HOUSE OF COMMONS
CANADA

LARGE BANK MERGERS IN CANADA: SAFEGUARDING THE PUBLIC INTEREST FOR CANADIANS AND CANADIAN BUSINESSES

REPORT OF THE STANDING COMMITTEE ON FINANCE

Sue Barnes, M.P.
Chair

March 2003

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has the honour to present its

THIRD REPORT

In accordance with its mandate under Standing Order 108(2), your Committee has studied the public interest implications of large bank mergers and has agreed to report the following:

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LARGE BANK MERGERS IN CANADA: SAFEGUARDING THE PUBLIC INTEREST FOR CANADIANS AND CANADIAN BUSINESSES

INTRODUCTION

In October 2002, the Minister of Finance and the Secretary of State (International Financial Institutions) wrote to the Standing Senate Committee on Banking, Trade and Commerce and the House of Commons Standing Committee on Finance asking for their views on the major considerations that should apply in determining the public interest with respect to large bank mergers. They indicated that, since the release of the Merger Review Guidelines applicable to proposed mergers of banks with more than $5 billion in equity, some stakeholders had suggested that the public interest tests needed greater clarity.

In particular, the letter indicated that the committees might wish to consider the public interest implications of large bank mergers in four areas:

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

It was within this context that the House of Commons Standing Committee on Finance held public hearings and received input from Canadians on what they believe should be meant by the term "public interest."

In beginning its work, the Committee started with the reality that mergers by large Canadian banks are "legitimate business strategies for growth and success."[1] Consequently, we examined not whether large bank mergers should or should not be allowed, but rather the "public interest" considerations that should exist with respect to

[1] *Reforming Canada's Financial Services Sector: A Framework for the Future*, 25 June 1999, p. 22.

mergers by large banks. This report summarizes the testimony received by us on the public interest considerations and provides our views on what criteria should guide the public interest assessment of a particular merger proposal by Canada's large banks.

THE PUBLIC INTEREST IN THE LARGE BANK MERGER REVIEW PROCESS

The current merger review process for Canada's large banks and bank holding companies — those with more than $5 billion in equity — flows largely from the conclusions reached by the Task Force on the Future of the Canadian Financial Services Sector. In its 1997 interim report, the Task Force recommended that the federal government abandon its informal "big shall not buy big" policy disallowing mergers among large financial institutions and that proposed transactions be reviewed on their merits. It also recommended that:

- the Competition Bureau should assess the effects of a proposed merger on competition on the basis of the *Competition Act*;
- the Office of the Superintendent of Financial Institutions (OSFI) should assess whether a proposed merger raises concerns about the safety and soundness of the institutions or the financial system; and
- the Minister of Finance should assess whether a proposed merger is consistent with the public interest.

Following the Task Force's final report, the Department of Finance released its Merger Review Guidelines. They identify three distinct stages in the large bank merger review process — the examination stage, the decision stage and, if required, the remedies stage — and set out a three-part review process in the examination stage:

- the Competition Bureau reviews the merger proposal from a competition perspective;
- the Office of the Superintendent of Financial Institutions reviews the merger proposal from a prudential perspective; and
- concurrently with these reviews, the Standing Senate Committee on Banking, Trade and Commerce and the House of Commons Standing Committee on Finance are asked to conduct public hearings into the broad public interest issues raised by the merger proposal, using the Public Interest Impact Assessment prepared by the merger applicants as an input to the process.

In the decision stage, the Minister of Finance uses the reports of the Competition Bureau, the OSFI and the Parliamentary committees to decide whether the competition, prudential and public interest concerns raised by a proposed merger are capable of being addressed. If they are not, the transaction is denied.

If, however, the concerns are capable of being addressed, the remedies stage begins, with a view to addressing concerns raised during the review process. The Competition Bureau and the OSFI will negotiate competition and prudential remedies with the merger applicants, and will work with the Department of Finance in coordinating a set of public interest remedies. Once remedies have been negotiated, the Minister of Finance will approve the proposed transaction with terms and conditions that reflect those remedies. Failure to comply with these terms and conditions may result in the Minister applying to a court for an order directing that the terms and conditions be respected. On application, the court may so order and may make any other order it believes is appropriate.[2]

The Merger Review Guidelines — which are not part of the *Bank Act* — make clear that, subject to the prerogatives of Parliament, the federal government will attempt to complete the decision stage of the review within no more than five months after receiving a completed application and adequate supporting documentation from the merger applicants.

This merger review process differs from that which is generally applied to other private sector businesses, which raises a question about why large banks are treated differently. A discussion of this issue and a more detailed description of the public interest assessment of large bank merger proposals are presented below.

A. The Rationale for Differential Treatment of the Banking Sector

Since the first bank charters were granted to the Bank of New Brunswick in 1820 and to the Bank of Montreal in 1822, the Canadian banking sector has been relatively heavily regulated.[3] At present, there are four government institutions that regulate or address issues affecting the banking system: the Bank of Canada, which acts as a lender of last resort in the event of a major financial crisis; the Canada Deposit Insurance Corporation, which guarantees eligible deposits at member institutions (up to $60,000 per depositor); the Office of the Superintendent of Financial Institutions, which oversees the financial stability of the financial services sector; and the Financial Consumer Agency of Canada, which has responsibility for protecting and educating bank customers.

Banks play a critical role in the day-to-day economic lives of individuals and businesses, and through their charters have the right to create money via loans and lines of credit. As Mr. Bernard Sieger suggested to the Committee, "(t)he bank is the core of

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[2] Section 229.1 of the *Bank Act* provides that:
229.1 (1) If a bank or any director, officer, employee or agent of a bank is contravening or has failed to comply with any term or condition made in respect of the issuance of letters patent of amalgamation, the Minister may, in addition to any other action that may be taken under this Act, apply to a court for an order directing the bank or the director, officer, employee or agent to comply with the term or condition, cease the contravention or do any thing that is required to be done, and on the application the court may so order and make any other order it thinks fit.
(2) An appeal from an order of a court under this section lies in the same manner as, and to the same court to which, an appeal may be taken from any other order of the court.

[3] See H.H. Binhammer and Peter S. Sephton, *Money, Banking, and the Canadian Financial System, Eighth Edition*, Thomson Canada Limited, 2001.

our financial life." Most would agree that there is a need to regulate the banking sector. Differences of opinion exist, however, about the scope of that regulation. In his appearance before the Committee, Mr. Harold MacKay, former Chair of the Task Force on the Future of the Canadian Financial Services Sector, characterized the large banks as the most important financial intermediaries in Canada and indicated that a strong and competitive Canadian banking sector is critical to the country's future. Teamsters Canada urged the Committee to "focus on banking as a social good and create policies that will work for banks and consumers. … Forgetting the social good embodied in financial services may lead to a decision that works only for banks and their shareholders."

For their part, Canada's large banks also recognize the need for regulation. For example, the Bank of Montreal Financial Group told the Committee that the banking sector is "a highly regulated sector because of our sensitive role as financial intermediaries, and we fully accept that there is a valid public interest component in how the sector is organized and how it performs for individuals, businesses large and small, and the economy as a whole."

The Committee acknowledges the views of those witnesses who indicated that many Canadians see banks as a utility and bank access as a fundamental right, and that banks play a key role in our socio-economic environment. We believe that regulation of the banking sector is both appropriate and necessary, but also caution that it must be the correct level and type of regulation. Similarly, in our view it is entirely suitable that merger proposals by large Canadian banks be subject to a different merger review process than that which is generally applicable to other sectors. For this reason, the Committee recommends that:

RECOMMENDATION 1

Merger proposals by Canadian banks and bank holding companies with more than $5 billion in equity continue to be subject to review by the Competition Bureau to assess competition concerns, by the Office of the Superintendent of Financial Institutions to assess prudential concerns and by the House of Commons Standing Committee on Finance to assess public interest concerns. To ensure that the review occurs with the assistance of all relevant information, the Competition Bureau and the Office of the Superintendent of Financial Institutions should complete their reviews as expeditiously and thoroughly as possible in order that their analysis is available to assist in the public hearing process.

The Committee does not comment on the role of the Standing Senate Committee on Banking, Trade and Commerce, believing that it is within that committee's prerogative to determine the nature of its involvement in the public interest assessment hearings within the large bank merger review process.

B. The Public Interest Impact Assessment

As noted above, the parties to a merger proposal are required to prepare a Public Interest Impact Assessment (PIIA), which is meant to be one of the elements used by the Parliamentary committees in their assessment of the broad public interest issues raised by a merger proposal. In the PIIA, the merger applicants are required to explain the rationale for the proposed merger as well as the steps that could be taken by them to mitigate any potential costs or concerns. The Merger Review Guidelines itemize the information that the merger applicants are expected to provide:

- Their business case and objectives;
- The possible costs and benefits to customers and to small and medium-sized businesses, including the impact on bank branches, the availability of financing, price, quality and the availability of services;
- The timing and socio-economic impact of any branch closures or alternative service delivery measures at the regional level, as well as alternative service delivery measures that might reduce the impact;
- The manner in which the proposal would contribute to the international competitiveness of the financial services sector;
- The manner in which the proposal would directly and indirectly affect employment and the quality of jobs in the sector, with a distinction made between transitional and permanent effects;
- The manner in which the proposal would increase the ability of the banks to develop and adopt new technologies;
- Remedial or mitigating steps in respect of public interest concerns that the merger applicants are prepared to take, such as divestitures, service guarantees and other commitments, and the measures to ensure fair treatment of those whose employment is affected; and
- The impact that the transaction might have on the overall structure of the industry.

In addition, the PIIA covers any other issues that the Minister of Finance or the merger applicants deem relevant in the context of a particular proposal.

Several of the Committee's witnesses commented on the Public Interest Impact Assessment. There was a general consensus that the preparation of such an assessment — and the items that have been identified — have value, particularly in ensuring reasonable commitments to protect the public interest.

Some concerns were, however, voiced. For example, the Public Interest Advocacy Centre argued that "(t)he implication … 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 bank or an ATM?"

Professor Jean Roy suggested to the Committee that one solution to the vague nature of the PIIA criteria would be for "the government to take the position that any transaction that is acceptable to the Office of the Superintendent of Financial Institutions and the Competition Bureau would be permitted, on the condition that reasonable commitments are undertaken to protect (the) public interest." He also argued, however, that "the government (should) continue … to be responsible for monitoring any negative effects in the short term that these transactions could have on vulnerable clients. … (T)he Public Interest Impact Assessment component needs to be maintained in order to force banks interested in merging to make reasonable commitments to protect the public interest."

The Bank of Montreal Financial Group noted additional elements that might be included in the PIIA, and suggested that the Committee might wish to recommend that the PIIA include an assessment by the merger applicants of:

- how rural communities would be served, including a commitment to retain a branch presence for a reasonable length of time;
- how customers would be affected with respect to price, products and services;
- how the availability of credit would be affected, with identification of the role of personal and small business banking in the business mix of the merger applicants;
- how full use would be made of attrition, retraining and redeployment to mitigate job losses in situations where there would be some short-term overlap or duplication;
- how severance packages would be made available to employees losing their positions in the short term, with an indication of the number of positions that would be lost in the short term; and
- how employment would grow in the longer term as a consequence of the merger.

The Committee notes that such issues as the availability of financing, price and employment impacts are already explicitly identified as components of the PIIA in the Merger Review Guidelines, and the issue of service to rural communities is implicit in the Assessment.

Representatives of Canada's large banks stressed the importance of ensuring a predictable process. According to the Canadian Imperial Bank of Commerce, the OSFI and Competition Bureau processes are clear. What is needed, in its view, is "the same level of predictability in determining what criteria satisfy the 'public interest' of Canada." The RBC Financial Group told the Committee that "(t)he fact that (there are) already … guidelines in place that deal with issues like access to service, branch closures and transitional issues such as employment, creates additional ambiguity and leaves the industry struggling with how to define public interest issues … . Therefore, … it is imperative that the government defines more precisely not only the concept of 'public interest' but also specific guidelines and requirements for addressing the Public Interest Impact Assessment."

Mr. Harold MacKay argued that any clarification of individual items should avoid fixed numeric criteria. He stated that too much precision could restrict a minister from doing what is in the public interest in the context of a particular merger proposal. He recommended instead that the Guidelines state explicitly that the Minister must balance public interest benefits and costs in making the final decision rather than specific hurdles on an item-by-item basis. This view was supported by Option Consommateurs, which said that while the Guidelines could be improved, each bank merger should be dealt with separately, and numerical thresholds could prove to be "cumbersome and inflexible."

TG International and the Canadian Community Reinvestment Coalition argued for greater and more consistent provision of data on bank-related public interest issues. Specific mention was made of public accountability statements and the U.S. *Community Reinvestment Act*. The Committee notes that, at this time, banks with equity of $1 billion or more are required to file annual public accountability statements containing a range of information.

In the Committee's view, the existing requirements of the Public Interest Impact Assessment are quite comprehensive and we see no need to identify any additional areas that should be added. We support the Minister's ability to request additional information in the PIIA — perhaps in response to the circumstances presented by a particular merger proposal — and the ability of merger applicants to provide any additional information they deem to be relevant. From this perspective, the Committee recommends that:

RECOMMENDATION 2

The list of items to be included in the Public Interest Impact Assessment, as identified in the Merger Review Guidelines, be retained. In completing the Assessment, merger applicants should have due regard for the clarification provided by the House of Commons Standing Committee on Finance in the areas of access and long-term growth for Canada. Moreover, the ability of the Minister of Finance to request, and of the merger applicants to provide, additional information should continue to exist.

There is, however, a need to clarify what is expected in several of the areas in order to safeguard the public interest, and the Committee provides this clarity in a non-prescriptive manner in recommendations 3 through 10 of the report.

ACCESS

In a market economy such as that of Canada, access to the financial services sector is a necessity. Banking needs vary depending on each customer's circumstances. Small and medium-sized enterprises (SMEs) need access to loans or lines of credit in order to finance ongoing costs, while students may require loans to finance their education and prospective homeowners typically need mortgages to buy a house. Moreover, employees often require a bank account to cash their cheque or to accept electronic deposit of their cheque, and consumers may need credit cards to shop online, over the telephone or in person.

From an economic perspective, active membership in society requires a relationship between the financial services sector, and citizens and businesses. A range of access issues — for all Canadians, for Canadian businesses, to reasonably priced services, in all regions of the country, to a range of service providers and a range of services, to employment transition measures and to high-quality jobs — are discussed below.

