Canada's Policy on Financial System Consolidation:
A Political Economy of Public Policy Transformation in an Era of
Globalization

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Abstract

Positioning itself within the comparative and international political economy tradition, this study critically examines within a longer-term historical perspective and in a wider comparative context the transformation of the Canadian federal policy on financial system consolidation with a keen eye on whether or not, for the period between 1970 and 2005, the Canadian federal policy on bank mergers and acquisitions was converging on the U.S. model of bank merger governance. Special attention is focused not only on whether there are convergent trends or not, but also on understanding the dynamics involved particularly as regards to the role of globalization and regionalism in such transformation processes.

The analytical framework developed in Part I is applied in Part II in the empirical investigation and comparison of the Canadian and U.S. bank merger policies. What emerge from this study are three key findings. First, while there has been a growing similarity in some aspects of the two countries' bank merger policies (e.g., policy objectives, competitive reviews), these convergent trends have not always been about Canada converging on the U.S. as, in some cases, it was the U.S. that followed Canada (e.g., in the scope and types of mergers governed, and nationwide branching). Secondly, despite the tendencies for convergence, Canadian and U.S. bank merger policies continue to exhibit distinctive characteristics in several key aspects (e.g., in institutional arrangements, geographic scope, concerns about concentration of power, substantive issues of law, and policy styles). Thirdly, although globalization and regionalism are potent sources of institutional change and that while some of the pressures toward greater policy convergence are undeniable and significant, but given that each country has unique

historical, economic, political, ideological, and institutional conditions, all of which have (in varying degrees and at different historical moments) influenced and shaped the evolution, patterns, and directions of each country's financial regulatory regime, it is no wonder that there has not been substantial convergence around the American model of bank merger governance. These outcomes reflect the nature of globalization and regionalism (as both having homogenizing and heterogenizing tendencies) and the contested and historically contingent nature of the transformation processes of the Canadian and American bank merger policies. Thus, convergent tendencies have been just one of a number of possible (non-automatic, non-inexorable, and potentially reversible) institutional and policy outputs, outcomes and trajectories. These developments have serious economic, political and social implications that warrant further study.

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Table of Contents

Abstract	iii
Acknowledgements.....	v
Table of Contents	vi
Acronyms	ix
List of Figures.....	xi
List of Tables	xi
List of Boxes.....	xi
List of Appendices.....	xi
 Chapter 1: Introduction	 1
1.1 The Research Problem	1
1.2 Purpose of the Study	7
1.3 Rationale and Significance of the Study	9
1.3.1 Theoretical Significance	9
1.3.2 Empirical Considerations.....	12
1.3.3 Policy Considerations	14
1.4 Research Methodology	18
1.5 Research Findings and Argument.....	19
1.6 Organization of Chapters	20
 Chapter 2: Finance in a World of Varieties of Capitalism	 25
2.1 Introduction.....	25
2.2 Varieties of Capitalism Approach: A Brief Overview.....	27
2.3 Relevance of the VoC Approach for this Study	29
2.4 Financial Systems: Mapping a Diverse and Dynamic Terrain	32
2.5 Financial System Governance in a World of Varieties of Capitalism.....	40
2.5.1 Financial Sector Governance and the Governance of Non-financial Firms	57
2.5.2 State Governance of Financial Systems.....	60
2.6 Conclusions.....	64
 Chapter 3: Financial System Consolidation and Comparative Bank Merger Policy Analysis	 67
3.1 Introduction.....	67
3.2 Financial System Consolidation: A Conceptual Overview	68
3.3 Bank Mergers and Acquisitions: Patterns, Sources and Rationales	70
3.3.1 Patterns of Bank Mergers and Acquisitions.....	70
3.3.2 Rationales for Bank Mergers and Acquisitions	71
3.4 Public Policy on Financial System Consolidation and Bank Mergers	81
3.4.1 Bank Merger Policy Defined	82
3.4.2 Bank Mergers and Financial Consolidation: Key Policy Implications.....	86
3.5 Comparative Bank Merger Policy Transformation	101
3.6 Conclusion	107

Chapter 4: Bank Merger Policy Convergence and/or Divergence: An Analytical Framework	110
4.1 Introduction.....	110
4.2 Convergence/Divergence: A Conceptual Overview	111
4.3 Bank Merger Policy Convergence/Divergence: Nature and Substance	115
4.3.1 Existence of Bank Merger Regimes	117
4.3.2 Scope of Bank Merger Policy	118
4.3.3 Policy Objectives/Goals, Ideas and Discourse.....	121
4.3.4 Banking Business and Investment Powers, and Ownership Rules	122
4.3.5 Bank Merger Review, Policy Instruments and Institutional Configuration ..	122
4.3.6 Policy Styles.....	125
4.3.7 Policy Impacts.....	129
4.4 Dynamics of Bank Merger Policy Convergence/Divergence.....	130
4.4.1 Globalization, Regionalism and Bank Merger Policy Convergence	130
4.4.2 Dimensions of Bank Merger Policy Dynamics	150
4.5 Significance and Implications of Bank Merger Policy Convergence.....	182
4.6 Applying the Analytical Framework	183
 Chapter 5: Canadian Bank Merger Policy (1970s-2005)	185
5.1 Introduction.....	185
5.2 Early Bank Merger Policy: Foundation Laying and Change.....	186
5.3 A Post-1970s Thematic History of Canadian Bank Merger Policy.....	193
5.3.1 Bank Merger Policy Objectives, Ideas, and Discourse.....	194
5.3.2 Banking Business and Investment Powers, and Ownership Rules	208
5.3.3 Bank Merger Review Process, Instruments and Institutional Configuration	225
5.3.4 Bank Merger Policy Style	236
5.3.5 Bank Merger Policy Impacts	249
5.4 Conclusion(s).....	267
 Chapter 6: U.S. Bank Merger Policy: 1970s - 2005	270
6.1 Introduction.....	270
6.2 The Pre-1970s U.S. Banking System and Regulatory Framework.....	272
6.3 A Post-1970s Thematic History of U.S. Bank Merger Policy.....	297
6.3.1 Bank Merger Policy Objectives, Ideas, and Discourse.....	297
6.3.2 Bank Business and Investment Powers, and Ownership	312
6.3.3 Bank Merger Review Process, Instruments and Institutional Configuration	325
6.3.4 Bank Merger Policy Styles	334
6.3.5 Bank Merger Policy Impacts	341
6.4 Conclusions.....	353
 Chapter 7: Canadian and U.S. Bank Merger Policies: Significant Convergence or Enduring Divergence?	356
7.1 Introduction.....	356
7.2 Existence of Bank Merger Regimes	357
7.3 Dimensions and Dynamics of Convergence and/or Divergence	360
7.3.1 Scope of Bank Merger Policy	360

7.3.2 Bank Merger Policy Objectives, Ideas and Discourse.....	363
7.3.3 Banking Business and Investment Powers, and Ownership Rules	371
7.3.4 Bank Merger Review Process, Instruments and Institutional Configuration	375
7.3.5 Bank Merger Policy Styles	385
7.3.6 Bank Merger Policy Impacts: Convergence or Divergence?.....	388
7.4 Significance of Bank Merger Policy Convergence and/or Divergence	391
7.5 Conclusions.....	397
Chapter 8: Conclusions	399
8.1 Introduction.....	399
8.2 Study's Findings	400
8.3 Contributions of this Study	404
8.4 Limitations of the Study	407
8.5 Suggestions for Further Research	408
Bibliography	409
Appendices	470

Acronyms

ATMs	Automated Teller Machines
BCBS	Basle Committee on Banking Supervision
BHCs	Bank Holding Companies
BIS	Bank of international Settlements
BMO	Bank of Montreal, Canada
BNA	British North America
CB	Competition Bureau, Canada
CBA	Canadian Bankers' Association
CCRC	Canadian Community Reinvestment Coalition
CDIC	Canada Deposit Insurance Corporation
CFIB	Canadian Federation of Independent Business
CFSO	Canadian Financial Services Ombudsman
CIBC	Canadian Imperial Bank of Commerce
COMER	Committee on Monetary and Economic Reform (Canada)
CPA	Canadian Payments Association
CPRN	Canadian Policy Research Networks Inc
CRA	Community Re-investment Act (USA)
CRIC	Centre for Research and Information on Canada
CSOs	Civil Society Organizations
CUSFTA	Canada-US Free Trade Agreement
DIDCA	Depository Institutions Deregulation Committee
DIDMCA	Depository Institutions Deregulation and Monetary Control Act (USA)
DOJ	Department of Justice, USA
EU	European Union
FBSEA	Foreign Bank Supervision Enhancement Act (USA)
FCAC	Financial Consumer Agency of Canada
FDIC	Federal Deposit Insurance Corporation (USA)
FIRREA	Financial Institutions Reform, Recovery, and Enforcement Act of 1989
FRB	Federal Reserve Board (USA)
FRBNY	Federal Reserve Bank of New York
FRS	Federal Reserve System (USA)
FSF	Financial Stability Forum
FTC	Federal Trade Commission (USA)
G10	Group of 10
G20	Group of 20
GATS	General Agreement of Trade in Services
GATT	General Agreement on Trade and Tariffs
HHI	Herfindahl-Hirschman Index
IAIS	International Association of Insurance Supervisors
IBA	International Banking Act (USA)
IBBEA	Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994
IBC	Insurance Bureau of Canada
ICBA	Independent Community Bankers of America
ICN	International Competition Network

ILSA	International Lending Supervision Act
ILO	International Labour Organization
IMF	International Monetary Fund
IMFC	International Monetary and Financial Committee
IOSCO	International Organization of Securities Commission
JFFC	Joint Forum on Financial Conglomerates
LTCM	Long Term Capital Management
M&As	Mergers and Acquisitions
MNCs	Multinational Corporations
MP	Member of Parliament
NAAG	National Association of Attorneys General (USA)
NAFTA	North American Free Trade Agreement
NDP	New Democratic Party (Canada)
NICs	Newly Industrialized Countries
NS	Nova Scotia, Canada
OCC	Office of the Comptroller of Currency (USA)
OECD	Organization for Economic Cooperation and Development
OSFI	Office of the Superintendent of Financial Institutions, Canada
PC	Progressive Conservative Party (Canada)
PEI	Prince Edward Island, Canada
PIAC	Public Interest Advocacy Centre, Ottawa
PIIA	Public Interest Impact Assessment
RBC	Royal Bank of Canada
Rt.Hon.	Right Honourable
Scotiabank	Bank of Nova Scotia, Canada
SMEs	Small and Medium Size Enterprises
TD	Toronto Dominion Bank, Canada
TNCs	Transnational Corporations
UK	United Kingdom
US	United States
U.S.	United States
USA	United States of America
VoC	Varieties of Capitalism
WTO	World Trade Organization

List of Figures

Figure 2.1: Financial Systems in a World of Varieties of Capitalism	36
Figure 2.2: Economic Governance: Financial System vs. Non-financial System Governance	58
Figure 2.3: Players in the Governance of Financial Systems	59
Figure 2.4: Players in the Governance of Non-Financial System.....	60
Figure 3.2: Bank Merger Policy as an Intersection of Multiple Policy Fields	84
Figure 4.1: Bank Merger Policy Convergence and/or Divergence: A Dynamic Model.	181

List of Tables

Table 4.1: Globalization - A Synthetic Perspective.....	135
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List of Boxes

Box 4.1: Explaining Causal Dynamics	180
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List of Appendices

Appendix 1: Types of Mergers	471
Appendix 2: Canadian Bank Mergers – Pre-1960s and Post 1960s	472
Appendix 3: Bank Mergers in the U.S.....	478
Appendix 4: Canadian Royal Commissions and Task Forces on Banking	479
Appendix 5: International Bank Rankings – Canada vs. U.S. Banks	480
Appendix 6: Bank Numbers and Bank Branching in Canada.....	481

Chapter 1: Introduction

1.1 The Research Problem

Canada entered the new millennium with a significantly reformed policy on bank mergers and acquisitions. After rejecting two large bank merger proposals in 1998 and subsequent to receiving the final report of the Task Force on the Future of the Canadian Financial Services Sector in 1998 (MacKay Task Force), the Canadian government made significant policy and legislative changes in how it intended to govern bank mergers and acquisitions (Craig, 1998; Department of Finance, 1998a, 1998b, 1998c, 1998d, 1998e, 1999a, 1999b, 1999c; Eggertson, Walker & Ferguson, 1998; Foot & Beauchesne, 1998; Marotte, 1998a, 1998b; Tedesco, 1998; Walters, J., 1998; Whittington, 1998).

Through these changes Canada's longstanding unwritten rule that "big-shall-not-buy-big" (a rule that had for a number of years ruled out mergers among Canadian large banks) was in effect rescinded and instead the federal government subsequently introduced a new review process for large bank mergers (i.e., for banks with equity exceeding \$5 billion) that was far more elaborate than any that had existed previously (Department of Finance, 1999b, 2001).

However, no sooner had the legislation passed, than it was deemed insufficiently clear. Thus, it was reported in the Summer of 2002 that the Bank of Montreal (BMO) and the Bank of Nova Scotia (ScotiaBank) had indicated their interest in merging but that this plan was scuttled by the Prime Minister's Office even before a formal application, or a public announcement was made (Kalawsky, 2002:C5; MacKlem, 2002:70-74). The Bank of Nova Scotia subsequently disputed these allegations when its CEO met the Senate Committee on Banking on the 25th of November 2002 (Baxter, 2002:D1). All in all, as it

turned out, the Bank of Montreal and Bank of Nova Scotia had confidentially requested further clarification on the criteria the government would apply in assessing the "public interest" aspects of bank mergers (Baxter, 2002:D1; Beltrame & MacKlem, 2002; Jack, 2002b:FP6). In response to this request, the Minister of Finance, in turn, asked two parliamentary committees for advice on the considerations that should apply in making such a determination (Beauchesne, 2002: C3; Department of Finance, 2003:Annex A; Reed, 2004:4). These committees issued their reports in January and March of 2003 respectively (The House of Commons Standing Committee on Finance, 2003; The Senate Committee on Banking, Trade and Commerce, 2002).

After receiving and considering these reports, John Manley (then Finance Minister) issued a response in June 2003 in which he noted that while the government supported the notion that bank mergers were a valid corporate strategy to "enhance their international competitiveness and facilitate their strategies for international growth", the prospect of mergers among Canada's large financial institutions raised important public policy issues that "justify a broader public interest test that goes beyond the reviews by the OSFI and the Competition Bureau" (Department of Finance, 2003). Consequently, Mr. Manley rejected the Senate Committee's suggestion to eliminate the public interest review of bank merger transactions, and set out new public interest considerations for large bank mergers, including a clarification on the roles of parliamentary committees in the large bank merger review process.

In his response, Mr. Manley also highlighted several broader issues that required further consideration and on which the government sought public input, and thus, set out a timetable for a public consultation process regarding the subject issues and also specified a transition period before mergers were to be considered by the government

(Department of Finance, 2003). Thereafter, an extensive public consultation process ensued but the issuance of the federal government's position on bank mergers (and indeed on financial system consolidation in general) was stalled by the government transition in which Prime Minister Jean Chretien stepped down and passed the Liberal Party leadership on to Mr. Paul Martin who soon thereafter called a national election in the Summer of 2004 in which he only won a minority government. The vicissitudes of Prime Minister Paul Martin's minority government further delayed the issuance of the new government policy on bank mergers (Argitis & Deslongchamps, 2005:B5; Cordon, 2005; Kalawsky, 2004: FP1, FP3; Patridge, 2001:B1; Robinson, A., 2005: B7: The Globe and Mail, 2005:A12; Vieira, 2004: FP3). Indeed, as it turned out, Paul Martin's Liberal government was defeated in the December 2005 federal election before the long awaited bank merger policy was announced and the incumbent minority Conservative government of Steven Harper has indicated that it is not in a hurry to deal with the bank merger file (Laghi, 2006; Mavin, 2006: FP4; Reuters, 2006; The Canadian Press, 2006).

Parallel to the foregoing Canadian policy developments, the U.S. was also making radical changes in its financial regulatory policy. One of the most significant responses to domestic and international pressures was the passage of the Gramm-Leach-Bliley Act in November 1999 (Biswas & Lochel, 2001: 22) which repealed Section 20 of the Glass-Steagall Act of 1933 with the result that the hitherto prohibited affiliations between banks, securities firms, insurance companies and other financial service providers were rescinded. The same Act also modified the Bank Holding Company Act of 1956 and allowed the establishment of new organizational structures (financial holding companies) that could own commercial banks and engage in any type of financial activity. As such, through the medium of the financial holding structure, securities firms were allowed to

buy banks. These financial holding companies were permitted to acquire insurance companies as well (Biswas & Lochel, 2001).

Viewed from a historical perspective, these changes were, indeed, a culmination of several changes to the U.S. federal policy on bank regulation that had picked up steam during the “deregulatory/regulatory” movement of the 1980s and 1990s. These policy shifts saw, among other things, the extension of permissible banking business and investment powers, the revisions of bank merger guidelines as well as the removal of the inter- and intra-state banking and branching barriers that had hitherto persisted, paving “the way for a nationwide banking system” (Matasar & Heiney, 2002: 91; see also Stiroh & Poole, 2000); and a tendency for increased and rapid consolidation and concentration of the U.S. banking industry (Pilloff, 2004; Rhoades, 2000).

To be sure, change in the Canadian and American financial regulatory policies is nothing new, but viewed from a broader perspective these shifts were significant in, at least two important ways. To begin with, these developments bring into sharp relief the extent to which different countries still retain the freedom and capacity to make and implement domestic regulatory policies as they respond to the various opportunities and risks wrought about by increasing regional and global integration.

Secondly, the developments in both Canada and the U.S. take on an added poignancy when one considers the challenges small states like Canada face in their relations with a global super power. In fact, the influence of the U.S. on Canadian public policy is a longstanding one, for, “Despite the links with Britain, Canada’s history is, to a large extent, the story of successive attempts to manage economic integration with the United States while maintaining some degree of independence” (Macdonald, 1997:174). As such,

“Canada has always been preoccupied with how it is affected by its giant neighbour to the south”(Hoberg, 1991:108). And, as Hoberg, Banting, and Simeon (2002:252) have noted:

For Canada, a small open economy overwhelmingly dependent on the world’s largest and most dynamic national economy, this anxiety is particularly acute. Indeed, concerns about ‘Americanization’ have been part of Canadian identity, politics, and public policy since before Confederation (Hoberg, Banting & Simeon, 2002:252).

The influence of the U.S. on Canada is not only bilateral but also regional and global because the U.S. has a disproportionate clout in these arenas. As Mandle (2003: 121) has observed:

The United States, far more than any other country, has had a decisive voice in determining the content of the policies and procedures that have accompanied globalization. Its voice has been and still is dominant in multilateral organizations such as the World Bank and the IMF, and it was the most powerful influence in shaping the content of the rules that the WTO enforces.

It is not surprising, therefore, that people in countries like Canada would be concerned about America’s influence as their societies become increasingly intertwined (see e.g., Boothe & Purvis, 1997; Clarkson, 2002a, 2002b). Indeed,

Many Canadians worry that they have forfeited – either through international agreement or through economic and technological change – the ability to make choices that protect and promote a distinctive Canadian way of life. Instead, they find themselves forced down a path of policy harmonization with the United States (Hoberg, Banting & Simeon, 2002:252).

Consequently, a study of how and to what effects such a giant neighbour -- and globalization in general -- might have influenced Canadian public policy on bank mergers is crucial in understanding the evolution of Canadian bank merger policy. Currently, a prominent issue in the globalization debates is the question of whether states are converging in how they manage and govern their respective economies. And those analysts who foresee the convergence of national policies naturally also postulate that contemporary

transformations will lead to a significant convergence of financial sector public policies molded on the American system. Other scholars, however, disagree and point to the continued national policy diversities and particularities (see Berger & Dore, 1996; Boyer, 1996, 2000; Coleman & Porter, 1996; Crouch & Streeck, 1997; Gilpin, 2000; Moran, 1986; Radice, 2000; Vitols, 1997).

Furthermore, with the establishment of the NAFTA by Canada, Mexico, and the USA in 1994, an added dimension (i.e., the role of regionalism/regionalization) has been introduced into the debate regarding the convergence and/or divergence of financial regulatory policies in the member states (see Clarkson, 2002a, 2002b; Coleman & Underhill, 1998; Fratianni, 1997; Germain, 1996a, 1996b, 1997; Le Pan, 1997; Mailander, 1999; Martinson, 1997; Nolle, 1997; White, W., 1994). Controversy here also rages on. For instance, whereas Fratianni (1997) argues that the NAFTA (in contrast to the EU) is not likely to lead to a convergence of financial regulatory policies, others have found very little if any integration of the financial systems but predict some (albeit slow) convergent trends (Mailander, 1999). Nolle (1997) on his part argues that NAFTA will only have modest impact. Indeed, he observes that although the integration of the banking systems of Canada, the United States, and Mexico is likely to continue, the agenda of international bank regulatory issues facing bankers and supervisory authorities in these countries will likely continue to be set, not by NAFTA-induced changes, but by the wider, ongoing globalization of banking (Nolle, 1997:160).

Whether or not regional arrangements like the NAFTA will have a significant impact on Canadian and American bank merger policies, one thing is clear: change continues whereby some changes are a direct result of NAFTA while others are not. Furthermore, the changes currently taking place in Mexico, the overhaul of the Canadian

financial services legislation, and the recent repeal of Glass-Steagall in the U.S. are definitely going to usher in more changes in the financial landscapes of the NAFTA countries.

Against this background, the issue of Canadian and U.S. bank merger policy convergence constitutes an important hypothesis especially in view of the fact that Canada's banking and financial system has historically been very different from that in the United States. The central question is whether and to what degree the hitherto distinctive Canadian mode of bank merger regulation/governance has survived, and is likely in the future to survive, the pressures of globalization and/or regionalization.

1.2 Purpose of the Study

This study aims to determine whether Canadian federal policy on bank mergers over the period between the 1970s and 2005 has converged on its counterpart in the U.S. or whether the two countries continue, by and large, to be characterized by idiosyncratic national bank merger policies. Accordingly, this study is guided by the following primary question:

Is the Canadian policy on bank mergers and acquisitions converging on the American model? If so, to what extent and in what respects are they converging and why?

Anchored in a political economy tradition, this study will critically examine the transformation of Canadian bank merger policy between the 1970s and 2005 with the express aim of discerning what key bank merger policy elements (e.g., goals, permissible

investment and business powers, review processes, institutions, instruments, styles, impacts, etc.) have converged on or diverged from the U.S. model.

The political economy approach that has been adopted in this study is deemed appropriate because as McBride (1996:49) has aptly observed:

Political economy's focus on power leads to a major interest in the state; what the state does or does not do is the focus of public policy studies. In searching for explanation, policy studies can find valuable resources in political economy's concern with the interaction of economic, social, political, cultural, and ideological factors. In particular, focusing on the impact of economic forces poses quite directly the question: Who benefits? Political economy's interest in the interconnection between social, cultural, and economic-political factors is thus helpful in understanding public policy.

Based on such a view, this study will take a broad perspective and investigate the transformation patterns and trajectories of key bank merger policy elements. It will also seek to understand and account for those changes and tendencies and their significance as understood within the context of Canada's wider political economic development. In doing so, particular attention will be paid to the role of globalization and regionalization, and to bilateral pressures (i.e., Canada-U.S. relations) as well as to the domestic dynamics shaping the transformation process.

To accomplish these tasks, the study does two things. First, it offers a conceptual and analytical framework that can assist in examining and understanding changes in bank merger policy in terms of convergence and/or divergence. Second, it then applies this framework to a critical examination of the Canadian and U.S. bank merger policies to discern whether globalization and regionalism are leading Canadian bank merger policy to converge on its American counterpart.

1.3 Rationale and Significance of the Study

The intellectual impetus for this study originates in the broader debates about the transformative “powers” of recent globalization processes, particularly as they pertain to contentious claims regarding the universalizing (homogenizing) tendencies of contemporary globalization (and regionalization) processes and their ability to overcome the forces seeking to protect the continued national specificities and particularities of domestic institutions and processes.

The researcher’s interest in this issue was especially stimulated by the debates and events surrounding the Canadian federal government’s rejection of particular bank merger proposals in 1998, and the subsequent policy reforms that followed a comprehensive financial sector policy review by the MacKay Task Force.

1.3.1 Theoretical Significance

From a theoretical standpoint, this study is significant in several ways. First, and foremost, unlike most conventional studies on banking and financial regulation, this study explicitly focuses on the issue of public policy on bank mergers as a central part of the larger puzzle. This focus is distinctive particularly because most studies in financial regulatory policy do not treat bank merger policy as a central subject of study. As Kurgan van Hentenryk, lamenting the hitherto marginality of public policy on bank mergers in studies on financial regulation and supervision, has observed:

Literature on the supervision and regulation of bank mergers appears at first sight somewhat frustrating. Indeed, the topic falls between research on concentration on the one hand and banking regulation of the other, while being central to neither. Studies on banking concentration focus on its economic aspects, taking little interest in legislation and government policy; whereas studies on banking regulation are principally concerned with prudential control of banks and mergers are considered of secondary importance (Hentenryk, 2001:89).

Moreover, even studies on the history of banking systems have not explicitly focussed on the governance of bank mergers as Hentenryk goes on to observe:

Many historians have written about the evolution of the banking system of their country and analysed the factors that influenced concentration. But, although much data is available on mergers and related legislation, it remains difficult to find extensive research on the development of supervision and regulation of mergers, the players involved in it and the socio-political framework wherein it operates (Hentenryk, 2001:89).

It is in this context that this study will endeavour to fill this particular gap in the literature. Moreover, by specifically investigating the public policy process pertaining to bank mergers, it will seek to deepen our understanding of regulatory change and continuity - especially as it pertains to understanding policy change patterns and the sources and mechanisms of such changes -- since conventional regulation theories have been unable to convincingly explain financial regulatory change and stability over time (Khoury, 1997; Magnusson & Ottosson, 2001; McFetridge & Lall, 1991).

Thirdly, a review of extant studies on market governance reveals that the primary focus by scholars (especially those working within the varieties of capitalism (VoC) approach) has hitherto been on the governance of non-financial firms and the crucial role played by financial institutions in such governance processes. This has led to a situation whereby the governance of financial systems is understudied. This study is thus unique in that it focuses on the governance of financial systems per se; and thus fills an important gap.

Fourthly, a review of relevant literature reveals that the focus of conventional studies has been on understanding the motivations for mergers by financial firms. Consequently, (except in some respect for the brief assessments of the policy impacts/implications of bank mergers, e.g., Dermine, 2000; Kashyap, 1999; Kwast, 1999;

Santomero, 1999; Solomon, 1999), not much is understood about the implications of bank merger policy transformation or of the issues pertaining to the intersection between prudential regulation, competition policy, monetary policy, and international trade concerns.

This study thus provides a unique window through which one can analyze these issues.

Lastly, by approaching the study of financial regulatory transformation through the convergence lens this study will also contribute towards a better understanding of the notion of convergence per se. This need to better conceptualize the notion of "convergence" is aptly stated by Robert Seeliger who observes that:

Considering the convergence hypothesis' increasing prominence in the literature, it is surprising that much more space and thought has been devoted to the presentation of "results" than to the rigorous conceptualization of hypotheses, the design of appropriate research strategies, and the discussion of its potential to advance our general understanding of comparative public policy (Seeliger, 1996: 287).

Furthermore, Seeliger (1996:301) notes that: "the key to theory-building is not simply affirming or disconfirming convergence, but to identify the different patterns of relative policy development and to explain them." In this regard, therefore, this study contributes in two significant ways. First, by constructing a holistic analytical framework it contributes towards a better conceptual and theoretical understanding of the various ways bank merger policy may evolve – incrementally and radically. As a matter of fact, in building such a framework, we have had to retool our conceptual and theoretical apparatus by adapting and extending several concepts and notions beyond those suggested within extant literature (e.g., Bennett, 1991; Coleman, 1994a, 1994b; Seeliger, 1996, etc.) so as to align them within the context of what we understand the processes of globalization and regionalism to mean in the study of bank merger policy.

Secondly, the investigation of the Canadian and American bank merger policies provides us with an opportunity to test the utility of the framework as well as with an arena to elucidate not only the various ways bank merger policy elements may change but also on how and why these change patterns emerge and to what effect. In short, this study helps to shed better theoretical/conceptual light on not only bank merger policy patterns and trajectories but also on the dynamics, significance and implications of such changes – all of which are critical ingredients for theory building.

It is on such a premise that this study will endeavour to understand and account for the Canadian federal bank merger policy's convergence on and/or divergence from the American model dialectically, spatially, temporally, and hierarchically in the sense that policy convergence or divergence is seen as an outcome and a process (among a multitude of alternative processes and outcomes) of the interplay among interests, institutions/structures, ideas, and mechanisms at various historical moments and places. By so doing, this study will have contributed, in a modest way, to the multi-causal approach in the study of public policy transformation.

1.3.2 Empirical Considerations

Empirically, the contribution of this study is threefold. To begin with, a study of Canadian bank merger policy and its evolution is unique in itself because, to our knowledge, no in-depth and comprehensive study has been conducted that examines the transformation of Canadian bank merger policy. Nor is there a study that comparatively examines the Canadian and U.S. bank merger policies for the given period.

Second, as a comparative investigation this study offers better insights than would have been obtained in two separate country case studies. Indeed, as Mildred Schwartz has aptly noted:

Comparing Canada and the United States in preference to focusing on each country independently expands the possibilities for explanation. Even a sample of only two cases permits more convincing generalizations than are possible with a single case. Conversely, restricting comparison to two similar cases rather than attempting to work with larger samples of countries controls the amount of variation that will be found. Working with manageable numbers of both similarities and differences, Canada-U.S. comparisons allow the researcher to hone in on the particular factors that distinguish between them (Schwartz, M., 1996: 346).

Thirdly, this study offers a dynamic framework of analysis that is geared to a better understanding of bank merger policy transformation in this era of global and regional integration. Specifically, it allows us (in an environment of an otherwise confusing mass of information) to discern the long-range patterns and dynamics of Canadian and U.S. bank merger policy developments which, in turn, helps us to engage with ongoing debates about financial globalization and regionalism and the attendant transformation of financial systems and their governing frameworks. Indeed, the Canadian financial system -- like many in the advanced countries -- provides an interesting, rich and challenging empirical field and setting within which to examine the changing role of the state, and its relation with finance especially because the financial sector is arguably one of the most "globalized" and "globalizing" social domains. And, in light of the special role financial institutions play -- domestically and internationally -- a better understanding of bank merger policy change (and shifts in the governance of financial institutions in general) is of particular concern to regulators, economic players, and citizens. These concerns take on added weight partly because of the recent consolidations in the financial services industries, as well as due to the

increasing fragility of financial systems around the world as evidenced by the widespread episodes of financial/banking crises (e.g., Mexico 1982, 1994; the USA thrift industry debacle of the 1980s; the 1990s financial crises of Norway, Finland, Sweden, Russia and the Asian Flu, etc.) (Isard, 2005: chapters 4 & 5). These developments, in turn, have a direct bearing on public policy – an aspect we now turn to.

1.3.3 Policy Considerations

From a practical perspective, the study of contemporary financial policy transformation has several uses. As Andrew Sobel observes, financial globalization presents "policy-makers, investors, borrowers, and financial market players with an expanding menu of opportunities, pitfalls, and dilemmas as financial flows transmit benefits and risks across borders" (Sobel, 1999: 2). Consequently, among other things, financial globalization has important implications for the way in which the financial sector is governed or regulated (Freedman & Goodlet, 1998).

To begin with, it is important to study the evolution of Canadian bank merger policy vis-à-vis the American framework because differences in national institutions are one of the important causes of cross-country variations in economic and political performance. This study, therefore, helps us to better understand the role of regulatory policy in financial system development.

Secondly, comparative research is important because it "can aid in the specification of the conditions under which one country can learn from another" (Antal, Dierkes & Weiller, 1987: 14); as "Identifying the differences among various national approaches to a given policy problem can assist in the specification of the structural, institutional and cultural constraints of the public policy" (Antal, Dierkes & Weiller,

1987:14). It also helps to create an “awareness of alternative challenges the political and cultural assumptions upon which a nation's policies are based” (Antal, Dierkes & Weiller, 1987:15). Most importantly, “it brings to light underlying, often unquestioned premises (Antal, Dierkes & Weiller, 1987:15). Furthermore, as Antal, Dierkes and Weiller (1987) point out:

Researchers conducting comparative investigations often find that they learn as much, if not more, about their own political systems by studying others. Not only do they find new policy options in other countries, but they also discover latent policy constraints and opportunities within their own system (Antal, Dierkes & Weiller, 1987: 15).

In short, “comparison can put our judgment about policy processes and outcomes into a broader and more refined perspective” (Antal, Dierkes & Weiller, 1987: 14). Consequently, this study will help in refining research methodologies in the study of public policy on bank mergers.

Furthermore, the study of Canadian and American banking systems is important not only because decisions by banks have significant economic, political, and social consequences, but also because state authority has significant impact on the existence, structure, and functioning of financial markets (see Hoffman, 2001; Strange, 1986:29). Indeed, as Susan Hoffman has noted “banks not only affect politics; they are products of politics. U.S. banking institutions have been shaped – empowered and constrained – by public policy” (Hoffman, 2001:x). It is thus useful to study the state's relationship with the financial sector because its involvement in the economy has its own direct and indirect ramifications. State intervention -- and regulation in particular -- is critical because, in the words of the OECD: “The legislative and regulative provisions that define the permissible spheres of activity for various institutions operating in the financial services sector

determine to a great extent the kind of institutions and the kind of financial services that develop” (OECD cited in Moran, 1991: 6). Moreover, as Susan Strange (1994: 60) has poignantly stated:

States intervene in markets for credit and for currencies, but who loses and who benefits as a result of their intervention? What new risks are run and by whom? Who gets new opportunities to make money, to escape poverty, to avoid violence, to provide for a secure future for themselves and their families? This is always the bottom line of political economy.

Indeed, a study of bank merger policy brings into sharp relief how states attend to issues of equity and representation in a world seemingly preoccupied with market and regulatory efficiency and international competitiveness. A study of public policy on domestic and cross border bank mergers of necessity involves an examination of the transnationalization of both states and capital. As such, “This must involve an examination of the role played by foreign capital as a social force within each nation-state, as well as of the increasing transnational orientation to accumulation on the part of domestic capital” (Panitch & Gindin, 2004:10-11). Such analysis Panitch and Gindin (2004) argue “must also not ignore the responsibility that states have increasingly taken for ensuring that national policies contribute to the stability of, or at least do not disrupt the functioning of, the global economy” (pp.10-11). In a nutshell, the study of financial system consolidation is significant in the sense that it sheds important light on the political economy of domestic and global economic governance in an era of increasing integration.

Furthermore, from a policy perspective, the study of Canadian bank merger policy is interesting and important because the Canadian financial services sector, and the banking industry in particular, play key roles in the Canadian political economy (see e.g.,

CBA, 2006a; Department of Finance, 2005; Williams, H., 1999). In fact, the financial services sector “represented 6 per cent of Canada’s gross domestic product in 2003” (Department of Finance, 2005). Within the financial services sector banks play an integral part: for example, they accounted for over 70 per cent of the total assets of the sector in 2005 whereby domestic and foreign banks operating in Canada managed almost \$1.8 trillion in assets (Department of Finance, 2002, 2005). Moreover, Canadian banks make a significant contribution to Canada’s economic growth employing 249,000 employees domestically in 2005, on a payroll of over \$18 billion (CBA, 2006a). The six largest banks alone spent about \$4.4 billion on technology in 2005 (and \$33.3 billion from 1996-2005), and paid \$6.1 billion in taxes (CBA, 2006a).

It is light of such special roles the Canadian banks play, that a better understanding of how mergers and acquisitions in the industry are governed (and how such governance changes over time) acquires increased saliency because the decisions the state makes and the policies it adopts with regard to bank mergers affect not only the structure and/or performance of the banking industry (and financial services sector in general) but also because they have a direct bearing on public macro-economic management including serious repercussions on monetary transmission mechanisms, and financial system stability, efficiency and effectiveness, as well as on access to financial services by various groups and sectors in society, employment prospects, and concentration of economic power.

In summary, therefore, this study makes three important contributions: (a) It focuses attention on one of the most important issues and exciting debates and empirical work being done today in public policy analysis; (b) it offers an analytical framework that can best help us understand the patterns, dynamics, and implications of bank merger

policy convergence and/or divergence; and, (c) it demonstrates the utility of such a framework by applying it to the study of Canadian and American bank merger policy transformation which in turn offers us a better understanding of Canadian bank merger policy transformation -- theoretically, empirically and practically. In other words, this study has both theoretical justification and practical utility.

1.4 Research Methodology

In this study we used three methodological approaches, namely: in-depth examination of primary documents, the review and analysis of secondary sources, and interviews. A detailed examination of Canadian and U.S. legislative debates, legislative reports, pieces of legislation, government reports, backgrounders, press releases and coloured papers was conducted. These documents provided the main sources of information for the empirical part of the dissertation.

The second method involved the review and analysis of recent and not so recent research studies on bank mergers and bank merger policy as well as newspaper and magazine articles. In particular, research by governmental bodies (e.g., BIS, Bank of Canada, Federal Reserve Board, FDIC, G10, IMF, Industry Canada, royal commissions and task force reports, OECD, Statistics Canada, World Bank), civil society organizations (e.g., CBA, CCRC, C.D. Howe Institute, CFIB, Center for Strategic and International Studies, COMER, Conference Board of Canada, CPA, CPRN, Fraser Institute, IBC, PIAC, World Economic Forum), consulting firms (e.g., Bain & Company, Davis International Banking Consultants), law firms (e.g., McMillan Binch LLP), reports and submissions by financial institutions, as well as reports by newspapers and magazines

(e.g., Financial Post, Globe and Mail, McLean's, Ottawa Citizen, The Banker, Toronto Star) were also consulted.

The third method involved interviews with representatives of government, CSOs, and business groups who are part of the bank merger policy community. Interviews were conducted in person or via e-mail. These interviews served to provide a better understanding of events as well as confirming or clarifying information obtained from primary and secondary literature. Interviews were conducted with the promise of confidentiality and on a 'not for direct attribution basis'.

1.5 Research Findings and Argument

Overall, the key finding in this study is that despite increasing global and regional integration, and although there has been some measure of convergence in (certain elements of) the bank merger policies of the two countries (e.g., policy objectives, competitive reviews, policy scope with respect to types of mergers), Canadian and American bank merger policies continue to exhibit distinctive features with respect to institutional structures, geographic scope, procedural and enforcement matters, substantive issues of law, concerns about the concentration of economic power, as well as policy styles. Moreover, in spite of a long history of cross learning between the two countries, their merger policies have charted distinctive tracks.

In regard to the above findings, the study will argue that it is quite reasonable not to observe substantial convergence around the American model of bank merger (and financial system) governance for the following key reasons. First, although globalization and regionalism are potent sources of institutional change and although some of the pressures toward greater policy convergence are undeniable and significant, globalization

and regionalism contain both homogenizing and heterogenizing tendencies. Second, the transformation of the Canadian and American bank merger policies are essentially contested, and historically contingent processes. This is particularly so given that each country (even when highly integrated and within the same capitalist model such as Canada and the U.S. -- i.e. the Anglo-Saxon model) has unique historical, economic, political, legal, sociological, ideological, and institutional conditions -- all of which may (in varying degrees and at different historical moments) influence and shape the evolution, patterns, and directions of a particular country's financial regulatory regime. Convergent trends and outcomes are, thus, just one of a number of possible (non-automatic, non-inexorable, and potentially reversible) institutional and policy outputs, outcomes and trajectories. As such, it should not come as a surprise that there has not been substantial convergence around the American model of bank merger (and financial system) governance on some key policy elements.

1.6 Organization of Chapters

Apart from the introductory and concluding chapters, chapters in this dissertation are divided into two main parts. Part One (comprised of three chapters) undertakes the first main task of this study; i.e., building an analytical framework, while Part Two (also comprised of three chapters) applies this framework to examine and compare the Canadian and American bank merger policies.

Briefly, Part One presents, discusses, and synthesizes the relevant contributions in the extant literatures with the aim of developing the necessary inputs required in the building of a framework for analyzing Canadian bank merger policy transformation with a particular eye on investigating whether the Canadian policy on bank mergers is

converging on and/or diverging from the U.S. model of bank merger governance. In order to do so, the discussion in this part hinges on a number of key concepts that have diverse meanings and are highly contested. Thus, prudence requires that we not only be aware of the diverse interpretations these individual concepts might have, but also that we be clear in specifying the notions adopted. Otherwise, we may run the risks of concept misformation, conceptual stretching, and degreeism (Radaelli, 2003).

In our case, the focus on convergence or non-convergence of Canadian and U.S. bank merger policies and the main sources of such policy patterns necessitates that we be clear on a number of key concepts/notions. Consequently, to have a clear understanding of how bank mergers are governed requires lucidity on what we mean by financial systems and how they are governed, which in turn, requires clarity in at least six concepts viz.: financial systems, financial system governance, bank merger policy, comparative public policy, and bank merger policy convergence. Moreover, to understand the various dynamics involved in bank merger policy convergence (and/or non-convergence) requires an effective grip on the theories of financial regulation and those about contemporary global transformations. As such, the notions of regulation, globalization, and regionalism are prised open and applied in conjunction with the other notions mentioned above to provide the necessary input or building blocks for the analytical framework and ultimately to inform the empirical study of the Canadian and U.S. bank merger policies.

Having said that, however, it is important to point out that we are acutely aware of the limitations and implications of these efforts to attain conceptual clarity. We are not as ambitious as Giovanni Sartori and his colleagues were in their endeavour to remove conceptual ambiguities in political science (Sartori, 1970, 1984, 1991). Unlike them and

other logical positivists who “believe firmly that if they only succeed in cleaning up the conceptual apparatus of political science discourse, the promised land of a truly empirical science can soon be entered” (Coser, 1984:735), we tend to believe that conceptual diversity cannot be eliminated. In fact, it is an invaluable feature of a vibrant discourse. As such, we believe our purpose should be to understand/comprehend the various extant conceptions, eschew sloppiness, and synthesize concepts where it is deemed feasible and desirable, rather than attempt to offer a definitive conception of any and all the key notions of this study. With that in mind, the three chapters in Part I undertake to accomplish the following purposes.

Chapter 2 presents the notion of finance in the context of a world comprised of a variety of financial systems that are embedded within a variety of capitalist models. To do so, it draws insights from the literature on the “Varieties of Capitalism” (VoC) approach (see Hall, P., 1999; Hall & Soskice, 2001) as well as from economics and finance scholarship (see Allen & Gale, 2000), regulation theories (see Baldwin & Cave 1999; Moran, 1986; Noll, 1985), and theories on governance especially those pertaining to multi-level governance (see Ahrens, 2002; Hooghe, 1996; Hooghe & Marks, 2001; Keohane & Nye, 2000; Kooiman, 2000; Marks & Hooghe, 2004; Walters, W., 2004). Applying insights from these literatures, the chapter first links the typologies of financial systems offered in economics and finance literature to the VoC framework and then, drawing from regulation and governance theories, it maps the contours within which financial system governance takes place by delineating three major modes or genres of financial governance, namely, financial governance by state, civil society, and market institutions and actors. Based on such a tri-modal typology of governance, the chapter focuses and expands on one of the modes of governance, namely, state (public) governance of financial systems and bank

mergers. This discussion forms the context within which our perspective on bank merger policy is developed in the next chapter.

Chapter 3 introduces the subject matter of this study: the transformation of public policy on financial consolidation. It does so by presenting this study's definition of bank merger policy and by mapping the notion of comparative public policy analysis and how it is related with the study of bank merger policy convergence.

Chapter 4 draws insights from the preceding chapters and ties them together to formulate the study's analytical framework. Basically, this chapter completes the first task of this study, i.e., developing/formulating an appropriate analytical framework for studying Canadian bank merger policy in a comparative context. In developing such a framework, the chapter draws insights from the convergence debates of the 1950s/1960s, as well as from current debates on globalization/regionalism and convergence. It takes advantage of the contributions/debates while at the same time eschewing their shortcomings. A framework thus constructed provides a better way of connecting the dynamic sinews among the domestic market, the state, civil society, and the global political economy (and their attendant co-transformation). Specifically, the analytical framework helps in addressing the following aspects:

- (a) What elements or dimensions need to be considered when attempting to establish whether or not there has been bank merger policy convergence?
- (b) What factors (or sources of change) need to be investigated in the study of bank merger policy convergence?
- (c) What are the likely implications of bank merger policy convergence or non-convergence?

The analytical framework, at the minimum, enables the analyst to understand and delineate the nature and substance of policy convergence, the dynamics involved in the generation of such policy patterns as well as their meaning and significance. In other words, the framework offers a dynamic and integrated approach that explicitly (and creatively) delineates the nature and substance of bank merger policy convergence and/or divergence while linking these elements of change with their corresponding dynamics that encompass the interplay of ideas, structures/institutions, and processes critical in understanding and accounting for such public policy change patterns and their significance and implications.

The second part of the dissertation features three empirical chapters on the evolution and comparison of Canadian and U.S. bank merger policies. Consistent with the definition of bank merger policy offered in Chapter 3, and the relevant policy elements delineated in the analytical framework (Chapter 4), Chapter 5 traces the evolution of Canadian bank merger policy from 1970 to 2005, while Chapter 6 describes the evolution of U.S. bank merger policy for the same period. Drawing on these two chapters, Chapter 7 presents a comparison between the Canadian and U.S. bank merger policies – delineating aspects of policy convergence and divergence, and an account of the convergent/divergent trajectories of the Canadian and the U.S. bank merger policies as well as the implications of such developments for Canada.

Lastly, Chapter 8 offers some substantive conclusions and recommendations following from this study. These conclusions and recommendations cover the theoretical, empirical and practical aspects of this study.

Chapter 2: Finance in a World of Varieties of Capitalism

2.1 Introduction

In this study, we argue that the reason why there has been limited convergence of the Canadian bank merger policy on its U.S. counterpart is because these two countries differ significantly in terms of differences in the structure of their respective financial systems, ideas and institutions. This argument is rooted on a twofold premise. First, public policy contexts play a significant facilitating/mitigating role in the sense that convergent trends are more likely for countries (or jurisdictions) with similar cultures, and with similarities in political and socio-economic institutions, structures and development (see also Knill, 2005:770). Second, institutions through which societal actors operate, play a pivotal role in facilitating/mitigating convergence pressures because they serve to filter, mediate and channel these pressures in highly specific ways often resulting in the continued distinctiveness of bank merger policies (see Hay, 2000; Cortell, 2006). Indeed, as Cortell has aptly argued: “for globalization, like other systemic dynamics, to affect national policy, it must be acted upon by agents who must work through national political institutions to achieve their preferences” (Cortell, 2006:41).

However, it is important to note that these two countries have their similarities too and to highlight some of the main similarities and differences we draw upon insights from two clusters of literature, namely that on the “varieties of capitalism” (VoC) (see Hall, P., 1999; Hall & Soskice, 2001) and that on typologies of financial systems (see Allen, Chui & Maddaloni, 2004; Allen & Gale, 2000; Chandavarkar, 1992; Goldsmith, 1969, 1987; Rybczynski, 1997). Through a synthesis of these literatures we show how the Canadian and U.S. political economies in general, and financial systems in particular, are

similar and different at the same time. For instance, they are similar in the sense that they bear the traits of the Anglo-Saxon model of capitalism to which they both belong; but, they are also different in many respects, including significant differences in their financial structures.

We then proceed to articulate how and why financial systems are publicly governed by drawing on insights from traditional regulation theories (see Baldwin & Cave 1999; Moran, 1986; Noll, 1985) and the literature on governance (see Ahrens, 2002; Gamble, 2000; Hooghe, 1996; Hooghe & Marks, 2001; Keohane & Nye, 2000; Kooiman, 1999, 2000; Marks & Hooghe, 2004; Payne, 2000; Pierre, 2000; Walters, W., 2004).

Ultimately, this chapter seeks to demonstrate that finance in general, and bank mergers in particular, are governed in different spatialities (and at different times) in a world comprised of diverse financial systems that are rooted in a variety of capitalist models. This seemingly obvious premise has two key implications for this study. First, at a general level, and in contrast to mainstream economics in which financial systems are not generally differentiated, such an understanding opens up a conceptual space that enables us to compare and contrast specific bank merger policies in a world in which financial systems differ and are governed differently in a variety of capitalist political economies. Second, it facilitates the situating of Canadian and U.S. financial systems, and their accompanying governance frameworks, within their particular social and political economic milieus, namely: the shared Anglo-Saxon model of capitalism. A clear understanding of the contexts within which bank merger policies change is crucial in understanding the dynamics of policy convergence because, as noted earlier, national and international contexts play pivotal facilitating/mitigating roles.

Finally, by delineating the relevant contexts within which financial consolidation (and mergers and acquisitions in particular) takes place, we will be better positioned to understand how diverse financial systems can affect or influence public policy change and vice versa.

Thus, in order to articulate the nature of the contexts within which public policies on bank mergers function and change, this chapter proceeds as follows. In the next section, a brief overview of the varieties of capitalism (VoC) approach is presented, followed, in the third section, by a discussion of its relevance for this study. The fourth section endeavours to conceptualize financial systems. It also links the typologies of financial systems offered in the economics and finance literature to their corresponding models of capitalism as understood within the VoC approach. In the fifth section, the chapter maps the contours within which financial system governance occurs. In this section, three major modes or genres of financial governance are delineated, namely, financial governance by state, civil society, and market institutions and actors. To the extent that this study's focus is on how bank mergers are governed in the public sphere, and given the tri-modal character of governance delineated earlier, the chapter concentrates and elaborates on one of the modes of governance, namely, state (public) governance of financial systems and bank mergers. This discussion sets the stage on which our conception of bank merger policy and its rationales are developed in the next chapter. In the last section, some concluding remarks are provided.

2.2 Varieties of Capitalism Approach: A Brief Overview

The varieties of capitalism (VoC) approach takes off from the premise that capitalist economies are not alike in the sense "that there are greater variations in the

institutional arrangements among different national varieties of capitalism than would be suggested by the accounts of either Marxist or neoclassical theorists" (Block, 1999:463). Moreover, this perspective insists that, "economies work in ways quite different from those described by neoclassical economics and American practice" (Berger, 1996:4). As such, the VoC approach "is marked by its focus on the way in which multiple institutional frameworks in the political economy of a nation interact to produce unique types of outcomes" (Hall, P., 1999:143). And, as Peter Hall (1999:144) further notes, "analysts working along these lines argue that the organization of the political economy makes certain kinds of collective action that might not otherwise be feasible more likely." In short, the different types of national political economies (each typified by different institutions, practices, values, and politics) are "characterized as coherent, resilient alternative forms of capitalism, not as detours off a common trajectory" (Berger, 1996:4).

A number of different criteria have been advanced to distinguish the various capitalist models (Coates, 1999, 2000; Dore, 2000; Hall, P., 1999; Richardson, 2001). These include the nexus of accumulation decision-making, type of industrial relations, state's role and involvement in economic management, market governance, financial market structure including the role of financial institutions (e.g., banks, stock markets) in the financing of business as well as in corporate governance, the nature and extent of welfare provisions, and cultural values including political philosophies (free market, social market, state-business partnership, etc.).

David Soskice (1990a, 1990b, 1991) distinguishes between Liberal Market Economies (Britain, the United States, Ireland, Canada and Australia), and (b) Coordinated Market Economies (Germany, Japan, Sweden, Norway, Switzerland, Austria) (Hall, P., 1999). Moreover, "liberal market economies" have also been referred

to as "market-led capitalisms", "neo-American" or "Anglo-Saxon" capitalisms (Coates, 1999). David Coates (2000) further distinguishes the "coordinated market economies" into two groups, viz.: (a) "state-led capitalisms", also known as "Asian capitalism" or the "developmental state" model (e.g., Korea and Japan); and (b) negotiated or consensual capitalisms", also known as "European Welfare capitalism" or the "Rhine model" (e.g. Scandinavian countries and Germany) (Coates, 1999, 2000). (For a discussion on the problems associated with labelling these different types of capitalism see Crouch, 2005.)

2.3 Relevance of the VoC Approach for this Study

The insights of the VoC approach are relevant for this study on a number of dimensions. Generally, as Leo Panitch and Sam Gindin have observed:

One virtue of this academic and political project – which within the field of comparative political economy has come to be known as the “varieties of capitalism” approach – is that it challenges the notion that capitalist globalization inevitably needed to take the form it has, apparently entailing, as so many of its proponents imagined, the growing impotence of nation-states and the increasing homogenization of social formations. The insistence on variety among states has meant trying to refocus attention on the continuing salience of institutional arrangements and social relations specific to particular social formations and their histories, the very dimensions largely ignored in the equations of neoclassical economics and the prescription of the IMF. Above all, this approach has suggested that whether and how societies adapted to global competition remains an open and important question (Panitch & Gindin, 2004:7).

Indeed, the salience of societal responses to domestic as well as global and regional pressures is best revealed when examined with an explicit recognition (and consideration) that institutional variety or heterogeneity across nations is the norm.

Furthermore, in his work “Capitalism against Capitalism”, Michel Albert (1993), sees governance/regulation as one of the key elements of contrast among the models of capitalism. Thus, with economic governance as one of its key concerns, the VoC approach,

we believe, offers a unique perspective that is useful for this study in the following specific ways. First, it recognizes not only that national economic and governance systems are embedded within a specific capitalist model but also that the specific model is itself nested within the broader world capitalist system. Secondly, it offers a framework within which the linkages between the various players -- market, state, and civil society -- relevant to financial system governance can be systematically explored within a broader context. Thirdly, it advances conceptual tools for apprehending and comparing diverse financial systems and how they interrelate. Fourthly, it provides an analytical space for studying policy transformation as a holistic and dynamic process. Fifthly, in dealing with domestic and international/global pressures, the VoC approach has room for the emergence of a variety of responses, processes/mechanisms, and outcomes that are contingent on the national context. This is especially important because even scholars who do not work within the VoC approach, for instance, Keohane and Nye (2000:16), acknowledge that "the impact of globalization on the state varies substantially by political economic system."

However, as still a "work-in progress" (Hall & Soskice, 2001), the VoC approach has its own shortcomings. First, it has been primarily applied in the study of the so-called polar cases, for example, the USA (Anglo-Saxon model) versus Germany (Rhenish model). As such, the study of systems within models has been rare (e.g. Canada versus the USA -- both considered as belonging to the Anglo-Saxon model of capitalism).

Secondly, the modelling of political economies has hitherto been confined to advanced capitalist systems (Hall, P., 1999). As such, it has hitherto left out several countries from its ambit e.g., those in the "developing" world, and in the so-called "transition" political economies of Eastern and Central Europe. Consequently, its tools may

not be generally applicable to (nor may its conclusions necessarily hold for) countries falling outside its current ambit.

Thirdly, the VoC approach inadequately conceptualizes the relationship among the different models of capitalism. As such, the approach not only treats states as equal units of analysis, it also occludes the asymmetric power relations among the capitalist political economies, e.g., U.S. vis-à-vis other leading capitalist states (Panitch & Gindin, 2004). As a corrective, and without compromising the approach, we will in this study treat the link between Canada and the U.S. as one based on a differential power relationship.

Fourthly, most of the studies on market governance within this approach have hitherto focused primarily on the governance of non-financial firms and the role played by the financial system therein. This thrust, while important, has consequently left a blind spot in the study of financial system governance per se. Needless to emphasize that a focus on financial system governance deserves special attention given the prominent role financial systems play in their respective economies. This, however, is not a weakness of the approach per se. As will be explained below (section 2.5.1), extending the application of this approach to the analysis of financial system governance does not compromise the framework.

Lastly, the approach has not adequately benefited from some of the recent conceptual and methodological insights offered by the literatures on policy change as well as those on "policy convergence".

Nevertheless, as indicated earlier, the above shortcomings are remedied where deemed appropriate through extensions and/or syntheses with other relevant theoretical contributions. In sum, the adoption of some insights from the VoC approach (*mutatis mutandis*) enables us to better explore and understand the transformation of the Canadian

federal bank merger policy (and financial regulatory policy in general) within the context of its distinct "economic/market governance system" and capitalist model.

2.4 Financial Systems: Mapping a Diverse and Dynamic Terrain

A financial system is here understood as a set of interlocking arrangements governing the availability of credit and through which economic agents can transact to facilitate and/or expand their activities -- be they personal or business related. The financial system has three overlapping components – financial enterprises (e.g., banks), financial markets, and the payments system. To these components some authors add financial regulatory authorities (e.g., ILO, 2001; Nardozzi, 1992). Indeed, Nardozzi (1992:254) defines the financial system “*model* as the whole financial structure and the regulation applied to it.” He contends that this “is not a simple tautology, because the concept of model allows regulation to be considered as an integral part of the financial system, and not just a set of restrictions imposed from outside on a system that, if left alone, could work freely” (Nardozzi, 1992: 254). Financial systems on this view, serve several economic purposes (e.g., the creation of money, payment systems, resource pooling and transfer through time, across industries and borders, risk management, collection and interpretation of information, incentive management in a world of asymmetric information and uncertainty) as well as political functions (e.g., the distribution of economic power) within and between/among nations.

Structurally, one can distinguish between domestic (sub-national, national) and international systems (regional, global). Institutions within a financial system may be distinguished with respect to the arenas in which they operate (Germain, 1996a, 1996b, 1996c, 1997, Le Pan, 1997). Financial institutions may offer retail and/or commercial

services as well as engage in high-risk speculative activities. Furthermore, financial institutions differ with respect to ownership patterns (privately-owned, state-owned, mixed ownership), profit motives (for-profit, non-profit oriented), and organizational type (local, sub-national, regional, multi-national, etc.).

Functionally, as interconnected networks of institutions and markets in financial instruments, a financial system is considered as a collection of formal industries (such as banking, securities, insurance) as well as informal financial arrangements (e.g., self-help groups, rotating savings and credit associations, money lenders, etc.) both of which are inextricably linked (Chandavarkar, 1992).

Lastly, it is worth noting that financial systems resemble and differ in a number of respects. In fact, scholars engaged in the study of financial systems have constructed various typologies to differentiate financial systems -- spatially (within and across countries) and temporally -- that have taken root in many parts of the world and how they have changed over time (see Allen, Chui & Maddaloni, 2004; Allen & Gale, 2000; Chick, 1992; Demirgüç-Kunt & Levine, 1999; Germain, 1996a, 1996b, 1996c, 1997; Gerschenkron, 1962; Goldsmith, 1969, 1987; La Porta, Lopez-de-Silanes, Shleifer & Vishny, 1997, 1998; Rybczynski, 1997; Vitols, 1999; Zysman, 1983).

A review of the various typologies from the relevant literature reveals that the similarities and differences could be usefully examined by exploring how financial systems compare temporally and spatially along the following key dimensions: (a) degree of formality, (b) financial structure, (c) institutional type, (d) institutional capacity, (e) type of functions served, (f) ownership, (g) type of governance system (private and public), (h) motivational and strategic positioning, (i) level of country's economic

development, and (j) location of a (national) financial system within the global capitalist system.

These dimensions provide a useful guide in incorporating the various financial systems within the VoC framework. In order to incorporate the various national financial models within the VoC approach we begin with the three models of capitalist political economies we delineated earlier, viz.: market-led, negotiated/consensual, and state-led capitalism. We further delineate within each of these models three social spheres viz.: economy, state, and civil society. The economy is then divided into two broad analytical categories: financial structure and the non-financial sectors. The financial structure is further divided into two parts: formal and informal. The formal segment of the financial system is then divided into two types: bank-based and market-based systems. Each of these two broad categories is, then, sub-divided into three sub-types: segmented or specialized financial systems (comprising of banks, securities, insurance, credit unions, etc.), universal banking system (wherein not only are a variety of services provided under the umbrella of the same firm or group of firms but there is a direct involvement of financial firms in the ownership and control of non-financial firms), and mixed financial system. Lastly, each of these sub-types could be predominantly owned and controlled by the private sector (for profit and non-profit) or the state; or a mixture of private and state.

Following such a breakdown, we then match the various financial systems within the above framework -- hence, incorporating and linking the various financial systems within the appropriate capitalist models. Accordingly, the financial systems of Australia, Canada, Ireland, New Zealand, the UK, and the U.S., are grouped under the market-led (Anglo-Saxon model). Within the Anglo-Saxon model, the UK and U.S. are grouped

under segmented financial systems while Canada's financial system is grouped under the universal banking model that it currently approximates.

Although both the German and Japanese financial systems belong to the “coordinated market” type of economies they are sub-grouped differently. The German financial system is situated within the “negotiated capitalist system” while the Japanese financial system is categorized under the “state-led capitalist model”. Moreover, although both the German and Japanese financial systems are considered as bank-based systems, the German one is classified under the “universal” banking model while the Japanese one is categorized under the “segmented” model. These systems are depicted in Figure 2.1 below.

Figure 2.1: Financial Systems in a World of Varieties of Capitalism

The main insights that can be gleaned from the above framework are fourfold. First, the integration of financial system models within the VoC framework is deemed profitable for if we are to glean meaningful insights, any analysis of public policy on financial consolidation needs to be contextualized and linked with an appropriate financial system that is in turn embedded within a specific model of capitalism. Moreover, any link between a particular financial system with a specific model of political economy is valid only within a specific historical and cultural context.

This has important implications with regard to what changes in a particular financial system and how these changes occur. Moreover, the linking of financial systems with their corresponding capitalist models highlights the fact that financial systems within a model (i.e. as variants of a model) will of necessity encapsulate both similarities and differences (Allen & Gale, 2000; Chick, 1992; Demirgüç-Kunt & Levine, 1999; Germain, 1996a, 1996b, 1996c, 1997; Goldsmith, 1969, 1987; La Porta, Lopez-de-Silanes, Shleifer & Vishny, 1997, 1998; Rybczynski, 1997; Vitols, 1999; Zysman, 1983).

In short, read together the literature on financial systems demonstrates, *inter alia* that:

- (a) financial systems even within a similar model differ (e.g., under the coordinated capitalist model the pre-1990s segmented bank-based Japanese system differs from the universal bank-based German model of financial system; likewise the Canadian financial system differs from the U.S. system even though both national systems belong to the market-led (Anglo-Saxon) model);
- (b) financial systems are not static, i.e., they change over time and do not follow a single path; and

(c) financial system transformation processes vary with regard to speed of change as well as with respect to organizational type and capacity, and to the industrial structures that emerge. The issue is to examine whether these similarities and differences persist over time, how, why, and to what effect. Moreover, financial system features that may change in a capital-market-based Anglo-Saxon political economy may not be necessarily relevant in a bank-based Rhenish model.

Furthermore, by incorporating the diverse financial systems into the VoC framework we believe we have laid the foundations for further linking the literature on financial systems with that of the varieties of capitalism literature. And, linking these two sets of literatures (i.e., the literature on financial system models with the literature on models of capitalism) is significant for at least three reasons. First, by demonstrating that financial systems are embedded within specific political economies we eschew the tendency to treat all financial systems as universally the same. As such, we are able to appreciate that what changes in one system may not necessarily occur in another system.

Second, to understand the evolution of a national regulatory policy one needs, *inter alia*, to also understand the evolution of its respective national financial structure. Thirdly, it will help us see clearly that the hitherto stereotyping of financial systems is outdated. For example, the notion that bank-based systems, like that of Germany, are characterized by "universal" banks no longer holds because with the crumbling of the financial "pillars" a market-led system like Canada's is increasingly developing into a system that resembles some form of universal banking. Moreover, a bank-based system like the Japanese one (unlike the German that is also bank-based) was until recently (post 1996 Japan's Big Bang)

to large extent characterized by a segmented/specialized banking system (see Hamilton-Hart, 2006:112).

Fourthly, consistent with such a perspective, we need to understand the recent changes in financial institutions in a broader perspective. This viewpoint, according to Banuri (1992):

...holds that these changes have resulted neither from some inexorable historical trend towards the refinement of market freedom nor from an ineluctable process of technological development which erodes the possibilities of societal regulations of finance. Rather the changes are argued to be the result of political actions of interest groups who find themselves in particular situations (Banuri, 1992:87).

Indeed, Nardozzi (1990:75), in a theoretical analysis of the structural evolution of financial systems in the 1980s, argues, "there is no theoretical basis to define an optimal financial structure which can serve as model for the financial systems." He further argues that "theory does not identify any irreversible tendency towards the emergence of one particular financial structure that is more advanced than the others" (p.77). Consequently, he contends that we cannot consider "the recent evolution of financial systems as progress towards better patterns" (p.77); nor can we "think of deregulation and re-regulation processes, which have accompanied recent transformations, as the outcomes of a natural evolution" (p.77). He thus posits that

... the structural and institutional changes that have been taking place in financial systems throughout the '80s... are not the result of a progressive evolution unalterably leading to a superior stage of financial development. Rather, they are largely the outcome of the crisis of a specific national model that of the extreme specialization of financial intermediaries set up in the U.S. during the '30s (Nardozzi, 1990:71).

In sum, the above analysis suggests the following. First, financial systems change over time consonant with changes in the capitalist system. Second, these changes are not

irreversible. Thirdly, they are not necessarily an optimum state of evolution nor are they necessarily superior to other models. Lastly, the above analysis provides a context within which financial system mergers and acquisitions take place and how these processes are governed publicly and privately. This is crucial in understanding the transformation of the Canadian and American bank merger policies.

2.5 Financial System Governance in a World of Varieties of Capitalism

Bank merger policy is essentially about financial system governance and regulation. In this study, we view the governance of financial systems as a dynamic set of informal and formal rules, institutions, values, and processes through which societal actors -- often with different objectives, values, capacities, and power -- manage economic, political, and social processes as they pertain to the financial realm (Ahrens, 2002; Cheema, 2000; Keohane & Nye, 2000).

Also worth noting is that most of the mainstream literature on financial regulation (public interest theories, special interest/public choice theories -- both theoretical and empirical) approaches financial system governance from a utilitarian, neo-functionalist perspective (see Baldwin & Cave, 1999; Noll, 1985; Moran, 1986 for an overview of theories of regulation). Theories based on such perspectives take a narrow view of regulation. For instance, while the formal/legalistic approaches focus on "the construction and application of rules"... "for many economists, regulation is primarily the means by which private firms are constrained from anti-competitive behaviour" (Minogue, 2002:650). The shortcomings of these approaches have been well documented (Beeman, 2002; Hills & Michalis, 2000; Horwitz, 1989; Johnson & Libecap, 2001; Lecours, 2005a; Mahon, 1979; McFetridge & Lall, 1991; Noll, 1985). Suffice it here to note that regulation theories have a

limited ability to explain the incidence and timing of regulatory change, let alone regulatory convergence. As such, it is difficult to use these theories to understand or to explain why, for instance, Canada and the U.S. chose to deregulate and re-regulate their financial systems in the 1980s. A brief overview will illustrate the key concerns. We begin with public interest theories.

Rooted in welfare economics and taking a pluralist view of the state, public interest theories picture regulation as directed towards advancing the public interest by a benevolent state that remedies market imperfections and/or failures such as externalities, information asymmetry, and pure/natural monopoly – hence the name (see e.g., Beeman, 2002; Magnusson & Ottosson, 2001; Moran, 1986). These theories, however, have been criticized from a number of angles. To begin with, “critics argue that the concept of public interest is nearly impossible to define. They also cite many empirical studies finding that ‘regulatory agencies make numerous decisions that reduce conventional measures of economic welfare,’ thereby rendering welfare-centered theories incorrect *prima facie*” (Beeman, 2002:6).

Secondly, critics argue that some regulations and “agencies were not established in response to democratic demands of the abused public” (Horwitz, 1989:26). In addition, the public interest approach, it is argued, incorrectly identifies public interest with consumer interests (Horwitz, 1989:26).

Thirdly, because public interest theory is “tied to a pluralistic theory of power, “it slights the structural importance of the economy and of economic power” (Horwitz, 1989:26). It conflates regulatory genesis with operation and thus “fails to look at what regulation accomplishes once an agency is established” (Horwitz, 1989:26). It fails to understand the distributional aspects of regulation.

Moreover, it is argued that “regulation is not an 'objective' mechanism. It forms part of a political process and is closely related to the specific economic, political, social and cultural characteristics of each country” (Hills & Michalis, 2000:438). As such, a “purely economic view ignores the role of the regulatory agencies themselves in the process” (Hills & Michalis, 2000:438).

Last, but not least, the public interest argument provides little guidance in explaining why regulation is chosen as a preferred instrument instead of other governing instruments or modes of governance such as public ownership (Magnusson & Ottosson, 2001:2).

From the public interest perspective, policy change (e.g., deregulation) is anticipated under three circumstances. It is predicted that deregulation “would occur if the market imperfection which necessitated regulation in the first place were to disappear” (McFetridge & Lall, 1991:15). For example, when a change in technology would eliminate a natural monopoly, hence rendering extant regulation obsolete. Secondly, according to McFetridge and Lall (1991:16) the public interest theory also predicts that deregulation “would occur if it were discovered that a regulatory regime that had been perceived to be in public interest either never had been or no longer was.” A third instance would be when “in the light of experience, the cost of the regulatory apparatus is or has become greater than the loss resulting from the market imperfection it was designed to correct” (McFetridge & Lall, 1991:16).

The special interest perspective can be traced to George Stigler who developed an economic version of the capture theory of regulation based on a demand and supply framework. In this framework, producers will demand regulation in an attempt to use the state’s coercive powers to try to prevent the growth of competitors through such measures as controls on market entry and prices at the expense of customers. Moreover, for certain

industries, government regulation may be demanded to serve as a stimulant to spending in complementary products, or to discourage the utilization of substitutes (Beeman, 2002; McFetridge & Lall 1991). Politicians, on the other side of the equation, as suppliers of regulation, are viewed as competing to enact (demanded) regulation in exchange for votes, contributions, or both. In short, it is posited that particular interests (e.g., industries, occupational groups, etc.) can use the government as regulator to their own advantages, instead of in the public interest (McFetridge & Lall, 1991). Stigler's perspective was further elaborated/extended by Posner (1972), Peltzman (1976), and Becker (1983, 1985).

In the public choice stream of the special interest theories, deregulation can be accounted for in two broad ways. According to the Stigler-Peltzman version of the special interest theory, McFetridge and Lall (1991:17) suggest at least three factors that may give rise to deregulation:

First, a reduction in the cost consumers must incur in order to inform themselves regarding the effect of regulation on them.... Second, increasing substitutability between regulated and non-regulated products should reduce the profitability and hence the incentive to lobby for regulation-induced price increases... Third, a change in industry structure can reduce either the incentive or the ability to lobby for regulation.

As regards Becker's model:

... theory predicts that the incidence of rent-seeking of which regulation is but one form, is reduced if (a) the taxed group becomes politically more effective; (b) the subsidized group becomes politically less effective; or (c) the dead-weight loss associated with the transfer increases (McFetridge & Lall, 1991:17).

In short, theories based on a utilitarian perspective suggest that institutions are demanded because they enhance the welfare of rational actors. On this view, institutions are thus transformed when they become dysfunctional or yield sub-optimal results. In other

words, institutional change is viewed as “the product of a strategic decision on the part of actors” (Lecours, 2005a: 12).

Special interest theories, like other mainstream theories of regulation, have been challenged from several quarters and are well documented. Suffice it here, therefore, to note the following key flaws. To begin with, from a sociological institutionalist perspective, “institutions do not necessarily crumble when they lose efficiency, as argued by rational choice institutionalists, but rather when they no longer are in tune with dominant social and cultural codes. Institutions can, therefore, survive even if they engender sub-optimal outcomes” (Lecours, 2005a: 13).

Moreover, critics contend that the special interest theory explanation “is tautological: it assumes its conclusion by presuming the existence of suppliers, demanders, and an equilibrium between the two. It is impossible to conceive of a market managed by a regulatory agency that is as efficient as either a perfect cartel with legally enforceable rules or a perfectly competitive industry” (Noll, 1985:27).

Second, as Noll (1985:27) has argued, “because everything else can be construed as a wilful redistribution of income that stands at the intersection of institutional demand and supply”, special interest theory:

... must include an explanation of why certain groups receive benefits as successful purchasers of institutional protections while others receive no benefits at all but bear some costs through the economic inefficiencies of administrative management, and it must describe the factors that determine the relative sizes of these amounts (Noll, 1985:27).

Thirdly, the political decision-making process in these models is a black box. For instance, with respect to deregulation, McFetridge and Lall (1991:12-13) note that there is vagueness:

... about what political support is and how it is maximized. Indeed, these theories leave the political sector virtually unspecified...Political parties, legislatures, and regulatory agencies are treated as interchangeable. They are assumed to maximize support but the means by which this occurs remain unstated. What might constitute support or contribute to political effectiveness is not discussed. Although special interest theory turns on coalition formation and political entrepreneurship, neither is modelled.

