recommendations

Re existing regulatory framework governing bank mergers

Despite the lack of clarity and some inconsistency in the guidelines issued by the Department of Finance and the Competition Bureau, we strongly support the existence of such guidelines. They need to be reinforced and clarified with respect to consumer interests, not watered down or eliminated. Together these guidelines identify important public interest considerations raised by a bank merger: costs and benefits to customers, including impact on branches, availability of financing, price, quality and availability of services. But they need to be examined in a substantive way, so that there is a real analysis of the impact on issues such as access, choice and price with respect to retail banking services for Canadians. Without this analysis, any guidelines, no matter how they are worded, are meaningless.

We have identified problems with inconsistency and lack of clarity in both the Competition Bureau and Finance Department guidelines. Our recommendations with respect to the Finance Department Merger Review Guidelines are:

- The reference in Bullet 3 of the Public Interest Impact Assessment to “the timing and socio-economic impact of branch closures” should be eliminated. The implication of this provision is that branch closures are a ‘given.’ This proposition should not be assumed by a public interest impact analysis, but must be part of the overall examination of the public interest impact. This provision also contradicts the previous bullet 2, which refers to impact on branches.

- Reference in Bullet 3 of the Public Interest Impact Assessment to alternative service delivery measures should be explained as to what is meant by this term. The provision should be restated to require applicants to demonstrate how alternative service delivery measures will be an acceptable replacement for branches and at no greater cost to consumers.

- Under Bullet 7 with reference to divestitures of bank branches, the provision should be amended to say that where federal consumer protection legislation is now applicable to Canadian deposit taking institutions, undertakings will be made with entities to which any branches have been divested to ensure that these provisions continue to apply as a condition of any contractual agreement.

With respect to the Competition Bureau's merger enforcement guidelines and the *Competition Act*:

- The sections of the *Competition Act* that govern the Competition Bureau's merger review process, specifically section 93, should be amended to make reference to the extent to which the proposed merger would 'provide consumers with competitive prices and product choices."

- The interpretation given to the term "public interest" by the guidelines is misleading. The fourth paragraph of Annex I to *The Merger Enforcement Guidelines as Applied to a Bank Merger* implies that the public interest is concerned only with the interests of the financial system. This paragraph should be eliminated.

Re choice, access and price of banking services

There is no persuasive evidence that under the current financial services framework consumer choice and access to banking services will be enhanced by a large bank merger. There is more persuasive evidence that in the current climate, mergers will mean fewer choices, fewer physical bank branches, more ATMs, and therefore more costs for basic banking services. Given that legislative changes to encourage foreign bank entry have not worked, any proposed measures to enhance this element will have to be accompanied by a much more transparent public consultation process, since Canadians express substantial concerns about loss of Canadian control over banking.

Choice

- Reverse the trend of bank branch closures

- Remove legislative impediments to allow for a federally regulated national cooperative banking structure

- Banks be required, as a condition of any divestiture of bank branches under a merger, to enter into negotiations with credit unions to be prospective buyers of divested branches

Access

- Banks should reduce hold periods on cheques, expand lines of credit and offer overdraft protection to more customers

- The Federal Department of Finance needs to devote research to understand why a growing sector of bank customers are turning to alternative financial services

Price

- Banks should provide more transparency about service fees and charges and substantive analysis as to how they can be justified as banks move to less costly electronic platforms.