A. Access for All Canadians

During the Committee's hearings, some witnesses expressed concern that bank mergers could hurt certain vulnerable groups in society, including disabled persons, seniors and low-income individuals. These groups may rely on branch banking to a greater extent than other segments of the population, and telephone and Internet banking services are often not an option for them.

For example, people with cognitive or physical impairments may find it hard, if not impossible, to use telephone or Internet banking services because of difficulties remembering their personal identification number, using access codes or going through multiple layers of information for verification. Others may find it difficult to access telephone and Internet banking services because they have lower literacy skills or the costs of telephone and Internet access are prohibitive for them. Furthermore, although Canada's major banks provide low-cost bank accounts,[4] low-income individuals may face financial barriers to opening such accounts, a point which was made to the Committee by the Canadian Community Reinvestment Coalition. Figure 1 provides information on the low-cost accounts offered by major Canadian banks as of February 2001.

[4] In 1997, the major banks adopted a voluntary code regarding access to low-cost bank accounts to anyone with adequate identification. Details can be found at http://www.fin.gc.ca/news97/97-012e.html.

Figure 1: Low-Cost Accounts Offered by the Major Canadian Banks as of February 2001				
Bank	Monthly Fee	Total Transactions	Maximum Number of In-Branch Transactions	Other Features
Bank of Montreal	$3.50	10	10	1 free account history inquiry
The Bank of Nova Scotia	$3.95	12	4	
Canadian Imperial Bank of Commerce	$4.00	12	12	
HSBC Bank Canada	$4.00	12	4	1 additional electronic debit for each direct deposit; free account balance updates through HSBC automatic teller machines (ATMs), over the telephone or on the Internet
Laurentian Bank of Canada	$2.95	8 (6 electronic + 2 in-branch)	2	
National Bank of Canada	$ 3.50	12 (10 electronic + 2 in-branch)	2	
Royal Bank of Canada	$4.00	No less than 12 (currently offering 15)	15	
The Toronto-Dominion Bank	$3.95	14 (10 electronic + 4 in-branch)	4	Monthly fee waived with minimum monthly balance of $1,000; free bank statement or $2.00 per month passbook option
Source: Department of Finance News Release 01-014. Available at: http://www.fin.gc.ca/news01/data/01-014_4e.html				

The Committee notes that the federal government has prepared Regulations, which are currently available for review in the *Canada Gazette*, that codify the banking sector's existing voluntary guidelines, with some minor differences. For example, the Regulations stipulate that an individual must be permitted to open an account, regardless of their previous financial record,[5] provided they have either:

- two pieces of acceptable identification, which includes a Canadian driver's licence, a Canadian passport, a birth certificate and a social insurance card;[6] or

[5] In other words, a previous bankruptcy filing or other financial difficulties are not grounds for denying an individual the right to open an account, although an account can be denied if the individual has a record of fraud or other illegal activity related to bankruptcy.

[6] For a complete list of acceptable identification, as well as a detailed description of the Regulations, see the *Canada Gazette*, "Access to Basic Banking Services Regulations," available at: http://canadagazette.gc.ca/partI/2002/20021130/html/regle-e.html.

- one piece of identification if the identity of the individual is also confirmed by a client in good standing with the member bank or by an individual of good standing in the community where the member bank is situated.[7]

If the bank refuses to allow an individual to open an account because of concerns raised about the person's identification, it must provide written notice of its refusal and a statement advising the client that he or she can file a complaint with the Financial Consumer Agency of Canada.

In its 1998 report, the Task Force on the Future of the Canadian Financial Services Sector noted that "bank closures have a disproportionate impact on particular groups in society. They have been … primarily a concern of those who live in smaller, rural communities, and low-income neighbourhoods in urban centres."[8] The banks have promised to implement measures to address these concerns. For example, the Canadian Imperial Bank of Commerce has said that "providing access to banking for people with special needs is an integral part of our philosophy where it is possible to do so, and we believe should be the philosophy of the entities proposing a merger."

Other banks have similar perspectives. Scotiabank told the Committee that "(l)ow-cost accounts, rural branches and the branch closure regime, with formal notice periods and community consultations, access for the disabled and access through new technologies at ABMs, online and over the phone — all of these are important for Canadian consumers and businesses." Moreover, the Bank of Montreal Financial Group indicated that "(w)hile there is increased availability of alternative channels, such as telephone banking, automated banking machines (ABMs) and the Internet, some Canadians — in particular some seniors — may not be comfortable with alternative channels. For them, a branch closure may be felt to impose a significant cost."

Although not specifically mentioned by witnesses, the Committee believes that such other vulnerable groups as Aboriginal Canadians and new Canadians may also encounter difficulties in accessing credit and other financial services. We note that some financial institutions are providing specifically directed Aboriginal banking services, and initiatives in this regard should continue.

Concerns were also raised about the potential impact of large bank mergers on charitable giving. Community Foundations Canada told the Committee that "(t)here is some evidence, and some research has been undertaken to demonstrate this, that when two businesses merge the amount of community involvement that the two entities may have had separately is reduced to the equivalent of one. I fear that will be the case if banks merge."

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[7] Individuals must also disclose their name, date of birth, address (if any) and occupation (if any) and allow the banks to verify that their identification is valid.

[8] *Change Challenge Opportunity: Report of the Task Force on the Future of the Canadian Financial Services Sector*, September 1998, p. 165.

The Committee shares the concerns expressed by witnesses about access to financial services for all Canadians — particularly disabled persons, seniors, low-income individuals and other vulnerable groups — and about the impact that approval of a merger application might have on charitable giving and other types of community involvement by banks. At the same time, we are aware of efforts taken by the banks with respect to low-cost accounts and the development of technology, and of their involvement in the social fabric of our country. In our view, the financial challenges faced by some groups and individuals within society can lead to a social deficit, and the Committee believes that large banks — regardless of whether mergers occur — are and should continue to be a partner in remedying any social deficit resulting from financial challenges. For these reasons, the Committee recommends that:

RECOMMENDATION 3

Merger applicants provide no less than an equivalent level and range of services to all Canadians before and after the merger, bearing in mind technological change and changing consumer requirements. Moreover, the merged entity should pay particular attention to ensuring access for disabled Canadians, seniors, low-income individuals and Aboriginal Canadians, as well as to ongoing community and charitable involvement efforts.

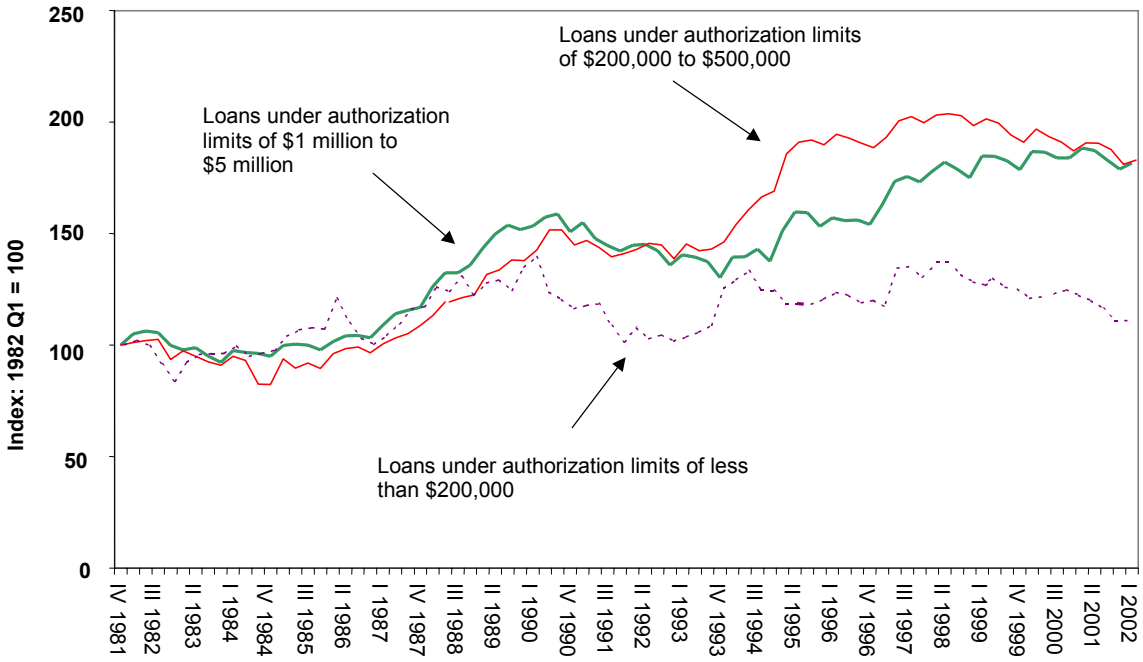
B. Access for Businesses

Access is also an important issue for small and medium-sized businesses,[9] especially with respect to financing, primarily through lines of credit and loans. In the first half of the 1990s, many SMEs suggested that the major chartered banks were unduly rationing credit. For their part, the banks indicated that as a consequence of the 1990-91 recession many firms became insolvent or near-insolvent and, consequently, it was unwise to lend under such conditions.

Figure 2 shows authorized chartered bank loans by size over the 1981-2002 period, and indicates a decline in the amount of authorized loans worth $200,000 or less in the early 1990s. It also shows that loans of this size stagnated during the 1990s despite strong economic growth in the latter half of the decade. In contrast, authorized loans worth $200,000 to $500,000 and worth $500,000 to $1 million have recovered from the recession of the early 1990s.

[9] Small firms are usually defined as having fewer than 50 employees, while medium-sized firms have from 50 to 499 employees.

Figure 2: Chartered Bank Loans by Size, 1981-2002



Source: Library of Parliament and *Bank of Canada Banking and Financial Statistics* (Quarterly Data); CANSIM II Series, Numbers: B2773, B2786 and B2799.

Most SMEs are thought to have relatively small loan needs. According to some estimates, the average loan size to SMEs is less than $50,000.[10] Moreover, the Canadian Imperial Bank of Commerce has indicated that 70% of all small business loans are for amounts less than $250,000. Furthermore, Industry Canada has found that 23% of SMEs made a request for debt in 2000 and 82% of these requests were approved.[11] A 1998 survey by the Canadian Bankers Association found that 38% of SMEs applied for debt and 93% of these requests were approved.[12]

Much of the data reflects overall industry figures and includes all chartered banks, rather than the five large banks. Some of Canada's large banks told the Committee that small business lending by them increased during the 1990s and into the new millennium, and that lending to this market is more than competitive. The TD Bank Financial Group told us that "small business banking is an area to which all banks are firmly committed. Competition among banks for this segment is fierce. Small business is the backbone of Canada's economy."

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[10] Allan Riding. 1998. *Financing Entrepreneurial Firms: Legal and Regulatory Issues*, p. 18.

[11] *SME Financing in Canada*, Industry Canada, 2002, p. 18.

[12] Ibid.

Data from the Canadian Federation of Independent Business show that, when taken as a whole, the market share for small business loans held by the five large banks fell from 75.5% in 1989 to 66.7% in 2002.[13] Credit unions and caisses populaires gained the most market share, rising from 13.4% of all small business lending in 1989 to 20.7% in 2002.

The Committee notes that small business loans are generally riskier than larger loans. Statistics Canada data indicate that in 2000 the loss rate was 1.5% for loan authorizations of less than $50,000, 0.9% for authorizations between $50,000 and $249,999, 0.5% for authorizations between $250,000 and $999,999, and 0.3% for authorizations of $1 million or more.[14]

Notwithstanding the gain in market share by credit unions and caisses populaires and some evidence suggesting that they offer better SME customer service,[15] the Committee was told that large banks continue to play an important role in SME financing because of their branch and ATM networks, and because they tend to offer a greater range of banking services and are better positioned to assist the SME sector as it grows. Nevertheless, branch closures could affect access to these services, and the Canadian Federation of Independent Business told the Committee that "despite the fact that there has been some limited entry of other players into the market place in recent years, the reality from a small business standpoint is that these alternate players cannot supply the range of financial services required by the average SME." The Federation also noted that while "(s)upporters (of bank mergers) say credit unions and trust companies will fill the void … (t)his is highly unlikely. While it is true that some credit unions offer good service, … it must be said that credit unions and trust companies have very little national market presence/power, have underdeveloped commercial lending expertise and are not as well equipped to grow with companies as they expand and specialize."

The Committee notes Statistics Canada data for 2000 showing that credit unions and caisses populaires have a disproportionate share of the SME loan market, with 38% of the market in loans under $50,000 and 26% of the market in loans worth between $50,000 and $249,999, compared with 51% and 57% respectively for large banks. Credit unions and caisses populaires appear anxious to grow their SME business. The Credit Union Central of Canada informed the Committee that "(i)n the event of large bank mergers, it is anticipated that many Canadians will look to … credit unions to provide greater choice and access to retail financial services including SME lending." Moreover, the National Bank of Canada told us that any merger should compel the merging banks to sell a sufficient number of branches to ensure competition for SME banking needs.

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[13] Canadian Federation of Independent Business, "Bank Mergers: In Whose Interest?", October 2002, available at: http://www.cfib.ca/default_E.asp?1=E.

[14] Statistics Canada, "Survey of Suppliers of Business Financing," *The Daily*, 29 January 2002.

[15] See Canadian Federation of Independent Business,"Banking on Entrepreneurship: Results of CFIB Banking Survey," March 2001, available at: http://www.cfib.ca/research/reports/default_e.asp.

The Committee also heard testimony that women entrepreneurs may find it particularly difficult to obtain bank financing. The Women Entrepreneurs of Canada told us that there is "serious concern that small and middle-size businesses run by women do not presently have the same access to capital and services that are provided to male owned businesses. Access to financing for women run businesses needs to be strongly supported to ensure that availability will not be further reduced by bank mergers."[16]

The Committee believes that our large banks play a critical role in providing a range of services — particularly access to capital — to Canadian small and medium-sized businesses, and in our view these services should be provided to all sectors and in all regions of the country. Small and medium-sized businesses are key engines of growth for our economy. Consequently, we feel that they must continue to have access to services, particularly while other competitors — credit unions, caisses populaires and others — emerge and grow. From this perspective, the Committee recommends that:

RECOMMENDATION 4

Merger applicants demonstrate the manner in which the merged entity would increase access to capital for small and medium-sized businesses.