Fourthly, special interest theories (like public interest theories) suffer from monocausality for they place undue emphasis on “interests” as the primary causal factor for regulatory genesis, change and demise. This is a serious handicap because we find it problematic to ascribe all processes of change primarily in terms of interests for there are many other factors such as ideas, institutions and processes that play a pivotal role in regulatory emergence, persistence and change as well. In this regard, for instance, McFetridge and Lall (1991) seem to be on the same page with other critics when they note that: “In seeking regulatory benefits, special interests cloak their arguments in the public interest. A consequence of this is that ideas matter and that there is political opportunity in introducing new ones or repackaging old ones”(McFetridge & Lall, 1991:24). They further go on to argue that:

This may account for the problem the public and [sic] special interest theories have in explaining the timing of deregulation. It is not only necessary for the regulatory tax base to be eroded, for example, but also for this to be seen as the case. The two events may be widely separated in time (McFetridge & Lall, 1991:24).

Nevertheless, this is not to imply that the traditional approaches, theories and conceptualization of regulation are useless. We would be wiser to learn from these approaches -- both from their weaknesses and strengths. Accordingly, as a corrective to the narrow and neo-functionalist perspectives we suggest that a broader perspective on bank merger policy and financial regulation in general be adopted – a perspective that understands bank merger policy within the framework of societal governance that is

characterized by overlapping and interacting modes of governance occurring at multiple levels (see Ahrens, 2002, Gamble, 2000; Hooghe, 1996; Hooghe & Marks, 2001; Keohane & Nye, 2000; Kooiman 1999, 2000; Marks & Hooghe, 2004; Pierre, 2000). On this view, finance systems (and bank mergers in particular) are understood to be governed within a context of multiple modes, realms, social domains, institutions, actors, and processes.

It is pertinent at this juncture, however, to point out that although we study public policy on bank mergers within the context of societal governance, we do not minimize the vital and central role played by the state. Thus, we reject the idea that contemporary governance can be characterized as a “no-one-in-charge” phenomenon (see Kooiman, 1999, 2000). Nor do we subscribe to the misguided view that there has been a shift from “government” to “governance” as espoused by those who subscribe to the notion of “governance without government” (see Rhodes, 1996, 1997). These views that “wish to advance the primacy of markets and extol the virtue of minimum state” (Richards & Smith, 2002:15) are very unhelpful for they only further confuse the meaning of governance.

Moreover, we agree with Walters (2004) that governance discourse as it currently stands, tends to embody “anti-political motifs and tendencies” (p.33) in the sense that it displaces political conflict, mis-states the state, and misconstrues its own genealogy in the following ways. First, to the extent that governance is viewed to operate “not as a site of politics but as a space of technocratic management” (Walters, W., 2004: 34), “Questions of political conflict are obviated, displaced, or sublimated by an appeal to universal values and virtues, and the need to cultivate the mechanisms and institutions which promote them” (Walters, W., 2004: 37). Second, governance discourse mis-states the state through a narrative of state decline that is based on “a somewhat exaggerated

conception of the power of the postwar welfare state” (Walters, W., 2004: 38). Finally, governance discourse misconstrues its genealogy through a “meta-narrative of complexity” that presents governance as an appropriate “political response to the growth of social complexity” (Walters, W., 2004: 40).

However, despite the above flaws of the present governance discourse, it is also important to highlight some of its main contributions. Again, we concur with Walters (2004), that the current discourse “captures many novel and innovative aspects” of our time and as such it offers a language that encapsulates some key aspects of the current “experimentation and pluralization of forms of governance” (Walters, W., 2004: 31). To begin with, “it suggests a welcome reorientation of political studies towards the “mechanics” of governing, a question that had for sometime been the specialized preserve of public administration (Walters, W., 2004: 31). “Second, governance does this without recentring the state at a theoretical level” (Walters, W., 2004: 31). Thirdly, “governance signifies something of an “epistemological” shift for political science” (Walters, W., 2004: 31) in that:

By foregoing how governing operates through networks which associate multiple actors and sites, governance nudges political science and political economy towards a more relational and associational understanding of power – a view which has for some time been more common in disciplines like sociology and human geography (Walters, W., 2004: 32-33).

It is against such a backdrop that we will, in this study, view the governance of bank mergers in Canada and the U.S. as specific forms of financial system governance that are embedded within a specific (Anglo-Saxon) model of political economy. This conceptualization allows for a relatively more holistic understanding of the multiple realms and levels of action involved, as well as the interaction of multiple actors with

unequal powers and influence; and, of course, for our purposes in the analysis of public policies, the potential for diverse (and convergent) policy outputs, outcomes and performance. Such a conceptualization, we believe, will help focus our attention on the key variables that one should consider in the comparative examination of the Canadian and U.S. bank merger policies.

Undoubtedly, to achieve such a re-conceptualization, and to effectively comprehend regulatory policy transformation, we will have to incorporate into our analysis (and research strategies) a whole range of elements and practices that have hitherto been considered outside the domain of regulatory study. Accordingly, we will consider six key elements including the need to: (a) broaden the definition of regulation; (b) clarify the relationship between the state and the private sector/market; (c) theoretically re-institute the “constitutive”, “policing” and adjudicative roles of regulation; (d) clarify the nature of the state and its implication on the notion of regulation; (e) link public regulation with private self-regulation; and (f) distinguish and link formal with informal regulation. We will discuss these elements in turn.

Contrary to the orthodox perspective, and drawing on Baldwin and Cave (1999), Bowman (1996), Francis (1993), and Minogue (2002) among others, we reject the view that regulation is an imposition of restrictions on choice and behaviour through rules for the following reasons. First of all, not all economic regulation is “negative and proscriptive” in purpose. Regulation can actually strengthen choice, by sanctioning and enabling (“green-light concept”). Moreover, governments do not impose all regulatory measures against the wishes of economic actors. As such, positive and prescriptive regulations exist too (Schultz & Alexandroff, 1985). Indeed, Hamilton (2000:263) argues that regulation “cannot be reduced to a single dimensional issue about the battle to impose the public interest over

private interests." "To do so", she argues "is to ignore the extent to which political, legal and cultural factors have shaped the 'regulatory space' in which the particular regulator operate and which operate to inform and limit the regulatory process, irrespective of 'form'" (Hamilton, 2000:263).

Secondly, we concur with Wilks (1996:539) that the conventional economic treatment of regulation as a "regrettable but necessary response to market failure" is highly inadequate. "In fact regulation is not about market failure any more than the judicial system is about legal 'failure'" (Wilks, 1996:539). (For an in-depth discussion of perspectives on instrument choice see Linder & Peters, 1989.)

Thirdly, we eschew the prevailing Anglo-American tradition in economics that views markets as separate, rational and self-regulating (i.e., "if left to themselves, market forces will develop spontaneously and operate freely to generate an efficient market economy") for the simple reason that it "fundamentally misconceives the origins of markets" (Wilks, 1996:539). As such, we view the role of regulation to include "constitutive", "policing", and "adjudicative" functions. We agree with Wilks that "Regulations constitute and define the market" (1996:539) in the sense that "Markets are created by governments, ordered by institutions, and sustained by regulations" (1996:538). Moreover,

... market creation is a conflictual process; the market said Weber, is 'struggle of man against man' (Smelser and Swedberg 1994, p.11) and as in all struggles the rules are of paramount importance. Thus markets are social institutions governed by a set of rules, many of which are framed by the public authorities. Markets and governments are not separable; without government there is no market (Wilks, 1996:538-9).

In this regard, Wilks reminds us of Polanyi's insightful observations that:

...economic history reveals that the emergence of national markets was in no way the result of the gradual and spontaneous emancipation of the economic sphere from

governmental control. On the contrary, the market has been the outcome of a conscious and often violent intervention on the part of government which imposed the market organization on society for non-economic ends (Polanyi, 1957:250, cited in Wilks, 1996:539).

Similarly, Macgregor, Prosser and Villiers (2000b: 341) emphasize that "rather than regulation being an external constraint on markets, regulation can also constitute markets and, indeed, some forms of regulation are necessary for market creation and for the policing of markets to ensure that they remain competitive." In the same vein, Shearing (1993) had also observed that:

Scholars of a variety of persuasions have for a long time argued that the conditions required for social interactions are not given by interaction itself. Interaction, they have argued, is not self-constituting. Markets are not self-ordering. Markets are always and necessarily regulated through careful constitutive work (cited in Macgregor, Prosser & Villiers, 2000a:3).

In fact, Macgregor, Prosser and Villiers (2000a: 3) posit that:

Not only does this imply that markets and regulation are complementary rather than opposed, it suggests that both are means of delivering public interests, rather than regulation being the only means of doing so ...the role of regulation in constituting and structuring markets, a process in which economics, politics and law are inextricably intertwined (Macgregor, Prosser & Villiers, 2000a:3).

Furthermore, "the creation of markets is not the end of the process, for they need continued policing to keep them open" (Macgregor, Prosser & Villiers, 2000b: 345-6). In sum, therefore, broader notions of financial regulation and governance encompass constitutive (market creation), structuring, policing and adjudication functions -- aspects that tend to be ignored in mainstream analyses. In other words, financial governance and regulation are multi-functional/purpose in nature.

Fourthly, it is important to understand regulation in terms of scope (i.e., breadth) and depth (intensity) of governance mechanisms as they may vary from one type of

arrangement to another. Scope here is understood in terms of social domain coverage (e.g., societal-wide, economy-wide, multiple-sector, industrial-wide, etc.), as well as spatial span (sub-national, national, extra-territorial, global). Depth of governance refers to the intensity of governance modes and instruments applied, as governance could simply be undertaken through a single mode of governance or through multiple modes employing a variety of governing instruments. For example, in the governance of the financial sector by the state, governments could employ a combination of governing tools including, prudential regulation and supervision, competition policy, taxation, public expenditure, public ownership, exhortation and moral suasion, etc.

Fifthly, we believe that it is crucial to consider the political-economic context when studying bank merger policies. Except for culture-based theories of regulation (e.g., Dyson, 1992; Hancher & Moran, 1989c), most traditional perspectives do not take into account that regulation takes place within different and specific contexts. As such, the existence of a variety of capitalist models is not explicitly taken into account. It is thus vital that we consider the contexts of regulation because regulation “forms part of a political process and is closely related to the specific economic, political, social and cultural characteristics of each country” (Hills & Michalis, 2000:438). Consequently, it is here suggested that regulation be understood in a multi-dimensional context.

The multi-dimensionality of regulation is reflected in several aspects. As a set of multi-level/multi-layered phenomenon, regulation involves a variety of actors with differing values and capacities (acting singly or in collaboration) operating in different social realms (economy/market, state, or civil society) exercising authority at one or more levels (global/international, regional, national, and sub-national levels, etc.) through a variety of general and specific arenas, modes of governance, mechanisms and processes,

for a variety of purposes/objectives and functions. In short, we situate financial sector governance within a framework that views governance as a set of multi-realm, multi-actor processes through which society structures and gives meaning to the participants and their roles, as well as through which society manages and coordinates its activities. Moreover, the multidimensionality of regulation is also reflected in its sources. As Swan (2002:23) has argued:

We should not look for the principal location for regulatory impulses in the state alone. Increasingly, we must also locate such impulses in the codes of conduct of corporations, or industrial associations, in the activities of domestic and transnational non-governmental organizations, and in the rules and practices of supranational organizations such as the European Union and international organizations such as the World Trade Organization.

Moreover, in contrast to the traditional overly state-centric view of regulation, we view finance to be governed in and by several overlapping and interacting modes, realms, arenas/sites, and processes of governance. This, we believe, provides a better perspective even when focusing on public governance of the economy. It is pertinent to reiterate that although we present the governance of financial systems in a multi-realm, multi-actor framework, we do so without necessarily minimizing the central and vital role played by states. As such, in the process of governing, we see the state as sharing, coexisting, and sometimes, in conflict with other actors.

This view will disabuse the notion of the “shrinking” role of the state in this era of globalization and regionalism. Instead, we will view the changing relationships among societal actors and their roles therein as “shifting” rather than “shrinking” processes: shifts that are a reflection of a restructuring of collective action processes, a re-composition of states, as well as a reconfiguration of governance institutions in a number of social domains. The point being made here is that:

The state is neither transcended nor unaltered in some overarching, all encompassing fashion: instead each state is finding that its relationship to key social forces both inside and outside of its national space is being restructured as part and parcel of all the other shifts to which globalization as a concept draws attention (Payne, 2000:204; emphasis in the original).

“In other words”, as Payne aptly notes, “the roles (not role) that can now be played by states (not the state) will vary with their history, their leadership, their location in the world order and so on” (Payne, 2000:204). On such a view, explicating the various governance genres (and how they are inter-related), therefore, will shed some useful light on how a shift in public governance of the financial markets is directly related to shifts in other modes of governance. Moreover, to the extent that governance models differ across nations and over time, then it is reasonable to expect that merger policies may also vary spatially and temporally. Further still, bank merger policy understood within a multi-realm, multi-actor governance framework alerts us to the possibility of multiple channels (direct and indirect) through which influences for (or against) bank merger policy convergence can pass or be exerted. Furthermore, and perhaps more importantly, it also helps us better understand how the state and market are embedded (or dis-embedded) in society across time and space. Certainly, an exposition of the parallel existence, mutual interactions and interdependencies, as well as contestation and tensions among state, market and civil society governance mechanisms surely helps to eschew the tendency in mainstream analyses to consider the state and market as separate and distinct social domains. Of course, we are mindful that the relative influence of the three domains changes over time and in different circumstances and locations.

Sixthly, we will eschew traditional perspectives on regulation that tend to treat the state as undifferentiated or monolithic category. We do so because with the complexities

of the modern state (in terms of its roles, functions, structures, etc.) there are a plurality of sites, multiple actors, fragmented perspectives, and rivalries within the state (as well as within private economic sectors and civil society). Indeed, public “authorities operate at a range of different levels, often with different interests, and cultures” (Macgregor, Prosser & Villiers, 2000a: 9). As such,

... public competence and power to take economic decisions may today be exercisable at levels above the state, in international organisations; it may also, within the state, be diffused among public authorities with specific territorial or functional competencies. In addition, the boundaries between the action of the state, and private economic action, may often be blurred, either by reason of the purposes of the action, or... of the nature of the institutions involved (Daintith, 1997; cited in Macgregor, Prosser & Villiers, 2000a:10).

In a nutshell, multiple actors exercise public authority at multiple levels, and, while the state may possess several unifying characteristics it is also riven with internal contradictions and conflicts. Moreover, we view regulation as encompassing both public and self-regulation. Self-regulation being understood as “private techniques for constituting and policing markets [including] the rules and principles of corporate governance, as well as sectoral or industrial private regulation” (Macgregor, Prosser & Villiers, 2000a: 14-15). In other words, “Self regulation can be seen as taking place when a group of firms or individuals exerts control over its own membership and their behaviour” (Baldwin & Cave, 1999:125).

Contrary to the view that sees self-regulation as opposed to public regulation (and for some seen as better than and thus preferred from state intervention), we do not see self-regulation as the antithesis of public regulation (see Baldwin & Cave, 1999; Macgregor, Prosser & Villiers, 2000a), but as “a technique of regulation rather than an alternative to it” (Macgregor, Prosser & Villiers, 2000a:14). This contention can be

understood in at least three senses. First, is “the governmental nature of self-regulation” (Baldwin & Cave, 1999: 125): “An association may self-regulate in a purely private sense – in pursuit of the private ends of its membership – or it may act governmentally in so far as public policy tasks are delegated to private actors or institutions. Both forms of activity may, indeed, be combined” (Baldwin & Cave, 1999: 125). While self-regulation may be constrained governmentally in a number of ways this may not always be apparent. In addition, it is important to recognize that in those cases where “self-regulation may appear to lack any state involvement ... in reality it may constitute a response to threats by government that if nothing is done state action will follow” (Baldwin & Cave, 1999:125-6). The main point is that “regulation in areas often seen as essentially private is a complex mix of different normative and institutional systems; neither those of public authorities nor those of private organisations have a monopoly on the exercise of regulatory functions” (Macgregor, Prosser & Villiers, 2000a:14-15). Thus, “Self-regulation does not always mean freedom for private actors to regulate themselves. It can range from a system with minimal public intervention to one in which strong constraints are set by law and in which there is extensive power for government to intervene” (Macgregor, Prosser & Villiers, 2000b:347).

Lastly, it is worth underscoring the fact that private self-regulation as well as public regulation can be informal or formal. It is important to stress this point because “areas where there is apparently no formal regulation or little regulation of any kind are in fact subject to forms of regulation which are less apparent than in more conventionally regulated fields” (Macgregor, Prosser & Villiers, 2000b:341-342). The implications of this view are twofold. First, is that “regulation is not limited to 'command and control' or the use of officially sanctioned legislative programmes” (Macgregor, Prosser & Villiers,

2000b: 342). And, the “second is that those introducing new regulatory schemes must be aware that they are not simply sowing virgin fields, for there are likely to be informal networks already operating” (Macgregor, Prosser & Villiers, 2000b: 342).

The significance of this discussion is that when we examine regulatory change it is important that we do not only focus on formal regulations, for doing so might mean missing significant changes or misinterpreting change patterns and dynamics.

In summary, we wish in this study to transcend the traditional approaches by taking a broader perspective on financial system governance and bank merger policy in particular. In other words, we view governance in a multi-realm, multi-actor framework involving a variety of state and non-state actors (acting singly or in collaboration) operating in different social realms (economy/market, state, or civil society), exercising authority at one or more levels (global/international, regional, national, and sub-national levels, etc.) through a variety of general and specific arenas, employing a variety of modes of governance, (including overlapping forms of governance mechanisms such as norms, regulations and laws i.e., formal and informal; direct and indirect, horizontal and vertical processes), for a variety of purposes and functions (e.g., constitutive, regulatory, adjudicative, punitive, socializing, etc.).

It is in light of such a backdrop that we will in this section begin by delineating the boundaries between the governance of financial systems and that of other (non-financial) firms. Next, we will show how states, market participants, and civil society actors govern financial enterprises. Thereafter, we will examine the international dimensions of financial system governance, inter-regime coordination and management, and financial governance regime transformation.

2.5.1 Financial Sector Governance and the Governance of Non-financial Firms

We distinguish between the governance of the financial sector and that of non-financial sectors. In other words, economic governance is viewed to consist of two subsystems – financial sector governance vs. non-financial sector governance -- as shown in Figure 2.2 below. We distinguish these two subsystems primarily to highlight this study's focus on financial system governance and to underscore the point that in spite of the recent resurgence in interest and focus on governance, current political economy scholarship tends to focus relatively more on the governance of the non-financial sectors and the role of financial institutions in such governance processes as opposed to the governance of the financial sector per se. Consequently, less attention has been paid on the governance of financial systems per se (see also Macey & O'Hara, 2003:90).

As a corrective, it is vital that financial system governance be carefully studied for the following reasons. First, financial institutions (banks) are “monitors” or governors of other firms. Second, banks are not like other firms and, thus, we need to study the governance of banks and the specific problems that arise from such processes. Third, governance systems differ across countries and as such, different countries have different governance configurations and mechanisms. These factors alone warrant special attention to the governance of the financial sector.

Figure 2.2: Economic Governance: Financial System vs. Non-financial System Governance

Briefly, in the figure above, the non-financial sector governance sub-system focuses on the governance of the non-financial corporations/players (with of course, the financial system playing a pivotal role therein). Financial system governance sub-system, on the other hand, primarily focuses on how the financial sector per se is governed. Both of these sub-systems are governed severally and sometimes jointly by the state, the market, and civil society. Governance by the state, civil society and market institutions (at different levels including international, national and sub-national levels) are as specified in the two figures below.

Figure 2.3: Players in the Governance of Financial Systems

Figure 2.4: Players in the Governance of Non-Financial System

2.5.2 State Governance of Financial Systems

We conceive the governance of financial institutions to consist of control by the state as well as by non-state actors including market/industry self-regulators, and civil society actors and institutions. As such, financial system governance can at the very least encompass four genres of governance namely: (a) public governance of financial system institutions and organizations, (b) governance of the financial system by market institutions and participants, (c) financial system governance by civil society, and (d) some combination of the above three modes.

Accordingly, we understand state-led governance of financial institutions to consist of control by the state in collaboration with non-state actors including market/industry self-regulators, and civil society actors and institutions. On this view, the state plays a prominent role in governing financial institutions through a variety of mechanisms encompassing an array of norms, rules and institutions that are firm specific (i.e., geared towards governing individual firms), industry-specific (geared towards governing specific economic sectors and industries), as well as economy-wide in nature.

Moreover, we allow for the possibility that multiple state bodies would undertake state-led governance of the financial sector. In fact, state governance of financial institutions is usually shared among different branches of the state (i.e., among the executive, legislative and judiciary). Worth noting also is that even within a branch of government, it is not uncommon that, say, a particular industry (e.g., banking) would be under the purview of multiple regulatory agencies or departments. What role each department, agency or branch of government plays as well as how these collaborative mechanisms are structured and operationalized depends on a country's history, economy, political system, and culture. Indeed, these governance configurations reflect (and are also a result of) the division of power and authority between state and non-state institutions, distribution of power among non-state institutions, and the distribution and balance of power within the state. These considerations account, primarily, for the prevalence of diverse multi-level and multi-actor governance systems across nations; hence, the diversity of governance arrangements around the world. In other words, national governance models will differ according to how the various elements of financial system governance are configured. Moreover, and more importantly, it is pertinent to note that these diverse arrangements are not carved in stone. They do tend to change or

evolve over time although some aspects of these arrangements may change faster than others.

As a set of multi-realm, multi-institutional, and multi-actor processes, state governance of financial institutions and organizations can take place at different levels and jurisdictions including international, national and sub-national levels. With increasing globalization, international and transnational collaboration of economic governance mechanism by states and inter-state bodies have gained prominence. At the international level, the acceleration of financial globalization has been accompanied by a number of bilateral, regional, plurilateral, and multilateral governance regimes through the “evolution of new multilateral mechanisms and of the breathing of new life into old ones” (Cerny, 1998:179). This has involved the “development of intergovernmental cooperation, evolution of international non-governmental “regulatory” institutions, and/or the establishment and/or enforcement of more autonomous transnational regimes” (Cerny, 1998:179), as exemplified by the establishment of a number of permanent institutions.

For our purposes, a notable recent development in the global governance of financial activity and institutions is the Joint Forum on Financial Conglomerates (JFFC) established in 1996 under the collective auspices of the BCBS, IOSCO, and IAIS. The JFFC is a good example of an emerging regime for the control of the huge and diversified financial organizations that have resulted from the mega-mergers of recent years. It is aimed at inspiring more formal cooperation among the bank, securities and insurance supervisors from the largest nations (Germain, 2002). Among some of the achievements of the JFFC is a release in February 1999 of a series of papers on the supervision of financial conglomerates covering: (a) “techniques for assessing the capital adequacy of conglomerates”; (b) “tests for

the fitness and propriety of managers, directors and major shareholders of conglomerates”;
 (c) “facilitators of the exchange of information among the various supervisors”; and (d)
 “methods of coordinating the activities of the supervisors in emergency and non-emergency
 situations” (Bryant, 2000:252).

Other recent examples include the formation of:

- (a) the Financial Stability Forum (FSF) – a new regulatory initiative “created to
 bring together key national and international regulators in an attempt to
 eliminate the perceived regulatory gap which enables financial contagion to
 spread” (Germain, 2002:20);
- (b) the G20; and
- (c) the International Monetary and Financial Committee (IMFC).

These upward shifts in governance processes have been spurred by at least four
 inter-related factors including: the emergence of a range of issues that have required
 collaboration and action at multilateral and regional levels; willingness by state
 authorities to pool sovereignty and resources; changes in ideational foundations with
 regard to how and why financial institutions/systems should be governed; and, changes in
 the configuration of material interests and power structures and relations among societal
 actors.

2.6 Conclusions

This chapter presented the notion that financial systems are diverse and are embedded in specific models of capitalist political economy and are therefore differently governed. We did so because it is the position of this study that the contexts within which bank mergers are governed and in which bank merger policies are conceived, function and change are crucial in facilitating/mitigating pressures for convergence.

To articulate this conception of financial systems, the chapter drew and synthesized relevant insights from at least four main clusters of knowledge, including literature on the VoC approach, finance, regulation theories, and multi-level governance.

The observation that financial systems are embedded within specific political economies has implications for how we understand what changes in a particular financial system and how these changes occur. To begin with, the linking of financial systems with their corresponding capitalist models highlights the fact that financial systems within a model (i.e., as variants of a particular model) will of necessity encapsulate some similarities and differences. The issue is to examine whether these similarities and differences persist over time, how and why. Moreover, financial system features that may change in a capital-market-based Anglo-Saxon political economy may not be necessarily relevant in a bank-based Rhenish model.

Second, we noted that even within a capitalist model national financial systems differ in two distinct ways. For instance, in the market-led Anglo-Saxon model, the hitherto highly segmented U.S. banking system is quite different from the Canadian “universal” banking system. Similarly, we also highlighted the fact that the state-led bank-based Japanese financial system differs from the negotiated/consensual universal

bank-based German model even though both countries may be considered to belong to the “coordinated market economies”.

Thirdly, we noted that financial systems are not static i.e., they change over time and that financial system development does not follow a single path. In fact, financial system transformation processes vary with regard to speed of change as well as with respect to organizational type and capacity, and the industrial structures that emerge. This is best exemplified (as will be presented in detail in Part II) by the history of both the Canadian and U.S. financial systems. A case in point is the de-segmentation of the U.S. system that is currently underway following the repeal in 1999 of the Glass-Steagall Act of 1933 – a process that Canada had already embarked some two decades earlier in 1986.

Furthermore, by incorporating the diverse financial systems into the VoC framework we believe we have laid the ground for further linking the literature on financial systems in economics and finance with that of the varieties of capitalism literature. Linking these two sets of literature is significant for at least three reasons. First, by demonstrating that financial systems are embedded within specific political economies we eschew the tendency to treat all financial systems as universally the same and/or as being affected by similar pressures. As such, we are able to appreciate that what changes in one system may not necessarily occur in another system.

Second, to understand the evolution of a national regulatory policy one needs (inter alia) to also understand the evolution of its national financial structure. Thirdly, it will help us see clearly that the hitherto stereotyping of financial systems is outdated and may in fact be misleading. The customary labelling of bank-based systems, like that of Germany, as characterized by “universal” banks may not hold as: (a) financial systems like that of Japan (that is also a bank-based system but unlike the German universal

banking system) was until recently primarily characterized by a segmented/specialized banking system; and (b) a market-led system like Canada is increasingly developing into a system that resembles some form of universal banking as the hitherto financial “pillars” have all but crumbled.

Lastly, the above analysis provides the context within which financial system mergers and acquisitions take place and helps to determine how these processes are governed publicly and privately. This is crucial in understanding the transformation of the Canadian and American merger policies. It is crucial primarily because it helps us appreciate that differently situated/positioned authorities may respond differently even when faced with similar pressures or influences. It is in such a context that we will proceed in the next chapter to develop our perspective on bank merger policy including its characteristics and rationales.

Chapter 3: Financial System Consolidation and Comparative Bank Merger Policy Analysis

3.1 Introduction

In order to clearly map the context within which Canadian and American bank merger policies are formulated, applied and changed, the previous chapter presented our notion of national financial systems within a world of variety of capitalist models and how such financial systems are governed. Proceeding from this premise, this chapter endeavours to sketch the boundaries of our study of the comparative transformation of Canadian public policy on bank mergers and acquisitions vis-à-vis its U.S. counterpart. It does so in four stages as follows.

First, the chapter commences by introducing the notion of financial system consolidation. Essentially, the chapter presents here our take on what financial consolidation entails and thus locates bank mergers and acquisitions within the broader notion of financial consolidation.

Second, the chapter explores, albeit briefly, some of the patterns, key drivers and purposes of bank mergers and acquisitions. It does so in a manner that transcends (neo)functionalist and structural accounts of bank merger processes. Such exploration will be useful in apprehending some of the dynamics of public policy transformation -- particularly as they relate to the interests of the banking community with regard to bank merger policy processes.

Third, a concise view on: (a) public policy on financial system consolidation, and (b) bank merger policy are presented. This sets the stage for examining some of the key policy concerns regarding contemporary financial consolidation in general and bank mergers in

particular, and perhaps most importantly, for presenting our understanding of what public policy on bank mergers means and how it is related to other policies.

Having presented our notion of bank merger policy, the chapter then proceeds to introduce the notion of comparative bank merger policy transformation and analysis. In this section, we distinguish between the comparison of two or more public policies at a given point in time (i.e., a comparison of similarities vs. dissimilarities) and the comparison of two or more policies over time when the purposes of such comparison may include, *inter alia*, discerning patterns of convergence or non-convergence, dynamics and sources of policy change, modalities of policy implementation, as well as the consequences and significance of such policy convergence and/or divergence. We also explore the various patterns that such policy changes may take. This we believe is helpful in highlighting the point that bank merger policies may change in various ways and that these change patterns may or may not necessarily lead to bank merger policy convergence among jurisdictions.

Finally, we offer some concluding remarks aimed at providing some preliminary insights on how to comprehend the convergence and/or divergence of public policy on bank mergers and acquisitions in particular and of financial system consolidation in general. Thus, the stage is set for a full-scale development of this study's framework of analysis in the next chapter.

3.2 Financial System Consolidation: A Conceptual Overview

We conceive of financial system consolidation on two levels, viz. domestic and international (including regional and global levels), and four dimensions namely, consolidation in financial (a) instruments, (b) markets, (c) firms and organizations, and (d) industries. Consolidation in financial instruments includes processes involved in the

combination or integration of financial products and services in spite (and perhaps because) of product and service innovations. Financial market consolidation involves the integration of markets within and across financial industries, as well as consolidation of geographic markets -- domestic and international ones. Consolidation or fusion of financial institutions, firms, and organizations includes amalgamations, mergers and acquisitions, formation of financial conglomerates, as well as strategic alliances and networking involving financial firms within a financial industry (e.g., bank-bank mergers, or insurance-insurance mergers) as well as across financial industries (e.g., bank-insurance mergers, or bank-securities mergers, etc.). It would also concern the failure or exit of financial institutions as a decrease in the number of financial firms has a direct bearing on the consolidation process. Lastly, consolidation of financial industries is understood here as the restructuring and the breaking down of boundaries between and among the traditionally distinct industries (sub-sectors) e.g., banking, securities, and insurance, etc. – the so-called “crumbling of financial sector pillars” or “de-segmentation process”. The blurring of boundaries between financial industries is of course, linked to the three previous processes i.e., the consolidation of financial products, markets, and firms. The upshot of these various processes has been the rapid growth of financial conglomerates that are able to offer a range of financial services within a single organization: one-stop shopping. In other words, it has resulted in the rise of a form of universal banking undertaken by “large, integrated financial services organizations that combine elements of the previously “siloes” insurance, brokerage, investment management, and banking sectors” (Tuohy, 1999: 329).

It is in such a context that bank mergers and acquisitions are viewed as a subset of processes within the broader trend of financial system consolidation. To be sure, bank

mergers are inextricably linked with the other processes of financial consolidation. For example, product and financial (geographic) market consolidation may shape and facilitate (if not trigger) bank mergers. By the same token, bank mergers (within and across financial sub-sectors) are bound to promote the consolidation of financial sectors. Lastly, bank mergers promote financial consolidation for they may serve as an instrument for dealing with distressed financial firms; hence facilitating “orderly” exit (Broker, 1989; Berger, Demsetz & Strahan, 1999; Elsas, 2004).

3.3 Bank Mergers and Acquisitions: Patterns, Sources and Rationales

3.3.1 Patterns of Bank Mergers and Acquisitions

One of the main recent trends and developments in financial systems around the world has been their increased (re)integration and consolidation both domestically and internationally (G10, 2001; ILO, 2001; OECD, 2001b). Indeed, as part of the general economic consolidation trend, the last two decades have witnessed an upsurge in financial sector mergers and acquisitions both within and across industrial countries (G10, 2001; OECD, 2001b; Scholte, 2000b). Undoubtedly, as the G10 (2001), ILO (2001) and the OECD (2001b) reports demonstrate, the level and intensity of consolidation activities differ across and within countries, as well as across and within sub-sectors of financial systems. For instance, a study of 13 advanced countries commissioned by the finance ministers and central bank governors of the Group of Ten nations in September 1999, reported on a number of key trends in financial sector consolidation, the following four of which pertain to consolidation in banking (G10, 2001). First, there has been a high level of M&A activity among financial firms with a

noticeable acceleration in consolidation activity in the last three years of the 1990s (G10, 2001:2). Second, most of the M&A activity involved banks in that “acquisitions of banking firms accounted for 60% of all financial mergers and 70 % of the value of those mergers” (G10, 2001:2). Third, “cross-border M&As were less frequent, especially those involving firms in different industry segments. However, cross-border activity was relatively strong at insurance companies and in joint ventures and strategic alliance outside the United States” (G10, 2001:2). Fourth, as a result of these M&A activities, “a significant number of large, and in some cases increasingly complex, financial institutions have been created” (G10, 2001:2).

In this regard, some “observers believe that cross-border M&As in the financial services will be the next phase once internal consolidation is complete and the drive towards higher concentration will only end when there are no more acquisition targets” (ILO, 2001:5). One of the key issues in this regard is what motivates these bank merger trends. We discuss this next.

3.3.2 Rationales for Bank Mergers and Acquisitions

The contemporary trends in financial consolidation have been explained from a number of perspectives including theories based primarily on economics, finance, legal, international relations, and political economy scholarship. Given this range of perspectives it is no wonder that the literature offers a plethora of competing, complementary, and sometimes overlapping explanations as to the key sources or drivers of contemporary financial consolidation (see e.g., Allen & Santomero, 1998; Benston, Hunter & Wall, 1995; Berger, Demsetz & Strahan, 1999; Bowman, 1996; Caves, 1989; Davis, 2000; Freedman & Goodlet, 1998; G10, 2001; Germain, 1996a, 1996b, 1996c,

1997; Gorton & Rosen, 1995; Hawawini & Swary, 1990; ILO, 2001; Mathewson & Quigley, 1998; Milbourn, Boot & Thakor, 1999; Mueller, 1989; OECD, 2001b; Scholte, 2000b; Thakor, 1996, 1997).

Legal scholars like Bowman (1996) note that mergers in general “have served a variety of purposes since the late nineteenth century, including the monopolization of industries, the control of markets through vertical integration, economic survival of firms, speculation, expansion through diversification, and centralization of control over related industries and markets” (Bowman, 1996:174). In other words, “Mergers ... have provided the primary means by which corporate capitalists have restructured the marketplace to achieve greater economies of scale and to enhance market power both as an offensive and as a defensive strategy” (Bowman, 1996: 174-5).

Bowman’s observations are echoed in the finance literature. Berger, Demsetz and Strahan (1999) offer a useful framework for organizing theories on financial consolidation. They delineate two broad (non-mutually exclusive) categories of drivers for bank mergers, viz.: value maximization motives, and non-value maximization motives (Berger, Demsetz & Strahan, 1999:136).

This dichotomous framework is useful since it serves as a reminder that mergers and acquisitions are pursued for reasons other than or in addition to profit maximization which has profound implications for the formulation and implementation of competition (anti-trust) policies which are generally predicated on an excessively narrow emphasis on the monopoly-profit effects of mergers (Rhoades, 1983).

However, a word of caution is in order at this juncture. In the finance literature, bank merger accounts are frequently discussed from neo-functionalist perspectives that tend to focus on the diverse motivations leading to such mergers but fail to explain how

these varied motivations are translated into actual bank mergers. Nevertheless, they do offer a starting point from which we hope to develop an analysis that transcends the limitations of such neo-functionalist accounts. And, as noted above, in the neo-functionalist finance literature, it is common to distinguish between value maximization and non-value-maximization motives (Berger, Demsetz & Strahan, 1999). We will briefly explore these motives below.

As regards value maximization motives, the most prominent hypothesis contends that M&As are pursued to achieve “economies of scale” through the consolidation of operations and the efficient elimination of excess capacity (Berger, Demsetz & Strahan, 1999; Freedman & Goodlet, 1998; ILO, 2001). Moreover, it is argued that M&As have been promoted by technological advances since “Technological progress may have increased scale economies in providing financial services, creating opportunities to improve efficiency and increase value through consolidation” (Berger, Demsetz & Strahan, 1999:148).

In addition, bank mergers and acquisitions are also viewed as strategies for enhancing “economies of scope”, i.e., banks merge to diversify (product-wise, marketwise, geographically, etc.) in order to reduce the risk of failure in a declining industry with over-capacity as well as to adapt to changing customer preferences and demands (Gorton & Rosen, 1995; Thakor, 1997). Freedman and Goodlet (1998:17-18) contend that in this changing environment a “successful financial institution will have to be large enough to provide all or most types of services to its customers in a sort of financial supermarket, either because of demand or to take advantage of economies of scope (or “synergy”).” To realize these objectives, “large amounts of capital will be necessary to handle the kinds of transactions and provide the kinds of services demanded

by some customers in the future” (Freedman & Goodlet, 1998:17-18). This therefore, implies that “the successful financial institution of the future will be a very large conglomerate, operating in an international context, and providing all or most types of services to its customers in a technologically advanced way” (Freedman & Goodlet, 1998:17-18).

Indeed, many finance executives have advocated mergers and acquisitions (both domestic and cross-border) as a key survival and competition strategy for dealing with increased globalization and/or regionalization of financial markets (Berger, Demsetz & Strahan, 1999; Germain, 1996a, 1996b, 1996c, 1997; Scholte, 2000b; Thakor, 1997). In Arvind Thakor’s words, “for purveyors of financial services, the world is increasingly becoming a single market as an increasing number of their corporate customers expand globally and seek financial service companies that can leverage their global capabilities to provide a more comprehensive range of financial products” (Thakor, 1997:197). As such, “international presence is essential for success, and only large institutions can compete outside the domestic market” (Freedman & Goodlet, 1998: 17-18).

M&As are also rationalized as crucial in the strategic positioning of financial institutions particularly because they afford financial firms with ways of seeking and/or pooling strategic assets (resources) such as technology and management capabilities to complement internal resources and competences (OECD, 2001b). Freedman and Goodlet (1998: 17-18) assert that “given technological requirements, it will be extremely expensive in the future to maintain a competitive infrastructure for delivering financial services efficiently and only large institutions can manage these costs.” In the same vein, Thakor also contends that “as technology increasingly replaces human capital in the

provision of financial services, scale becomes more important. Mergers are simply viewed as a low-cost way to increase scale” (Thakor, 1997:197; see also Portanger & Sidel, 2004).

Beyond these basic rationales, there are also a number of other motives suggested for M&As from time to time. These include (a) the market-power hypothesis, whereby bank mergers are pursued to enhance market power (i.e., horizontal mergers create monopolistic power by reducing the number of competing firms in an industry) (Thakor, 1997:199); (b) the tax savings hypothesis (i.e., a merger may be pursued because the tax liability of the merged entity may be smaller than the combined tax liabilities of the two (or more) separate firms); (c) the too-big-to-fail argument which suggests that bank mergers may be undertaken because the merged entity will enjoy public protection beyond that which is provided by the existing deposit insurance umbrella. From this perspective, the merger in effect increases “the value of the deposit insurance put option” for the merged bank (Benston, Hunter & Wall, 1995); (d) the inefficient-management hypothesis (i.e., mergers provide a mechanism to remove poor management from target firms and potentially raising the value of the firm by improving its performance); and (e) improvements in financial condition argument whereby it is posited that recent improvements in the financial condition of institutions may be another factor behind the increase in M&As (Berger, Demsetz & Strahan, 1999:149). Low interest rates and high stock prices are said to reduce financing constraints on M&A activity, although, of course, they, also raise the price of target firms (Berger, Demsetz & Strahan, 1999:149). This argument is especially pertinent as stock deals are more common than cash acquisitions in banking (Berger, Demsetz & Strahan, 1999:149; Esty, Narasimhan & Tufano, 1999).

Finally, irrespective of these various pressures for M&As in the financial sector, the level of M&A activity will ultimately also depend on the attitude of governments since governments generally play a direct role through the review process (e.g., in their approval/disapproval of individual M&As) and through their ability to redefine the restrictions imposed on such M&As (Berger, Demsetz & Strahan, 1999:147). Thus, it is clear that the removal of certain restrictions (for example, deregulation of intra and interstate banking and branching in the USA) has contributed to the recent bank merger movement in which governments have “allowed some previously prohibited M&As to occur” (Berger, Demsetz & Strahan, 1999:150).

In addition to their restrictive or proscriptive roles, governments may also encourage consolidation for reasons of their own. First, “State intervention may also be a factor in financial sector consolidation, with governments acting as sellers in privatization” (ILO, 2001:9). Second, governments may actively support M&As as a means of bailing out distressed financial firms (Broker, 1989; Berger, Demsetz & Strahan, 1999; Elsas, 2004). During periods of financial and banking crises, governments may provide financial assistance or otherwise aid in the consolidation of troubled financial institutions for M&As, i.e., government supported/facilitated M&As serve as distress resolution mechanisms (pre-emptive or otherwise) (Elsas, 2004). For Berger, Demsetz and Strahan (1999:148) government assisted financial consolidation is viewed as an efficient way of resolving problems of financial distress; better than bankruptcy and other means of exit. Elsas (2004), however, cautions that although distress mergers can foster reorganizations, realize diversification gains, and avoid public attention, they nonetheless do not come without costs.

The second cluster of arguments for M&As according to Berger, Demsetz and Strahan (1999) is that pertaining to “non-value-maximizing motives”. Arguments in this category recognize that managers “may be able to pursue their own objectives in consolidation decisions, particularly in banking where corporate control may be relatively weak” (Berger, Demsetz & Strahan, 1999:146).

M&A activity is linked to the need for “corporate control” in the sense that bank mergers can facilitate the post-acquisition divestitures and the elimination of excess capacity, rationalization of bank branches and staffing. This can be undertaken by the acquiring firm/management because, unlike the acquired firm's CEO, the acquiring firm's CEO is unencumbered by the fear of lost reputation. Divestiture by the acquired firm without a merger could have been interpreted as an admission of error in investing and would have thus damaged the reputation of those concerned CEO (Thakor, 1997:198).

Managerial preference for M&A activity is also linked to what is known as “the hubris hypothesis” exemplified by overweening pride and arrogance of the managers of the bidding firms. A prominent argument is that of “empire building” also referred to as the manager-utility-maximization hypothesis. In this strand, it is argued that managers would prefer to engage in M&As for selfish motives (i.e., to enhance their own utilities) as large firms pay higher salaries to their managers, offer non-monetary rewards such as power, prestige, perquisites, job security, etc.). As Berger, Demsetz and Strahan (1999:146-7) observe:

Executive compensation tends to increase with firm size, so managers may hope to achieve personal financial gains by engaging in M&As, although at least in part the higher observed compensation of the managers of larger institutions rewards greater skill and effort. To protect their firm-specific human capital, some managers may also attempt to reduce insolvency risk below the level that is in shareholders' interest, perhaps by diversifying risk through M&A activity.

In sum, a plethora of rationales (both profit-maximizing oriented and non-profit-maximizing based arguments) have been advanced as important motivations for bank mergers and acquisitions. These include technological progress (including improvements in information technology), improvements in financial conditions, excess capacity/financial distress, corporate control and managerial hubris, international consolidation of markets (including competition from off-shore financial centres, financial dis-intermediation), regulatory reforms, regional pressures (e.g., the EU), and increased shareholder pressure for financial performance (Berger, Demsetz & Strahan, 1999; G10, 2001; ILO, 2001; OECD, 2001b; Scholte, 2000b). Worth noting also are factors that hinder merger and acquisition activities. For instance, the G10 report (2001) identifies diverse domestic regulatory regimes and corporate and national cultural differences as factors discouraging financial consolidation, particularly cross-border M&As.

While the above cited factors are important to consider when explaining why (or why not) M&As among financial firms take place, it is crucial here to underscore the point that it is seldom only one factor that is decisive. Invariably, a complex nexus of considerations motivates bank mergers. As Scherer and Ross (1990: 159) have put it: "Mergers occur for a myriad of reasons, and in any given case, several different motives may simultaneously influence the merging parties behaviour." In general, while the above perspectives are useful, they usually do not adequately link the purposes/motivations for bank mergers with the dynamics of financial consolidation. And, to do that we need to link the acquisition behaviour of firms with other changes in the economic, political, and social environment – domestically, regionally and globally which can be best accomplished by drawing on insights from political economy

perspectives (e.g., Germain, 1996a, 1996b, 1996c, 1997; Scholte, 2000b). In other words, it is insights from political economy that will enable us to better appreciate how the demand for mergers and acquisitions and the subsequent behaviour of firms are affected by the complex interaction of processes and changes taking place in this era of globalization and regionalism. They will also help to contextualize the public policy responses since they help to shape the premises on which state authorities decide to permit or refuse different types of bank mergers.

From a general perspective, Scholte (2000b) contends that the contemporary rise in domestic and international mergers and acquisitions should be seen as part of the reorganization of contexts of accumulation as a result of globalization, understood as the rise of supraterritoriality. While cognizant of the other sources of contemporary M&As, Scholte sees globalization as playing a significant role in the consolidation process. Many M&As have therefore, “had the specific aim to create a larger national firm that can hold its own in globalizing capitalism” given that “corporate combination has been a strategy for company survival in the face of global competition” (Scholte, 2000b:127). The upshot of this rise in domestic and trans-border M&As has been a substantial increase in market concentration in many sectors, as “global capital has, on the whole, meant bigger and more centralized capital” (Scholte, 2000b:129) with the result that a “handful of big firms now dominate many sectors” (Scholte, 2000b:129).

These trends have significant implications for the state and public policy. Scholte observes that “Governments have been loath to hinder such (transborder) acquisitions, partly for fear of alienating supraterritorial capital that might otherwise locate in another jurisdiction” (2000b:127). Governments have been reluctant to hamper domestic M&As,

“for fear of prompting relocation and/or of undermining the position of ‘their’ firms in global markets” (Scholte, 2000b:127).

In a similar vein, Germain (1996a, 1996b, 1996c, 1997) views financial integration at domestic, regional, and global levels as processes shaped by changes in the forms of wealth creation and the strategic responses of the financial system players (both private and public) in terms of the introduction/adoption of innovative instruments and practices, competition among financial firms and centres as well as the fusion of private and public power. Indeed, Germain, drawing on a Braudelian perspective, sees a differential pattern of financial development and integration within the three levels of the “world-economy”, namely, “the domain of material life”, “the domain of market economy”, and “the arena of capitalism” depicting distinct trajectories. On this view, financial consolidation takes on different forms and dynamics in each of the three domains.

It is also crucial to underline the point that while financial services consolidation is partly driven by globalization and regionalism, it is itself also a driver of further globalization, i.e., “liberalization and technological advances are increasingly pushing the sector towards greater globalization in which M&As are both a cause and a consequence” (ILO, 2001:5). Indeed, Parker (1998) sees the rise in mergers and acquisition as a source of globalization itself. She writes:

Many acquisitions and mergers differ from past transactions because whereas many were paid in cash in the past, now they are more likely to be the result of stock swaps and spinoffs, and those stock investments create long-term cross-border links. One result is that stock distribution disperses firm ownership beyond a select group of nations or individuals and into a worldwide pool of people and institutions who may hold divergent views about how firms should be managed (Parker, 1998: 17).

In sum, the foregoing discussion points us to the notion that globalization is better understood both as an independent and dependent variable. Moreover, it indicates that

there are a diversity of motives and driving forces for the contemporary mergers and acquisitions (M&As). While mergers and acquisitions within the context of globalization and regionalism have given firms a quick entry into markets and/or countries as an alternative to de novo establishment, and supported firms' strategies to increase economies of scale and scope, it is also true that M&As have provided firms with a way to dispense with competitors as well as to increase market concentration with serious political, economic, and social implications – aspects we will consider next.

3.4 Public Policy on Financial System Consolidation and Bank Mergers

Public policy on financial system consolidation is here understood to encompass the public authority's position or broad framework within which the public authority's decisions and actions are taken with respect to financial system consolidation. Such public policy may take a variety of forms, including legislation, regulations, administrative and executive orders, judicial decisions as well as unwritten rules.

Based on how we earlier conceptualized financial consolidation, public policy on financial system consolidation is here understood to encompass at least four interrelated dimensions. First, it would involve public policy on the integration of financial instruments, as well as on innovations in financial products and processes. Secondly, it would involve public policy on market integration within and across financial industries, as well as consolidation of geographic markets – domestically and internationally. Thirdly, it would pertain to policy on mergers and acquisitions among financial firms within a financial industry (e.g., bank-bank mergers), across financial industries (e.g., bank-insurance mergers), among financial firms and non-financial firms, as well as among domestic and

foreign financial institutions. Fourthly, it will also pertain to public policy on bank (and other financial institution) failures and exit.

It is on such a basis that we situate bank merger policy as part and parcel of public policy on financial system consolidation.

3.4.1 Bank Merger Policy Defined

Viewed from a narrow perspective, bank merger policy can be understood to encompass the public regulation/governance of mergers and acquisitions within the banking industry. In this study, however, we adopt a relatively wider notion of bank merger policy. We do so particularly because, given the contemporary restructuring of financial systems, bank merger policy has increasingly tended to touch in significant ways other financial industries (pillars) as banks have gone about merging with and acquiring non-bank financial institutions. As such, with increasing financial integration and consolidation, bank merger policy will increasingly tend to touch on several aspects of public policy on financial system consolidation, including the governance of financial integration processes in financial products, markets, institutions and organizations.

It is thus pertinent to note that given the variety of forms business combinations can take, bank merger policy (and policy on financial sector consolidation in general), usually encompasses mergers and acquisitions (M&As) that are:

- (a) horizontal (i.e., within-industry, when competitor firms in the same industry merge, e.g., bank-bank mergers);
- (b) vertical (i.e., the merging of firms having a supplier-consumer relations -- upstream or down-stream); and,

- (c) conglomerate: a term "applied to mergers that are neither horizontal nor vertical, that is to say mergers that do not involve the joining together either of companies producing the same or similar products or of companies that are actual or potential suppliers of each other" (Maycock, 1986:1). It is worth noting that financial conglomerates are "characterised by an additional important element that is often lacking in their industrial or commercial counterparts, and that is a high degree of complementarity between the services provided by the different parts of the organisation" (Maycock, 1986:2).
- (d) Geographic: i.e., M&As can be (a) within-country, and (b) cross-border consolidations.

The above different types of merger (and integration) processes raise several regulatory/governance issues pertaining to: (a) how much and what business powers should be granted to merged entities; (b) relationships among business entities; (c) ownership rules (foreign and domestic); (d) industrial structure, (e) financial system stability, soundness and integrity; (f) economic efficiency; (g) consumer and investor protection; (h) market access and treatment of foreign investors; (i) cooperation among competition (anti-trust) authorities; and (j) the urge/need for harmonization of regulatory policies (domestically and internationally).

As such, the ability of banks to merge with or acquire other banks and/or financial firms is governed (directly or indirectly) by various policies and laws including financial regulation and supervision, competition (anti-trust) policy, international trade policy, foreign direct investment policy, foreign policy, tax policy, securities laws, private law

(bank confidentiality, conflicts of interest, etc.), and other laws relevant to corporate formation and liquidation. (See e.g., Cranston, 2002; Gaughan, 2002.) In other words, we need to view bank merger policy from a broader perspective: i.e., as an intersection of multiple policy fields (Figure 3.2 below).

Figure 3.2: Bank Merger Policy as an Intersection of Multiple Policy Fields

A close examination of the above figure reveals that to effectively apprehend the nature of bank merger policy, it is pertinent that one explores how a particular country's bank merger policy intersects with at least its respective monetary policy, prudential regulation and supervision policy, as well as its competition policy (if any), and other policy fields such as foreign policy, trade policy, and foreign direct investment policy.

To be sure, although inter-related, these policy fields have distinct (sometimes conflicting) objectives, (overlapping) modes of delivery, instruments, and institutional arenas. Indeed, how these aspects are blended in a country's or jurisdiction's bank merger policy is what determines the uniqueness of a particular bank merger governance regime. Generally, the key objectives contained in bank merger policies include prudential (financial system stability, soundness, and integrity; as well as depositor and investor

protection) and increasingly market competition issues. In addition, many countries also tend to incorporate non-prudential, non-competition policy objectives (termed “public interest” objectives) in their merger policy regimes (OECD, 2000). These include equity considerations as well as concerns about concentration of economic and political power.

Depending on a country’s political structure and history, some of these policies may be formulated and executed at the national level while others may be administered at sub-national levels. Moreover, bank merger policies may be formulated and/or implemented/enforced by a few agencies or by multiple overlapping authorities. In other words, bank merger governance is best understood in the multi-realm, multi-actor framework advanced in the previous chapter.

In sum, the above discussion highlights the various dimensions around which bank mergers may be publicly governed. These dimensions are in turn framed and embedded within the countries’ financial system governance framework including its objectives, institutional arrangements, and regulatory and governance styles. Equally important is the fact that bank mergers are governed through a variety of instruments and governance modes. In short, the disparate bank merger policies around the world reflect the roles played by a country’s history, culture, political-economic, and legal system in shaping public governance systems. Indeed, the existence of a diversity of bank merger policies is a feature consistent with the prevalence of diverse financial systems embedded within the varieties of capitalist political economies articulated in the previous chapter.

3.4.2 Bank Mergers and Financial Consolidation: Key Policy Implications

Bank mergers and financial system consolidation in general have significant and pervasive policy implications (Berger, Demirgüç-Kunt, Levine & Haubrich, 2004; BIS, 1999b; Dermine, 2000; ILO, 2001; Peters & Donner, 1999; White, W., 1991; Wolgast, 2001). They raise concern for a number of reasons. To begin with, state authorities have reasonable grounds to be sceptical of claims regarding the ‘successes’ “of M&A transactions among financial firms” since a large body of research by academic economists and business consultants generally does not confirm the alleged benefits or rationales for such mergers (Wolgast, 2001:227). Indeed, empirical studies on bank-to-bank mergers in the U.S. and Europe indicate that the purported/expected post merger economies of scale and scope are – depending on the size of merging firms – minimal at best (Amel, Barnes, Panetta & Salleo, 2004; Berger & Humphrey, 1992; Berger, Leusner & Mingo, 1997; Hunter, Timme & Yang, 1990; Jagtiani, Nathan & Sick, 1995; Mathewson & Quigley, 1998; Noulas, Ray & Miller, 1990; Pilloff, 1996; Rhoades, 1994; SECOR, 2003; Shaffer, 1993; Tirtiroglu, Daniels & Tirtiroglu, 2005).

Second, bank mergers raise several serious concerns that public authorities cannot ignore, including fears of diminished levels of service, of higher fees, of disrupted banking relationships, of decreased credit availability (particularly for small businesses), loss of employment (directly and indirectly) and, of financial exclusion (hence, for instance, calls for community re-investment) (Beauchesne, 1999; Broaddus, 1998; Bruce, 2003; Carow, Kane & Narayanan, 2006; CFIB, 1998; Frieswick, 2004; Garmaise & Moskowitz, 2006; ILO, 2001; Keeton, 2001; Kerton, 2003; Libin, 2003; Peters & Donner, 1999; Scott & Dunkelberg, 2003; Starr, 2003; Tam, 1999; Watson, T., 2003). Consequently, rather than risk a reduction in the number of banking firms (and hence a

potential diminution of competition) public authorities are often disinclined to allow bank mergers to take place especially since the alleged benefits are apparently so uncertain.

From an economic point of view, financial integration and consolidation have both positive and negative macro-economic and micro-economic (structural) implications (White, W., 1991) that are inter-related. At a macro-economic level, financial consolidation affects monetary policy transmission mechanisms, payment and settlement systems, as well as fiscal policy management (G10, 2001; OECD, 2001b; White, W., 1991). Moreover, as discussed in Chapter 2, financial systems can have a direct bearing on economic growth and development (Dymski, Epstein and Pollin, 1993; Goldsmith, 1969, 1987; Levine, 1997; Shearer, Chant & Bond, 1995). Policy-makers are right, therefore, to pay close attention to financial sector consolidation as countries struggle for comparative/competitive economic advantage in this era of globalization when the role and management of the financial services sector becomes even more central since its growing rise and volatility affects its ability to mobilize and channel funds productively to other sectors (Moran, 1991). Ultimately, "in this struggle for comparative advantage state agencies are key actors" (Moran, 1991:5) because:

... states dispose of one critical resource -- the system of regulation itself. The extent, form, and purpose of state intervention is the single most important feature of any system of financial regulation; and this system is itself a source of comparative advantage, or of disadvantage (Moran, 1991:6).

To be sure, the state's interest in the economic impact of financial consolidation is ultimately rooted in the fact that financial markets play the crucial role of supplying investment funds to all other sectors of the economy (and to the state itself) and are therefore a source of employment and prosperity. In other words, financial institutions are crucial in that they provide credit to other sectors that in turn provide employment opportunities as

well as being major employers in their own right (ILO, 2001:4; Moran, 1991:5). Given these broad economic and social ramifications of financial system consolidation, the ILO documents a number of issues of concern associated with contemporary M&As in the financial sector including, direct job losses as well as their impact on the growth of non-standard forms of employment (part-time, temporary, or contingent), on remuneration and other compensation issues, on changing patterns of work-time, on stress and de-motivation, on job insecurity as well as on the financial exclusion of some communities and, on the denationalization of finance (ILO, 2001).

Furthermore, changes in the financial system are also of significant interest to politicians, policy makers and regulators because as Moran (1991:13) writes:

The financial services revolution has an economic face, but it also has a political face. It amounts to more than a set of changes in ownership structures, and trading practices; it also involves a series of changes in the rules governing those structures and practices. In brief, it is a revolution in *regulation* (emphasis in original).

In fact, the revolution goes beyond regulation as manifested in various dimensions of the state's involvement in the financial sector. To be sure, state interest and involvement in the financial sector -- in various forms and degrees -- has always been prominent. Indeed, history has shown that the role of the state has been paramount in the emergence and development of financial systems around the world. As Sylla, Tilly and Tortella (1999:1) observe:

The more one studies the historical origins and development of modern financial systems, the more it becomes apparent that at most of the critical points when financial systems changed, sometimes for better and sometimes for worse, the role of the state was of paramount importance. That is hardly surprising. Long before private economic entities -- trading, transportation and manufacturing enterprises may be cited -- came to require financing on a scale beyond the capabilities of individual proprietors and partners, governments had needs for large-scale finance.

These governmental needs for large-scale finance are due to a variety of reasons. For example,

The most durable reasons for these needs involved the political ambitions of governments: solidifying and extending their authority, unifying the disparate components of their states under a central administration, promoting state-led and state-financed economic development projects as a means of increasing state power, and, perhaps most important of all, waging wars against other competing states (Sylla, Tilly & Tortella, 1999:1).

Also worth noting is that, despite its seemingly technical nature banking has always been intensely political. As Rosenbluth and Schaap (2003:307) have noted,

...politicians do care about banking at a very basic level: in good times, banks can be profitable businesses that make large campaign contributions; in bad times, bank failures can get politicians into electoral hot water. Whether politicians like it or not, they are forced to make trade-offs between the well-being of banks and of bank customers.

It is against such a backdrop that we will briefly examine below the pertinent issues raised by changing financial structures, increased innovation and risk, ascendancy of non-bank intermediaries and the resulting enhanced competition as well as the emergence of financial conglomerates and the increased internationalization of financial markets. Moreover, we will examine these issues in the context of their impact on monetary policy, prudential regulation and supervision, and on competition policy, with a particular eye on how these in turn, have helped to shape public policy on bank mergers.

(a) Monetary Policy and Payment Systems Implications

With regard to monetary policy, at least two issues stand out as being directly related to contemporary changes in financial markets, viz.: the changing role of financial players and the changing nature of various policy indicators (BIS, 1999b; White, W., 1991). Both

have implications for the mechanisms of monetary policy transmission in that a higher degree of financial integration “does affect the channels through which monetary policy acts in the pursuit of its objective” of securing price stability and of protecting the value of money (White, W., 1991:10).

To the extent that money is created and circulated by the financial system, governments (mostly through central banks) employ monetary policy in their pursuit of macroeconomic objectives. To conduct monetary policy central banks use a variety of approaches and mechanisms, most of which rely heavily on financial institutions, especially the banks (Shearer, Chant & Bond, 1995). Consequently, financial consolidation has the potential to “alter the channels through which the monetary transmission mechanism links monetary policy actions to the rest of the economy” (G10, 2001: 4). Thus, it could for instance, reduce competition in financial markets, thereby “increasing the cost of liquidity for some firms, impeding the arbitrage of interest rates between markets” (G10, 2001: 4). Similarly, a “reduction in the number of institutions providing payment and settlement services below a certain level might result in higher prices and lower incentives for innovation” (G10, 2001: 6).

Bank mergers are therefore of special interest to monetary authorities since they can potentially affect the supply of money and alter monetary transmission mechanisms (BIS, 1999b; White, W., 1991). To be sure, this “interest” does not necessarily imply that monetary authorities (e.g., the central bank) will always be given the responsibility to review and/or authorize bank merger proposals. Thus, although in some countries (e.g., France and the U.S.), the central bank does indeed have such a mandate to review and approve bank mergers, in others (e.g., Canada) it does not have much say on the matter, except indirectly (OECD, 2000).

(b) Implications for Prudential Regulation and Supervision

Financial consolidation raises a number of issues of direct relevance to the prudential regulation and supervision of financial systems (White, W., 1991). While financial consolidation may have some favourable effects, such as the reduced cost of some financial services and the spread of innovative instruments some of which could be helpful in hedging risks, the negative effects often seem to outweigh these positive effects (White, W., 1991; see also Lamfalussy, 2000). These effects, in turn, help to shape bank merger policies.

It is now widely agreed that, structurally, bank mergers (and financial consolidation in general) affect the relationships among financial actors and have an impact on systemic risk. Dermine (2000:410), for example, observes that bank mergers raise at least four concerns, viz.: “investor protection, systemic stability, concentration and lending to small and medium sized firms, and the competitiveness of national financial institutions.” In the same vein, Michael Wolgast notes that “bank supervisors are concerned that the process of consolidation might have a negative impact on the stability of the financial system” (Wolgast, 2001:227). This is in part because of “the fear that liquidity in interbank markets might shrink given the diminishing number of market participants and ever more netting within the larger financial institutions”(Wolgast, 2001:227), which leads him to conclude that:

...the current reorganization of the industry, and especially the increase both in cross-border M&As as well as in transactions across financial sectors have important implications for bank supervisors, since the existing structures of financial supervision might very soon turn out to be inadequate, given the large and unprecedented structural changes in the financial industry (Wolgast, 2001:227).

Many now believe that systemic risks (new and old) have increased due to fierce competition, declining profits margins, and the intensification of market linkages leading them to interact “in new ways that are not yet fully understood” (White, W., 1991:6; see also Lamfalussy, 2000). Meanwhile, financial consolidation has increased the demand for a “level playing field” among the financial sub-sectors as financial institutions branch out into each other’s businesses, blurring boundaries between financial sub-sectors (pillars) while all financial actors, in pressing for “fair” treatment, demand greater harmonization of national rules and standards.

These challenges and demands should be viewed within a context of increasing pressure on the very objectives of financial system governance including: (a) maintenance of confidence in financial systems, markets and institutions through the protection of systemic stability, institutional soundness and market integrity; (b) protection of the interests of financial service consumers and investors; (c) maintenance and promotion of international competitiveness; (d) consideration of certain social objectives such as the encouragement of the widespread and fair direction of credit allocation, the prevention of an undue concentration of power, and the promotion and safeguarding of domestic ownership while ensuring that foreign ownership of financial institutions (if and when permitted) works in the national interest, and (e) prevention of and combating domestic and international crime (Chant, 1987; Dale, 1984; Le Pan, 1997; Shearer, Chant & Bond, 1995).

A close examination of the relationship between these various policy objectives and the dynamics of financial consolidation (and of bank mergers in particular) reveals that M&As have a direct bearing on the risk taking behaviour of financial firms with potentially serious ramifications for financial system stability and soundness. The main channels of

systemic risk pertain to the increased integration of financial products and markets, decline of traditional banking and the ascendancy of non-bank intermediaries, enhanced competition brought about by enhanced internationalization of financial markets, and the rise of financial conglomerates.

To begin with, increased financial product integration adds to the complexity of financial operations and of the financial system in general, altering the risk characteristics of all financial transactions as product integration leads to the introduction of ever new and adapted products not within the purview of existing regulations.

Second, financial consolidation and interdependence may serve “to accentuate the potential role of payment and settlement systems in the transmission of contagion effects” (G10, 2001:6) since “volatility due to exogenous factors will be transmitted across borders disrupting national economies including sudden and large scale layoffs and social disruptions” (OECD, 2001b:113).

Third, as the boundaries between the financial institutions become increasingly blurred, the systemic dimension to regulation and supervision can no longer be exclusively or even primarily, focused on banking (Goodhart, Hartmann, Llewellyn, Rojas-Suarez & Weisbrod, 1998:143). Thus, as merged financial institutions (e.g., financial conglomerates) end up being regulated and supervised by various industrial/sectoral regulators -- most of whom are not designed or equipped to fulfill the new roles thrust upon them -- serious gaps, loopholes, and inconsistencies in regulatory regimes become endemic and unmasked. As Goodhart, Hartmann, Llewellyn, Rojas-Suarez and Weisbrod (1998:143) have observed:

The emergence of financial conglomerates has challenged traditional demarcations between regulatory agencies and has made the business of regulation more complex. A particular issue is whether a structure based on

specialist agencies supervising different parts of the business of financial conglomerates might lose sight of the institution as a whole.

Thus, they conclude:

In general, the emergence of financial conglomerates and the increasing international dimension to financial operations of regulated institutions have combined to challenge some of the traditional assumptions about the institutional structure of financial regulation and supervision (Goodhart et al., 1998: 143).

To the extent that firewalls can be breached and history has demonstrated that they can melt under pressure, the expanding scope of banking (and financial conglomerate) operations runs the risk of increasing system fragility and thereby compromising the financial system's stability and integrity. This is a prospect that has far-reaching implications for the public purse since public authorities (e.g., deposit insurance schemes) will probably have to come to the rescue of depositors and investors, especially if bank mergers lead to "too-big-to-discipline-adequately" and "too-big-to-fail" syndromes (Carow, Kane & Narayanan, 2006; Thakor, 1997).

Furthermore, there is a concern that the rise in conglomerate banking will have a negative impact on financial innovation (Thakor, 1997). This may in turn have serious implications on a number of levels including potential limitations on accessibility to financial services, enhancing financial efficiency, and international competitiveness.

In addition to the above concerns, the consolidation of financial institutions has implications at the international level that are of concern to public authorities in at least three aspects. First, "the increasing internationalisation of financial operations has accentuated the international dimension to regulation, which in turn has implications for the institutional structure of agencies at both national and international levels" (Goodhart et al., 1998:143). Moreover, the rise in cross-border M&As has meant an increase in

governance of financial systems by hitherto disparate national and international regulators. These tendencies have enhanced the tensions among regulators as demands for “market access”, “national treatment” and “reciprocity” continue to intensify (see Simmons, 2001; White, L., 1994); which in turn has increased the frequently heard calls for more coordination and collaboration among regulators, for example, the call for consolidated supervision (Goodhart et al., 1998:144).

In short, financial consolidation and bank mergers in particular have important implications for the way in which the sector is regulated. And, as Freedman and Goodlet (1998:26) aptly observe:

Just as financial institutions are trying to develop their strategic directions, policy-makers are grappling with the nature and type of regulation that would function best in the evolving financial landscape, with financial institutions developing into conglomerates, non-regulated firms competing increasingly with regulated financial firms, and international operations becoming ever more important for large financial institutions. From a broader perspective, policy-makers also have to worry about such issues as competition, the appropriateness of commercial-financial linkages, and the relative reliance to be placed on disclosure and market discipline as opposed to direct supervision.

Indeed, these developments all point to a clear outcome: prudential regulation and supervision in this era of globalization have become more and more challenging in the face of the continuing re-integration of financial services, increases in the size and scope of firms including their expanded geographic scope (nationally and globally), the increasing sophistication of financial instruments, and the growing complexity of financial organizations and their operations.

In sum, bank mergers are of serious concern to prudential regulators and policy-makers in general, for they pose a challenge to financial system stability and soundness which in turn tends to create tensions with extant regulations, institutional arrangements,

as well as with relations amongst regulators and regulatory regimes across financial industries and across nations. Hence, the demands and pressures for policy change, and the calls for the harmonization of rules and standards across financial industries -- within and across nations -- which ironically tends to intensify the pressure for consolidation.

(c) Competition Policy Implications

In addition to the monetary policy implications and the prudential concerns, financial consolidation also has significant and obvious implications for competition (anti-trust) policy understood as encompassing “measures designed either to promote a competitive environment or to prevent a reduction in competition” (Ferguson, 1988:123). And, increasingly of late, competition policy concerns have helped to shape bank merger policies.

Here it is worth noting that, until recently, banks in many countries have not been subject to competition policy but that there is currently a trend in many jurisdictions to apply competition (anti-trust) policy to the financial sector in general and to bank mergers and acquisitions in particular (Cranston, 2002). For example, in Canada, this is a recent development, since before 1986 banking as a regulated sector, was effectively exempted from competition legislation under the “regulated industry defence” (Stewart, 1982; Trebilcock, Winter, Collins & Iacabucci, 2002). And, in other countries this change came even later, if at all. For instance, in the year 2000, the OECD was able to report that “bank mergers are exempt from application of France’s competition law and formal review by its competition authorities” (OECD, 2000:53).

In those jurisdictions where competition (anti-trust) policy has been applied to banks (or to financial services in general), it has usually focussed on several key aspects,

including the control of certain business conduct or behaviour and/or the ability of certain financial institutions to merge. However, the standards applied to such mergers and acquisitions do vary from one jurisdiction to another. While in some jurisdictions, standards appear to be derived from more general competition policy (e.g. European Union) when those general standards are applied to banking and other financial and non-financial firms, in other jurisdictions those standards have been specifically tailored to banking (albeit patterned in the main on general competition standards) as in the case of the Bank Merger Act (1960) and the Bank Holding Company Act (1956) of the United States (Cranston, 2002:16).

To appreciate the nuances of these differences we need to recognize that general competition policies (where they exist) also differ among countries and continue to evolve over time. Moreover, they differ along a number of dimensions including: (a) underlying philosophies, (b) economic paradigms, (c) enforcement models, (d) substantive focus, and, (e) procedural aspects (Boner & Krueger, 1991; Marsden & Sharma, 1996). In short, since general competition policies differ among jurisdictions it should not come as a surprise that their application to (and impact on) the banking sector should also differ significantly.

In fact, competition policies can affect financial markets and the broader economy in several ways in that financial consolidation, by increasing market concentration, may result in (a) efficiency losses; (b) abuses of market power or dominant positions to arbitrarily limit or skew access to finance, thereby negatively affecting certain consumers, investors, and small businesses (Thakor, 1997); and (c) enhanced political power by economic elites (Rhoades, 1983).

Not surprisingly, different jurisdictions have dealt differently with these concerns. These differences have, in turn, raised issues of international regulatory cooperation especially as the OECD (2001b:117) has noted:

The size and complexity of cross border M&As and alliances, and the multiplicity of competition law regimes world-wide clearly increase uncertainty and the transaction costs imposed on business, owing, for example, to the need for multi-jurisdictional review.

Thus, the increase in uncertainty and transaction cost has led to the often-heard refrain about cross-national policy harmonization. This call has become louder as several countries have gone about instituting competition policies in their respective jurisdictions (Addy, 1995; Jordan & Majnoni, 2003; OECD, 1994, 2000; Waverman, Comanor & Goto, 1997; White, L., 1994).

(d) Other Policies

Space does not allow us to go into details but suffice it to note here the following examples on how bank merger governance is potentially impacted by other policies and vice versa. First, social policy has direct and indirect implications on how bank mergers are governed. Transition issues such as concerns of labour (layoffs and unemployment) may help shape bank merger policy in significant ways in the sense that policymakers may be loath to permit bank mergers for fear of public backlash and loss of legitimacy (ILO, 2001). Likewise, concerns about bank service accessibility, especially by low-income individuals and small businesses, may also influence bank merger policy in the sense that bank merger proposals may be denied if access to banking services would likely be negatively impacted were the merger transaction allowed to proceed.

Another notable public policy that has a direct bearing on bank merger policy is a country's trade policy. For instance, trade liberalization in financial services may require a redesigning of domestic merger policy consistent with the principles of non-discrimination, notably, "national treatment" and "most-favoured-nation (MFN) treatment" as is the case with the NAFTA and GATS (WTO) treaty provisions. The principle of "national treatment" requires that foreign financial service providers be treated at par with domestic providers with respect to market entry, investment powers including mergers and acquisitions, ownership rules, permissible business activities and geographic location, as well as rules on exit from the industry. The MFN treatment, on the other hand, precludes situations when a particular foreign financial service provider could be accorded preferential treatment in areas beyond those granted to or open to providers from other jurisdictions or countries.

