



# Bank Mergers — The Second Round

While legislation makes bank groupings possible, Canada's chartered banks still face many hurdles



By Peter Diekmeyer

Bill C-8, the financial services legislation that breezed through Parliament this summer, opens up the possibility that Canada's chartered banks will soon be considering a new round of mergers. But the key word remains "possibility."

Finance Minister Paul Martin has

called bank mergers and acquisitions "a legitimate business strategy," provided they do not unduly concentrate economic power or significantly reduce competition. But new combinations will have to go through an extensive approval process. This gives the federal government substantial leeway to intervene if it feels a deal is against Canada's national interest.

Of course, mergers have been tried before. In 1998, two of Canada's five largest banks — the Royal Bank of Canada and the Bank of Montreal — announced merger plans, seemingly out of the blue. Toronto Dominion and CIBC — afraid of being left out — quickly followed up with their own announcement. But Martin, who had not been briefed beforehand, rode the rising tide of public opinion against the proposed unions and in December 1998, he put a stop to all merger talks.

However, a lot of things have changed since then. For one, the new legislation codifies the principle that Canadian banks will be given leeway to merge with one another under certain conditions, and puts in place a regulatory framework to govern merger activity — a compromise that appears to have softened public opinion somewhat.

The Internet bubble that brought the NASDAQ to dizzying heights, then crashing back

down again, and the globalization protests in Seattle and Quebec City have heightened public consciousness about how small a world we live in. While not directly related, these events also lead to a better public understanding of the competitive global context that all companies, including banks, are operating in.

One thing that hasn't changed is the likelihood that banks will return to the merger table. "It is our view that the value proposition

of merging is so compelling that the banks will inevitably make a second attempt," said Robert Wessel, an analyst at National Bank Financial, in a report earlier this year.

According to Wessel, foreign competitors such as MBNA, Fidelity and Goldman Sachs are increasingly grabbing market share from Canadian banks in a variety of lucrative lines such as credit card operations, mutual funds and investment banking.

"The opportunity to create significant value for shareholders, while providing the scale and financial strength to meet these competitive challenges, will provide impetus for mergers," writes Wessel, who cites Royal Bank and TD Canada Trust as the two banks most likely to initiate acquisitions.

However, the mergers are hardly a sure thing. There are many regulatory bodies that could stop or hamper any potential deal. For one, under

the new legislation, banks that are planning a merger will have to apply in writing to the Minister of Finance, the Superintendent of Financial Institutions and the Competition Bureau, all of which could throw a wrench in the wheels.

In addition, the banks will be required to submit a public interest impact assessment to both the House of Commons Finance Committee and a similar Senate committee, both of which will hold hearings on any proposal. The Competition Bureau's role is especially important. Almost any proposal is likely to result in branch clos-





ings down the line, which will almost certainly reduce competition in some markets.

Having learned the hard way, the banks will likely work closer — through informal negotiations — with the regulatory bodies and the Canadian government. But the approval process for any merger will be a long, drawn-out affair. There will be a considerable time lag between the date any merger is announced and the time it is finally consummated. Public opinion — although more attuned to the competitive challenges facing Canadian banks than it was in 1998 — could shift at any time. Politics being what they are, this could force the government to stop an unpopular proposal.

The two main interest groups that are most likely to be concerned about proposed bank mergers are consumers and small businesses. Small businesses, traditionally among the most vocal opponents, have long complained about the lack of responsiveness to their concerns from Canadian banks.

However, small business satisfaction with banks has been rising in recent times according to a Canadian Federation of Independent Business (CFIB) survey. This leaves the lobby group less leverage in requesting a halt to any impending merger, particularly in light of the fact that small business was not one of the areas that the Competition Bureau focused on in their reports on the 1998 merger proposals.

The three business sectors of concern to the Competition Bureau were branch banking services to individuals, credit cards and securities. But it is services to individuals that is likely to be the most contentious area. Already, consumers in many smaller Canadian markets have access to only one bank and some have no access at all. As noted, any merger between two banks is likely to result in branch closings somewhere down the line, which will inevitably lead to a decrease in competition in many markets. If the number of closures is too high, the merger could be rejected outright. But the Competition Bureau has indicated that the most likely remedy would be the sale of the excess branches from the merged institution to another bank.

The problem with forcing merging Canadian

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banks to sell off excess branches is that there are few companies to sell them to. One solution, according to a recent paper produced by the C.D. Howe Institute, is to allow foreign banks to buy these excess branches. Canada would enter into reciprocal agreements with foreign countries — similar to those that already exist in the European Union’s single banking market — which would allow banks to compete in each other’s backyards.

This proposal would allow Canadian banks to merge to achieve the size required to compete effectively internationally, and at the same time allow new foreign players to come in and pick up the slack in underserved Canadian markets.

It’s difficult to see how the merger process will play out. There has been speculation that the banks will wait for the ink to dry on the new legislation before lining up partners. With their 1998 defeat still top-of-mind, this would probably be the wise course. Most likely, there will be consolidation in Canada’s banking sector, but there is no guarantee that any particular proposal will make it through the approval process.

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