C. Access to Reasonably Priced Services

The Committee also heard concerns about the potential impact of large bank mergers on prices. In the view of the Consumers' Association of Canada, "(p)rices reliably rise as competition is reduced. Some proponents who feel certain that economies of scale exist cannot explain how the reduced competition will increase loans to small business or how it will result in more attentive service or lower bank fees."

The Committee shares the concerns expressed by witnesses about access to appropriately priced financial services — adjusted for inflation — for all Canadians and Canadian businesses, and in all regions of Canada and sectors of the Canadian economy. Consequently, the Committee recommends that:

RECOMMENDATION 5

Merger applicants outline the manner 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 three years.

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[16] While the data show that women entrepreneurs are less likely to obtain a loan than male entrepreneurs, it is difficult to say whether the loan applications are denied because the applicant is a woman or because of the nature of the business she operates. Women entrepreneurs tend to be disproportionately engaged in relatively new and small start-up businesses, frequently in such areas as retail. To the extent that age, size and type of firm are indicative of credit risk, it is unclear to what extent gender might account for differences in borrowing experiences. See Allan Riding, *Financing Entrepreneurial Firms: Legal and Regulatory Issues*, 2002, p. 27-30.

D. Access in All Regions

Data from the 2001 Census show that rural and small municipalities, defined as areas outside urban populations with 10,000 or more inhabitants, experienced a 0.4% decline in population between 1996 and 2001. In 2001, 20.3% of Canadians lived in rural and small town areas, down from 21.5% in 1996. The population of these areas declined in every province except Ontario, Manitoba and Alberta.[17] With the exception of a few remote areas, rural and small town areas experienced declines in their population because of out-migration. At the same time, an aging population meant that their rate of population increase was low and, in some cases, negative.[18]

These trends have particular consequences for rural and remote municipalities, businesses, individuals and financial service providers. For municipalities, declining population levels lead to declining property values, which result in a smaller tax base, lower tax revenues and a narrower range of — or more costly — municipal services. For businesses, declining population levels mean lower sales and lower profits. For individuals, job losses may be the consequence. For financial service providers, low property values mean that businesses and individuals have less collateral to offer as security against new debt, and the threat of even lower property values in the future may mean that banks may have to charge higher interest rates on new loans or refuse loans altogether, which also negatively affects local economic activity. Personal and business bankruptcies may also occur, which would also affect banks.

Even in the absence of mergers, some banks have sold branches in rural and remote areas and have focused their efforts on urban centres. The Federation of Canadian Municipalities told the Committee that Canada cannot afford to let the financial services sector abandon rural and remote communities since, in these communities, "the physical presence of a bank branch can be extremely important to a community's morale. When one place of business closes down, other businesses are affected."

The Committee was told that, in some cases, credit unions and medium-sized banks have purchased branches that would otherwise have been closed by the large banks. ATB Financial — a provincial Crown corporation — told the Committee that in Alberta it acts as a "provider of services to all areas of the province" and has continued service in rural and remote regions. Its branches are largely in rural and remote areas, with 104 of 145 branches located outside the Edmonton and Calgary metropolitan areas. In addition to branches, services may be distributed through 132 agencies operated by insurance brokers, grocery stores and travel agencies, among others, primarily providing deposit-taking and cheque-cashing services as well as loan referrals.

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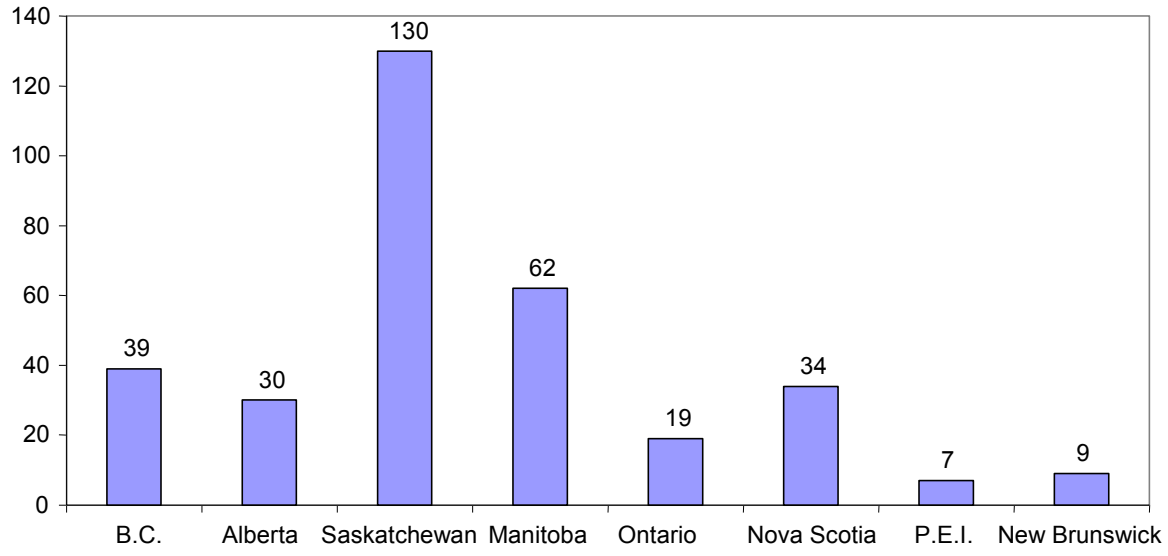
[17] The growth of rural areas in these three provinces depended on the proportion of their residents who commuted to urban centres, choosing to live just beyond urban boundaries in more rural settings. The population of rural areas in which more than 30% of the residents commuted to urban centres increased 3.7% between 1996 and 2001.

[18] The population of the most remote areas grew by 1% because the birth rate, especially among Aboriginal Canadians, was high enough to offset out-migration.

Moreover, since 2000, the Credit Union Central of Canada has purchased about 72 branches from chartered banks and resold them to local credit unions in British Columbia, Alberta, Saskatchewan, Manitoba, New Brunswick and Nova Scotia. It told the Committee that "(r)ather than closing (branches, the banks) are going to be looking for a buyer and (the credit unions will) be there, (credit unions) have the ability to pick up these branches, … the staff … (and) the facilities and the community has a financial service there. … I think in rural Canada, for the most part, the banks when they merge will not be a negative aspect because there will be somebody there to fill the gap."

According to the Credit Union Central of Canada, about 330 Canadian communities have a credit union as their only financial institution. This figure excludes Quebec, which has a separate system of caisses populaires, and Newfoundland, for which data are not available. Figure 3 shows the provincial distribution of credit unions in the 330 communities.

Figure 3: Number of Communities with Credit Unions Only



Source: Credit Union Central of Canada, January 2003.

The Committee believes that bank branches are an integral part of many communities across Canada — urban, rural and remote — and in all regions of the country. Nevertheless, we are particularly concerned about the importance of branches in rural and remote communities, where the presence of that branch may mean that other businesses are attracted to the communities, thereby assisting in their economic development. We are sympathetic to the view that a merged entity may wish to divest branches and are cognizant that the Competition Bureau may in fact suggest such divestitures as a remedy. Moreover, we are confident that other financial service providers — such as credit unions, caisses populaires, medium-sized banks and foreign banks — will be drawn to divested branches and areas of Canada that are currently underserved, provided the correct legislative, regulatory and policy environments exist for

them. Nevertheless, we have a concern that the loss of a local branch could have significant negative effects on some communities. For this reason, the Committee recommends that:

RECOMMENDATION 6

Merger applicants outline the manner in which the merged entity would ensure service to rural and remote communities where they are providing financial services at the time of the merger application.

E. Access to a Range of Service Providers Offering a Range of Services

Some witnesses told the Committee that credit unions, as well as domestic and foreign-based medium-sized banks, are anxious to grow and have an interest in purchasing branches that might be divested as a result of a merger by large Canadian banks.

For example, CS CO-OP told the Committee that "it is reasonable to anticipate that if two or more of Canada's largest banks merged, credit unions could be positioned to benefit in two important respects: (a) obtaining customers; and (b) acquiring assets. … (T)here may well be some customers of a newly merged bank wanting to move their business to a credit union. … Opportunities for credit unions and other competitors to acquire branches or other business operations from merging banks can also arise." Similarly, ATB Financial told the Committee that, "in the event of an allowed merger, ATB sees opportunities to increase … market penetration through possible purchases of branches, and an opportunity to attract customers and staff either through negotiated transactions or general disaffection arising from a large merger."

The manner in which branches are divested was a concern for some. For example, the National Bank of Canada told the Committee that "divestiture of local networks of retail and SME service points should be structured in a way to promote the arrival of new competitors … . For a given territory, such a sale should provide for the presence of groups of branches and SME loan offices of only one of the two banks and not an amalgamation of the service points — often the smaller or less profitable — of either of the two banks, in order to: … enhance client retention for the acquiring bank; reduce confusion among customers; facilitate the preservation of the existing management structure at the local level; (and) promote the preservation of support jobs outside the branches — help and call centres — which comprise an important segment of the personnel assigned to individuals and SMEs."

Providing a bank perspective, the Bank of Montreal Financial Group suggested to the Committee that "a merged bank would have to reorganize … to eliminate wasteful duplication such as when two branches are literally adjacent to each other. However, this need not necessarily lead to fewer branches in the marketplace. Rather than dealing with overlap through closures, the merging institutions could seek to sell them to competitors. This would lead to a 'win-win' for both the seller and acquirer." Moreover, the RBC

Financial Group indicated that "while mergers would reduce the number of domestic banks serving small business, it would also widen the scope for other providers — including foreign banks — to enter the market or to expand their existing market share. For example, National Bank, HSBC, credit unions and others have already confirmed their interest in buying bank branches and acquiring a greater share of the small business market."

The requirement for bricks and mortar is one example of what might be termed a barrier to entry into the financial services sector. Barriers to entry or expansion limit the emergence and growth of competitors within an industry. Ensuring a high level of competition is one of the most effective means of attaining competitive prices, high-quality service and the availability of a variety of products. As Professor Robert Brown remarked to the Committee, "(t)he most effective way to combat the excesses of industry concentration on issues of pricing and service availability is to permit new outside players to compete. This will guarantee lower prices and more services."

In the context of the banking sector, the requirement to have a local branch might be such a barrier. From this perspective, a requirement to divest branches in the event of a large bank merger would be viewed positively, since it would lower a barrier to entry or expansion. There are, however, other barriers to entry and expansion in the sector that the federal government should consider if it wishes to facilitate the emergence of new competitors and the growth of existing participants, such as the importance of acquiring not only the physical assets of a divested branch, but also its customers and employees, and access to the large banks' ATM network.

Current barriers to entry and expansion in the banking sector take a number of forms:

- Regulations, including those related to minimum capital requirements, "fit and proper" management tests, restrictions on activities, ownership rules and the application approval process, which enhance the stability of the financial system but increase the cost of starting a bank and thereby limit the number of potential competitors;

- Consumer habits, since consumers often favour large, easily accessible banks with whom they develop a relationship for the majority of their banking needs;

- Information asymmetry, since consumers lack full access to the information they need to evaluate businesses' products, given the wide variety of products available at different locations and with different service charges;

- Sunk costs, since Canada's large banks are highly capitalized and have an extensive national branch network that makes it difficult for new entrants and existing competitors to compete effectively when

locating, leasing and opening new locations, recruiting, selecting and training staff, setting up branch operating systems and advertising services; and

- A highly competitive market, since margins are low and there are few incentives for firms to enter the banking sector.

The Credit Union Central of Canada identified certain federal changes that could facilitate credit union growth. For example, the Credit Union Central of British Columbia and the Credit Union Central of Ontario are involved in ongoing discussions with the Department of Finance to seek changes in federal legislation that would make it easier for their proposed merger to proceed. In the organization's view, "the efficiencies gained by the merger will help credit unions in B.C. and Ontario compete effectively with the big Canadian banks." Mouvement des Caisses Desjardins suggested that "(t)he government could show its support for cooperative values and principles and acknowledge the importance of these institutions, thereby allowing them to better respond to market realities and compete on an equal footing."

Additional actions could be taken by the federal government to lower or eliminate barriers to entry or expansion. While it was hoped that the recent legislative changes to the *Bank Act* would result in more competition in the financial services sector, the result has been less than some had hoped. The Canadian Federation of Independent Business told the Committee that little has changed over the last five years, and noted that "(d)espite … positive changes in the regulatory climate, increased competition has failed to materialize. Indeed, as a result of such factors as continuing bank branch closures and the TD Bank takeover of Canada Trust, there are even fewer major players in the mix than there were in 1998. As a result, given that it was determined that big bank mergers were not in the public interest in 1998, it is hard to see what has changed for the better that would suggest that they are now acceptable from a public interest perspective."

Economic theory predicts that increased competition results in lower prices and a better quality of service. From this perspective, if a merger of large banks resulted in less competition, then higher prices and lower quality services would likely result as the banking sector becomes increasingly concentrated and the remaining banks have an enhanced ability to charge higher prices. As noted earlier, this is the position taken by the Consumers' Association of Canada.

This view was also presented by the Honourable Douglas Peters and Professor Arthur Donner, who told the Committee that "(b)ank mergers are about raising prices and reducing service to the public and concentrating economic power in the hands of the few," and by the Public Interest Advocacy Centre, which argued that "bank mergers will result in increases in banking costs overall for consumers, given that the electronic banking alternatives being proposed are costlier for consumers. The amount of bank fees and charges is 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."

Nevertheless, it is possible that a merger between large banks could mean growth in the financial services sector as new competitors and/or existing participants acquire divested branches. Greater competition should result in lower prices and a higher quality of service. The Insurance Bureau of Canada informed the Committee that "(c)ompetition and choice increases accountability to consumers through powerful incentives for financial institutions when consumers have the options to go to competitors for financial services. Customer choice is the greatest guarantee of better service and product innovation."

The Committee was also told that mergers can be beneficial even if reduced competition — which may occur if credit unions and other competitors fail to emerge — leads to higher prices. In particular, Professor James McIntosh argued that "mergers can be beneficial, even when reduced competition leads to higher product prices, if the increase in … bank profits … offsets the loss … to consumers from higher prices." The Committee notes that the Competition Bureau's Merger Enforcement Guidelines as Applied to a Bank Merger recognize this possibility, since mergers may proceed even if they entail some increase in prices or lower quality services, provided that they generate overall gains for society.