It is, however, also worth noting that although the purchase of financial services abroad by domestic consumers/customers (i.e., cross-border trade in financial services) and/or the presence of foreign providers may potentially enhance competition and efficiency as well as potentially improve variety and quality of financial services and products, trade liberalization in financial services has its own drawbacks and challenges (see Tamirisa, Sorsa, Bannister, McDonald & Wieczorek, 2000). Pertinently, cross-border trade in financial services may increase competitive pressures on domestic banks, which in turn may motivate the banking community to demand changes in the rules pertaining to mergers and acquisitions, as well as on strategic alliances. The entry of foreign providers also brings with it its own governance challenges. To begin with, liberalization in financial services trade expands and speeds up the encounters among financial regulatory authorities internationally – the upshot of which is, among other

things, the demands -- by both domestic and foreign providers -- for “level playing fields”, and by pressures for harmonization of regulations and supervisory standards (see Tamirisa et al., 2000). Moreover, as Tamirisa et al. (2000:4) have observed:

Allowing foreign financial services providers to enter domestic markets via local presence requires removing barriers to direct investment and thus could raise strategic and cultural concerns about foreign ownership in the financial sector. It also brings sectoral concerns about the quality and soundness of foreign entrants, and the possibility that they would engage in “cherry-picking” in the most profitable segments of the market or would drive domestic providers “up the risk curve”.

Furthermore, the entry of foreign providers may also potentially increase risks in the payment and settlement system (Tamirisa et al., 2000:4). Thus, given these concerns, trade liberalization has invariably been accompanied by a re-regulation of the financial sector, including the redesigning of bank merger policy. For instance, to better govern bank mergers and acquisitions in the context of a liberalized environment, the state may redesign (as Canada did after signing the CUSFTA, NAFTA, and GATS) rules pertaining to foreign ownership of banks, and business and investment powers distinguishing between: (a) foreign banks owned by residents of NAFTA member countries versus banks owned by residents of non-NAFTA member countries; and, (b) banks owned by residents of WTO member countries versus banks owned by residents of non-WTO member countries). As we will discuss in Chapter 5, in accordance with its commitments under the NAFTA and the WTO, Canada has recently had to redesign its rules pertaining to how much ownership stake foreign firms could take in domestic financial institutions, as well as on the permissible size of their firms and operations, type of organization (subsidiary, branch, etc), business and investment powers, and mode of entry. Of course, while doing so it accorded financial institutions owned by residents of the U.S. and

Mexico preferential treatment pursuant to the NAFTA treaty provisions, without violating the WTO rules.

Lastly, bank merger policy is also shaped by domestic laws pertaining to securities primarily because these laws regulate the orderly transfer of ownership by, for instance, providing for rules that require greater information disclosure by firms so as to enable stockholders of targeted firms as well as acquiring firms to make informed decisions and to protect the value of their properties (Gaughan, 2002). Securities laws could be enacted and enforced at the national (federal) level as in the U.S. or at the provincial level as is currently the case in Canada.

In sum, the policies and laws discussed in this section (including those pertaining to monetary policy, prudential regulation and supervision, competition, social, and trade policies as well as securities laws), whether explicitly reflected or incorporated into the bank merger policy statutes or not, illustrate some of the multi-dimensional policy implications of financial consolidation and most importantly the need for parties to merger transactions to recognize and abide with these policies and laws. All in all, such conceptual mapping helps us to present a reasonably holistic interpretation of public policy on financial system consolidation. Indeed, such a perspective is crucial in understanding the key patterns and dynamics of bank merger policy transformation. It is to this aspect that we now turn.

3.5 Comparative Bank Merger Policy Transformation

Public policies, examined through a comparative lens (i.e., a comparison of corresponding policies of two or more jurisdictions) may encompass an analysis of “national to national” (e.g., Canadian federal policy on bank mergers vs. its U.S.

counterpart), “national to sub-national” (U.S. federal policy vs. state policies on bank mergers), “sub-national to sub-national” (state policies e.g., Texas vs. New York bank merger policy), or “national to supra-national comparisons” (e.g., Canadian or American policy vs. EU policy on bank mergers) just to mention a few possibilities.

These comparisons could be conducted in at least two ways, namely, comparison of bank merger policies: (a) at a particular point in time (similarities versus dissimilarities) (e.g., Canadian vs. U.S. bank merger policy as they currently exist), and (b) over a given period of observation (e.g., from the 1970s to the present).

In this study our focus is on national-national policies examined (compared) over a specified period of time (1970s to 2005). That is, Canadian and U.S. bank merger policies will be comparatively examined to discern whether there are significant tendencies of convergence and/or non-divergence (including parallel trajectories). The study therefore consists of a cross-national comparison to discern patterns in bank merger policy change, trajectories and dynamics within the context of globalization and regionalism.

To effectively apprehend the nature and substance (patterns and dynamics) of changes in bank merger policy it is necessary to have a firm grasp of the historical evolution of the bank merger policies under examination. Approaching it this way demands that we have a clear notion of what public policy transformation means.

To begin with, it is best to view public policies as a set of dynamic processes – exhibiting both stability and change. In effect, change is ongoing with changes ranging from minor/miniscule to radical. Moreover, not all changes, even if apparently on the same scale, are of the same type or significance (Hogwood, 1992:17). Consequently, any attempt to understand the evolution of bank merger policy must begin by delineating the changes

within the context of a certain understanding of the magnitude and significance of certain types and directions of policy change because as James Rosenau (1989:16) contends:

... without a conception of what constitutes meaningful changes, as distinguished from temporary or minor fluctuations, we are likely to be overwhelmed by the welter of activities that sustain world affairs. Without a conception of when the complexities and dynamism of world politics give rise to enduring changes and when they merely reinforce existing continuities, we may too readily presume that nothing remains constant and thus overlook how the endless tensions between past and present can often result as much in stalemate as in transformation.

This, then, raises the critical question of how to delineate and measure changes in bank merger policy, given that public policy processes are complex in nature and that “some aspects of policy change are subjectively defined”? (Radaelli, 1997:555; see also March & Olsen, 1995:119). Notwithstanding the difficulties involved, and as is familiar to students of public policy, policy change has been characterized in a number of different ways -- ranging from simple descriptions to complex models (Sabatier, 1999). Moreover, while some characterizations are based on a simple listing of the potential dimensions of change, others are based on estimates of the scope, depth and significance of change. Some distinguish between volitional (planned) versus organic (unplanned/spontaneous) change (Dallago, Brezinski & Andreff, 1992). Further still, some differentiate between quantitative and qualitative changes, while others combine the above characterizations in one way or another with some conceptions of the inner dynamics of policy change (Doern, Pal & Tomlin, 1996; Hall, P., 1993; Hogwood & Peters, 1983; Hogwood, 1992; Radaelli, 2003).

For our purposes, we take the view that policy changes can be both quantitative and qualitative. Quantitative changes are best exemplified by changes in budgetary allocations and spending, number of clients served, number of regulatory agencies, etc. (Hogwood, 1992), while qualitatively, policy change may encompass change in objectives and policy

styles just to mention a couple of examples. Secondly, policy change analysis entails not only discerning what elements of a particular policy have changed but also ascertaining the type, scope (depth and breath), trajectory and significance of that change. We find Peter Hall's (1993) framework to be useful in distinguishing between minor and major policy changes. On the basis of changes in the settings of governing instruments, changes in instruments themselves, and changes in policy goals, Hall (1993:278-9) identifies three types of policy change:

- (i) **first order change:** "whereby instrument settings are changed in the light of experience and new knowledge, while the overall goals and instruments of policy remain the same";
- (ii) **second order change:** "when the instruments of policy as well as their settings are altered in response to past experience though the overall goals of policy remain the same"; and,
- (iii) **third order change:** which entails "simultaneous changes in all three components of policy: the instrument settings, the instruments themselves, and the hierarchy of goals behind policy."

The above taxonomy is helpful in distinguishing minor policy changes from major changes. Minor policy change is represented by first-order change while radical, multi-dimensional change is best represented by third-order change. It should be noted that these types of change do not in themselves determine policy convergence as convergence may also depend on how far or different two or more policies are. While in some cases convergence may require a third order change (in one or two policies), in other instances, a first order change may very well bring about policy convergence (see Knill, 2005).

Furthermore, as most analysts have emphasized, understanding policy change involves considering the importance of time. Time is a central concept because the direction, the pattern, and the scale of public policy change, to borrow a phrase from Richard Rose, "is revealed only in the course of time" (Rose, 1984:31). For, "Whereas it is not always easy to disentangle cause and effect in the analysis of contemporary conditions, one can be certain about their temporal priority. Action taken yesterday can influence government today, but the opposite cannot be the case" (Rose, 1984:31).

The temporal dimension is also crucial for several other reasons. First, policies take time to change. Secondly, viewing policy transformation from a temporal perspective allows us to consider the significance of the velocity or speed of policy change. Thirdly, with time most social factors are variable. As such, whatever factors might today cause or block policy change, these may not continue to do so because with time the entire policy environment changes so that these same factors will affect policy differently in the future (Rose, 1993). In other words, over time policy outcomes are always uncertain and therefore unpredictable. Methodologically, selecting a timeframe is therefore important because it helps to delimit the period in which a policy and its effect(s) are to be examined. A change in the timeframe may always result in a change in study results.

Furthermore, viewed temporally, all change possesses a morphology or trend. Dodgshon (1998:47-49) distinguishes three types:

- (i) change that unfolds continuously or gradually -- smooth linear curve;
- (ii) change that unfolds discontinuously as a broken trend "one that involves revolutionary moments, knickpoints, punctuated equilibrium, non-linear processes, bifurcation points, dissipative structures, catastrophic collapses or sudden upward/downward surges"; and,

- (iii) “a trend that captures the three-dimensional nature of societal change, highlighting the fact that it works itself out through space as well as time.”

Lastly, but not least, a temporal understanding of policy processes permits us to examine changes in relation to past, current and future policy circumstances. In this regard, Hogwood and Peters (1983:20-25) provide a useful guide (consisting of four different ideal types of policy change). First, policy changes that involve the government entering into new areas in which it had not previously been involved (i.e., policy innovation). Second, policy change that involves the replacement of existing policy by one or more different policies in the same area of activity -- this can involve linear succession, policy consolidation, policy splitting, partial termination, non-linear succession, and incidental policy succession (i.e., policy succession). Third, policy change that involves minor changes to existing programs, e.g., addition of a new "clientele" or the dropping of some clientele, the geographical or jurisdictional expansion or retreat, the addition or reduction of a service, or changes in policy delivery methods/approaches (i.e., policy maintenance). Fourth, policy change that involves a repeal of relevant laws, a complete winding down of organizational structures, complete cessation of public expenditure on a policy, etc. (i.e., policy termination). To these four ideal-types Hogwood (1992) adds a fifth, namely: "policy reversal" (p. 20). According to Hogwood, "policy reversal" is a type of change that occurs, "when a government does not simply terminate a programme, but introduces a new one which has an objective in the opposite direction" (1992: 20). Worth adding to this list are (a) policy inertia (a situation of lack of change typified by forms of lags, delays or sheer resistance), and (b) policy retrenchment (Radaelli, 2003:37).

In sum, taking comparative public policy as a dynamic process permits us to examine policy transformation spatially and temporally as well as quantitatively and qualitatively. Examined spatially, our approach allows us to compare similar policies across jurisdictions even as they continue to change. Viewed temporally, public policy analysis involves an examination of a particular policy with respect to past, present and future policy circumstances and context as well as with respect to the evolution of key policy inputs and ramifications.

3.6 Conclusion

To introduce this study's subject matter we began by conceptualizing the notion of financial system consolidation so as to delineate the key dimensions that could then be usefully applied in conceptualizing public policy on financial consolidation and bank merger policy in particular. Having done so, we then briefly examined the recent patterns of bank mergers and explored the various rationales for contemporary bank mergers and acquisitions. This was necessary because a clear understanding of the various rationales for bank mergers and acquisitions will help us comprehend the private and public impulses for promoting and/or regulating bank mergers and acquisitions.

Thereafter, we presented our particular understanding of public policy on financial system consolidation. The earlier conceptualization of financial consolidation and the preceding discussion on the rationales for bank mergers had underscored the point that the effects of financial consolidation cut across a large number of interdependent policy dimensions. This insight established a basis for framing bank merger policy within the broader context of public policy on financial consolidation occurring against a backdrop of other significant changes in financial systems -- changes

whose actual and potential effects were viewed as varied and dynamic with wide-ranging implications for policy-making.

In the discussion, bank merger policy was shown to lie at the intersection of, at least, three policy fields, viz.: prudential regulation and supervision, monetary policy, and competition (anti-trust) policy. It was also argued that with the increasing internationalization of banking activities, bank merger policy was increasingly touching on international trade policy issues especially as they pertain to matters of market access, ownership rules, treatment of foreign investors, national sovereignty and policy autonomy.

The implications of financial consolidation on these various policies and vice versa were then discussed. These issues were by and large examined within the context of the key purposes of financial regulation and governance including the need to ensure financial system stability and soundness, consumer and investor protection, as well as efficiency and equity considerations (BIS, 1999a; Dermine, 2000; G10, 2001; Santomero, 1999; White, W., 1991). Read together with the rationales advanced for bank mergers and acquisitions presented earlier, the discussion highlights the contested nature of bank merger governance.

Lastly, we focussed on the comparative analysis of public policies, differentiating comparisons of public policies at given points in time, from those comparing them over a period of time in order to discern, inter alia, patterns of policy change, the sources and dynamics of change, policy implementation, and policy impacts, consequences and ramifications.

In sum, this introduction has not only sought to clarify our understanding of two key concepts, namely those of financial consolidation and of public policy on bank

mergers, but it has also sought to outline our approach to the analysis of comparative bank merger policy transformation. This approach will be developed further in the next chapter dealing more formally with the analytical framework of this study.

Chapter 4: Bank Merger Policy Convergence and/or Divergence: An Analytical Framework

4.1 Introduction

Drawing on the diverse range of perspectives and insights delineated in the two preceding chapters, this chapter presents the framework of analysis that is to be applied in this study and that seeks to establish a wider vantage point from which to examine the evolution of Canadian policy on bank mergers vis-à-vis that of its American counterpart. The underlying approach is dynamic in the following sense. First, we assume that bank merger regimes are embedded within specific political-economic systems that are in turn embedded in a global system comprised of a variety of capitalist systems. Second, we assume that these diverse political economies are in an interactive mode with each other. Moreover, we assume that these systems are ever changing due to both internal and external dynamics.

Briefly, the analytical framework focuses on (and as such enables us to answer) three basic questions, viz.: (a) what is it that has changed in Canadian and U.S. policies on bank mergers, and what elements of the Canadian policy have converged on (or diverged from) the American model?, (b) What accounts for these changes?, and, (c) What is the significance of these changes? Accordingly, the framework is comprised of the following three analytically distinct yet inter-related elements, including the: (a) nature and substance of policy convergence and/or divergence; (b) dynamics of policy convergence and/or divergence; and, (c) significance and implications of policy convergence and/or divergence.

This chapter will proceed as follows. The next section will present a conceptual overview of convergence and divergence. The third section will discuss the nature and

substance of bank merger policy convergence and/or divergence. The main focus here will be on the substantive and procedural dimensions of bank merger policy as well as on policy formulation processes, implementation styles and policy impacts. The fourth section will then discuss the dynamics of bank merger policy convergence with the explicit aim of presenting a causal model of policy convergence or divergence capable of incorporating a diversity of forces including those of globalization and regionalism. In the fifth section, the chapter will explore some of the key implications of bank merger policy convergence. Lastly, closing remarks on the application of this framework will be made.

4.2 Convergence/Divergence: A Conceptual Overview

Social scientists have endowed the notion of “convergence” -- a recurrent theme within the social sciences -- with a “meaning overload” (Quah, 1999). In fact, it is used in various disciplines to denote different meanings (Dallago, Brezinski & Andreff, 1992). Kerr (1983) defines convergence as “the tendency of societies to grow more alike, to develop similarities in structures, processes, and performances”, while divergence is defined as a tendency of societies “to recede from one another, to develop greater dissimilarities in structures, processes, and performances” (p.3). As a process of becoming, convergence, by definition, entails a comparison of change patterns between two or more societies (jurisdictions) over at least two points in time (see Bennett, 1991:219; Dunning & Hopper, 1966:164-7; Seeliger, 1996:288). It is necessary to emphasize this point because the fact that two or more societal characteristics may be similar or different at any given point in time indicates nothing about their past or future patterns of change (see Dunning & Hopper, 1966:167). In short, convergence research

must focus not only on change patterns but also on temporal aspects of those change patterns. The temporal aspect of convergence is vital in that it sets the context within which observations can be interpreted. As Seeliger perceptively observes: "Convergence is a relative concept, and the shifting of time frames changes reference points, and thereby changes results" (Seeliger, 1996: 296). In other words, different time frames may yield different observations.

Furthermore, it is important to underline the fact that convergence (or divergence) need not necessarily occur simultaneously in all the three dimensions (i.e., structures, processes, and performance) delineated by Kerr (1983) above. This is particularly worthy of emphasis because convergence and divergence can be conceptualized in either broader (total/societal convergence) or narrower (partial convergence) terms (Dallago, Brezinski & Andreff, 1992; Inkeles, 1998). From a broader perspective, the focus of convergence studies is on entire societies as was the case in the 1960s/70s debates on the convergence between capitalism vs. communism (e.g., Goure, 1973; Tinbergen, 1959). Contemporaneously, this would also apply to studies such as those about the convergence of models of capitalism (e.g., the Rhine model vs. the Anglo-Saxon model) or convergence within models of capitalism (e.g., Canada vs. U.S. whereby both societies belong to the same Anglo-Saxon model). In other words, the study of convergence can focus on change patterns within a particular model, group of political economies or between models of capitalism. What is important to note, however, is that convergence can occur within a group or category with little or no convergence occurring between groups (i.e., dual convergence may not necessarily occur; see Inversen, Pontusson & Soskice, 2000: 3). For instance, convergence may occur among countries within the Anglo-Saxon model (or within the Rhine model for that matter) in the absence of convergence between different models,

that is, without there being any convergence, for example, between the Anglo-Saxon and the Rhine models.

In general, national studies comparing two or more countries necessarily make use of the broader notion of convergence in that the scope of analysis pertains to characteristics of a national society. However, studies from a meso- (e.g., sectoral), or micro-perspective, would employ the narrower concept since the focus would be restricted to certain elements of a social realm including the economic, social, cultural or political domains. For instance, Inkeles (an early proponent of convergence theory in the 1960/70s), identifies the following elements in which partial convergence might be expected to occur: (a) modes of production and patterns of resource utilization; (b) institutional arrays, forms, and processes; (c) structure and patterns of social relationships; (d) systems of popular attitudes, values, and behaviour; and, (e) systems of political and economic control (Inkeles, 1998: 23).

In this view, the comparison of public policies of two or more jurisdictions would be considered within this narrow conception of convergence. Public policy convergence defined as “any increase in the similarity between one or more characteristics of a certain policy (e.g. policy objectives, policy instruments, policy settings) across a given set of political jurisdictions (supranational institutions, states, regions, local authorities) over a given period of time” (Knill, 2005:768).

As will be further elaborated in the next section, this study will broadly follow the above conception of convergence to compare public policies pertaining to federal level financial regulation in two countries (Canada and the U.S.) belonging to the same Anglo-Saxon model of capitalism. Within that context it will focus specifically on convergence -

- or its absence – with respect to bank merger policy, broadly defined within this distinct model of capitalism.

Beyond adopting a narrow (yet deeper) focus of convergence, the study will endeavour not to conflate Colin Hay's (2000:514) four rather different senses of convergence, namely:

- (1) **Input convergence:** convergence of "pressures and constraints placed upon a particular political economy";
- (2) **Policy convergence:** convergence of "policies pursued by (or the paradigms informing) particular states";
- (3) **Output convergence:** convergence of "consequences, effects and outcomes of particular policies"; and
- (4) **Process convergence:** convergence of "processes sustaining the developmental trajectories of particular states."

It is necessary to make the above distinctions since "input convergence need not imply policy convergence, policy convergence need not imply output convergence, and output convergence need not imply process convergence (as, for instance, in most neoclassical-inspired accounts)" (Hay, 2000: 514). Moreover, the distinction between input convergence and output convergence serves as a reminder that: "Common pressures produce ...divergent tendencies by virtue of their institutional mediation" (Hay, 2000:514). Just as the distinction between policy convergence and outcome convergence points to the fact that "institutional specificities (the distinctiveness of national capitalisms) dictate that policy convergence ... need not dictate a convergence in outcomes" (Hay, 2000: 514-5), while the distinction between "aggregate output convergence with convergence in the process(es) precipitating such a tendency",

demonstrates that "different and, indeed, divergent processes may sustain convergent outcomes" (Hay, 2000: 515).

In summary, convergence in this study will be understood as a process of becoming, focussing primarily on a sectoral level of analysis (bank merger policy), while differentiating between input, policy, output, and process convergence. Moreover, the study will focus on a comparison between Canadian and American federal bank merger policies for the period between 1970s and 2005.

4.3 Bank Merger Policy Convergence/Divergence: Nature and Substance

In this study, we define convergence between the Canadian and U.S. policies on bank mergers as the growing similarity over time in a number of key dimensions of their public policies on bank mergers. In examining the transformation of these two countries' policies one would look out for at least three tendencies. First, one would examine if there has been a growing similarity in those policy aspects that may have been dissimilar at the beginning of the study period. Second, one would observe if there have been any divergent trends for those aspects that were similar at the initial period of examination. Third, one would also look out for any patterns of parallel trajectory trends.

Last, but not least, this comparative examination of changes in bank merger policies will focus on multiple realms, actors and processes as discussed in chapters 2 and 3 -- consistent with the notion of multi-layered governance of the financial system. Accordingly, to effectively apprehend the patterns and trends of policy change in the two countries and in order to determine whether Canadian and U.S. bank merger policies

have converged or diverged, we take as our point of departure, Bennett's (1991:218) fivefold framework of possible policy convergence, including:

- (a) **Policy goals** -- "a coming together of intent to deal with common policy problems";
- (b) **Policy content** -- "the more formal manifestations of government policy -- statutes, administrative rules, regulations, court decisions and so on";
- (c) **Policy instruments** -- "i.e. the institutional tools available to administer policy, whether regulatory, administrative or judicial";
- (d) **Policy outcomes, impacts or consequences** -- "the results (positive or negative, effective or ineffective) of implementation";
- (e) **Policy style** -- "a more diffuse notion signifying the process by which policy responses are formulated (consensual or conflictual, incremental or rational, anticipatory or reactive, corporatist or pluralist, etc.)."

The above distinctions are useful to the extent that we treat them as heuristic devices for as Bennett himself cautions, such distinctions:

... hardly represent sharply defined analytical categories. They tend to slice policy making into overly mechanistic and linear stages and are probably insensitive to the shifting and interactive processes of feedback that shape policy content. Moreover, in comparative analysis policies adopted by different governments frequently do not fit into the same conceptual categories (1991:218).

Bearing this in mind and with careful application, as many analysts have done, fruitful analysis can be realized from the adoption of Bennett's approach. In fact, several authors have applied and enriched Bennett's framework (e.g., Coleman, 1994b; Seeliger, 1996). For our purposes, drawing on Bennett's fivefold schema, the following (as elaborated

below) will form the core of the dimensions we will investigate in this study: (a) scope of bank merger policy, (b) bank merger policy objectives/goals, ideas, and discourse; (c) banking business and investment powers, and ownership rules; (d) bank merger review process, instruments and institutional configuration, (e) policy styles, and (f) policy impacts. But, before we undertake to examine whether there has been a tendency for convergence or divergence in any or all of these elements, it is necessary to establish that the jurisdictions under review do, indeed, actually have explicit bank merger policies. At first, blush this may sound trivial but it is crucial because not all jurisdictions have bank merger policies in place (OECD, 2000). In fact, as elaborated below, this could on its own be an element of convergence as various jurisdictions go about establishing bank merger regimes. We briefly discuss these elements next.

4.3.1 Existence of Bank Merger Regimes

To the extent that some countries have specific bank merger regimes and others do not, it seems logical to start by finding out if there has been a convergence in establishing bank merger regimes. In short, for the purposes of this study we first need to establish if Canada and the U.S. have specific bank merger regimes. And, if they do, under what statutes and rules are bank mergers controlled in the two countries? When did each develop its merger regime? Moreover, an examination of the principles and philosophies underpinning those merger regimes is crucial in facilitating a comparative investigation of such regimes. After establishing whether Canada and the U.S. do in fact have merger regimes, the next step then will be to determine/establish whether these bank merger regimes have been converging or not. To do so we will focus on the six aspects

delineated above. We begin with the analysis of trends in the scope of bank merger policies.

4.3.2 Scope of Bank Merger Policy

Convergence (or divergence) in the scope of bank merger policies can occur with regard to the following dimensions: (1) jurisdictional coverage, e.g., state vs. federal; national and/or extra-territorial application; (2) issues covered, e.g., a narrow focus on financial probity vs. a broader focus including competition issues and other aspects such as socio-economic accountability, employment and transition concerns, etc.; (3) rules regarding the type of transaction or method of merger, i.e., whether mergers are undertaken through purchase of shares, assets or exchange of shares, etc.; (4) rules pertaining to the size of merging firms (e.g., mergers among large banks may be prohibited while smaller banks may be allowed to do so); and, (5) the types of mergers (e.g., vertical, horizontal or conglomerate).

To the extent that bank merger policies are shaped at the intersection of multiple policy fields (refer to Chapter 3), convergence can potentially occur in several substantive aspects pertaining to these policies. For instance, convergence could occur with respect to how different authorities define: (a) what is a bank merger, and (b) relevant geographic and product markets. Defining what is a bank merger is crucial because what is considered a merger in one jurisdiction may not be deemed so in another. As such, a transaction may be subject to merger rules in one jurisdiction but regulated by other means elsewhere (OECD, 2000). In this regard, therefore, convergence would occur if two or more jurisdictions that originally defined bank mergers differently end up defining them similarly during the period under observation. Moreover, convergence

could occur with respect to how authorities treat joint venture cases and strategic alliances vis-à-vis merger transactions.

Secondly, determining relevant geographic and product markets, (i.e., market definition) is a vital technical exercise because the assessment of competitive effects of mergers crucially depends on how the relevant market is defined. Thus, convergence would occur if two or more authorities that originally defined relevant geographic and product markets differently end up defining them similarly during the period under observation.

Moreover, from a competition (anti-trust) policy perspective, convergence could occur with regard to how authorities assess the (potential) competitive effects of (proposed) merger transactions. In most cases the issue of concern is whether the proposed merger transactions would lessen competition substantially. In this respect, there can be a growing similarity in the types of measures or indicators used (e.g., market concentration) as well as on the threshold levels of the indicators considered to be most significant. Similarities could also arise in how the different regulatory bodies treat efficiency gains in merger transactions.

Also worth noting is that while the first three dimensions delineated above (i.e., jurisdictional coverage, issues covered, and rules on types of transactions) are relatively straight forward, the fourth is rather more complex such that within it policy convergence can happen along several dimensions depending on whether the proposed merger/acquisitions involves only banks or other types of financial institutions or even institutions from other economic sectors. And, whether the mergers involve: (a) consolidation within a particular domestic jurisdiction, or (b) mergers and acquisitions

linking units from different jurisdictions, public policy on bank mergers (and financial institution consolidations in general) must therefore be assessed separately for:

(1) Domestic consolidations including mergers:

- (a) within a financial industry/pillar i.e., horizontal mergers (e.g., mergers between banks, i.e., bank-bank mergers, or mergers between insurance firms, i.e., insurance-insurance mergers; but not between e.g., banks and insurance, etc.);
- (b) across financial industries (pillars) within the financial sector (e.g., mergers between banks and securities firms, or banks and insurance firms, etc); and,
- (c) across sectors (e.g., financial firm acquiring a non-financial firms and vice versa -- "upstream" or "downstream" links); and,

(2) Cross-border consolidation -- these would mirror the domestic alternatives but in this case the acquirer may be a domestic firm, while the target may be a foreign firm (outward M&As), or vice versa (inward M&As). Moreover, it is increasingly becoming evident that mergers could occur involving foreign-based parent firms, but having policy implications for a jurisdiction that may be hosting subsidiaries of the foreign merging parties/parents. (See Appendix 1.)

In looking for evidence of convergence in the scope of bank merger policy it is therefore necessary to examine change along each of these various dimensions.

Moreover, in each case a judgement must ultimately be made as to whether the evidence suggests significant convergence over time.

4.3.3 Policy Objectives/Goals, Ideas and Discourse

Convergence of bank merger policies could also take the form of increased similarity in the economic, political, and social objectives of the bank merger policies, including both stated and un-stated objectives of such policies.

Some of the main objectives that could become more commonly shared priorities might include the safeguarding of financial system integrity and stability, the promotion of competition and efficiency, the limited protection of consumers and investors, the restraint of concentration of economic power, and the safeguarding of some degree of domestic ownership.

Furthermore, convergence can also occur in policy discourse and ideas. Convergence in bank-merger policy discourse would happen when the language, ideas, concepts, and terminologies grow similar in two or more jurisdictions. Convergence or divergence of policy discourse is plausible because policy discourse changes over time. For instance, the OECD (1997) notes that, over the years, ideas surrounding financial services regulation have significantly changed whereby concepts such as “investor/depositor protection, avoidance of systemic risk, capital adequacy, portfolio balance, Chinese walls, the public interest and ensuring the efficacy of monetary policy – [have become] less dominant in the decisions surrounding liberalisation of financial systems in the OECD area” (OECD, 1997:39). Instead, “new” ideas such as “level playing field”, “regulatory transparency”, “market determined interest rates and credit allocation”, “market determined commissions”, etc., have become common (OECD, 1997:39). As such, an analysis of changes in ideas is significant because as the OECD (1997) notes, “in the earlier part of the twentieth century” the ideas then prevalent:

... had given rise to the particular structures of the financial services industries. Over time these structures were seen by the relevant private sector actors as providing them or their industry with a “property right” from which they reaped economic and political rents. This “property right” phenomenon made the process of formal adjustment and reform very difficult indeed. The financial industry, generally, was content to compete internationally on another country’s turf, but reluctant to loosen its oligopolistic grip on its national market (OECD, 1997:39).

As a key focus of this study, therefore, we will include an examination of the changes in discourse surrounding Canadian and American financial regulation in general and bank merger control in particular, as advocates and opponents of bank mergers endeavour to influence public policy formulation and implementation.

4.3.4 Banking Business and Investment Powers, and Ownership Rules

The parameters within which bank mergers and acquisitions may occur are to a large extent set by what banks are allowed to provide, invest in as well as by the rules on who can own banks (both domestic and foreign) and at what levels of ownership. As such, in order to determine whether Canadian and American bank merger policies were growing similar or dissimilar we will examine for each jurisdiction the evolution of the rules pertaining to permissible banking activities, investments and ownership rules over time.

4.3.5 Bank Merger Review, Policy Instruments and Institutional Configuration

Convergence may also occur with respect to the ways in which, and the jurisdictional levels at which bank merger proposals are subjected to review, the

instruments then employed in regulating them, and in the type of institutional configurations.

Thus, bank merger review procedures could become more similar in terms of: (a) triggering events and/or pre-merger requirements, such as pre-notification, exemptions, pre-merger filing and information requirements; (b) threshold levels for reporting transactions; (c) processing stages, time limits within which decisions must be reached by relevant regulatory authorities, and/or waiting periods before a transaction may be consummated, etc.; (d) transparency and confidentiality rules in relation to the exchange of information between the various agencies reviewing a single transaction; (e) the roles and powers of the various parties involved (including merging parties, regulatory authorities, competitors, interest groups, etc.); (f) the onus of the burden of proof; and, (g) remedies such as injunctions, orders of dissolution, and/or divestitures, remedies for injured parties, etc.

Bank merger policy convergence could also arise because of a growing similarity in the mix of preferred policy instruments in the different jurisdictions. Convergence in bank merger policy instruments may include a growing similarity (or dissimilarity in the case of divergence) in the use (or abandonment) of a particular instrument or in the instrument setting or mix; including such policy instruments as regulatory tools, taxation, public expenditure, public ownership, exhortation and moral suasion, etc. (recall Bennett, 1991; Hall, P., 1993). As such, convergence in bank merger policy content would include a growing similarity in a number of elements (e.g., statutes, administrative rules, regulations, court decisions, etc.). Convergence in this respect would mean "the process of applying increasingly similar rules to a given situation in different jurisdictions, and is closely related to the harmonization or approximation of laws" (Whitakker, 1996; cited in

Schooner & Taylor, 1999). That being said, a word of caution is in order here. Even if two or more countries or jurisdictions end up adopting a particular policy instrument, it is crucial that one be sensitive to the fact that these subject jurisdictions may in fact not be using the particular instrument in precisely the same way (see Jordan, 2005:948).

Lastly, convergence could occur with respect to how the institutions governing bank mergers are configured in the jurisdictions under examination. This is so because institutional arrangements and mechanisms for bank merger regulation/governance differ across countries/jurisdictions (OECD, 2000). For instance, in some jurisdictions bank mergers may be governed by a few agencies while in others they may be subject to multiple overlapping regulatory authorities. And, as discussed in Chapter 3, in some jurisdictions, some public agencies may have purview over bank mergers while in others they may not be involved, at least directly. Another dimension in bank merger control that shapes the nature of institutional arrangement is the role of competition policy. Where competition authorities have oversight powers, the institutional arrangement would reflect not only the involvement of bank regulators and competition (anti-trust authorities) but would also depict the nature of the enforcement model of the respective jurisdiction's competition (anti-trust) policy on banking. For instance, while in some countries competition policy enforcement is executed through a judicial framework (e.g., Germany, USA), in others enforcement is through an administrative/political system (e.g., Sweden, UK). Still, in other jurisdictions, enforcement is through a mixture of the two i.e., through a combined judicial and administrative/political model (e.g., Canada; recall Boner & Krueger, 1991; Marsden & Sharma, 1996).

As such, depending on the model adopted by a particular jurisdiction, the institutional arrangements and mechanisms may vary among jurisdictions; hence the

possibility of convergence or continued diversity of institutional configurations. In this respect, therefore, convergence is likely to occur with respect to the following institutional dimensions: (a) type and number of regulators; (b) enforcement model adopted; and, (c) relationship, mandate, and respective powers of the relevant regulators and decision-makers.

4.3.6 Policy Styles

The application of the notion “policy styles” (also regulatory styles) in comparative public policy analysis pre-dates Colin Bennett’s (1991) framework on policy convergence (e.g., Richardson, 1982; Vogel, D., 1986). Thus, in an edited collection of essays, Richardson (1982) and his colleagues explored the trajectory of policy styles in Western Europe in an effort to discern evidence of convergence. And, in the first chapter of the book, Richardson, Gustafson and Jordan (1982:3) defined policy styles as “the *main* characteristics of the ways in which a given society formulates and implements its public policies” (emphasis in the original), while acknowledging “that in any one society public policies are *always* formulated and implemented in a particular way. Even if a predominant style can be identified, exceptions will always occur” (p.3; emphasis in the original). After carefully considering the complexities of identifying predominant policy styles, they proposed a basic typology of policy styles based on a “government’s approach to problem-solving – often characterised in terms of the incrementalist/rationalist debate” (p.12); and on “a government’s relationship to other actors in the policy-making and implementing process” (i.e., consensus vs. imposition) (p.13).

The notion of policy styles was also applied by Vogel (1986) in the examination of the British and American national styles for environmental regulatory policies.

Conceptualizing policy style as approaches to regulation (in terms of state-business relationships), Vogel found that while each of the two systems may have had distinctive regulatory styles, their outcomes were on balance quite similar.

Some of the relevant studies undertaken subsequent to the formulation of Bennett's framework on policy convergence include work by Coleman (1994b) and Kagan (2000a). Coleman, in examining the relationship between global economic integration and policy convergence had focused on policy styles and modes of decision-making with respect to banking in five countries (including Canada, France, Germany, the UK and the USA). In doing so he had refined Bennett's concept of policy styles by distinguishing between "patterns of inclusion and exclusion in the policy community, and the structure of policy networks within that community", where a policy community includes "all actors or potential actors with a direct or indirect interest in a policy area or function who share a common 'policy focus' and who, with varying degrees of influence, shape policy outcomes over the long run", while a policy network describes "the relationship within policy communities that form around an issue of importance to the members of the policy community" (Coleman, 1994b: 275-276).

Meanwhile, Kagan, in a comparative study of national styles of regulation in Japan and the United States, had used a broader definition of regulatory styles, including:

...such matters as the detail, specificity, and complexity of the statutes and regulations that embody general policy; the degree to which regulations are made and enforced through informal dialogue with regulated entities and industry associations (as opposed to more formal interaction); the frequency with which courts and litigation are employed in implementing and challenging governmental policy; the severity of legal penalties actually imposed on violators; and the

finality, uniformity, and predictability of case-by-case regulatory decision making (Kagan, 2000a:227).

It is noteworthy that Kagan's more disaggregated conception is basically compatible with that used by Coleman as both point to the fact that the notion of policy style encompasses all stages of the policy process, including agenda setting, policy formulation, implementation, enforcement, and evaluation (see also Howlett & Ramesh, 2003).

While basically adopting this framework, we believe that in this era of globalization and regionalism, we need to go one step further, in the sense that it is important to extend the notion of "policy style" from its current "domestic-oriented" focus to include explicitly the way in which state regulators relate to international actors including other states, multilateral/inter-state organization such as the IMF and WTO, multinational/transnational business corporations, civil society organizations, etc.

For our purposes, therefore, convergence in bank merger policy styles could occur with respect to styles in agenda setting, policy formulation, implementation, enforcement, and evaluation and would be reflected in a growing similarity in how Canadian and U.S. federal regulators operated and related to other regulators and actors including: sub-national governments, intra-state players, market/private actors, civil society actors, as well as multilateral bodies or actors.

Convergence (or divergence) in bank merger policy styles could be discerned in: (a) how domestic regulators relate with each other; (b) the way domestic regulators relate with foreign regulators (e.g., foreign national/multilateral/supra-national regulatory agencies); (c) the manner in which domestic (state) regulators relate to domestic financial

firms as well as foreign financial firms; and (d) in respect to the relationship between the regulators and civil society.

The relationship between state actors, private for-profit sector actors, and civil society could take various forms including pluralist, corporatist, parentela, and clientela arrangements (Peters, 1995). Needless to emphasize, different countries adopt these arrangements differently and as such for there to be a convergent trend on this dimension, jurisdictions will have to be seen as moving towards the adoption of similar state-society arrangements with respect to bank merger policy agenda setting, formulation, implementation and evaluation. Moreover, convergence could develop with respect to: (a) which social group(s) participate(s) in shaping and implementing bank merger policy, and (b) who has access or standing to procedures to enforce regulations and penalties. In short, which social group is included, consulted, excluded, or marginalized -- when and under what terms, etc.-- is an important element when considering tendencies for bank merger policy style convergence or non-convergence.

The variety of relationships noted above could be adversarial or collegial, coercive, accommodative, flexible or rigid. They could be proactive/anticipatory or of a reactive type. Moreover, regulations could be either lax or stringently enforced; they could also be of higher or lower standard. Lastly, convergence in bank merger policy styles could potentially occur in how transparent, even-handed, cost-effective, and independent the enforcement processes and agencies are. In sum, as noted in other aspects above, the comparison of policy styles will require a consistent examination of these dimensions/aspects of policy style. In other words, the same dimensions should be considered for all jurisdictions under investigation.

4.3.7 Policy Impacts

While regulation can be studied as an output of the government or the state (Doern & Wilks, 1998), its greatest significance lies in the outcomes that it yields. Hence, it is important to compare the impacts of respective bank merger policies in different jurisdictions to see if there is evidence of convergence. Initially, we will be comparing the impacts of particular policy changes, leaving the examination of the wider consequences and significance of policy convergence or divergence to section 4.5 below.

It is important to compare the impacts of bank merger policy changes because ostensibly different policies can lead to similar economic, social, and/or political outcomes under different circumstances, just as ostensibly similar policies can have different outcomes. Given such possibilities it is crucial that policy impacts be considered as a salient aspect in the analysis of bank merger policy convergence and/or divergence.

As discussed in Chapter 3, the impacts of bank merger policy could include consequences for the structure of financial markets and institutions, financial performance, macro-economic impacts (e.g., impact on money supply, monetary transmission mechanism, economic growth, etc.), social impacts, as well as political ramifications including changes in social relations of power. For example, there could a growing similarity in terms of how bank merger policy preserves, consolidates or alters social relations of power. Convergence in policy impacts could develop if similar social groups acquire over time a particular standing as a result of policy changes. In short, bank merger policy may have consequences for individual banks, the banking industry, the financial sector as whole, the regulatory system, and society at large.

Thus, convergence in bank merger policy impacts (intended/unintended; positive/negative; direct/indirect; short-term, medium term, or long-term) would include

a growing similarity in such aspects as: enhanced power of large firms versus small and medium sized firms; increased concentration; reduction in domestic competition; reduction/increased efficiency; enhanced power of the federal government vis-à-vis the provinces/states, or vice versa; enhanced role and power of financial system regulators vis-à-vis the politicians, etc.; systemic risks and financial crises; reconstruction/reconstitution of market governance system; increased stratification of society; ascendancy of capital over labour; erosion of democracy, and so on.

In sum, the effects of bank merger policy convergence could potentially be felt (even if unevenly) in all social domains and orders: political, economic, social and cultural.

4.4 Dynamics of Bank Merger Policy Convergence/Divergence

The sources of bank merger policy convergence or divergence are varied and historically contingent. In this study we focus on these sources with a keen eye on the effects of the forces of globalization and regionalism, particularly with respect to the increasing integration and restructuring of financial systems and their accompanying governing systems -- processes that are hotly debated and contested.

4.4.1 Globalization, Regionalism and Bank Merger Policy Convergence

A common refrain about globalization – a buzzword since the 1980s -- is that financial systems and their accompanying regulatory regimes are being transformed by global forces so that the wave of bank mergers and the transformation of the regulatory frameworks governing such bank mergers are effectively attributed to globalization (Allen & Gale, 2000; Goodhart, Hartmann, Llewellyn, Rojas-Suarez & Weisbrod, 1999;

Scholte, 2000b). And, for many observers, this transformation is said to be leading to the convergence of financial systems and their regulatory frameworks (see Coleman, 1994b, 1996; Coleman & Porter, 1996; Coleman & Underhill, 1998; Dore, 2002; Moran, 1991; Porter, 1993, 1997). Indeed, such claims are frequently extended to other economic and social domains as when Eckes and Zeiler (2003:2) assert that: "Globalization promotes convergence, harmonization, efficiency, growth, and, perhaps, democratization and homogenization."

Similarly, those who study current processes of regional integration are also engaged in a debate as to whether those processes are leading to a convergence of public policies at the regional level (see Clarkson, 2000a, 2000b; Coleman & Underhill, 1998; Fratianni, 1997; Germain, 1996a, 1996b, 1997; Le Pan, 1997; Mailander, 1999; Martinson, 1997; Nolle, 1997; White, W., 1994).

However, while proponents of the convergence hypothesis (i.e., convergence scholars, à la Mosley, 2000, 2003) contend that globalization and/or regionalism are responsible for a convergence of domestic policies and institutions, critics (sometimes termed divergence scholars) challenge this contention. While acknowledging the sea changes occurring in economic, political and social policies, institutions and systems around the globe, these scholars emphasize the resilience, persistence and even expansion of diverse national policies, institutions, regulatory systems and models of capitalism (see Banting, Hoberg & Simeon 1997; Berger & Dore, 1996; Crouch & Streeck, 1997a; Gilpin, 2000; Vitols, 1997; Zysman, 1996). Indeed, they identify globalization and/or regionalism with tendencies towards divergent developments leading to a heterogenization in economic, social, cultural, and political domains. In short, they argue that globalization is not an ineluctably, or inexorably, homogenizing process.

It is in light of such debates that this study rejects the extreme claims of convergence or divergence and therefore situates itself among those studies that allow for the possibility of policy convergence and/or divergence. To effectively articulate this position it is imperative that we have a clear perspective on the notion of globalization and how it relates to the transformation of bank merger policies if we are to fruitfully examine the dynamics and trajectories of the Canadian and American federal policies on bank mergers. A clear perspective we believe will go a long way in demystifying some of the key issues pertaining to financial system transformation as well as changes in financial system governance. Moreover, we need to understand financial development and financial regulation beyond the categories of the domestic and the global for the regional dimension in finance is increasingly becoming important. As Germain has argued: "Finance in North America contains not only national and global dynamics but specific regional ones as well, and it is useful to consider the impact of these various dynamics on specific financial practices" (1996a: 186).

Indeed, an examination of the notions of regionalism and globalization offers a unique window in analyzing the contemporary co-transformation of the economy and the state. As Francis aptly states:

Exploring the relationship between globalisation and regionalism is important because the two phenomena bring together the economics and politics of contemporary global restructuring. The resurgence of regionalism in North America (NAFTA), Latin America, Asia, Europe and Africa have been against the background of increasing globalisation (Francis, D.J., 2001:66).

To the extent that globalization and regionalism bring together the economics and politics of contemporary global restructuring it is therefore crucial for us to examine these processes in an inter/transdisciplinary framework because a disjointed or single

discipline approach is severely handicapped in apprehending the complex and multi-dimensional processes that characterize the financial system -- arguably one of the most globalized/globalizing social domains in the contemporary global scene. This section is thus a modest endeavour to provide such an inter/transdisciplinary perspective on the two subject notions.

(a) Globalization

Globalization (both as a concept and as a set of societal processes) is controversial and highly contested. This is not the place to revisit such controversies. Nevertheless, we will need to have a clear notion of the idea if we are to effectively grapple with its implications for bank merger policy transformation. We take as our departure point the suggestion by Keohane and Nye (2000) who posit that to understand the word “globalization” we need to start with defining “globalism” which they define as:

...a state of the world involving networks of interdependence at multicontinental distances. The linkages occur through flows and influences of capital and goods, information and ideas, and people and forces, as well as environmentally and biologically relevant substances (such as acid rain or pathogens) (Keohane & Nye, 2000:105).

On this view, therefore, “Globalization and deglobalization refer to the increase or decline of globalism” (Keohane & Nye, 2000:105). Keohane and Nye (2000) further contrast globalization with delimited processes such as “localization, nationalization, or regionalization” (p.105). While these insights are useful we wish to situate them in a holistic schema. To do so we draw on Held, McGrew, Goldblatt and Perraton (1999), Helleiner (1997), and Germain (2000b).

In their magisterial *Global Transformations: Politics, Economics, and Culture*, David Held, Anthony McGrew, David Goldblatt, and Jonathan Perraton (1999), suggest that globalization be viewed along three dimensions including its manifestations, dynamics, and impacts and that the processes of globalization be assessed in terms of their extensity, intensity, and velocity. We combine these aspects with four other dimensions suggested (from a Braudelian perspective) by Germain (2000b) and Helleiner (1997), and as a result, we take it that the manifestations, dynamics, and impacts of globalization are best viewed simultaneously from spatial, temporal, social order, and hierarchical dimensions (see Table 4.1 below).

Table 4.1: Globalization - A Synthetic Perspective

Dimensions		Manifestations		Dynamics			Impacts
				Factors	Mechanisms Vertical and/or Horizontal	Actors	Positive or Negative
Spatial		Increasing regional and inter-continental flows	Time-space distantiation Time-Space compression	Technological advances	Cooperation	State actors	Uneven geographic consequences (extensity/density/depth); deterritorialization
Temporal		Rapid/high velocity interactions Short, medium and long term processes		Public policies Strategies of TNCs/MNCs		Competition	Inter-state actors Private for profit actors
Social Order	Economic	Economic globalization: Increasing/rapid flows of trade, capital, and people.		Global Institutions	Contestation	Private not-for-profit actors	Increasing trade and economic growth (unevenly); increasing economic and financial fragility
	Political	Globalization of politics: Increasing regional and global governance		Ascendancy of neo-liberal ideas			Coercion
	Social	Social globalization:			Emulation		Increasing inequality, job insecurities, social stratification, and global spread of diseases
	Cultural	Cultural globalization: Increasing flows of ideas;			Bargaining		Cultural hybridization Cultural homogenization
	Environmental	Ecological globalization:					Ecological degradation Increasing urge/need for regional/global solutions
Hierarchical		Hierarchical compression: Intensification of relations between layers of social hierarchy					A reconfiguration of hierarchical structures and relationships

As regards to how globalization is manifested, we consider spatial, temporal, social order and hierarchical dimensions in the following sense. Spatially, globalization is considered to involve a re-configuration in which the significance of distance or space is increasingly reduced but not eliminated. On this view, globalization processes are “extensive” in the sense that social activities are becoming ‘stretched’ (albeit unevenly) “across national frontiers such that flows, events, decisions and activities in one part of the world come to have immediate significance for individuals and communities in distant parts of the globe” (McGrew, 1997a: 7).

Viewed from a temporal perspective, globalization is first and foremost a historical phenomenon i.e., it is a set of processes of change over time whose manifestations should be viewed from three timeframes, viz.: short, medium and long-term. Indeed, a consideration of the temporal dimension permits one not only to periodize the globalization processes (i.e., into different phases) but also to depict the changing speed/velocity or rapidity of flows, interactions, changes and outcomes.

Linking the spatial and temporal dimensions of globalization, therefore, helps us to understand two notions, viz.: “time-space distantiation” (Giddens, 1991) and “time-space compression”(Harvey, 2000). Time-space distantiation “involves the stretching of social relations over time and space so that relations can be controlled or coordinated over longer periods of time (including the ever more distant future) and over longer distances, greater areas, or more scales of activity” (Jessop, 2001:13). “Time-space compression involves the intensification of ‘discrete’ events in real time and/or the increased velocity of material and immaterial flows over a given distance” (Jessop, 2001:13). Globalization processes are “intense” as the flows and patterns of interaction or interconnectedness transcending world states and societies become (over a given time

frame) increasingly dense. Moreover, the growing extensity and intensity of global interactions is associated with a deepening enmeshment of the local and global such that the distinction between what is internal and external is increasingly blurred (Held, McGrew, Goldblatt & Perraton, 1999). Alongside the 'stretching' goes a 'deepening' such that even though "everyone has a local life, phenomenal worlds for the most part are truly global" (Giddens, 1991:187).

Viewed along the dimension of social orders, it is also crucial that the various manifestations of globalization be considered from the standpoint of four distinct (yet inter-related) social domains, viz.: economic, political, social and cultural perspectives (Helleiner, 1997). This is particularly so because the differential patterns and intensity of global interconnectedness are pervasive and therefore manifested (albeit unevenly) in various spheres of social life including the economic, the technological, the political, the legal, the military, the social, the cultural, and the environmental (Germain, 2000b; Held, McGrew, Goldblatt & Perraton, 1999; Helleiner, 1997). Viewed this way, globalization is understood to involve the flow of capital, goods and services, people as well as ideas.

Lastly but not least, the manifestation of globalization processes must be understood in relation to hierarchy i.e., globalization as intensification of relations between the various layers of social hierarchy. As such, globalization is more than time-space compression --it can also be viewed as a process of "hierarchical" compression (Helleiner, 1997). A process that is manifestly hierarchically uneven and unequal in its patterns and repercussions.

In a nutshell, economic globalization can be viewed as an "intensification of worldwide economic relations that can be seen as economic, political, social and cultural

processes taking place at several different historical speeds and involving a compression of space, time and hierarchy” (Helleiner, 1997:102).

The causes of globalization are many and varied. Similar to how we examined the manifestations of globalization above, to understand the dynamics of globalization demands that we examine the sources, actors (proponents as well as resisters) from spatial, temporal, social order and hierarchical dimensions. Spatially, the dynamics of globalization have geographic sources and actors. Temporally, the dynamics of globalization may emanate or operate at different historical time periods as well as at different pace/velocities. From a social orders perspective, the key sources, actors and processes/mechanisms of globalization can be located within most of the social domains identified earlier. Moreover, there is a growing consensus that new technologies, the strategies of multinational corporations, state policies, international institutions (e.g., the International Monetary Fund, the World Bank, the GATT/WTO) have been largely responsible for the emergence and promotion of the current phase of globalization.

Examining the terrain of globalization permits us to explore the various sources and patterns of globalization in their true complexity, understanding that contemporary financial globalization is not some inexorable and irreversible supra-human process driven by abstract, intangible, unchangeable and uncontrollable market and/or technological forces/developments, but that it is also the result of “active political choices and state decisions” (Helleiner, 1995b:154). According to Helleiner (1995a:316) “states can be seen to have played three key roles in the globalization process including: (1) granting freedom to market actors through liberalization initiatives; (2) preventing major international financial crises; and (3) choosing not to implement more effective capital controls on financial movements.” Moreover, he argues that the growing

enthusiasm of states for financial globalization process can be explained by the following factors:

... a competitive deregulation dynamic, political difficulties associated with the implementation of more effective capital controls, the 'hegemonic' interest of the US and Britain, the growing domestic prominence of neoliberal advocates and internationally-oriented corporate interests, and the unusually cooperative nature of central bank interaction (Helleiner, 1995:316).

Indeed, in addition to institutional factors, interests and deregulatory processes, ideas (particularly free market ideas) have also helped to shape contemporary globalization processes. In short, globalization has several sources and drivers: institutional, ideational, interest-based and associational processes. Furthermore, viewing globalization through the dimension of social order permits an understanding of the notion that the forces of globalization (both for or against) may emanate from any (and potentially all) social domains.

Viewed from such an angle one can specify the different fields (institutional dimensions) in which globalization is occurring in society. A focus on the different institutional dimensions of globalization (e.g., polity, economy, and civil society) “provides a suitable entry point to mapping what we might call the terrain of globalization” (Germain, 2000b:71). Such a method, “allows for a complex and nuanced consideration of where and how the social practices constitutive of globalization are most likely to be reproduced” (Germain, 2000b:71) and allows us to transcend the narrow assumption “that the state is the only institutional bulwark to globalization” (Germain, 2000b:70), and to realize that “the way in which institutionalized practices within the economy and civil society uphold, extend or undermine globalization should also be explored” (Germain, 2000b:71). In short, it is crucial to recognize the multiplicity of

actors involved in and affected by the process of globalization, even though the state does remain central at this time.

The consequences of globalization also need to be examined in relation to their spatial, temporal, social order and hierarchical dimensions. Spatially, it is increasingly clear that the processes of globalization affect different countries -- and different communities within countries -- unevenly. From a temporal perspective, the impacts of globalization are clearly uneven as different societies progress while others are left behind and even marginalized during the current era of globalization. Viewing the impacts of global forces through the social order dimension helps us to focus on the economic, political, social, cultural, and environmental effects of globalization and to examine how people and societal actors in different social realms are affected differentially by globalization. Certainly, while globalization may be implicated in transforming every social sphere, we reject those accounts that attribute most outcomes to global forces (Germain, 2000b). Moreover, we reject those accounts that portray globalization as ineluctable and uni-directional. We thus submit that the ramifications of contemporary global forces and interactions are complex, diverse, uneven, unpredictable and yet not entirely uncontrollable.

In sum, the manifestations and ramifications of globalization are unevenly experienced within and across nations. Indeed, as McGrew (1997a:8-9) observes:

... inequality and hierarchy are deeply inscribed in the very processes of globalization. States, communities, and nations are differentially enmeshed in global and transnational flows and networks.... Patterns of hierarchy and stratification mediate access to sites of power whilst the consequences of globalization are unevenly experienced ... Moreover, the unevenness of globalization simultaneously stimulates processes of global fragmentation and global integration.

Furthermore, it is incumbent upon us to realize that it would be erroneous to conceive of the forces of globalization as synonymous with external or exogenous factors of policy change. As Shaw (2000b:14) argues it is a fallacy to consider transborder or international transactions as global, and national dynamics and transactions as non-global. Moreover, elsewhere Shaw (2000a:17) argues that "state politics is the core of globality, not its epiphenomenon." Thus, he contends that:

...the global is not constituted by global market relations or global communications, which then affect non-global political structures and institutions. Rather, it is the case that globality is constituted by state politics, quite as much as contemporary state politics are constituted by globality (Shaw, 2000a: 17).

In the same vein, Bernstein and Cashore (2000) also caution against conflating international sources of change and those of globalization. To avoid this, they suggest that the pathways and mechanisms of policy transformation be clearly delineated.

Consequently, we agree with Schaeffer (2003) that any attempt to generalize or universalize about the effects of globalization is mistaken. Only by taking a careful, historical analysis of its implementation in particular settings can any assessment be made of its effects, benefits and disadvantages (Schaeffer, 2003). Moreover, globalization does not necessarily or automatically have uniform consequences or create a more homogeneous world. Instead, the history of globalization to date indicates that it has had diverse consequences that cannot be anticipated in advance (Schaeffer, 2003).

In summary, globalization is best understood not as a singular condition or process but rather as a set of wide-ranging, uneven, hierarchical, asymmetrical and unpredictable processes of increasing interactions, interconnections, integrations and interdependencies among people and the world's societies (Tully, 2001:47; see also Held, McGrew, Goldblatt & Perraton, 1999). In other words, it is not a single and identifiable

entity but rather it is an ongoing set of dynamic and synergetic (as well as counteracting) processes that have many elements and levels. We also take the view that globalization is not an inexorable or irreversible process. Moreover, while globalization is transformational, it is also a set of processes that are governable and changeable (even if not completely so) (Eckes & Zeiler, 2003; Gamble & Payne, 1996; Held, McGrew, Goldblatt & Perraton, 1999:16). Thus, to the extent that globalization is not a singular economic process, we will be well advised not to look for causal factors of bank merger policy change emanating solely from economic processes and outcomes.

(b) Regionalism

The term “regionalism” will be applied in this study in a broader sense as opposed to a narrower view that is solely reserved for the arena of trade policy (Hveem, 1999; see also Bhagwati, 1992a:535; Sampson & Woolcock, 2003:277). Drawing on Hettne (1999) we will view regionalism as a “multidimensional form of integration which includes economic, political, social and cultural aspects and thus goes far beyond the goal of creating region-based free trade regimes or security alliances. Rather, the political ambition of establishing regional coherence and identity seems to be of primary importance” (Hettne, 1999: xvi). Regionalism will be understood as the urge of state, market and a wide range of (civil) society actors to merge, and “regionalization” as a corresponding empirical process of state, market and civil society regional interaction and integration (see Schulz, Soderbaum & Ojendal, 2001:5), i.e., regionalization is viewed as a process “that actually builds concrete patterns of transaction within an identified regional space” (Hveem, 2000b:72). On this view, regionalization:

... may be caused by regionalism. But...it may emerge irrespective of whether there is a regionalist project or not. For those agents who are not directed by regionalism, the boundaries of the 'region' are rather pragmatically defined and regional action is temporary (Hveem, 2000b:72).

In other words, "regionalization" is viewed as *"the process by which state and non-state actors seek to enhance their economic, political, cultural, social, and security interaction with societal forces within a region through formal and informal structures"* (Lee, 2003: 8-9; emphasis in the original).

Furthermore, it is important to distinguish between the "old" and "new" regionalisms where the difference between the "new" and the "old" regionalisms is more than just chronological (Bhalla & Bhalla, 1997; Greenaway & Milner, 2001; Hurrell, 1995). The current regionalism is considered to be 'new' to "the extent that the process of internationalization has acquired a qualitatively new, 'global' dimension" (Hettne, 1999: xix). Indeed, the differences between the old and the new regionalism are manifested in a number of distinctive dimensions including: (a) types, forms, and objectives of regionalist projects/schemes; (b) membership patterns, actors, and relationships; (c) context in which the regionalist schemes are being formed; (d) structural aspects and dynamics of regionalism; and, (e) impacts and implications of regionalism.

Briefly, we view the "new" regionalism as comprising heterogeneous schemes that are comprehensive, multi-dimensional, multi-level processes, that are in many respects "open", "deep" with overlapping membership involving countries of the North and the South in common schemes involving state, market, and society actors covering economic, cultural, political, security and environmental aspects.

The impacts of regionalism can be considered on various levels (e.g., local, national, regional, global, etc.) and on several social domains (e.g., economic, social,

cultural, and political). Furthermore, the impacts of regionalism can be delineated in terms of their effects on various social groups e.g., producer groups, working class, aboriginal peoples, women, etc., as well as temporally (i.e., they can also be short, medium, or long-term).

And, as discussed above (with respect to globalization), the impacts of regionalism too can be understood to be effected through multiple sources of pressures including: (a) economic structural pressures; (b) interest group politics; (c) institutional pressures; and, (d) ideational processes and pressures. However, the nature of the various influences and the channels of pressure will vary depending on the type of regionalist arrangement and on whether such arrangements are compatible and mutually reinforcing, or contradictory to globalization (see Bienefeld, 2000; Black, 2002; and the discussion below).

(c) The Nexus between Globalization and Regionalism

To the extent that there are a variety of regionalist arrangements the relationship between globalization and regionalization/regionalism is best understood when the different types of regionalist schemes are disaggregated. Depending on the type of regionalist scheme/project, globalization and regionalism can be contradictory or compatible, and mutually constituting and reinforcing (see Bhagwati, 1992a, 1992b, 1993, 1996; Bienefeld, 2000; Black, 2002; Marchand, Boas & Shaw, 1999). Regionalism can be seen as an integral part of globalization, and on the other it can represent state-led or grassroots counterforce against globalization (Bienefeld, 2000; Black, 2002; Marchand, Boas & Shaw, 1999). Regionalism is: (a) compatible with globalization in the case of the “neoliberal type of regionalism (NR -- à la Bienefeld) or facilitative regionalism (à la Black); and (b)

incompatible in the case of “sovereign regionalism” (SR -- à la Bienefeld) or transformative regionalism (à la Black). As such, depending on the type of regionalist arrangement, regionalism could either act as a stepping-stone or a stumbling block to globalism/globalization. “Which tendency prevails depends on the historical circumstances and the effects of the pressures to which it leads” (Hveem, 1999:103).

Briefly, as a complement to globalization, regional integration serves as a conduit for global forces in at least three different ways. First, it opens up the political economies of the member states to international markets and competition. Secondly, it serves to channel global institutional and governance pressures into member states; and thirdly, it channels ideas (e.g., neo-liberal ideas) into the political discourse of member states. Especially, as these ideas are invoked to justify changes brought about by global forces.

Regionalism, however, is not just a complement to globalization. As a force in its own right it can also counter some of the effects of globalization. As such, regionalism can serve as a shield against global forces by containing them through the discipline of regional institutions and processes. In a nutshell, regionalism can enhance global penetration at the same time protect against it (Schmidt, 1999:172).

All in all, however, as Black cogently argues: “regionalist projects are, in one way or another, indissolubly linked to (or articulated with) processes of globalisation and globalist visions. Whether as aids or alternatives, they are conditioned by the pressures and opportunities of global trends and forces” (Black, 2002:27).

The key implication of the above discussion is that when searching for the influences of regionalization/regionalism on bank merger policy (and public policy generally), it is necessary to disaggregate the different types of regionalist arrangements because each has different motivations and consequences. Moreover, when focusing on

the impacts of regionalism on Canadian financial sector policy we will be well advised to consider the influences of a number of regional arrangements instead of focusing on NAFTA alone. For one thing, Canada, like several countries in this new era of regionalism, is a member of a number of regionalist schemes (Schiff & Winters, 2003). As such, each regional arrangement can plausibly and potentially have different (countervailing) impacts and ramifications on Canadian public policy. Alternatively, they could also have mutually re-enforcing effects as well. Second, in this era of globalization, inter-regional and trans-regional relationships, interactions, pressures and influences are also critical. A case in point is the Canadian bank merger proposals of 1998. Before the Canadian authorities had concluded their review of the mergers, the EU competition authorities had already reviewed and approved the subject proposals, further influencing the dynamics in Canada. In other words, this indicates that the EU is also a potential regionalist factor that could influence Canadian (and U.S.) policy on bank mergers and acquisitions, even though Canada is not “formally” a member of the EU. Moreover, as Marchand, Boas and Shaw (1999) have argued, in studying regionalisation one needs to consider both formal and informal processes. They contend that:

...if we bother to look beyond the formal expressions of state-led regionalism we find a multitude of partly competing/partly cooperating regionalisms guided by various regional visions, values and ideas. There are not one, but several ‘regionalisation’ actors, and subsequently there are many regional projects, which sometimes peacefully coexist and sometimes are bitterly opposed. In other words, this questioning of state-centric regionalism opens up an entire new line of inquiry (Marchand, Boas & Shaw, 1999:904).

They, therefore, assert that: “Taking new regionalisms seriously implies that actual practices, and not geographic proximity alone or formal political and economic cooperation, will determine the delimitation of the region” (Marchand, Boas & Shaw, 1999:905). By

taking such a perspective, our focus and approach to researching Canadian and U.S. bank merger policies is of necessity broad, deep and multi-layered. For as Marchand and her colleagues argue:

In so doing, it is important to design research strategies which will enable us to tap into the complexities of the formal/informal nexuses. This means that we will have to incorporate into our research strategies and analyses a whole range of elements and practices that have been considered outside the domain of political research and the study of regional organisations... In other words, we have to establish ways of studying the political economy of regionalisation from below. This involves focusing on ordinary people and their daily activities as well as on the more formalized aspects of regionalisation (Marchand, Boas & Shaw, 1999:905-6).

Lastly, regionalism depicts and indeed underlies a set of processes that foster the emergence and/or further development of distinctive forms of capitalism. In the words of Richard Stubbs, "Regional economic activity is heavily influenced by increasingly regionalized forms of capitalism" (Stubbs, 2000:233). On this view, we take it that the different forms of capitalism are in many ways going to continue to significantly and differentially shape the bank merger policies of different jurisdictions.

In sum, understanding the influences of regionalism on policy convergence and/or divergence helps to clearly discern (and hopefully disentangle) the effects of globalization as distinguished from the effects of other factors in the transformation of Canadian and American financial regulatory policies in general and bank merger policies in particular.

(d) Globalization, Regionalism and Bank Merger Policy Transformation

For the purposes of examining the Canadian and U.S. bank merger policies, and in light of the above discussion, we suggest that globalization and regionalism be understood as a set of interests, institutions, structures, ideas and social mechanisms. As a set of interests, current globalization and regionalism depict: (a) the nexus in which

varied societal interests interact and are affected differentially; (b) the subordination of social goals and values to economic exigencies; and, (c) the predominance of Western countries' interests and demands in the international world order. As sets of institutions, globalization and regionalism refer to social spaces in which domestic and international/global norms, rules, and institutions are dialectically related (affecting/pressuring the interests, preferences of societal actors) and hence shape and reshape societal performance and outcomes. It involves the pushing back of the boundaries of unfettered capitalist processes and an alteration of the instruments available to policy-makers for resolving societal issues and problems.

Globalization and regionalism as structures thus represent the: (a) reconfigured (and re-configuration of) contexts through which contemporary economic, political, social and cultural activities take place; (b) changing relationship between state, market and society; (c) increased structural power of capital and private actors vis-à-vis other societal actors; (d) enhanced role of finance; (e) exacerbation of inequalities among and within nations and groups of people; and, (f) the advancement and differential restructuring of technology, technological capabilities, and technological divide among and within nations. In this view, globalization and regionalism are understood as structural and structuring phenomena.

As ideas, contemporary globalization and regionalism represent neo-liberal ideas and are to a large extent part and parcel of the mechanisms for the conveyance of neo-liberalism. Neo-liberalism is here being understood in both its historical and definitional aspects. In its historical dimension, liberalism "revolves around the idea that advanced economies – particularly those of Britain and the US – developed under conditions that are best characterized as *laissez-faire*" (Dowd & Dobbin, 2001:61). From a definitional

stand point, neoliberalism “revolves around the idea that one group of industrial policies can be defined as ‘non-interventionist’ (that is, those that reinforce the unabated competition of free markets) while another group can only be defined as ‘meddlesome’ (that is, those that contravene free markets” (Dowd & Dobbin, 2001:61). On this combined view,

Globalisation itself can be seen as a form of international neo-liberalism advocated by the the [sic] United States, by the EU, by transnational corporations, and by global organizations such as the International Monetary Fund (IMF) and the OECD, the latter organisations playing a key role in transmitting and (technocratically) legitimizing values and ideas about policy change (Humphreys & Simpson, 2005:11).

And as Stephen Gill (1995:66) has aptly noted:

The growth in this global power has been accompanied by a neo-liberal, laissez faire discourse which accords the pursuit of profit something akin to the status of the quest for the holy grail; and the agencies associated with this discourse are staffed by neo-classical economists who assume – in matters of social policy – the role of a modern priesthood. Deviation from their orthodoxy is viewed as a sign of either madness or heresy, a view which acts to disarm criticism and to subvert the development of alternatives.

In other words, contemporary globalization and regionalism represent and are, indeed, predominantly imbued with free market-oriented ideas of openness, liberalization, privatization, minimal state, and reduction in social spending. Indeed, the ascendancy of neo-liberal ideas has been a direct complement to the growth in the global power of capital. These ideas find their manifestation (and are indeed embodied) in the institutions and mechanisms of globalization and regionalism including: (a) from an economic standpoint, enhanced domestic and international market competition and collaboration including mergers and acquisitions, strategic joint ventures, network industries; as well as increased competition among workers; and, (b) from a political perspective they represent increased

regulatory competition, collaboration, emulation and coercion; and, the emergence of counter-movements by civil society.

It is in light of such an understanding of globalization and regionalism that we will now examine the dimensions of bank merger policy dynamics.

4.4.2 Dimensions of Bank Merger Policy Dynamics

In order to account for bank merger policy convergence and/or divergence we need to be able to delineate not only what has converged but also the dynamics of change.

Analysis of the dynamics of policy convergence and/or divergence includes an examination of the: (a) paths of convergence, (b) context of change, (c) policy actors, (d) the causes(s) or the source(s) of the change as well as resistors to change/convergence, and (e) multi-dimensional processes and mechanisms through which such change/convergence occurs (Bennett, 1991; Borzel, 1999, 2002; Braithwaite & Drahos, 2000; Dyson, 2002; Inkeles, 1998; Radaelli, 1997, 2000, 2003).

These dimensions are pivotal in understanding bank merger policy convergence and/or divergence, because policy processes may: (a) take any number of diverse paths, (b) occur in a number of different contexts; (c) involve a diversity of actors, and (d) be caused by a number of causal processes -- thus, leading to uncertain yet significant economic, social, political and environmental consequences and implications. In the discussion that follows, we will, therefore, seek to clarify the context, drivers, processes and mechanisms associated with policy convergence and/or divergence (with special attention being placed on spatial and temporal aspects in the dynamics of convergence). We will examine these aspects in turn.

(a) Paths of Convergence

It may seem trite to note that any process of change must ultimately describe a sequential path of outcomes and it is such paths of change that are the focus of studies of policy convergence or divergence over time. Moreover, it is vital to remember that in order for the bank merger policies of two or more countries to converge, their policies do not have to follow the same path. Indeed, there are several possibilities to consider since, as Inkeles (1998:30) points out:

There is ... more than one pattern of change over time that can lead to a point of convergence. Change may also stop short of actual convergence and still be of great significance if the units undergoing the change cross certain critical thresholds.

Moreover, not only is it true that "the paths to a point of convergence need not be common or uniform" (Inkeles, 1998:3), convergence can occur as a result of parties moving from different (not necessarily opposite) directions towards a common point or merely in a common direction. And, in some cases, "Divergent movements that may seem the deviant case at one point may in fact define the norm around which other units will converge later on" (Inkeles, 1998:3).

Moreover, convergent patterns can be "one-way" or "two-way" (Dunning & Hopper, 1966:164-165). For "one-way" convergence, a system of type A becomes more like type B, or vice versa, while a "two-way" convergence pattern when type A and type B will "become more alike by both moving toward the middle of a continuum of change" (Dunning & Hopper, 1966:164-165). This is similar to Dallago, Brezinski, and Andreff's (1992) concept of "hybridizing convergence" which they define a "dynamic process in which each system 'borrows' traits, institutions and regulations from the other" (Dallago, Brezinski & Andreff, 1992:65).

In a one-way process only one party needs to change for convergence or divergence to occur, whereas in a two-way process both parties need to change. However, hybridity may not always result in homogeneity. For instance, two systems may each adopt some characteristics from each other without the two systems becoming homogeneous i.e., the result may be: heterogeneous hybridization.

Of course, over time, a convergent trend can turn into a divergent trend. Thus, Inkeles refers to the possibility of "convergence and cross-over" when "two trends may meet and fuse but they may also cross and then start to diverge" (Inkeles, 1998:40). This is important because it means that even when we observe convergence there is no reason to think that these policies may not diverge again at a later date.

Of course, policy trends may also run in parallel (Dunning & Hopper, 1966; Inversen, Pontusson & Soskice, 2000:3). And, as noted by Dunning and Hopper:

In addition to convergent and divergent patterns of change, the possibility should also be noted that 'parallel' changes may occur. In such cases, two or more changing societies become neither more nor less alike -- that is, they neither converge nor diverge, but nonetheless both of them change (Dunning & Hopper, 1966:164).

It is also worth noting that change (whether convergent or divergent) should always be viewed as potentially non-linear and discontinuous. As Kerr aptly notes: "At some point, movement may be blocked and may proceed no further. Reversals also are possible ...and even reversions to some earlier stage of history are possible, although this seems unlikely" (Kerr, 1983:34-36).

Lastly, public policy convergence can take many forms. In this regard, Seeliger (1996) provides a useful classification of policy developments, including: (a) divergent policy development; (b) convergent policy development; (c) synchronous and identical policy development; and, (d) indeterminate policy development.