Professor James McIntosh also suggested that a merger between large banks could lead to overall gains for banks in the form of higher profits and for consumers in the form of lower prices, provided that the merged entities use technology that can produce the same amount of output at a lower cost. His research suggests that this is a likely outcome of bank mergers.

Finally, the extent to which consumers now access banking services other than at a local branch should be recognized. Professor Robert Brown told the Committee that "(t)he government may have an unnecessary focus on the need for retail banking outlets that could be shut down. Increasingly, physical, face-to-face exchanges are being replaced by telephone, fax and Internet transactions. The existence of today's inventory of banking real estate adds unnecessarily to the cost of banking services. Improved methods of facilitating access at remote locations, methods that do not involve retail branches, have been and continue to be developed."

A similar point was made by the Bank of Montreal Financial Group, which told the Committee that "(m)ost people with routine transactions choose ABMs. Canadians have access to more than 18,000 automated banking machines which allow them to do the most common banking transactions — deposits, withdrawals, bill payments, account inquiries, transfers, etc. — with 24-hour access at most locations." The presence of ING Direct in the Canadian market is an example of a successful no-bricks-and-mortar entity.

Nevertheless, technological innovations have not eliminated the need for bank branches by small businesses and for certain transactions. In its study of the large bank mergers proposed in 1998, the Competition Bureau found that technology is not becoming a substitute for branch banking and would not become a substitute over the next decade. According to the Bureau, "(i)n the view of a technology expert made available by one of the merging banks, Internet technology will not replace the need for

physical presence in the next five to ten years. Another expert interviewed by the Bureau puts the time frame at between 10 years and 15 years."[19] As well, the HSBC Bank Canada told the Committee that many ATMs are not full-service and, consequently, cannot replace functions fulfilled by branches.

Moreover, while technology has the potential to lower barriers to entry, the Committee heard that barriers can be increased if new entrants and expanding competitors are required to have both the technology that consumers have come to expect and full-service branches. According to CS CO-OP, "(o)ne of the reasons for increasing size and scale is to build the capacity to invest in the expensive new technologies that Canadians have come to expect from their financial service providers. Canadians are increasingly knowledgeable consumers — they understand, and want, the benefits of accessing banking services at any time of the day, seven days a week. Operating several electronic networks while simultaneously maintaining a branch distribution system is an expensive proposition."

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, a number of witnesses indicated that little competition has resulted. Nevertheless, the Department of Finance is studying how to set up a cooperative banking structure that could provide some competition to banks. There is some support for a federally regulated national cooperative banking structure, which would allow provincially regulated credit unions to realize economies of scale by belonging to a national banking structure.

The Committee believes that, given the appropriate legislative, regulatory and policy environments, competitors to Canada's large banks will emerge — with or without large bank mergers. In our view, a range of actions must be taken and measures implemented that would facilitate the type and level of competition that had been anticipated with the recent *Bank Act* amendments. We feel that healthy competition in the financial services sector will ensure that individuals and businesses will have a range of financial service providers from which to choose and that these providers will offer the range of services that individuals and businesses want at a price they are willing to pay. From this perspective, the Committee recommends that:

RECOMMENDATION 7

The federal government, having due regard for jurisdictional issues, take immediate steps to remove any impediments to the emergence and/or growth of credit unions in Canada.

[19] Competition Bureau, Letter to the Royal Bank and the Bank of Montreal, 11 December 2001, p. 15, available at: http://strategis.ic.gc.ca/SSG/ct01330e.html.

F. Access to Employment Transition Measures

One consequence flowing from most merger and acquisition activities is job loss, as duplicate operations are eliminated and other aspects of the operation are rationalized. It is unlikely that a merger by large banks would escape the probability of employment reductions.

Employment reductions are a key public interest concern for the communities and employees affected. A number of the banks spoke to the Committee about the magnitude of job losses that might occur with a merger by large banks, and the manner in which these losses would be addressed. The consensus was that most — if not all — job losses could probably be accommodated through attrition, early retirement options or relocation to other jobs in the merged organization.

For example, the Canadian Imperial Bank of Commerce shared with the Committee its belief that a bank merger proposal must "commit to treating employees fairly and with respect and dignity in the case that corporate head office functions are affected. Wherever possible, the institutions should commit to assist employees whose positions are eliminated to find another position with the new entity. As well, the institutions should make every effort to utilize normal attrition to achieve position elimination targets. Further, in the case that the employee cannot be placed into another position, severance payments above the statutory requirements are preferable." Scotiabank identified its annual rate of turnover as 3,500 employees, a number it characterizes as "far more than any sort of rationalization of people we would ever foresee in a merger." The Bank of Montreal Financial Group suggested that the banks could make specific commitments on how long they would continue to employ persons no longer required as a result of a merger.

Like a number of witnesses, the Committee is concerned about job loss in the event of a merger by large banks and the impact on both employees and communities, particularly immediately following the approval of a merger application. In our view, merger applicants should make a commitment to minimize job loss, and relocation, training and outplacement counselling should be provided. Nevertheless, like the large banks, we are confident that any employment dislocations — which should be minimal — could be accommodated through attrition and early retirement packages. Should this not be possible, then we believe that compensation associated with job loss should be appreciably more generous that the statutory minimum, and should be consistent with that provided by other financial service providers in similar circumstances. Consequently, the Committee recommends that:

RECOMMENDATION 8

Merger applicants, to the greatest extent possible, ensure that job losses are minimized. Moreover, training, relocation and outplacement counselling should be provided by the merged entity, and employment reductions should be accommodated through attrition and early

retirement incentives. In the event of involuntary job loss, compensation should be consistent with that provided by other financial service providers in similar circumstances.

G. Access to High-Quality Jobs

According to the Canadian Bankers Association, Canada's chartered banks employed 235,000 people as of 31 July 2000, of whom 173,300 were in full-time positions. According to Statistics Canada data for November 2002, salaried employees in the financial and insurance sector earned an hourly wage of $24.86, compared with a national average for all salaried workers of $23.47.[20] Workers paid on an hourly basis in the financial and insurance sector earned $16.45 per hour, below the national average of $16.61.

In their appearance before the Committee, the Honourable Douglas Peters and Professor Arthur Donner argued that any job losses resulting from a large bank merger would be significant, affecting many of the better-paying positions in the banking sector. In their view, "(n)ot all of the lost jobs would be junior positions, as either one of the two banks would only require one legal, human resources, treasury, taxation or economics department. There would be only one division and credit office in each geographic area."

Some witnesses argued that job growth at the large Canadian banks has suffered because of difficulty in competing for the large and complex financing needs of their major Canadian clients. Professor James McIntosh told the Committee that, "(b)ecause of regulatory constraints, Canadians end up importing banking services, instead of exporting them, and the high skill, high salary jobs that are associated with head office activities to San Francisco and Amsterdam rather than Toronto."

From this perspective, a merged entity — perhaps with a greater presence on the world stage — might have certain employment advantages. The Bank of Montreal Financial Group argued that expansion abroad means more work for the home office, rather than less, as "Canadian banks rely on their head-office and support functions to support their expansion effort. This means more high quality jobs, not fewer. … (T)he body of existing evidence suggests we will continue to draw disproportionately heavily on the Canadian employee base for head office and other high-level support functions." This view was also expressed by Mr. Harold MacKay, who told the Committee that "an internationally competitive banking sector will better ensure that in the long run, there will be high quality, head office jobs based in this country, and that the banking sector won't consist of a series of branch plants administering policies, established by companies based outside of Canada." Moreover, the Investment Dealers Association of Canada identified "the opportunity for new value-added management positions in Canada, as the global business of these merged entities grows."

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[20] Statistics Canada, *Employment, Earnings and Hours*, Tables 6 and 7, November 2002. Salaried data are for employees who earn a fixed salary rather than an hourly wage. For these employees, average hourly earnings are derived by dividing total weekly payroll by the number of paid hours.

In the Committee's view, it is important that banking sector jobs in Canada be high-quality. While we believe that the enhanced international competitiveness that may result with a bank merger could lead to high-quality jobs in Canada, there is no guarantee that these types of jobs will result or that they will necessarily be located in Canada if they do, although we note that section 237 of the *Bank Act* requires that a domestic bank have a head office in Canada. Although it may be difficult to guarantee the existence of high-quality jobs, we believe that Canada's large banks must make every effort to ensure that employment growth occurs — generally and particularly following a merger — and that this growth involves the creation of jobs that provide Canadians with a desirable compensation package. From this perspective, the Committee recommends that:

RECOMMENDATION 9

Merger applicants optimize head office and executive activities, and high-quality employment opportunities, in Canada.

LONG-TERM GROWTH FOR CANADA

Institutions seek mergers for a variety of reasons. For example, mergers present opportunities to realize economies of scale (spreading costs over a larger base) and scope (reducing costs by sharing overhead and technology in producing different but related services). They might also be used as a defence against acquisition. Although there are other reasons to merge, a common ingredient probably is a desire to improve organizational growth and prosperity.

The public interest, broadly defined, is served when the country is prosperous. Increasingly, our prosperity is tied — in part — to our ability to be effective competitors worldwide. In the context of large bank mergers, it is logical to examine whether large banks would create long-term growth prospects for Canada through Canadian-based, internationally competitive institutions. Such issues as the ability of our large banks to compete effectively in the international marketplace, the potential effect of large bank mergers on shareholder value and the implications of large bank mergers for the health of the Canadian financial system are examined below.

A. International Competitiveness

In the Public Interest Impact Assessment, merger applicants are asked to identify the manner in which their merger would contribute to the international competitiveness of the financial services sector. Witnesses presented the Committee with a variety of opinions about large bank mergers and international competitiveness.

A number of the Committee's witnesses, including some of the banks, indicated that Canada's large banks already enjoy economies of scale and scope, with few opportunities for further economies in the domestic market. This raises the question of

why large banks would want to merge. Some witnesses, notably the large banks, argued that large size — such as that which would result with large bank mergers — is needed if Canadian banks are to compete effectively in the international marketplace.

Although Scotiabank believes that banks could grow internationally without merging — albeit "not at the same level, and not as quickly" — it also told the Committee that "(y)ou merge for one reason and one reason only … to diversify and grow outside Canada … ." The TD Bank Financial Group suggested that "(t)he financial services industry (is) consolidating globally. We are afraid that if we can't achieve the bulk we need to make larger acquisitions in the United States, we will not be able to compete in any significant way outside our borders." Professor Jean Roy noted that, given the size of our economy, Canada is under-represented in the group of the top 51 banks globally, and indicated that if Canada's 5 large banks were to merge into 3, Canada would rank eighth in the world in terms of bank equity as a percentage of gross domestic product.

Moreover, it was suggested that Canadian banks operating in the global marketplace would benefit Canadian companies operating internationally, enable employment growth in Canada, and provide benefits to Canadians and Canadian businesses. For example, the RBC Financial Group suggested that internationally competitive industries generate "the capital and jobs to support ongoing economic vitality; … higher incomes and pensions for Canadians; and … additional tax revenues. Global companies with Canadian head offices are critical to maintaining a level of investment and innovation that keeps bright young people in Canada and generates the overall employment creation that every country needs." Mr. Harold MacKay told the Committee that successful international banks could provide Canadian customers with "(b)etter efficiencies with improved pricing, new product offerings, and improved service delivery techniques … ."

Recognizing, however, that size does not guarantee international competitiveness, the National Bank of Canada commented that "(a) merger by large Canadian banks is not in itself an absolute guarantee that the Canadian banking sector will have a greater presence on international markets and even less of the success of their international ventures. On the other hand, it is clear that larger, better-capitalized banks will have more resources to develop beyond the country's borders and thus reach the critical mass these markets require."

Other witnesses suggested that large size is not a requirement for international competitiveness. For example, some noted that nothing in the current legislative, regulatory or policy environments prevents Canadian banks from joining forces — without a merger or acquisition — in order to compete more effectively in the international marketplace. In the view of the Ontario Teachers' Pension Plan Board, in order for our banks to compete abroad they could instead choose to deploy limited capital "on a single business line or geographic area to which a bank can bring a competitive advantage" or to combine "their operations outside of Canada. Rather than operate branches all around the world to offer foreign currency and loan support, perhaps the branches and support functions could be shared in joint ventures. Such an approach could free up resources for

customer marketing and support. If our banks believe that they are individually too small to generate added value from participating in large loan syndicates, perhaps they should combine forces in markets outside of Canada."

Witnesses also expressed concern that any merged entity might become so focused on success in the international marketplace that it would neglect the domestic market. In the view of the Canadian Action Party, "(i)t is inevitable that merged banks would expand their foreign operations even further at the expense of Canadian priorities. Their foreign loans finance jobs, growth and development outside Canada rather than at home which should be their top priority in view of the sacred trust with which they have been endowed." A similar view was expressed by the Federation of Canadian Municipalities, which told the Committee that "(a) focus on global banking and international competitiveness will reduce attention paid to local financial services and domestic competition. Less competition in the financial sector domestically will likely result in decreased services, increased costs for services and bank branch closures."

The concern was also voiced to the Committee that financial losses could result. The Canadian Labour Congress, for example, told the Committee that it is "far from clear that this large outflow of investment is a positive development in terms of the Canadian public interest. As noted in the recent (International Monetary Fund) country report on Canada, recent serious loan losses by Canadian banks are almost entirely attributable to lending to US rather than Canadian corporations. It is foreign, not Canadian, operations which account for low bank profits this year."

Moreover, the Women Entrepreneurs of Canada recommended to the Committee that, in the event of a merger between any of Canada's large banks, the federal government should take steps to ensure that the large banks do not lose their focus on the domestic market. In its view, this result could be achieved by "setting and monitoring targets in lending to small and medium sized businesses in Canada. This strategy should also include developing geographic requirements for loans provided to rural communities."

The cost/benefit analysis that is applied, implicitly or explicitly, to most decision making — including decisions related to large bank mergers and international competitiveness — was captured in Professor Jean Roy's remark to the Committee that "(w)e can frame the question of mergers including major Canadian banks as follows: 'Do the potential benefits of increased international expansion resulting from one or more bank mergers exceed the potential costs associated with the impact on the domestic market?'"