It is in light of such a possibility of a range of divergent paths that it is important to bear in mind that given the complex nature of bank merger policies (and public policy processes in general), a wide variety of policy responses, change patterns and impacts are conceivable. This, however, must be understood within the context of the fact that changes do not take place from scratch. In other words, policy change is invariably path-dependent in the sense that new policies tend to interact with and carry forward some elements of existing policies.

(b) Actors

In a multi-realm/layer governance framework, financial governance involves a multitude of actors at different levels with varying roles and unequal powers and clout (Chapter 3). This is even more so with the increasing globalization of societies across the globe. Consequently, in order to effectively comprehend policy convergence/divergence processes (and policy change in general) it is necessary to clearly identify and understand who the relevant policy players are. In this regard, Braithwaite and Drahos (2000) provide a useful list.

A focus on policy actors helps not only in delineating whether policy convergence is elite-driven or activist-driven, but it also helps to account for the political-economic dynamics of the very process of policy convergence. Moreover, the relevant policy actors or players (domestic and international) pertaining to bank merger policy may differ across countries. Indeed, even within a jurisdiction different players may be involved at different times or eras.

Generally, the following may play an active role in bank merger policy formulation, implementation and evaluation: (a) domestic regulatory agencies (bank

supervisors, competition (anti-trust) authorities), politicians, and bureaucrats, inter-state/multi-lateral organization (e.g., BIS, OECD, World Bank); (b) financial sector corporations; (c) bank customers and suppliers; and, (d) civil society organizations and individuals including, mass publics, epistemic communities, domestic/local and international chambers of commerce, as well as producer and sectoral/industrial associations, consumer groups, labour groups, environmental groups, etc.

While the above non-exhaustive list is very helpful, it is important to bear in mind that incorporating actors in the analytical framework implies the need to understand the actors' perceptions and motivations. Given the limitations of the rationalist approaches (e.g., neoclassical economics, rational/public choice approaches, etc.) it is thus prudent to seek guidance elsewhere. The hermeneutic or interpretivist tradition (see Germain, 1996a, 1996b, 1996c, 1997) seems to lend itself well to this task. With its focus on ideas and perceptions as critical transformative elements, this perspective significantly helps in understanding the relevant actors' roles over time and space, their respective interests, preferences, values, motivations, relationships amongst themselves, their strategies, and, most importantly, their power and influence.

(c) The Context of Policy Convergence and/or Divergence

Policies do not change, converge or diverge in a vacuum. They change in a specific context including “the historical era within which societies change, the relationship between a given society and others, and the kind of economic regime directing the program of change” (Feldman & Moore, 1962:161). Indeed, as Feldman and Moore (1962:161) have argued, “the social settings, or environment within which change takes place, provide the factors that mold programs, ideas, and driving ideologies, both political and economic.”

And, as discussed in Chapter 3, institutional contexts matter because they serve to mediate pressures for policy change including those of policy convergence.

Indeed, a consideration of contextual factors is important because each society has its own history, political ideology and culture. Moreover, policy contexts are invariably shaped by prior policy choices: policy feedback and path dependency. As Judith May and Aaron Wildavsky have observed: “past policy becomes an important (and sometimes the most important) part of the environment to which future policies must adapt” (May & Wildavsky, 1978:13). Policy feedback is important because it may: (1) “create strong political interests anchored in prior policy, (2) provide significant incentives to protect those interests, and (3) promote policy ‘lock in’ effects that can encourage governments to forego alternative policy options” (Williams, M., 2001:24).

In sum, it is in such policy environments that bank merger policies are devised; objectives defined and articulated, implementation strategies developed and executed. And perhaps most importantly, these arenas are dynamic i.e., they are constantly changing. It is within such a context that one finds the forces for and against policy change, convergence and/or divergence.

The contextual dimension does not only refer to the domestic or national realm. It encompasses the international, regional and global as well. As such, the Canadian and U.S. bank merger policies can be best examined and understood when they are clearly situated in their social, economic, and political milieu -- a context that acknowledges that the contemporary world capitalist system is comprised of distinct capitalist models that are under pressure from domestic, regional as well as global forces for change. Specifically, the transformation (convergence and/or convergence) of the Canadian and U.S. bank merger policies need to be understood as processes occurring within the

context of the Anglo-Saxon model of political economy that is embedded within a world of a variety of capitalist systems. Moreover, the transformation (or lack thereof) of bank merger policies of these two countries needs to be situated within the context of ever changing national, regional and global environments encapsulated in the current processes of globalization and regionalism.

Generally, from an economic viewpoint, the current era of globalization and regionalism is best characterized as one of: (a) trends towards expanded commodification, and (b) the reorganization of the contexts of capitalist accumulation (Germain, 1996a, 1996b, 1996c; Scholte, 2000b). Politically, the current context could be characterized by the post-Bretton Woods era, the end of the Cold War, and the dominance of the USA (Pax Americana) — albeit in a multi-polar world. Briefly, the political aspects of contemporary globalization are best summed up by Cerny (1997:253) when he writes:

Globalization as a political phenomenon basically means that the shaping of the playing field of politics is increasingly determined not within insulated units, i.e. relatively autonomous and hierarchically organized structures called states; rather, it derives from a complex congeries of multilevel games played on multi-layered institutional playing fields, above and across, as well as within, state boundaries.

In short, taking the context (economic, political, social and cultural) into consideration allows us to consider pre-existing situations and practices as well as current pressures and influences. These conditions are important because they structure the costs and benefits of altering the status quo. Put differently, policy change patterns (convergence or divergence) are best understood as necessarily path dependent and historically contingent. The question then is: what is it in this "new" context that will (or has) contribute(d) to the convergence and/or divergence of Canadian and U.S. financial

policies? Specifically, how would the contextual aspects shape the bank merger policies of the two countries? It is to these and other factors that we now turn.

(d) Causal Factors and Processes

The mainstream view predicts public policy convergence as resulting from the pressures exerted by market forces unleashed by the growing openness, integration and interdependence of societies and economies around the world. Robert Boyer suggests that the mainstream views can be reduced to a chain of three arguments or propositions: (a) “that globalization and the dominance of finance are explained by an economic determinism which cannot be thwarted, since these two processes are by their very nature irreversible;” (b) “in this context, market mechanisms are superior to state interventions, in solving almost all – if not all – contemporary problems;” and, (c) “The logical consequence is, then, that all forms of capitalism will converge towards a configuration in which the market is dominant and organizes all spheres of social and economic life, in the model offered by the American economy” (Boyer, 2000:274-75).

On this view, policy change and convergence are viewed as resulting from the “triumph of market forces”, primarily engendered by technological changes, trade and capital mobility, competition among institutional forms, emulation and diffusion of best practices, “abetted by complicit or passive governments” that often believed that there is a “lack of viable alternatives” (Berger, 1996:16).

In contrast to the above viewpoint, we take it that globalization is “by no means merely a homogenizing force” (Held, McGrew, Goldblatt & Perraton, 1999:441) for globalization forces have both centripetal (centralizing, homogenizing) and centrifugal (decentralizing, heterogenizing) tendencies. As such, policy convergence and/or

divergence are essentially contingent historical processes shaped by conjunctural factors leaving the impacts of globalization open-ended and highly uncertain. Arguments that posit an a priori expectation for public policy convergence are therefore untenable. In fact, although globalization and regionalism may often be constraining, they can also be enabling forces, meaning that the claims about the erosion of state sovereignty and policy autonomy are frequently exaggerated and presented ahistorically (Boyer & Drache, 1996; Gelber, 1997; Helleiner, 1998, 1999; Hirst & Thompson, 1996; Kapstein, 1994; Krasner, 1993, 1999; Pauly, 1997; Scholte, 2000b; Thomson & Krasner, 1989; Weiss, 1998). Rather than simply undermining state sovereignty, globalization can also enable states in certain ways (Mosley, 2003; Sobel, 1999).

Secondly, we do not share the premise that when confronted with global/regional challenges, nation-states will necessarily adopt free-market (read: flexible, efficiency-maximizing) policies (Hall, P., 2001), in part because free-market solutions are not necessarily efficient -- especially in the long-term -- but also because the selection and adoption of such policies are always necessarily political (see Berger, 1996; Boyer, 1996; Powell & DiMaggio, 1991; Wade, 1996). In fact, "the economic rationale of institutions cannot be isolated from political and social contexts" (Boyer, 1996:55) since:

Institutions are not designed uniquely to solve an efficiency problem or fulfill social objectives, but in most cases they are the unintended consequences of the pursuit of strategic advantage by unequal agents. Consequently the asymmetry of power has definite consequences on the design of institutions, which only rarely enhance efficiency (Boyer, 1996:55-56).

Thirdly, even when states are actively searching for solutions to the challenges posed by increasing global and regional integration, it does not follow that globalization will lead to the homogenization of economic systems and public policies around the

world through the emulation of best practices. Not only do best practices differ in different circumstances, but, even when the “best practices” of others are replicable these are never obvious or available to all (Berger, 1996; Boyer, 1996) especially since the pressures mediated by market pressures are never unambiguous as noted by Berger when she argues that:

... the failure of market pressures to produce greater uniformity of policy and institutional configuration in individual countries reveals the fundamental ambiguity of these pressures. They may signal problems and provide general pressure for change without providing unequivocal clues about which policies or institutions need to be altered and how. If, for example, national policy is to reduce the deficit, even extreme competitive pressures might not indicate which sectors need to be privileged to reach that goal (Berger, 1996:20).

Hence, “if world markets do not have the predicted effects on national systems, the explanation may lie not only in the possibilities for success in special niches or in one's home market but also in the indeterminacy of market pressures” (Berger, 1996:20).

In any case, whatever emulation might be taking place, it may not necessarily be due to globalization since many other pressures and processes are also at work (Banting, Hoberg & Simeon, 1997). Moreover, we need to recognize that even when different actors do adopt similar policies, this may not necessarily be the result of emulation based on competitive (market) dynamics but could simply be the result of trial-and-error experimentation, or of coercion via international negotiations or threats – clearly non-market mechanisms (Boyer, 1996; Gilpin, 2000).

There are therefore many reasons why homogenization is not automatic and is fraught with several barriers. Indeed, the emulation of best practices must always adjust “apparent lessons” to local circumstances, even when those lessons are clearly

recognized. The assumption that competitive emulation should lead to policy convergence therefore is unwarranted because it:

- (a) ignores that different political economic institutions may be “functionally equivalent” i.e., “Differing but equally effective systems of corporate and other institutions within national societies limit the need for convergence to achieve particular objectives” (Gilpin, 2000:321), meaning that “there is more than one way to secure economic flexibility” (Hall, P., 2001: 230). Thus, some would argue that instead of relying on market mechanisms, some organized market economies (such as those of Japan or Germany) “have had equal if not greater success in using non-market institutions to manage adjustments” (Hall, P., 2001:230);
- (b) underestimates the difficulties involved in the transplantation of practices across systems due to the quasi-indivisibility of social institutions and socially embeddedness/nestedness of systems/institutions i.e., the “tightness-of-fit argument” (Woolcock, 1996); and, also because it
- (c) disregards path-dependency, which means that institutional change is often heavily influenced by the initial conditions that exist before and during the change process itself (Schooner & Taylor, 1999).

Of course, this is not to argue that social institutions can never be emulated. While lessons are never simple or universal, it is not totally impossible to learn from history (i.e., “total blockage” condition; Rose, 1993). But policy emulation is never synonymous with copying, since any policy “whether original or derived is bound to be modified by the concrete political and institutional conditions in which it is carried out” (Majone, 1991:80).

In fact, Richard Rose suggests that emulation can take place in several ways, by: (a) copying: “enacting more or less intact a program already in effect in another jurisdiction”; (b) adaptation: “adjusting for contextual differences a program already in effect in another jurisdiction”; (c) making a hybrid: “Combining elements of programs from two different places”; (d) synthesis: “Combining familiar elements from programs in a number of programs from different places to create a new program”; and (e) inspiration: “Using programs elsewhere as an intellectual stimulus to develop a novel program” (Rose, 1993:30).

Lastly, we do not concur with the argument that convergence is a result of the lack of viable alternatives to neo-liberalism since such alternatives to neo-liberalism are potentially available (e.g., social democracy, varieties of capitalism, etc.; see Carranza, 2000; Petras, 1999; Richardson, 2001). Moreover, far from being in decline, the Left is still very much alive as evidenced by the resurgence of resistance in civil society. Consequently, instead of wondering whether there are alternatives to neoliberalism, we should be discussing the ways in which neo-liberal discourse has tended to marginalize any consideration of alternatives as it: (a) seeks to promote its ideology with threats of “adjust or perish”; and (b) endeavours to mask its own failure in addressing pressing political, economic and social issues (Richardson, 2001:94-95). In reality, the neo-liberal discourse is both limiting and ahistorical since it ignores that fact that as Chomsky (and Gershenkron before him) has noted: “a sharp departure from neo-liberal doctrines was a pre-requisite for economic development in our own century” (Burchill, 2001:50). “In fact,” Burchill observes, “the post-war period, the experience of Japan and the other dynamic economies of East Asia has demonstrated that ‘late development’ would appear

to be critically dependent on state intervention in the economy. There are few, if any, examples of laissez-faire transitions to economic development” (Burchill, 2001:50).

It is in light of taking such a position that it behooves us to be cautious and to stress the possibility of both divergence as well as of convergence. And, as Cerny (2000:137) has aptly noted:

The central paradox of globalization is that rather than creating one big economy or one big polity (what has been called the ‘airport bookshop’ image of globalization), it also divides, fragments and polarizes. Convergence and divergence are two sides of the same coin, and the relationship between them is open to wide influence from state and other actors at many levels. Whatever direction the future takes, therefore, it will be a path-dependent one where hard political choices will be made and the very complexities of globalization will increasingly shape both the problematic and the understanding of potential solutions (Cerny, 2000:137).

And, much the same conclusion is reached by Croucher when she says:

This indeterminacy reflects, in part, the variable nature of globalization itself. Globalization is powerful and widespread, but its impact is not experienced equally or identically in all parts of the world or for all people. Globalization’s tendency toward homogenization and standardization is strong, and few regions, locales, or individuals escape its reach. But, still, it must and does work through, with, and around an array of distinct local, state, and regional contexts – all of which shape and reshape the otherwise uniform patterns and processes of globalization in particular ways (Croucher, 2004:186).

It is in such context that we deem it necessary to carefully consider the main factors (including both domestic and international/transnational) that drive the policy change process; for, what causes policy change (convergence and/or divergence) is a key issue, since our understanding of what has changed (or not changed), our assessment of the consequences of, and the meaningful and workable policy responses (public and private) to, convergence (or divergence) depends largely on our interpretation of the forces that have generated (or hindered/mitigated) the trend(s) under study.

In this regard, it is important to consider both the driving forces (drivers, stimulants, forces, catalysts, facilitators, etc.), as well as the counter forces (inertia, resistors, constraints, obstacle, hurdles, barriers, filters, etc) that resist change and thereby help to shape the outcomes. Moreover, by also considering the resistance to change the thesis highlights the contested nature of the policy process.

Moreover, it is important to note that the existence of (common) pressures for change, or of actors with certain objectives and goals is not a sufficient cause for policy change, much less of policy convergence (see Hay, 2000). For that, we also need to consider resources and constraints (including structures -- institutional and non-institutional; material and non-material), as well as causal mechanisms including strategies and tactics of the main actors.

Policy convergence, therefore, is viewed in this study as a process that is caused by multiple factors and processes – both for and against convergence. On this view, we contend that the current single-variable approaches that either privilege structural changes, ideas or interests (illuminating as they might have been) are insufficient to discern and explain the radical changes that have occurred. Rather, we suggest that in order to provide an adequate account we do the following: (a) ideas and interests must be taken into account in conjunction with several other interrelated but analytically separable factors such as institutional and non-institutional structures, actors, and processes and mechanisms; and (b) instead of considering these factors separately, policy transformation (including policy convergence and/or divergence) be understood as a result of the combined effect of these factors. Essentially, it is being suggested that we understand policy change (convergence and/or divergence) -- dialectically, spatially, temporally and historically -- in the sense that it is a process and a result (among a myriad

of alternate processes/outcomes) of a combination and interplay of ideas, interests, structures (institutional and non-institutional), and processes/mechanisms.

Furthermore, as discussed above, bilateral dynamics, global and regional forces will hereby be understood as a set of structures (institutions and non-institutional), ideas, interests, and processes. How these factors matter in bank-merger policy convergence are briefly explained below.

(i) Structures (institutional and non-institutional)

In the present context, structures are understood to comprise of institutions and non-institutional structures that constitute, enable, empower as well as constrain policy actors (Banting, 1986; Campbell, J., 2004; Cortell, 2006; Eisner, 2000; Hall & Taylor, 1996; Lecours, 2005a; North, 1990; Pontusson, 1995; Thatcher, 1999). Institutions are here conceived to encompass “formal and informal rules, monitoring and enforcement mechanisms, and systems of meaning that define the context within which individuals, corporations, labour unions, nation-states, and other organizations operate and interact with each other” (Campbell, J., 2004:1). Non-institutional structures, on the other hand, refer to such factors as financial structure, size of economy, power structures (domestic and international), and spatial characteristics, etc.

Institutional and non-institutional structures matter because as argued and highlighted in this study, the critical limiting factors with respect to Canada-U.S. convergence in bank merger policies have been the prevalence of different economic and political institutions, different financial structures, and the legacy of past policies, just to mention a few examples. These factors have played a pivotal role in mediating the pressures for convergence in that they have helped to guide action in terms of shaping the

behaviour of policy actors and their preferences as well as in the choice of policy instruments or tools.

That being said, it should be noted here that we have also highlighted in this study those cases in which institutions have played a significant role in engendering or facilitating convergent trends in the bank merger policies of the two countries. The point being made here is that institutions and non-institutional structures can facilitate or mitigate/limit convergent tendencies. In other words, institutions create conditions in which policymakers may adopt policies that may or may not lead to policy convergence depending on how they interact with other interrelated factors such as ideas and interests as institutions are not determinative.

Institutions and non-institutional structures can facilitate or hinder policy convergence because they influence policy outputs and outcomes by binding policy actors together and thus provide a framework within which the interests, preferences, goals and objectives, and strategies of policy actors are shaped and pursued – successfully or unsuccessfully. For instance, with respect to institutions, Mark Eisner has observed that:

Institutions provide the context for the formulation and implementation of policy. They are central to politics and the policy process because they define the tasks of organization members, determine the way in which and the extent to which specialized knowledge will be brought to bear on policy problems, and shape the relationships among agencies, private associations, and organized constituencies. Thus they play a central role in shaping policy (Eisner, 2000:10).

Moreover, institutions are crucial in shaping policy because:

... the institutional framework expands or contracts the circle of critical decision-makers, structures the nature of political competition, and specifies the form of representation of the wider public, it necessarily conditions the access of different political interests to policy-makers, smoothing the pathway of some and raising obstacles to others (Banting, 1986: 42).

Of course, institutions are not static. When they change, however, they do so in a path-dependent way in the sense that “the composition of new institutions tends to interact with and carry forward key elements of existing institutions, including their incongruities and asymmetries” (Cortell, 2006:12). All in all, changes in institutions may affect the balance of power as well as the behaviour, preferences, capacities and strategies of policy actors. Hence, as Eisner contends:

Institutional evolution is of paramount importance to those who seek to understand the development of regulatory policy. It strongly affects the content and implementation of policy by determining which forms of expertise and which policy tools will be available to administrators; it determines how societal interests will be integrated into the policy process (Eisner, 2000: 25-26).

In short, institutions matter because they determine: (a) “the capacity of governments to legislate and implement policies”; (b) “the strategies of political or economic actors by virtue of the opportunities and constraints that they provide”; (c) “the distribution of power among political or economic actors”; and, (d) “who the actors are and/or how actors conceive their interest” (Pontusson, 1995:117-147). And, as Colin Hay has argued, institutions “serve to channel, filter and mediate common challenges in highly specific ways, often reinforcing the distinctiveness (both institutional and cultural) of distinct national (and, indeed, local and regional) capitalisms” (Hay, 2000:512).

Globalization and regionalism, understood as structural and structuring phenomena, may, thus, induce bank merger policy convergence via international political pressures as well as through international treaty constraints. In regard to international political pressures, policy convergence may result from pressures brought about by tensions over international trade. These tensions may arise due to the perceived “unfairness” in trade rooted in the diversity of institutions (i.e., behind-the-border issues

such as regulatory or competition policies as opposed to the at-the-border issues e.g., tariffs and quotas) which may be deemed to confer advantage on some parties over others (Bhagwati, 1996; Kahler, 1996; Ostry, 1996). Indeed, Bhagwati (1996:9) discerns three main sources for the demand for policy harmonization and reduction of diversity, including: (a) philosophical arguments (in the sense of transborder obligations, distributive justice, ethics, and fairness), (b) economic arguments, and (c) political arguments (protection seeking, race to the bottom, etc.).

It should be noted, however, the demands for a "level-playing field" may be pernicious because the very *raison d'être* of international trade is comparative advantage (Herring & Litan, 1995). Moreover, in a systematic analysis on the various contributions in Bhagwati and Hudec (1996), it is clearly demonstrated that the case for harmonization of policies across countries is very weak indeed. Furthermore, and to the extent that every party to a trading relationship (including the USA) is likely to have its own unique strengths and weaknesses, demands that some countries should dismantle their comparative advantage(s) are at best disingenuous (Crouch & Streeck, 1997). Moreover, since different systems may be functionally equivalent -- "varieties of capitalism" argument -- the demands for homogeneity may be to ignore the realities of contemporary capitalism. Lastly, pressures to adjust may not necessarily result in convergence for (a) they may be resisted, and/or (b) solutions adopted may be modified hence entrenching diversity (Berger, 1996; Boyer, 1996).

In regard to international treaty constraints, policy convergence may be due to the pressures and influences of supra-national organizations (e.g., BIS, WTO, EU, NAFTA, IMF, OECD, etc.) that can constrain the policies, actions and strategies states can adopt. Thus, in their endeavour to fulfill their international obligations states may take or adopt

measures, practices, etc., that may render their policies convergent (Banting, Hoberg & Simeon, 1997; Clarkson, 2002a, 2000b; Grinspun & Kreklewich, 1994; Stewart, 2006). A case in point is Canada's removal of restrictions on foreign banks to open branches in Canada. As a condition of its accession to the World Trade Organization (WTO) Agreement on Financial Services, Canada had in 1999 to permit foreign banks (from WTO member countries) to establish bank branches in Canada and thus remove the condition that foreign banks seeking to enter the Canadian market must do so by establishing a separately capitalized bank subsidiary (Statutes of Canada, 1999, Chapter 28; see also Mailander, 1999).

Furthermore, as Ricardo Grinspun and Robert Kreklewich argue, free-trade agreements centred in Washington such as the NAFTA, "serve as a restructuring tool, or, put differently, as a conditioning institutional framework that promotes and consolidates neo-liberal restructuring" (Grinspun & Kreklewich, 1994:33). In a similar vein, Stephen Clarkson, viewing NAFTA and the WTO as Canada's supra-constitution, sees Canada converging on American norms, corporate rights, adjudicative and enforcement mechanisms and processes (Clarkson, 2002a, 2000b).

It is, however, pertinent that we understand that international "constraints are not a straight-jacket; they are a cost that citizens and politicians may or may not be willing to pay. The stronger the constraints, the more it costs to adopt distinctive policies; the weaker the constraints, the lower the cost of divergence" (Hoberg, Banting & Simeon, 2002: 256). Moreover, as some critics have argued, while it is true that international treaties and supra-national organizations may constrain national/state policy autonomy, we would be remiss not to acknowledge that states can also be strengthened by international treaties (Gelber, 1997). As such, states can also resist or support those

pressures depending on whether they perceive them to be fostering or undermining their national interests. Finally, states (some better than others) can influence/shape the formation of the international treaties and/or institutions to suit their interests (Hall, P., 2001).

(ii) Ideas

Ideas are here understood as normative content including ideologies, dominant ideas, paradigms, worldviews, principled beliefs as well as causal beliefs. Ideas could be “home-grown”, imported or exported. At a policy level, ideas are held by a variety of actors including: (a) politicians, (b) bureaucrats, (c) returning foreign trained experts, intellectuals, etc., (d) members of epistemic communities; (e) international management consultants, and (f) (managers of) foreign firms including law firms (Dore, 2002; Hall, P., 1989, 1997, 2001; Kagan, 2000b, 2000c; Keleman & Sibbitt, 2004, 2005; Levi-Faur, 2005).

Ideas are a crucial element in bank merger policy change dynamics because “National policies are not the inevitable product of economic or social conditions.... They are formulated through intellectual debate, adopted through political struggle, and consolidated through administrative planning”(Bradford, 1998, 8-9). And, as Peter Hall has pointed out, “politicians, officials, the spokesmen for societal interests, and political experts all operate within the terms of political discourse that are current in the nation at a given time” (Hall, P., 1993:289). It is in such a context that it becomes vital to understand the role ideas play in bank merger policy process and transformation.

From a policy perspective, ideas serve important roles on several dimensions. First, ideas provide a lens through which policy actors may decipher complex reality

(Eisner, 2000:20). By doing so it helps policy actors establish the basic notions of the policy problem at hand (Lenschow, Liefferink & Veenman, 2005:803). And, by “emphasizing certain aspects of this reality, ideas may prove critical in shaping groups’ perceptions of what is in their interests” (Eisner, 2000: 20). Moreover, as ‘road maps’ “showing the way beyond crisis, new ideas can provide for actors either broad moral visions that enable decisive action despite uncertainty, or more narrow technical interpretations clarifying causal relationships and likely consequences of decisions” (Bradford, 1999: 21). In a nutshell, ideas are a critical factor in bank merger policy process and transformation because they help to: (a) decipher complex reality, (b) reduce uncertainty, (c) shape expectations and how these expectations are articulated, and, (d) search for solutions.

Secondly, ideas serve to establish the legitimate means of handling particular policy problems or issues (Lenschow, Liefferink & Veenman, 2005:803). They do so by shaping or providing the norms about the legitimate role of the state, market and civil society, as well as the rights and duties of citizens (Bradford, 1999). And, as Eisner has observed, because ideas “define the parameters of legitimate state action, ideas may shape public authority and political demands” (Eisner, 2000: 20). It should also be noted that to the extent that ideas differ among the various policy actors, these differences help to: (a) account, in a significant, albeit partial way, for the differences in strategies by policy players including state, market and civil society actors (Germain, 1996a, 1996b, 1996c, 1997), and, (b) depict the fact that policy continuity and change involves a contestation of ideas, and indeed, is in part a reflection of the power of ideas.

Thirdly, ideas can enable or impede policy implementation or change. They facilitate implementation because they provide institutionalized discourses supplying “the

operational language and organizational framework for the state officials in implementing public policy” (Bradford, 1999: 21).

Lastly, ideas can galvanize, divide or exclude policy actors. While they can act as focal points and glue “for social coalitions, [whereby] new ideas become the necessary currency for policy entrepreneurs to negotiate political realignments” (Bradford, 1999: 21), ideas can also serve to lend “legitimacy to some social interests more than others” (Hall, P., 1993:289). Since, policy actors tend to hold different (including contradictory) viewpoints, ideas tend to divide actors hence engendering political contestation. Moreover, to the extent that “the theories and assumptions that professionals bring to bear in their work shape policy” “this specialized knowledge plays an important role in structuring political participation in regulatory politics” (Eisner, 2000: 23) in the sense that ideas facilitate the entry of certain individuals and groups in policy discourses while at the same time erecting barriers for others. This is so particularly because:

Professional specialization ... makes it increasingly difficult for laymen and for specialists from different areas of expertise to speak one another's language. Inability to communicate creates a barrier to entry into policy discourse and thus has an inherently fragmenting effect (Yates, cited in Eisner, 2000: 23).

As a result, Eisner posits:

The "barrier to entry into policy discourse" created by specialists both within the agency and in the larger policy community limits the access and influence of groups incapable of mustering the necessary resources. The power of ideas thus affects the influence of interest groups and their ability to participate in the policy process (Eisner, 2000: 23).

In short, ideas are a vital part of policy process and change. This is best summed up by Mark Blyth (2002:15) who hypothesizes that "as part of an overall sequence of institutional change, ideas reduce uncertainty, act as coalition-building resources,

empower agents to contest existing institutions, act as resources in the construction of new institutions, and finally coordinate agents' expectations, thereby reproducing institutional stability" (Blyth, 2002:15). He, thus, argues that viewing "institutional change ideationally and sequentially offers a better explanation ...than purely structural or interest-based models can offer" (Blyth, 2002:15).

Worth noting, however, is that "ideas do not have any impact by themselves ...[but] influence politics only by acting through or on a particular political actor"

(Berman, 1998:22). And, as Bradford has argued:

New ideas are a necessary condition for launching policy innovation, but they are not "sufficient" in consolidating change. The policy influence of ideas does not rest only on their innate intellectual qualities. Rather, in order for new ideas to progress they must "work on" interests to realign the policy goals of collective actors, and they must "work through" organizations to transform policy-making routines and state capacities (1999:19).

As such, he posits that:

Mapping the flow of new ideas through political institutions bounded by economic structures allows us to explain why and how certain ideas prevail over others at critical junctures of strategic policy choice in a country's development (Bradford, 1999:19).

It is in light of such an understanding of the role of ideas that, with respect to bank merger policy, one could plausibly argue that convergence on the American model (during the period 1970s-2005) could be influenced by neoliberal ideas such as those that extol the virtues of the market and discredit the role of government. Pertinently, these ideas were embraced in the 1980s by the Reagan Administration in the U.S. and then by the government of Brian Mulroney in Canada. During this era the thinking about economic policy and the role of government involvement in the economy saw the revival of the belief in market forces as understood within orthodox (neoclassical) economics. With

the “new” orthodoxy exerting considerable influence on economic policy there emerged a shift in emphasis away from interventionist policies towards a reliance on corrections to competitive distortions and privatization of public assets. This “new” thinking is quite in contrast to the consensus – “based on the ‘mixed economy’ with considerable government intervention at both the macro-economic and micro-economic levels” - that had emerged after the Second World War (Helm, 1989: 9). And, as Holtham and Kay (1994:3) have observed:

Fifty years ago, most economists shared the view that market failures were endemic in modern economies and that these market failures would be remedied, or at least ameliorated, by government intervention. That such intervention would be benevolent in intention and effective in result was assumed to be so obvious as to merit little discussion.

But, this consensus did not last long (Helm, 1989: 9-10). Instead, views on “the economic role of government changed and government or regulatory failure” became “an issue on a par with market failure” (Holtham & Kay, 1994: 3). The recognition of “government failure” has meant that market failure is no longer regarded as a sufficient justification for state action. Any proposal for state action has to be proven to be less costly than the costs of market failure it was aimed to remedy. In short, the ascendancy of neoliberal/neoconservative ideology in the 1980s and the intellectual contributions from the neo-classical economics (price-auction model approach), the public choice school, and the Austrian School, have been instrumental in bringing about change in the way economic regulation and the role of the state in general is perceived by those in power to make public policies.

The influence of these ideas is clearly reflected in the transformation of the Canadian and American bank merger policies during the post-1970s period. On the other

hand, however, it is also important to note that resistance to policy convergence on bank mergers could also emerge as a result of the ideas pertaining to the: (a) perceived costs of convergence/harmonization, and (b) disagreements and different interpretations about the virtues of convergence in favour of diversity, beliefs in other ideas such as social democracy, egalitarianism, etc. One could also argue that interest groups in favour of American style policies or regulations may find it difficult (but not impossible) to garner or sustain domestic support due to the significant differences between Canadian and American political values and approaches. In spite of the neo-liberal, neo-conservative right turn that these two countries might have taken in the 1980s (and despite the fact that these two countries belong to the same Anglo-Saxon model of capitalism), differences in ideas (including ideologies, norms, values and causal beliefs) still persist. These differences in ideas may, thus, serve to limit the convergence between Canadian and U.S. public policies (Doern, 1995; Ross, S. F., 1997).

(iii) Interests

In addition to institutions and ideas, interests are a crucial aspect to consider in analysing bank merger policy transformation. It is important, at the outset, that we distinguish "interests" from "interest groups" (Doern & Phidd, 1983). Interests are here understood in two ways: (a) as "the real, material interests of the principal actors, whether conceived as individuals or groups" (Hall, P., 1993:176), and (b) as non-material interests of key policy actors. It is crucial we consider both dimensions because as Adrian Hyde-Price has argued:

How a political community defines its interests depends on objective, material factors (such as geography, size and wealth), but also on a range of subjective, normative considerations. These include the identity of a community, its political culture,

dominant moral and ethical values, sense of justice and conceptions of the common good, and its belief in what makes it distinctive as a political community (Hyde-Price, 2004:102).

Interest groups, for our purposes, include both ad hoc as well as organized/established groups and organizations – formal and informal. Interest groups are an integral part of the policy process for they act as communication, legitimation and regulatory agents (Adolino & Blake, 2001; Doern & Phidd, 1983). As a reflection of a country's social cleavage patterns, interest groups "serve as democratic linkage mechanisms, connecting citizens to their political systems by communicating citizens' interests and demands" (Adolino & Blake, 2001: 47). "In addition they act to regulate their members and to supplement governmental administration" (Doern & Phidd, 1983:75).

Since governance is a set of contested social processes involving actors with diverse interests, values, and power, this contestation in the arena of governance shapes policy outputs as well as outcomes – hence observed patterns – whether convergent, divergent or parallel trajectories. As such, interests matter because as Eisner posits, "All individuals and social groups have interests that are affected by economic change; they seek to execute certain economic functions within the constraints imposed by existing institutions and regulations" (Eisner, 2000: 24).

To the extent that globalization and regionalism affect economic sectors and regions within a country differentially, it stands to reason that the underlying interests of economic sectors/groups (as well as regions within a country) may shift, which may in turn lead to interest coalitions that may or may not support the convergence of public policies (Frieden, 1991; Frieden & Rogowski, 1996; Held, McGrew, Goldblatt & Perraton, 1999; Hall, P., 1999, 2001; Rogowski, 1989). Thus, depending upon the

influence these coalitions have on the state (relative to other interest groups), Canadian public policy on bank mergers and acquisitions may or may not converge on the American model.

(e) Causal Mechanisms and Processes

A number of mechanisms and processes may lead to policy convergence and/or divergence. It is, thus, crucial to understand these:

Because identifying mechanisms enables us to understand the details of causal processes, it reduces the risk of lapsing into either erroneous functionalist accounts in which institutional outcomes are explained by their consequences ... or spurious accounts that mistake correlations among variables for causal relationships (Campbell, J., 2004:63).

Moreover, as Roger Dale has argued, “mechanisms are not merely neutral conduits”, for they “modify the nature of the effect they convey” (1999:2). As such, he contends, “the variety of mechanisms through which globalization affects national policy is itself a diversifying factor” (p.2). By way of extension, Dale’s argument could be broadened to an understanding of the variety of mechanisms and processes of policy change as important sources not only of divergence but also of convergence and/or parallel trajectory. On this view, we take it that the mechanisms through which national, regional, and global influences affect a particular national policy as crucially important in defining the nature of the effects and patterns.

It is not our intention, however, to identify or classify all of the numerous mechanisms that may affect bank merger policies. Suffice it to note here that Bennett’s (1991) fourfold framework of mechanisms provides one foothold. In the framework, Bennett includes “emulation, where state officials copy action taken elsewhere; elite

networking, where convergence results from transnational policy communities; harmonization through international regimes; and penetration by external actors and interests" as key mechanisms of policy convergence (1991:215). Braithwaite and Drahos' (2000) contribution, however, offers a broader list. According to Braithwaite and Drahos (2000:25-26), some of the key mechanisms include: coercion (economic, political, military), competition, modelling (emulation, copying), reciprocal adjustment, non-reciprocal coordination, harmonization, systems of reward, and capacity-building.

As one can note, two types of mechanisms (emulation and harmonization) appear in both frameworks, while two mechanisms in Bennett's framework (elite networking and penetration) are not effectively covered in Braithwaite and Drahos' list. Thus, the need to merge the two frameworks to remove the duplication as well as to incorporate the elements not covered in one framework by the other. Moreover, we believe "emulation should be more clearly distinguished from learning (one can learn also from another's mistakes and do the opposite of imitating)" (Unger & van Waarden, 1995:21).

To the above mechanisms we need to add another set of processes, viz.: "convergence by independent problem solving" (Boyer, 1996: 46). As Robert Boyer observes:

...even isolated social and economic systems might converge toward the same organization if they find, by chance or necessity, the same solution to common internal problems. ...In other words, facing the same problems and opportunities, national economies could finally find the same steady state and institutional arrangements after trial-and-error experimentation, even in the absence of external competition (Boyer, 1996: 46).

In sum, by taking the above sets of mechanisms together, we derive the following key processes and mechanisms with regard to bank merger policy convergence and/or divergence:

- (1) Independent problem solving including trial and error experimentation.
- (2) Learning from other jurisdictions including eschewing inappropriate lessons as well as avoiding the mistakes experienced by the innovators/innovating jurisdictions.
- (3) Emulation of all or some elements of merger policy e.g., goals/objectives, procedures, institutions, policy styles, etc. In this category we include processes of both unilateral and mutual emulation.
- (4) International cooperation/interdependence processes through which -- as a response to regionalist or global pressures -- the policy outcome(s) is/are "derived from extensive negotiation between different national authorities and involves the usual compromises and trade-offs inherent in bargaining" (Schooner & Taylor, 1999:598). This, Schooner and Taylor label as "negotiated convergence" (1999: 598).
- (5) International coercion and pressures for harmonization of bank merger policies (i.e., imposed convergence). In this regard, Schooner and Taylor (1999:597) suggest that:

Policy convergence among regulators may be the result of unequal bargaining power. One regulator using power might attempt to impose its own rules on others -- claiming its own to be superior. Policy convergence might also result from the almost opposite scenario in which no one regulator or subgroup of regulators has the power to impose its own standards on others. The group, therefore, would be left with the choice of either declining to converge (thereby accepting the diverse standards within the group requiring, at very least, each regulator to understand the regulatory approach of the others) or adopting distinct, uniform standards for all. The latter might prove the easier choice.

- (6) International competition within the arena of policy-making and regulation. In addition to negotiated or imposed policy convergence, Schooner and Taylor (1999:598) identify an alternative process termed "convergence by competition". Under this process, convergence results from regulatory/jurisdictional arbitrage activities.

In summary, the above mechanisms as well as the other factors (structures, ideas and interests) discussed above interactively influence bank merger policy convergence and/or divergence as shown in Box 4.1 and Figure 4.1 below.

Box 4.1: Explaining Causal Dynamics

Policy changes (convergence and/or divergence) will be explored and

understood on the basis on the following model:

Policy change/convergence = Interplay of ideas, interests, structures (institutions and non-institutional), and mechanisms/processes

Whereby, the:

Dependent variable = Bank merger policy convergence

Independent variables = ideas, interests, structures (institutions and non-institutional structures), and processes.

Ideas = shift in dominant domestic/international views (e.g., Keynesian synthesis to neoliberal views); shift in motivational dynamics, and ideational foundations.

Interests = shifts in the material interests of the various players (financial sector players, non-financial sector economic players, the state, civil society players)

Structures = changes in the political economic structures including financial institutional changes; financial integration; intra-state structures, federal-provincial relations; inter-state structures (e.g., NAFTA, WTO), civil society structures, etc.

Processes = trial-and-error, learning, emulation, competition, cooperation, domestic and international policy harmonization, elite networking, coordination, coercion, etc.

Figure 4.1: Bank Merger Policy Convergence and/or Divergence: A Dynamic Model

4.5 Significance and Implications of Bank Merger Policy Convergence

In exploring the significance of bank merger policy convergence (or divergence) this study adopts a wider focus by looking at the economic, political, and social implications rather than focusing narrowly on the century old debate on the merits of the bank-based versus market-based financial systems with respect to economic growth and corporate governance (Levine, 2000). The stalemate in this debate suggests that we are better off adopting a broader perspective.

Secondly, it is important we consider the implications of both convergence and/or divergence of the Canadian bank merger policy on the American model. Although for Canadians the possibility and consequences of a convergence on the American model may be an intense worry (Boothe & Purvis, 1997), we would be well advised to also explore the implications of a convergence of the American system on the Canadian model, as well as of the divergence of the Canadian system from the U.S. system.

Lastly, the ramifications of policy convergence should be considered not only on their effects on a single country but also on the wider international context -- e.g., on the significance of the loss of international institutional diversity.

In sum, we wish to emphasize that a clear understanding of the significance of contemporary changes is indispensable. It is worth pondering what globalization and regionalism mean to people. As Herman Schwartz has suggested we would be well advised "to remember what Polanyi pointed out about the end of the nineteenth century" (2000:317) as:

For Polanyi the 'Great Transformation' was not simply the fact that markets had become more global, that trade had risen, and that capital flowed across borders. For Polanyi the significant transformation was the exposure of virtually all life chances and income streams to the logic and volatility of the market. Polanyi's counter-movement against the market and for 'social protection' was about sheltering

people's (and firms') incomes and life chances from market outcomes and market volatility, much of which was 'domestic' in the sense in which debunkers of 'globalization' have labeled most economic activity domestic. After a period in which they tried to contain markets, states in the post-Bretton Woods period have actively recreated markets (Schwartz, H., 2000:317).

It is in such a perspective that we will examine the implications of bank merger policy transformation in the two countries within the context of both the positive and negative political, economic, social and cultural ramifications of contemporary globalization and regionalism (Banting, Hoberg & Simeon, 1997; Berger, Demsetz & Strahan, 1999; Clarkson, 2002a, 2002b; Crouch & Streeck, 1997; Dore, 1996; Edwards & Mishkin, 1995; Germain, 1996a, 1996b, 1996c, 1997; Gilpin, 2000; Held, McGrew, Goldblatt & Perraton, 1999; Lamfalussy, 2000; Rhoades, 1983; Rodrik, 2000; Scholte, 2000b).

4.6 Applying the Analytical Framework

This chapter sought to provide an analytical framework for investigating the transformation of the Canadian bank merger policy vis-à-vis its U.S. counterpart. The emphasis of this framework has been threefold. First, it has been on how to identify and assess the elements or components of bank merger policy that are likely to converge or diverge. Secondly, it has focussed on the dynamics of convergence processes. Thirdly, a focus was turned on the implications of such bank merger policy convergence or non-convergence.

A focus on all these three aspects is necessary to provide a common point of reference and thus facilitate the assessments and drawing of conclusions about the transformation of Canadian bank merger policy. This assessment will be undertaken in the next part of this dissertation in two steps. First, in chapters 5 and 6 (and based on the

elements delineated in section 4.3 above), the evolution of the Canadian and American bank merger policies will be separately traced. This analysis will then form the basis for comparing the two countries' policies in Chapter 7. Briefly, Chapter 7 will delineate some of the key elements that may have converged, diverged or tracked parallel trajectories.

Chapter 5: Canadian Bank Merger Policy (1970s-2005)

5.1 Introduction

Canadian bank merger policy has a long history dating back to the time of Confederation in 1867. Since then it has evolved into a sophisticated regime reflecting its rich heritage as well as the hitherto development of the Canadian financial system (and its accompanying regulatory framework), and, indeed, the Canadian political economy itself.

The aim of this chapter is first and foremost, to provide an overview of the path/trajectory that the Canadian public policy on bank mergers has taken during the period under observation (i.e., 1970s to the present). Secondly, this analysis will form the basis on which to compare the evolution of Canadian bank merger policy to that of the evolution of the U.S. bank merger regime over the same period.

The chapter will proceed as follows. In the next section, a brief overview of the early Canadian financial sector governance system beginning at Confederation in 1867 will be presented, so as to place the post-1970s Canadian bank merger regime (and its evolution) in context. In the third section, we will chronicle (in the context of earlier developments) the evolution of Canadian bank merger policy for the period between the 1970s and the present (2005) based on the key policy elements delineated in the study's analytical framework. As such, for each policy component, public policy on bank mergers and acquisitions at different time periods, as well as policy changes (turning points, episodes, etc.) will be noted and explained as we proceed. The fourth section will offer some concluding observations.

5.2 Early Bank Merger Policy: Foundation Laying and Change

Public governance of banks and banking in Canada has its beginnings long before Confederation in 1867 as the provinces undertook oversight with the home government in London (Committee of the Privy Council for Trade) exercising important influence (Jamieson, 1957).

Chartered banking in Canada began in Upper Canada when the first bank charter was granted in 1819 to the Bank of Kingston. Immediately thereafter, the first bank in the Maritimes, the Bank of New Brunswick, Saint John, was granted charter by the Province of New Brunswick in 1820 (Curtiss, 1935:154). This was followed by an Act by the Province of Lower Canada granting a charter to the Bank of Montreal on July 22, 1822. In fact, the Bank of Montreal had petitioned for a charter in 1818 and had been conducting a general banking business as a private corporation since November 3, 1817, rendering it the first institution in British North America to provide a full banking service (Jamieson, 1957; see also Curtiss, 1935:153).

Three other banks also began to operate under charter in 1822, including (a) the Bank of Canada (Montreal) which had been carrying on business since 1818 as a private corporation, (b) the Quebec Bank (Quebec) which also had been carrying on business as a private corporation since 1818, and (c) Bank of Upper Canada (York) whose charter was granted by the Province of Upper Canada in 1819, and became law on April 21, 1821 (Jamieson, 1957:3).

Thereafter, for the period between the granting of the first bank charters and Confederation, a number of banks were established in the different provinces. While the provinces chartered most of these banks, two early banks (the Bank of British North

America and Bank of British Columbia, both in British Columbia), were in fact chartered in the United Kingdom (Jamieson, 1957:15).

The charters of these early banks were practically identical as their articles had been copied from the articles of the Bank of Montreal whose charter had been crafted closely following the charters of the first and second Bank of the United States -- established in 1792 and 1816 respectively -- which were themselves based on the recommendations of Alexander Hamilton, the first Secretary of the U.S. Treasury (Beckhart, 1929: ff.66; Curtiss, 1935; Jamieson, 1957:4, 20; see also Shortt, 1986:18-25 for a clause by clause comparison of the Charter of the Bank of the United States and the proposed Charter of the Bank of Lower Canada by Adam Shortt). American influence also came by way of the adoption of the Free Banking Act in 1850 modelled on New York's Free Banking legislation of 1838. However, due to the Act's own defects and resistance from the Canadian chartered banks, not many banks came under its jurisdiction (Curtiss, 1935:154). Nevertheless, the Act was significant in three respects.

In the first place, it was the first general Act which applied to all banks, a point to be accepted later in the Canadian system. Secondly, it associated the government for the first time with the note issue, another feature which was later to become a part of the Canadian system. Thirdly, it made bank notes a first charge on the assets, which was also to be accepted later (Curtiss, 1935: 154).

Indeed, a number of the key features of the early bank charters were later incorporated into the Canadian Bank Act after Confederation (Jamieson, 1957). Having said that, however, it is also worth noting that the ideas and practices borrowed from the U.S. were in time modified and adapted to Canadian circumstances. Moreover, the British government also played a key role in further shaping the Canadian banking

legislation (Curtiss, 1935). In short, it was this combined rich banking legacy (American, British and Canadian) that was inherited by the new Dominion of Canada.

At Confederation, the British North America Act of 1867 (the Canadian Constitution) divided legislative responsibilities between the federal Parliament of Canada and the legislatures of the provinces (Statutes of Canada, 1867, Chapter 3). Specifically, Section 91(5) granted the Canadian federal Parliament, among other things, exclusive legislative authority in all matters pertaining to currency and coinage; banking, incorporation of banks, and the issue of paper money; savings banks; the regulation of trade and commerce (Statutes of Canada, 1867, Chapter 3; see also Beckhart, 1929; Jamieson, 1957:16). Pursuant to this authority, the first Parliament enacted during its first session in 1867 “An Act Respecting Banks” under which 27 inherited banks from the founding provinces (18 under the Province of Canada charters, 4 in New Brunswick, and 5 in Nova Scotia) were placed within the purview of the federal government (Statutes of Canada, 1867, Chapter 11; see also Beckhart, 1929; Curtiss, 1935; Jamieson, 1957). “By it the provincial charters were made, in effect, Dominion charters” (Curtiss, 1935: 155). The Act extended for three years the charters of the inherited banks, and, as a temporary measure, it served to provide “time for consideration of the form which permanent monetary and banking legislation should take” (Jamieson, 1957:16); hence ensuring an orderly transition into the new framework. Banks in Newfoundland and Prince Edward Island continued to operate under local charters while banks in British Columbia continued with their charters granted in the UK. These banks came under the ambit of federal jurisdiction as and when these provinces joined the Confederation. As such, the scope of the federal Bank Act expanded as more provinces came into the Confederation. The Bank Act of 1867 laid the groundwork for a national banking system in Canada by

authorizing the inherited banks at Confederation (and those that were subsequently inherited and/or established) to operate nation-wide hence establishing a national banking system governed primarily under the federal Bank Act (Beckhart, 1929: 298; Jamieson, 1957:16).

A review of the federal government's legislative measures immediately after Confederation reveals that it was the federal government's policy at the time that both the incorporation of banks, as well as the approval of bank mergers and acquisitions were to be effected through special acts of parliament. This policy was immediately put into practice in three significant ways. First, six banks were incorporated through special statutes. Second, this policy provided a framework for handling the collapse of two Ontarian banks, namely, the Bank of Upper Canada (Statutes of Canada, 1867, Chapter 17), and the Commercial Bank of Canada (Statutes of Canada, 1867, Chapter 18). Thirdly, it provided the framework for the amalgamation of the Commercial Bank of Canada and the Merchant's Bank as evidenced by the passage of two special statutes: one in 1867 to authorize the amalgamation of the Commercial Bank of Canada, with any other Bank or Banks, or for its winding up (Statutes of Canada, 1867, Chapter 18); and the other in 1868 to ratify and confirm the amalgamation of the Commercial Bank of Canada and the Merchants' Bank (Statutes of Canada, 1868, Chapter 84). It is in such a context that the origin of Canadian bank merger regulation can be traced to the passage of these early statutes.

Soon thereafter, faced with the impending expiry of the charters for the Ontario and Quebec banks (due in 1870), coupled with the diversity of banking systems inherited from the Provinces, and the fragility of the extant banks, the government struck a 15 member parliamentary "Select Committee on Banking and Currency of the Dominion" in

April of 1868 to advise the government on the establishment of a stable and uniform national banking system. Subsequently, the federal government introduced some extending and amplifying Acts in 1869 and 1870 (Ogilvie, 1985: 55). The 1869 statute extended until 1870 “some charters which were about to expire” (Curtiss, 1935:155), while the passage of the 1870 statute extended until 1872 the provisions of “An Act Respecting Banks of 1867” passed by the Dominion Parliament in its first session (Jamieson, 1957:19). Moreover, we see in the 1870 legislation, the emergence of an explicit prudential regulatory framework as the Act “laid down certain general principles and regulations intended to protect the community and put banking on a safe and stable basis. These provisions were to apply to all new banks and to be incorporated in all existing charters when renewed” (Jamieson, 1957:19).

The following year, in close cooperation with the banking community, the federal government crafted and adopted a new piece of legislation: “An Act Relating to Banks and Banking”, popularly known as “The Bank Act of 1871” (Statutes of Canada, 1871, Chapter 5) which “embodied the fundamental principles of the charter of the first Bank of the United States and of the first bank charters granted in Canada” (Jamieson, 1957:20). The passage of this act was important in several respects. To begin with, “conditions applying to new banks and new stock issues and the general powers granted to banks were for the first time contained in one statute” (Jamieson, 1957:20), thus replacing the several pieces of legislation that had hitherto provided the basis for governing banks. Also included in the new Act were:

...the general principles and regulation laid down in ‘An Act Respecting Banks and Banking’ passed in 1870, and certain new features intended to adapt the banking system to the growing requirements of the country. There were regulations of an internal nature too, which although almost universally in force, had not previously been embodied in any general law (Jamieson, 1957: 20).

The Bank Act of 1871 was also significant as it made nation-wide bank branching permanent. This was the culmination of a relatively brief but very intense struggle between those in favour of branch banking and those opposed to it -- particularly those in favour of American style unit banking based on the U.S. National Banking Act of 1863 (Beckhart, 1929; Curtiss, 1935). As Beckhart (1929: 300) has noted:

So intense grew the hostility that Rose [then Finance Minister] was forced to relinquish his portfolio in the Cabinet. At about this same time King [then General Manager of Bank of Montreal] retired from the active management of the Bank of Montreal. All prospects therefore of recasting the Canadian banking structure along American lines vanished. Canada had made a definite and clear-cut decision not to have small local branchless banks.

In fact, it was the Finance Minister Sir John Rose's successor, Sir Francis Hincks who eventually succeeded in getting the Bank Act of 1871 passed "after a careful study of existing legislation" and "numerous conferences with bankers, merchants, publicists and others" (Beckhart, 1929:300). Thereafter, the Bank Act has hitherto been revised almost regularly; and in the process several changes with respect to how bank mergers were to be governed in Canada were made. (See Table 1 and Table 2 in Appendix 6 for a distribution of bank branches in Canada).

It should also be noted that additional powers have also accrued to the federal government to regulate other types of financial institutions through the indirect use of its constitutional power to regulate federally incorporated entities. Thus, non-bank financial institutions such as trust, loan and insurance companies that have chosen to incorporate under federal statute come under the regulatory purview of the federal government as well. Moreover, the federal government obtained under section 91(2) of the constitution (the federal trade and commerce power) jurisdiction over all inter-provincial and international

transactions (Coleman, 1996: 207). Consequently, this provision empowers the federal government to regulate inter-provincial and international aspects of financial institution operations.

Also, worth noting is that although bank mergers and acquisitions have been primarily under the purview of the federal government, provincial governments too have played a number of key governing roles especially as regards to financial system (de)segmentation and cross pillar consolidation -- thus affecting bank mergers and acquisitions directly and indirectly. In fact, banks “are responsible to provincial legislation for matters under provincial jurisdiction so long as there is no conflict with the Bank Act” (Bryce Commission, 1978: 220; see also Trebilcock, Winter, Collins & Iacobucci, 2002).

Provincial authority to regulate (non-bank) financial institutions derives mainly from section 92(13) of the Canadian Constitution that grants the provinces jurisdiction over property and civil rights (Statutes of Canada, 1867, Chapter 3; see also Coleman, 1996:207). With the authority granted under this provision, coupled with case law interpretations of the constitutional division of powers in favour of the provinces, Canadian provincial governments have come to have authority to regulate firms in the securities, trusts, and insurance sub-sectors (Coleman, 1996:207). Moreover, like the federal government, jurisdiction has also been granted to the provinces to incorporate companies with provincial objects. The provincial governments, thus, exert regulatory control over “non-bank” financial institutions that choose to incorporate under provincial statute.

Lastly, provinces also regulate credit unions. In spite of attempts to interest the federal government to regulate credit unions, these institutions have primarily fallen

under provincial jurisdiction. The federal government's argument has been that "these were local matters more properly the responsibility of provincial governments" (Coleman, 1996:207). Having said that, however, it is important to note that despite its reluctance the federal government has in fact been in the business of regulating credit unions under the Cooperative Credit Association Act first passed in 1953. As the Porter Commission has noted, the passage of this act was to "remove any doubts about the constitutional position of the provincial centrals permitting them to register under a federal act, and to establish a national central, The Canadian Cooperative Credit Society Limited" (Porter Commission, 1964:167).

In sum, the public governance of bank mergers had an early beginning -- a start that would help shape the subsequent regulation of the Canadian financial system. The regulatory structure that has since emerged consists of the federal government controlling and regulating banks as well as trust and loan companies, insurance companies and cooperative credit unions, while the provinces are in charge of "non-bank" financial institutions including securities firms as well as trusts and cooperative credit unions. It is within this framework that Canadian bank merger policy has evolved and been implemented. We will, therefore, in the next section, discuss this evolution focusing primarily on the period between 1970 and 2005.

5.3 A Post-1970s Thematic History of Canadian Bank Merger Policy

This section will present the evolution of Canadian bank merger policy for the post-1970s period concentrating primarily on the evolution of (a) bank merger policy objectives, ideas and discourse, (b) bank ownership rules, business and investment powers, (c) merger review process, instruments and institutional configuration, (d) policy

styles, and (e) policy impacts. Of course, the evolution of these policy elements will be discussed in a historical context. We begin with bank merger policy objectives.

5.3.1 Bank Merger Policy Objectives, Ideas, and Discourse

A longstanding overarching objective of Canadian financial regulation has been the safeguarding of financial system stability. Other objectives have included with varying degrees of emphasis at different times: the protection of consumers, protection of domestic ownership, prevention of concentration of economic and political power, promotion of efficiency and competitiveness of Canadian banks. The latter two goals are of recent origin (traced back to the 1960s), while the protection of domestic ownership has been relegated with the opening up of the Canadian financial market place and in consideration of the treatment Canadian banks might be visited upon in foreign jurisdictions (Bryce Commission, 1978). In short, Canadian bank merger objectives have evolved to include prudential objectives (e.g., financial system stability, soundness, and integrity), competition policy objectives (e.g., efficiency, consumer protection) as well as public interest goals (e.g., access to banking services, protection against job losses, prevention of concentration of economic and political power, protection of domestic ownership, etc.).

The federal government's commitment to financial system stability can be gleaned from the various preventative measures (e.g., minimum capital requirements, restrictions on business and investment powers, etc.) and protective devices (e.g., lender of last resort, deposit insurance, etc.) it has hitherto introduced in its endeavour to govern the Canadian financial system. An early indication of this commitment was reflected in the government's endeavours to build an integrated national banking system. Thus,

underscoring the significance of a stable banking system and the integration of the inherited (diverse) banks, Hon. Mr. John Rose (then Finance Minister) argued in 1868 that “There could be nothing more essential to the prosperity and material well being of the country than that the banking interest should be established on a sound and satisfactory basis” (House of Commons Debates, 1868: 483). The federal government’s aspirations were also expressed and codified through the enactment of a number of key statutes very early on. The passage of the Bank Act in 1871 “which set minimum capitalization requirements and limited the scope of services which could be offered by the ‘Chartered’ banks” is a case in point (Lew & Richardson, 1992:168). The government’s position on a stable financial system was reiterated in 1890 by Hon. Sir George Foster (then Finance Minister). Summing up the experience of banking legislation since Confederation he noted:

It also appeared to be the desire of Parliament to hedge around the banking system, which then prevailed, by severer conditions of charter, by regulations which should be restrictive upon the dealings of the banks, especially with their own stock and with the stock of other banks, to foster the laying by of reserve capital, and by a judicious requirement of returns to perfect the system and render it as safe as possible without interfering voluntarily with the general principles upon which the banks had been operated from the earlier time (Debates of the House of Commons, 1890:2235).

Furthermore, the goal of financial system stability and soundness is also embodied and reflected in the government’s handling of distressed banks through mergers. Since the early days of public regulation, the federal government has tended to view and indeed utilized bank mergers as a useful mechanism for handling the several cases of troubled banks. Hon. W. S. Fielding’s statement (the then Finance Minister in 1923) captures well the federal government’s position in the face of serious opposition to bank mergers when he acknowledged: “I am prepared to admit that there may be need in

the future of some mergers. I think, as a rule, they should be discouraged but circumstances may arise which may render a merger necessary and proper" (Debates of the House of Commons, 1923:4134). In opposing the suggestion by opponents of bank mergers to revert to the previous (pre-1900) approach of approving bank mergers by special acts of parliament, Hon. Fielding further revealed the government's policy when he said:

I am not anxious to promote mergers unnecessarily, but I cannot conceive of any arrangement that could be made which would be better than that which we already have. If it were a case of two large banks where the amalgamation involved a diminution in competition it might be held there is no particularly good reason for the merger except from a profit-making motive. There might be no public reason which would indicate its necessity (Debates of the House of Commons, 1923: 4134).

Thus, during the discussion he restated his position that:

The whole situation should be reviewed from the point of view of not desiring mergers, but at the same time you do not want to sacrifice any existing institutions or destroy the property of shareholders if, by allowing a merger in time, you can safeguard the property (Debates of the House of Commons, 1923:4139).

Thereafter, successive governments reiterated the above policy position. For instance, Sir Thomas White (a former Minister of Finance) expressed a similar policy stance following the collapse of the Home Bank in 1923 (McKeown Commission, 1924, vol. 5. 324). So did Hon. J.A. Robb (then Minister of Finance in 1928), after he had permitted the Canadian Bank of Commerce to absorb the ailing Standard Bank of Canada in November of 1928 (Jamieson, 1957:69). To be sure, not all early bank mergers were effected to rescue banks in serious difficulties. The absorption of the sound and well-managed Bank of British North America by the Bank of Montreal in April 1918, and the amalgamation of the Bank of Toronto with the Dominion Bank (both in healthy financial position) to form the Toronto-Dominion Bank in February 1955 are cases in point (see Jamieson, 1957).

Historical evidence thus indicates that in the early days the federal government's policy was one of not desiring bank mergers that reduced competition, but of permitting bank mergers primarily as a means of handling distressed banks so as to safeguard financial system stability and in the process to preserve shareholders' property and to protect depositors (see also Beckhart, 1929:343). And, over the years, this position has remained unchanged as the federal government has continued to abide by the policy of promoting and safeguarding the stability of the Canadian financial system through a number of mechanisms and legislative measures. This is clearly expressed by the establishment and subsequent strengthening of the Canada Deposit Insurance Corporation (CDIC) and the Office of the Superintendent of Financial Institutions (OSFI). Moreover, since then, several financial institutions (e.g., banks and trusts) have been permitted to merge or be acquired by banks so as (among other considerations) to safeguard the stability of the Canadian financial system (see Appendix 2).

In addition to the prudential goals (i.e., financial stability), other objectives have also featured prominently from the very early beginnings of Canadian bank merger governance. These have included the protection of customers as well as the prevention of concentration of economic and political power. On balance, however, it can be argued that financial stability, in a sense, has been more important than the fear of concentration that has been expressed by parliamentarians from time to time in various sessions of Parliament since Confederation. Having said that, however, it should be noted that although not totally hostile to big business (as has been the case in the U.S.), Canadian public policy, to some extent, can be considered to include an objective aimed at guarding against the concentration of economic power. For instance, the prohibition on chartered banks from owning shares in one another (e.g., as per the Bank Act Section

75(2)(c) that states that “a bank shall not, directly or indirectly ... acquire, deal in or lend money on ... the capital stock of the bank or any other bank” is clearly intended to control market concentration and economic power. And as Krossel has argued “the restrictions against one party owning more than 10% of a chartered bank can be seen in part as arising out of the same concerns about the concentration of economic power” (Krossel, 1984: 53). Moreover, “the legal restrictions which places limits on the ownership by banks and other institutions of businesses outside of the financial industry, effectively is a check, albeit a small one, on this economic power being diffused through the rest of the economy” (Krossel, 1984: 53). Indeed, even during the heyday of “deregulation” the Hon. Mr. Tom Hockin (the federal minister of state - finance) expressed the state’s reservation about concentration when he noted:

The philosophy underpinning financial services integration will be to build – not buy. To protect against harmful concentration, acquisition of financial services companies will require the approval of the Minister of Finance. As a general rule, large financial institutions will not be allowed to acquire other large institutions (Hockin, 1988:505).

However, Hockin further noted that:

An exception to this general policy will be made for the securities industry. Given the desire for a viable Canadian presence in this strategic industry, the federal government will permit domestically owned, federally regulated financial institutions to build or buy securities dealer subsidiaries (Hockin, 1988:507).

Thus, he promised that “necessary legislative amendments to permit such participation in the securities industry” would be made (Hockin, 1988:507). In fact, as we will discuss in the next section, the government did permit banks to acquire securities dealers in the revisions to the Bank Act in 1987 as promised.

Since then, the need to safeguard the public interest has continued to feature in Canadian bank merger policy. Recently, it was again clearly spelled out by the then

Finance Minister Paul Martin, Jr. when he challenged the Royal Bank and the Bank of Montreal “to lower consumer charges, to guarantee that there will be no job loss, to guarantee that small and medium-sized business and that small towns in this country will benefit from this [merger]” before he could approve the merger they had announced, without consulting him in advance (The Globe and Mail, January 27, 1998: A1).

In addition to the above goals, maintaining domestic ownership has also featured as an important facet of Canadian financial regulatory policy. Canada’s nationalist sentiments were tested in 1963 when an American bank (First National City Bank of New York) intended to and eventually acquired the Dutch-owned, Canada-based Mercantile Bank in spite of strong opposition from the Canadian banking community and the then Finance Minister Walter Gordon (Azzi, 1999; Economic Council of Canada, 1989b; Fayerweather, 1974; Industry Canada, 1998; Safarian, 1993). The opposition was mainly based on the fear:

... that the entry of a large U.S. bank might result in an unacceptably large share of the Canadian retail-banking market being placed under the control of a large U.S.-based bank. During this period, foreign direct investment in Canada, particularly by U.S. residents, raised much concern about the ability of Canadians to control their own destiny (Economic Council of Canada, 1989b:89).

But the opposition was unsuccessful and the Mercantile Bank was eventually acquired. As it turned out, this episode was very significant in that it exposed a gaping hole in the Bank Act by showing that for all this time there had been no provision prohibiting foreign firms from acquiring Canadian or Canadian-based banks, at a time “when a Canadian bank could not take over another Canadian bank” (Economic Council of Canada, 1989b: 89; see also Porter Commission, 1964:374). As a result of this episode and following the consideration of the Porter Commission’s Report (1964), enhanced restrictions were formally instituted in the Bank Act of 1967 (Statutes of Canada, 1967,

Chapter 87). Specifically, provisions with respect to bank ownership were introduced to protect the Canadian banking industry from foreign control (Bryce Commission, 1978; Economic Council of Canada, 1989b; Statutes of Canada, 1967, Chapter 87).

Nationalist sentiments and the resultant restrictive measures clearly were undertaken in an era in which the Canadian control of capital markets was considered a prerequisite for the independence of the economic fate of Canadians (Bodkin, 1990:154). It was “an era of a fondly cherished belief that a Canadian owner was always better than a foreign one” (Shortell, 1991:11). These sentiments were not only expressed at the national level, they were also palpable at the provincial level. For example, while foreign ownership of securities firms was not a serious political issue in Ontario up until 1969, the Ontario government strongly reacted when Royal Securities was acquired by Merrill Lynch, Pierce Fenner and Smith (a U.S. firm) (Economic Council of Canada 1989b:91-2; see also Economic Council of Canada 1989a: 24). Motivated by the fear of growing foreign ownership of securities firms, and following the Moore Committee’s report (1970) and the Joint Industry Committee’s position paper (1971), the Ontario government responded by introducing new rules “establishing a ceiling of 10 per cent on the portion of the shares of a securities firm that a single non-resident and its associates and affiliates could hold, and a ceiling of 25 per cent on the portion that all non-residents could own” (Economic Council of Canada 1989b:91-2; see also Economic Council of Canada 1989a: 24). Thus, it was not until after the province of Quebec had relaxed its own securities regulations in 1973 and 1983 by deciding not to restrict foreign entry (so as to re-capitalize its securities industry) that Ontario reconsidered its position.

About two decades after the Mercantile Bank affair, another event at the federal level -- the acquisition of the assets of the Continental Bank of Canada by Lloyds Bank in

1986 -- resurrected the issue of foreign ownership. And again, as discussed below, like the Mercantile Bank affair, a foreign bank eventually acquired a Canadian bank to the frustration of Canadian lawmakers.

Nationalist thinking, however, gradually changed over time in favour of more openness. Accompanying this change were also changes in dominant ideas about financial system competition and efficiency. Whereas Canadian policy makers had for a long time been averse to the idea of promoting financial system competition (and thus were content to allow cartel-like arrangements in the Canadian banking system primarily as a safeguard against financial system instability) this position began to be undermined in the 1960s. One can trace the talk of domestic competition and efficiency in banking to the Porter Commission's Report of 1964. According to the Commission, its recommendations were "designed to promote continued evolution of the financial system, to encourage it to be creative and competitive, and to ensure that it is sound (Porter Commission, 1964:357). As such, the Porter Commission argued that:

...it should be remembered that competition is an uneasy state and that, however much they may thrive under it, businessmen have an inclination to protect themselves against it. We must therefore be alert to developments in two areas to which we draw attention and in which we have proposals to make, the first that of agreements which limit competition among financial institutions and the second that of concentration in the financial system (p.369).

Accordingly, Porter recommended that chartered banks continue to be widely held; that "all mergers or asset acquisitions involving any bank on either side of the transaction should also be subject to prior approval by the Treasury Board, as is now the case with chartered banks" (pp.371-2); and that although exceptions could be made to permit bank mergers (e.g., absorption of those in distress) "the prime objective should be

to maintain and increase competition in the financial system” (pp.371-2). It is in such light that Porter’s recommendations are considered to be unique for:

... they derived from a grand design which emphasized competition rather than regulation as the regulatory mechanism. In this, Porter was much less concerned with “soundness” and more concerned with efficiency and innovativeness than was traditional (Shearer, 1977:46).

As such, although the federal government did not adopt all of the Porter Commission’s recommendations (e.g., introducing a functional definition of banking or the broadening of the scope of the Bank Act to bring under its purview other financial institutions), the federal government did embrace the idea of enhancing economic efficiency and competitiveness in its reform of the Bank Act of 1967 (Shearer, Chant & Bond, 1995: 437; Slater, 1968:79). “The basic thrust of the legislation was to try to make banking business more competitive and to reduce the degree of regulation and restraint upon its operation” (Bryce Commission, 1978: 220). Worded differently, the Act was aimed at enhancing efficiency, flexibility and innovation in the financial system.

Henceforth, as Canada coped with domestic challenges and intensified regional (read: increasing U.S. protectionism) and global pressures, the federal government responded by tilting towards more openness and a market-friendly paradigm as crystallized in the Macdonald Commission Report of 1985. Achieving efficiency through market competition became a paramount goal of Canadian economic policy. Summarizing the impact of the Macdonald Commission, Neil Bradford (1998:164-5) posits that:

The commission closed ranks around a neo-liberal agenda that had mobilized considerable support in the business community and economics profession since the mid-1970s. The commission integrated policy reforms in numerous fields in a coherent discourse of market liberalization and social adjustment that would substantially retrench the federal government’s role in the economy and society.

With an abiding commitment to market values and incentives, the commission emphasized the modest administrative-political demands of its package. Politically attractive to a floundering new government seeking to confirm support in the multinational business community and free trade provinces, the Macdonald Commission's neo-liberal discourse became the blueprint for two terms of Progressive Conservative government. And since 1993, the Liberals have practiced 'Macdonaldism' with a vengeance.

Canada thus opened up to the ideas of enhanced foreign investment and free trade and ultimately signed the Canada-U.S. Free Trade Agreement (CUSFTA) in 1988. The signing of a free trade agreement with the U.S. represented a historically profound reorientation of Canadian public policy. It saw Canada's nationalist outlook transformed from one of "social democratic nationalism" (à la Walter Gordon's nationalism) to "neo-conservative continentalism" of the Mulroney Conservatives (Inwood, 2005). In this new brave world, postwar Keynesian ideas in favour of state intervention were abandoned in favour of the neoclassical liberal economics of free markets and minimal state as expressed in de-regulation, liberalization, and privatization policies.

This change in the ideational base, coupled with the pressures exerted by both domestic financial interests and international influences, consequently led the Canadian government to reform how it governed the financial system. Rather than protecting the financial sector, Canada -- like many other advanced industrial countries -- redefined its responsibility "to be one of 'enhancing competitiveness'" and set out to reorganize its financial governance regime in ways more suited to the objective of facilitating Canadian firms to compete in a globalizing economy (Coleman, 1996: 236).

The goals of economic efficiency and competitiveness in banking were further entrenched when in 1986 banks and banking were brought under the purview of the Canadian Competition Act. However, here it should be noted that economic efficiency as

a primary goal of federal competition policy is itself of recent origin too -- traced to the 1960s. From a historical perspective, Gorecki and Stanbury (1984: xviii) observe that:

The framers and supporters of the first competition legislation in 1889 had a clear idea of what they expected the law to accomplish. It was to prevent agreements or other arrangements among competitors that raised prices (or debased the quality of products) and 'rooked' the consumer or the farmer. It was also to ensure that those businessmen who sought to restrain trade were not able to coerce their competitors who wished to remain free of agreements to curb competition, by such means as predatory pricing, refusal to deal or similar 'disciplinary' practices.

As such, Gorecki and Stanbury (1984: xx) remind us that:

The idea that economic efficiency should be the principal objective of competition policy is of fairly recent origin...while it was given some weight in the 1950s, perhaps the strongest endorsement was given by the Economic Council of Canada in 1969. The Council said, "the main objective of the competition policy should be that of obtaining the most efficient possible performance from the economy...in dynamic as well as static terms... and the avoidance of economic waste."

In short, the idea that "efficiency" should be the primary objective of competition policy and the touting of competition as the best means of achieving economic efficiency and of meeting other public interest objectives, are post-1960s phenomena. This is best captured in the preamble of Bill C-256 of 1971, where it was argued that "not only is competition the best means of achieving efficiency, but that it is also the best method to transmit the benefits of efficiency to the public and an effective way to decentralize economic power" (cited in Gorecki & Stanbury, 1984: xviii).

Nevertheless, even after efficiency was embraced as the key goal of economic policy, Canadian policy makers did not permit the Competition policy authorities to review bank mergers until 1986. As such, for a long period, a cartel-type of banking structure was acceptable as a means of preserving financial stability and thus banking was treated as different from other economic sectors and was consequently exempted from the competition legislation. With the passage of the Competition Act in 1986 we

also witness several protracted efforts to instil the idea among members of policy circles that competition and efficiency were beneficial to society. Andre Ryba (of the former Economic Council of Canada) captures well this faith in the virtues of competition in financial markets when he posited: “With competition, a greater variety of financial services are offered at a lower price. Competition leads to more innovation, less conservatism and a better allocation of resources” (Ryba, 1988:323). Since then this mantra has been picked up and repeated many times over by public policy-makers as well as by corporate managers, consultants and some academics (e.g., see Naiman & Brooks, 2004:FP17; Thorpe, 2004: FP4; Vieira, 2005b). Recently, for example, Mr. David Dodge (the Governor of the Bank of Canada) in a speech to business leaders in Ontario posited that “Policy-makers have an interest in providing a framework that will allow our financial institutions and markets to compete in an increasingly globalized world” and that “With global standards evolving rapidly, Canada and Ontario must be at the forefront in terms of efficiency and competitiveness” (Thorpe, 2004: FP4). Mr. Dodge further reiterated the importance of efficiency for Canadian banks when he met with members of the House of Commons finance committee on April 19, 2005 (Vieira, 2005b:FP1, FP2). Competition and efficiency, thus, to borrow from Riccardo Petrella have “acquired the status of a universal credo, an ideology” (Petrella, 1996:62).

Furthermore, the application of competition policy to bank mergers in Canada as well as the strengthening of pro-market oriented prudential regulation should also be understood against a backdrop of increased “deregulation” of financial services in the 1980s in the major global financial centres where, as the traditional instruments of control were relaxed, public authorities increasingly resorted to or relied upon, general framework policies such as competition policy to take their place. Moreover, it is crucial

we note that, in a Canadian context, it was also the advocacy work of the Director of the Canadian Competition Bureau that played an important role in the adoption and extension of the application of competition policy in banking and financial services in Canada in spite of several earlier setbacks (Stanbury, 1998a; Stewart, 1982).

Also noteworthy, is that by the time the banking sector was brought under the purview of the Canadian Competition Act, the global financial market place was already a radically changed environment: technological innovations were advancing at rapid velocity, forms of wealth creation and accumulation were significantly transformed, shared ideas among policymakers, especially among major jurisdictions had already shifted towards de(re)-regulation, liberalization and privatization of their financial systems. As such, the bringing of the banking industry under the purview of the Competition Act, not only entrenched neo-liberal policies but it has also involved a skilful re-balancing act between prudential regulation, competition/ efficiency goals, and public interest objectives in financial regulatory policy.

Recently, this thrust is best reflected in how the federal government handled and eventually rejected two bank merger proposals (i.e., Royal Bank/Bank of Montreal, and CIBC/TD) in 1998. After a review of the merger proposals by the OSFI, the Competition Bureau, and in consideration of the public opposition to the mergers, the Finance Minister Hon. Paul Martin Jr. rejected the proposed transactions arguing that they would have resulted in: (a) “an unacceptable concentration of economic power in the hands of fewer, very large banks”; (b) “a significant reduction of competition”; and (c) the reduction of “the government's flexibility to address potential future prudential concerns” (Department of Finance, 1998c, 1998d; see also Harris, 2000: 230; Wyman, Shulman & Ham, 2000:60). In the letters to the respective bank presidents the Competition Bureau

argued that the proposed pair of mergers were “likely to lead to a substantial lessening or prevention of competition that would cause higher prices and lower levels of service and choice for several key banking services in Canada” (Competition Bureau, 1998b, 1998c; see also McIntosh, 2002:458). The OSFI on its part raised a cautionary flag but did not advise the Minister to prohibit the mergers as such (Palmer, 1998; see also Harris, 2000: 232). As Chant (1999:418) notes:

The Superintendent, though satisfied with the likely state of the merged bank, claimed that a traditional method for dealing with a weak bank would be foreclosed by the merger. Specifically, a rescue by another large Canadian bank would no longer be feasible because of the size of the merged entities and a lack of appropriate acquirers. Any rescue would require a relaxing of current ownership restrictions in order to permit a takeover by a large international bank.

In other words, Chant (1999:419) notes: "Any merger among major banks, by their very size, means that the takeover by another Canadian bank no longer remains an option for the rescue of the resulting bank if it runs into difficulties."

In short, we see in the contemporary handling of merger proposals a highly sophisticated approach whereby Canadian policy-makers have framed bank merger policy objectives from a multi-faceted perspective whereby prudential, competition policy and public interest goals are articulated simultaneously. This approach is embodied in the new regulatory framework presented in the White Paper of June 25, 1999 which was issued soon after the release of the MacKay Task Force Report (Department of Finance, 1999a, 1999b, 1999c). That framework established a formal review process for the large banks (i.e., those with equity exceeding \$5 billion) based on three criteria, namely, mergers could not: (a) unduly concentrate economic power, (b) significantly reduce competition, or (c) reduce flexibility to address prudential concerns (Department of Finance, 1999a, 1999b, 1999c).

In summary, although the objectives of the Canadian bank merger policy have evolved over time, safeguarding of the financial system stability, soundness and integrity has remained a dominant objective. The 1960s was a watershed decade as the shift in ideas witnessed the objective of financial stability being complemented with efficiency and competitiveness goals. Moreover, public interest goals (the protection of consumers, protection of domestic ownership, prevention of concentration of economic and political power) have also continued to feature (albeit with varying degrees of emphasis). In a nutshell, the process of Canadian bank merger policy evolution reveals a transformation of the government's position from one that permitted mergers almost exclusively only when distressed banks were acquired by healthy ones (as a safeguard against financial instability) to one that prohibited horizontal mergers among large banks (the longstanding unwritten big-shall-not-buy-big rule), to the current position that recognizes bank mergers and acquisitions (horizontal, vertical, and conglomerate) as legitimate strategic options.

5.3.2 Banking Business and Investment Powers, and Ownership Rules

Some of the key parameters that have governed bank mergers and acquisitions in Canada have been the rules pertaining to: (a) ownership (in terms of who can own banks and at what levels of ownership; domestic vs. foreign, etc.); (b) business powers (including the powers to set interest rates, engage in a variety of financial business activities, where to locate, etc.); and, (c) investment powers (i.e., what banks can own or invest in). These provisions are crucial because they in effect set out the parameters within which banking mergers and acquisitions could or could not take place.

Established by local merchants, early banks in Canada were very closely held firms. Gradually, however, through a number of public policy measures and changes, Canadian banks have evolved into widely held institutions. Further, as noted earlier (section 5.2), Canadian banks have had the right to locate nation-wide through a branch system since Confederation in 1867. Internationally, Canadian banks have engaged in overseas operations (without close monitoring by Canadian authorities) for more than a century in such centres as London and New York, as well as in the Caribbean and Latin America (Bryce Commission, 1978: 232; Neufeld, 2001; Patterson, 1941). Consequently, Canadian banks abroad have been able to establish *de novo* or acquire local banks in host countries with little, if any, home country regulation (Patterson, 1941). Inwardly, as discussed in the previous section, foreign banks have not had a strong presence until of late (partly as a result of restrictions on foreign ownership and entry).

In a nutshell, as the Canadian financial system has evolved several regulations pertaining to bank ownership, business and investment powers have been revised (as some were tightened, while others were relaxed or dropped completely) with direct and indirect implications for bank mergers and acquisitions. The most notable changes, for the period under examination, were those enacted in the revisions to the Bank Act in 1967 (Statutes of Canada, 1967, Chapter 87). First, the statutory ceiling of 6 % on interest rates the banks could charge was removed (section 91(1); see also Bryce Commission, 1978:220). Second, banks were granted permission to enter into conventional mortgage lending, as up to then they were confined to government-guaranteed mortgages (section 75(1)(c); see also Bryce Commission, 1978:248): signalling a gradual encroachment of financial institutions into each other's activities and the consequent blurring of boundaries between the financial sector pillars.

Third, a 10 per cent ownership limit on the shares of banks was introduced (section 75; see also Bryce Commission, 1978:221). This was primarily aimed at preventing concentration of ownership and also of ensuring domestic ownership of Canadian banks (Shearer, Chant & Bond, 1995: 437-8; see also Gouvin, 2001:399). Fourth, banks were prohibited from owning trust companies. This came “to serve as a way of preventing commercial ownership of banks (of the sort that later became prevalent in the trust industry) and as a way of avoiding self-dealing between a bank and its owners” (Freedman, 1998:8).

Fifth, the 1967 Act prohibited certain interlocking directorates (section 18(5)(6)). Thus, a person could not be a director of a chartered bank and simultaneously the director of another chartered bank, a Quebec savings bank, or a trust or mortgage loan company that accepted deposits from the public. Moreover, the directors of any one bank could not constitute more than one-fifth of the directors of any Canadian corporation (Shearer, Chant & Bond, 1995: 437). But, as Stewart (1982) notes, this restriction was weak because directors from several banks could fill a corporate board as long as representatives from one bank do not constitute more than one-fifth of the directors.

Sixth, the Act included rules to maintain a clear separation between banks and their customers. Banks were not to control important customers; and important customers were not to control banks. Thus, chartered banks were prohibited from owning, directly or indirectly, more than 10% of the voting shares of any relatively large Canadian corporation or more than 50% of the shares of a smaller corporation, with the exception of corporations providing ancillary services directly to the bank. Consequently, “a bank could not be part of a group of affiliated companies subject to a single control, nor could it form such a group itself” (Bryce Commission, 1978:221).

Seventh, crucial changes were made to the Bank Act with respect to foreign interests. There is no doubt that the Mercantile Bank affair was a key factor because:

Even as late as the beginning of the 1960s, the presence of foreign banks in Canada was at best marginal. Moreover, in 1966, 89 per cent of the shares of all banks (both foreign- and Canadian-owned) were held by Canadians even though, until 1967, the Bank Act placed no limit on the foreign ownership of Canadian banks (Economic Council of Canada, 1989b:89).

Thus, primarily motivated by the fear that foreign banks might dominate the Canadian banking industry, the Act introduced stringent limitations on foreign ownership by distinguishing between Schedule A (domestically owned) and Schedule B (foreign owned) banks. Specifically, the Act introduced provisions limiting the aggregate ownership of chartered banks (as well as trusts, loan and investment companies) by non-residents to 25 per cent of equity and that no single foreign shareholder was to own over 10 per cent. Moreover, provisions pertaining to citizenship and residency requirements for the majority of directors were introduced (section 18). These changes were a major departure because, as alluded earlier, prior to 1967, there were almost no restrictions on the entry of foreign banks into Canada or on foreign ownership of Canadian banks. In short, the 1967 revisions “ended this open-entry policy, prohibiting foreign banks from operating as banks in Canada” (Economic Council of Canada, 1989a: 24; see also Globerman, 1999; Industry Canada, 1998).

The limitation on foreign ownership was carefully considered “because a general discrimination against foreign control was felt potentially to endanger the position of Canadian banks in foreign countries” (Bryce Commission, 1978: 221). Also worth noting, however, is that although the Act “prevented foreign banks from fully participating in the domestic Canadian market, it allowed them to incorporate affiliates

(providing leasing, factoring, and some other banking services) at either the provincial or the federal level, provided that these subsidiaries did not call themselves banks and did not accept deposits transferable by cheque” (Economic Council of Canada, 1989a: 24; Economic Council of Canada, 1989b: 89).

Some of the changes made in 1967 could not withstand the challenges of the turbulent eighties. The 1980s were, indeed, a period marked by a sea change in Canadian public policy towards the financial sector as several crucial changes were made at both the federal and provincial levels that ushered in a new era of financial services governance in Canada. To begin with, the federal government reversed its 1967 position and relaxed restrictions on foreign bank entry into the Canadian financial market place. The shift was intended to bring under the control of Canadian regulators the affiliates of foreign banks that had already entered the Canadian market but were not regulated (Economic Council of Canada, 1989b: 90). It was also envisaged that the entry of foreign banks would enhance competition in the Canadian banking industry – an objective articulated since the 1964 Porter Commission (Economic Council of Canada, 1989b: 90; Freedman 1996; Porter Commission, 1964). Moreover, “Canadian bank expansion abroad weakened the case for protection of the home front” (Taylor & Baskerville, 1994:463), leading the policy-makers to allow foreign entrants into the Canadian marketplace although with some restrictions.

In order to allow foreign banks into Canada, some of the rules for Schedule B banks were relaxed in the 1980 Bank Act (Statutes of Canada, 1980, Chapter 40). Ownership of Schedule A banks was limited to 10 per cent on any individual or related person, and 25 per cent aggregate ownership for non-residents. Foreign banks were allowed to incorporate subsidiaries under Schedule B of the Act subject to a number of

constraints including, for example, restrictions in their powers to establish branches, and a 16 % ceiling on the proportion of assets of a Schedule B bank to total domestic assets of all chartered banks in Canada (Economic Council of Canada, 1989b: 90).

A second interesting change included the amendment to formalize the separation of banking from investment services -- a segmentation that had in fact already been the norm in Canada as commercial banks had by then withdrawn from investment activities early in the century (Coleman, 1996; Freedman, 1996).

Thirdly, the 1980 amendments to the Bank Act permitted banks to own subsidiaries in areas such as mortgage loans and venture capital which in turn led banks to create or acquire mortgage loan companies (see Calmès, 2004:12).

Furthermore, the above changes were followed by several crucial reforms made at the provincial level - led by the province of Quebec, and followed by Ontario and British Columbia. Spurred by the “resurgence of Quebec’s business community” the Quebec “Minister of Finance Jacques Parizeau engaged the Quebec financial community in support of measures to encourage firms to diversify and to attract international business” (Bodkin, 1990:162). The most notable changes (for our purpose) pertain to: (a) “the 1984 opening of the securities business to non-Canadian firms” (Bodkin, 1990:162); (b) the 1985 legislation permitting “insurance companies to open subsidiaries, for activities such as deposit-taking” (Bodkin, 1990:162-3); (c) “the 1986 registration of the first full service securities subsidiary of a Canadian chartered bank” (Bodkin, 1990:162); and (d) the 1989 “legislation to fully open competition in financial services” (Bodkin, 1990:163). As a matter of fact, the permission granted to financial institutions to hold any number of shares in a securities firm (subject to the Quebec’s Commission’s consent) opened a

window for banks – subject to federal government approval -- to own securities firms in Quebec (Economic Council of Canada, 1987: 21; Freedman, 1998: 9, ff.17).

Significant changes were made in Ontario too. “Faced with the threat that the other chartered banks would establish brokerages in Quebec, Ontario hastily opened up its own securities legislation” (Clarkson, 2002b: 158). Moreover, Ontario’s “1971 policy that the financial sector should be Canadian controlled” came under intense pressure from global forces (Bodkin, 1990: 163). Whereas prior to June 1986, Ontario provincial laws had imposed significant restrictions on the access of foreign dealers into Canadian securities markets (Freedman, 1996: 727), in response to the inter-provincial and global pressures, the Ontario provincial government issued several discussion papers and reports in search of a policy position (Bodkin, 1990: 161-162) and ultimately in June of 1986 made “changes to the rules governing the securities industry, partially opening up the securities industry to non-industry participants” (Economic Council of Canada, 1987:21). These rules were soon thereafter further relaxed as the Ontario securities industry was faced with the need for more capital. As a matter of fact, the Ontario government (after six months of intensive discussions) introduced more sweeping changes in December of 1986 by removing restrictions on entry into the Ontario securities industry (Economic Council of Canada, 1987: 21). According to these changes, (effective June 30, 1987), Canadian financial institutions were allowed, subject to federal government approval, “to own up to 100 per cent of a securities dealer” (Economic Council of Canada, 1987:21). Non-residents, on the other hand, were only permitted to own up to 50 percent of an existing securities firm from June 30, 1987; and were allowed to increase their stake to 100 percent a year later (on June 30, 1988) (Economic Council of Canada, 1987:21; see also Freedman, 1996: 729).

The changes in Ontario were also echoed in the province of British Columbia. “[M]otivated by a trade related interest”, the British Columbian government “maintained policies which allowed non-Canadian and non-industry access to particular segments of the financial sector” (Bodkin, 1990: 163). It fully opened up its doors to foreigners, by permitting the Vancouver Stock Exchange to allow foreign membership (Economic Council of Canada, 1989a: 24).

Briefly, the changes at provincial level opened up avenues for banks to acquire securities dealers that had previously not existed. This, in turn, had a significant bearing on federal policy on bank mergers and acquisitions as federal authorities had to provide instruments for such processes to happen. These were realized through amendments to the Bank Act in 1987 (Statutes of Canada, 1987, Chapter 26: section 6.1).

To be sure, the federal government also in part brought the 1987 changes against a backdrop of mounting global and regional pressures on Canadian banks as corporate borrowers increasingly sought external financing from non-bank sources. As Freedman (1992: 382) has noted:

...the increasing use of securities markets by corporate borrowers was probably the single most important factor driving the integration of the banking and securities industries. As the traditional bank loan lost ground to the bond, equity, and especially, the paper market (including bankers’ acceptances), as well as to Euro-Canadian dollar and foreign currency issues, the banks became increasingly concerned about their ability to operate profitably and to compete effectively with both domestic securities dealers and with foreign banks and securities dealers. Some observers in the mid-1980s went so far as to argue that there was no future for the traditional bank with its focus on corporate loans, and that the future would belong to institutions that could offer their clients the widest possible range of financing options.

Thus, these concerns were translated into the Canadian bankers’ urge to merge with domestic securities dealers, and hence the bankers’ pressure on the federal

government to permit them to do so. And as it turned out, the securities firms were also ready and permitted to do so by their provincial authorities.

Moreover, it is also worth noting that in addition to the provincial reforms and pressures facing Canadian banks, federal policy was also made against a backdrop of the acquisition of a Canadian Schedule A bank (the Continental Bank of Canada) by a foreign bank (Lloyds Bank of UK) in 1986. According to Continental's submission to the House of Commons Finance Committee (House of Commons, 1986: Issue No. 4), faced with a dire situation and after a consideration of the options available to it (made with the help of investment houses in Toronto and New York), Continental opted to deal with a major international bank. As such, on October 2, 1986, the Board of Directors of the Continental Bank of Canada and Lloyds Bank announced that they had reached an agreement for Lloyds Bank Canada (a Schedule B bank and a wholly-owned subsidiary of Lloyds Bank Plc of the UK) to purchase approximately 90 per cent of the assets and assume most of the liabilities of Continental Bank.

The purchase of the Continental's assets meant the disappearance of the seventh largest bank in Canada and the emergence of Lloyds as the largest Schedule B bank controlling about 2 per cent of bank assets in Canada with the Schedule B banks as a group controlling 11 per cent of bank assets. Although the purchase of Continental's assets did not violate the Bank Act (in the sense that the resulting aggregate asset level of 11 per cent was well below the 16 per cent limit that Schedule B banks as a group were then permitted to hold), it nonetheless raised several political issues and concerns as reflected in the deliberations of the House of Commons Finance Committee that met during October and early November of 1986 (House of Commons, 1986: Issues No. 3, 4 & 16).

Although the Continental-Lloyds merger transaction was found by a majority of the Committee members to be in the best interest of Canadians (e.g., by providing stability in the financial system, employment security, maintaining competition, and generating an orderly repayment of the Bank of Canada's advances to the Continental) the Committee was "concerned with the ad hoc nature of the process used by the Government to approve the acquisition of the assets of a Canadian Schedule A bank" (House of Commons, 1986, Issue No. 16:4). It was concerned that the government did not handle the review of the asset acquisition properly and effectively. The close relationship between the regulators and the subject banks was questioned. The role of some individuals was also scrutinized for possible conflict of interest situations. In the end it was deemed that the regulators did not afford other Canadian parties an equal opportunity of acquiring the assets of the Continental (House of Commons, 1986, Issue No. 16:4).

The Committee was also concerned about the lack of a clear policy on the ownership of Canadian financial institutions. It was of the opinion that the government had mishandled the transaction partly because it had failed to implement the Committee's previous recommendations with respect to bank ownership set out in its report of November 1985 (House of Commons, 1986, Issue No. 16:4). Moreover, the Committee decried the fact that the federal government had not acted upon similar concerns the Committee had also raised at the time of the merger between Canadian Trust and Canada Permanent Trust, as well as at the time of the purchase of Genstar by Imasco (House of Commons, 1986, Issue No. 16:4).

The Committee also deemed the terms and conditions for bank mergers under the Bank Act were un-conducive to Canadian banking firms interested in merging or

acquiring other Canadian banks. It found the 10% limit affecting the ownership of Schedule A banks to have also contributed to the acquisition of Continental by Lloyds because Continental could not remain as a Schedule A bank if were not to be widely owned.

The committee thus suggested reforms based on a five-level bank ownership framework (ranging from 100 % ownership for banks with domestic assets under \$10 billion to 10% ownership limit for banks with over \$40 billion in domestic assets) that would preserve the domestic ownership of Canadian large banks while at the same time permit foreign interests to “be the sole owners only of those Canadian banks with less than \$10 billion in domestic assets” (House of Commons, 1986, Issue No. 16:5). In other words, “once a foreign bank approached the \$10 billion limit it would be obliged to take in Canadian partners” (House of Commons, 1986, Issue No. 16:5).

Although the government did not adopt the above suggestions right away, we see these proposals being implemented (albeit in a modified way) in the current size-based ownership regime and bank merger review framework introduced in 1999. The federal government, however, proceeded to effect changes to the Bank Act in 1987 in order to accommodate the changes made at the provincial level noted above (Statutes of Canada, 1987, Chapter 26). These changes effectively eliminated the separation of banking and securities business. This was a significant shift from the past whereby up until 1987 through a combination of custom and law (both federal and provincial) banks were kept out of much of the securities business (Freedman, 1996, 1998). With the relaxation, however, came tight restrictions on both upstream and downstream linkages between banks and securities dealers (Freedman, 1998: 9). Federal financial institutions were only allowed to enter securities business through a subsidiary. In this changed environment,

Canadian banks, insurance companies, and trust companies were the first to benefit from the new policy, which was extended one year later to foreign firms. Indeed, the major chartered banks entered into the securities business in a major way. Most of them bought (outright or in part) an existing securities dealer (Freedman, 1996: 731-2). In fact, “the then largest four Canadian brokerage firms were acquired by the major banks within a nine month period” (Power Financial Corporation, 2003). (See Appendix 2, Table 6). Thus, Canada’s banks entered “into securities, a business they [had] lobbied hard to join” (Galt, 1987:53).

Right on the heels of the 1987 Bank Act amendments came the Canada-U.S. Free Trade Agreement (CUSFTA) of 1988. The signing of CUSFTA introduced a new set of regulatory parameters into the Canadian domestic financial system. Under the CUSFTA, U.S. financial services were accorded “national treatment”, i.e., U.S. financial services firms were to be treated at par with Canadian financial institutions (Folsom, 2004; Industry Canada, 1998). As such, Canada agreed to exempt U.S. firms from the 25 per cent limit on foreign ownership of Canadian bank assets, as well as on the ceiling placed on the total assets of foreign banks in Canada. U.S. banks were also exempted from the need to seek approval from the Minister of Finance in opening new branches. Of course, consistent with the national treatment principle, U.S. firms, like Canadian firms, were not exempted from the 10 per cent limit on bank ownership – a condition instituted to ensure that Canadian banks were widely held.

The United States for its part agreed to accord Canadian financial institutions the same treatment as U.S. institutions as and when regulatory reforms were made in the U.S. In the short term, the CUSFTA seemed to favour the U.S. financial institutions for Canadian firms could not effectively capitalize on their strengths (Orchard, 1993; see also

Clarkson, 2002b). For instance, their experience, expertise, and technology in branch banking could not be utilized until the limitations on interstate banking were removed. Secondly, Canadian banks could not operate flexibly as universal banks due to the then tight and restricted regulation and indeed prohibitions that separated commercial banking from investment banking under the Glass-Steagall Act of 1933.

The CUSFTA was followed by the amendments to the Bank Act in 1992 (Statutes of Canada, 1992, Chapter 46). These amendments were far reaching in that by revising bank powers and ownership rules, the law set out new parameters within which banking mergers and acquisitions could take place. In essence, the 1992 amendments continued the process of removing regulatory barriers separating the financial pillars by permitting them to diversify into new lines of business through increased in-house powers as well as through subsidiary companies. In-house, banks were empowered to offer portfolio-management advice while life insurance companies were allowed full consumer and commercial lending powers. Constraints, however, were placed on financial institutions: notable among them being restrictions on the selling of insurance through branches of federal deposit-taking institutions and the prohibition of federal financial firms from engaging in car leasing business. These rules thus set the parameters within which banks could merge or acquire financial and non-financial firms.

Moreover, changes to ownership rules set out what types of financial sector firms (e.g., trust, insurance) could be acquired by banks and under what arrangements. Through subsidiary companies, banks and insurance companies were allowed to own trust companies, while banks and trust companies were permitted to own insurance companies. These changes eventually led to the acquisition by the major banks of most trust companies that were facing financial difficulties that followed “the collapse of the

speculative real estate boom in late 1980s” (Calmès, 2004:13; see also Power Financial Corporation, 2003).

In addition to the permission to acquire trust companies, the 1992 changes also permitted widely held non-bank financial institutions to own Schedule II banks. Moreover, the new legislation also permitted federal financial institutions to own firms involved in a number of specified activities including factoring, mutual fund distribution, information services and other ancillary activities. The legislation, however, continued the prohibition on federal financial institutions from owning car-leasing companies. Generally, the new statute strove to provide identical investment powers (level playing field) for all types of financial institutions and in the process opened up more avenues for bank mergers and acquisitions.

The 1992 Bank Act reforms were followed by the signing of the North American Free Trade Agreement (NAFTA) in 1993 (effective January 1994) (see Folsom, 2004; Johnson & Langley, 2002; Schefer, 1999). Chapter 14 of the NAFTA governs the establishment of financial services (Article 1403), and cross border trade in financial services (Article 1404). The NAFTA also provides that each party must accord “national treatment” to each other (Article 1405). Thus, national treatment provided in the CUSFTA between Canada and the U.S. was extended to Mexico. Consequently, under NAFTA, American and Mexican banks are to be treated in Canada at par with Canadian banks. Likewise, Canadian banks are accorded national treatment rights in the U.S. and Mexico. Moreover, Article 1406 of the NAFTA provides for the “Most-Favoured Nation Treatment” that defines how NAFTA members should treat each other vis-à-vis non-member countries in the sense that “no member of NAFTA will provide preferential treatment to investors of a non-member country over a member country” (Johnson &

Langley, 2002: 17). Lastly, Article 1408 limits the restrictions a member country may impose on the nationality of senior management and members of board of directors of financial firms.

In addition to the above cited regionalist adjustment, a crucial change was made in 1999 (through amendments to the Bank Act, and other financial institutions acts) in how foreign financial institutions were treated in Canada (Statutes of Canada, 1999, Chapter 28). In accord with its obligations under the World Trade Organization (WTO) agreement on financial services, the federal government undertook to allow foreign banks (from WTO member countries) to establish branches directly in Canada. A new category of banks, named Schedule III banks, was added into the Bank Act (Section 14.1). This move, thus effectively, removed (subject to certain restrictions) the condition that foreign banks seeking to enter the Canadian market place must do so only by establishing a separately capitalized bank subsidiary (Statutes of Canada, 1999, Chapter 28; see also Mailander, 1999; OECD, 2006). As a result of this change, foreign banks can now operate branches in Canada subject to Ministerial approval (Section 422.2), but are also restricted from taking deposits of less than Canadian \$150,000 (OECD, 2006; see also Sections 21.1(5) and (6) of Statutes of Canada 1999, Chapter 28). Of course, as in the past, “foreign banks can also operate as separately capitalized subsidiaries” (OECD, 2006:69). The main implication of this change for Canadian bank merger policy is threefold. First, the Canadian bank merger policy has become more complex as, for example, the federal government (given its varied international commitments) has had to stipulate Bank Act provisions that distinguished foreign banks in terms of financial institutions owned/controlled by residents of WTO member countries from those owned/controlled by residents from non-WTO member countries as well as banks

owned/controlled by residents from NAFTA member countries versus banks owned/controlled by residents from non-NAFTA member countries. Second, the government had to stipulate (in the Bank Act) provisions under which, for example, foreign banks with branches or subsidiaries in Canada could acquire the assets and liabilities of domestic banks (Section 232). Lastly, the frontier or scope of Canadian bank merger policy has expanded in the sense that it has now to formally consider the ramifications of mergers taking place overseas especially of those involving foreign banks with branches in Canada.

These shifts were subsequently followed by further changes two years later. Following a consideration of the MacKay Task Force Report of 1998 the federal government introduced a new framework replacing the previous regime (of Schedule I and Schedule II banks) with a new size-based ownership regime comprised of three categories of banks (Department of Finance, 1999a, 1999b, 1999c, 2001a, 2001b). In the first category, i.e., large banks (banks with equity in excess of \$5 billion) must remain “widely held” whereby an individual investor would be permitted to own up to 20 per cent of any class of voting shares of a widely held bank and up to 30 per cent of any class of non-voting shares, subject only to a “fit and proper” test designed to evaluate the applicant’s character and suitability. This, it was hoped, would allow widely held banks to enter into strategic alliances and joint ventures involving significant share exchanges. At the same time, the Bank Act would continue to prohibit the control of a large financial institution by any single shareholder or group of shareholders (Department of Finance, 1999a, 1999b, 1999c, 2001a, 2001b; see also CBA, 2001).

In the second category (comprised of medium-sized banks with equity between \$1 billion and \$5 billion), the new rules permitted individual shareholdings of up to 65 per

cent, with at least 35 per cent of voting shares being publicly held. In the third category, comprised of small banks with equity of less than \$1 billion, the new rules placed no ownership restrictions other than “fit and proper” tests (Department of Finance, 1999a, 1999b, 1999c, 2001a, 2001b).

The new framework also enabled banks to organize under a regulated holding-company structure that provided them with greater flexibility to compete with large specialized or unregulated firms. Both holding companies and banks structured along the traditional parent-subsidary model were permitted to have a broader range of investments than under the previous regime (Department of Finance, 1999a, 1999b, 1999c, 2001a, 2001b).

The new size-based ownership regime also allowed for the creation of community-based banks with services tailored to the needs of a specific clientele. These banks would still be able to compete with the major banks in local or regional markets. The new regime also allowed commercial enterprises (for example, those with a significant retail presence) to own a bank (Department of Finance, 1999a, 1999b, 1999c, 2001a, 2001b). To encourage competition, the legislation also reduced the minimum capital requirement to start a bank from \$10 million to \$5 million (Department of Finance, 1999a, 1999b, 1999c, 2001a, 2001b).

The federal government, however, did not permit banks to sell insurance through their branch networks or enter into car leasing business directly as had been suggested by the MacKay Task Force. In addition, the government has prohibited large banks from acquiring the recently de-mutualized large insurance companies (Department of Finance, 2003). The federal government’s stance has in major part been influenced by the stiff opposition from some insurance companies and their industry associations (see e.g.,

Insurance Bureau of Canada, 2003; Power Financial Corporation, 2003; Sun Life Financial, 2003;) and car dealership lobby (see Dobson, 1999) who fear loss of business to the large banks.

In summary, the rules pertaining to bank ownership have evolved from those allowing a close ownership of banks (in the early days of Canadian banking) to rules that emphasize that large banks be widely held. The preceding discussion also highlighted how public policy focus has evolved from one that was preoccupied with horizontal (bank-bank) mergers to one that currently deals with different types of mergers (horizontal, vertical and conglomerate mergers) whereby banks are permitted to merge with or acquire firms engaged in trust and securities business. As regards foreign ownership, the open-door policy was reversed in 1967 when strict restrictions were imposed only to be relaxed in the 1980 revisions of the Bank Act. In regard to rules on business powers, the preceding discussion highlighted how banks have successively acquired permission to engage in a variety of financial services ultimately leading to a crumbling of the financial pillars. What is common among all these types of changes is that they all have been influenced and shaped by both domestic and external factors in a path-dependent trajectory.

5.3.3 Bank Merger Review Process, Instruments and Institutional Configuration

As noted earlier, the primary source of public oversight is the Canadian Constitution that gave the federal government exclusive authority on all matters pertaining to banks and banking. How the federal government has exercised this authority with respect to procedures for bank merger review, instruments used, institutional

configuration and arenas of governance, however, has changed over the years in a path-dependent manner. While at Confederation, the law vested final authority with the federal parliament, this power has gradually migrated from parliament to Governor in Council and eventually to the minister of finance who currently has the final say on bank mergers and acquisitions. These shifts have in turn been accompanied by a change in policy instruments as well as in the institutional configuration of the bank merger regime.

To arrive at the present framework, the federal government has had to make several incremental as well as radical policy changes along the way. For instance, at Confederation, the law provided that banks could merge only under special acts of parliament. This is evidenced, as discussed earlier, by the passage in 1867 and 1868 of special statutes to respectively authorize and confirm the amalgamation of the failed Commercial Bank of Canada with the Merchants' Bank to form the Merchants' Bank of Canada (Statutes of Canada, 1868, Chapter 84).

This approach was concretized with the passage of the Bank Act of 1871. Moreover, the Bank Act of 1871 provided that the chartering of any new bank must be authorized by a special act of parliament, the terms of which must conform to the general Bank Act (McIvor, 1958: 68). The introduction of this provision was an abandonment of the provision made in 1870 -- that is, banks could also be incorporated through letters patent (Jamieson, 1957: 21). This meant merging banks had to go through only one process that culminated with the passage of a special act of parliament (introduced via a private member's bill).

The process continued for about three decades (without any important changes in the 1880 and 1890 revisions to the Bank Act) until 1900 when significant changes were made including the revision of the Bank Act and the accordancy by the federal

government of statutory recognition to the Canadian Bankers' Association (which had been organized in 1892) by "conferring on it certain duties with respect to the supervision of failed banks and the handling of banks notes" (Curtiss, 1935: 158). Specifically, sections 33-44 of the Bank Act of 1900 (Statutes of Canada, 1900, Chapter 26) provided for the powers and processes for the "purchase of assets of a bank." Section 33 explicitly authorized any bank to "sell the whole of any portion of its assets to any other bank which may purchase such assets." Section 36, on the other hand, provided for the approval process through which the sale and purchase of bank assets could be made by applying "to the Governor in Council, through the Minister of Finance and Receiver General" (Statutes of Canada, 1900, Chapter 26). As the parliamentary debates of 1923 indicate, these sections were understood to encompass not only the purchase of bank assets but also bank mergers and acquisitions (House of Commons Debates, 1923).

Worth noting here is that the vesting of power in the Governor in Council to approve the sale of bank assets was a significant change because prior to this amendment, the sale of bank assets or bank mergers required sanction by a special Act of Parliament. Under the new framework, merging parties would first enter into agreement and get approval from their respective shareholders. They would then approach the minister of finance who would then forward their request for a merger to the Governor in Council for approval. The minister of finance did not then have the power to veto bank merger proposals. In this case, it was the Governor in Council (instead of the Parliament) that had the final say on whether or not to permit a merger proposal.

This framework, however, did not last long as significant changes pertaining to the rules on the sale and purchase of bank assets were introduced in the revisions of the Bank Act of 1913 (Statutes of Canada, 1913, Chapter 9). While still retaining final power

with the Governor in Council (section 102), the Bank Act of 1913 this time gave the Minister of Finance prior approval power before (purchase/sale) agreements by the banks intending to merge could have any effect. Specifically, section 99(2) of the Act provided that “No agreement by a bank to sell the whole of any portion of its assets to another bank shall be made unless and until the Minister, in writing, consents that an agreement under subsection 1 of this section may be entered into between the two banks.” This provision was further reinforced by Section 106 (a) of the Act which specifically stated that the “approval of the Governor in Council shall not be given to the agreement unless among other things, “the consent of the Minister as prescribed by subsection 2 of section 99 of this act has been given.”

Consequently, prospective merging parties had first to win/secure the consent of the minister of finance before the Governor in Council could consider their proposal. It has been argued that the change was made “to appease those who feared that the rapidly declining number of banks would lead to the establishment of a ‘money trust’” (Beckhart, 1929:339). While the intent may very well have been to appease the opponents of bank mergers, it is clear from reading the debates in the House of Commons as well as in the Banking and Commerce Committee of the House of Commons that the serious apprehensions about, and vigorous opposition to bank mergers were hardly resolved (Debates of the House of Commons, 1913).

While the concerns of the parliamentarians were not clearly settled the legislative changes were carried. No sooner had the legislation passed did the First World War break out. Banks played a critical role in war financing and in turn benefited greatly (Darroch, 1994; Jamieson, 1957). And as it turned out, instead of effectively addressing the

concerns of the opponents of bank mergers, the changes made to the Bank Act in effect initiated the shift of power from the Governor in Council to the Minister of Finance.

Thereafter, the federal government stayed the course resisting the calls for tightening its bank merger policy. Calls by opposition MPs for drastic changes with regard to bank merger provisions of the Bank Act made in 1923 were futile (Debates of the House of Commons, June 20, 1923:4134; also see CBA, 1933:362). A motion (Bill No. 44 to amend the Bank Act on February 15th, 1928) by Mr. T. L. Church, M.P. (Hansard, 1928: 480) to require that agreements for bank mergers should have the approval and sanction of Parliament instead of that of the Governor in Council and the Minister of Finance was defeated (CBA, 1933:363).

The government's position with regard to bank mergers did not change very much up until the 1954 amendments to the Bank Act (Statutes of Canada, 1954, Chapter 48) when it clearly distinguished between the "purchase of bank assets" and "bank amalgamations" (new Section 100) – two distinct transactions that were up to then subsumed under the "purchase of bank assets" provision first introduced in the Bank Act revision of 1900. The bank merger review process, thus established, remained largely intact for about three decades until 1980 when the Bank Act was revised (Statutes of Canada, 1980, Chapter 40).

The 1980 Bank Act revisions were far-reaching in that under the significantly revised part on "conversions, amalgamations and sale of assets" (Part X: sections 254-275), the Act empowered the Minister of Finance "with the approval of the Governor in Council, but otherwise at his sole discretion", to issue letters patent: (i) converting a non-bank financial institution to a bank (Section 255(1)); (ii) amalgamating two or more banks or one or more banks and one or more financial institutions (Section 255(2)); and

(iii) amalgamating and continuing as one corporation the financial institutions and converting that corporation to a bank (Section 255(3)). This change, in essence, effectively shifted power to the minister of finance – a process that was begun with the changes to the Bank Act in 1900.

Noteworthy also are exemptions under the Bank Act of 1980. For instance, Sections 255(5) continued the exemption of banks from the purview of the Combines Investigation Act (Canada's antitrust legislation) in spite of the attempt by the then director (Mr. Robert Bertrand) to subject the banks to the provisions under the competition law (Stewart, 1982:175). Furthermore, the banks were exempted under Section 307 of the Bank Act from the application of the Foreign Investment Review Act. Both these exemptions ensured that the Minister of Finance retained final authority with regard to domestic as well as cross-border (inward) bank mergers.

The above changes and continued exemptions were soon followed by major shifts in the governance of banks and banking in Canada at both orders of government: federal and provincial. At the federal level, a historical shift occurred when, for the first time, the banking sector was explicitly brought under the purview of the overhauled Competition Act. This move had significant implications for the configuration of institutions and agencies involved in the governance of bank mergers as the review of mergers among financial services firms also became for the first time a responsibility of the Competition Bureau albeit jointly shared with the Inspector General of Banks, with the federal minister of finance retaining the final authority in permitting or prohibiting any bank merger transaction.

At the provincial level, as discussed in the previous section, reforms to allow securities firms to be acquired by banks meant a review of federal banking legislation in

1987 (Statutes of Canada, 1987, Chapter 26: s.6.1). Moreover, alarmed that the Ontario government's move to open up the securities industry would affect the trade talks with the United States, the federal government entered into an agreement with the Ontario government in April 1987 to preserve its jurisdiction over any measure with international implications (Bodkin, 1990: 165). As Jill Bodkin has observed:

The basis of this agreement was that the Ontario Securities Commission would regulate securities activities conducted through subsidiaries of non-securities firms, with the federal government regulating securities activities of the parent. Decisions on entry of non-resident firms, by then eligible on a phased basis for full access or 100 per cent ownership of a Canadian dealer, would rest with the federal government (Bodkin, 1990: 165).

The institutional set up of the Canadian financial services regime was further transformed following the Estey Commission's Report (1986) and with the passage of two key statutes, viz.: the OSFI Act in 1985 (Statutes of Canada, 1985, Chapter 18, in force July 2, 1987), and the Bank Act of 1987 (Statutes of Canada, 1987, Chapter 26). In a partial response to Estey Commission's recommendations the federal government amalgamated the Office of the Inspector General of Banks with the Department of Insurance and thus established the Office of the Superintendent of Financial Institutions (OSFI) (Coleman, 1996:219; Lew & Richardson, 1992:176). Consistent with the blurring of the financial boundaries the OSFI was granted "considerable autonomy" and "expanded powers" and was thus charged with the responsibility for the regulation and supervision of federally chartered and regulated financial institutions including "chartered banks, federally chartered trust and loan companies, insurance companies, investment companies, and cooperative credit associations" (Coleman, 1996: 219). The OSFI thus replaced the Office of the Inspector General of Banks as one of the key agencies advising the Minister of Finance on bank mergers and acquisitions.

Subsequent to the above changes, bank merger provisions were further revised in 1992 with the changes to the Bank Act (Statutes of Canada, 1992, Chapter 46).

Pertinently, the section on “Amalgamations” was revised in two important ways. First, under Section 223(1) the Minister was given sole powers to issue letters patent in the amalgamation of banks. The clause “with the approval of the Governor in Council” in the previous legislation was completely eliminated; hence giving the minister of finance sole powers in the review of bank mergers. Secondly, rules for two more types of amalgamations were specified. Section 227(1) dealt with “Vertical short-form amalgamation”, and Section 227(2) dealt with “Horizontal short-form amalgamation”. Whereas the vertical amalgamation provisions covered the combining of firms across the financial pillars, the provisions for horizontal amalgamation covered the combining of firms within a financial pillar e.g., mergers among banks.

Specifically, under the vertical short-form amalgamation a bank may, without complying with Sections 224 to 226, amalgamate with one or more bodies corporate that are incorporated by or under an Act of Parliament if the body or bodies corporate, as the case may be, are wholly-owned subsidiaries of the bank. Under the horizontal short-form amalgamation, two or more bodies corporate incorporated by or under an Act of Parliament may amalgamate or continue as one bank without complying with section 224 to 226 if (a) at least one of the applicants is a bank; (b) the applicants are all wholly-owned subsidiaries of the same holding body corporate.

These changes basically simplified mergers within a group of firms (banks and non-banks) as opposed to mergers between firms belonging to different groups of companies. Moreover, this change was followed six years later by the issuance of the Competition Bureau’s Merger Enforcement Guidelines as Applied to Banking in 1998

(Competition Bureau, 1998a). Soon, thereafter, the bank merger process, institutional arrangement and instruments used were re-articulated following the federal government's decision to end the prohibition on large bank mergers – a decision that was made after the rejection of the Royal/BMO and CIBC/TD merger proposals in 1998, and the receipt and consideration of the MacKay's Task Force Report (see next section). The federal government introduced a new framework for bank merger regulation in a White Paper of 1999 proposing to create “a process under which mergers would be extensively reviewed to ensure that they were in the best interests of the institutions, Canadians, and the Canadian economy” (Department of Finance, 1999b; Dobson, 1999:13). The framework was subsequently codified in the Bank Act of 2001 (Statutes of Canada, 2001, Chapter 9). In fact, the new framework was further fine-tuned and elaborated on June 23, 2003, when the then Finance Minister Hon. Mr. John Manley released his response to the reports of the House of Commons Standing Committee on Finance and the Senate Standing Committee on Banking, Trade and Commerce. In his response, the minister outlined the specific roles of the governmental agencies (OSFI, Competition Bureau, Minister of Finance) and parliamentary committees (Department of Finance, 2003).

Accordingly, as discussed in the preceding section, in the new framework, the previous regime of Schedule I and Schedule II banks was replaced by a new size-based ownership regime comprised of three categories of banks. Based on the categories, the framework outlined for large banks only (i.e., those banks with equity in excess of \$5 billion) a three-stage bank merger review process, viz.: an examination phase, a decision phase, and a remedies negotiation phase (Department of Finance, 1999b; chart 2.2).

During stage one (the “examination phase”) merging banks would submit a written application to the OSFI, Competition Bureau, and Minister of Finance requesting

approval to amalgamate. The application would contain necessary information including a Public Interest Impact Assessment (PIIA) that would present the costs and benefits of the proposed merger, including the impact on sources of financing for households and small and medium-sized business, the implications for branch closings and service delivery, and the effects on international competitiveness, employment, and technology.

During this phase, the OSFI and the Competition Bureau will conduct concurrent reviews focusing on prudential issues (safety and soundness) and competition issues (efficiency, market concentration, etc) respectively. The relevant House of Commons and Senate committees will conduct public hearings into the broad public interest issues that may be associated with a proposed merger transaction (Department of Finance, 1999a, 1999b, 1999c, 2001a, 2001b, 2003).

Once the OSFI, the Competition Bureau, and the parliamentary committees have completed their tasks they will each submit a report to the Minister of Finance detailing their respective concerns and recommendations.

During the second stage (i.e., decision phase) the Minister of Finance will review all the reports and then make a decision on whether to approve or deny the application. If the minister is of the opinion that the prudential, competition and public interest concerns raised by the proposed merger transaction cannot be satisfactorily addressed, the minister may deny the application and the review process would end at this stage. If, however, the minister decides that the concerns raised could be satisfactorily addressed the review process will proceed to the next stage.

During the third stage (negotiation of remedies), merging parties will negotiate with the OSFI (on remedies necessary to deal with prudential concerns raised) and the CB (on remedies necessary to address competition concerns). Both the OSFI and CB will

work with the ministry of finance to negotiate remedies for public interest concerns. Once the Minister of Finance is satisfied with the negotiated remedies, the minister will approve the proposed merger transaction subject to the terms and conditions set out to address the concerns raised and as reflected in the negotiated remedies.

In this new framework, the final authority to permit or deny bank mergers would continue to rest with the Minister of Finance, who would have legislative authority to enforce remedies or other undertakings given by the merger partners (Department of Finance, 1999b; Dobson, 1999:13; Harris, 2000: 221). In justifying the need for retaining the final authority with the Minister of Finance (and for a public interest review of bank mergers), then Finance Minister Manley argued that the Minister of Finance, as the Minister responsible for the financial sector and capital markets, is the appropriate person to review the full range of relevant issues, weighing the benefits and costs of a merger proposal and to make a final decision (Department of Finance, 2003). This approach, he contended, was appropriate given the special status afforded financial institutions by Parliament under federal legislation, and the role that they play in the Canadian economy and Canadian capital markets (Department of Finance, 2003). In this regard, he noted:

Given their vital role in the Canadian economy... mergers involving large banks in Canada are not like mergers in other industries. They raise special concerns that justify a broader public interest test. This is especially true given the degree of existing concentration in the Canadian banking industry and the possibility of multiple merger applications, which have the potential to significantly alter the landscape of the financial sector in Canada (Department of Finance, 2003).

In summary, the current approach to bank merger review has evolved from a rudimentary process that saw bank mergers reviewed and approved by parliament to one that currently involves the OSFI, Competition Bureau, Minister of Finance, and two parliamentary committees, with the Minister of Finance having the final authority to

approve or deny merger proposals. Essentially, the current approach is a culmination of the centralization of power within the ministry of finance. Interestingly, consistent with the rise in “multi-layered institutional playing fields” (Cerny, 1997:253), Canadian bank mergers now also face international reviews. For example, the Royal/BMO and CIBC/TD bank merger proposals of 1998 were reviewed by the European Union (Blackwell, 1998b). U.S. authorities also reviewed these proposals in light of the subsidiaries the Canadian banks own in the American market.

5.3.4 Bank Merger Policy Style

To better comprehend the Canadian bank merger policy style, and for tractability purpose, we suggest that we examine separately two interrelated aspects, viz.: (a) policy formulation style, and (b) policy enforcement style. Doing so will help us apprehend how the federal government has hitherto related to other policy actors, the uneven powers of the actors, and the differential roles these various actors have played in bank merger policy formulation as well as in policy implementation processes. We begin with Canadian bank merger policy formulation style.

(a) Bank Merger Policy Formulation Style

The Canadian approach to bank merger policy formulation is both anticipatory and reactive. It can also be characterized as a system of uneven interaction between the state and society, and one that shows an increasing tendency for cooperation among regulatory agencies (both domestic and international). We discuss these aspects in turn.

(i) Combined Anticipatory and Reactive Approaches to Policy-making

The key feature that allows Canadian policy makers to approach bank merger policy-making in an anticipatory manner is the regular revisions of the legislative

framework. Indeed, one of the key distinguishing characteristic of the Canadian banking legislation is the existence of an explicit sunset clause in the Bank Act that was first introduced in 1871 and later discussed and clarified in the parliamentary sessions of 1913 and 1923. This provision has remained a permanent feature since then obliging the government to periodically review bank charters and its banking legislation so as “to keep pace with current and future needs and to govern the banks’ activities in the prevailing public interest” (CBA, 1975a:1). In light of the rapid changes in the financial system, the sunset clause was scaled down in 1980 from decennial reviews to every five years to enable policy-makers to institute timely changes to the Bank Act. Surely, revisions to the Bank Act have not always been made as scheduled; nor has the government been precluded from amending the banking legislation before the scheduled time when deemed necessary.

Furthermore, beginning in 1992, the practice of regular reviews of the Bank Act was extended to include the statutes of other federally chartered and regulated financial institutions by incorporating sunset clauses that required the relevant statutes be reviewed at five-year intervals consistent with the equivalent provision in the banking legislation.

The Canadian bank merger policy approach is reactive in the sense that at several critical moments public policy has been driven by pressures from the financial institutions, provincial governments, and financial firm failures and near failures rather than proactively from within the federal government system itself. For instance, although the first Bank Act (1871) required that detailed monthly reports on bank assets and liabilities be submitted to the minister of finance, “proposals for external inspection were staunchly opposed by most bankers, it took a commission of enquiry into the failure of the Farmers Bank of Canada [1913] ... to persuade the government to enact a compulsory

shareholders' audit. It took a second, similar inquiry into the failure of the Home Bank (1924) to persuade the government to introduce compulsory government inspection" (Shearer, 1977:47).

Likewise, the government responded to the Mercantile Bank affair of 1963 with the tightening of foreign ownership and entry rules in the 1967 Bank Act only to reverse this policy in the 1980s as the pressures from the Canadian provinces and globalization impelled the federal government to permit foreign banks to enter the Canadian bank market place as well as to permit Canadian banks to enter into hitherto out-of-bounds securities business and consequently to acquire provincially-regulated securities dealers.

Similarly, after the demise of the Canadian Commercial Bank (1986) and Northland Bank (1985) and, in partial response to the Estey Commission's recommendations, the government responded by merging the Office of the Inspector General of Banks (OIGOB) and the Department of Insurance to establish the Office of the Superintendent of Financial Institutions (OSFI) so as to strengthen the financial regulatory regime. The rescinding of the longstanding (unwritten) big-shall-not buy-big rule in 1998/1999 is another case of the government responding to the pressures emanating from the financial institutions.

(ii) Policy Actor Relations

As regards to the evolution of the relationship between the federal government and other bank merger policy actors, we believe it is better to disaggregate the various relationship patterns with respect to (1) intra- and inter-state relations including the relationship amongst the agencies within the federal government departments, and the

relationship between the federal government and the provincial governments as well as with international/multilateral agencies; and (2) the relationship between the federal government and non-state actors including the banking (financial sector) community, and (non-profit) civil society. It is crucial we do so because as financial integration has accelerated and as financial pillars have converged, the banking policy community has broadened and deepened (albeit unevenly) to encompass actors previously belonging to the other financial industries (e.g., foreign banks, securities, trusts, insurance and credit unions). We begin with the relationship among federal government agencies.

When one examines the nature of the relationships among federal government agencies one can clearly see a tendency towards increased cooperation. As the number of institutions involved in the formulation of bank merger policy increased, so has the tendency for increased tension, cooperation and coordination. For instance, this tendency was institutionalized in 1987 when the amendments to the Bank Act also included the establishment of a coordinating committee under the chairmanship of the Superintendent of the OSFI (Statutes of Canada, 1987, Chapter 23: Section 18(2) and (3)). This committee was to consist of: (a) the Superintendent of Financial Institutions, (b) the Governor of the Bank of Canada, (c) the Chairman of the Canada Deposit Insurance Corporation, and (d) the Deputy Minister of Finance. The main purpose of the committee was to facilitate consultation and the exchange of information among its members on all matters relating directly to the supervision of financial institutions (Section 18(3)).

It should, however, be noted that although there has been a tendency for increased cooperation and codification of such cooperation, what is striking in the institutional evolution of Canadian financial regulatory regime is that a number of key aspects have also remained unspecified in the relevant statutes. For example, when the Bank Act was

revised in the 1987 Bank Act, the role of the OSFI with regard to bank mergers remained unspecified, as the relevant sections of the Bank Act pertaining to bank mergers (i.e., Part X) were not amended as a consequence of the establishment of the OSFI. This is interesting because with the abrogation of section 255(5) of the Bank Act and the consequent transfer into the Competition Act, the provisions of section 309 of the Bank Act one would have expected a clear specification of the role of the OSFI. It is even more interesting because, while in amending Subsection 91(5) to (7) of the Loan Companies Act, the Superintendent was given an explicit role in the amalgamation process of loan companies (Section 154(6)(a)), a similar move or amendment was not made in the Bank Act (Statutes of Canada, 1987, Chapter 23). Moreover, it should also be noted that:

While the authority of both the Director and Minister of Finance are spelled out in the *Competition Act* and *Bank Act*, both acts however, are silent as to how the Director and the Minister should interact and how this process should unfold (Competition Bureau, 2003a:42).

To be sure, these shortcomings were partially addressed by the introduction of the new framework in 1999 that was subsequently fine-tuned in 2001. But, as Neufeld has noted, this very framework “is not reflected in any statute” (Neufeld, 2001:342). By not being part of the relevant statute(s) “the guidelines can be changed by the government with ease, which is fortunate or not depending on how such discretionary policy-making will be used” (Neufeld, 2001:342).

As regards to the relationship between the federal government and the provinces one can also observe a tendency for increased cooperation. Institutionalized cooperation between the federal government and the provinces was, in fact, preceded by an enhanced cooperation among provincial governments as evidenced by the signing of an accord by

western provincial Ministers in 1988 to make the “regulation of financial institutions more compatible across provinces, and to share information for regulatory purposes” (Bodkin, 1990: 168). “Other provinces joined in this agreement in April 1989” (Bodkin, 1990: 168). The federal government was also invited to these meetings (Bodkin, 1990: 168).

Thereafter, federal-provincial cooperation also saw an upward turn, as “until 1985 there was no forum for regular meetings at the ministerial level” (Bodkin, 1990: 167). One of the measures taken by the federal government to facilitate cooperation and coordination with provincial regulators involved an amendment of the OSFI Act to enable the “Minister [of Finance], with the approval of the Governor in Council, [to] enter into agreements with the appropriate authority of a province (Section 7.1(1), Statutes of Canada, Chapter 18, 3rd supp. Part I).

Worth noting also is that there has been an increasing relationship between Canadian federal authorities and multilateral agencies such as the Bank for International Settlement (BIS), Basle Committee on Banking, Joint Forum on Financial Conglomerates, Financial Stability Forum and the WTO. In fact, Canada has played an increasingly active role in these and other institutions (see e.g., Department of Finance, 1998f; ICN, 2006).

In sum, enshrining areas of cooperation between the federal authorities and relevant provincial counterparts and international/multilateral agencies further affirms the increasing need and willingness for cooperation between and among policy actors at different levels (sub-national, national, regional, and global) as financial institutions, markets and organizations continue to integrate domestically, regionally, and globally.

The changing pattern of relationships between and among state-based actors described above is also reflected in regard to the relationship between the federal government and the Canadian banking community, but in a different direction. Unlike the increasing cooperation among state actors, one observes a gradual transformation in the relationship between the federal government and the banking community from one that was very close in the early days of Canadian banking to a relatively arms-length one in the present era.

The close relationship between the federal government and the banking officials was clearly reflected in the process of crafting and implementing the banking legislation of 1871. Although the Bank of Montreal played a key role in drafting the Bank Act of 1871 (Stewart, 1982), the government also strove to involve the larger banking community in crafting the statute. Indeed, George Hague, then the general manager of the Bank of Toronto and an influential participant in the discussions and drafting of the new legislation, captures well the nature of such cooperation between the government and the banks. Hague notes how: "The best legal minds in Parliament were then convened, in conjunction with the Finance Minister, to frame a general act" and that the "Representatives of banks from all parts of the country, therefore, sat in conference, day by day discussing the clauses of the proposed act one by one" (Hague, cited in Jamieson, 1957:19). The significance of the process is described in this way:

We sat in one of the committee rooms of the House, and discussed the bill with considerable sense of responsibility, being well aware not only that our conclusions would affect the whole banking interest of the country, but every other interest, commercial, manufacturing, and industrial, not to speak of the interests of the government itself (Hague, cited in Jamieson, 1957:19).

As such, Mr. Hague saw this process as a positive one and that it was instrumental in shaping the Canadian banking legislation. In his words:

I have always considered that this gave our Banking Act its peculiar value, in that it expressed the matured judgement, sharpened by experience, of the foremost men in banking, commercial, and political life. After all this preliminary work, in which members of both political parties joined, it may be imagined that the bill passed through Parliament with little criticism and no opposition (Hague, cited in Jamieson, 1957:19-20).

Hague also notes that:

Many of the directors of the banks and several of their presidents were members of Parliament, some in the Senate, some in the House of Commons. These of course, sat with us from time to time, so that, though not formally constituted as such, we really were a joint committee of Parliament and bankers" (Hague, cited in Jamieson, 1957:19).

Certainly, according to Stewart (1982:167), among

... the MPs with dual loyalties on this rudimentary bankers' committee were the rascally Francis Hincks, who was at the time a director (later president) of City Bank as well as Minister of Finance, and Louis Davies, President of the Merchants Bank, and Minister of Fisheries.

Indeed, Robert MacIntosh confirms that:

From its earliest years, banking has been inseparable from politics. The founders of banks were usually prominent members of the merchant establishment in the larger communities, which in the early nineteenth century were Montreal, Quebec City, Halifax, Saint John, and Kingston. They were normally well represented in the legislative assembly or better still, in the legislative council, which was the appointed executive before the days of full responsible government. Modern notions of conflict of interest hardly existed, and it was not until the early twentieth century that there began to emerge a more clearly defined line between business and government (MacIntosh, 1991:7).

The old-style bipartite relationship has gradually changed and expanded to a bargaining process that includes representatives from a broad spectrum of societal actors (Coleman, 1996; MacIntosh, 1991). The broadening and deepening of the financial services policy community is attributable to the arrival of new economic players into the banking marketplace (e.g., trusts, credit unions, foreign banks, insurance companies) and the emergence of a number of diverse civil society organizations (e.g., C.D. Howe

Institute, Fraser Institute, Canadian Bankers' Association, Canadian Community Reinvestment Coalition, Council of Canadians, Canadian Centre for Policy Alternatives, Canadian Federation of Independent Businesses, COMER, Conference Board of Canada, PIAC, etc). Again, as MacIntosh (1991: 4-5) observes:

Forty years ago, significant changes in the Bank Act were made after the intervention of relatively few players. Nowadays, the process of reform of financial legislation is practically an ongoing game. After the Bank Act Revision of 1980, the "banking policy community" plunged immediately into the struggle over the Bank Act revision of 1990, which has not yet quite run its course. The decennial revision will continue (after an initial review in five years), and this will involve not just the banks, but also the trust and loan companies, credit unions, and insurance companies. Meanwhile, the Canadian system is being influenced by the rapidly changing American scene, and also by the European Community. Although there is widespread fatigue among the players, it is unlikely that they will get much rest before the next round.

Thus, the cozy relationship and dual loyalties reflective of the early days have over the years eroded. It should be noted, however, that although the relationship between the state and the banking community is not as close as it used to be, the financial community does still have more clout and access to policy-makers compared to the interaction between the state (federal government) and (non-profit) civil society actors. Moreover, due to financial consolidation (attributable to several acquisitions of securities dealers and trust companies) Canadian banks are presently even more dominant in the financial services market place than they were a couple decades ago. Furthermore, not only have banks had the capacity to engage in policy debates on an ongoing basis, but they have hitherto contributed substantial sums of funds to political parties (except for the NDP) in support of their political/electoral campaigns (Stewart, 1982).

In contrast to the close relationship between the state and the banking community, the Canadian state has traditionally tended to involve civil society (individual citizens and

organized groups) in the review and formulation of financial policy in an ad hoc manner that can best be described a “managed inclusion” consultative process. By this we mean the state’s approach has been one that is structurally designed to incorporate civic engagement in a manner that is enabled, constrained and managed by the state. Unlike consultations with the core actors (e.g., banking community, state agencies) where multiple channels and mechanisms exist, consultation with civil society actors is mostly predicated on an invitation-only basis. To be sure, the esoteric nature of financial issues and the fact that very few individuals and civil society organizations have the resources and capacity necessary to enable them to engage in bank merger policy debates on an ongoing basis have also played a part in constraining the involvement of civil society actors.

The ad hoc nature of civil society’s engagement in policy formulation is best gleaned in the federal government’s proclivity to establish royal commissions of inquiry, taskforces, and select/special committees (and, increasingly, to draw on public opinion polls). The history of Canadian banking shows a number of these commissions being formed since Confederation – the earliest example being the 15 member parliamentary “Select Committee on Banking and Currency of the Dominion” struck in April of 1868 to advise the government on the establishment of a stable and uniform national banking system. Thereafter, several commissions, taskforces and committees have been established to study the Canadian financial system (see Appendix 4 for a list of the key commissions). These organs once established would usually hold hearings across the country where they would receive and consider both oral and written submissions from a cross-section of witnesses including individuals (in their own capacities) and organized groups as well. The commissions would then report to the government.

The very structure of these commissions and taskforces limits the involvement of a diversity of actors. But as “sites of policy development” (Inwood, 2005:5), this limited and at best ad hoc involvement, in our opinion, deprives the government (and the nation) of a balanced and rich menu of policy options by constraining the articulation of new ideas, not to mention that it does not sit well with modern democratic ideals (more of this in Chapter 7; and for earlier reviews of Canadian royal commissions see e.g., Courtney, 1969, Doern, 1967, Walls, 1969).

(b) Bank Merger Policy Enforcement

The Canadian approach to bank merger policy enforcement can be best described as case-by-case approach that is relatively less adversarial than the U.S. styles. We discuss these two aspects below.

(i) Case-by-Case Approach

The history of Canadian bank merger policy enforcement clearly depicts a case-by-case approach whereby each merger transaction has hitherto been reviewed and approved or rejected by state authorities (by Parliament in the early days, then by the Governor in Council, and currently by the Minister of Finance) without reliance on standardized rules (e.g., HHI benchmarks on market concentration levels, etc.) or routines. This in part has been feasible because of the low number of merger transactions at any given time. It is also a reflection of the tendency to disfavour a reliance on mechanistic indicators (Porter Commission Report, 1964).

(ii) A Non-adversarial Approach

The Canadian approach to bank merger review can be characterized as “regulatory” as opposed to the U.S. “law enforcement” approach (Collins & Brown,

1997; Goldman & Bodrug, 1997; Kagan, 2000c). This approach is best depicted by the Competition Bureau's "compliance-oriented approach" (open door, ongoing, confidential dialogue between the prospective merging parties and officials of the Competition Bureau). This, however, is not always reflected in the relations between banks and other government agencies. The announcement by the CEOs of the intended merger of Royal and BMO in January 1998 without consulting the Minister of Finance created a highly charged political environment that clearly reflected a growing chasm between the government and the banks (Blackwell, 1998a; Eggertson, Walker & Ferguson, 1998; Foot & Beauchesne, 1998; Marotte, 1998a; McNally, 1998; Tickell, 2000).

As can be recalled, Canada's longstanding unwritten rule that "big-shall-not-buy-big" had for a number of years ruled out mergers among Canadian large banks. However, this rule was put to the test when on January 23, 1998 Canada's first and third largest chartered banks, the Royal Bank of Canada (RBC) and the Bank of Montreal (BMO), announced that they intended to merge (Walters, J., 1998; Whittington, 1998). Not to be disadvantaged, the Canadian Imperial Bank of Commerce (CIBC) and the Toronto Dominion Bank (TD) followed suit on April 17, 1998, by announcing their desire to merge too (Craig, 1998; Marotte, 1998b).

These "surprise" announcements -- which came before the completion of the review by Mr. Harold MacKay's Task Force on the Future of the Canadian Financial Services Sector set up in December 1996 -- were not kindly met by the public, as well as by politicians, particularly by the then Finance Minister Paul Martin Jr. with whom the ultimate approval authority rested (Anderson, 1998; Bouerette, Mahood, McCarthy & Mitchell, 1998; Crone, 1998; Francis, D., 1998; Greenway, 1998; Philp, 1998; Tandt, 1998; The Toronto Star, 1998; Toulin, 1998a, 1998b; Wilkes, 1998). Moreover, several

organizations including nationalist, labour, anti-poverty, women's and other groups banded together under an umbrella group the Canadian Community Reinvestment Coalition launched a vigorous campaign against the mergers. Opposition to the mergers also emanated from the financial system itself. The Bank of Nova Scotia's vocal criticism and Manulife's opposition are cases in point (Crone, 1998; Harris, 2000; Tickell, 2000, Whittington, 1999).

As a response to the proposed merger announcements a series of reviews were triggered. And, after the reviews by the Competition Bureau, the Office of the Superintendent of Financial Institutions, the Senate Banking Committee chaired by Mr. Michael Kirby, and by a Task Force of the Liberal Party's caucus led by Mr. Tony Ianno, the then Finance Minister Paul Martin Jr. rejected both merger requests on public interest grounds (Department of Finance, 1998c, 1998d).

Explaining the eventual rejection of the merger proposals Tickell (2000:154) maintains that:

... the government's rejection of the merger proposals occurred because the hegemonic project of bank capital in Canada became undermined over a period of years, as the banks became more visibly powerful, as the meso-corporatist relationship between the finance ministry and financial institutions came under closer scrutiny and as the banks vigorously attacked the product markets of other financial pillars, creating powerful enemies along the way.

Subsequently, after receiving Mr. MacKay's Report, the government introduced changes intended to establish a formal and transparent process for large bank merger review (Department of Finance, 1999a, 1999b, 1999c). In spite of the rejection, it is pertinent to note that, consistent with Canadian political culture, the banks did not resort to court challenges as might have happened in an adversarial environment. In short, the relationship between the two parties remains only moderately adversarial.

5.3.5 Bank Merger Policy Impacts

The impacts of Canada's bank merger policy can be discerned in a number of dimensions. For our purposes, we will examine (albeit briefly) bank merger policy impacts with respect to those aspects that have a significant bearing on Canadian bank merger policy objectives delineated earlier. These elements include financial system stability, international competitiveness, domestic ownership, banking concentration, financial system efficiency, and customer/consumer protection. We begin with financial system stability.

(a) Financial System Stability

By many accounts the Canadian financial system has a reputation for stability (see e.g., Bordo, 1995; Cornelius, P.K., M. Porter and K. Schwab, 2003, 2004; Darroch, 1994; Department of Finance, 2002; Drummond, 1991, IMF, 2000; OECD, 2006; Taylor & Baskerville, 1994). In spite of a rocky beginning, the history of Canadian banking depicts a relatively sound and stable banking system. Notwithstanding the 26 bank failures between Confederation (1867) and 1923 (the last time Canada had its last bank failure before the failure of two western-based banks in 1985; see Appendix 2, Table 3 for a list of bank failures), the Canadian banking system has worked quite well and has since then, in spite of domestic and global challenges, remained generally very stable, even as other countries and regions have gone through very turbulent times.

Indeed, the soundness of the Canadian banking system was demonstrated early on by its remarkable resiliency during the Great Depression. Even though "Canada was badly battered by the Depression" its banking system fared much better than other industries (Taylor & Baskerville, 1994:373; see also Drummond, 1991). In fact, unlike its

neighbour to the south (USA) Canada emerged from the Great Depression with a stronger banking system (Darroch, 1994; Taylor & Baskerville, 1994:373). Moreover, the soundness of Canadian banking was again demonstrated by its resiliency in the face the challenges brought about by Third World debt crisis in 1980s. The question then is: what accounts for such strength? Several factors have been ascribed to the stability of Canada's banking system. We briefly explore these below.

Writing about the early banking system in Canada, Jamieson (1957) attributed the stability of the Canadian financial system, in part, to bank consolidation. He posited that the acquisition of distressed banks by stronger ones:

... removed weak spots in the financial economy and put the banking system as a whole in a much better position to withstand the shocks of the great depression. The highly satisfactory way in which the system came through the ordeal and its record since furnish ample proof of the wisdom of the consolidations effected (Jamieson, 1957:165-6).

The stability of Canada's financial system has also been attributed to its nationwide branching system (e.g., Bernanke, 1983; Ely, 1988; Friedman & Schwartz, 1963; O'Driscoll, 1988). However, contrary to these writers, Kryzanowski and Roberts (1993:373) challenge "the accepted view... that "diversification benefits from national branching kept Canadian banks solvent and prevented runs and failures in the 1930s when no legal deposit insurance system was in place." Instead, they argue "the better failure performance of Canadian versus U.S. banks is attributed to the Canadian government's policy forbearance through implicitly guaranteeing all deposits at par, primarily by standing ready to lend to banks and by facilitating the merger of troubled and healthier" (Kryzanowski & Roberts, 1993: 373). As such they contend, "national branching did play a positive role in protecting Canadian banks and their depositors in the

1930s making government forbearance feasible by reducing the number of banks and lessening competition” (p.373).

Also interesting to note, is that it is not only the federal government that is seen to be preoccupied with ensuring financial stability, but, at least one provincial government has been noted to have played a key role in a bank rescue. The case in point is the Quebec government’s financial assistance for the merger of the Banque Nationale with the Banque d’Hochelaga in 1923 (The Globe, 1924:6). In fact, Bennett and Loucks (1996) conclude that the rescue of the “too-important-to-fail” La Banque Nationale (LBN), was facilitated through political connections ensured by a long period of forbearance for the LBN, accounting and reporting window dressing, generous financial arrangement with the Quebec government, and continuing federal government loans (see also Kryzanowski & Roberts, 1999; Noiseux, 2004:346).

In contrast to the above explanations, Ian Drummond attributes the 1930s stability of the Canadian financial system to multiple causal factors. He posits that:

... to explain the survival power of Canadian banks and near-banks one must draw on many elements – the branch system, the inherited asset structures, the absence of destabilizing external disturbances and commitments, the arrangements surrounding the issue of paper currency, and the fact that the government did not attempt to stay on the gold standard (Drummond, 1991:249).

Moreover, Drummond goes on to observe that:

Beyond this, and perhaps of equal or greater importance, were Prime Minister Bennett’s ‘rescue of the Pools’, and his arrangements for fictive valuations in 1931. These measures may have been of especial importance in so far as the banks’ own position had deteriorated during 1929, and because the depression would make their non-agricultural portfolios less liquid and more insecure. We cannot be sure what would have happened if the Prime Minister had not acted as he did. But the banks and near-banks had every reason to be grateful (Drummond, 1991:249).

In a similar vein, Taylor and Baskerville (1994:373) provide multiple reasons for the stability of Canada's early banking system. They note that:

In striking contrast to the US situation, Canada's chartered banks survived the Depression without a single failure – reflecting the strength of the branch system, their orientation toward short-term commercial credit and rapid liquidation of other debt, to the distress of the securities market, at the outset of the depression (Taylor & Baskerville, 1994:373).

These findings are echoed in a study by Michael Bordo (1995) who compared the Canadian and U.S. banking systems for a period spanning between 1870 and 1980.

Overall, Bordo (1995) found out that, for both sub-periods of his study (1870-1920 and 1920-1980), the Canadian banking system enjoyed greater stability vis-à-vis its American counterpart. For the period between 1870-1920, Bordo found that (except for the period between 1880 and 1900), the Canadian banking system enjoyed greater overall stability. He attributes this performance to geographic diversification (especially the ability to absorb regional shocks through its nation-wide branching system), ability to absorb distressed banks by stronger banks due to existence of bank branching system and given that the Canadian Bank Act was revised in 1900 permitting banks to merge without seeking the approval of Parliament making it much easier for banks to merge. Moreover, Bordo notes that the Canadian banks' hiring and promotion policies coupled with sophisticated systems of fail-safe devices also contributed to the safety of the Canadian banking system. In short, Bordo contends that these factors were primarily responsible for ensuring Canadian banking system stability after 1923. In fact only one major bank, the Home Bank of Winnipeg, failed in 1923 compared to about one third of all banks in the U.S. during the great Depression (Bordo, 1995:4).