The Committee recognizes the divergent views that exist about whether large bank mergers are needed to facilitate international competitiveness, whether international competitiveness is desirable, whether service to the domestic market would be reduced and whether financial losses would grow. In our view, a true evaluation of the trade-offs between service to the domestic market and the benefits of Canadian large bank presence internationally can only occur in the context of a particular merger proposal and

through the resulting public interest assessment. Nevertheless, we believe that the domestic market should not be put at increased risk as a consequence of an increased international focus by our large banks. For this reason, the Committee recommends that:

RECOMMENDATION 10

Merger applicants, when preparing their business case as required by the Public Interest Impact Assessment, indicate the manner in which the merger would benefit the domestic market and enhance their international competitiveness.

B. Shareholder Value

Some witnesses who appeared before the Committee supported large bank mergers because they believe that the many Canadians who hold bank stocks would benefit. Professor James McIntosh informed the Committee that "(t)he two most prominent institutions are mutual funds and pension funds, both of which involve a large proportion of the Canadian public." Scotiabank also told the Committee that strong international banks "will create greater wealth for Canadians — half of all working Canadians own shares in Canadian banks, either directly or indirectly … ."

A different point of view was adopted by the Consumers' Association of Canada, which indicated to the Committee that mergers are often unsuccessful, and most actually destroy shareholder wealth. Although its comments were not specific to the financial services sector or to Canada, it told us that "(m)ost mergers do not pass the market test. … The competitive race may go to the swift, or to the agile, not necessarily to the one with the most bulk. When we merge two corporate cultures we can get Tyrannosaurus Rex — with attitude."

An issue related to shareholder value is wealth creation more generally. The Canadian Imperial Bank of Commerce told the Committee that "(a) strong financial services sector is an important base for many other high-value industries including law, computer sciences, accounting, management consulting, advertising, technology, market research and new media. Facilitating a globally competitive financial services sector with strong Canadian headquartered champions has positive implications for wealth creation in Canada."

While only limited information was presented on the issue of shareholder value, the Committee recognizes both the extent to which mergers are often not immediately successful and may require a transition period and the extent to which Canadians directly or indirectly hold bank shares. Enhanced shareholder value is in the interest of the shareholder, but also in the public interest. We prefer to be optimistic, and trust that any large bank merger in Canada would be accompanied by the corporate culture, human resource and other measures needed to maximize the chance of success.

C. The Health of the Financial Services Sector

In the context of the public interest, an important consideration for many Canadians is whether large bank mergers would enhance or diminish the health of the country's financial system. A range of views was presented to the Committee. The Honourable Douglas Peters and Professor Arthur Donner raised the possibility that the failure of a merged bank could have severe implications for our financial system, and that a bank becoming "too big to fail" could require increased regulator oversight. In their view, "(i)f you had two huge banks … (t)hey would indeed be too large to fail. … Now if you look at that from a regulatory point of view, you have to ask the question, 'What (regulations) would … be required for such an institution?' and the regulations would seem to me to be far steeper, far more detailed, far more intrusive than any of the banks imagine." Continuing with the "too big to fail" argument, the Consumers' Association of Canada argued that "(w)hat's really happening … is that (the banks are) shifting the liabilities, or the risk, from the shareholders onto the taxpayers and that's not necessarily a good idea." A different point of view was provided by the Canadian Imperial Bank of Commerce, which told us that the already high level of regulation in the banking sector reduces the risks that banks will experience serious financial difficulties.

Finally, for many Canadians, the health of the financial system requires domestic control. By extension, limited foreign involvement is called for. At the present time, foreign control of Canada's large banks is not possible, since the *Bank Act* limits any single shareholder — Canadian or foreign — to ownership of 20% of a large bank's voting shares and 30% of non-voting shares, and also prohibits the exercise of effective control by a group of shareholders.

Nevertheless, some witnesses raised the possibility of encouraging greater competition from foreign banks as a means of balancing the market power of Canada's five large banks. The Women Entrepreneurs of Canada suggested that "(t)o ensure that the public interests will be served, as the Canadian banks merge-consolidate and reduce in numbers, barriers to foreign banks entry or alternative financing institutions need to be relaxed to promote access and choices."

The Committee notes that it is likely too early to discern the full effects of recent changes to the *Bank Act*, although greater foreign competition in the Canadian financial services sector might occur if regulatory barriers to entry for branches of foreign banks were lowered. ATB Financial told the Committee that "(w)ithout a lifting of ownership restrictions it is unlikely we will see significant competition from foreign institutions. While it may be politically unpalatable for one of the big banks to be sold to a foreign bank, if large foreign banks were to bid for a significant portion of a bank's branch network, existing competition would be maintained and possibly enhanced." A background paper prepared for the Task Force on the Future of the Canadian Financial Services Sector

remarked that foreign branch banking raises regulatory and prudential problems, and noted that "Canada is not out of step in imposing strong prudential requirements on foreign banks wishing to accept domestic retail deposits."[21]

The Canadian Imperial Bank of Commerce informed the Committee that "(h)istory would suggest that foreign banks expand to foreign markets when their balance sheets are under leverage and quickly retreat their loan portfolio when Canada is suffering." Past and present experience would indicate that there is not a great desire on behalf of foreign banks to enter the Canadian market, except in certain niches. For example, ING Direct, although offering a relatively higher rate on savings accounts, represents a small percentage of consumer deposits. Moreover, the Public Interest Advocacy Centre shared the concern 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 regulations protecting more vulnerable customers with respect to improving or ensuring access will be inapplicable to such institutions."

Like many witnesses — and, indeed, many Canadians — the Committee believes in the health of the Canadian financial system and in domestic control of that system. We are confident that the OSFI will protect the health of the system on an ongoing basis and with respect to any large bank merger proposal. Moreover, we feel that the Canadian financial system must be characterized by domestic control, but believe that foreign banks have a role to play in providing the competition that helps to ensure a range of high-quality services at acceptable prices. The financial services sector is constantly changing, and we believe that, notwithstanding the review that occurs as a consequence of section 21 of the *Bank Act*, there is an ongoing need to examine the legislative, regulatory and policy environments to ensure that competition in the financial services sector — including the role played by foreign banks in the sector — is as intended. Consequently, the Committee recommends that:

RECOMMENDATION 11

The federal government undertake ongoing review of the legislative, regulatory and policy environments of the financial services sector to ensure that barriers to entry and expansion are eliminated or minimized, that the widely held ownership provisions which preclude foreign control continue, and that the sector is characterized by a level of competition that will continue to provide Canadians and Canadian businesses with high-quality, appropriately priced services.

[21] *Competition, Competitiveness and the Public Interest*, Background Paper #1, September 1998, p. 106, prepared for the Task Force on the Future of the Canadian Financial Services Sector.

THE LARGE BANK MERGER REVIEW PROCESS

As noted earlier, the Merger Review Guidelines require the Competition Bureau, the Office of the Superintendent of Financial Institutions, the Standing Senate Committee on Banking, Trade and Commerce and the House of Commons Standing Committee on Finance to review the competition, prudential and public interest aspects of a merger proposal by Canada's large banks. The elements of these reviews, as well as the role played by the Minister of Finance, are discussed below.

A. The Roles of the Competition Bureau and the Office of the Superintendent of Financial Institutions

The Competition Bureau is responsible for determining the effect of merger proposals on competition in the marketplace. Its review occurs in three stages: an examination stage; a decision stage; and, if required, a remedy stage. While the Bureau does not have the power to approve or to deny mergers, it can negotiate remedies if a proposed merger prevents or lessens, or is likely to prevent or lessen, competition substantially.

The Bureau's process for reviewing mergers by large banks resembles the process it uses to evaluate mergers in other industries. Its Merger Enforcement Guidelines as Applied to a Bank Merger state that the goal 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." In fulfilling this role, the Bureau uses data supplied by the merger applicants and consults with competitors, customers and industry experts. For the purposes of its review, the Bureau considers what level of competition would be likely within a two-year period following the merger.

In determining the effects of a proposed merger on competition, the Bureau examines the marketplace from a product and a geographic perspective. Banks provide a variety of products (including deposits, loans, mortgages, credit cards, and brokerage and other services) to different types of customers (including individuals, small and medium-sized enterprises and large corporations) delivered through various means (including local branches and the Internet). Moreover, depending on the clients, the types of products and the means of delivery, markets can be local, regional or national. Since the national scope and diversity of products offered by banks present additional complexities for the analysis of a proposed merger's effects on competition, the Bureau must first define and then conduct separate analyses for each relevant market. The Competition Bureau also considers whether increased efficiencies resulting from a merger would be sufficient to offset the negative effects of decreased competition.

In analyzing the potential effects of the merger, the Bureau considers such barriers to entry as branch loyalty, regulatory constraints, economies of scale and scope, cost advantages and sunk costs, as well as the reaction of existing competitors to the merger, such as changing prices or market share.

At the decision stage, the Competition Bureau reports its views on the competitive impacts of the proposed merger in a letter to the Minister of Finance and the merger applicants. Bearing in mind the need to maintain the confidentiality of commercially sensitive information, the Minister releases the letter, which may be used by the Parliamentary committees in their public interest assessment if it is received within the five-month timeframe provided by the Merger Review Guidelines. If the Minister determines that remedies are needed, the Competition Bureau will negotiate with the parties in the remedies stage, and will recommend solutions to competition issues.

A number of the Committee's witnesses commented on the role played by the Competition Bureau in the merger review process for large banks. While most supported the Bureau and the role it plays in the process, the Canadian Action Party described the Bureau as "probably the most useless of government institutions. … It is the office which allowed Chapters to buy Coles and Smithbooks leading to the destruction of the Canadian book-publishing industry. It is the body that allowed Air Canada to buy Canadian Airlines and when that merger resulted in too great a market share for Air Canada could think of no better remedy than to allow foreign competition." The Public Interest Advocacy Centre suggested that the Bureau's Merger Enforcement Guidelines as Applied to a Bank Merger are not internally consistent and do not provide much assurance for consumers that the public interest will be protected.

Other views, however, were also expressed. The National Bank of Canada, for example, told the Committee that "(t)he Competition Bureau is the main player in this aspect of the merger proposal review, and this is as it should be."

Like most witnesses, the Committee believes that the Competition Bureau plays a valuable role in the large bank merger review process, and that the Bureau is the appropriate agency to assess the competition aspects of any merger proposal. We do, however, have a concern about the timeline of the process. While the Competition Bureau believes that it could complete its investigation into a large bank merger proposal within five months from the time at which it receives a completed application and adequate supporting documentation from the merger applicants,[22] use of the entire five-month period would probably mean that the Bureau's letter to the Minister of Finance would be unavailable to the Parliamentary committees — and their witnesses — during the public interest assessment.

The Committee feels that it should have all relevant information — including the letter from the Competition Bureau — as hearings on the public interest are undertaken. The Bureau's letter should serve as an important input into the assessment, particularly if comments are made about such public interest issues as branch divestitures. Consequently, we would urge merger applicants to submit all necessary documentation as soon as possible, and ideally when the application is made.

[22] It might be noted that, in 1998, the Competition Bureau simultaneously examined two merger proposals. At that time, its review process took 11 months.

The Office of the Superintendent of Financial Institutions (OSFI) is the primary regulator and supervisor of all federal financial institutions. In the merger review process for large Canadian banks, the OSFI assesses the proposed merger from a prudential perspective, or with a view to the impact on the stability and financial well-being of the merger applicants and on the Canadian financial system.

In addition to the assessment of the impact of the proposed merger on the stability of the Canadian financial system, the OSFI's review involves identifying and examining any issues that could put the merged entity at risk, should the merger application be approved. Its assessment includes a review of the merger applicants' implementation and integration plans, as well as an examination of their completeness and reasonableness, and any challenges that might be posed. It also examines the reasonableness of financial projections, including business plan and earnings assumptions as well as the effect of the proposed merger on the merged entity's capital position. Finally, the OSFI also considers potential changes to risk profiles and the capacity of the merger applicants' risk management systems, particularly the extent to which the level of risk would change as a result of the proposed merger and the merged entity's ability to measure, monitor and manage those risks.[23]

Once the OSFI has completed its analysis of a proposed merger, it provides the Minister of Finance and the merger applicants with its view on the prudential aspects of the merger proposal. The Minister then publicly releases the letter, with due regard for the confidentiality of information that may affect the stability of the Canadian financial system. This letter, too, may be used by the Parliamentary committees in their assessment of the public interest implications of a proposed merger, should it be available within the timeframe provided by the Merger Review Guidelines.

Earlier, the Committee expressed concerns about the likelihood that the Competition Bureau's letter would be available for use in the public interest assessment, particularly in light of the five-month time limit. These concerns also exist with respect to the letter by the Office of the Superintendent of Financial Institutions, and we reiterate our desire that all needed information be provided as soon as possible in order that the review can be completed within a timeframe that would allow the Parliamentary committees to benefit from the work done by other entities in the large bank merger review process.

B. The Role of Parliamentary Committees

The Merger Review Guidelines indicate that, concurrently with the reviews by the Competition Bureau and the OSFI of a large bank merger proposal, the Standing Senate Committee on Banking, Trade and Commerce and the House of Commons Standing Committee on Finance will be asked to convene public hearings into the broad public interest issues raised by a merger proposal. Moreover, the Guidelines indicate that the

[23] In its review of the two large bank merger proposals in 1998, the Office of the Superintendent of Financial Institutions considered the relevant literature and consulted industry, government and academic experts.

Parliamentary committees will have the benefit of the Competition Bureau and the OSFI reports after they are released by the Minister of Finance in addition to the PIIA that the merger applicants are required to complete.

The final report of the Task Force on the Future of the Canadian Financial Services Sector did not recommend a role for Parliamentary committees in the large bank merger review process, but did argue for "a reasonable time period for written public comment on the (Public Interest Impact) Assessment to be made to the Minister of Finance. Such comment should also be made available for public review in an open and transparent manner."[24] Nevertheless, the Department of Finance's Merger Review Guidelines give two specific Parliamentary committees — the Standing Senate Committee on Banking, Trade and Commerce and the House of Commons Standing Committee on Finance — a role in the large bank merger review process, since they will be asked to assess the broad public interest implications of a proposed merger.

Witnesses presented the Committee with a range of views about the role that Parliamentary committees should play in the large bank merger review process. Some advocated removal of Parliamentary committees from the process. The National Bank of Canada, for example, suggested that the review be conducted exclusively by the OSFI and the Competition Bureau solely on the basis of prudential and competitive concerns, although these two agencies could hold public hearings and the Minister of Finance could provide public guidelines to the Competition Bureau. Moreover, the Retail Council of Canada suggested that the Competition Bureau could be given the mandate to evaluate the public interest. In its view, "(r)ecent legislative changes permit the Bureau to share information with the Department of Finance under certain specified conditions, and this should enable the two organizations to integrate the top down and bottom up information into a single coherent perspective and to develop recommendations that accommodate both sets of concerns."

Other witnesses suggested that removing Parliamentary committees from the process would be inappropriate. The Canadian Action Party argued that such a change would be "an abdication of duty and responsibility of unprecedented proportions." Furthermore, in the view of the Canadian Federation of Independent Business, "(i)t is clear that the banks believe that large-scale mergers are in their self-interest, but the role of (the House Finance) Committee is to establish what is good for Canada." The Honourable Henry Jackman stated that bank mergers are "primarily a political issue and the government cannot avoid its responsibility."

Moreover, a number of witnesses expressed broad support for a public interest review, without specifying the forum for the review. According to the Canadian Labour Congress, "(g)iven the enormous concentration of economic power in the hands of the major Canadian banks, it is essential that any further concentration among them be subject to wide-ranging, open and transparent review of public interest issues." It noted that not all public interest issues would be covered by the Competition Bureau and OSFI

[24] *Change Challenge Opportunity: Report of the Task Force on the Future of the Canadian Financial Services Sector*, September 1998, p. 118.

reviews, and provided such examples as employment issues and broad public concerns about undue concentration of economic power. Moreover, Option Consommateurs told the Committee that "it is clear that the review of mergers on this scale cannot be restricted to expert agencies such as the Competition Bureau or the Office of the Superintendent of Financial Institutions. Many essential issues lie outside the mandates of these organizations, and they are unable to hold extensive public consultations. The Canadian public interest is much broader than the agencies' fields of expertise."

The Committee supports the reviews conducted by the Competition Bureau and the Office of the Superintendent of Financial Institutions of the competition and prudential issues respectively raised by a large bank merger proposal. Like many of our witnesses, however, we believe that their reviews do not adequately address the range of public interest considerations that would exist. For example, we note that one issue that might be important to both the banking sector and Canadian individuals and businesses — but that is not covered in the Competition Bureau's or the OSFI's terms of reference — is the need for an internationally competitive financial services sector.

C. The Role of the Minister of Finance

Once the letters from the Competition Bureau and the Office of the Superintendent of Financial Institutions and the reports from the Parliamentary committees have been received, the Minister of Finance must decide whether the competition, prudential and public interest concerns raised by the proposal can be addressed. If they cannot be addressed, the merger application is denied. If they can be addressed, the Competition Bureau, the OSFI and the Department of Finance will negotiate competition, prudential and public interest remedies and the Minister will approve the transaction with terms and conditions that reflect the remedies.

Several witnesses commented on the role played by the Minister of Finance in the large bank merger review process. While some — notably the large banks — argued that the Minister should indicate clearly whether the federal government is likely to approve a merger application at this time, others focused on the Minister's specific role in the process. Mr. Harold MacKay highlighted the key role played by the Minister when he told the Committee that "(i)n the end the Minister of Finance is the guardian of the public interest. It's for the (M)inister to balance the costs and benefits by evaluating the risks and the opportunities in the context of a specific deal and the expectations of the country for its financial sector in general and the banks in particular. … (T)he (M)inister should come to the decision after putting all the factors in the balance. There's simply no magic formula that can achieve a decision. (E)nsure that the ministerial discretion is used so that any merger benefits Canada and doesn't damage the public interest. Be sure that there's a way so that the (M)inister's well informed to make the decision to approve or disapprove a merger, or to design the public interest conditions for any approval."

The Committee is aware that some of the banks appearing before us were seeking clarity on a number of issues, including more certainty surrounding the appropriate timing of merger applications to the federal government. We acknowledge that the financial services sector would welcome a statement by the Minister of Finance, on behalf of the government, about the potential timing of large bank mergers.

D. Conclusions about the Process and the Timeline

The Committee supports the current large bank merger review process that requires the Competition Bureau to assess competition issues, the Office of the Superintendent of Financial Institutions to assess prudential concerns and the House of Commons Standing Committee on Finance to assess public interest considerations. As already noted, we do not comment on the role of the Standing Senate Committee on Banking, Trade and Commerce, believing that it should determine the nature of its involvement in the public interest assessment hearings within the large bank merger review process.

While some of the Committee's witnesses argued that all public interest considerations would be addressed by the Competition Bureau and the OSFI reviews, we support the view of other witnesses who believe that there are issues of concern to the public that would not be assessed by the Competition Bureau or the Office of the Superintendent of Financial Institutions. There is a clear need for a public forum for consideration of the public interest, and public hearings by a Parliamentary committee are the most appropriate venue. This process provides the transparency needed in a public review of this nature. It also provides a public forum for the merger applicants to outline their case for merger.

Moreover, the Committee is of the opinion that the final decision about a particular merger application must rest with the Minister of Finance, and that the Minister must continue to use the analyses of the Competition Bureau, the OSFI and Parliamentary committees in making his or her determination.

Finally, the Committee believes that a timeline is needed in order to ensure the timely completion of the large bank merger review process. Although some witnesses recommended a shorter timeframe of perhaps 100 days and others suggested an extension of two weeks beyond the existing five months, we feel that five months is appropriate. We are, however, mindful of the point made to us by Mr. Harold MacKay that "(a) merger proposal requires an efficient, focused process. As things now stand, proponents and opponents must make their representations in five places, to the Competition Bureau, to (the) OSFI, to this (House Finance) Committee, to the Senate (Banking Committee) and to the (M)inister. In my view, this is cumbersome: there are too many players. The process can subject our financial system and capital markets to unnecessary delay and uncertainty." He suggested revisiting the concept of "a process in which submissions from the banks, other persons, companies and organizations would be promptly posted on a well publicized website to ensure a robust debate to which all

Canadians would have immediate access and opportunity for full participation." Mr. Harold MacKay also mentioned the option of "a small task force investigating an issue in a particular region, because that merger has special issues for that region."

Having expressed concerns about the need for timely completion of the Competition Bureau and the OSFI reviews in order that their letters to the Minister of Finance and merger applicants can be used as inputs to the Parliamentary committee process, the Committee is confident that the merger applicants — who want the process to be completed in a timely manner — will submit all required documentation as expeditiously as possible.

CONCLUSION

Recognizing the role of the banking system in the Canadian economy and its importance to Canadians and Canadian businesses, a merger review process for Canada's large banks is needed. Ensuring a competitive marketplace is central to the public interest; consequently, the Competition Bureau has an essential role to play. Similarly, protecting the safety and soundness of Canada's financial system is in the public interest; thus, the Office of the Superintendent of Financial Institutions should also play a crucial part. Finally, safeguarding the public interest is, without doubt, in the public interest; therefore, Parliamentary committees — which are creatures of Parliament and themselves representative of the public — have a vital responsibility in the large bank merger review process.

The Committee was asked by the Minister of Finance and the Secretary of State (International Financial Institutions) to consider the public interest implications of large bank mergers in four areas:

- The access of Canadians in all regions to convenient and quality financial services, with special attention to the disabled, low-income individuals and rural communities;

- The choice among finance service providers and the availability of financing for businesses, particularly small businesses, and Canadians;

- The creation of long-term growth prospects for Canada through more effective Canadian-based internationally competitive institutions; and

- Any adjustment or transition issues, including the treatment of employees.

The Committee starts from the notion that bank mergers are a legitimate business strategy, and then considers how the public interest can be safeguarded within this context. With our elaboration of the public interest considerations, the Committee hopes that Canada's large banks will be better able to anticipate the requirements of Parliamentarians who will assess the public interest implications of a specific merger proposal.

The Committee also believes that the onus is on the merger applicants to make their case that a merger by them would be in the public interest. Ultimately, they bear the burden of proof in this regard. We anticipate that the applicants would be asked to appear during the Committee's public hearings, at which time they could detail the benefits of the proposed merger and how the public interest would be safeguarded.

Clearly, the public interest is safeguarded when, following a large bank merger, all Canadians and Canadian businesses of all sizes and sectors and in all regions of Canada can access a comparable range of services as before the merger, with comparable convenience and at a comparable or lower price and similar or higher quality.

There will be concerns about the impact of potential branch closures, particularly in rural and remote regions and on Canadians (particularly the disabled, seniors and low-income individuals as well as those who reside in rural and remote regions) and Canadian businesses (particularly SMEs and perhaps in certain sectors). Concerns about the range of services and the ability to choose from a variety of service providers in all regions of Canada are also likely to exist, as are issues about the availability of financing. Job loss and the availability of high-quality jobs and head office locations within Canada are also elements of the public interest, as is the manner in which larger, more internationally competitive Canadian banks can contribute to long-term growth for Canada, increased shareholder value and a healthy financial services sector. The Minister of Finance will have to balance a range of competing interests in making the final decision about a specific merger application.

The Committee believes that all elements identified as components of the Public Interest Impact Assessment, as well as additional issues identified in this report, are public interest issues. We feel that, when assessing a particular merger proposal, a full range of access issues and contemplation of the impact on long-term Canadian growth are public interest considerations. Should a merger application be approved, what is needed for success is a seamless transition — for individual customers, small and medium-sized businesses, communities, shareholders and the banks themselves. Remedies — and the terms and conditions that flow from them — are an important tool that can be used by all parties in assuring that, in the transition, disruptions are minimized and stakeholders are at least as well off as they were prior to the merger.

LIST OF RECOMMENDATIONS

RECOMMENDATION 1

Merger proposals by Canadian banks and bank holding companies with more than $5 billion in equity continue to be subject to review by the Competition Bureau to assess competition concerns, by the Office of the Superintendent of Financial Institutions to assess prudential concerns and by the House of Commons Standing Committee on Finance to assess public interest concerns. To ensure that the review occurs with the assistance of all relevant information, the Competition Bureau and the Office of the Superintendent of Financial Institutions should complete their reviews as expeditiously and thoroughly as possible in order that their analysis is available to assist in the public hearing process. ..... PAGE 4

RECOMMENDATION 2

The list of items to be included in the Public Interest Impact Assessment, as identified in the Merger Review Guidelines, be retained. In completing the Assessment, merger applicants should have due regard for the clarification provided by the House of Commons Standing Committee on Finance in the areas of access and long-term growth for Canada. Moreover, the ability of the Minister of Finance to request, and of the merger applicants to provide, additional information should continue to exist. ..... PAGE 7

RECOMMENDATION 3

Merger applicants provide no less than an equivalent level and range of services to all Canadians before and after the merger, bearing in mind technological change and changing consumer requirements. Moreover, the merged entity should pay particular attention to ensuring access for disabled Canadians, seniors, low-income individuals and Aboriginal Canadians, as well as to ongoing community and charitable involvement efforts. ..... PAGE 11

RECOMMENDATION 4

Merger applicants demonstrate the manner in which the merged entity would increase access to capital for small and medium-sized businesses. ..... PAGE 14

RECOMMENDATION 5

Merger applicants outline the manner 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 three years. ..... PAGE 14

RECOMMENDATION 6

Merger applicants outline the manner in which the merged entity would ensure service to rural and remote communities where they are providing financial services at the time of the merger application. ..... PAGE 17

RECOMMENDATION 7

The federal government, having due regard for jurisdictional issues, take immediate steps to remove any impediments to the emergence and/or growth of credit unions in Canada..... PAGE 21

RECOMMENDATION 8

Merger applicants, to the greatest extent possible, ensure that job losses are minimized. Moreover, training, relocation and outplacement counselling should be provided by the merged entity, and employment reductions should be accommodated through attrition and early retirement incentives. In the event of involuntary job loss, compensation should be consistent with that provided by other financial service providers in similar circumstances. ..... PAGE 22

RECOMMENDATION 9

Merger applicants optimize head office and executive activities, and high-quality employment opportunities, in Canada. ..... PAGE 24

RECOMMENDATION 10

Merger applicants, when preparing their business case as required by the Public Interest Impact Assessment, indicate the manner in which the merger would benefit the domestic market and enhance their international competitiveness. ..... PAGE 27

RECOMMENDATION 11

The federal government undertake ongoing review of the legislative, regulatory and policy environments of the financial services sector to ensure that barriers to entry and expansion are eliminated or minimized, that the widely held ownership provisions which preclude foreign control continue, and that the sector is characterized by a level of competition that will continue to provide Canadians and Canadian businesses with high-quality, appropriately priced services. .. PAGE 29

APPENDIX A
LETTER FROM THE MINISTER OF FINANCE AND THE SECRETARY OF STATE (INTERNATIONAL FINANCIAL INSTITUTIONS)

October 24, 2002

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

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

Dear Ms. Barnes and Senator Kolber:

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

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

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

- the access of Canadians in all regions to convenient and quality financial services, giving special attention to the disabled, low income, and rural communities;

- the choice among financial services providers and the availability of financing for businesses, especially small businesses, and Canadians;

- the creation of long-term growth prospects for Canada through more effective Canadian-based internationally competitive institutions; and

- any adjustment or transition issues, including the treatment of employees.

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

Yours sincerely,

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

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

APPENDIX B
MERGER REVIEW GUIDELINES

Department of Finance - News Release 01-014 -

On June 25, 1999, in *Reforming Canada's Financial Services Sector: A Framework for the Future*, the Government noted that:

> In this era of rapid economic change, technological revolution and globalization, mergers and acquisitions are legitimate business strategies for growth and success. However, given the key importance of the financial services industry, and the largest banks in particular, to the entire Canadian economy, it is essential to ensure that proposed mergers are in the best interests not only of their proponents, but of Canadians and the Canadian economy overall. To this end, the Government will establish a formal and transparent Merger Review Process among banks with equity in excess of $5 billion.

This document spells out the framework for the new Merger Review Process. This process applies to mergers among banks and bank holding companies with equity in excess of $5 billion. The application of the process will take into account changing circumstances in the condition of the banks.

There are three distinct phases to the Merger Review Process: an examination stage, a decision stage and, if required, a remedies stage.

Subject to the prerogatives of Parliament, the Government will seek to complete the decision stage of its review of major transactions within a maximum of five months after receiving a complete application and adequate supporting documentation from the parties. This will depend on the co-operation of the merging parties to quickly provide all of the necessary information for the assessment of the transaction.