What the above discussion suggests is that it was a combination of factors (mergers and acquisitions of distressed banks, nation-wide branch system, government forbearance, management strategies, etc.) at various levels (federal, provincial and firm levels) that helped to maintain and safeguard the stability of Canada's financial system.

From our perspective, such an approach best explains the continued integrity and stability of Canada's financial system over the years. Undoubtedly, among the various factors involved, state assistance programs and bank merger policy have continued to play a critical role in ensuring the stability of Canada's financial system. Programs such as the federal government's loan guarantees under the Small Business Loans Act (since 1961) and Quebec government's Paille program (since December 1994) both aimed at encouraging banks to lend to small business enterprises have also been an important factor in promoting banking system stability. Essentially, these programs have subsidized small and medium sized enterprise (SME) loan defaults hence shielding Canadian banks from loan losses, which in turn has partly helped promote the Canadian banking system's stability.

Furthermore, the absorption of distressed banks and trusts by healthier institutions over the years has also helped an orderly exit of troubled financial institutions and hence helped safeguard the integrity and strength of Canada's financial system. Indeed, it is fair to conclude that public policy in Canada has helped its financial system to weather well domestic financial and banking crises as well as several regional and global financial/economic storms of the 1980s and 1990s. As a result and in contrast with the U.S., Canada's financial system "remained strong in the 1980s as U.S. bank failures multiplied, and as the cost of rescuing the deregulated Savings & Loans soared to incredible levels" (Bienefeld, 1992: 34). Moreover, Canadian institutions survived the Third World

debt crisis of the 1980s; Mexico's Peso Crisis of 1994; the failure of LTCM in 1998; the 1990s financial/banking crises of Western Europe (Norway, Finland, Sweden), Russia, and the Asian Flu. Remarkably, Canada continues to fare much better even as the Japanese and German banking systems were recently faced with banking system difficulties. Assessments by the International Monetary Fund and the World Economic Forum attest to this fact (Cornelius, Porter & Schwab, 2003, 2003; IMF, 2000). For instance, in recent appraisals by the World Economic Forum, Canadian banks were ranked very highly: out of 80 countries assessed with respect to the soundness of their banking systems, the Canadian banking system was ranked 4th in the 2002/2003 review (Cornelius, Porter & Schwab, 2003:558). In the following year, Canada's standing further improved as it was ranked 3rd out of 102 countries (Cornelius, Porter & Schwab, 2004:407).

In sum, over the last century and half Canada has advanced to build a relatively sophisticated and modern banking system; and in spite of the several serious challenges, the Canadian financial system has remained relatively stable and has continued to perform relatively well reflecting an effective corporate and public governance of the financial system – one aspect of which has been the governance of bank mergers and acquisitions.

(b) International Competitiveness

The stability of Canadian banking system alluded to above, its steady growth and operating performance have earned it favourable international reviews and ranking. Although the rankings of Canadian banks, as per *The Banker's* annual review of top banks in the world, have slipped down from their glory days in the 1970s, the top five

Canadian banks are still amongst the most highly ranked firms globally (see Appendix 5, Table 1).

Moreover, it should be noted that the performance, stability and relative high ranking of Canadian banks is in part a result of financial consolidation and growth as the history of Canadian banking is replete with bank mergers and acquisitions. Indeed, the Canadian big five banks owe much of their size to banking consolidation (see Appendix 2). It should be also noted that, although the above-discussed performance is to a large measure very impressive, Canadian bankers have not been content to stay at those levels. They have, in fact, in recent years, pointed to the global conditions and rankings as one of their rationales for seeking domestic mergers so as to strategically position themselves better (e.g., recall the debates of the eventually rejected bank merger proposals of 1998 discussed above). It should also be noted that although Canadian banks have long been involved in international operations, their current acquisitions abroad (especially in the U.S.) is in important ways a response to their failure to merge domestically (Ferguson, 2003; Howlett, 2001; MacKlem, 1999; Shecter, 2005a, 2005b; Stevenson, 2000; Tedesco, 1999; Willis, A., 2001; Wong, 2003) coupled with the fact that global and regional integration arrangements (e.g., GATS under the WTO, and NAFTA) have opened up alternatives for an otherwise smaller sized Canadian political economy.

(c) Domestic Ownership

As discussed in sections 5.3.1 and 5.3.2 Canada strived for about a century after Confederation to safeguard the ownership of Canadian banks in the hands of Canadians. Consequently, "Unlike the resource and manufacturing sectors in the Canadian economy, financial services remained firmly under domestic ownership and control at the dawn of

the present globalizing era” (Coleman, 1996: 201). But, as Canada’s policy position changed (reflected in the opening up of the Canadian financial market place in the 1970s and 1980s due mostly to the intensification of regional and global economic and political pressures) so did the number of foreign-owned banks rise (Economic Council of Canada, 1987, 1989a, 1989b; see also Hinchley, 2006, and Appendix 2).

Also worth noting is that the rise of foreign ownership is not only determined by the entry of foreign banks in Canada, but as Neufeld (2001) has surmised the “degree of foreign ownership will increase” (p.335) as the “forces of globalization will generate a persistent tendency towards increased foreign ownership [especially] as “Canadian institutions acquire foreign institutions through share exchanges to grow their businesses” (Neufeld, 2001:334). Neufeld further argues that as the search for executive talent extends internationally “this will mean more non-Canadians running Canadian institutions. Board of directors will have a growing number of non-Canadian members as business activities are globalized” (Neufeld, 2001:335).

Lastly, it is also interesting to note that the impacts of Canadian policy on bank mergers and acquisitions are not confined within Canadian borders. In some instances, Canadian policy has had some ramifications (albeit unintended) abroad. An excellent case is the Mercantile Bank affair discussed earlier. As it turned out, the Mercantile Bank affair did not end with the eventual acquisition of the bank. As noted in section 5.3.1, the fear of foreign control motivated the federal government, thereafter, to make restrictive changes to foreign ownership rules in 1967. As the Canadian government went about drafting the revisions to the Bank Act of 1967, the tightened provisions drew a very sharp note from the State Department in Washington (The Banker, 1967:73). The U.S. was concerned that the proposed changes pertaining to foreign ownership were “not only

discriminatory, and a bad example to other countries where U.S. banks operate, but also retroactive” (The Banker, 1967:74). In a bid to sway the opinion of the Canadian legislators appearances were made by James S. Rockefeller (Chairman of First National City Bank and of Mercantile) along with Mercantile President R. P. MacFadden (The Banker, 1967:188). Rockefeller and MacFadden, appealed for fairness as they could not understand why the acquisition (by a U.S.-based owner) of a bank like the Mercantile (that had been foreign owned from its very inception) was drawing such hostile reaction from the Canadian policymakers -- i.e., restricting foreign banking operations in Canada (The Banker, 1967: 187-189). The *Banker* summed up well the Canadian policy makers reservations and mood during “Canada’s centennial year, when economic nationalism was at its highest pitch in years” (The Banker, 1967:189) by pointing out that in the context of retaining Canada’s “economic autonomy” the First National City Bank was considered to be “aggressive and, in the Canadian Government’s opinion, a little too much for Canada to cope with” (The Banker, 1967:189).

In addition to the strong diplomatic reaction from Washington, *The Banker* (in its June issue of 1967), reported that, partly as a reaction to the Mercantile Bank affair, the U.S. federal government (through a bill by Senator Jacob Javits) had embarked on bringing about “far-reaching changes in the regulations of foreign banks operating in the United States” which up to then had been “left to the tender mercies of state authorities” (The Banker, 1967:470). It observed that:

Needless to say, the motives behind the proposal are not wholly altruistic. The Mercantile Bank affair has aroused much bitterness in New York. Central control by Federal authorities will undoubtedly allow them to threaten retaliation against banks from countries which impose restrictions on US banks (The Banker, 1967:470).

In short, the Mercantile Bank affair shows how a policy move in one jurisdiction can draw attention (sometimes hostile) and ultimately trigger policy shifts in other jurisdictions.

All in all, the history of Canadian banking demonstrates how the confluence of regional and global pressures working through domestic dynamics have worked to open up the Canadian financial system resulting in the increasingly diminished importance of the goal of safeguarding domestic ownership of Canadian financial institutions.

(d) Financial System Consolidation/Concentration

Canada's banking system is a relatively highly concentrated one compared to other industrialized countries (Statistics Canada, 1997; Williams, H., 2000). The Conference Board of Canada found that in 1998 the top 5 banks in Canada held 84 per cent of total bank assets ($HHI = 1,427$). At this level, Canada ranked fourth after Switzerland (where the top 5 banks held 87 % of total bank assets, $HHI = 3,259$), Netherlands (top 5 banks held 96%, $HHI = 2,843$), and Australia (top 5 banks held 84%, $HHI = 2,541$), well below the U.S. (at number 9) whereby the top 5 banks held 47% with the HHI at 527 (Williams, H., 2000:3).

The high concentration level of the Canadian banking system has, in fact, historically been one of its characteristic features (Beckhart, 1929:330-33; CBA, 1975b:24; Mayrand, 1988). According to Beckhart (1929:330-33), the percentage of total bank assets held by the top 5 banks rose from 43.35 percent in 1895 to 81.99 per cent in 1927. Likewise, the percentage of total bank assets held by the top 10 banks rose from 64.07 per cent in 1895 to 99.78 per cent in 1927. (See also Bordo, 1995:18.) These high levels persisted for a long time thereafter. According to the Canadian Bankers'

Association, the concentration levels were still in 1975 as high as they were in the 1920s; for example, in 1975 the top 5 banks held about 89.5 per cent of total assets while the top six held about 95.2 percent (CBA, 1975b: Table 1, p.15).

The dominance of the top 5 banks within the banking industry is, indeed, compounded by the dominance of the banking industry with respect to the financial services sector as a whole. For example, Mayrand (1988) notes that for the period between 1967 and 1985, chartered banks held almost half of all assets held by financial institutions rising from 42.2 % in 1967 to 55% in 1985 with a peak of 56.2 per cent in 1984. In fact, since then, banks have continued to dominate the financial services sector. For instance, as of July 2002, banks accounted “for over 70 per cent of the total assets of the Canadian financial services with the six largest domestic banks accounting for over 90 per cent of the assets of the banking industry” (Department of Finance, 2002).

This level of concentration is primarily attributable to three factors, viz.: mergers and acquisitions, relatively fewer new entries/charters as well as a number of exits (e.g., failures) (see e.g., CBA, 1975b). To be sure, these factors in turn have both economic and political causes.

From an economic standpoint, the size, structure and level of development of the Canadian economy have clearly over the years influenced the number of banks established in the country as well as those that have exited the market place. For example, when Canada was enjoying a great expansion and prosperity in the period between 1868 and 1873 a number of new banks were established (Jamieson, 1957:22). “Between 1868 and 1874 no fewer than twenty-eight new bank charters were granted. Although several of these were forfeited for non-user, the result was a substantial addition to the number of banks in operation” (Jamieson, 1957:22). “From 1875, however, a deep-seated recession

set in which continued until the latter part of 1879” (Jamieson, 1957:22). As Jamieson has noted: “This was a trying period for the banks. The older, better established and well managed came through creditably, but several of the smaller and newer banks which had been operating in restricted territory went down” (Jamieson, 1957:22).

Furthermore, it is also worth noting that regulations also played a part in limiting the number of new bank establishments. For example, although the provisions for minimum capital requirements may have helped safeguard the stability of the financial system these provisions may have also served as barriers to entry and hence limiting the number of banks in the Canadian economy (see Bond, 1969). Moreover, while economic conditions may have contributed to the difficulties faced by the early banks and hence the need to let distressed banks be absorbed by the healthy ones, some observers (Jamieson, 1957; Neufeld, 1972) have also attributed the merger movement to a change in public policy made in the year 1900. Rather than stem the tide of the bank merger movement then prevalent, it is argued that the empowerment of the Governor in Council in 1900 (i.e., instead of parliamentary approval) seems to have paved the way for more bank mergers (Bond, 1969; Jamieson, 1957; Neufeld, 1972). It is observed that “Although some bank mergers took place before 1900, it was not until the revised Bank Act of that year made provision for mergers without a special act of Parliament that there was any movement to speak of in that direction” (Jamieson, 1957: 65-6). Whereas out of the 25 banks that disappeared between 1867 and 1899 only six disappeared in mergers, after the revision of 1900 (whereby bank mergers required only the approval of the Governor in Council) we find an increase in bank mergers, whereby out of the 23 banks that disappeared between 1900 and 1913, sixteen involved mergers. In fact, the merger movement continued unabated until the 1930s at which time the system had been reduced

to ten banks (McIvor, 1958:82-83). In short, it is argued that while there were relatively few mergers between 1867-1900 (as up until 1900 bank mergers required special acts of Parliament -- which were not easy to obtain), the number of bank mergers rose after the policy was changed.

Moreover, the number of banks did not increase after the 1930s because no new charters were issued between 1931 and 1953. Thus, "for most of the first half of the 1900s the country was served by ten chartered banks with nationwide branch networks" (Strick, 1990:195).

Financial consolidation and concentration during the post-1960s period can also be attributed to economic and political/regulatory factors. Clearly, economic factors have played a significant role in the establishment of domestic banks and in the entry of foreign banking firms in Canada in the 1970s and 1980s as well as in the failure of a number of banks (in 1980s) and trust companies (1990s). The incorporation of new banks such as the Mercantile Bank of Canada (1953), Bank of British Columbia (1966), Northland Bank (1975), Canadian Commercial Bank (1975), Western and Pacific Bank (1982), and the Bank of Alberta (1984) marked a period of growth in banking firms in Canada (Strick, 1990:195). Moreover, although the 1967 amendments to the Bank Act were very restrictive in terms of foreign bank entry, we find that a strong growth in the Canadian economy in the early 1970s, coupled with a buoyant demand for funds (particularly in the areas of energy and natural resources), and a stable political climate, made the Canadian market very attractive for foreign banks (Economic Council of Canada, 1989b: 90). The 1970s, therefore, saw the influx of foreign-owned financial institutions such that:

By 1976, 60 foreign banks, of which about one half were from the United States, had equity interests in some 120 Canadian affiliates that were engaged mainly in money-market activity and commercial lending. In addition, there were more than 40 representative offices of foreign banks in Canada (Economic Council of Canada, 1989b: 90).

To the extent that during this period foreign banks could not enter as chartered banks most of them remained unregulated. But as the government made changes to the Bank Act in 1980, foreign banks were permitted to enter the Canadian market. This was done primarily to enable the government to regulate these entities as well as to enhance domestic competition. "Thus, as Canada entered the 1980s, hardly a week passed without a new financial service being offered, one institution acquiring another, or an institution entering a new field – quite a change from the tranquil days of the 1960s!" (Economic Council of Canada, 1987: 4).

But with the economic downturns of 1981/82 and the 1990s the number of domestic banking institutions decreased due to failures and mergers and acquisitions as a number of banks and trusts found themselves in serious difficulties. For instance, the number of banks declined with the failure of the Canadian Commercial Bank and the Northland Bank in 1985. In the same year, the Mercantile Bank merged with the National Bank of Canada, the Security Pacific Bank acquired the Morguard Bank, and Lloyds of London absorbed the Continental Bank. And, with the legislative changes of 1992, the number of trusts declined as distressed trust companies were acquired by the major banks. Indeed, by 1994, three of the four major Canadian trust companies were owned by commercial banks (see Appendix 2). To be sure, the decline in the number of domestic banking institutions has been somewhat counter-balanced by the entry of foreign banks such that as of December 2005 Canada had 72 banks (21 domestic banks, 27 foreign

banks, 19 full service foreign bank branches and 5 lending foreign bank branches; 45 Trust companies, 22 Loan companies, 7 Cooperative Credit Associations) (see OSFI, 2005; See Appendix 2 and 6). This trend has implications for banking efficiency as well as customer services. We discuss these aspects below.

(e) Banking System Efficiency

Banking consolidation and concentration raise concerns about efficiency because they have the potential to reduce competition, which in turn has the potential to negatively affect the efficiency of banking markets and institutions (see Bordo, 1995:4). The question then is: how has the Canadian banking system -- that has remained highly concentrated for a long time -- fared on this front?

Contrary to the assumption that oligopolistic markets may reduce efficiency, Bordo (1995) found that although Canadian banks were not more efficient than U.S. for the period between 1870 and 1920, they performed much better than the American banks for the period between 1920 and 1980. Moreover, Allen, Engert and Liu (2006) found that Canadian banks were as productive as American banks for the post-1980 period (i.e., 1980-2006).

Bordo (1995) attributes Canadian banks's relative better performance to stability in the sense that they were able to earn relatively better returns because they could maintain low reserve ratios and higher leverage without alarming their customers because of their reputation for soundness. The gap between U.S. and Canadian banks is thus attributed mainly to high reserve requirements imposed in the U.S. "to counter instability" (Bordo, 1995:6).

A close reading of these explanations indicates that bank mergers and how they were governed may have only played an indirect role in enhancing or ensuring efficiency in the sense that Canadian bank mergers and bank merger policy may have helped in enhancing Canadian banks' stability which then may have helped Canadian banks to perform better.

(f) Customer/consumer Protection

The trend in banking market concentration discussed above raises concerns about customer/consumer protection (Canadian Press, 1999; Cooke, 2006; Goff, 1998; Lott, 2005). As noted earlier, while the number of domestic banking institutions had declined over the years, this trend was counteracted by the entry of foreign financial institutions, it is also important to note that most of the foreign banks have been content to focus on niche markets only. "A notable exception is HSBC Bank Canada, which has a strong retail presence with branches across Canada" (CBA, 2006b). In fact, in a study by Statistics Canada (Hinchley, 2006), it was found that, in terms of market share, "domestic banks and trust companies continue to dominate the industry, accounting for 80.0 % of the real value of services in 2004, down slightly from 82.4 % in 1997" (p.8); with the 2.4 % drop being picked up by foreign bank subsidiaries and branches (2.1 %) and credit unions and caisses populaires (0.3 %) (Hinchley, 2006:8). The study also found that these slight gains were made only in specific markets and by very few foreign banking institutions. In this regard, it is noted that the "gains in market share by the foreign bank operations is even more significant when we consider that only a handful of foreign bank subsidiaries and branches dominate the group in terms of size" (Hinchley, 2006:9). Moreover, most of the gains in market share (about 6.2 %) by foreign bank subsidiaries

and branches were in corporate and institutional finance -- rising from 18.4 % of this market in 1997 to about 24.6 % in 2004 (Hinchley, 2006:9).

Financial market concentration has been of major concern to several groups, including the Canadian Federation of Independent Business (CFIB), the Public Interest Advocacy Centre, Canadian Community Reinvestment Coalition (CCRC) and Committee on Monetary and Economic Reform (Canada) (COMER), just to mention a few examples.

In its several reviews the Canadian Federation of Independent Business (CFIB) has noted the increasing dissatisfaction of its membership (small and medium size enterprises) with the services they receive from the Canadian banking industry (see e.g., Bruce, 2003, CFIB, 1998). The banking community, however, disputes such claims and grievances. For instance, the Canadian Bankers Association in its submission to the Minister of Finance in 2003 argued that Canada's SMEs were well served by the banks in terms of access to capital as well as price wise (CBA, 2003). The CBA pointed out that price wise, Canada's SMEs enjoy competitively priced financial services with interest rate spread on loans and deposits, and service charges being at par or well below those obtaining in peer group of countries such as Australia, Germany, the United Kingdom, and the U.S. Moreover, in terms of access, the CBA observed that Canadian SMEs had several alternative sources of finance compared to SMEs in many advanced countries (CBA, 2003). In short, the CBA not only defended the record of its members, it endeavoured to highlight the role other institutions play in serving Canada's SMEs.

This was done to allay the fears against further industry consolidation and in support of the bankers' desire for further mergers and acquisitions. Disabusing the notion that the state of competition in the Canadian banking marketplace could be derived from

concentration levels, the CBA argued that “competition is ultimately a matter of firm behaviour, not industry structure” (CBA, 2003). In this effort, the CBA has had the support of the Fraser Institute which is in favour of a further (rational) consolidation of the Canadian financial sector (Clemens, Law & Mihlar, 1998).

However, other social groups (e.g., CCRC, COMER, Council of Canadians, PIAC) are sceptical of the touted benefits of further financial consolidation in Canada. A recent study by the Public Interest Advocacy Centre (Lott, 2005) concludes that further consolidation would not be in the public interest. The study contends that:

... there is no persuasive evidence that consumer choice and access to banking services will be enhanced by large bank mergers and no evidence that the cost of banking services will be reduced under a bank merger. The dominance of Canada’s major banks makes successful new entry of foreign banks or other domestic entities very difficult. The proposal that physical branches can be replaced by electronic banking does not begin to meet the range of banking needs of Canadians and small business. The reliance on electronic banking also exacerbates age and income divides. There is also no guarantee that banking costs will not increase with increased reliance on ATMs resulting from a bank merger (Lott, 2005:5).

In fact, the study argues that there “is more persuasive evidence that in the current climate, mergers will mean fewer choices, fewer physical bank branches, more ATMs, and therefore more costs for basic banking services” (Lott, 2005:45).

All in all, what the above discussion suggests is that many aspects of the impacts and implications of financial consolidation raised in these reviews, submissions and studies require further investigation. These studies are, in fact, in many respects indicative of the fact that the implications of increased consolidation and concentration in Canadian financial markets on market contestability, financial exclusion, social stratification, job losses, and the proliferation of unregulated pawnshops and pay-day moneylenders are still an understudied

area (see Buckland, 2003; CBC Manitoba, 2003; ILO, 2001; Rupert, 2005: B1; Vieira, 2005a; Whitelaw, 2006: FP19).

5.4 Conclusion(s)

The discussion in this chapter has endeavoured to demonstrate how Canada's bank merger policy has radically changed after the 1960s. As a prelude to the discussion, the chapter went back in time and provided a brief background on how the Canadian banking system and its accompanying governance framework were established at Confederation in 1867. The synopsis provided a context in which bank mergers have been governed since then. The chapter then turned its attention to the evolution of bank merger policy elements for the post-1960s period focusing primarily on (a) bank merger policy objectives, ideas and discourse, (b) bank business and investment powers, and ownership, (c) bank merger review process, instruments and institutions, (d) policy style, and, (e) policy impacts.

In a nutshell, we demonstrated how Canadian bank merger policy has gone through drastic changes during the period under observation. To begin with, we showed how the objectives of Canadian bank merger policy have seen significant changes. The 1960s were indeed a watershed period when the focus on financial system stability and soundness was complemented with a preoccupation with competition, efficiency, and international competitiveness. This was a radical change in thinking as up to then competition was viewed to be incompatible with financial system stability. The chapter also chronicled how Canadian bank merger policy has evolved from one that initially viewed bank mergers as a crisis management tool for handling troubled banks and effectively prohibited large bank mergers: the so called longstanding unwritten "big-

cannot-buy-big” rule) to one that has gradually come to see bank mergers as a legitimate corporate strategic choice.

In regard to bank ownership, business and investment powers, the period saw the permission of mergers between banks and securities firms as well as between banks and trust companies. The discussion also highlighted the drastic changes in how foreign banks are treated: from tight restrictions imposed in 1967 to a gradual relaxation in the 1980s, to national treatment for U.S. and Mexican banks, to the permission (pursuant to WTO agreement) for foreign banks to establish bank branches instead of subsidiaries.

Institutionally, the chapter showed how the authority to approve or reject bank merger proposals has shifted from the parliament to Governor in Council and eventually to the minister of finance where it currently resides. Moreover, the expanded scope of bank merger regulation (to encompass prudential and competition (antitrust) policy dimensions) has also meant the direct involvement of additional regulatory authorities on bank merger governance, namely the Competition Bureau and Competition Tribunal.

Furthermore, the Canadian bank merger policy style has also evolved with time. The number and variety of policy participants and players has increased over time – characterized by an increasingly role of civil society, a “slight” erosion of the relationship between the state and the banking community, as well as enhanced interaction between Canadian and foreign regulators. In response to these developments the government has seen it fit to clarify, streamline and codify the roles of the various parties.

Lastly, the chapter noted the various impacts of Canadian bank merger policy. Unlike many countries around the world Canada’s financial system has maintained a reputation for stability, soundness and international competitiveness. These developments, however, have been accompanied by an increasing concentration of the

financial system and centralization of power with direct and indirect (positive and negative) social, political and economic implications.

Chapter 6: U.S. Bank Merger Policy: 1970s - 2005

6.1 Introduction

The 1970s began with a U.S. bank merger governance regime that had been significantly transformed as a consequence of the passage of the Bank Merger Act of 1960 and its subsequent amendment in 1966. From there on, the federal bank merger regime – driven by both internal and external forces -- has path-dependently evolved in terms of policy objectives, policy instruments, arenas of governance, institutional configuration, and policy style. What has remained constant, however, is the fact that bank mergers and acquisitions continue to be governed within the context of dual, overlapping federal and state regulations -- a system in which mergers among banks, whether among national banks, state banks or between national and state banks (as well as between banks and non-banking firms), are governed by different sets of policies distinguished between those that fall under federal jurisdiction, those that are governed under the purview of state authorities, and those that are governed by overlapping federal and state jurisdiction (see Table 31-1 in Shull, 1981:675 for a graphic representation of complex network of regimes governing mergers and acquisitions among banks).

This chapter discusses the evolution of the United States' federal policy on bank mergers for the post-1970s period. In order to appreciate the evolution of the U.S. federal bank merger policy we will discuss this evolution in a historical context bearing in mind bank merger policy developments prior to the 1970s. This is especially crucial because, not only will doing so help us to better apprehend (and comprehend) the patterns and significance of the post-1970s U.S. bank merger policy evolution, it will also help us appreciate that the evolution of the federal financial regulatory framework reflects and is,

indeed, rooted in the history of the United States of America. Accordingly, the next section will, therefore, briefly trace the history of American banking from its early beginnings to the 1960s whereby federal bank merger policy took a significant change in direction – combining hitherto prudential and public interest standards with anti-trust norms and goals in bank merger review processes. Having thus set the stage, the third section will then delve into more detail on the evolution of U.S. federal policy on bank mergers for the period under study (i.e., 1970s to the present). The discussion will be structured around key bank merger policy elements delineated in the study's analytical framework. As in the previous chapter, we will also discuss the evolution of these policy elements (chronologically and thematically) covering the critical phases and turning points over which American federal bank merger regulation has evolved responding to (and influencing) both internal and external economic, political, and social pressures and circumstances. Lastly, the fourth section will offer some concluding remarks.

The key finding of this chapter is that, with the exception of policy style, most of the components of the U.S. federal policy on bank mergers were significantly transformed during the post-1970s. Undoubtedly, there are still some elements within each of these components that have not changed. This discussion (in conjunction with the discussion in the previous chapter) will provide the basis for comparing the Canadian and U.S. federal bank merger policies in the next chapter whose primary aim is to discern whether the respective bank merger policies of these two countries were converging or not.

6.2 The Pre-1970s U.S. Banking System and Regulatory Framework

During colonial America there were no chartered commercial banks as they only emerged after the Revolutionary War (Wilkins, 1989:47). It should also be noted that banks were controversial institutions in the early days of American history. "Because their operations were badly understood, commercial banks were regarded suspiciously and had great difficulty in getting started" (Blyn, 1981:39; see also Sylla, 1999). As such, according to Blyn (1981:39), "most of the first commercial banks entered the financial community through the back door." Since then, American banking has evolved into a large and complex system of a diversity of banking firms and regulatory regimes. For a brief insight into the co-evolution of the chartered banks and their accompanying regulatory framework we begin with the establishment of the first chartered banks in the U.S.

Encouraged by Alexander Hamilton's suggestions for the establishment of a national bank, Robert Morris (then Congress' Superintendent of Finance) led the drive and was successful in getting the Bank of North America chartered by Congress in 1781 (Sylla, 1999:262). Thus, the Bank of North America (modelled on the Bank of England) opened in 1782 in Philadelphia as America's first chartered bank (Hixson, 1993:86; Sylla, 1999:262). Due to constitutional controversy, the bank was subsequently also chartered by several states because states doubted that Congress had the power to charter a bank (Sylla, 1999:262). Hamilton was also instrumental in the founding of America's second bank, the Bank of New York, which was organized in 1784 and incorporated in 1791. The same year (i.e., 1784) also saw the incorporation of the third U.S. bank, the Massachusetts Bank in Boston (Sylla, 1999:262).

Establishment in 1792 of the fourth bank -- the first Bank of The United States -- was particularly controversial. The initiative began with Hamilton's suggestions against a

backdrop of organized political opposition to Federalist policies led by Thomas Jefferson and James Madison. In the face of fierce opposition by Madison and other congressmen, President Washington:

... asked Jefferson and Randolph, the Attorney General, for their opinions on the measure. Both said it was unconstitutional because the Constitution said nothing about chartering banks. Washington then asked Hamilton for his response to the opponents' arguments. Hamilton dissected and dismissed them while advancing a new doctrine of powers implied by sovereignty even if not explicitly enumerated in the Constitution. The President was persuaded by Hamilton's argument and approved the Bank bill in February 1791 (Sylla, 1999: 258).

Thus, was born the (first) Bank of the United States -- the country's fourth bank -- modelled on the charter of the Bank of England (Sylla, 1999: 258; see also Shull, 1999). Opposition to the first Bank did not end with its establishment. Strong pressure against the Bank by politicians and the bankers, coupled by a weak defence by its directors (most of whom were composed of conservative merchants), eventually led to the non-renewal of its 20-year charter in 1811 and hence of its demise (see Hammond, 1963:12; Hixson, 1993; Shull, 1999; Sylla, 1999). Politicians who opposed the Bank did so ostensibly in defence of the rights of states over those of the federal government, while the bankers were opposed to the bank because they viewed it as an unfair competitor and meddlesome regulator (Hixson, 1993; Sylla, 1999).

The expiry of the first Bank of the United States' charter on March 4, 1811 was followed fourteen months later by the U.S. declaration of war on Britain. As it turned out, the absence of a central bank made "the government's task of financing the war" ... considerably difficult" (Hixson, 1993:115). Moreover, the War of 1812 was soon followed by the first general currency suspension in 1814 that lasted for about five years or so thereafter.

Consequently, due to the currency crisis and “the many problems encountered in the financing of the war and increasing dissatisfaction with state-chartered banks” (Hixson, 1993:116), the federal government was impelled to establish the second Bank of the United States in 1816 based in Philadelphia. However, the difficulties of a severe business depression, an incompetent and corrupt management, and renewed opposition from the local banks and states’ rights politicians ensured a rocky start for the new Bank (Hammond, 1963). The favourable decision by the Supreme Court in 1819 (*McCulloch v. Maryland*), however, helped to assure the second Bank of its hitherto highly contested constitutionality; hence, earning it the freedom from prohibitive taxation by the states in which it had offices (Hammond, 1963: 12; Hixson, 1993:116-7).

Henceforth, as it secured a competent management under the presidency of Nicholas Biddle, and as business recovery began, the second Bank of the United States turned around and prospered (Hammond, 1963:13). However, the bank’s prospects became clouded during Andrew Jackson’s administration, which began in 1829. Although chartered by Jackson’s own party, Jackson did not support the second Bank of the United States for a number of reasons including his sentiments against foreign ownership of the bank, his views on state rights above federal rights, and his opinion that Congress had no powers to charter a bank (Hixson, 1993:118). Thus, with fierce opposition from state banks against the second Bank, coupled with the pressure and advice from Wall Street interests in New York against those of Chestnut Street (Philadelphia), Jackson vetoed the renewal of the second Bank’s charter in 1834 (see Hammond, 1963; Hixson, 1993; Shull, 1999; Sylla, 1999). Henry Clay (presidential candidate) and Nicholas Biddle made the Bank a campaign issue, but as it turned out, Jackson’s decision to veto the renewal was a politically astute one for him as he

was re-elected a few months later with an enthusiastic majority (Hammond, 1963:13; Hixson, 1993). The Bank's charter was ultimately allowed to expire in 1836.

In an effort to keep the bank alive, Nicholas Biddle (bank president) obtained a burdensome charter from Pennsylvania where the bank continued as a state bank for another four years until it failed in 1841 -- sealing the transfer of power and financial primacy from Chestnut Street (Philadelphia) to Wall Street (New York) (Hammond, 1963).

With the demise of the second Bank, the federal government withdrew from bank chartering business altogether and left it to the states. This, however, did not slow down the growth of chartered banks as the number of banks rose from thirty state chartered banks in 1800 to "100 by 1810, 300 by 1820, 700 by 1836 and 1,600 by 1860" (Sylla, 1999:262; see also Blyn, 1981:38-40). The rapid spread of chartered banking can be attributed to economic growth as well as to the utility of banks to the state governments that chartered them for banks were, in several ways, beneficial to chartering states and politicians (Sylla, 1999: 261-5; see also Blyn, 1981).

Furthermore, the expiration of the second Bank's charter was accompanied by two key developments. First, came the adoption in New York of its Free Banking Act in 1838 (Hammond, 1963:7). Bank chartering having become a nuisance (and often a scandal) and the feeling "that banking should not be a privilege granted to a few favoured persons but a business, like any other, open to anyone able to engage in it" (Hammond, 1963: 7-8; see also Willis, J., 1954), the state of New York decided to go the free banking route which "as the Comptroller of New York explained in 1849, took its name from the fact that anyone was 'freely permitted to embark in it', upon compliance with certain conditions" (cited in Hammond, 1963: 8).

The enactment of this statute formalized the tendency towards uniform banking legislation and the practice of granting charters by administrative process (Hammond, 1963; Willis, J., 1954). Thus, while for a period of over 50 years (i.e., from 1781 to 1838) most American bank charters were granted through special legislative acts of incorporation, after 1838 bank charters were (except in the South and West) mostly issued by administrative officers under the general banking laws enacted by individual states (Hammond, 1963: 8).

Secondly, it should also be noted that the demise of the second Bank of the United States was again immediately followed by a currency crisis due mainly to the circulation of unregulated bank notes. It is estimated there were about “8,000 to 10,000 differently designed and denominated varieties in circulation” issued by some 1600 banks (Sylla, 1999: 266). This had its costs. Among other things, it encouraged counterfeiting and loose banking practices as well as it was an inconvenience and served to heighten uncertainty among merchants and citizens alike as sorting out trustworthy notes from untrustworthy ones was not an easy task (Sylla, 1999: 266).

Under such circumstances “a more uniform national currency was [thus] clearly desirable” and the Civil War provided the opportunity to achieve it (Sylla, 1999: 266). With the war going on for two years and the federal government in desperate need for cash to finance the war effort, then Secretary of the Treasury Salmon P. Chase came up with an idea of funding the war effort whereby the federal government would charter national banks that would have authority to issue their own currency so long as it was backed by holding U.S. Treasury bonds (Sylla, 1999:266-7). This idea was implemented through the National Currency Act, which was subsequently completely re-written two years later as the National Bank Act of 1863, which was then amended in 1864 (Chapter 106, 13 STAT. 99).

Under the National Bank Act, the Office of the Comptroller of the Currency (OCC) was established with the authority to charter and examine national banks. The Act established uniform chartering rules, which set the stage for the establishment of national banks. The federal government also attempted, but failed, to abolish state chartered banks by taxing their note issues (Schooner & Taylor, 1999). In sum, the need for a uniform and stable currency coupled with the need for war financing resulted in the establishment of a national currency and a national banking system. This, together with the failure to abolish state-chartered banks, in effect launched the dual system of banking in the U.S. with some banks being chartered and regulated nationally by the OCC and others chartered and regulated by states as had been before 1863 (Schooner & Taylor, 1999).

Due to a combination of factors such as low minimum capital requirements for state banks and the OCC's liberal chartering policies, the period after 1863 saw a rapid increase in the number of decentralized unit banks in the U.S. – "rising from 1,532 in 1865 to 27,285 by 1913" (Schooner & Taylor, 1999: 612).

The establishment of national banks, however, did not prevent the U.S. banking system from going through serious difficulties. The banking panic of 1907 led Congress to appoint the National Monetary Commission (Aldrich Commission) in 1908 to study the nation's banking system. A confluence of internal and external factors including chronic domestic financial and banking crises (e.g., in 1873, 1884, 1890, 1893, and 1907), a weak regulatory framework and international pressures prompted American lawmakers to establish the Federal Reserve System (e.g., see Broz, 1997; Meltzer, 2003; Moore, 1990; Warburg, 1930). Undoubtedly, the process followed to establish the Federal Reserve System and the form it eventually took were shaped by the lessons learned from the past abortive experiences with the first and second Banks. For instance,

policymakers had learned from the two experiences that: (a) joint ownership between public and private sectors was consistent with democratic governance; (b) foreign bank ownership and control were not popular; (c) a central bank was a bank for the bankers and not their business competitor; (d) regulatory powers of a central bank should be explicitly specified; and, (e) a twenty-year federal charter was fatal (Hughes, 1987: 200). Consequently, the establishment of the Federal Reserve System was based on the idea of a perpetual charter, and that a central bank would be a bankers' bank with stock ownership being limited to member banks with government ownership limited to the headquarters in Washington (Hughes, 1987: 200). Moreover, the Federal Reserve System was established as an independent central bank based on a decentralized regional system of 12 district banks and a Board in Washington.

National banks were (and still are) required to become members of the Federal Reserve System and are, thus, subject to Federal Reserve regulation. State banks, on the other hand, were not (and still are not) required to become members, and few in fact have sought membership. Consequently, national banks, which up to 1913 had been under the sole regulation and supervision by the OCC, were now subject to overlapping federal jurisdiction by the OCC and the Federal Reserve Board.

Although it was established as a decentralized system it should also be noted that the founding of the Federal Reserve System (and the post-Civil War reconstruction efforts) should be understood as a set of political and economic processes "in which the country's monetary and financial organization served as a principal instrument of policy for the push toward centralization" (Macesich, 1990:79). In this regard, George Macesich posits that:

The American monetary scene in the period beginning with the Civil War, including the National Bank Act and the eventual establishment of the Federal Reserve System in 1913, is but the monetary manifestation of the beginning of centralization and communitarianism with its idea that if the community is well-designed, its members will have a sense of identity with it. This is the period which shaped the country decisively and laid the groundwork for a strong central government (Macesich, 1990:79).

Pertinently, the launching of the dual system of national and state banks and the establishment of, first, the OCC (in 1863) and then the Federal Reserve System (in 1913), had profound effect on how bank mergers were to be governed in the U.S. at the federal level. Noteworthy, however, is the fact that the U.S. bank merger governance framework did not start out without serious kinks or technical hitches. For instance, “prior to 1918, the National Bank Act had not made legal provision for consolidation of national banks” (Anderson, 1934:178). Consequently, during the early period (1863 to 1918), two national banks could not merge until either one went into voluntary liquidation so that the other could buy its assets and assume its liabilities (White, E., 1985:288; see also Anderson, 1934:178), or both went into voluntary liquidation so that a “newly organized bank [could] purchase the assets of both liquidating banks” (Lamb, 1961: 36).

Such a cumbersome process was also relatively awkward when compared to the governance of bank mergers within states. In fact, “Although state legislation varied, the complexities of consolidation of two state banks were never so formidable, since in most instances the merging institutions were chartered by the same state” (Lamb, 1961: 36).

In order to avoid such a liquidation process (required at the federal level), some national banks thus chose to convert “into state banks before a merger in order to effect the consolidation directly under state law” (Lamb, 1961: 36). Even with such tactics we find that prior to 1900 bank mergers were very meagre in scale (Lamb, 1961: 35). In fact,

even with the few mergers that took place thereafter “there was no marked upward tendency prior to the close of World War I in 1918” (Lamb, 1961: 35). The situation, however, drastically changed after the passage of the Consolidation Act in 1918 that “permitted two or more national banks to consolidate directly without the liquidation of either” (Lamb, 1961: 36; see also Anderson, 1934; White, E., 1985). As such,

After 1918, two banks could consolidate under either’s charter, subject to the approval of the Comptroller of the Currency. Considerable flexibility was allowed in devising merger agreement. The basic requirement was that the bank had to specify the amount of capital, surplus, and undivided profits of the new organization and what assets, if any, would be eliminated (White, E., 1985: 288).

Thus, by facilitating banks to amalgamate, the passage of the Consolidation Act of 1918 provided national banks “a means to establish branch networks in the states where branching was permitted and hence to compete more effectively with state banks” (White, E., 1985: 288). It is worth noting, however, that while mergers between national banks were made easier by the passage of the 1918 legislation, “any merger of a national bank and a state-chartered bank, trust company, or savings bank had to employ the old method or consolidate by taking out a state charter” (White, E., 1985: 288; see also Lamb, 1961). Faced with such a situation, national banks found other ways of consummating mergers. For instance, whereas prior to 1918 some national banks had to convert themselves into state banks to effect mergers directly under state laws, the “reverse was true in connection with the absorption of state banks by national banks after the enactment of the 1918 law” (Lamb, 1961:36). After 1918, a national bank could, where state law permitted, organize a state bank with branches then convert it into a national bank and thereafter consolidate with it. This was made possible because the 1918 legislation also provided “that a national bank with branches, acquired through conversion from a state charter could consolidate with

another national bank and retain those branches involved in the consolidation” (Lamb, 1961: 36; see also Willis, J., 1954:852).

According to Lamb (1961) – a view also shared by White (1985) -- the Consolidation Act of 1918 was a crucial factor that facilitated bank mergers by doing away with the previous cumbersome process such that the bank merger trend steeped up after 1919 which saw 178 mergers; a number that was greater than for any previous year (Lamb, 1961:35). To be sure, the merger movement was also motivated by economic factors (White, E., 1985).

The bank merger trend alarmed federal authorities (Lamb, 1961). Congress responded by enacting “the McFadden-Pepper Act, which provided that national banks could consolidate directly with state banks on practically the same terms and conditions as were required for the consolidation of two or more national banks” (Lamb, 1961: 36; see also White, E., 1985: 288).

Interestingly, the legislative measures did not slow down the bank merger movement. The trend was further exacerbated as the economy down-turned and worsened. Indeed, for the period 1921-1928, “a total of 3,118 mergers took place involving about 5,800 banks with aggregate resources of slightly more than \$40 billion” (Lamb, 1961:36-7). As a result, the number of banks declined from a peak of roughly 30,000 banks in 1922 to about 24,000 in 1929 (Willis, J., 1954:843). Of the decline, “a decrease of 4000 banks was a result of suspensions, consolidations, and absorptions” (Willis, J., 1954:843). In fact, the financial fortunes that began to fade in early 1929 evaporated with the stock market crash of October 1929. During the Great Depression, as the waves of panic swept across the country, the number of banks further drastically declined from 24,026 (as of December 31, 1929) to 13,949 on June 1933. This decline

was partly due to the rise in bank mergers during this period. For instance, from “1929 through 1931, a total of 1,976 mergers were accomplished involving 3,769 banks with aggregate resources of more than \$42 billion” (Lamb, 1961: 37).

The resultant collapse of the financial system also saw radical steps taken by state and federal governments. “In the first days of March 1933, and after almost all state governors had issued orders temporarily closing banks in their respective states, President Roosevelt declared a nationwide banking ‘holiday’” (Schooner & Taylor, 1999:616). The federal government then responded with legislative reforms and stricter control of the financial system. The Banking Act of 1933, followed by that of 1935, established the most fundamental and unique aspects of the United States banking regulation that were to endure for a long time (Schooner & Taylor, 1999:617).

Notable among the stipulations of the Banking Act of 1933 are four provisions “commonly referred to as the Glass-Steagall Act” which: (a) separated the business of commercial and investment banking, (b) raised the minimum capital requirements for national banks, (c) barred the payment of interest on demand deposits, and (d) permitted the Federal Reserve to regulate interest paid on time deposits (Schooner & Taylor, 1999:617).

Furthermore, in an amendment to the McFadden Act of 1927, the Banking Act of 1933 permitted national banks to branch anywhere within a state that permitted statewide branching for state banks (Willis, J., 1954). Moreover, and in spite of strong opposition, the Banking Act of 1933 also established a federal deposit insurance scheme and the Federal Deposit Insurance Corporation (FDIC) for its administration (Schooner & Taylor, 1999:617). The Banking Act of 1935 (P.L. 74-305, 49 STAT. 684) established the FDIC as a permanent agency of the government.

Although the period 1932 to 1938 saw a further decrease of about 1,608 commercial banks through mergers, the bank merger movement subsided for most of the 1940s (Lamb, 1961: 37). According to Willis (1954:845): commercial bank mergers, consolidations, and absorptions declined from a total of 5,257 (for an average of 526) for the period 1924-33, to a total of 760 (for an average of 190) for the period of 1934-37, to 1,228 (for an average of 88) for the period 1938-51.

The lull, however, was short-lived as the bank merger movement picked up steam in the 1950s. Akin to the motivations for the earlier consolidations there were both economic and regulatory factors behind the bank mergers and acquisitions during the depression and post-depression era (Lamb, 1961; Willis, J., 1954). Certainly, there were also political and economic factors that mitigated against the continued trend of such mergers (Lamb, 1961: 66). "In the ten-year period ending December 31, 1959, a total of 1,503 state and national banks with aggregate resources of over \$30 billion were absorbed ...During 1960 a total of 132 banks ceased operations because of absorptions, consolidations, and mergers, as compared to 169 for 1959. It is significant that for the fifth consecutive year the number of such transactions was substantially less than the high of 231 for 1955" (Lamb, 1961: 61-2).

The number and magnitude of such mergers created serious public concerns that caught the attention of federal and state authorities. Consequently, Congress and the various supervisory and enforcement agencies at both the federal and state levels sought new approaches of dealing with bank mergers (Lamb, 1961: 37-40) primarily because the extant state laws provided only limited control over bank mergers and consolidations as their main objective was "to protect the interests of the stockholders and the depositors" and as such, "relatively little attention was paid to the competitive impact" (Smith &

Greenspun, 1967: 47; see also Hazleton, 1970:295). Likewise, up until 1960 the relevant federal legislation, generally, only required the regulatory authorities to consider “banking factors” and the “convenience and needs of communities” in their assessment of bank mergers. In other words, bank mergers (at both the state and federal levels) were not reviewed on competitive grounds in spite of the prevalence of an anti-trust regime in the U.S. As a matter of fact, although the Sherman Act of 1890, the Clayton Act of 1914, and the Federal Trade Commission Act of 1914, together have defined U.S. antitrust policy these pieces of legislations were not used effectively in the review of bank mergers before 1960 (Horvitz & Shull, 1971; Lifland, 1967; Shull, 1996b, 2002; Smith & Greenspun, 1967).

The key reason why the Justice Department did not intervene in bank mergers was the understanding that the Sherman Act was up to then “considered inapplicable to all but the most serious restraints of trade” (Lifland, 1967: 15-6). Moreover, it was generally believed that Section 7 of the Clayton Act was of limited applicability because “the language of the original Section 7 of the Clayton Act did not reach transactions other than acquisitions of ‘stock or share capital’” (Lifland, 1967: 16). Consequently, since Section 7 of the Clayton Act did not reach those mergers effected through “acquisitions of assets” (a common practice in the industry), “this gap in coverage essentially precluded the control of most bank mergers” through anti-trust measures (Lifland, 1967: 15-16; see also Shull & Hanweck, 2002: 215).

It should also be noted that most bank mergers were generally effected through asset acquisition because the provisions of federal law prohibited member banks of the Federal Reserve System from directly purchasing corporate stocks. As such, “most

mergers were effected through an acquisition of assets and assumption of liabilities, or an exchange of stock” (Horvitz & Shull, 1971: 864).

It was against such a backdrop that public authorities (at state and federal levels) sought measures to address the shortcomings. For instance, in the state of New York, concern over bank mergers and the interest in seeking new measures peaked in early 1955 with the “two actions taken in 1956 by the New York Superintendent of Banking in connection with mergers proposed to be effected under state laws” (re: County Trust Company of White Plains and Ramapo Trust Company of Spring Valley; Manufacturers and Traders Trust Company and Liberty Bank of Buffalo) (Lamb, 1961: 67).

At the federal level, the Antitrust Committees and the Banking and Currency Committees of both Houses, concerned with the rising tide of banking concentration and the shortcomings of Section 7 of the Clayton Act, held numerous Congressional hearings on the issue of banking mergers and concentration. During these hearings, three bank supervisory authorities and the Department of Justice (DOJ) testified “to the need for appropriate, practical legislative restrictions that would overcome the weaknesses of the existing law” (Lamb, 1961: 67; see also Lifland, 1967). In the hope of preventing further mergers, efforts were focused on amending the Clayton Act so that it would encompass and hence regulate mergers effected through asset acquisitions as well as those accomplished through stock acquisitions, culminating in the passage of the Cellar-Kefauver Act of 1950 that amended Section 7 of the Clayton Act as shown below in italics:

No corporation engaged in commerce shall acquire, directly or indirectly, the whole or any part of the stock or other share capital, *and no corporation subject to the jurisdiction of the Federal Trade Commission shall acquire the whole or any part of the assets* of another corporation engaged also in commerce, where *in any line of commerce in any section of the country* the effect of such acquisition may

be substantially to lessen competition, or to tend to create a monopoly (cited in Lifland, 1967:16).

Worth noting, however, is that although the above amendment (i.e., Celler-Kefauver Act of 1950) helped to close the “asset acquisition” loophole, it however, opened up a new loophole by the inclusion of the words “subject to the jurisdiction of the Federal Trade Commission” italicised in the quote above (Lifland, 1967:16). This inclusion precluded bank mergers from falling within the purview of the amended Clayton Act precisely because “banks were not subject to the jurisdiction of the Federal Trade Commission” (Lifland, 1967:16). As such, banks were deemed to be “subject to the law only with respect to stock acquisition, as they had been previously” (Lifland, 1967: 17). Consequently, “it was the view of enforcement authorities and legislative experts for several years that section 7 of the Clayton Act did not apply to bank mergers as customarily effected” (Lifland, 1967: 17).

In spite of such a setback and constraints (and perhaps because of them), multi-prong approaches were pursued to stem the tide of rising corporate reorganizations and mergers among banking firms. These included vigilant enforcement by regulatory authorities (e.g., bringing about of antitrust cases against bank mergers) in spite of legislative limitations, and renewed efforts to amend relevant pieces of legislation. The first antitrust case brought against a bank by the Federal Reserve Board was against the multi-state banking empire of Transamerica Corporation (see Mason, 1997:13). The Federal Reserve Board, however, lost its case on Transamerica’s appeal before the Supreme Court in 1953 prompting the United States Congress to intervene in the Transamerica case and ultimately forcing the break-up of Transamerica Corporation

through Congressional legislation. This unusual case clearly demonstrated the need for legislation to demarcate the legal boundaries of a bank holding company.

Renewed efforts to rectify legislative shortcomings came with the calls to amend the Clayton Act to address the loophole created by the Cellar-Kefauver Act. Testifying before Congress in support of such a proposal, Stanley N. Barnes, the Assistant Attorney General in charge of the Antitrust Division, posited that:

The pending proposal would plug a loophole left by present section 7's failure to cover asset acquisition by banks. On the one hand, the provision's stock acquisition bar applies to all corporations "engaged in commerce." Section 7's acquisition portion, in sharp contrast, covers only corporations "subject to the jurisdiction of the Federal Trade Commission." Further, section II of the Clayton Act exempts banks from Federal Trade Commission jurisdiction by specifying that "authority to enforce compliance" with section 7 "is hereby vested in ...the Federal Reserve Board where applicable to banks, banking associations, and trust companies." On the basis of these provisions this Department has concluded that asset acquisition by banks is not covered by section 7 as amended in 1950 (cited in Lifland, 1967: 17).

Consequently, Barnes stated that: "Even though we may still move against banks under Sherman Act Section 1 our antimerger efforts are nonetheless cramped by Clayton Act Section 7's failure to cover bank asset acquisitions" (cited in Horvitz & Shull, 1971: 864).

Subsequently, over the following five years, four other representatives of the Department of Justice testified before Congress calling for the amendment and strengthening of the Clayton Act (Lifland, 1967: 17). In response to the various calls and concerns, one of the approaches to the problem taken by the lawmakers came in the form of a proposed amendment to the Clayton Act. It was proposed that the standards of Section 7 be applied to bank assets as they applied to bank stock acquisitions (Lamb, 1961: 71). As such, "prior notice of any bank merger would be required and the Board of Governors of the

Federal Reserve and the Department of Justice would have investigative and enforcement responsibilities” (Lamb, 1961: 71). The proposals were “passed by the House of Representatives in April of 1956 and later [lay] pending before the Antitrust Subcommittee of the Senate Judiciary Committee” (Lamb, 1961: 71).

The non-implementation of the above legislative efforts accentuated the urgent need for legislative measures to address the main concerns against bank mergers and acquisitions. In response, the first measure taken by Congress was the passage of the Bank Holding Company Act in 1956 (P.L. 84-511, 70 STAT. 133). The Bank Holding Company Act of 1956 gave the Federal Reserve Board the primary responsibility for approval of establishing, supervising and regulating multi-bank holding companies. In order to avoid restraint of trade in banking and to maintain a separation between banking and commerce, bank holding companies were permitted to engage only in non-banking activities that were closely related to banking (Mason, 1997:27). The Act also prohibited a bank holding company headquartered in one state to acquire a bank in another state “unless that state expressly authorizes the acquisition by statute” (Mason, 1997:27). The Act further prohibited bank holding companies from owning more than 5 percent of the voting shares of any company engaged in non-banking activities. It, however, “grandfathered existing interstate bank holding companies to place certain non-bank affiliates in other states” (Mason, 1997: 27).

Also worth noting, however, is that the Bank Holding Act of 1956 did not include one-bank holding companies because, according to Mason,

... it was believed that the only way to get the legislation passed was to exempt one-bank holding companies from the legislation. The key obstacle to including one-bank holding companies was the 5 percent ownership of non-banking firms (Fisher 1961). Hence, a one-bank holding company remained a viable alternative for bank diversification (1997: 30).

The enactment of the Bank Holding Company Act in 1956 was in a way a loss for the opponents of bank holding companies especially considering the fact that there was strong opposition against holding companies before the act was passed. Rather than undermine bank holding company form of group banking, the Act legitimized them and provided the first legal definition of a multi-bank holding company (Mason, 1997:30).

A second measure came in a piece of legislation considered in 1957 under the title “Financial Institutions Act of 1957” (Lamb, 1961: 72). Title III of the bill, relating to insured banks, contained in section 23 new provisions requiring that all mergers and consolidations (whether or not a diminution of capital funds was involved) be approved in advance. The approving body in each instance was one of the three federal bank supervisory agencies, each operating in its respective area of authority. In addition to considering the usual banking factors stated in the Federal Deposit Insurance Act, the supervisory authorities were required under the Act to consider whether the effects of the proposed transaction might be “to lessen competition unduly or to tend unduly to create a monopoly” (Lamb, 1961: 72). Thus, in this piece of legislation we see the initial inclusion of some competition (antitrust) policy aspects in the governance of financial institutions -- a departure that would be concretized in 1960 with the passage of the Bank Merger Act.

But, prior to the passage of the Bank Merger Act of 1960, it is important to point out that the DOJ attempted to disrupt a bank merger by filing a suit against “the merger of California Bank (Los Angeles) and First Western Bank and Trust Company (San Francisco) both subsidiaries of Firstamerica Corporation, a holding company then operating twenty-four banks in eleven western states” (Lamb, 1961: 68). Although Firstamerica tried to obtain a dismissal of the DOJ’s action, the United States Supreme

Court dismissed it on January 11, 1960. “[T]o avoid further expensive litigation Firstamerica entered into negotiations with the DOJ with a view to bringing the contest to an end on known and definite terms”(Lamb, 1961:68).

Soon thereafter, in order to deal with the increase in concentration in many banking markets due to the rise in mergers among large banks in the 1950s, the U.S. Congress in an amendment to the Federal Deposit Insurance Act enacted the Bank Merger Act in May of 1960 that authorized bank regulators to bring suit against anti-competitive bank mergers and acquisitions (P.L. 86-463, 74 STAT. 129). Although the Act included standard antitrust concepts and language, it also “recognized that banking was different from other industries, and provided that the banking agencies could approve mergers under certain circumstances even if the merger had adverse effects on competition” (Horvitz, 1983: 247).

The Bank Merger Act of 1960 provided for a pre-merger approval process by which different federal bank regulatory authorities would be responsible depending on whether the type of the bank that would result from a proposed merger transaction was a national bank, a state-bank member of the Federal Reserve System or an insured non-member. It thus provided that: (a) the Comptroller of the Currency was to be responsible for national banks, (b) the Federal Reserve Board for state member banks, and (c) the Federal Deposit Insurance Corporation in the case of state non-member insured banks (Lifland, 1967; Smith & Greenspun, 1967; Shull & Hanweck, 2002). “Taken together, these categories covered at the time about ninety-five per cent of the banks in the United States” (Lifland, 1967: 18; see also Hazleton, 1970: 295, ff.5).

Under the Bank Merger Act of 1960 no insured bank could merge with any other insured bank without specific written approval from the appropriate regulatory agency.

Moreover, the Act prohibited mergers between an insured bank and a non-insured institution without approval of the Federal Deposit Insurance Corporation.

The Act provided three broad clusters of criteria that had to be considered by the appropriate regulatory authority in granting or withholding consent on a merger proposal application. This set of criteria comprised of: (a) banking factors, (b) competitive factors, i.e., effects of a proposed transaction on competition (including any tendency toward monopoly); and, (c) convenience and needs of customers and community (Lifland, 1967; P.L. 86-463, 74 STAT. 129). Briefly, the bank stability or “banking” factors included (Lifland, 1967: 17-8; P.L. 86-463, 74 STAT. 129) such factors as:

- (1) “the financial history and condition of each of the banks involved”;
- (2) “the adequacy of the capital structure”;
- (3) “its future earnings prospects”;
- (4) “the general character of its management”;
- (5) “whether or not the corporate powers were consistent with the purpose of the Act”.

In regard to “competitive factors”, the Act specified that mergers were not to be approved if they would create a monopoly or if they would substantially lessen competition unless anti-competitive effects were clearly outweighed by the convenience and needs of the community (Lifland, 1967: 17-8; P.L. 86-463, 74 STAT. 129). Moreover, in order to promote uniformity in administration with respect to competitive factors, the Act also required that before making a decision on a merger application the relevant “approving agency must request the Attorney General and the two other banking authorities for an advisory opinion on the competitive factors involved in a proposed merger transaction” (Lamb, 1961: 73). “The Attorney General thus received, in connection with regulated mergers, pre-merger notification and the opportunity to render an advisory opinion” (Lifland, 1967:18; see also Horvitz, 1983: 246; Mason, 1997: 27).

Thirdly, the Act provided that the “convenience and needs of the community” must be served (P.L. 86-463, 74 STAT. 129). In other words, a regulatory agency would “not approve a proposed transaction unless it found the proposed combination to be in the public interest” (Lamb, 1961: 73).

After the passage of the Bank Merger Act of 1960 a number of bank mergers were approved. For the period between May 13, 1960 and December 31, 1960 the Office of the Comptroller of the Currency (OCC) approved 57 bank mergers and denied one merger proposal while the Federal Reserve Board approved 17 and disapproved 3 mergers (Lamb, 1961: 77). Of course, these “statistics do not reflect the number of applications that were discouraged by the regulatory agencies in earlier informal discussions and consequently not formally submitted” (Lamb, 1961: 77).

Shortly after the passage of the Bank Merger Act of 1960, however, two main policy implementation issues arose due to the ambiguity of the wording of the Act (Lifland, 1967). First, there was the issue of how much weight to allocate to the decision criteria (e.g., banking vs. competitive factors). In other words, the Act was not clear as to what factor was to take precedence over the others. Second, disagreement arose between the Department of Justice and the Office of Comptroller of the Currency as to who had the final authority over bank merger approval as:

The law did not deal specifically with the question what was to happen if the advice given by the Attorney General was not followed. It was clear that his advice was not necessarily to prevail over all other factors. But the law was silent on whether the Attorney General could make an antitrust attack if the merger were approved without, in his opinion, adequate justification (Lifland, 1967: 18-9).

While it is true that the law was not specific enough, but as Lifland has observed, an examination of the history of the legislation could have mitigated the tensions between the Attorney General and the bank regulators. Lifland notes that:

The legislative history makes clear that the competitive factor was not necessarily to be decisive. This was emphasized in the Senate report, and the House report though not as emphatic, was in agreement: "Your committee is convinced the Senate's approach is basically sound. Where demonstrable benefits would flow from a proposed merger, these should be weighed against any adverse effect on competition"(Lifland, 1967: 18).

Nevertheless, dissatisfied with the implementation of the Bank Merger Act of 1960, the Department of Justice began to review closely all bank mergers and acquisitions and as a result a "number of cases attacking mergers approved by the Comptroller were filed by the Department of Justice under the antitrust laws" (Lifland, 1967: 20). A notable case is the DOJ's antitrust action filed in Philadelphia on February 25, 1961 asserting that the merger of Philadelphia National Bank with Girard Trust Loan Exchange Bank (under the name Philadelphia Girard National Bank and Trust Co.) would violate both the Clayton and Sherman Antitrust Acts. The United States Supreme Court's decision on the Philadelphia National Bank –Girard Trust case in 1963 ruled that bank mergers were subject to the standards of both the Sherman Act and Section 7 of the Clayton Act. Thus, affirming the relevance and applicability of antitrust law to banking -- setting a precedent for the involvement by and "oversight of bank mergers by the Antitrust Division of the Department of Justice" (Dymski, 1999: 34; see also Smith & Greenspun, 1967; Lifland, 1967:21-3). Indeed, the DOJ "continued to be involved in the litigation of antitrust cases involving bank mergers and acquisitions in the early 1960s and provided an additional barrier to the use of multi-bank holding company as a means of entry into new markets for banks" (Mason, 1997: 31).

Spurred by these decisions, and “in an attempt to untangle the regulatory maze confronting bank mergers and acquisitions”, and concerned that a possibility might arise that bank mergers might have to be undone after having been approved by a banking regulatory agency (Mason, 1997:31), Congress reconsidered the bank merger question and enacted the Bank Merger Act of 1966 (P. L.7-12, 80 STAT. 1828) specifying the terms under which the DOJ could bring a suit against a proposed merger transaction (Horvitz, 1983: 247-8). In the interest of avoiding an unscrambling of a consummated merger, the Act set a thirty-day deadline for the DOJ antitrust challenge from the day that a merger or acquisition application is finalized by a bank regulator. In the event the DOJ was inclined to bring suit, the Act specified that a merger under review could “not be consummated until the case is resolved by a final court decision” (Horvitz, 1983: 248).

In the same year, the U.S. Congress also passed the Bank Holding Company Act (P.L. 89-485, STAT. 236) on February 21, 1966 (see Mason, 1997:28). For our purposes, the passage of this legislation was significant in two key ways. First, it “made the factors that the Federal Reserve Board is to consider in acting on bank holding company applications conform to those designated in the 1966 Bank Merger Act” (Mason, 1997: 28). Specifically, the Bank Merger Act of 1966 required bank regulators to deny mergers that substantially reduced competition unless “the anticompetitive effects of the proposed transaction are clearly outweighed in the public interest by the probable effect of the transaction in meeting the convenience and needs of the community to be served” (Dymski, 1999: 35; see also Mason, 1997: 27). In effect, the Act “created a two-step process for bank mergers: the Federal Reserve was first to approve or deny merger application, then the Fed’s decisions were to be reviewed by the Department of Justice pursuant to U.S. antitrust law” (Dymski, 1999: 35).

The passage in 1966 of the Bank Merger Act and the Bank Holding Company Act was subsequently followed by the adoption of merger guidelines in 1968 by the Department of Justice (Hazleton, 1970; Mason, 1997). These guidelines were “based on then-conventional wisdom that concentrated markets allow excess profits, high prices, and reduced output through oligopolistic coordination” (Mason, 1997). As such, using the Herfindahl-Hirschman Index (HHI) as the principal measure of market concentration the “guidelines developed formulas that emphasized market shares in given market areas”(Dymski, 1999:35). “Under these rules, mergers could be blocked between banks with as little as 8 percent of market share in a given banking market area...The Warren Court supported these guidelines in a series of cases defining bank markets and the allowable activities of bank holding companies (BHC)” (Dymski, 1999: 35).

In sum, the upshot of the legislative enactments and subsequent amendments, the antitrust court cases, and the publication of merger guidelines by the DOJ were significant in a number of ways. First, prior to the 1960s, the federal banking agencies had prior approval authority for bank mergers within their respective regulatory domains, but had no authority to challenge mergers on competitive grounds. Their evaluations were largely confined to “banking factors,” and the “convenience and needs” of communities. Nor did the Justice Department intervene in bank mergers because it was generally believed that Section 7 of the Clayton Act did not apply and that, under the extant standards, the Sherman Act was not a practical remedy (Shull & Hanweck, 2002: 215).

Secondly, the passage of the Bank Merger Act in 1960, the Supreme Court’s Philadelphia National Bank-Girard Trust decision in 1963 and amendments to the Bank Merger Act and Bank Holding Company Act in 1966 helped in the development of

systematic evaluations of the likely competitive effects of proposed bank mergers by both the federal bank regulatory agencies and the Justice Department.

In addition to making antitrust standards applicable, the provisions of the relevant statutes required that the Office of the Comptroller of the Currency (OCC), the Federal Reserve Board (FRB) and the Federal Deposit Insurance Corporation (FDIC) deny mergers that violated Section 2 of the Sherman Act, and also those that violated Section 7 of the Clayton Act, unless “the anticompetitive effects of the proposed transaction are clearly outweighed in the public interest on the probable effect in meeting the convenience and needs of the community” (Shull & Hanweck, 2002: 216). Moreover, the Supreme Court’s decision in the Philadelphia case established the basic economic terms for competitive evaluations, including, defining “local areas”, “relevant product and geographic markets”, as well as a method for measuring a “substantial lessening competition” under section 7 of the Clayton Act (Shull & Hanweck, 2002: 216).

Thirdly, as Horvitz and Shull (1971:887) have observed:

... the passage of the Bank Merger Act of 1960 was intended to establish regulatory control over bank mergers particularly those effected by and among large banks, and to restrain a trend toward increased banking concentration in relevant geographic areas. It proved, over time, to be the point of entry for consistent application of antitrust standards to bank acquisitions. Through interpretation, amendment and passage of related laws, the Clayton and Sherman Act standards were coupled with a system of prior approval by the bank regulatory agencies, i.e., a system of administrative evaluation of all proposed combinations, with the antitrust standards effectively providing a minimum (but not necessarily a maximum) barrier to approval.

Fourthly, the measures substantially reduced uncertainty and potential litigation costs associated with bank mergers and acquisitions. The upshot of such “clarification of legal issues proved a stimulant for multi-bank holding company activity. The codification of court tested bank merger and acquisition guidelines contained in the Bank Merger Act of

1966 and the publication of the DOJ's guidelines were followed by a significant increase in the number of multi-bank holding company foundings and acquisitions" (Mason, 1997: 31-2).

In summary, the 1960s saw the institution of anti-trust norms in bank merger governance – a process that was in the making for almost a century. Looking at the history of American banking and its governance, the pre-1970s period was clearly an era that saw the establishment of key regulatory agencies and bank merger review processes and, indeed, the shaping of the main contours of U.S. bank merger governance. But, as we will discuss next, the U.S. bank merger framework further saw significant changes thereafter as it faced severe challenges in the post-1970s period; an examination we now turn to.

6.3 A Post-1970s Thematic History of U.S. Bank Merger Policy

This section, like the corresponding section in the previous chapter, will present in a historical context the evolution of the U.S. federal bank merger policy for the post-1970s period. These developments will be linked with the sub-national (i.e., state), regional, and global developments and dynamics. The analysis will concentrate primarily on the evolution of (a) bank merger policy objectives, ideas and discourse, (b) bank business and investment powers, and ownership rules, (c) merger review process, instruments, and institutional configuration, (d) policy styles, and (e) policy impacts. We begin with bank merger policy objectives, ideas, and discourse.

6.3.1 Bank Merger Policy Objectives, Ideas, and Discourse

A predominant objective of financial regulation in the United States has been the safeguarding of financial system stability and soundness. This commitment to financial

stability is reflected in the longstanding goals and practices of both the state and federal level regulators. At the level of individual American states the concern about financial system stability is reflected in the various measures taken by state authorities early on in state banking history. For instance, the provision for “double liability” (i.e., the liability equivalent to twice the face value of bank stocks) imposed on bank stockowners in New York in 1827 – a provision/practice that spread rapidly to other states – “was instituted in an effort to encourage prudence among bankers” (Hughes, 1987:200). A second early example pertains to the establishment of the New York Safety Fund (a mandatory insurance paid for by the bankers; and a forerunner of the modern Federal Deposit Insurance Corporation) in the state of New York between 1825 and 1839. Even though the Fund was later “abandoned it did signal the state authorities’ desire to ensure financial system stability” (Hughes, 1987:200). Since then, all states have hitherto undertaken a variety of measures (sometimes unsuccessfully) to safeguard banking stability (see Teske, 2004). (A detailed discussion of these measures is, however, beyond the scope of this investigation). In short, state authorities have always placed prudential goals as paramount even when some of their actions and practices have tended to undermine such goals.

At the federal level, and as highlighted in the previous section, a commitment to financial system stability is reflected in the prudential regulatory and supervisory measures and activities undertaken over the years to prevent systemic failures as well as initiatives to resolve financial and banking crises. These include the establishment of the Office of the Comptroller of Currency (1863), Federal Reserve System (1913), the Federal Deposit Insurance Corporation (1935), as well as the various measures taken over the years to resolve the problems of the distressed banks through orderly closure and

through the facilitation of mergers of weak banks with stronger ones. The burden of proof for the “failing company defense” for banking firms was clarified by the Supreme Court in the *U.S. v. Third National Bank in Nashville* case (Hazleton, 1970:302). To be sure, the persistence of (crisis-prone) small-scale unit banking coupled with the restraints on inter/intra-state branching have hitherto undermined such objectives. But such is the paradox of American banking.

A second key objective in American financial regulation in general, and bank merger policy in particular, pertains to the promotion/preservation of competition and efficiency. Emphasizing the importance of both competition and prudential objectives in American financial regulation, the Report of the President’s Commission on Financial Structure and Regulation (1971) aptly noted that the unique American financial system “did not evolve through happenstance. For well over a century the American public has insisted that its financial institutions be both competitive and sound” (United States, 1971:1). It further continued to observed that:

The two objectives are not easily reconciled, and yet both must be achieved if we are to avoid, on the one hand, a highly concentrated financial structure and, on the other, a system unable to withstand the vicissitudes of economic change. The public is entitled to the benefits of a dynamic and innovative system responsive to shifting needs. Yet the public also should be able to rely on the strength and soundness of the system (United States, 1971:1).

That said, however, it is interesting to note that, in spite of the long antitrust tradition in the U.S., the objectives of competition and economic efficiency in banking are of fairly recent origin having been formally incorporated into its bank merger policy in 1960 with the passage of the Bank Merger Act (Dymski, 1999; Horvitz, 1983; Horvitz & Shull, 1971; Lamb 1961; Lifland, 1967; Mason, 1997; Shull & Hanweck, 2002; Smith & Greenspun, 1967). To a large measure, the gradual introduction of anti-trust objectives

in banking can be viewed as a reflection of the gradual change in ideas, the persistent need to mitigate against banking concentration, chronic banking crises, and “a continual balancing of the conflicting objectives of increasing competition and minimizing risk” (Horvitz, 1983:247).

Moreover, one can also observe that even when the anti-trust objectives and standards were introduced banks and banking were treated differently from other firms and sectors. In fact, Lawrence J. White notes that:

Banks and banking have not been seen as just another group of firms in just another industry; rather, they have been exempted from the application of some laws, but in other respects have also had special legislation and special burdens placed on them (White, L., 1996: 324).

From an antitrust (competition) policy perspective, this special treatment of banks in the U.S. is well captured by Bernard Shull when he notes that:

Competition policy in banking has been and remains different from competition policy for industry in general. The distinctive nature of banking policy was originally a product of the special charters granted banks and, in recent years, has been perpetuated by the continuing tension between maintaining bank safety and soundness, on the one hand, and sustaining entrepreneurial opportunity and encouraging efficiency, on the other. Significant changes in policy have occurred when pressures intensified, in one direction or the other, as the result of outside political and/or economic events (Shull, 1996b: 284).

It should also be noted that the antitrust component and its objectives introduced in the bank merger legislations of the 1960s were radically transformed in the 1980s as they were re-shaped by the ascendancy of the “new learning” in industrial organization and market-oriented ideology; particularly those emanating from the Chicago-based revision of industrial concentration theory as understood under the rubric of what came to be known as the “contestable markets” hypothesis (Dymski, 1999; Eisner, 1991). The “contestable markets” hypothesis challenged the popular perception that the number of firms

in an industry was directly related to the level of competition - that is, the more firms the better. In other words, under this “new” perspective, it could not be concluded that the fewer the number of firms in a market meant less competition because “the degree of competition in a market is not properly measured by the number of competitors at any point in time”, but rather “effective competition requires only contestability – that is, the degree to which a particular market is open to entry by whatever competitors care to take on incumbent firms” (Dymski, 1999: 42). Thus, in deciding whether a merger or acquisition is likely to reduce competition and thus be detrimental to the public interest, under the contestable market perspective, authorities could no longer rely on such popular measures such as concentration ratios. The potential for competition from new entrants that were not even in the market also had to be considered if one were to adequately gauge the level of competition in a particular market (Dymski, 1999:42).