Stage 1: Examination of the Proposal

1. The banks will apply to the Competition Bureau, the Office of the Superintendent of Financial Institutions (OSFI) and the Minister of Finance in writing for permission to merge and will provide information necessary to assess the merger request.

2. The applicants will be required to prepare a Public Interest Impact Assessment (PIIA).

3. The Competition Bureau and OSFI will conduct reviews of the proposal from the competition and prudential perspectives.

4. Concurrently with the Bureau and OSFI reviews, the House of Commons Standing Committee on Finance (Finance Committee) and the Standing Senate Committee on Banking, Trade and Commerce (Senate Committee) will be asked to conduct public hearings into the broad public interest issues that are raised by the merger proposal, using the PIIA as a key input.

5. Once they have completed their analyses of the proposed merger, the Commissioner of Competition and the Superintendent of Financial Institutions will provide to the applicants and to the Minister of Finance a letter with views on the competitive and prudential aspects of the proposed merger.

6. Upon receiving the inputs of the Competition Bureau and OSFI, the Minister of Finance will publicly release the documents, with due regard to the need to maintain the confidentiality of commercially sensitive information and information that may affect the stability of the Canadian financial system. These public documents will be available for scrutiny by the Finance Committee and Senate Committee.

7. Upon completion of its hearings and deliberations, the Finance Committee and Senate Committee will each report to the Minister of Finance on the broad public interest issues that are raised by the proposed merger.

Contents of the PIIA

8. In the PIIA, the applicants explain the rationale for the merger and the steps that they could take to mitigate any potential costs or concerns. It should be made widely available to provide a solid basis for public hearings on the transaction. Applicants will be expected to articulate the following in the PIIA:

   - their business case and objectives, that is, why they wish to merge;
   - the 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;
   - the 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;
   - how the proposal would contribute to the international competitiveness of the financial services sector;
   - how the proposal would affect direct and indirect employment and the quality of the jobs in the sector, distinguishing between transitional and permanent effects;
   - how the proposal would increase the banks' ability to develop and adopt new technologies;

- what remedial or mitigating steps in respect of public interest concerns the banks are prepared to take, such as divestitures, service guarantees and other commitments, and what measures to ensure fair treatment of those whose jobs are affected; and
- the impact the transaction may have on the overall structure of the industry.

9. The PIIA will also cover any additional issues that the Minister of Finance or the parties deem relevant in the context of a particular proposed transaction.

Stage 2: Minister of Finance Decision

10. Using the reports of the Competition Bureau, OSFI, the Finance Committee and the Senate Committee as inputs, the Minister of Finance will render a decision on whether the public interest, prudential and competition concerns that are raised by the transaction are capable of being addressed. If not, the transaction will be denied and the process will stop at this stage. If these concerns are capable of being addressed, the Merger Review Process will enter the negotiation of remedies stage.

Stage 3: Negotiation of Remedies

11. 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). These remedies would address concerns that have been raised during the review process.

Following the successful negotiation of remedies, the Minister of Finance will approve the transaction with terms and conditions that reflect those remedies.

APPENDIX C
LIST OF WITNESSES

TUESDAY, DECEMBER 10, 2002
Meeting No. 32

Competition Bureau

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

Office of the Superintendent of Financial Institutions

Julie Dickson, Assistant Superintendent, Regulation Sector
Paul Fecser, Senior Director, Registration and Approvals Division

TUESDAY, JANUARY 28, 2003
Meeting No. 33

Canadian Federation of Independent Business

Catherine Swift, President, Chief Executive Officer
Brien G. Gray, Senior Vice-President, Field Operations

WEDNESDAY, JANUARY 29, 2003
Meeting No. 34

Federation of Canadian Municipalities

James Knight, Chief Executive Officer
Susan Welke, Policy Analyst

Ontario Teachers' Pension Plan Board

Brian Gibson, Senior Vice-President, Active Equities

As an Individual

Robert Brown, Director, Institute of Insurance and Pension Research

FRIDAY, JANUARY 30, 2003
Meeting No. 35

"Option consommateurs"

Louise Rozon, Director
Jacques St-Amant, Legal Counsel

Consumers' Association of Canada

Robert Kerton, Chair, Economics and Finance Committee

Public Interest Advocacy Centre

Sue Lott, Counsel

Retail Council of Canada

Diane Brisebois, President and Chief Executive Officer

MONDAY, FEBRUARY 3, 2003
Meeting No. 36

Canadian Imperial Bank of Commerce

John Hunkin, Chairman and Chief Executive Officer

National Bank of Canada

Réal Raymond, President and Chief Executive Officer
Jean-Paul Caron, Vice-President, Corporate Affairs
Jean Houde, Senior Vice-President, Corporate Affairs, Member of the Executive Committee

RBC Financial Group

Gordon Nixon, President and Chief Executive Officer
Anne Sutherland, Senior Vice-President, Client Segment Strategies
Charles Coffey, Executive Vice-President

TUESDAY, FEBRUARY 4, 2003
Meeting No. 37

Investment Dealers Association of Canada

Joseph Oliver, President and Chief Executive Officer

Jon Cockerline, Director, Capital Markets

As Individuals

Hon. Douglas Peters, Economist

Arthur Donner, Economist and Consultant

Jean Roy, Full Professor of Finance

TUESDAY, FEBRUARY 4, 2003
Meeting No. 38

ATB Financial

Robert Ascah, Vice-President

Credit Union Central of Canada

Joanne De Laurentiis, President and Chief Executive Officer

Jack Smit, Chairperson, Board of Directors

Wayne Nygren, Director, Board of Directors and Chair, Legislative Affairs Advisory Committee

CS CO-OP (Community Financial Services)

Gary Seveny, President and Chief Executive Officer

Madeleine Brillant, Vice-President, Corporate Affairs

WEDNESDAY, FEBRUARY 5, 2003
Meeting No. 39

Canadian Community Reinvestment Coalition

Duff Conacher, Chairperson

Canadian Labour Congress

Andrew Jackson, Senior Economist, Social and Economic Policy

Community Foundations Canada

Monica Patten, President and Chief Executive Officer

HSBC Bank Canada

Martin Glynn, President and Chief Executive Officer

Women Entrepreneurs of Canada

Ada Lee, President

Pirjo Friedman, Member, Board of Directors

THURSDAY, FEBRUARY 6, 2003
Meeting No. 40

BMO Financial Group

Tony Comper, Chairman and Chief Executive Officer

Tim O'Neil, Executive Vice-President and Chief Economist

Karen E. Maidment, Executive Vice-President and Chief Financial Officer

Scotiabank

Peter C. Godsoe, Chairman and Chief Executive Officer

TD Bank Financial Group

Edmund Clark, President and Chief Executive Officer

THURSDAY, FEBRUARY 6, 2003
Meeting No. 41

As an Individual

Harold MacKay, Former Chair, Task Force on the Future of the Canadian Financial Services Sector

APPENDIX D
LIST OF SUBMISSIONS

Jerry Ackerman

Association of Canadian Pension Management (ACPM)

ATB Financial

Bernard Sieger

Bank of Montreal Financial Group

Robert Brown

Canadian Action Party

Canadian Community Reinvestment Coalition

Canadian Federation of Independent Business

Canadian Imperial Bank of Commerce

Canadian Labour Congress

Committee on Monetary and Economic Reform

Competition Bureau

Consumers' Association of Canada

Credit Union Central of Canada

CS CO-OP (Community Financial Services)

Arthur Donner

R. Haalbroom

HSBC Bank Canada

Insurance Bureau of Canada

INTERAC Association

Investment Dealers Association of Canada

Hon. Henry N.R. Jackman

Frank Kovitz

James McIntosh

"Mouvement des caisses Desjardins"

National Bank of Canada

Office of the Superintendent of Financial Institutions

Ontario Teachers' Pension Plan Board

"Option consommateurs"

Pension Investment Association of Canada

Hon. Douglas Peters

Public Interest Advocacy Centre

RBC Financial Group

Retail Council of Canada

Mary Richardson

Ridgeline Corporation (The)

Jean Roy

Salter Street Films

Scotiabank

TD Bank Financial Group

Teamsters Canada

TG International Ltd. Management Consultants

Ray Waters

Lorne White

Women Entrepreneurs of Canada

Tom Wood

REQUEST FOR GOVERNMENT RESPONSE

Pursuant to Standing Order 109, the Committee requests that the Government table a comprehensive response to the report; however, notwithstanding the deadline of 150 days stipulated in Standing Order 109, the Committee requests that the comprehensive response to this report be tabled within 90 days of the presentation of the report to the House.

A copy of the relevant Minutes of Proceedings *(Meeting No. 48 including the present report)* is tabled.

Respectfully submitted,

Sue Barnes, M.P.
Chair

SUPPLEMENTARY OPINION BY THE BLOC QUÉBÉCOIS

TO THE REPORT OF THE STANDING COMMITTEE ON FINANCE ENTITLED LARGE BANK MERGERS IN CANADA: SAFEGUARDING THE PUBLIC INTEREST FOR CANADIANS AND CANADIAN BUSINESSES

TABLED WITH THE STANDING COMMITTEE ON FINANCE

In a spirit of co-operation and openness and with considerable interest, the Bloc Québécois was actively involved in the deliberations of the Standing Committee on Finance on the impact of the merger of the large banks in terms of the public interest.

The Bloc Québécois supports the general thrust of the report that the burden of proof lies with the banks, which have to prove that the mergers are necessary and in the public interest. However, we note that, while this notion is expressed in the text of the report, it is not given sufficient mention in the recommendations, and in recommendations 6 and 10, specifically.

Furthermore, the Bloc Québécois would have liked the report to be more explicit about public consultation. The requirement to evaluate proposed mergers as announced in debates on the bill entitled *An Act to establish the Financial Consumer Agency of Canada* (Bill C-8) in June 2001 must be not only retained but incorporated in the *Bank Act*.

Two recommendations in particular do not reflect the Bloc Québécois desire to protect public interest in the process of bank mergers.

Recommendation 6

This recommendation makes timid reference to access to financial services for rural and remote communities, but ignores disadvantaged urban regions. We would have liked to see the Committee recommend the government establish a public consultation mechanism within the communities where a merger would result in the closure of branches, before such closure occurred, because the Bank Act is not sufficiently exigent in this regard. We would have liked the Committee to recommend to the government that it require banks to consult the public locally in the case of all proposed branch closings and to report their profits, losses and net income to permit an assessment of the merits of such closures. The consultation mechanism used by the Mouvement des caisses Desjardins du Québec, which allows its members review branch closings, could serve as an example.

As banking services are an essential service, we also consider that banks have a responsibility not only to serve the public, but to invest in the community. This is why the Bloc Québécois tabled a bill on community re-investment, an approach that will become all the more important in the case of mergers.

Recommendation 10

In the case of recommendation 10, the Bloc Québécois is of the opinion that most of the Committee members missed what is probably the most important issue and the one most difficult to evaluate, namely the macro-economic impact of creating a Canadian mega bank through a merger. Determining a merger's impact on the public interest requires a highly accurate evaluation of whether the benefits for the Canadian economy of a bank merger, specifically the new bank's increased international activity, offset the increased concentration in the banking sector. No study on the economic impact of a bank merger was brought to the attention of the Committee, and, to our knowledge, none exists. Indeed, at the first meeting of the Standing Senate Committee on Banking, Trade and Commerce on the impact of bank mergers on the public interest, the Director of the Financial Institutions Division, Financial Sector Policy Branch of the Department of Finance, Gerry Salembier, responded in answer to questions that no document or study existed with regard to the examination of bank mergers other than the guidelines of the Minister of Finance.

Of the factors that must be considered in determining whether a proposed merger is in the public interest, the matter of risk and the various types of risk is material for both the institutions merged and the other financial stakeholders and, in the final analysis, for the entire Canadian economy. A merger could, for example, increase risk in management terms. Accordingly, the following questions must be answered.

What impact would the failure of computer systems have on the protection of privacy, for example?

What protection would there be in the event of bad management by the managers of a mega bank?

What effect would increased homogeneity have on Canada's financial market?

Would the reduction in the number of players in the market not increase imitative behaviour thereby potentially increasing the volatility of economic and financial activity?

In short:

What impact could the merger of the big banks have on the Canadian financial markets?

In addition, however, the effects mergers might have on other areas must also be considered.

> **What impact could the creation of a mega bank have on monetary policy, the management of interest rates and on the Canadian dollar?**
>
> **What threat to the Canadian economy is posed by the difficulties experienced by a mega bank in its international activities?** For example, Jean Roy, professor at the school of Hautes Études Commerciales (HEC) suggested during Committee hearings that the provisions of the *Act to establish the Financial Consumer Agency of Canada* (Bill C-8) permitting the creation of financial holdings be used entirely to keep national and international activities separate as much as possible.

It is in response to these very legitimate concerns that the Bloc Québécois suggested to the Committee it include a recommendation to have the banks involved in a proposed merger demonstrate that the international activities of the new merged entity would be beneficial to the Canadian economy.

In addition, we would have liked the Committee to recommend to the Minister of Finance that he start looking now at ways to keep the national and international operations of a future merged entity as separate as possible.

In the opinion of the Bloc Québécois, the federal government has a responsibility to convince the public that its trust in the banks and their dealings as they affect the public interest is well placed, in particular, when the banks propose mergers.

Pierre Paquette
MP for Joliette

Pauline Picard
MP for Drummond

THE PUBLIC INTEREST IMPLICATIONS OF LARGE BANK MERGERS: A DISSENTING OPINION

Hon. Lorne Nystrom, M. P.
NDP Critic for Financial Institutions
March 2003

"The banks have survived quite nicely the way they are."
– Dr. Robert Kerton, Consumers' Association of Canada

Minister of Finance John Manley and Secretary of State for Financial Institutions Maurizio Bevilacqua have asked the Standing Committee on Finance and the Senate Banking Committee to spend time and energy to further investigate and clarify the public interest implications of large bank mergers. In so doing they have resurrected an issue that has been thoroughly rejected by Canadians.

The position of the NDP is clear: mega bank mergers have never been, and will never be, in the public interest. When four of the largest Canadian banks proposed to merge in 1998, it took a year of public hearings, protests, $4 million, five reports and the Competition Bureau to convince then Finance Minister Paul Martin that leaving one or two large private banks in control of the nation's credit was bad for competition, bad for jobs and bad for communities, and, therefore, not in the public interest.