Moreover, unlike the “prior consensus linking monopoly to excessive profits and welfare losses for consumers” the proponents of the “new learning” argued: “monopoly could have arisen due to a super-efficient institution having crushed all its competition”(Dymski, 1999:42). This view, thus, challenged the then prevailing practice that tended to block mergers when concentration ratios rose above certain threshold levels.

The “new” learning about contestable markets and its implications for competition policy was in fact a part of a broader “new” process that saw the rise of market-oriented (neo-liberal) ideology that was embraced by the Reagan administration in the 1980s. Describing how antitrust policy was (re)interpreted during the Reagan era Mark Eisner (1991: 2-3) observes that:

During the Reagan presidency, antitrust policy was defined in the terms presented by the Chicago school, a body of microeconomic theory that depicts markets as self-sufficient and at all times efficiency promoting. Given the benefits of market governance, the role of public authority in governing the economy is highly constricted. The efficiency of the market is contrasted with the wastefulness and corruption of the state. Government cannot provide a cure for monopoly because it is all too often its source and its patron. Based on this understanding of the political economy, the Chicago school presents limited circumstances under which corporate autonomy should be challenged. The Reagan administration's Chicago school interpretation of antitrust deemphasized and in many cases rejected the political and social goals of policy. The only objective that could be correctly derived from the history of antitrust was the promotion of business efficiency – a goal often best realized through systematic deference to the market. The Chicago-based re-definition of policy was in keeping with the Reagan agenda, which questioned the legitimacy of state “intervention in a number of policy areas.

The question then is: to what extent did the Reagan administration's embrace of the “new” learning in industrial organization and market-oriented ideology permeate the American bank merger policy and review processes? D. L. Baker (1992), DeYoung (2001), and Dymski (1999), among others, provide some useful answers to this question. For instance, DeYoung (2001) found some evidence that bank merger regulatory policy changed significantly in the 1980s. In the study, DeYoung (2001:83) concludes that:

During the early 1980s a confluence of events changed the economic, political, and regulatory underpinnings of bank merger policy. Decades old regulations of financial institutions were phased out, the Justice Department relaxed its overall merger antitrust policy, and appointments by President Reagan changed the ideological composition of the Federal Reserve Board of Governors. In addition the scholarly literature in economics challenged the conventional wisdom regarding the impact of market concentration and bank scale on bank performance. This study finds evidence that the Board of Governor's bank merger policy responded to some, but not all, of these changes.

Thus, the new learning (on contestable markets hypotheses and the minimal role of the state in the economy) did find its way into American bank merger policy and as we will further discuss in the coming sections a number of changes continued to be made well into the 1990s.

A third objective of American bank merger policy pertains to the longstanding goal of limiting concentration of economic and political power. In a statement before a sub-committee of the House of Representatives in 1976, the Comptroller of the Currency best captured the essence of this attitude when he said: "If there has been a single identifiable public objective with respect to government's involvement with banking in this nation over almost two centuries, it has been hostility towards the concentration of financial power, whether in public or private hands" (cited in Maycock, 1986:34). Indeed, Horvitz and Shull (1971:860-1) have also noted that:

Among all the industries in the United States to which intense public concern over concentration of economic power has attached, banking most surely ranks near the top. In terms of longevity of public concern, it is probably number one. Large numbers of Americans were decrying the concentration of economic power in the hands of banks before there was a Standard Oil, a U.S. Steel, or a General Motors.

Consequently, U.S. antitrust laws "are founded on a theory of hostility to the concentration of power in private hands so great that even a government of the people can be trusted to have it only in exceptional circumstance" (Adams, 1982:487 cited in Eisner, 2000: 61; 1991:2). The distrust of centralized money power in the U.S. is in part reflected in the: (1) demise of both the first and second Bank of the United States, (2) limited powers granted to banks under the National Bank Act, (3) prevalence of the unit banking system, (4) establishment of a decentralized Federal Reserve System, (5) prohibition of interstate and intrastate bank branching, and (6) the enactment of the Bank Merger Act of 1960 just to cite a few examples.

Inarguably, the above mentioned events, features, and restrictions, as has been discussed earlier, have occurred due to, and sustained by other reasons too. For example, the imposition of limits to branch office locations by states that began in the 19th century

was in part motivated by the need to “outlaw the sleazy practice of choosing inaccessible office sites to deter customers from redeeming a free-wheeling institution’s circulating banknotes” (Kane, 1996:142; see also Jayaratne & Strahan, 1999:9). Moreover, the limitations on geographic expansion were not only a measure to protect the public interest, but they were also advocated by small bankers (unit banks) to protect their own turf from large (mainly urban) banks. For example, in defence of unit banking the Secretary of the Independent Bankers Association, appearing before Congress in 1939, warned that branch banking would “destroy a banking system that is distinctively American and replace it with a foreign system ... A system that is monopolistic, undemocratic and with tinges of fascism” (cited in Jayaratne & Strahan, 1999:9; see also Kohn, 2004; Lamb, 1961).

It should also be noted that, in spite of the intense concern over the concentration of economic and political power, some of the unique features of American banking such as unit banking and geographic restrictions have hitherto come under increasing pressure from both domestic and external forces leading to a gradual relaxation of a number of key public policy positions. For instance, as the vulnerabilities of unit banks became increasingly clear with the rash of bank and thrift failures in the 1980s, public awareness of the advantages of large, well-diversified banks also increased, hence undermining the preference for a unit banking structure (Kohn, 2004; Matasar & Heiney, 2002). Secondly, as a result of the pressures from global competition (both at home and abroad), American bankers realized that the relatively smaller and highly specialized American financial institutions “were disadvantaged in the global financial arena where they were confronted with opponents able to offer a wide range of products and services to their clientele” (Matasar & Heiney, 2002:3). In time this helped to change the attitude of the U.S.

government such that “in 1987 the Treasury was reported to be in favour of a plan to create ten ‘mega-banks’ to prevent Japanese banks from occupying seven of the top ten positions in the international ranking” (Hentenryk, 2001: 98).

In addition to the above three goals (i.e., financial stability, fostering of competition and economic efficiency, and the limitation of concentration of power) American federal bank merger policy also considers other public interest issues such as community re-investment and domestic ownership and control. To these ends, the federal government has undertaken several measures -- notable among them being the enactment of the Bank Merger Act of 1960, the Community Reinvestment Act of 1977, and the International Banking Act of 1978.

As noted earlier, the Bank Merger Act (1960) explicitly specified that the “convenience and needs of the community” must be served in any bank merger proposal. Secondly, Congress passed Title VIII of the Housing and Community Development Act of 1977, popularly known as the Community Reinvestment Act (CRA) in a bid to encourage financial institutions to help meet their respective community’s needs. Specifically, the CRA was aimed at confronting discriminatory lending practices (commonly known as redlining) “that caused local disinvestments when banks exported deposits from poor, old, and racially transitional areas to provide credit in another usually richer and more stable area” without due “consideration of an individual’s or business’ credit worthiness or income level or a community’s general viability” (Matasar & Heiney, 2002: 5). In a bid to discourage banks from redlining the CRA required banking agencies to review how banks considered the needs of their communities (Matasar & Heiney, 2002).

Thirdly, Congress passed the Riegle Community Development and Regulatory Improvement Act of 1994 (RCDRIA) (P.L. 103-325, 108 STAT. 2160). The RCDRIA established a Community Development Financial Institutions Fund, a wholly owned government corporation that would provide financial and technical assistance to community development institutions. The Act also contained several provisions aimed at curbing the practice of “reverse redlining” in which non-bank lenders were targeting low and moderate income homeowners, minorities and the elderly for home equity loans on abusive terms. The significance of this piece of legislation is that it reinforces the application of the Community Reinvestment Act (CRA) of 1977. Indeed, this statute coupled with the CRA (1977) have helped to focus the regulators’ attention on the impacts of bank branching and mergers on the poor segments of society and their communities.

Lastly, to strengthen the community reinvestment objectives, the Gramm-Leach-Bliley Act (1999) also amended the Community Reinvestment Act to require that financial holding companies not be formed before their insured depository institutions receive and maintain a satisfactory CRA rating (FDIC, 2004). Moreover, it also requires the public disclosure of bank-community CRA-related agreements and prohibits affiliations and acquisitions between commercial firms and unitary thrift institutions (FDIC, 2004). It, however, grants some regulatory relief to small institutions by reducing their CRA examinations if they have received outstanding or satisfactory rating (FDIC, 2004).

In regard to the preservation of domestic ownership and control, the American public policy (state and federal) can be best described as one that has hitherto welcomed investments into the U.S., but has at the same time resented foreign control of such

investments. In fact, this resentment/concern about foreign control is traceable to the early beginnings of American banking (Hixson, 1993; Quintana & Pfeffer, 1981; Wilkins, 1989).

At the federal level the antipathy towards foreign control is depicted in the limitations on voting rights of non-resident shareholders in the legislation of both the first and the second Bank of the United States. For instance, although foreign investors owned 62% of the shares of the first Bank in 1803 and 70% by 1811 (the year before the U.S. went to war with Britain) the law provided that only resident shareholders could vote and only American citizens could become a director (Hixson, 1993; Wilkins, 1989). This provision was also introduced in the charter of the second Bank (Hixson, 1993). Moreover, resentment against bank foreign ownership was reflected in President Andrew Jackson's rationale for vetoing the Second Bank of the United States' charter in 1834 (Hixson, 1993; Wilkins, 1989). Decrying that "many of its stockholders were foreigners" President Jackson argued, on national security grounds, that it would not be wise to let American banks be owned by foreigners because:

Should the stock of the bank principally pass into the hands of the subjects of a foreign country, and we should unfortunately become involved in a war with that country, what would be our condition? ... All its [the bank's] operations within [our country] would be in the aid of the hostile fleets and armies without. Controlling our currency, receiving our public moneys, and holding thousands of our citizens in dependence, it would be far more formidable and dangerous than the naval and military power of the enemy. If we must have a bank... it should be *purely American*" (cited in Wilkins, 1989: 84).

The policy against foreign control is also reflected in the National Bank Act (1864), which required that the directors of national banks had to be American (Wilkins, 1989:455). In other words, "foreign individuals and foreign financial institutions could buy shares in U.S. national banks if they were prepared to have American citizens as their

representatives on the board of directors” (Wilkins, 1989:583). This position remained even after the establishment of the Federal Reserve System in 1913 (Wilkins, 1989:583).

At the state level, policy towards foreign (out of state and non-U.S.) investment and ownership was mixed. While most of the states welcomed foreign investment they were also uneasy about foreign control. To be sure, some states were more hostile than others. For instance, the New York state government took a particularly hostile attitude towards foreign investment in finance (Wilkins, 1989). The state of New York in the 1880s restricted foreign banks from engaging in “Banking business”, and in 1914 it enacted a banking law prohibiting the establishment of foreign bank branches (Wilkins, 1989: 456).

Resentment against foreign control is not just a concern of the eighteenth or nineteenth centuries because it was also clearly evident during the 1970s (and well into the 1980s) when there was a dramatic rise in the number of foreign banks that had entered the United States for a variety of reasons including the desire to (a) service the U.S. activities of home-country multinational clients/firms, (b) conduct trade financing activities, (c) participate in the U.S. interbank market, (d) manage the dollar assets and liabilities of their parent organizations, (e) engage in foreign exchange trading, and (f) develop retail banking business (Graham & Krugman, 1995; Houpt, 1980, 1999; Tschoegl, 2000).

The surge in the number of foreign owned (de novo and acquired) banks was accompanied by increased anxieties that hinged on a number of economic, political, and national security concerns associated with foreign investment and control in banking (Graham & Krugman, 1995; Houpt, 1980, 1999). From an economic perspective, concern was raised with respect to fears that foreign banks might lack commitment to their local communities or may be less responsive to U.S. domestic customer needs, and hence may

provide inadequate services or impair access to banking services (Graham & Krugman, 1995; Houpt, 1980). From a regulatory and supervisory standpoint, it was feared that “foreign ownership may present heightened risk because the organization that controls a U.S. bank is outside the jurisdiction of federal authorities (and consequently less known to them)” (Haupt, 1980:2). “From the perspective of national policy, some speculate[d] that significant foreign ownership of such an important industry as banking could expose this country to harm initiated by foreign interests” (Haupt, 1980:2). Political concerns on the other hand, have hinged on “the worry that a substantial presence of foreign-owned firms will distort the domestic political process” (Graham & Krugman, 1995:85). Lastly, from a national security standpoint, concern was (and continues to be) on the potential for foreign banking firms serving as a fifth column or conduct overt espionage for their respective home countries against the U.S. (host) as well as when “the foreign affiliate’s home country is a friendly nation but foreign ownership is deemed nonetheless to impair the host nation’s defense capability” (Graham & Krugman, 1995: 95).

Many of these concerns were addressed at the state and federal levels. A compendium compiled by Raymond Waldmann (1980) shows how widespread state level restrictions on foreign investment in banking (and statutes to delay takeovers) are in the United States (see also Table 4-1 in Clarkson, 1985:96-7). At the federal level, the angst towards foreign investments in banking was in major part addressed by the passage of the International Banking Act of 1978 (IBA) which tightened federal and state control over foreign bank operations in the United States; and by the Foreign Bank Supervision Enhancement Act of 1991 (FBSEA) that greatly expanded the supervisory authority contained in the International Banking Act of 1978.

Certainly, the above concerns (and responses) only reflect anxieties about inward foreign investment in banking – both cross-border mergers, and de novo bank establishment. Some Americans were also concerned about the adverse effects of international expansion of American financial institutions that had picked up speed in the 1970s (Dombrowski, 1996). While it is true that there were those who saw American bank expansion abroad favourably, there were also others who “feared for the ‘safety and soundness’ of the domestic banking system and the overall health of the economy” (Dombrowski, 1996: 13). “In their view, the international expansion of U.S. banks posed unusual risks for banks and exposed the domestic economy to internationally transmitted maladies including inflation and financial crises (Dombrowski, 1996: 13). Further still, some were also “worried about the impact of internationalization of U.S. foreign policy” (Dombrowski, 1996: 13). For,

In their view, American banks had become key geopolitical players capable of weakening the foundations of the nation’s foreign policy. For example, private lending could influence the development prospects of the nation’s allies in the developing world, restrictive lending policies could slow economic development and, perhaps, drive countries toward the united states’ political competitors. In the long run, banks could also help undermine the nation’s position atop the global economy. By exporting American capital and enhancing the prosperity of economic competitors banks reduced the nation’s ability to meet its military and political objectives. Banks thus played a critical role in America’s balance of payments position and long-term competitiveness within the international economy. Finally, financial integration could threaten the independence of the nation’s foreign policy. Viewed in the context of international relations, the expansion of American banks was sure to create public policy problems requiring official action (Dombrowski, 1996:13).

Consequently, as a result of increased international lending by domestic banks, coupled with a mounting debt crisis, the American government undertook several initiatives to address these concerns; key among them being the “voluntary credit restraints”, the Baker and Brady plans, and the passage of the International Lending and Supervision Act (ILSA) of 1983, (Dombrowski, 1996; Schooner & Taylor, 1999:628). For instance, the ILSA,

among other things, required banks to maintain special reserves against certain international loans. Significantly, the ISLA contained the first statutory capital requirements. It directed the federal banking agencies to require banks “to achieve and maintain adequate capital by establishing minimum levels of capital” (Schooner & Taylor, 1999:628). In this regard,

Congress also signalled its desire for international convergence of capital standards by directing the banking agencies to ‘consult with the banking supervisory authorities of other countries to reach understandings aimed at achieving the adoption of effective and consistent supervisory policies and practices with respect to international lending.’ Congress’ exhortation would be answered by a joint initiative between the United States and United Kingdom and later by the Basel Accord in 1988 (Schooner & Taylor, 1999:628).

In sum, the treatment of foreign bank entry, management and ownership of American banks by foreign interests as well as the views on overseas operations of U.S. bank has consistently favoured the attraction of capital into the U.S. (as opposed to capital exports) while holding suspicions and anxieties about foreign control and competition. This enduring theme is also matched by Americans’ longstanding antipathy towards concentration of economic and political power. In a nutshell, the above discussion in this whole section has demonstrated that even as “competition and efficiency” have come to occupy the centre stage, U.S. bank merger policy has for a long while encompassed a complex set of economic, political, and social goals aimed at safeguarding financial system stability and soundness, maintaining “competitive” financial markets, limitation of concentration of economic and political power, protection of consumer interests, and preservation of domestic ownership and control.

6.3.2 Bank Business and Investment Powers, and Ownership

By the 1970s the contours of regulations governing U.S. banks and banking were pretty well much in place encompassing at least four different types of regulations: (a) product/service regulation, i.e., regulations on what products/services U.S. banks could or could not offer, and the businesses they were permitted or prohibited to enter, (b) pricing regulation, i.e., interest banks could pay on customer deposits and/or interest they could charge on loans to customers, (c) geographic regulation, i.e., regulations pertaining to where U.S. banks could locate their headquarters and branch offices – inter- and intra-state wise, and internationally, and, (d) ownership regulation, i.e., regulations on levels and types of ownership arrangements for both domestic and foreign banks. We discuss these different types of regulations because, as elaborated in the study's analytical framework, they are key dimensions in how U.S. bank mergers and acquisitions are governed -- directly and indirectly. Certainly, as we will shortly discuss, these rules have evolved over time.

(a) Product & Price Regulation

Chartered banks in the U.S. started out in the eighteenth century as highly specialized institutions. Their charters, modelled on the Bank of England, granted them limited powers allowing them only to issue notes, and to borrow and lend on short-term basis (Shull, 1999:5; 2000b). In fact, up until the 1920s, generally, every financial institution (banks, insurance companies, investment banks, building and loan associations, etc.) performed:

...distinctive functions that rarely overlapped. Thus, commercial banks in the big cities were not interested in time deposits or in long-term loans. Savings banks did not make short-term loans. Building and loan associations did not accept funds for deposit. Life insurance companies insured lives and granted annuities, but they

did not describe themselves in any way as savings institutions. Investment bankers monopolized the flotation of new securities (Blyn, 1981:45).

Over time, however, chartered banks expanded their activities as business opportunities arose, and especially as restrictions were relaxed through legislative reforms, or through regulatory and judicial interpretations. For instance, as a result of the growing familiarity and importance of government securities and insurance (during the First World War), the growth of large scale enterprises, and intense competition among financial institutions, coupled with the permission under the McFadden Act (1927) for national banks to buy and sell marketable debt obligations, the 1920s saw banks diversifying into retail business, securities, and real estate loans (Blyn, 1981:47; Shull, 1999, 2000b). “By 1929, private banks and chartered commercial banks were well on their way of fusing into a new type of institution that combined commercial banking with the securities business” (Kohn, 2004:160). The trend, however, came to a halt with the collapse of the U.S. economy and of the financial system due to “the Great Crash of 1929 and the Depression that followed” (Kohn, 2004:160). In response, the federal government passed a series of legislations that drastically transformed the U.S. financial system as several of the previously granted powers to the banks were revoked. Prominent among them being the Banking Act of 1933 that included the well-known Glass-Steagall provisions that separated commercial banking from investment banking. (For a review of the rationales for the Act see Shull, 1999, 2000b.) Furthermore, other provisions of the Banking Act of 1933, (i.e., other than Glass-Steagall provisions) imposed restrictions on bank holding companies so as to prevent them from circumventing the restrictions on commercial banking activity (Shull, 2000b:1, 9). All in all, the Banking Act (1933) provisions restricted the types of business activities commercial

banks could get involved in which in turn altered the parameters within which commercial banks could merge with or acquire other firms.

To be sure, the restrictions of the Banking Act (1933) were never total or waterproof for there were exceptions to the prohibitions as well as potential ways around the prohibitions. Not unexpectedly, U.S. banks learned how to live with and around the restrictions as they engaged in activities not prohibited domestically or internationally. Moreover, faced with restrictive rules, they responded with innovative products and services while simultaneously lobbying for expanded powers (see Haraf & Kushmeider, 1988). For instance, since banks were only restricted to deal in publicly traded corporate securities, they conducted business in government securities (such as Treasury and municipal bonds) as well as in privately placed debt which were not prohibited. Moreover, since the act applied only to activities within the United States, U.S. commercial banks operating abroad freely dealt in securities business, while overseas subsidiaries of U.S. securities firms engaged in banking abroad (Kohn, 2004:161).

That said, however, it is important to note that some of the endeavours to take advantage or skirt around the legal restrictions were sooner or later thwarted by public authorities. For instance, as bank holding companies found ways of circumventing regulatory barriers and expanded into a variety of non-banking activities in the 1940s and 1950s, Congress intervened by passing the Bank Holding Company Act of 1956 that restricted inter-state banking as well as it prohibited bank holding companies from engaging in almost all non-banking activities and control of non-banking affiliates (Shull, 1999:11; Shull, 2000b). But, as we pointed out in Section 6.2, the Bank Holding Act (1956) only covered bank holding companies that controlled two or more banks. Consequently, banks reorganized themselves into one-bank BHCs so that they could

undertake other kinds of business without legal challenge prompting Congress to plug the loophole in the 1966 amendments to the Bank Holding Company Act by redefining a bank holding company to include one-bank organizations (i.e., those that controlled one or more banks). Nevertheless, there were always some exceptions. For example, Section 4(c)(8) authorized the Federal Reserve Board to permit the bank holding companies to undertake activities it determined were “so closely related to banking or managing or controlling banks as to be a proper incident thereto” (Shull, 2000b:6).

In spite of these exceptions, however, commercial banks continued to experience increasing competition from non-bank financial institutions that moved in to capitalize on the limitations imposed on commercial banks (Kohn, 2004:161). To be sure,

Commercial banks did not stand idly by while securities firms and others were invading their territory. They responded by trying themselves to expand into activities that had been bared to them by Glass-Steagall. Regulators were sympathetic and used their discretion to interpret the law as much as possible in the banks’ favor (Kohn, 2004:161).

Nonetheless, competitive pressure continued to build up with the increasing globalization of the international financial system. “More and more, U.S. banks and securities firms were finding themselves in competition for business, both at home and abroad, with Japanese and European rivals” (Kohn, 2004:161). This led to the perception that “if there were economies of scope between banking and other financial activities, then prohibiting American financial institutions from combining these activities placed them at a competitive disadvantage in the world marketplace” (Kohn, 2004:161). Thus, as domestic and global competitive pressures increased so did the pressures for the removal of restrictive regulations and an institution of level playing field. Consequently, a “deregulation movement” that began in the 1970s proceeded through into the 1990s

carrying with it a number of key policy shifts that included a removal of several barriers as well as a re-regulation of the financial system affecting U.S. and foreign owned bank in the U.S.

If we begin with regulations pertaining to foreign direct investments in the United States, and as noted earlier, foreign banks in the U.S. have long been permitted under specific rules to operate as agencies, branches or subsidiaries of foreign banks. This did not change during the post-1970s period. What changed, however, pertained to some important measures that were taken to level the playing field between foreign banks and domestic ones. For instance, while prior to 1978, foreign banks were free to carry on deposit taking operations in more than one state as long as state laws permitted such activities, U.S. lawmakers, under pressure from U.S. banks “to curtail the competitive advantages of the growing number of foreign banks”, coupled with the U.S. regulators concern about the lack of supervision of foreign banks in the U.S., responded by enacting the International Banking Act (“IBA”) in 1978 to rectify the situation (Schooner & Taylor, 1999:627). Interestingly, rather than dismantle the barriers facing domestic banks, Congress instead chose to treat foreign banks at par by bringing foreign banks within the federal regulatory framework based on the principle of “parity of treatment” between domestic and foreign banks (Schooner & Taylor, 1999:627). In other words, the IBA “imposed many of the same regulatory restrictions on foreign banks as on domestic ones” (Schooner & Taylor, 1999:628). For instance, it required deposit insurance for branches of foreign banks engaged in retail deposit taking in the U.S. as well as it “closed loopholes that had allowed foreign banks operating in the United States to avoid restrictions on securities activities, and interstate banking restrictions” (Schooner & Taylor, 1999: 628).

Worth noting also is that Congress refrained from imposing stricter requirements on foreign banks operating in the United States “in an attempt to encourage other foreign nations to treat U.S. banks operating abroad in a similar fashion” (Schooner & Taylor, 1999: 628).

In regard to the regulation of banks generally, the IBA was subsequently followed by the passage of two key statutes by Congress -- the Depository Institutions Deregulation and Monetary Control Act of 1980 (DIDMCA) (P.L. 96-221, 94 STAT. 132), and the Garn-St. Germain Depository Institutions Act of 1982 (P.L. 100-86, 101 STAT. 552) -- which considerably expanded the allowable scope of bank activities and the range of permissible banking-market competition. On the premise that regulated interest rates were not beneficial to depositors or banks, DIDMCA (1980) called for the phasing out of interest rate ceilings and the establishment of the Depository Institutions Deregulation Committee (DIDCA) to implement the phase out. “The DIDMCA also required all banks, both members and non-members, to maintain reserves with the Federal Reserve” (Schooner & Taylor, 1999: 627). Moreover, the “DIDMCA also eliminated many restrictions on the activities of federally chartered thrifts. It authorized thrifts to make commercial real estate loans, secured and unsecured consumer loans, to issue credit cards, and invest up to 20% of their assets in commercial paper and corporate debt” (Schooner & Taylor, 1999: 627).

The implications of removing interest restraints for bank merger policy are twofold. First, it made competition on the basis of price a “permissible” strategic option. This, coupled with advances in technology reduced the reliance of competition on the basis of (brick-and-mortar) convenience; hence, it revealed a real estate overcapacity in the banking system. In the attempt to reduce the overcapacity banks saw mergers as a

preferable route; and thus, the urge to merge. Second, the (re)emergence of price competition in banking, and the blurring of boundaries among financial institutions has led bank regulators and the DOJ to revise their respective merger guidelines (see also section 6.3.3(a) below).

The Garn-St. Germain Depository Institutions Act of 1982 expanded thrift powers even further, allowing for thrifts to make commercial loans and accept commercial deposits (Schooner & Taylor, 1999: 627). It authorized thrift institutions to (a) invest in state government securities, (b) make commercial and agriculture loans up to 10 percent of assets, and (c) to accept deposits from businesses with which a loan relationship had been established. This relaxation prepared the way for further expansion of business activities and removal of barriers that had hitherto limited the opportunities for mergers and acquisitions among financial institutions. It also led banking agencies to revise their guidelines in consideration of the role of thrifts and other players as bona fide (actual or potential) competitors to the commercial banks.

In addition to the passage of the IBA (1978), DIDMCA (1980), and Garn-St. Germain (1982), the U.S. government also signed of a number of bilateral, regional and multilateral free trade agreements that had a direct impact of U.S. banking market activities and bank merger policy. For instance, the American government signed the Canada-US Free Trade Agreement (CUSFTA) in 1988 that was subsequently followed by the North American Free Trade Agreement in 1994 signed by Canada, Mexico, and the United States. The U.S. also signed on the GATS under the WTO.

Under the provisions of Chapter 17 of CUSFTA the U.S. made three major commitments (Folsom, 2004:48) including:

- (a) "permission for U.S. banks to underwrite Canadian debt";

- (b) “extension of future U.S. Glass-Steagall Act (48 Stat. 162) amendments to Canadian-controlled financial institutions”; and
- (c) “a promise not to restrict interstate branching rules”.

These commitments (to Canada) were subsequently retained under the NAFTA (Chapter 14). Worth noting, however, is that although Canada extended to Mexico the financial services commitments it had made under the CUSFTA, the U.S. did not fully extend its commitments to Mexico. For instance, under NAFTA, “U.S. banks may not underwrite Mexican debt” (Folsom, 2004:137).

The above movement towards deregulation/re-regulation culminated with the enactment of the Gramm-Leach-Bliley Financial Modernization Act in November of 1999 (P. L. 106-102, 113 STAT. 1338). The Gramm-Leach-Bliley Act repealed the last vestiges of the Glass-Steagall Act of 1933 that had hitherto kept commercial banking apart from investment banking and also amended the Bank Holding Company Act in order to relax the restrictions on the activities of commercial bank affiliates (Shull, 2000b: 1). To the extent that several attempts at repealing Section 20 of the Glass-Steagall Act of 1933 had failed in the past, the enactment of the Gramm-Leach-Bliley Act was “perhaps the most significant response of the U.S. financial system to the pressures of global competition” (Biswas & Lochel, 2001: 22).

The Gramm-Leach-Bliley Act (1999) expanded the range of banking powers by establishing a set of new types of permissible activities and new methods for determining additional activities for financial institutions (Shull, 2000b: 1). Under the Act, the hitherto prohibited affiliations between banks, securities firms, insurance companies and other financial service providers were rescinded. To delineate what was permissible and

what was not, the Act introduced three broad classes of permissible activities: financial activities, complementary and incidental to financial activities (Shull, 2000b: 12).

It is, however, important to note that, although the Gramm-Leach-Bliley Act removed several barriers pertaining to what activities banks can undertake it has not removed the restrictions separating banking and commerce; hence “precluding the establishment of universal banks”(Shull, 2000b:1).

The Gramm-Leach-Bliley Act also established new corporate organizational arrangements through which banks could carry the permissible activities by allowing for a new “financial holding company” structure, as well as of “financial subsidiaries of national or state-chartered banks” (Shull, 2000b:10). The new financial holding companies are authorized, subject to some limitations, to engage in any type of financial activity including: underwriting and selling insurance and securities, conducting both commercial and merchant banking, investing in and developing real estate and other “complementary activities” (FDIC, 2004;Shull, 2000b). However, it should also be noted that although the Act has preserved the traditionally exclusive authority of states to regulate insurance, it prohibits state actions that have the effect of preventing bank-affiliated firms from selling insurance on an equal basis with other insurance agents (FDIC, 2004).

(b) Geographic Regulation

In addition to the further relaxation of product/services restrictions, the 1970-2005 period saw an increasing trend towards a removal of geographic restrictions that had hitherto fragmented the American financial system (Becher, 2005; Clarke, 2004; Stiroh & Strahan, 2003). As discussed in Section 6.2, geographic restrictions with respect to branching and

acquisitions can be traced to the early days of American banking. To the extent that the National Banking Acts (1863, 1864) made no provisions for branch banking, the OCC interpreted this to be a prohibition on branching (Lamb, 1961:29). Although an amendment made in 1865 authorized the OCC to permit state banks converting to a national bank to retain their branches under some conditions, the “regulations were so restrictive ... that most of the state institutions which reconstituted themselves as national banks chose to obtain a separate charter for each branch” (Lamb, 1961:29).

In short, federal strictures combined with state restrictions meant branching for national and state banks was highly proscribed. In fact, up until 1922, “national banks were not even permitted to establish additional offices with narrowly limited functions in head office cities” (Lamb, 1961:29). However, under pressure to afford competitive equality between national and state banks and the need to check the defections from the National Banking System, federal lawmakers brought about some changes with the passage of the McFadden-Pepper Act in 1927 (Lamb, 1961:32). The McFadden Act allowed “national banks to establish and operate branches in the city of the parent bank, provided the state law permitted state banks and trust companies to operate branches in such cities” (Lamb, 1961:31-2). Thereafter, Congressional attempts to expand branch banking in the 1930s were unsuccessful (Lamb, 1961:34). And as it turned out, the minimum concessions afforded by the federal authorities and the restrictions by state authorities “furnished much of the incentive to obtain the advantages of large-scale operations by another method of multiple office banking” (Lamb, 1961:32); hence the expansion of bank holding company structure and banking. The passage of the Bank Holding Act of 1956, however, curtailed this movement by limiting the ability of national banks to cross state lines. Specifically, the Bank Holding Company Act (1956) prohibited bank holding companies headquartered in

one state to merge with or acquire a bank in another unless such merger or acquisition was permitted by the target bank's state.

Geographic restrictions persisted up until the mid-1970s when state authorities began (in piecemeal) to relax barriers to bank expansion. The deregulation trend at the state level was essentially completed by 1992 (Jayaratne & Strahan, 1999). At the federal level, the removal of geographic barriers came with the passage of the Garn-St. Germain Depository Institutions Act of 1982 that amended the Bank Holding Company Act to allow failed banks and thrifts to be acquired by any bank holding company, regardless of state laws. The Act also "authorized various actions by regulatory agencies to assist troubled institutions, including approval of emergency acquisitions across state lines" (Mason, 1997: 28). Subsequently, "many states then entered regional or national reciprocal arrangements whereby their banks could be bought by any other state bank in the arrangement" (Stiroh & Strahan, 2003: 807).

Furthermore, banking restrictions were relaxed when regulatory agencies made permissive and creative interpretations of extant statutes and regulations thus contributing to the removal of geographic barriers limiting bank and banking expansion. For instance, in the mid-1980s, the Office of the Comptroller of the Currency (OCC) took advantage of a clause in the 1864 National Bank Act to allow nationally chartered banks to branch freely in those states where savings institutions (savings and loans, and savings banks) did not face branching restrictions. In fact, the "Comptroller's action was instrumental in introducing state-wide branching in several southern states" (Stiroh & Strahan, 2003: 807; see also Jayaratne & Strahan, 1999; Kane, 1996).

The bank "deregulatory/re-regulatory" trend was capped with the passage of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (the "IBBEA")

(P.L. 103-328, 108 STAT. 2338) (Stiroh & Poole, 2000). By repealing the McFadden Act of 1927 (that had hitherto restricted interstate banking) and the Douglas Amendment to the Bank Holding Company Act (that had restricted intrastate bank holding company acquisitions), “the IBBEA effectively completed the breakdown of intrastate and interstate barriers to banks’ geographic expansion” (Stiroh & Poole, 2000: 2); hence, paving “the way for a nationwide banking system” (Matasar & Heiney, 2002: 91).

In regard to interstate banking and branching activity, the IBBEA addressed five areas, including: (i) interstate bank holding company acquisitions, (ii) interstate bank mergers, (iii) de novo interstate bank branching, (iv) foreign bank interstate branching, and (v) interstate affiliate banking (Matasar & Heiney, 2002: 5). The IBBEA, thus, allowed “domestic and foreign banks to launch cross-border takeovers and to merge their operations into national networks” (Arshadi & Karels, 1997: 469-470). This was a far-reaching change given that “while in the past two decades all states except Hawaii had allowed out-of-state banks to do business within their borders, they often required separate subsidiaries within each state” (Arshadi & Karels, 1997: 470). Hence, “the act made interstate branching less costly by brushing aside the requirement for establishing separate subsidiaries” (Arshadi & Karels, 1997: 470).

It is worth noting here that although the IBBEA may have “eliminated state law restrictions on bank holding company acquisitions across state lines, in deference to states’ restrictions on branching, it stopped short of usurping a state’s right to decide whether interstate branching would be permissible within its borders” (Schooner & Taylor, 1999: 644). Consequently, the IBBEA permitted “the federal banking agencies to approve mergers between banks organized in different states unless one of the states adopted a law, after September 29, 1994 and before June 1, 1997, that prohibits such

mergers. Only one state, Texas, adopted such legislation” (Schooner & Taylor, 1999: 644). Moreover, as Kohn (2004) has noted, other barriers still remain under the IBBEA. For example, banks were “not allowed to simply open a branch across state lines. To enter a new state they must purchase an existing bank in that state. However, once in that state, if state banking laws permit, they may open additional branches” (Kohn, 2004:181).

(c) Ownership and Investment Regulation

As noted above, banks in the U.S. entered the 1970s still constrained by the Glass-Steagall provisions that prohibited affiliations between commercial banking and investment banking. Banks were further retrained by the prohibitions against affiliations between banking and commerce under the Bank Holding act (1956, 1966). Consequently, ownership rules were also shaped by these restrictions. Of course, there were always exceptions made for “investment in publicly favoured areas, such as investments in small business investment companies, low-cost housing, and community redevelopment” (Shull, 2000b:6).

Most of the Glass-Steagall related ownership and investment prohibitions were removed with the passage of the Gramm-Leach-Bliley Act in 1999. As a result, banks were permitted to own securities firms and insurance companies, and securities firms were allowed to buy banks as well (Biswas & Lochel, 2001: 22).

In sum, commercial banks in the U.S. commenced as highly specialized institutions and gradually evolved into diverse firms only to be stringently restricted (or thwarted) after the Great Depression. Likewise, American banks have for a long while been restricted geographically (in terms of bank branching and acquisitions). All these restrictions were, however, relaxed over the years such that by 1999 banks in the U.S.

could provide a variety of services, branch nationally, and merge or acquire nation-wide. In a nutshell, the easing of legal and regulatory restrictions on deposit rates of interest, multiple office banking, the scope of allowable/permissible banking activities had a direct bearing on how bank mergers were to be governed as reflected in the dramatic changes the DOJ and the Federal Reserve Board made to their merger guidelines; aspects we will now turn to.

6.3.3 Bank Merger Review Process, Instruments and Institutional Configuration

The post-1970s evolution of the U.S. bank merger review process, instruments, and institutional arrangement can be best examined by focusing on two dimensions: shifts in the types of reviews, and shifts in parties/entities involved in bank merger review.

(a) Types of Reviews

The U.S. entered the 1970s with a bank merger review process that typically involved three different types of assessments, namely, banking factors review, competitive review, and convenience and needs review. To these three assessments, a fourth type -- the "interstate banking review"-- was introduced after the passage of the IBBEA in 1994 (Smith & Biddle, 2005). The IBBEA, among other things, amended the Bank Holding Company Act to prohibit "the approval of an interstate proposal if the applicant controls, or upon consummation of the merger would control, more than 10 percent of the total amount of deposits of insured depository institutions in the United States", or "30 percent or more of the deposits in any state", or as a particular state may adjust the ceiling up- or downwards (Smith & Biddle, 2005:14).

Furthermore, the post-1970s period witnessed significant shifts in how these different reviews were conducted. For instance, if we begin with the convenience and needs review, the passage of the Community Reinvestment Act (CRA) in 1977 proved to be of particular importance as a regulatory tool in controlling bank branching and merger activities. In addition to its primary purpose of discouraging redlining (and thus encouraging financial institutions to meet their respective community's needs), satisfactory CRA audit ratings have since then become the litmus test for banks seeking to avail themselves of intra- and interstate branching and merger opportunities (Matasar & Heiney, 2002: 5; see also Pattison, 2005). And, as discussed in section 6.3.1, the Community Reinvestment Act was subsequently reinforced with the passage of the Riegle Community Development and Regulatory Improvement Act in 1994, and the Gramm-Leach-Bliley Act in 1999.

As regards to competitive reviews, three key developments stand out. First, the 1970s were marked by court decisions that “made it more difficult for the federal agencies to deny bank mergers on the basis of adverse potential competition effects, and determined that it was not within their power to deny mergers whose anticompetitive effects did not reach Section 7 standards” (Shull & Hanweck, 2002: 216-7). This was followed by revisions of the DOJ's Horizontal Merger Enforcement Guidelines in 1982 and 1992 as well as by those of the Federal Reserve in 1982 and 1984 -- heralding a new direction in bank merger governance. We briefly discuss these revisions below.

(i) Changes to the Merger Guidelines by the U.S. Department of Justice (DOJ)

The DOJ revised its Horizontal Merger Guidelines in 1982 by introducing a new method of determining product and geographic markets as well as changes in threshold HHI levels, and the negotiation of divestitures (Dymski, 1999:41). Thereafter, the DOJ

made two more crucial changes in the 1990s. One was a change in the method of analysis, particularly as it pertained to defining the product market for bank services; and, the second involved a change in investigation processes, especially as it regards to the mode of investigation it employed (Calvin, 1996, Dymski, 1999; Shull & Hanweck, 2002).

The departure in product market definition first occurred in a challenge to the First Hawaiian/First Interstate Bank of Hawaii merger transaction in 1990 and was subsequently followed by a challenge to the Fleet/Norstar Financial Group transaction (Calvani, 1996). In these challenges, the DOJ departed from the traditional market definition articulated by the Supreme Court in *Philadelphia National Bank –Girard Trust* decision in 1963 that held that “the ‘cluster of product and services denoted by the term commercial banking’ to be the relevant product market” (Shull & Hanweck, 2002:216).

This change was formalized in the 1992 revisions to the merger guidelines. Pursuant to the “new” approach the DOJ first distinguishes between consumer product market and business product market. Paying particular attention on business product market, the DOJ then breaks it down further to clearly focus on the effects of a particular merger proposal on “small and medium sized business customers and their ability to reasonably obtain banking services” (Smith & Biddle, 2005:11). To be sure, the focus on business banking does not mean that the DOJ ignores the effects of mergers on retail banking and consumers, but rather it places more emphasis on business banking because according to the DOJ there are more alternatives for retail bankers than there are for small and medium-sized businesses (Robinson, C.K., 1996:4).

The focus on small and medium-sized business/enterprises (SMEs) has two key implications. First, it in effect discounts banking service providers who do not cater to

SMEs and thus tends to raise the level of calculated HHI. Second, the narrow focus on product market also tends to focus on a small geographic market leading to a higher HHI than would otherwise have been determined had the analysis taken a broader view of product and geographic markets as traditionally determined. The upshot of this approach is that the DOJ's conclusions tend to be markedly different from those of the Fed and hence increasing the likelihood of a DOJ challenge of a merger transaction if approved by the Fed (Smith & Biddle, 2005:11).

The departure on how product markets were defined was also accompanied by a radical shift in how the DOJ conducted its investigations and assessments of bank merger transactions. Whereas, prior to the changes, the DOJ would embark on a merger transaction review only after being notified by the appropriate bank regulator, the DOJ this time chose to intervene directly. "Just as in other merger investigations, the DOJ chose to conduct its examination using compulsory process (demands for documents, interrogatories, depositions, and so on)" as well as discovery "directed at third parties, e.g., bank customers" (Calvani, 1996).

Lastly, the DOJ's approach to divestitures is also distinctive in the sense that it is usually directly engaged in the selection of "assets and branches to be divested", "competitively suitable buyer", and tends to "dictate the terms and conditions of divestiture" (Smith & Biddle, 2005:11).

In summary, the DOJ's revised Horizontal Merger Guidelines in 1982 and 1992 led to important changes in the competitive evaluations of bank mergers, in terms of how: product and geographic markets were defined, investigations conducted, and divestitures determined and implemented. Parallel developments were also happening at the Federal Reserve.

(ii) Changes to the Merger Guidelines by the Federal Reserve Board

Spurred by the dramatic developments in the financial markets and legislative framework, the Federal Reserve Board also changed its merger guidelines in 1982 and again in 1984. Indeed, “these shifts became all the more important in light of the implicit strategy of drawing on strong banks’ strengths to help embattled deposit insurance funds handle the disposition of the weak and insolvent” (Dymski, 1999: 41).

Although the Federal Reserve and other federal banking agencies, more or less, adopted the DOJ’s views on the levels of and changes in concentration that would be cause for concern, the competitive reviews by the Federal Reserve Board differ from the analysis employed by the DOJ in three significant ways. First, the Federal Reserve Board has not abandoned the traditional definitions of product and geographic markets established by the 1963 U.S. Supreme Court precedent (i.e., the relevant product market is a cluster of products in the line of “commercial banking”; and the relevant geographic market is the local market) (Smith & Biddle, 2005: 10). Secondly, in situations where the market concentration levels exceed the threshold levels, the Federal Reserve Board considers a set of “mitigating factors” that would permit approval even if concentration thresholds were violated. The mitigating factors include “the continued presence of potential competition, the existence of a substantial number of remaining banks in the market, improvements in efficiency and related ‘convenience and needs’ considerations” (Shull & Hanweck, 2002: 217; see also Smith & Biddle, 2005). In short, the Federal Reserve Board has made it clear that it would not always adhere to the Justice Department’s thresholds (Shull & Hanweck, 2002).

Thirdly, in contrast to the DOJ that tends to be “involved in all aspects of the divestiture process” (Smith & Biddle, 2005:11), the Federal Reserve Board differs by

taking a back seat in the selection of divestiture options and potential buyers of assets to be divested. “While expressing a preference for divestiture to out-of-market buyers, the Fed typically leaves the branch selection up to the applicants” (Smith & Biddle, 2005:10).

(b) Shifts in Entities Involved in the Bank Merger Review Process

In regard to parties involved in the merger review process, the U.S. entered the 1970s with a regime already characterized by a multiplicity of parties (public and private) that enjoyed (by statute and/or judicial decision) the power to formulate and/or enforce bank merger policy. Publicly, and as noted earlier, three federal bank regulators (OCC, FRB and FDIC), the DOJ, and state bank regulators shared the authority to establish merger guidelines and to review bank merger transactions. Privately, several entities/actors (customers, competitors, suppliers) were granted the power to challenge bank merger transactions too. Thereafter, several significant institutional changes took place. We will in this section, therefore, examine these developments (spanning over a period of four decades) beginning with the 1970s period.

The 1970s began with the amendment to the Bank Holding Company Act in 1970 that extended the Federal Reserve Board’s regulatory authority over bank holding companies to encompass one-bank holding companies – an issue that had lingered on since the Act was initially passed in 1956. This shift was subsequently accompanied by three key developments, viz.: the emergence of state attorneys general as important players in the regulation of bank mergers, the involvement of the U.S. Federal Trade Commission (FTC) in competitive reviews, and the increasing role of foreign antitrust enforcers. We will briefly examine each of the developments below.

(i) The Appearance of State Attorneys General on the Federal Antitrust Scene

Prior to the 1970s, the state attorneys general did not play an active role in the enforcement of antitrust law at the national level (Calvin, 1996, 2003; DeBow, 2002, 2004; Posner, 2004; Zimmerman, 2002). However, renewed interest in state antitrust law emerged with the enactment by Congress of two pieces of legislation in 1976, viz.: the Hart-Scott-Rodino Antitrust Improvement Act that conferred authority upon the states to bring *parens patriae* suits “on behalf of the residents of their states under federal antitrust law” (Posner, 2004:256); and, the Crime Control Act that “led to the appropriation of \$25 million over three years to aid state antitrust enforcement” (DeBow, 2004: 269).

A few years later, however, these initiatives came into conflict with the state minimalist policies of the Reagan administration that prompted state attorneys general (most of whom were Democrats) to react strongly against the federal government. Concerned by the “perceived lax enforcement of federal antitrust statutes” (Zimmerman, 2002:42), and in order to coordinate their activities and to assert themselves, these state attorneys general established a Multistate Antitrust Task Force under the National Association of Attorneys General (NAAG) (DeBow, 2004:270; Calvani, 1996). Due to the sharp differences between the state attorneys general and the Reagan administration, “many state AGs conducted a guerrilla war against Reagan administration efforts to rein in antitrust law” (DeBow, 2002:7). In a nutshell, the Reagan era was marked by serious and open confrontation (DeBow, 2004: 270).

The state attorneys general position was strengthened by the Supreme Court’s decision on the *American Stores* case in 1990, which held that the state attorneys general had standing to challenge mergers and acquisitions generally (Calvani, 1996). Soon thereafter, the Maine Attorney General intervened in the Key Bank of Maine transaction;

and, “since then various attorneys general have intervened in several bank merger transactions” (Calvani, 1996).

It should be noted, however, that although state attorneys general may have been granted standing, the law does not “provide states with the right to participate in the federal premerger review process other than those provisions of Section 16 of the Clayton Act existing for all interested third parties, private or otherwise” (Gotts, 1999:13)

The ascendancy of state attorneys general has its benefits and costs. The benefits of this development include the potential to: (a) deter under-enforcement, and (b) “generate more cases leading to a more ‘rapid’ evolution of antitrust jurisprudence” (Calvani, 2003: 419). Others, however, are concerned about the duplicative nature of multi-jurisdictional merger reviews, the potential for inconsistent determinations and its accompanying uncertainty and confusion compounded by coordination and administrative costs (Kovacic, 2003:10-13; Calvani, 2003: 419; see also Calvani, 1996). Moreover, it is feared that the existence of multiple, overlapping, and divergent merger enforcement domestically may undercut the United States’ “ability to call for more rational approaches abroad” (Calvani, 2003:420); and hence “make efforts at global harmonization more difficult to achieve” (Calvani, 2003:417).

In spite of these concerns, there seems to be no policy attempts to curtail the power of the state attorneys general for the time being (DeBow, 2002; Hahn & Farrar, 2003). Instead, as we will discuss shortly, measures are being taken to improve coordination between the DOJ and state attorneys general in the hope that a more rational and predictable bank merger review process may emerge (Bingaman, 1995; Calvani, 1996, 2003).

(ii) The Involvement of the Federal Trade Commission (FTC)

Whereas mergers among banking firms have traditionally been exempt from review by the Federal Trade Commission (FTC), the Gramm-Leach-Bliley (1999) amended the Hart-Scott-Rodino Antitrust Improvements Act (1976) “to require premerger notification filings and waiting periods for transactions involving financial activities that meet certain thresholds yet do not require Fed approval” (Smith & Biddle, 2005: 12); thus, adding “the FTC to the competitive review process when certain merging companies have competing non-bank subsidiaries” (Smith & Biddle, 2005: 9).

This development has undoubtedly added to the number of agencies involved in merger review whose implications are still unclear.

(iii) The Increasing Role of Foreign Antitrust Enforcers

Consistent with the increasing trends in inter-state (global) interaction, integration and cooperation, the post-1970s period also saw the increasing role of foreign antitrust enforcers as U.S.-based banks faced multiple reviews by authorities in foreign jurisdictions applying different standards and procedures (see McChesney, 2004:54). Notable among these enforcers are the EU and counterpart national antitrust authorities whose numbers have swelled particularly after the 1970s (McChesney, 2004). Moreover, U.S. agencies have also enhanced cooperation with counterpart domestic regulators as well as with multilateral agencies such as the Bank for International Settlements, Basle Committee on Banking, Joint Forum on Financial Conglomerates, Financial Stability Forum, and the WTO.

The enhanced cooperation and competition with foreign authorities has not only increased the incidence of multijurisdictional reviews but it has also increased the tendency and calls for the convergence of competition policies around the world and the

potential for foreign regimes to influence domestic instruments and institutions (see Calvani, 2003; Kovacic, 2003; McChesney, 2004).

In summary, the bank merger policy institutions, instruments, and processes witnessed important changes during the post-1970s period reflecting the changes in ideas as well as the growing interaction, integration, and interdependence of domestic and international regulators. What has remained stable, however, is the configuration of regulatory agencies inherited from the pre-1970s period.

6.3.4 Bank Merger Policy Styles

The U.S. federal bank merger policy has traditionally been crisis driven (see Coleman, 1996; Jacobs & Phillips, 1972a, 1972b; Pattison, 1997). Policy is invariably made when bank merger trends rise to “unacceptable” levels or when banks are in severe difficulties. Unlike the Canadian approach, the U.S. government does not have a single Bank Act nor are there regularly timed reviews of the various banking legislations. Moreover, federal bank merger policies once made take a long time to change due to inertia and prolonged political manoeuvring. For instance, Kane (1997:181) observes that “in deciding whether to relax statutory restrictions on the services that different types of financial institutions may perform, regulatory turf and money politics are far more important than projected societal benefits” (Kane, 1997:181). This is so, particularly, because:

Money politics and regulatory competition make it hard to revoke any longstanding statutory prohibition until sympathetic regulatory enforcement legitimated by court-approved reinterpretations of venerable exclusionary status has virtually eliminated the *de facto* value of the targeted provisions to their sponsoring coalition (Kane, 1997:181).

Moreover, not only does U.S. financial regulation take long to change, it tends to accumulate unwanted aspects. Again, in a succinct portrait of American financial regulatory process Kane (1997:181-20) observes that:

Financial supervision and regulation in the United States illustrate the richest meanings of the terms *jumble* and *confusion*. At every level of government, contradictions in statutes and regulations not only abound, but seem to multiply with every passing week. These contradictions are driven by efforts to deliver implicit government subsidies to designated types of financial firms or customers and magnified by technological change and misalignments in public-service incentives (emphasis in original).

In a nutshell, U.S. federal bank merger policy is slow to change with the times and as such, is on several dimensions, reactive in nature. In addition to lengthy Congressional debates U.S. federal financial policies have also been formulated and reviewed extensively by judicial courts. Not infrequently, “shifts in American policy toward financial deregulation repeatedly have been either stimulated or slowed by lawsuits and judicial appeals” (Kagan, 2000a:234).

A third peculiar feature of American bank merger regulation, as the discussion in section 6.3.3 has highlighted, is the existence of a multiplicity of regulatory agencies with overlapping jurisdictions -- bodies that may not share the same policy objectives, approaches or styles.

A fourth feature of U.S. bank merger governance is that the review of bank merger transactions is rule-oriented and highly routinized that is designed to accommodate the large number of merger transactions that is characteristic of the U.S. financial system (McFetridge, 1998a; Pattison, 2005). This approach is also reflected in the reliance on statistical methods such the Herfindahl-Hirshman Index of market concentration (HHI). As John Pattison has observed: “Such mechanistic approaches are

needed in markets such as the United States with eight thousand banks combined with geographic regulatory limits on competition” (Pattison, 2005:298).

It is in the context of such characteristic features that we examine the nature of relationships among regulators (i.e. inter-agency relations) and those between the regulators and prospective merging parties as well as the relationship between the state and civil society.

To begin with, the relationship between/among banking regulators can generally be described as one of competition tinged with some moments/episodes of conflict. For example, as noted in Section 6.2, the establishment of the Federal Reserve System in 1913 had resulted in strained relations between the OCC and the Federal Reserve Board. Moreover, the involvement of the DOJ in the review of bank mergers from the 1960s did not help matters either especially given the lack of legislative clarity that took years to rectify. Nevertheless, although since then turf wars and competition have continued, there is currently a discernable tendency towards increased cooperation among some state agencies as manifested along domestic and international levels.

Domestically, increasing cooperation is discernible between the DOJ and federal banking regulators, as well as between the DOJ and the state attorneys general. A notable case signifying the increasing cooperation between the DOJ and the bank regulators is the joint adoption by the DOJ, the Federal Reserve Board and the Office of the Comptroller of the Currency of the Bank Merger Screening Guidelines (BMSG). The BMSG is essentially aimed at minimizing conflict between and among the various agencies by signalling that each agency’s approach is equally legitimate and that “For the first time, at least in theory and as an initial matter, all the responsible agencies ‘begin’ their analysis by using the same guidelines” (Calvani, 1996). Moreover, DOJ’s Assistant Attorney

General Bingaman remarked: “the Federal Reserve now generally awaits the completion of [DOJ’s] investigation before reaching its decisions” (cited in Calvani, 1996). This is a significant change because in “the past the Federal Reserve might have announced its formal decision without waiting for the DOJ’s input”(Calvani, 1996).

The second level of cooperation among domestic authorities involves the closer cooperation between the federal and state level regulators. As noted earlier, the emergence of state attorneys general on the national scene had encountered serious resistance from the Reagan administration. Circumstances, however, changed during the Bush and Clinton administrations that saw reconciliation between the federal and state attorneys general (DeBow, 2004:270). For our purposes, a notable formal step that exemplifies this rapprochement is the adoption of the Protocol for Joint Federal/State Merger Investigations in 1998 (DeBow, 2004:270). Since then close cooperation between the DOJ and state attorneys general has continued. The DOJ has conducted joint investigations and prosecutions with various state attorneys general and “negotiated divestitures with merging banks that satisfied both the federal and state agencies” (Calvani, 1996; see also DeBow, 2004:270; Bingaman, 1995). Additionally, to further enhance cooperation between the DOJ and the state attorneys general, federal and state antitrust enforcement officials regularly meet under the Common Ground Conferences to exchange ideas and develop relationships (Bingaman, 1995).

Whereas the adoption of the joint Bank Merger Screening Guidelines should significantly help coordinate concurrent (rather than joint) investigations by various federal agencies, the improved cooperation between the DOJ and state attorneys general is still much more fragile because their respective guidelines differ significantly as well

as their interests may not necessarily be compatible (Calvani, 1996, 2003). The DOJ and the state attorneys general differ because the state attorneys general:

... implement their laws pursuant to merger guidelines that differ materially from those administered at the national level. The states consistently take a more aggressive stand than the national authorities, defining product and geographic markets more narrowly, downplaying the prospect of post-merger entry into the market, and refusing to consider efficiencies as a factor offsetting increased concentration (Ginsburg & Angstreich, 2000; cited in Calvani, 2003:417).

These differences which may be difficult to reconcile are primarily “a function of the state attorney-generals political constituencies: “At bottom, the states are more likely to be concerned with a merger’s local impact upon jobs, and may also be influenced by concern for a local competitor, neither consideration enters into the calculus at the national level” (Ginsburg & Angstreich, 2000; cited in Calvani, 2003:417). In other words, “state attorneys general often have different incentives and interest, and may even have non-anti-trust, non-banking agenda when they intervene” (Calvani, 1996).

In regard to the relationship between the antitrust regulators (DOJ) and merging parties, the American approach has been generally described as “law enforcement” that is: adversarial, trust-busting, and litigious in style (Collins & Brown, 1997; Crampton & Corley, 1997; Goldman & Bodrug, 1997). That said, however, it is important to underline that “adversarial legalism does not pervade the U.S. regulation of financial institutions as much as it does in some other areas of regulation” (Kagan, 2000a:234). Moreover, even though there is generally no “tradition of cooperation between counsel to merging parties and staff in the enforcement agencies” (Crampton & Corley, 1997), the DOJ has in recent years indicated a willingness to promote an open consultative approach to bank merger reviews (Robinson, C. K., 1996:3). It is also crucial to note that due to the existence of multiple regulatory agencies, the relationship between the regulators and the merging

parties has always differed among the regulatory authorities (Horvitz, 1983). In addition to the differences among regulatory agencies at different periods, there have also been significant policy changes over time within the agencies. For instance, Paul Horvitz notes that:

Although the Comptroller has generally been viewed as having more permissive attitude towards mergers than the Federal Reserve or FDIC, that has depended on the individual Comptroller. The merger policy of the FDIC was more restrictive during the term of Frank Wille as Chairman than before or since. And the policies of the Federal Reserve on holding company acquisitions are impossible to explain on any consistent basis that does not recognize changes in the composition of the Board of Governors (Horvitz, 1983:259).

Furthermore, regulatory styles have also changed (even if marginally, sometimes) with changes in prevailing ideas and attitudes. For instance, the ascendancy of neo-liberal ideas and the coming to power in the 1980s of the Ronald Reagan Administration provided a strong impetus to a number of key policy changes geared towards the realization of market-friendly policies with respect to banking. The Reagan appointees at the Department of Justice generally took a “much relaxed approach to mergers” (Baker, D. L., 1992: 653; see also Dymski, 1999); thus, “tipping the balance toward approval even for applications that previously would have been denied. Not until 1990 did the Department of Justice challenge a bank merger application under the new merger guidelines” (Dymski, 1999: 42). Moreover, “there is strong evidence that the Board’s merger policy became progressively more lax throughout the 1980s” (DeYoung, 2001:83).

All in all, even if the U.S. approach to financial regulation is not regarded to be “adversarial” as in other industries, a legalistic/litigious culture still persists. As such,

Financial institutions, like other regulated entities, have enjoyed easy access to courts to challenge regulatory decisions. Legislators and regulatory officials, in

response, elaborate the precision of statutes and regulations in order to make them more legally defensible. Popular suspicion that governmental regulators will be “captured” by major financial institutions has further increased the legal formality of interactions between the industry and governmental policymakers (Kagan, 2000a:234).

Indeed, this is also reflected in the relationship between the state and civil society.

The variety of banking institutions (federally and state chartered commercial banks, thrifts, savings & loan, etc) has also spawned a plethora of industry associations representing the various industry segments. Additionally, the U.S. bank policy community is populated by a number of community groups that are especially active in bank merger reviews under the CRA framework. It is in such a context that the multiple governmental agencies interact with industrial associations and community groups through a variety of processes including lobbying, litigation and through participation in a variety of commissions and special committees. In fact, the history of financial policy formulation/evaluation reveals a number of instances when commissions and committees were used to help develop policy ideas, delay action, develop consensus, portray that the government was taking action, etc. (Lapidus, 1972). These commissions and committees have included those established by Congress (e.g., The Aldrich Commission of 1908), the president (e.g., The Heller Committee of 1963; The President’s Commission on Financial Structure and Regulation of 1970 also known as the Hunt Commission), and even privately sponsored ones (The Commission on Money and Credit of 1960 sponsored by the Ford Foundation) (see Aliber, 1972; Baker, D. I., 1972; Jacobs & Phillips, 1972a, 1992b; Lapidus, 1972; Robertson, 1972).

In summary, the evolution of American bank merger policy style depicts tendencies of both change and enduring stability. Whereas, its characteristic legalistic

style has not changed much, there are also visible trends of increased cooperation among regulators -- domestically and internationally. As regards to the relationship between the regulators and merging parties, one can safely conclude that it is still litigious in nature.

6.3.5 Bank Merger Policy Impacts

In this section we focus on the effects of American bank merger policy on: (a) banking system stability, (b) financial system efficiency, (c) banking consolidation and concentration, (d) customer/consumer protection, (e) domestic ownership, and (f) international competitiveness. We will discuss each in turn.

(a) Banking System Stability

Throughout its history, the American banking system has gone through one crisis to another. In response to the chronic crises, and as noted in section 6.3.1, the U.S. federal government has hitherto undertaken various measures including reforming its bank governance system (e.g., change in regulations and the establishment of new regulatory agencies) as well as the “orderly” dissolution of distressed banks and the amalgamation of some ailing banks with healthy ones (Matasar & Heiney, 2002:92).

A notable set of measures undertaken to ensure the stability of the U.S. banking system during the period under investigation pertains to the measures taken to resolve the thrift debacle of the 1980s. As a response to the crisis, Congress passed the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (also known as FIRREA) with the purpose of restoring the public’s confidence in the savings and loan industry that had been severely undermined by the thrifts debacle (FDIC, 2004).

In spite of the crises that have plagued the U.S. banking system and in light of the efforts taken to address them, the contemporary American banking system can be considered, relatively speaking, a stable one even though it does not rank as high as other advanced countries such as Australia, Denmark, Finland, New Zealand, the Netherlands, or the United Kingdom. In terms of “soundness of banks”, the Global Competitiveness Report ranked the U.S. banking system at number 6 (out of 80 countries) in the year 2002-2003 (Cornelius, Porter & Schwab, 2002: 558), and at number 12 (out of 102 countries) for the year 2003-2004 (Cornelius, Porter & Schwab, 2003: 407).

While these current rankings are impressive for a system that has a history of banking crises and instability, it should be noted that increasing concentration, as some analysts have noted, risks the banks becoming too large to be permitted to fail (too-big-to-fail syndrome) and further complicate the supervision of complex financial organization (too-big-to-discipline-adequately syndrome), which in turn may jeopardize the stability of the banking system (see Carletti, Hartmann & Spagnolo, 2002; Kuritzkes, Schuermann & Weiner, 2003; O’Hara & Shaw, 1990; Walter, 2003:18).

(b) Banking System Efficiency

Empirical studies on efficiency gains following commercial bank M&As in the U.S. show very little evidence of any significant improvement in cost and profit efficiency or shareholder value (Amel, Barnes, Panetta & Salleo, 2004; Berger & Humphrey, 1992, 1994, 1997; DeYoung, 1997; Houston & Ryngaert, 1994; Peristiani, 1997; Pilloff, 1996; Rhoades, 1994, 1998; Srinivasan & Wall, 1992). Apart from difficulties of measuring efficiency gains, Amel et al. (2004: 2504-5) postulate that the lack of empirical evidence on efficiency gains is in part also due to the possibility that

gains in scale efficiency may be offset by organizational diseconomies of scale as well as due to the likelihood that M&As may be pursued for reasons other than value-maximizing objectives (e.g., managerial hubris).

It is in light of such findings with regard to the lack of positive relationship between efficiency gains and merger activity that one can conclude that the U.S. bank merger policy's goal of enhancing efficiency has so far empirically been elusive.

(c) Consolidation and Concentration in the U.S. Banking Industry

Historically, bank mergers (and failures) have been largely responsible for the decline in the number of banks, an increase in the size of surviving banks, and an increase in the levels of market concentration in the U.S. (see Janicki & Prescott, 2006; Lamb, 1961; Meyer, 1998; Pilloff, 2004; Rhoades, 2000; Stiroh & Poole, 2000). The number of independent banks decreased from about 13,000 in 1960 to about 6,500 in the year 2005 (Janicki & Prescott, 2006: 291). The decrease in the number of banks is largely attributed to mergers and acquisitions. While the number of bank mergers in 1976 was about 138 (Janicki & Prescott, 2006: 291), studies by Rhoades (2000) and Pilloff (2004) indicate that bank merger activity in the U.S. rose to unprecedented levels in the 1980s and 1990s only to taper off after 1998. As Table 1 in Appendix 3 shows, bank mergers rose from 190 in 1980 to a peak of 649 in 1987 -- for a total of 4,428 mergers during the 1980-89 period (averaging about 400 mergers annually). The 1990s continued to experience a fairly steady trend of bank merger activity. While the first half of the decade (1990-1994) saw a total of 1,995 merger transactions (for an average of about 310 mergers annually), the number rose to 2,311 (for an average of 462 mergers annually) for the period 1995-98. Thereafter, however, the numbers declined from 333 in 1995 to 184 in 2003 (Pilloff,

2004). In short, due to mergers and acquisitions, coupled with a decrease in the number of newly chartered banks and bank failures, the number of banks in the U.S. shrunk from 14,435 in 1980 to 10,070 in 1999 (Arshadi & Karels, 1997: 470; Biswas & Lochel, 2001:11). During this period very large bank mergers became much more common (Kohn, 2004; Pilloff, 2004; Rhoades, 2000).

Several factors have been attributed to the rising movement of bank mergers and acquisitions during the 1970-2005 period, including changes to banking regulations (e.g., the easing of restrictions on intrastate and interstate banking that began in the mid-1970s through the 1990s), revisions to merger guidelines issued by regulatory agencies, and court decisions as well as economic factors such as technological advances that opened up new markets and the creation of the potential for larger institutions. As discussed earlier, a notable development was the enactment of IBBEA in 1994 whose implementation (and that of its predecessor statutes) “sparked an era of rapid consolidation and rising concentration in the industry” (Stiroh & Poole, 2000: 2) as financial institutions “rushed to enter into markets that were previously closed to them” (Arshadi & Karels, 1997: 470). Indeed, the IBBEA “stimulated the ongoing movement toward consolidation within the banking community by opening new avenues for mergers and acquisition across state lines” (Matasar & Heiney, 2002: 92).

These regulatory changes have had a direct bearing on how bank mergers were reviewed as reflected in the dramatic changes to the merger guidelines issued by the regulatory agencies. Consequently, some mergers have been permitted that might otherwise have been denied under the old guidelines (Shull & Hanweck, 2002: 217). Moreover, with the introduction of “the practice of negotiated divestitures” the

“probability that a large bank merger will be denied” has been further diminished, if not extinguished altogether (Shull & Hanweck, 2002: 218).

In addition to the removal of regulatory barriers it is crucial to underscore the fact that economic factors (e.g., technological changes and increased global competition) have also played a significant role in driving or at least shaping the bank merger movement during the period under observation. Rapid technological innovation may also have made the larger bank holding companies (BHC) viable -- than they would have been in the absence of technological advances -- and hence induced greater industry-wide consolidation and concentration (Stiroh & Poole, 2000: 3).

The upshot of these mergers and acquisitions has been an increase in the concentration of American banking markets. Indeed, a study by Stiroh and Poole reveals that the rise in concentration in the 1990s is due almost entirely to external growth through M&As, especially as the top bank holding companies (BHCs) went about “consolidating operations and becoming increasingly dominant in size and market share of banking assets” (Stiroh & Poole, 2000:1). As a result, the American banking industry has increasingly been comprised of branch banks and banking companies owned/controlled by bank holding organizations as reflected by the decrease in the number of unit banks from 8,698 in 1976 to 2,892 in 1998 while at the same time the number of branch banks has risen from 31,344 in 1976 to 61,957 in 1998 (Morris, 2004:436; see also Hirtle & Metli, 2004). These trends have been accompanied by increasing concentration levels in the U.S. banking markets (Morris, 2004; Rhoades, 2000). For instance, the percentage of assets controlled by the five largest banks rose by about 30 percent from 13.5 % in 1980 to 17.6 % in 1995 (Morris, 2004:436). In terms of banking deposits, the share of domestic deposits held by the ten top banks in the U.S.

rose from 19 % in 1980 to 37 % in 1998 (Brewer, Jackson, Jagtiani & Nguyen, 2000:5; see also Morris, 2004:436; Rhoades, 2000:26).

These trends in the reduction of banking firms and rising banking concentration, as noted earlier, have some analysts concerned that U.S. banks may be becoming too big to be allowed to fail with serious implications for the public purse in case of bailouts for failed institutions. Furthermore, analysts are also concerned that increasing concentration may have adverse implications for access to credit and quality of banking services especially for individual consumers and small businesses. We discuss these concerns next.

(d) Customer/consumer Protection

Bank mergers and acquisitions can affect bank customers in several ways depending on the type of fusion. Mergers among banks (i.e., in-market, horizontal mergers) can potentially enhance economies of scale and scope. These gains could then, potentially, be passed on to consumers/customers in terms of higher deposit rates and/or lower loan rates. Mergers between banks and non-bank financial firms (e.g., with securities, insurance firms, etc) can potentially enhance production and/or consumption synergies. "Production synergies exist when it is less costly for a single company to provide a group of financial service than for several companies to provide them, each specializing in a different service" (Keeton, 2001:37). On the other hand, consumption synergies may occur, *ceteris paribus*, "when it is less time consuming or more convenient for the consumer to purchase different financial services from a single company than from a number of different companies" (Keeton, 2001:37).

These potential benefits, however, do not seem to emerge in the experience of American bank mergers and acquisitions. In fact, the concentration trends alluded to above have some analysts, industry and social groups concerned that increasing banking concentration and the rise of large financial corporations may undermine access to and the quality of financial/banking services, and negatively affect social conditions (ICBA, 2004; Dymski, 1999; Dymski, Epstein & Pollin, 1993; Garmaise & Moskowitz, 2006; Scott & Dunkelberg, 2003). Some analysts are, indeed, concerned that, unless some drastic measures are taken, increasing concentration will increase the challenges of dealing with issues of social exclusion and stratification associated with racial discrimination currently plaguing the U.S. financial system (Calem & Stutzer, 1995; Ladd, 1998; Nesiba, 1996).

In this section we will focus on the impacts of financial consolidation and integration on consumers and small businesses as well as on society in general. We focus on consumers and small businesses because as William Keeton has observed, surveys have consistently found that these two groups have historically “relied heavily on local banks for their credit and payments needs” (Keeton, 2001: 25). “It stand to reason, therefore, that ...[these two groups] would also be the most affected by any changes in local banking practices resulting from consolidation” (Keeton, 2001:25-26). Moreover, we also pay close attention on societal impacts because small businesses “play an especially important role in the economic performance of smaller communities – the communities where there has been the greatest concern about the possible adverse effects of the transformation in banking” (Keeton, 2001:26).

As regards to the impact of banking transformation on consumers, empirical studies have found the following to be the key findings. First, it has been found that

banks in highly concentrated markets pay relatively lower rates on their deposits (Keeton, 2001:33). Second, “annual surveys by the Federal Reserve have consistently found that large multi-state banks charge higher fees for many retail banking services than smaller single-state banks” (Keeton, 2001:34). Thirdly, even though the passage of the Gramm-Leach-Bliley Act (1999) was supposed to make easier for banks to provide consumers with a variety of financial services, “empirical studies have found little evidence of production synergies within the banking industry” (Keeton 2001:37). Moreover, studies have found that there is “no evidence that customers are willing to pay more when banking services such as lending and deposit-taking are provided by the same bank than when they are provided by separate banks” (Keeton, 2001:37).

As regards to the impact of banking transformation on small business, empirical studies have also not found any significant benefits accruing to small firms. To be sure, while there has been an increase in small business lending following a merger involving small banks and that there has been no noticeable change in bank lending following mergers between medium-sized banks and large institutions, it has also been observed that small business lending has declined following mergers between large banks as well as between small and large banks (Carow, Kane & Narayanan, 2006:823; Keeton, 2001: 40). Moreover, even those studies that have found no significant effect on the ability of small businesses to access credit, it has been noted that bank mergers have had an adverse impact on the quality of bank services. For instance, Jonathan A. Scott and William C. Dunkelberg have found that although bank mergers:

...had no significant effect on the ability small firms to obtain a loan ...the incidence of mergers does appear to increase nonprice loan terms, increase the incidence of related fees for services, raise the frequency of searching for a new bank, and result in deterioration of service quality” (Scott & Dunkelberg, 2003:999).