There is no evidence that the Canadian financial landscape in 2003 is fundamentally different than in 1998. The MacKay task force then tabled its final report, in which it recommended that a Public Interest Impact Assessment Process be part of any bank merger proposal. The Finance Department's *Merger Review Guidelines* were developed in response to MacKay to help define the public interest. The banking industry has argued that these guidelines are too broad, that they need clarity. On the whole, however, the *Merger Review Guidelines* are already clear and sufficient. They must remain broad, in order to give the Finance Committee enough room for interpretation on a case-by-case basis. We agree with the committee that no useful purpose could be served by being overly prescriptive in providing guidance on the public interest implication of large bank mergers. We also believe that the onus is on the merger applicants to make their case that a merger would be in the public interest.

The Canadian banking system is one of the most concentrated systems in the world. Six largest banks account for more than 85 per cent of the assets of our banking industry and have even increased their share of deposits from 70% in 1997 to 73% in 2001. What could possibly improve if only two or three banks controlled the banking business?

- **Why Mega Bank Mergers Are Not in the Public Interest**

The Hon. Dr Douglas Peters PhD PC, the former Secretary of State (finance) for the Liberal government from 1993 to 1997 and former chief economist and senior vice president of TD Bank has shown that the public interest implications of bank mergers becomes obvious when answering the following questions:

Would the merger of Canada's major banks:

1. Lower the cost of banking services to individual Canadians?

2. Improve the level and quality of service that Canadians receive from their banks?

3. Increase the choices of Canadians in their banking services?

4. Improve the availability of credit and lower the cost of credit to small and medium-sized businesses in Canada?

5. Lower the cost of credit to Canada's large businesses?

6. Increase the profitability of Canadian banks from their international operations?

7. Improve the Canadian economy by increasing employment and economic growth?

The answer to all these questions is no. It is obvious - bank mergers in Canada would be detrimental to the public interest.

Only the systemic threat of a massive financial sector failure could justify the unholy alliances to which the Senate Banking Committee wishes to give its blessings. Even in the event of a massive financial sector failure, a diversified Canadian financial sector would more effectively manage the crisis and rely less on public funding to bail them out.

Canadian chartered banks say they need to become extra large to prosper in a global economy. They argue that only mega banks are able to compete internationally. They believe economies of scale can only be realized by mega-institutions.

All these arguments are false.

It is wrong to claim that our big banks need to grow to achieve economies of scale. Even the Bank of Canada has written that "empirical work thus far has provided no evidence that a bank has to be a mega-institution, rather than just large, to exploit most economies of scale." When the C.E.O.s of Canada's chartered banks argue they need to become mega banks to compete internationally, they fail to note that they already do extremely well internationally. And when they do not, evidence shows that their losses

have nothing to do with size but with bad lending decisions, such as TD's loans to the U.S. telecommunications sector and CIBC's adventures in New York in investment banking.

A marketplace controlled by two or three financial consortiums also means that these financial giants will continue to subsidize their overseas losses on the backs of Canadian consumers and taxpayers.

- **Foreign Competition**

Some claim that bank mergers will not hurt Canadian consumers. But those who expect some cavalry of foreign competitors to charge in and save consumers are deluding themselves. For the sheer dominance of Canadian mega banks over our domestic market place discourages foreign competition from launching any frontal assault. In fact, foreign bank subsidiaries have reduced their share of deposits from 7% in 1997 to 3% in 2001.

Instead, foreign financial institutions will tighten their grip on Canada's financial institutions by taking advantage of Paul Martin's jettisoning of the 10% wide ownership rule, which guaranteed that no single shareholder would control more than 10% of the ownership of a chartered bank.

- **Parliament Must Have the Final Word**

As stated in the 1998 NDP minority report (A Response to the "First [Interim] Report" of the Standing Committee on Finance—"The Future Starts Now"):

> *"Banks decide which firms survive and which ones fail; which jobs are created and which jobs are destroyed; who gets a home and who does not. Simply put, banks are not ordinary corporations. The banking sector does much more than just lend deposits. Banking institutions create money by granting loans to firms, consumers or governments. Banks also create money through indirect means such as securitization and off-balance sheet activities."*

Parliament has given Banks a special protected situation in Canada that is unlike any other industry. Banks have benefited from a special charter, allowing them to control credit; they have gradually increased their grip over the trust industry, absorbed all the large brokerage firms and are breaking new ground in the insurance market. Now, in the name of global competitiveness, they want to concentrate control by merging ultimately into two or three megabanks.

Bank charters granted by Parliament confer powers so sweeping that to prevent abuse, banks must be regulated by a democratically elected government and submitted to the discipline of market competition. Market concentration erodes competition and challenges the authority of Parliament. Leaving one or two private banks in control of the nation's credit is not in the public interest.

Experience has shown that the more a banking system is concentrated, the greater the risk of speculation at everyone's expense. Japanese mega banks have accumulated $1 trillion (U.S.) of potential losses because of speculative loans. Similar losses have happened to mega banks in the United States, France, Switzerland and Germany.

We are being hopelessly naive if we think such disasters could not occur in Canada. What will happen if a $700 billion mega bank were to fail? The federal government would have little choice but to step in and bail it out with taxpayers' money.

- **Putting the Peoples' Priorities First**

The truth is that big banks want to merge to reduce competition and create greater profits to keep shareholders happy. In order for this to happen, consumers and communities will have to contend with reduced competition, less choice and higher service charges — not to mention lay-offs and branch closures. In fact, when Canada Trust merged with TD bank, Canada Trust's higher service fees were imposed upon TD Bank customers by the new TD Canada Trust Corporation. Moreover, there is compelling evidence that mega bank mergers would make a bad situation worse for Canada's small businesses, businesses that have generated the majority of new jobs.

The relationship of Canadians with the banking sector goes well beyond the simplistic view that what is good for bank shares is good for Canadians. The fact that many Canadians are directly and indirectly shareholders of major banks, and that mergers *may* improve the return on their shares, is cold comfort for someone who needs a mortgage today, or an affordable loan.

It is clear that by supporting bank mergers, the Senate Banking Committee is failing to acknowledge the needs of Canadians. Important issues are being forgotten. We know that it was the Parliament of Canada that granted charters to Canada's big banks. These charters were privileges that allowed Canadian banks to have a dominant position in the domestic market. Banks are therefore not only accountable to their shareholders; they are accountable to the Parliament of Canada. For the unelected, unaccountable Senate to suggest that a bank merger review process should exclude a review by the House of Commons Finance Committee is no less than an abrogation of responsibility. Further still, any mega bank merger that is triggered simply by the thirst for ever-rising profits should be submitted to a vote in the House of Commons, after having been reviewed by the Finance Committee.

What about the rising stress of families falling deeper into debt and the many Canadians with no choice but to work in retirement? With heartbreaking levels of child poverty, poor childcare programs and education, the state of the working poor is reaching crisis proportions. Should not the Senate Banking Committee, and of course the House Finance Committee, provide a perspective on these more pressing issues?

If Parliament is serious about reopening a debate about banking, it should focus on the bread and butter issues that are important to working Canadians. A starting point would be to examine bank service charges, abusive credit card rates, ATM rip-offs, community reinvestment, offshore tax havens, CEO stock options.

Under no circumstances should the business imperative override the democratic process. We must stop pretending that mega bank mergers will in any way serve the public interest and start working to enhance, not hinder, the economic potential of all Canadians.

DEPOLITICIZATION OF BANK MERGERS MUST OCCUR

Supplementary Opinion of the Progressive Conservative Party

Background

In June 2000, the Liberal government introduced legislation and released guidelines dealing with prospective bank mergers in Canada. These measures would establish a framework with which bank mergers would be considered.

Banks would file an extensive application outlining their merger proposal along with a Public Interest Impact Assessment statement (PIIA).

The merger application would be subject to a very thorough review by the Competition Bureau. The Office of the Superintendent of Financial Institutions (OSFI) would review the prudential soundness of the merger.

The House of Commons Finance Committee and the Senate Committee on Banking, Trade and Commerce would then conduct public hearings and summon the merging entities as witnesses in order to determine whether the merger is in the 'public interest.' The PIIA would serve as a key indicator.

The Minister of Finance, in October 2002, surprised the markets when he asked the committees to hold special hearings in order to first clarify somehow what the government itself meant by its own phrase 'public interest.' If the government did not know what the phrase 'public interest' meant, maybe they should not have used it.

The timing of this "public interest reference" was most curious inasmuch as it came scant days after the Prime Minister reportedly overruled his own Finance Minister and scotched merger proposals between the Bank of Nova Scotia and the Bank of Montreal, as well as between Manulife and the CIBC. The timing clearly showed that this was nothing more than another delaying tactic used by a government that is politically scared to death of bank mergers and is stifling the growth of a sector vital to the Canadian economy.

We believe this is simply foot-dragging — foot-dragging that will continue because this is a government that doesn't have the courage to make a difficult decision even if it is in the best interest of the country.

Ostensibly, after this Committee tables this Report, the government should be prepared to accept merger applications. However, whether this government will still be adverse to bank mergers remains to be seen.

Key Points

1. **Public Interest Meaning:** The Minister wanted the Parliamentary committees to clarify public interest. Such a term is difficult to clarify and snubs definition. There are many principles that might suggest that a particular bank merger is in the public interest, such as, a minimal reduction of retail services, no increased fees or no reduction in access to capital. But to bring clarity or define the phrase 'pubic interest' in all cases is to define the word 'art'.

   In any event, the exhaustive review that is to be undertaken by the Competition Bureau will survey all the likely events that might occur as a result of any bank merger, such as, any substantial lessening of competition or decrease in services. The Competition Bureau's report on any merger will address the key issues related to the public interest.

2. **Another Government Delaying Tactic:** This Government has had three years to start dealing with bank mergers since it introduced the Merger Review Guidelines in 2000. Giving the Minister an additional 90 days to respond to this Report is unacceptable. I would urge the Minister of Finance to show bold leadership and respond to the report within 30 days. Otherwise it would bring any proposal directly onto a collision course with the Liberal Party's leadership convention in November 2003, thus delaying it further.

3. **Bank Merger Process Is Still Politicized:** The success of a bank merger proposal should not hinge on personal whims of prime ministers or finance ministers, nor should mergers be subject to another round of politicized Finance Committee hearings.

   In the words of Matthew Barrett, the Group Chief Executive of Barclays, "It's purely political and not about concentration…I think it's a disgrace".

   The merger entities should not have to appear before Parliamentary committees during the examination stage. Information pertinent to the merger will be fleshed out by the Competition Bureau and OSFI, under very transparent conditions.

4. **Minister of Finance Should Justify His Decision:** Currently, it is the banks who are to come before the Parliamentary committees to testify further as to why and how they want to merge. This is redundant. Their PIIA is sufficient to put forth that information.

It is the Finance Minister, as the person with the final say as to whether banks will be allowed to merge (or the prime minister in some governments), who should come before the Finance Committee to publicly state on record why a particular bank merger was accepted or denied. This would further help to depoliticize the bank merger process.

Recommendations

That the Minister of Finance respond to this Report within 30 days.

That the Minister of Finance appear before the Finance Committee to justify any decision on a proposed merger whether it be a denial or an approval.

Conclusion

The Progressive Conservative Party calls on the Liberal government to stop delaying and to stop playing politics with this very important issue; failing to do so will further disrupt the ability of Canada's financial institutions to develop and execute sound business strategies that will allow them to grow and expand, creating opportunity and prosperity for Canadians.

Scott Brison, M.P.
Progressive Conservative Finance Critic

MINUTES OF PROCEEDINGS

Wednesday, March 19, 2003
(*Meeting No. 48*)

The Standing Committee on Finance met *in camera* at 3:43 p.m. this day, in Room 306, West Block, the Chair, Sue Barnes, presiding.

Members of the Committee present: Sue Barnes, Roy Cullen, Nick Discepola, Richard Harris, Sophia Leung, The Hon. Maria Minna, Shawn Murphy, Pauline Picard, Tony Valeri, Bryon Wilfert.

Acting Member present: Jim Peterson for Gary Pillitteri.

In attendance: *From the Library of Parliament:* June Dewetering, Acting Principal Analyst; Marc-André Pigeon, Analyst; Blayne Haggart, Analyst.

Pursuant to Standing Order 108(2), the Committee resumed its study on the public interest implications of large bank mergers.

The Committee resumed consideration of the draft report.

It was agreed, — That the draft report be adopted, as amended, as the Third Report of the Committee.

It was agreed, — That the title of the report be:

> LARGE BANK MERGERS IN CANADA: SAFEGUARDING THE PUBLIC INTEREST FOR CANADIANS AND CANADIAN BUSINESSES.

It was agreed, — That, pursuant to Standing Order 109, the Committee request that the Government table a comprehensive response to the report; however, notwithstanding the deadline of 150 days stipulated in Standing Order 109, the Committee request that the comprehensive response to this report be tabled within 90 days of the presentation of the report to the House.

It was agreed, — That the Committee append to its report the dissenting or supplementary opinions immediately after the signature of the Chair provided that they are no more than 2 pages in length and submitted electronically to the clerk of the Committee, no later than Friday, March 21, 2003 at 3:00 p.m.

It was agreed, — That the Chair, analysts and clerk be authorized to make such typographical and editorial changes as may be necessary without changing the substance of the report.

It was agreed, — That the Chair be instructed to present the Third Report of the Committee to the House.

It was agreed, — That the Committee print 500 copies of the report in a bilingual format.

The Committee proceeded to the consideration of matters related to Committee business.

At 5:58 p.m., the Committee proceeded to sit in public.

Pursuant to Standing Order 106(4), the Committee proceeded to the consideration of the request by Richard Harris, Charlie Penson, Pierre Paquette and Judy Wasylycia-Leis in relation to the appearance of the Minister of Finance.

After debate, the question was put on the request and it was negatived on the following recorded decision:

Yeas (2): Richard Harris, Pauline Picard.

Nays (7): Roy Cullen, Nick Discepola, Sophia Leung, The Hon. Maria Minna, Shawn Murphy, Jim Peterson, Tony Valeri.

At 6:00 p.m., the Committee adjourned to the call of the Chair.

Richard Dupuis
Clerk of the Committee