In sum, the decline in the supply of credit and deterioration in the quality of services to both individuals and small businesses are attributed to three key interrelated factors. First, the decrease in the number of banking firms has tended to erode the relative bargaining power of consumers/customers in favour of the banks (Carow, Kane & Nayaranan, 2006: 822). Second, the post-merger displacement of bank employees due to staffing cuts or transfers tend to remove bank officers “whose favor the customer had previously cultivated” (Carow, Kane & Nayaranan, 2006:822). Third, large banks are deemed ill-suited to cater to individual and small businesses due to: (a) the high costs of building and maintaining close, long-term relationship with bank customers; and (b) the tendency of widely dispersed banks to grant less autonomy to local bank officers in favour of a reliance on standardized, rigid credit scoring models and techniques that invariably lead to the rejection of otherwise good credit risks (Keeton, 2001: 39).

Together these factors have not only affected individual consumers and small business customers but they have had negative effects on local communities. In this regard, Mark J. Garmaise and Tobias J. Moskowitz provide evidence linking merger-induced reduction in banking competition, credit conditions, and social effects. They found that “neighborhoods most affected by bank mergers subsequently experience significantly worse credit terms, less development and investment, lower real estate prices, an inflow of poorer households, and greater increases in property crime in subsequent years” (Garmaise & Moskowitz, 2006:534). In other words, bank mergers may potentially have undermined the rebuilding of decaying neighbourhoods. Thus, these “findings suggest that in evaluating the impact of bank mergers, regulators would do well to consider not only the present bank concentration of potentially affected markets, but

also the social fragility of these markets” (Garmaise & Moskowitz, 2006:534; see also Dymski, 1999; Dymski, Epstein & Pollin, 1993).

The above discussion suggests, at least, two important things. First, U.S. bank merger policy has been unable to mitigate the hitherto rising trend of banking concentration. Second, measures to mitigate the negative impacts of market concentration such as the use of the Community Reinvestment Act are in need of augmentation if the American bank merger policy goal of protecting customers/consumers is to have any meaning.

(e) Domestic Ownership

As noted in Section 6.3.1, Americans have in most cases welcomed foreign banks (especially from advanced countries) for the capital they have brought to the U.S., but at the same time they have always been wary of foreign control of financial institutions in their country. Consequently, the entry, operations and growth of foreign banks have been governed by state and increasingly by federal authorities. However, we also noted that increasing regulation did not slow down the entry of foreign banks especially during the 1970s-1990s period that saw an increasing trend in financial globalization (Graham & Krugman, 1995; Houpt, 1980, 1999; Tschoegl, 2000).

Furthermore, the entry of foreign banks has also been influenced by domestic pressures exerted on city, state and federal governments to permit foreign banks into the U.S. One of the purposes of exerting such pressure was to create conditions that would enable American banks to implement their expansion plans abroad. For instance, “between 1959 and 1961, Chase Manhattan Bank and Citibank led the Association of New York Clearing House Banks to sponsor a bill permitting foreign banks to open

branches in New York” because they were “meeting resistance to their expansion in Japan and Latin America on the grounds that New York did not offer reciprocity” (Tschoegl, 2000:11; see also Pauly, 1988). Secondly, the entry of foreign banks has also been favoured in the bid to enhance the importance of some U.S. cities (e.g., New York, Chicago, Miami, Los Angeles, San Francisco, Houston, Dallas, and Atlanta) as financial centres as they compete against each other and against global centres such as London and Tokyo (Tschoegl, 2000:11; see also Rosen & Murray, 1997).

Pertinently, the entry and growth of foreign banks has in some sense been facilitated by bank merger policies at state and federal levels (Tschoegl, 2000). To begin with, the restrictions on interstate bank M&As that existed prior to 1994 tended to exclude out-of-state bank mergers and acquisitions. Secondly, antitrust concerns worked to exclude intra-state M&As for fear of increasing concentration and reducing competition. Thus, in the cases where state authorities permitted the acquisition of local banks by foreign banks, foreign acquirers usually became the only viable entities in the sense that they had the resources often required to rehabilitate local banks in distress and that their acquisition would not increase concentration and diminish competition. In short, state and federal bank merger policies worked in tandem to create conditions in which domestic purchasers were effectively barred from acquiring or merging with local banks that needed to be acquired while foreign banks were not. In other words, bank merger policies, in this case, did not work to protect domestic ownership and control.

To the extent that government regulations seemed to favour foreign banks, domestic banks campaigned for the removal interstate barriers to banking mergers and acquisition arguing that excluding domestic banks made the bidding process less competitive, leaving foreign banks “unopposed”. This, the domestic banks argued,

created a condition in which shareholders of an “acquired bank would not necessarily get the best price” (Tschoegl, 2000:29). “In time, this argument together with a general trend towards deregulation, had its effect in the passage of the IBBEA (1994)” (Tschoegl, 2000:29).

In sum, it is fair to conclude, in this regard, that the impacts of U.S. bank merger policy are threefold. First, in spite of the popular apprehension against foreign control, the U.S. bank merger policy has not been effective in countering the increasing trend in the entry and growth of foreign banks in the U.S. associated with the increasing trend of global financial integration. In fact, in some cases it has worked to enable foreign banks to enter the U.S. marketplace through cross-border acquisitions; hence fostering further financial internationalization and integration. Indeed, according to Adrian Tschoegl, most of the large foreign banks (10 of which account for 86 per cent of all assets in foreign affiliates and subsidiaries) owe their growth and size to acquisitions in the U.S. (Tschoegl, 2000:17). Finally, as a reaction to the perceived unfairness or lack of a level playing field vis-à-vis foreign banks – a condition created by the then prevailing policies -- large domestic banks campaigned for geographic deregulation that eventually led to the dismantling of the restrictions on interstate bank mergers and acquisitions.

(f) International Competitiveness

American banks have come a long way with respect to international competitiveness. While of the world’s top ten banks at the end of 1913 (measured by deposits) none were American (Wilkins, 1989:454), by 1970 U.S. banks had risen to occupy the top 4 of the top five in *The Bankers* listing of banks in the world (see Table 2 in Appendix 5). The rise of American banks, however, came to a halt in the 1980s as they

saw their world rankings tumble down when Japanese banks took the world by storm. For example, as Table 2 shows, BankAmerica Corp dropped from number 1 in 1970 to number 24 in 1987. The 1990s onwards, however, saw a revival of American banking as BankAmerica Corp recovered to number 7 in 1997 and to number 4 in 2004. Likewise, Citigroup rose from number 6 in 1987 to number 5 in 1997 to number 1 in 2004. The rise of U.S. banks is also reflected in the favourable assessments in the Global Competitiveness Reports. For instance, in terms of “financial market sophistication”, the U.S. was ranked at number 2 consecutively for the years 2002-2003 and 2003-2004 (Cornelius, Porter & Schwab, 2002: 557; Cornelius, Porter & Schwab, 2003:407).

What is important to note here is that the recent rise of American banks reflects not only their respective record performance vis-à-vis other international banks but it is also due to the emergence of super banks brought about mostly by mergers and acquisitions (The Banker, 2005). As a matter of fact, as noted earlier, the history of the major banks in the U.S. is replete with mergers and acquisitions that largely account for the size and position of most major U.S. banks and financial institutions (Lamb, 1961: 62; Stiroh & Poole, 2000: 2).

6.4 Conclusions

In this chapter we have endeavoured to demonstrate how the U.S. public policy towards bank mergers has evolved over the 1970-2005 period. To set the stage for such an examination we briefly discussed the evolution of American banking and its governance for the period prior to 1970. This discussion and that followed demonstrated that while most of the policy components examined have exhibited continued evolution (in a path-dependent manner), there are still several elements within these components

that have endured in one form or another and hence have continued to shape the unique character of American federal bank merger policy in particular and bank and banking regulation in general.

As noted in the chapter, American bank merger policy objectives have evolved to encompass a wide array of prudential, antitrust, and public interest goals and purposes. We discussed how antitrust objectives introduced in 1960 were further re-shaped during the Reagan era. We also discussed how the forces of globalization, regionalization, as well as other pressures in the 1970s, 1980s and 1990s have played an important role in re-shaping the goals and objectives of American bank merger policy.

In regard to business, investment, and ownership powers, the period from 1970s to 1999 witnessed gradual as well radical reforms. Most of the Post-Depression era product, price, and geographic restrictions were eliminated. Likewise, a number of reforms were implemented with regard to regulatory institutions, instruments, and merger review processes. Of course, most of the key regulatory institutions such as the OCC, the Federal Reserve, and the FDIC have endured when other countries have opted for single independent organizational frameworks. Moreover, in spite of the reforms in 1980s and the increasing regulatory cooperation indicative of growing global integration and regionalism, the characteristic American legalistic/litigious style of bank merger regulation has remained fairly stable.

Lastly, but not least, we explored the impacts of U.S. bank merger policy on bank stability, international competitiveness, consolidation and concentration, efficiency, customer/consumer protection. It was clear that compared to its own previous (crisis prone) history, the American banking industry has come a long way. It is currently relatively stable even when compared to international standards. Internationally, it is

currently considered to be highly sophisticated, competitive and dominant. The U.S. banking structure is also increasingly getting very concentrated as the number of banks continues to decline due primarily to mergers and acquisitions. In sum, the analysis of the five policy components discussed in this chapter renders the comparison, in the next chapter, between the American and Canadian bank merger policies effectively manageable.

Chapter 7: Canadian and U.S. Bank Merger Policies: Significant Convergence or Enduring Divergence?

7.1 Introduction

Over the past four decades significant socio-economic, political and technological changes have occurred in both Canada and the U.S. (as well as regionally and globally) resulting in the transformation of not only the structure of banking industries but also in how banking (financial) systems, in general, and bank mergers in particular are governed. The main purpose of this chapter is to compare the transformation of the Canadian bank merger policy with that of the U.S. Specifically, drawing on the discussion presented in chapters 5 and 6, it aims to discern, whether indeed, for the period between the 1970s and 2005, the Canadian bank merger regime has gravitated towards the U.S. model, or whether the respective bank merger regimes continue to exhibit significant and enduring differences as these two nations enter the 21st Century. Specifically, this chapter will endeavour to identify the patterns of change (areas/aspects of convergence and/or divergence) as well as attempt to understand the underlying dynamics and the sources of such convergence/divergence patterns and their implications.

Overall, the key finding in this dissertation is that although there has been some convergence in certain elements of the bank merger policies of these two countries – with Canada converging on the U.S. (e.g., with respect to policy objectives, competitive reviews, issues covered) and the U.S. converging on Canada (e.g., with regard to types and methods of mergers governed, nationwide branching) -- Canadian and American bank merger policies continue to exhibit distinctive characteristics/features with respect to institutional structures, geographic scope, concerns about concentration of economic

power, procedural and enforcement matters, substantive issues of law, policy styles as well as policy impacts.

Indeed, in spite of the radical changes that have occurred globally and within these two industrialized countries over the past four decades, and despite enhanced global and regional integration, in significant ways, the bank merger policies of these two countries continue to track divergent or at least parallel paths. This is so in spite of the fact that both countries share some common characteristics (e.g., they are federal states and belong to the same Anglo-Saxon model of capitalism).

The rest of this chapter proceeds as follows. In the next section, a discussion on the existence of bank merger policies in the two countries is presented in order to determine whether there has been a convergent tendency in the institution or establishment of such policies. In the third section, a detailed analysis of six elements of policy convergence/divergence is conducted. In addition to discerning the dimensions that might have converged and/or diverged, we will, in the section, endeavour to understand the dynamics behind the growing similarity in some elements and the continued divergence (or parallel track) in other aspects of these two countries' bank merger policies. The last section offers some concluding remarks.

7.2 Existence of Bank Merger Regimes

The discussion in chapters 5 and 6 has demonstrated that both Canada and the U.S. have federal policies on bank mergers and acquisitions. Indeed, the regulation of bank mergers and acquisitions in both Canada and the U.S. has a long history. At the federal level, Canadian policy on bank mergers and acquisitions can be traced to the time

of Confederation in 1867, while that of the U.S. can be traced to some four years earlier in 1863 with the establishment of the national banking system.

To be sure, the bank merger regimes of these two countries have evolved over time. While for the first hundred and twenty years (i.e., for the period 1867 to 1986) bank mergers in Canada were solely governed under the Bank Act, thereafter competition (anti-trust) authorities also gained authority to regulate banks with regard to matters of competition policy (Anderson, Hollander, Monteiro & Stanbury, 1998: 177). As a result, bank mergers in Canada are currently governed under both the prudential and competition policy norms and standards as well as on public interest grounds.

Pertinently, the application of competition policy to bank mergers in Canada as well as the strengthening of pro-market oriented prudential regulation should also be understood against a backdrop of increased “deregulation” and “re-regulation” of financial services in the 1980s. Generally, as the traditional instruments of control were relaxed, public authorities increasingly resorted to or relied upon general framework policies such as competition policy. Moreover, the advocacy work of the Director of the Canadian Competition Bureau also played an important role in the adoption and extension of the application of competition policy in banking and financial services in general (Stanbury, 1998a).

In the same token, the history of U.S. bank and banking regulation denotes a rich and evolving bank merger regime. In fact, public governance of bank mergers in the U.S. is traceable to state statutes long before the establishment of the national banking system in 1863. After the establishment of the national banking system and hence of the dual banking system of state and federal banks, bank mergers have hitherto been under the purview of federal and/or state authorities. Moreover, at the federal level, the regulation

of bank mergers has evolved from being the “sole” jurisdiction of bank regulators to one shared among bank regulators, the Department of Justice, and the courts.

As such, there have long been a number of statutes requiring the prior approval of merger transactions. For example, the Consolidation Act of 1918 required the advance approval of the Comptroller of the Currency (OCC) before two or more banks could merge under the charter of a national bank. This statute, however, did not explicitly instruct the Comptroller to consider the probable effects of mergers on competition (Horvitz & Shull, 1971: 862-3). Moreover, the Federal Deposit Insurance Act of 1950 provided that in cases involving capital reductions before an insured bank could merge with another bank, prior written consent would have to be obtained from the appropriate regulatory agency. As noted in the previous chapter, these measures/stipulations were followed by the Bank Holding Company Act (1956) and the Bank Merger Act (1960) – statutes that were subsequently amended more than once. These Acts, coupled with key court decisions, paved the way for the governance of bank mergers on prudential, antitrust, and public interest grounds. And, as was discussed in Chapter 6, American bank merger regulation continued to evolve thereafter.

In sum, both Canada and the U.S. have had bank merger policies from the very inception of their banking systems. Without question, Canada did draw some valuable lessons on bank and banking regulation from the American precedent and experience when it was establishing its earlier banks. As such, Canada can be seen at a certain level to have converged on the U.S. in terms of establishing bank and banking regulation.

Thus, having established that both Canada and the U.S. do indeed have bank merger policies we can now proceed to examine the comparative patterns of their

evolution and discern whether or not the subject policies have been growing similar (or dissimilar) over the time period under study.

7.3 Dimensions and Dynamics of Convergence and/or Divergence

In order to identify some of the salient aspects that might have converged and/or diverged during the period under review, this section -- as suggested in the study's analytical framework -- will particularly focus on the following elements: (a) policy scope, (b) policy objectives, ideas and discourse, (c) banking business and investment powers, and ownership rules, (d) bank merger review process, instruments, and institutional configuration, (e) policy styles and process, and, (f) policy impacts. We discuss these aspects in turn.

7.3.1 Scope of Bank Merger Policy

As provided in the study's analytical framework, the scope of bank merger policy entails, at least, four distinct (yet interrelated) aspects including: (a) jurisdictional coverage (e.g., state vs. federal; national and/or extra-territorial application), (b) issues covered, e.g., a narrow focus on financial probity (financial regulation and supervision) vs. broader focus including competition issues and other aspects such as socio-economic accountability, employment and transition concerns, etc.; (c) method of merger (e.g., asset acquisition or share acquisition), and, (d) type of merger (e.g., vertical, horizontal or conglomerate).

To the extent that Canada has had a nation-wide banking system from its earliest inception in 1867, the scope of its federal bank merger policy has been national too. To

be sure, the geographic coverage or scope of the bank merger policy has expanded as more provinces and territories joined the Dominion. The U.S. experience is, however, different. With its dual banking system (comprised of both state and federally regulated banks), bank merger governance has hitherto been a dual federal and state affair highly dependent on not only the type of merging firms but also on the nature of the resulting banking firm. In short, while in Canada bank merger governance has encompassed all banks on a nation-wide basis, the U.S. has seen the emergence of a dual, overlapping regime of governing mergers between and among national and state banks. Even with the recent removal of interstate and intrastate barriers (and hence the establishment of nation-wide banking) it is fair to surmise that the dual nature of bank merger governance will continue as long as some banks continue to be chartered and governed by state authorities while others by the federal authorities. And, especially given that of recent state authorities (state attorneys general) have reasserted themselves in the control of bank mergers (Calvani, 1996, 2003; DeBow, 2002, 2004; Posner, 2004). In this sense, therefore, the Canadian and U.S. trajectories can be said to have continued on distinct and parallel paths.

As regards to the control of the type of mergers, both the Canadian and U.S. bank merger policies began with a primary focus on mergers and acquisitions among banking firms (i.e., horizontal mergers). Over the years, however, the scope of both the Canadian and U.S. policies have grown (with some restrictions with regard to recently de-mutualized insurance companies in Canada) to encompass the control of mergers not only among banks but also between banks and non-banking firms (i.e., conglomerate mergers). Whereas the separation of commercial banking from investment banking (post-1933 in the U.S.; and after WWII in Canada) saw the proscription of mergers between

banks and securities firms, the late 1980s saw a relaxation of these restrictions in Canada thus permitting mergers between banks and securities dealers. Indeed, as discussed in Chapter 5, the federal government eventually permitted banks to acquire provincially regulated securities firms in 1987 after the British Columbia, Ontario and Quebec governments – faced with the increasing need for more capital in their respective securities industries, coupled with intense global and regional competitive pressures – had opened up the avenue for securities firms to be acquired by banks. As such, with the crumbling of the financial pillars (as banks went about acquiring securities firms), the scope of Canadian bank merger policy has evolved towards a broader scope encompassing mergers and acquisitions of all types of financial institutions. Moreover, as also noted in Chapter 5, the longstanding rule that “big-shall-not-buy-big” (banks) was rescinded by the Canadian federal government in 1999.

The U.S., however, was slow on this front. It was only with the repeal two decades later of the Glass-Steagall Act in 1999 that banks were permitted to merge with other financial firms. The upshot of this has been an extension of the U.S. bank merger regime to encompass the control of mergers among banks as well as among banks and non-bank financial institutions.

In sum, it is important to note that although there has been some convergence with respect to the types of mergers governed, the direction of this trend has clearly not been unilinear. For instance, in terms of the separation of commercial banking from investment banking, post-World War II Canada seems to have converged on the post-Depression (1933) USA. Canada, however, reversed direction in the 1980s by permitting the acquisition of securities dealers by the banks – a move that was only followed by the U.S. with the passage of the Gramm-Leach-Bliley Act in November of 1999 (P. L. 106-

102, 113 STAT. 1338) repealing the last vestiges of the Glass-Steagall Act of 1933. In other words, in terms of the control of mergers between banks and non-bank financial institutions, one can safely say that while the post-World War II Canadian bank merger regime had converged on the post-Depression era U.S. regime, it diverged in the 1980s; and currently the post-1999 U.S. regime is in many respects converging on the post-1980s Canadian regime. This tendency, however, is not replicated with regard to the geographic scope of Canadian and American bank merger policies as they continue to traverse along distinct and parallel paths.

7.3.2 Bank Merger Policy Objectives, Ideas and Discourse

In establishing its earlier banks Canada did draw some valuable lessons on bank and banking regulation from the American precedent and experience. These lessons were primarily channelled into Canada via the emulation of early American bank charters. For instance, as discussed in Chapter 5, the charter of the Bank of Montreal (the first bank in Canada) was modelled on the articles of the first Bank of United States (established in 1792) as drafted by Alexander Hamilton, the first Secretary of the U.S. Treasury. Other provincial banks later copied the articles of the Bank of Montreal. Moreover, a number of the key features of the articles found their way into the Canadian Bank Act after Confederation in 1867 (Beckhart, 1954; Shortt, 1986:18-25). Of course, while it is true that both the Canadian and American early banking legislations were crafted on the British model:

It is important to understand that, philosophically, the Canadian approach to financial regulation has been more influenced by American values than British traditions. Canadian commercial legislation is extremely detailed in outlining transactions allowed, and under what conditions (Bodkin, 1990: 154).

It is thus not surprising that, broadly speaking, the main objectives of the Canadian and the U.S. bank merger policies are similar. They include to: ensure financial system stability, soundness, and integrity; protect depositors; prevent concentration of economic and political power; and, to protect domestic ownership. However, it is important to note that in spite of the similarity, over time the relative emphasis/priorities accorded to many of these objectives have differed across the two countries. We will examine these in turn.

(a) Financial Market Stability vs. Economic Efficiency

In both Canada and the U.S., financial market stability and integrity have been of paramount concern since the early beginnings of their respective banking systems. However, when examined over the long horizon, one notes that in both the U.S. and Canada the 1960s were a watershed period as regulatory objectives began tilting more towards concerns for competition and economic efficiency as important (if not the dominant) public policy goals. From a Canadian perspective, talk of domestic competition and efficiency in banking can be traced back to the Porter Commission's report of 1964. Moreover, economic efficiency as a goal of the federal competition policy in Canada is also not a long-standing phenomenon either (Gorecki & Stanbury, 1984). And, as it was pointed out in Chapter 5, the early framers of the competition legislation in 1889 did not have economic efficiency as a primary goal in mind (Gorecki & Stanbury, 1984). Indeed, Tim Hazledine (1998:243-244) notes that:

The competition legislation that extends a century in Canada and the United States was based not on efficiency but on due process; specifically, on safeguarding the rights of households and small businesses to participate on fair and open terms in the market economy. We can see classical antitrust as a late flowering of the eighteenth and nineteenth century Enlightenment: the program establishing the rights of the

individual against the arbitrary exercise of power by the state. To extend the analogy of David McQueen (1991, p.22), western societies moved from “one King, one vote” to “one man, one vote”.

Hazledine (1998) continues to observe that as capitalism developed, democrats came to fear the erosion of one man one vote not by kings but by robber barons (i.e., one robber baron, one vote); hence, the enactment of U.S. Sherman Act (1890) and Canadian Anti-Combinations Act (1889). This fear, however, seems to have receded as advanced capitalist economies matured. The upshot of this development has been “the increasing use of civil as opposed to criminal law and the introduction of “the ‘efficiencies defence’ tradeoff into the 1986 Canadian legislation” (Hazledine, 1998:244). Thus, Hazledine (1998:244) contends, “Taken literally, this represents a quite fundamental shift from “one man one vote” to “one dollar one vote.”

In sum, economic efficiency as a goal in both the Canadian bank regulatory and competition policies are of recent mintage. In fact, even after economic efficiency was embraced as the key goal, Canada did not permit the Competition policy authorities to review bank mergers up until 1986. As such, for a long period in Canada, a cartel-type of banking structure was acceptable as a means of preserving financial stability and thus banking was treated differently from other economic sectors and was consequently exempted from the competition legislation up until 1986.

Similarly, in the U.S. the objectives of competition and economic efficiency in banking are also of fairly recent origin having being introduced in the 1960s and gaining ground in the 1980s (Dymski, 1999; Hawawini & Swary, 1990; Horvitz, 1983; Horvitz & Shull, 1971; Lamb 1961; Lifland, 1967; Mason, 1997; Shull & Hanweck, 2002; Smith & Greenspun, 1967).

Indeed, the importance of economic efficiency as a key goal in financial policy rose when both these countries took a Right-turn towards neo-liberalism in the 1980s when neo-liberal ideas gained prominence. The ascendancy of neo-liberal ideas and the coming to power in the 1980s of the Ronald Reagan Administration in the U.S. and of Brian Mulroney's government in Canada provided a strong impetus to a number of key policy changes geared towards the realization of market-friendly policies with respect to banking.

From a Canadian perspective, the ideas under the rubric of what we have termed the "new learning" found their way into public policy and public statutes with the periodic revisions of the Bank Act and the Competition Act. Worth noting, however, is that although the Canadian Competition Act was extended to encompass banking services, the Competition Bureau did not produce its Merger Enforcement Guidelines up until 1992. And, as McFetridge had noted, these guidelines were heavily influenced (inspired) by the DOJ Horizontal Merger Guidelines (McFetridge, 1998b).

In regard to developments in the U.S., the adoption of the neo-liberal position in bank merger governance is in main part reflected in the revisions of DOJ and Federal Reserve Board as well as in the appointment of antitrust officials at the DOJ by the Reagan administration (Baker, D. L., 1992: 653; see also DeYoung, 1994, 2001; Dymski, 1999).

(b) Concentration of Economic Power

In the U.S., the intense public concern over the concentration of economic power in the hands of the banks is a longstanding one rooted in American liberalism. As noted in chapter 6, the distrust of centralized money power in the U.S. is in part reflected in a

number of measures and instances including the: (1) demise of both the First and Second Banks of the United States, (2) limited powers granted to banks under the National Bank Act, (3) prevalence of the unit banking system, (4) establishment of the Federal Reserve System as decentralized institution, (5) prohibition of interstate and intrastate bank branching, and (6) enactment of the Bank Merger Act of 1960, just to mention a few examples.

And as discussed earlier, the U.S., in spite of its long antitrust tradition, only formally incorporated competition (anti-trust) objectives into its bank merger policy when it passed the Bank Merger Act of 1960. To a large measure, the gradual introduction of anti-trust objectives in banking reflects a congressional balancing act whereby safety and competition may potentially conflict (Horvitz, 1983:247). Moreover, even when the goals of competition and efficiency were introduced banks and banking were and have hitherto been treated differently from other firms and sectors (White, L., 1996).

Comparatively, however, the deep distrust of money power in the U.S. is not congruently matched in Canada. For instance, from an antitrust (competition policy) perspective Gorecki and Stanbury (1984: xviii) note that "The framers of Canada's early legislation were not hostile to big business in general. Indeed, they believed that the nation as a whole stood to benefit from large aggregation of capital." Moreover, as Doern (1995: 5) observes:

There has never been any Canadian equivalent to the populist basis of US antitrust law and actions. A free enterprise value system has never been as entrenched in Canada as it is in the US. Canadians support a market economy, but they and their business class have not looked to competition policy to pursue that objective.

Having said that however, it is worth noting that in spite of the difference, there are some similarities between Canada and the U.S. with respect to the need to curb the concentration of economic and political power. To begin with, although regulatory authorities have permitted the development of a nation-wide banking system, “yet the restrictions against one party owning more than 10% of a chartered bank can be seen in part as arising out of the same concerns about the concentration of economic power” (Krossel, 1984: 53). Moreover, “the legal restrictions which places limits on the ownership by banks and other institutions of businesses outside of the financial industry, effectively is a check, albeit a small one, on this economic power being diffused through the rest of the economy” (Krossel, 1984: 53).

In short, both in the U.S. and Canada, banking has been treated as different from other sectors and thus for a long while exempted from the purview of competition (antitrust) policy authorities and that even within the respective competition policies economic efficiency as a key objective is of recent origin. Moreover, as we will discuss in subsection 7.3.4(d) below, Canada and the U.S. have tended to interpret or treat efficiency differently. In sum, one can conclude that as far as ideas about competition and economic efficiency are concerned, there seems to be some tendencies for both convergence and divergence. (We will return to this issue in subsection 7.3.4(d) below.)

In addition to highlighting the underlying ideas about prudential regulation and competition policy we would be remiss if we didn't discuss (albeit briefly) the ideational basis, and indeed the transformation during the period under review, of Canada's and America's respective policies with regard to bank ownership and nationalism.

(c) Bank Ownership: Nationalism, Continentalism, or Globalism?

As discussed in Chapter 5, Canada's nationalist sentiments were highly tested in the 1960s when the American bank (First National City Bank of New York) intended to and eventually acquired the Dutch-owned Mercantile Bank in spite of strong opposition from the Canadian banking community and the then Finance Minister Walter Gordon (Azzi, 1999; Safarian, 1993). As a result of this episode and the need to protect the Canadian banking industry from foreign control, enhanced restrictions were imposed on bank ownership particularly with regard to foreign ownership rules. As noted earlier, this was an era in which there was a public policy inclination towards the protection of the Canadian financial marketplace driven by the fear that Canada's relatively small, open economy would be controlled by non-Canadians. As such, Canadian control of capital markets was considered a prerequisite for the independence of the economic fate of Canadians (Bodkin, 1990:154). In other words, it was an era of fondly cherished belief that a Canadian owner was always better than a foreign one (Shortell, 1991:11).

This thinking, however, gradually changed. As Canada coped with domestic challenges and international pressures it opened up to foreign investment and free trade. Certainly, embracing the idea of free trade with the U.S. represented a historically profound reorientation of Canadian public policy. It was an idea that had crystallized in the Macdonald Commission Report of 1985 and consolidated in the signing of the Canada-U.S. Free Trade Agreement in 1988 (Inwood, 2005). Postwar Keynesian ideas in favour of state intervention were abandoned in favour of minimal state, pro-free market ideas of the Brian Mulroney era. And, as Doern and Phidd (1992:240) note:

In the decisive battle over free trade, the ideas of sovereignty, nationalism and continentalism took on a somewhat different character than they had in earlier debates on Canada's foreign policy. The Mulroney Conservatives began to articulate

a form of 'entrepreneurial nationalism,' in short, an inbred confidence in the Canadian business community's capacity to compete. The pro-free trade coalition portrayed the anti-free traders as being defenders of a 'little Canada' with narrow notions of sovereignty and protection. The antidote to negative continentalism was not state-led sovereignty and intervention, but rather a new desire to show that Canadians could compete with the best and need not fear the larger global world.

It is in such a context that we should understand the evolution of ideas underpinning Canadian bank merger policy vis-à-vis its American counterpart that were concretized in the changed rules pertaining to banking powers, mergers and acquisitions, ownership rules, and the treatment of foreign financial firms. As a response to domestic, regional, and global pressures, old beliefs were abandoned for ideas that favoured the opening up of the Canadian market place to foreign banks in 1980, affording "national treatment" to U.S. banks with the signing of the Canada-U.S. Free Trade Agreement in 1988, subsequently followed by national treatment to U.S. and Mexican banks (with the signing of NAFTA in 1994) and the permission to foreign banks to establish branches instead of subsidiaries as per the WTO provisions in 1999.

American public policy with respect to foreign ownership and control, on the other hand, has evolved differently. While for the most part, American lawmakers have been open to foreign banking interests establishing bank agencies, branches or subsidiaries, they however, have been loath to permit foreigners to control banks in the U.S. (see Clarkson, 1985; Graham & Krugman, 1995; Wilkins, 1989). Accordingly, federal (and state) regulations have placed stringent restrictions on foreign control. Moreover, to ensure a level playing between foreign and domestic banks and to protect American interests abroad, foreign banks have been brought under the purview of federal regulations on a treatment at par with U.S. domestically owned banks (e.g., the passage of the International Banking Act in 1978). All in all, U.S. policy can be best characterized

as an ambivalent one that welcomes foreign capital but fears control by foreigners at the same time.

In summary, it is fair to conclude that although there seems to be a high degree of convergence in terms of combining antitrust norms and standards with prudential and public interest objectives, there still remain significant differences with respect to ideas about concentration of economic power and foreign bank ownership and control.

7.3.3 Banking Business and Investment Powers, and Ownership Rules

The 1967 Bank Act revisions ushered in a number of significant changes with regard to banking business and investment powers as well as with respect to bank ownership rules in Canada. As discussed in Chapter 5, the amendments to the (Canadian) Bank Act in 1967 saw five key shifts, viz.:

- (a) the hitherto statutory 6 per cent interest rate ceiling was removed;
- (b) banks were granted permission to enter into conventional mortgage lending;
- (c) banks were grouped into two categories -- Schedule A (domestically owned) and Schedule B (foreign owned) -- and a 10 per cent ownership limit was introduced for Schedule A banks while strict restrictions were placed on foreign owned banks;
- (d) interlocking directorships were prohibited; and,
- (e) a clear separation between banks and their customers was established.

These changes were followed by important shifts in the 1980s and 1990s.

The 1980 Bank Act amendments saw a relaxation of foreign ownership rules (Schedule B banks), and the formal separation of banking from investment services that was

subsequently eliminated in the 1987 Bank Act that also placed tight restrictions on both upstream and downstream linkages between banks and securities dealers and re-categorized banks into Schedule I (domestic) and Schedule II (foreign) banks. All in all, these changes set Canadian banks firmly on the “universal” banking model trajectory.

Soon thereafter, Canada signed a free trade agreement with the U.S. (CUSFTA) in 1988 through which Canada afforded U.S. banking firms national treatment (that is, American banks were to be treated in Canada at par with Canadian banks). The CUSFTA was subsequently followed by the 1992 Bank Act revision that saw the further expansion of in-house banking powers including the permission to offer portfolio management advice. Banks, however, were (and continue to be) restricted from selling insurance through their respective branch networks. Right on the heels of the 1992 Bank Act amendments came the NAFTA (signed in December 1993; effective January 1994) that extended national treatment to Mexican (and U.S.) banks. In 1998, the federal government replaced the Schedule I and II regime with a new size-based ownership regime comprised of three categories: (a) large banks and bank holding companies with equity of \$5 billion or more; (b) mid-sized banks and bank holding companies with equity between \$1 billion and \$5 billion; (c) small banks and bank holding companies with equity of less than \$ 1billion. Based on these categories the federal government introduced a formal bank merger review framework.

Thereafter, the federal government, pursuant to its obligations under the WTO moved in 1999 to permit foreign banks to establish branches (instead of having to establish subsidiaries) in Canada. Consequently, foreign interests can now (subject to certain conditions) establish agencies, branches, or subsidiaries to conduct banking business in Canada.

The upshot of these changes are that the focus of Canadian public policy has evolved from one that was preoccupied with horizontal (bank-bank) mergers to one that currently encompasses different types of mergers (horizontal, vertical and conglomerate mergers) whereby banks (that have historically always been permitted to branch nationally) are now permitted to merge with or acquire firms in other financial industries including those engaged in trust and securities business.

This trend in many respects mirrored in the U.S. Whereas, the U.S. commercial banks began the 1970s as highly specialized institutions constrained by the Glass-Steagall Act and geographically restricted (in terms of bank branching and acquisitions), most of these restrictions were, however, relaxed over the years such that after the passage of: (a) IBBEA in 1994 banks could establish themselves nationally; and, (b) the Gramm-Leach-Bliley in 1999 banks could provide a variety of services, branch nationally, and merge with or acquire other financial institutions nation-wide.

The removal of restraints on permissible product lines, geographic reach, and investment powers in the U.S. must be understood at a number of levels and as a result of the combined interaction of a number of factors. While a number of banking crisis episodes punctuated the policy shifts undertaken over the years, it is also important to recognize that it was an interplay of a number of factors such as the interests of the banking institutions and the regulatory agencies, technological change, U.S. federalism, global competition and change in ideology that helped to shape such regulatory shifts.

Understood from such a perspective, the post-Depression era restraints can be understood to have eroded due in part to technological innovations, increased domestic and international competition as well as due to the creative interpretations of statutes by regulatory agencies (federal and state-level authorities). The actions of the regulatory

agencies can in turn be attributable to two different (albeit interrelated) processes. To begin with, the regulators' actions (or inactions) can be understood as the result of the interaction between the incentives of the banks to have the restrictions relaxed and the interests of the regulatory bodies and their staff. The banks needed the relaxation of restraints so that they could diversify in pursuit of further profits in light of declining returns due to competition from non-banking firms. It was also in the regulators' interest to relax the restraints because in that way they could "keep" their respective regulates under their fold instead of losing them to other regulators. It is also important to note that the relaxation at the agency level was much more feasible and "opaque" than pursuing statutory reforms at the Congress level which more often than not was a slow process and relatively more transparent. Moreover, the "revolving door" policy with regard to employee mobility provided significant incentives for agency staff to consider bank requests favourably especially when agency personnel were to consider career shifts from the regulatory agencies to the private sector. In short, a number of factors combined to shape the evolution and relaxation of the rules pertaining banking business and investment powers.

All in all, these developments have ensured that the American bank merger policy, along this dimension, increasingly mirrors its Canadian counterpart in the sense that its scope is now truly national and encompasses horizontal, vertical as well as conglomerate mergers. In other words, American bank merger policy has in this dimension converged on the Canadian model.

7.3.4 Bank Merger Review Process, Instruments and Institutional Configuration

(a) Procedural Aspects

The procedures for bank merger review in Canada, as discussed in Chapter 5, have evolved in four distinct steps to their current form. Initially, banks were required to seek permission to merge from the parliament through a private member's bill. Thus, a bank merger transaction could only take effect if the bill passed in parliament. This requirement was abandoned with the Bank Act amendments of 1900. Instead, banks were then only required to seek the Governor in Council's (i.e., federal cabinet) permission to merge. Under this arrangement, the Minister of Finance played an advisory role only. However, this requirement did not last long, as with the revisions of the Bank Act in 1913 the Minister of Finance was given a prior approval (veto) power. Thus, the procedures the merging parties had to follow to seek approval were changed to conform with the power granted to the Minister of Finance. Procedures were again changed in 1920 when amendments to Bank Act vested the Minister of Finance – with the advise of the Inspector General of Banks -- with the final power to approve or reject bank merger proposals. This arrangement was further expanded in 1986 to include a review and hence a requirement to notify the Competition Bureau of any bank merger proposal. Banks were thus required under this arrangement to notify at least three agencies, namely, the OSFI, the Competition Bureau, and the Ministry of Finance.

As noted in Chapter 5, notification of the Competition Bureau was a result of the extension of the Competition Act in 1986 to cover banking mergers. This extension was in turn made feasible by the radical shift in Canadian competition policy, namely, the decriminalization of mergers (Ross, T., 1998) which had significant implications in how merger transactions were reviewed under the Competition Act for it opened room for

procedural changes in three key aspects. Since mergers were no longer criminally prohibited, the Competition Bureau was now able to: (a) institute or establish pre-notification procedures (i.e., filing of certain information prior to the completion/consummation of a merger transaction), (b) consider remedial measures such as divestitures, etc, and (c) issue merger guidelines. In fact, the Competition Bureau issued in 1992 its Merger Enforcement Guidelines (MEGS) broadly similar to those of the U.S. Department of Justice/Federal Trade Commission Horizontal Merger Guidelines (McFetridge, 1998b). These MEGS were subsequently followed by the issuance of the MEGS as Applied to Banking in 1998.

The notification of bank merger proposals to the Competition Bureau and the issuance of MEGS, are in every sense a convergence on the U.S. with respect to procedural aspects where the DOJ has had to be notified since the 1960s. The issuance of MEGS as Applied to Banking in 1998 is an emulation of U.S. practice by the Feds. The DOJ does not have separate guidelines for banks. However, it should be noted that continuing differences in substance and in the style of implementing these procedures still persist.

(b) Substantive Issues

As noted earlier, both the Canadian and U.S. federal bank merger policies have evolved over the years to encompass prudential regulation and competition (antitrust) policy aspects. The U.S. having done so in the 1960s with Canada following suit two and a half decades later when it extended the application of competition policy to banking in 1986. Substantively, this seemingly convergent trend, however, did not eliminate the dissimilarities between these two systems.

From a competition (anti-trust) policy perspective, the U.S. antitrust policy has historically reflected a strong commitment to consumer rather than welfare maximization. It has also tended to rely heavily on the use of market concentration evidence (i.e., HHI) in determining whether a proposed merger transaction would lessen competition substantially. Certainly, over the years several changes were introduced, notable among them being the 1982 revisions of the DOJ's Guidelines in which the definitions of both the product and geographic markets were enlarged. Needless to say that these changes significantly changed the way bank merger proposals were evaluated (Shull & Hanweck, 2002). Moreover, even though the Federal Reserve Board adopted more or less the DOJ's views on the HHI levels of and changes in concentration that would be cause for concern, the Federal Reserve Board also introduced its own set of mitigating factors (such as "the continued presence of potential competition, the existence of a substantial number of remaining banks in the market, improvements in efficiency and related 'convenience and needs' considerations") that would permit approval even if concentration thresholds were violated (Shull & Hanweck, 2002: 217).

These developments are to a large extent also reflected in the development of the Canadian competition policy. Akin to the Federal Reserve Board's position, the Canadian Competition Act directs the Competition Tribunal not to base its decision solely on market share or concentration evidence when determining whether a merger is likely to prevent or lessen competition substantially. As such it directs the Tribunal (Section 93) to consider other structure and conduct factors such as the extent of foreign competition, whether either of the parties is likely to fail, the availability of acceptable substitutes, barriers to entry, the extent of remaining competition, whether the merger eliminates a particular vigorous competitor and the extent of change and innovation in the market.

That said, however, it should be noted that, given the vast differences in the financial structures of the Canadian and U.S. systems, some criteria and definitions (e.g., market definition) applied in determining merger reviews in the U.S. may not be applicable in Canada (McFetridge, 1998a, 1998b; Mathewson & Quigley, 1998).

Moreover, to the extent that some merger proposals may be approved only subject to remedial measures, "the remedial approach taken in the United States could be much harder to effect in Canada" because given the limited number of financial institutions "there may not be a group of deposit taking institutions in Canada interested in buying additional branches as there has generally been the case in the United States" (McFetridge, 1998b: 50).

Perhaps most importantly, it should also be noted that one of the key provisions with regard to mergers that distinguishes the Canadian Competition Act from the U.S. antitrust policy (and indeed from the statutes of other countries) is the explicit provision for efficiency gains defence (McFetridge, 1998b; Ross, S. F., 1997; Sanderson, 1997). This provision was incorporated with the relatively small size of the Canadian economy in mind. As Doern (1995: 4-5) has noted:

... in a small economy there is also the problem of how to respond with competition policy because such an industrial structure is unlikely to have exploited all the economies of scale available. For this reason, Canada's 1986 competition law has an efficiency defence in its merger provisions.

Specifically, Section 96 of the Competition Act directs the Tribunal -- in the event it finds that a proposed merger is likely to prevent or lessen competition substantially -- to go on and consider efficiency gains from the merger and thus decline to issue a prohibition, divestiture or dissolution order:

... if it finds that the merger or proposed merger in respect of which the application is made has brought about or is likely to bring about gains in efficiency that will be greater than, and will offset, the effects of any prevention or lessening of competition that will result from the merger or proposed merger and that the gains in efficiency would not likely be attained if the order were made (McFetridge, 1998b: 49).

In other words, "when a merger is expected to be both anticompetitive and efficiency enhancing, Section 96(1) of the Competition Act resolves the conflict in favor of a merger when the likely efficiency gains are greater than and offset the likely anticompetitive effects" (Sanderson, 1997).

In summary, although the substantive aspect of the Canadian and U.S. bank merger policies appear to have grown similar over the years there still remain differences on a number of substantive issues. The general similarities, in fact, mask significant differences that have emerged over time. As a country with a much smaller internal market and far fewer firms competing in any given industry Canada has had to craft its competition policies to suit its position as a small open economy (Doern, 1995).

(c) Policy Instruments

In regard to bank merger policy instruments there has been some discernable convergence in two key aspects. First, both countries have moved away from requiring legislative approvals of bank mergers: the U.S. having done so in 1838 and Canada in 1900. Thereafter, it became unnecessary to pass of special acts of Parliament in Canada or to pass legislative instruments in Congress or state legislatures in the U.S. This, of course, has not precluded the intervention of the legislative bodies as was the case of congressional intervention in the break-up of Transamerica Corporation in 1953.

Secondly, both countries have gradually combined prudential and antitrust (competition) reviews of bank mergers proposals: thus, directly involving bank regulators and competition (antitrust) policy authorities. As such, since 1986, bank mergers in Canada are governed under both the Bank Act and the Competition Act. By subjecting bank mergers to review by competition policy authorities in 1986 -- an action the U.S. had already adopted since the 1960s -- Canada, in a sense, had converged on the U.S.

Also worth noting, however, is that although both the Federal Reserve Board and the DOJ have their own Horizontal Merger Guidelines, the Canadian OSFI does not have its own separate merger guidelines. It is the Competition bureau that has its own Merger Enforcement Guidelines (MEGS) issued in 1992, and the "MEGS as Applied to Banking" issued in 1998 and currently under review (Competition Bureau, 2003b).

In sum, therefore, one can conclude that in regard to policy instruments Canada has indeed converged on the USA on two counts: (a) in abandoning the need for passing special acts of Parliament, and (b) by incorporating competition (antitrust) policy dimensions into its bank merger policy in 1986. This convergence, however, masks several key divergences as alluded to earlier and as will be discussed below.

(d) Institutional Arrangements

If there is an area in which Canadian and American bank merger policies have continued to exhibit significant differences it is with respect to institutional configuration. Whereas the Canadian regulatory landscape has tended towards state structures featuring a single, federal, comprehensive prudential regulator and supervisor (namely, the Office of Superintendent of Financial Institutions), and a single federal competition (antitrust) authority (viz., the Competition Bureau), the American system has continued to feature a

complex network of multiple federal and state agencies -- banking and antitrust -- with overlapping authority.

In fact, comparatively, the establishment of the Office of Superintendent of Financial Institutions (OSFI) in 1987 was ahead of its time. For instance, while the UK and Australia followed suit a decade later, the U.S. has to date resisted such a move (MacKay Report, 1998; Coleman, 1994b). As such, even with the involvement of the Competition Bureau in bank merger review, the Canadian system pales in comparison to the American one in terms of the number of institutions and agencies involved in bank merger reviews. As noted in Chapter 6, bank mergers in the U.S. are governed by multiple institutions/agencies at both the federal and state levels. At the federal level, bank mergers are primarily governed by the federal banking agencies (OCC, FRB, FDIC), the DOJ and the court system. And, as discussed in Chapter 5, the Bank of Canada (central bank) and the Canada Deposit Insurance Corporation (deposit insurer), unlike their counterparts in the U.S. (FRB and FDIC respectively), are not directly involved in the review of bank merger transactions. Moreover, Canadian provincial governments have no direct role in the review process, while state attorneys general in the U.S. are increasingly involved in bank merger governance. Lastly, there is no U.S. equivalent to the Canadian finance minister's involvement (indeed, final say) in bank merger review.

It should be noted that the move towards single agencies in Canada is not just a reflection of the blurring of boundaries among financial sector "pillars" but it is also a reflection of the tendency to foster "independent" regulatory agencies predicated on the neoliberal orthodoxy that the state and political intervention are an impediment to social and economic development. But, as the Canadian experience indicates, independence

from political involvement has not been achieved. The federal finance minister remains the final authority responsible for approving or rejecting bank merger proposals.

Moreover, even with the shift of power from the parliament to the minister of finance, the role of parliamentary committees in the review of bank merger transactions has become even clearer and institutionalized with time.

Furthermore, the present edifice needs to be understood in a historical context. Historically, as noted earlier, Canadian bank merger control can be traced as far back as Confederation in 1867. Under the BNA Act of 1867 (i.e., Canadian Constitution) banking was (and still is) an exclusive federal responsibility. The division of regulatory power between the federal government and the provinces has been sustained not only by the Constitution, but as some observers have argued other factors have also played a key role in the separation or compartmentalization of such powers. For instance, Kane (1990) has suggested that regulators face bureaucratic and political incentives that reinforce such tendencies for power structural separation (see also Dale, 1988).

It should also be noted that although the Canadian federal government has been (from the beginning in 1867 up to the present) primarily responsible for bank merger governance, power within the federal government has shifted over the years. Whereas, in the beginning, power resided within Parliament in the sense that the Banking Act of 1867 passed soon after Confederation required that a special act of the federal parliament be passed to incorporate as well as to merge or dissolve banks, this authority shifted to the federal cabinet in 1900 when the Bank Act was amended to authorize the Governor-in-Council (with the advice of the Minister of Finance) to approve/reject mergers between and among banks. This responsibility was subsequently modified in 1913 by empowering the Minister of Finance to have prior approval of mergers before going to cabinet. Power

was then transferred from the Cabinet to the Minister of Finance with whom final approval would rest. While since then the final authority has rested with the finance minister, those who have been charged with advising the minister have changed over time. For instance, the Inspector General of Banks first advised the Finance Minister, but with the establishment of the Office of the Superintendent of Financial Institutions (OSFI), the advisory role shifted to it. With the extension of the application of the Competition Act to banking mergers in 1986, the advisory role was extended to include both the OSFI and the Competition Bureau. Currently, as we saw in Chapter 5, ex-Finance Minister Manley devised a merger review process in the year 2003 that explicitly incorporates advisory functions by not only the OSFI and the Competition Bureau but also of parliamentary (House of Commons & Senate) committees.

As regards to the evolution of bank merger regulation in the U.S., we saw in the previous chapter that its bank merger policy has hitherto taken a different path. With the establishment of early banks at the state level, the chartering of banks and control of bank mergers remained up to 1863 in the hands of state authorities. In other words, up until 1863 merger control rested with individual state regulators since before 1863 (except for the two abortive attempts to establish the first and the second Bank of the United States) there were no national banks. The passage of the National Banking Act in 1863 (and the failure to run out of business the extant state banks) led to a dual banking system, which in turn resulted in the hitherto overlapping control of bank mergers. At the federal level, for the period 1918 to 1950s the key agencies were the federal bank regulators. First it was the OCC (established in 1863) that was charged with merger control; then joined the Feds in 1913 followed by the FDIC in 1934. The DOJ during this period was deemed to have no jurisdiction with respect to the control of bank mergers. The situation, however, began

to change with the passage of the Bank Merger Act in 1960. Under this regime, with the co-existence of state and national banks, the governance of bank mergers evolved into a dual system of intricate and overlapping jurisdictions in which bank mergers – subject to the resulting nature of the bank -- were to be controlled by state banking commissions and federal agencies such as the Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, and the Federal Deposit Insurance Corporation. At this juncture, the Department of Justice's role in this regard was deemed advisory.

Thereafter, key court decisions in 1963 (e.g., Philadelphia National Bank- Girard case discussed in the previous chapter) and the subsequent amendment to the Bank Merger Act in 1966 changed the power balance. In the new situation, the power to control bank mergers became a shared process not only among the bank regulators but also with the DOJ, which was also empowered to challenge bank merger proposals in court.

In short, the U.S. bank merger regime has grown over the years into a complex network of regulatory institutions while the Canadian system has remained relatively simple. That said, however, it is important to mention, albeit briefly, that in addition to domestic institutions, bank mergers in Canada as well as in the U.S. are increasingly the focus of international governance mechanisms as financial integration proceeds at regional and global spheres.

In sum, therefore, one can conclude that when it comes to institutional configuration these two countries have remained very different. Even with the involvement of the Canadian Competition Bureau whose role could be considered as functionally equivalent to that of the U.S. Department of Justice, the U.S. system comprised of state commissions, federal bank regulators, the DOJ, the FTC, and state

attorneys general is clearly a much more complex one. Moreover, Canada's choice to take the quasi-judicial route with the establishment of the Competition Tribunal instead of U.S. style court system clearly distinguishes it from the American approach.

That being said, it should be noted that the institutions governing bank mergers have increased at the global and regional levels. With increasing regional and global integration, bank mergers in both the U.S. and Canada are now subject to, e.g., review by the European Union as well as to rules stipulated by the WTO (GATS) and the emerging regime of Joint Forum on Financial Conglomerates established in 1996 under the collective auspices of the BCBS, IOSCO, and IAIS. Whether these regimes will impel the bank merger policies of these two countries to converge in the future is not clear yet.

7.3.5 Bank Merger Policy Styles

The styles of Canadian and U.S. bank merger policies have evolved along very different tracks. These trends are depicted in a number of aspects in both prudential regulation and supervision, as well as in competition (antitrust) policy dimensions. Enduring differences can be discerned with regard to policy formulation, enforcement approaches, procedures and standards as well as in regard to policy communities and networks especially as they pertain to the relationships: (a) among members of policy communities, (b) between banks and regulators, and (c) among regulators (both domestically and internationally).

Over the years the Canadian banking policy community has expanded as the number of policy actors has increased with time to encompass a diversity of civil society actors as well as players from the other non-bank financial sectors as the financial sector pillars have crumbled. The relationship has gradually evolved from the old-style bipartite

cozy association between the federal government and a handful of bankers during the drafting of the first Canadian banking legislation to the current set of relationships involving representatives from a broad spectrum of societal actors (Coleman, 1996; Harris, 1996; MacIntosh, 1991; Stewart, 1982). Indeed, historically, Canadian state elites have relied heavily on the financial elites (and royal commissions) for suggestions on policy change and the evaluation of policy changes (Harris, 1996: 9; see also Inwood, 2005; MacIntosh, 1991). As well, some of the earlier Canadian politicians were also banking representatives (Stewart, 1982).

It is worth noting at this juncture that while over the years there have been an expansion of the Canadian banking community, the actors within this community do not possess equal power or representation. Whereas the banking actors are just a phone call away from public authorities, civil society actors get their voices heard by the regulators and politicians on an invitation-only basis.

The above developments are in part mirrored in the U.S.: the policy community has further expanded as barriers among financial institutions have been removed, while civil society organizations continue to be endowed with unequal power and access with governmental agencies. But, differences between the American and Canadian policy community and relations among the actors also still persist. As noted in the previous chapter, unlike the Canadian banking policy community, the U.S. policy community is populated with a large number and variety of industrial/banking associations, community groups and multiple governmental agencies. The number and variety of these organizations has increased with the blurring of boundaries among financial institutions. The relationship among these actors, again, unlike the Canadian scenario, continues to be based on distrust and a predilection to litigation and conflict.

From a competition policy perspective, broadly speaking, the characteristics of the Canadian and U.S. anti-trust (competition) policies have also evolved in quite different ways. While the U.S. approach to statute drafting can be described as minimalist, the Canadian one is relatively more comprehensive (Collins & Brown, 1997). The Canadian Competition Act “is more detailed than the collection of its U.S. counterparts’ (Collins & Brown, 1997). The Canadian approach to drafting antitrust statutes is, therefore, “far from minimalist and arguably leaves less scope for the development of judicial doctrines than in the United States” (Collins & Brown, 1997).

Worth noting also is that, compared to the DOJ’s Horizontal Merger Guidelines in the U.S., the Canadian Merger Enforcement Guidelines have hitherto tended to play only a minor role in contested cases” (McFetridge, 1998b: 54). The difference, according to McFetridge, “may be that the U.S. Horizontal Merger Guidelines are a codification of longstanding enforcement practice while the Canadian Merger Enforcement Guidelines are a statement of intent with no underlying enforcement history (McFetridge, 1998b: 55).

In regard to bank merger policy approach, the Canadian regime can be best described as one that began as a case-by-case based approach and has continued to be so. One of the crucial factors being the limited number of mergers -- given the size and structure of the Canadian banking industry. As such, simple decision rules have not emerged, as has been the case in the U.S. (McFetridge, 1998b: 50). Indeed, as McFetridge (1998b: 49) notes:

The U.S. system is rule-oriented and routinized. It is designed to accommodate the large numbers of merger transactions that occur in a unit banking system. The DOJ and the banking agencies have reviewed well in excess of a thousand merger transactions a year since 1990.

In contrast to the U.S., the situation in Canada is quite different in a number of respects. To begin with, due to a relatively fewer number of banks in the country, only a limited number of bank mergers are possible. In such circumstances, a case-by-case analysis of bank merger proposals is feasible and as such, simple decision rules are not necessarily required (McFetridge, 1998b). In fact, this has hitherto been the preferred Canadian approach.

In regard to the relationship between the antitrust regulators and merging parties, the Canadian approach can be described as “regulatory” as opposed to U.S. “law enforcement” approach (Collins & Brown, 1997; Crampton & Corley, 1997; Goldman & Bodrug, 1997). The Canadian compliance-oriented competition policy approach (open-door, ongoing, confidential dialogue between merging parties and the regulators backed by a commitment to vigorous enforcement in case cooperation is not forthcoming) is much less adversarial than in the United States. Indeed, it contrasts distinctly with the U.S. trust-busting and litigious style that has evolved over the years (Collins & Brown, 1997; Crampton & Corley, 1997).

7.3.6 Bank Merger Policy Impacts: Convergence or Divergence?

In this section, we examine whether there has been any convergence and/or divergence with respect to the impacts of the Canadian and American bank merger policies focusing primarily on the impacts of these two countries’ bank merger policies on their respective financial system’s stability, international competitiveness, and, consolidation and concentration. We begin with financial system stability.

(a) Financial System Stability

In spite of domestic and global challenges the Canadian banking system has historically remained very stable. A unique feature that is attributable to a large measure on the effective governance (public and private) of the financial system. This, however, has not been the case with the U.S. banking system that has historically been characterized by chronic crises. In contrast to the Canadian system, a key reason for the financial crises in the U.S. has been the ineffective governance and structure of the American financial regulatory system. Nevertheless, recent experience indicates that the American banking system has recovered a great deal compared to the situation it was in during the 1980s thrifts debacle (Gorton & Rosen, 1995). This improvement is primarily due to the drastic measures taken by the state (at federal and state levels) to resolve the problems of distressed banks through orderly dissolution and amalgamations as well as through regulatory reforms. However, as noted in the previous two chapters, the U.S. banking system has a long way to go if it is to match Canada's historical record and achievement.

(b) International Competitiveness

The Canadian banking system is considered in many respects as one of the best in the world. As discussed in Chapter 5 (section 5.3.5), not only does Canada rank highly in terms of the soundness of its banking system, its top five banks are also amongst the most highly ranked firms globally (see also Appendix 5). This reputation for soundness, performance and high global ranking is to a large measure attributable to the Canadian policy on financial consolidation that has not only facilitated the success of its large banks but also proactively endeavoured to nurture systemic stability, integrity and soundness of its banking system.

It is worth noting, however, that comparatively, Canadian banks are way far below the international ranking of American top banks (see Appendix 5). In fact, in spite of its weaknesses the U.S. banking system has been able to spawn a number of highly sophisticated and competitive financial giants whose international performance has long surpassed that of Canadian financial institutions.

(c) Financial System Consolidation and Concentration

Canada's bank merger policy has played a significant role in the consolidation of the Canadian banking system. Several measures taken to stem the tide of bank mergers weren't so successful. In fact, as discussed in Chapter 5, several bank mergers were facilitated to safeguard system stability. Similarly, American public policy on bank mergers and acquisitions has played a key role in the consolidation of the U.S. banking system either: (a) through the facilitation of mergers and acquisitions (through changes in substantive rules and procedures, and/or direct encouragement aimed at resolving problems facing distressed banks), or, (b) by its failure to stem the tide of bank merger movements.

As such, the U.S. banking system has increasingly become concentrated due to a reduction in the number of banks (through failures/exit, mergers) and due to the slower rate of new charters. The U.S. banking system, however, unlike the Canadian one continues to sustain a large number of unit banks and banking offices as a result its concentration levels remain lower compared to those of the Canadian marketplace. These developments and outcomes have significant economic, political and social implications – aspects we will now turn to.

7.4 Significance of Bank Merger Policy Convergence and/or Divergence

In the preceding discussion we have endeavoured to discern the elements of the Canadian and American bank merger policies that have converged and/or diverged and why. We noted how Canada has converged on the U.S. in terms of bringing the banking sector under the purview of competition (antitrust) authorities in 1986, as the U.S. had done in the 1960s. But, we also pointed out that although Canadian banks were subjected to the goals, norms and standards of competition policy, the Canadian competition legislation of 1986 had diverged from the U.S. by introducing an explicit “efficiency defence” provision into its competitive reviews. Secondly, the preceding discussion delineated those elements in which the U.S. seems to have converged on Canada. Notable among them being the removal of intra- and interstate banking and branching barriers (leading to nation-wide banking) and the removal of the functional separation of banking and securities business -- both of which are leading to the increasing consolidation and concentration of the American financial system. Lastly, the foregoing discussion noted the elements in which Canada and the U.S. have continued to track parallel trajectories. These include the continued differences in institutional configuration and policy styles. The question at this juncture, therefore, is: what does this all mean? In response, we briefly examine the implications of each of the above-mentioned trends beginning with the Canadian convergence on the U.S. in terms of introducing antitrust review of bank merger transactions.

(a) Aspects of Canadian Convergence on the U.S.

The adoption by Canada of antitrust/competition policy objectives, norms, and standards in its bank merger policy in 1986 has three key implications. First, it expanded the scrutiny of bank merger proposals into aspects that were hitherto not emphasized or

considered. However, the emphasis on competition and efficiency as the primary goals of competition policy has tended to overshadow other objectives (e.g., prudential, public interest). Second, the contemporary emphasis on “efficiency” as the primary, if not the only, objective of competition policy (as opposed to the traditional “due process” focus) and the introduction of explicit “efficiency defence” provision, if not carefully balanced, runs the risk of leading to a situation whereby “authorities will have no firm basis for intervening, and will therefore be bound to let the parties go about their practices or mergers untrammelled” (Hazledine, 1998:253). This, according to Hazledine (1998:262), could potentially lead to “laissez-faire and the emasculation of anti-trust” with serious political, economic, and social consequences. Lastly, the situation is further compounded by the introduction of the practice of considering “remedial measures” (e.g., negotiated divestures) in merger reviews. As noted in Chapter 6, this practice has further diminished the probability that large banks in the U.S. will be denied to merge (Shull & Hanweck, 2002: 218). What this means is that, *ceteris paribus*, financial consolidation and concentration in both countries may continue unabated with potentially serious economic, political, and social consequences. From a public policy perspective, it means that in order to safeguard their legitimacy, Canadian policymakers will not likely abandon the public interest reviews of bank merger proposals despite the calls by the banking interests and their supporters to do so. Thus, for those who are in favour of public interest reviews (e.g., social activists) this may be a welcome trend, but for those who are against (e.g., pro-business advocates who find these reviews as unnecessary and costly procedural delays) may not prefer this outcome.

(b) U.S. Bank Merger Policy Convergence on Canada

There is no doubt that by eventually removing inter- and intra-state banking and branching barriers in 1994 (and hence permitting nation-wide banking), the U.S. was converging on Canada's policy in effect since Confederation in 1867. Moreover, the U.S. converged on Canada when it repealed the Glass-Steagall Act in 1999 and thus removed the restrictions of commercial banking affiliations with investment banking – a stance Canada had already taken about a decade earlier in 1987. What does this all mean for Canada? First, it means that due to geographic and product diversification and consolidation the performance and soundness of U.S. banks may be potentially enhanced in the sense that “a more consolidated banking sector would be more stable” (Carletti, Hartmann & Spagnolo, 2002:14); and as such provide a more stable environment for Canadian banking operations in the U.S. Having said that, however, one needs to be cautious because other studies have suggested the opposite, pointing out that stability may be compromised because consolidation tends to: (a) worsen the problems associated with the “too-big-to-fail” syndrome, (b) complicate monitoring and supervision e.g., “too-big-to-discipline-adequately” syndrome, and (c) engender organizational diseconomies of scale (Carletti, Hartmann & Spagnolo, 2002:14; see also Kuritzkes, Schuermann & Weiner, 2003; Morgan & Stiroh, 2005; O'Hara & Shaw, 1990; Walter, 2003:18).

Moreover, the removal of inter- and intra-state restrictions on banking and branching and the repeal of the Glass-Steagall Act means that Canadian banks can now profitably exploit their experience and expertise in managing branch networks and “universal” banks something they have long been denied in the U.S. marketplace. In short, Canadian banks in the U.S. will have to continue operating prudently and strategically as usual as they go about deploying their competitiveness and acquired (expanded) business and investment powers.

(c) Patterns of Parallel Development and Divergence

Canadian and American bank merger policies have also tracked parallel trajectories with regard to institutional configuration and policy style. The Canadian bank merger regime is starkly different from its American counterpart in that it is comprised of relatively few agencies that are directly involved in bank merger policy formulation and implementation. From the merging parties' perspective, this development means there is, relatively speaking, less confusion and uncertainty in merger review determinations as the decisions points are minimal compared to the multitude of regulators in the U.S. On the other hand, however, the existence of fewer agencies means that Canadian banks "miss out" on the benefits afforded by the opportunity to choose who their primary regulator should be as their American counterparts have a choice among three federal regulators and fifty state authorities (Rosen, 2001). That said, it is crucial we note that the loss of opportunity to shop around for "appropriate" regulatory jurisdiction(s) may not be as significant given the small size of the Canadian banking industry and also given some of the dysfunctional ramifications of having multiple regulators (Rosen, 2001). From a political process standpoint, the small number of regulatory bodies means the opportunities for domestic regulatory arbitrage are minimized, which implies that banking institutions have fewer channels to "challenge" state authority. Fewer regulators also means there are fewer points of entry for political actors in terms of societal influence on both policy formulation and implementation. In both cases the state seems to be "insulated" from banking interests as well as from civil society.

This does not bode well for civic participation and balance of power in society (and democratic governance in general) because as the discussion in Chapter 5 has highlighted public policy reforms and outcomes have led to the increasing consolidation and

concentration of the financial services sector as reflected by the broadening of bank business powers as well as by their acquisition of securities dealers and trust companies. The upshot of this tendency has been the increasing dominance of the banking community both within the financial services market place and within the policy community network as well. Moreover, the discussion in Chapter 5 also highlighted how power within the state has gradually been centralized within the Ministry of Finance in spite of the establishment of other agencies (e.g., the OSFI, CB). The increasing power of the state and that of the banking community, however, is not evenly shared by other (non-profit) civil society actors. Moreover, resources among civil society organizations are not shared evenly. Certainly, civil society organizations such the Canadian Community Reinvestment Coalition, the Council of Canadians or the Canadian Centre for Policy Alternatives cannot match the resources and capacity of the Canadian Bankers Association, C. D. Howe Institute, or the Fraser Institute.

This asymmetry is also compounded by the shortcomings in the structure of the ad hoc consultative mechanisms (e.g., royal commissions, taskforces, public opinion polls) the state relies upon in its interaction with civil society. These factors combined, in effect, serve to limit the capacity of the federal policymakers to benefit (on an ongoing basis) from a diversity of voices in matters pertaining to bank mergers and acquisitions, especially given that a number of non-elite organizations continue to emerge. Apart from instrumental rationales for the need to tap into the resources of these institutions, the ineffective incorporation of civil society organizations clearly runs contrary to democratic (inclusionary) norms of modern public decision-making.

Having said that, however, a word of caution is hereby in order. While it is true that multiple entry points and decentralized structures may be conducive to societal

influence, it is also true that this access may also come at a cost not incurred in centralized structures as policy actors may have to incur relatively higher costs in building winning coalitions (see Cortell, 2006:13). As such, the benefits of multiple access points should be balanced with the costs of such access.

In regard to policy style, the Canadian bank merger policy is relatively less adversarial and non-litigious compared to the American approach. By not converging on the American style, Canada retains a system that is relatively less costly and perhaps more predictable in terms of merger proposal reviews and determination. The American approach is, however, more open and thus the persistent difference between the Canadian and American systems in this regard means Canadians are denied the enjoyment of an open approach and its attendant benefits. But as discussed in Chapter 6, American transparency and openness come at a steep price in terms of costly and protracted litigation as well as the erosion of trust and cooperative relations (see also Kagan, 2000a, 2000b; Kelemen & Sibbitt, 2004). The issue for Canadian policymakers therefore is how to engender openness and transparency in the Canadian bank merger policy process consistent with modern norms of democratic governance without embracing the “adversarial” and “litigious” attributes of the American system.

Lastly, the reluctance of Canadian policymakers to allow for the active involvement of community groups in bank merger proposal reviews (akin to the CRA framework in the U.S.) means the closing of a potential entry point for community groups in bank merger policy implementation which seems to go against the professed Canadian beliefs in modern, open and democratic governance.

7.5 Conclusions

This chapter endeavoured to discern the long-term (1970s-2005) trajectories of the Canadian and American bank merger policies with a particular eye on whether the two policies have shown any tendencies for convergence. As the discussion unfolded we delineated for the various elements of bank merger policy the areas of convergence or divergence and demonstrated that while the pressures toward greater policy convergence are real and significant, and although over the past forty years both Canada and the U.S. have moved toward market-oriented (neo-liberal) public policies, important differences remain in significant bank merger policy elements. A number of factors help account for the continuing policy divergence and persistent specificity, including:

- (a) the historically contingent nature of policy change processes;
- (b) historical choices of policy instruments and path-dependence;
- (c) the differential impacts of globalization/regionalization pressures and processes;
- (d) the distinctively Canadian institutional and non-institutional structural realities including federal provincial relations, open small political economy, legal and social structures, as well as Canada's position and role in the international political economy;
- (e) the role of domestic politics as shaped by the power dynamics of domestic (and international) interests (market, state and civil society); and,
- (f) the political economic power of ideas.

In short, it is the underlying realities of the Canadian political economy that have prevented the adoption of some features of the U.S. bank merger policy. Indeed, as MacIntosh has observed:

The banking system is a mirror of social and political change. The reason that we developed national branch banking was not so much a question of intelligent planning and foresight as it was a response to the combined forces of economics and politics, some of them related to banking and some not. The political forces which led the American and Canadian systems to diverge so greatly 150 years ago have continued until quite recent time. But now we are being treated to the spectacle of the American banking system moving rapidly in the direction of the Canadian model, in response to tremendous regional economic forces and technology (McIntosh, 1991: 3).

In sum, the study's main argument is predicated on two notions, viz., that: (a) globalization affects different countries (and sectors) differently; and (b) each country has unique economic, political, legal, sociological, and institutional conditions, all of which may (in varying degrees and at different historical moments) influence and shape the evolution and patterns of a particular country's financial regulatory regime. In other words, independent domestic dynamics are just as important as global and regionalist pressures for convergence and/or divergence. As such, even when confronted with similar pressures countries may respond differently. Consequently, convergent trends and outcomes are just one of a myriad of possible (non-automatic, non-inexorable, and potentially reversible) institutional and policy outcomes and trajectories.

Lastly, but not least, in most of the areas of bank merger policy examined in this study, it became clear that convergence couldn't be thought of as a one-way adjustment toward the U.S. position. It is at least a two-way street with Canada converging on the U.S. as well as the U.S. converging on Canada.

Chapter 8: Conclusions

8.1 Introduction

This study set out to investigate whether the Canadian bank merger policy was characterized by some convergence trends on its American counterpart. To do so, we first undertook to develop and provide an appropriate analytical framework that could then be applied in the empirical investigation of the Canadian and American bank merger policies. Drawing on theoretical and empirical literature on international political economy, finance, and public policy studies (chapters 2 and 3), we developed a dynamic and integrated framework (Chapter 4) that addressed the following three key aspects:

- (a) **Patterns of bank merger policy change.** We delineated five key policy elements or dimensions that needed to be considered to establish whether or not there has been some measure of convergence or divergence between the Canadian and American bank merger policies; the dimensions include: (i) bank merger policy objectives, ideas and discourse (ii) bank business and investment powers, and ownership rules, (iii) bank merger review process, policy instruments and institutional configuration, (iv) policy style, and (v) policy impacts.
- (b) **Dynamics of bank merger policy convergence/divergence.** The key actors, factors/sources, mechanisms of bank merger policy convergence and/or divergence were delineated and explained.
- (c) **Implications and significance of the convergence or non-convergence.** Economic, political and social implications of the convergence and/or Canadian and American bank merger policies.

Based on the framework we conducted an empirical investigation of the two countries' respective bank merger policies. This investigation was conducted in two steps. First, we mapped out separately (in chapters 5 and 6) the evolution of each country's federal bank merger policy. The analysis in these two chapters then formed the basis for comparison of the two countries' respective bank merger policies in the second step (Chapter 7).

In both steps, we investigated not only the transformation patterns of the key bank merger policy elements but also sought to understand and account for such changes and tendencies. Special attention was focussed on examining whether the forces/pressures of globalization and regionalism as well as bilateral influences were bringing the Canadian and U.S. bank merger policies closer together. The study paid particular attention to the dynamics (actors, paths, context, factors and mechanisms, policy styles, and impacts of policy change and stability) of change/convergence delineated in the analytical framework (Chapter 4) including domestic factors, regionalist influences and globalization pressures such as deregulation, dis-intermediation, de-segmentation, technological changes, intensified competition, and, neo-liberal ideology, among others. In other words, the study's analytical framework was aimed at helping us to improve our understanding (and reduce our misunderstanding) of how phenomena like globalization and regionalism influence institutional change, or not, in the world around us.

8.2 Study's Findings

What has emerged from this study are three key findings with respect to patterns of convergence and/or divergence, and four main findings with respect to the dynamics of such policy convergent and/or divergent patterns. In regard to patterns of policy

convergence and/or divergence, the study, first found that there has indeed been a growing similarity in some elements of Canadian and U.S. bank merger policies. This trend in growing similarity has involved both a convergence of Canadian bank merger policy on its American counterpart and vice versa, i.e., a convergence of the American federal bank merger policy on the Canadian. As noted in Chapter 7, the bringing of the Canadian banking sector under the jurisdiction of the competition policy authorities in 1986 is a clear instance of how an element of the Canadian bank merger policy has converged on the American policy. And, as also noted, the convergent trends have not always been about Canada converging on the U.S., but in some cases it was the U.S. that followed Canada. Notable examples of the U.S. converging on Canada include the removal of the inter- and intra-state branching barriers in the U.S. in 1994 that has led to the establishment of nation-wide banking, and the removal of functional separation of banking and securities business in 1999 that is leading towards the formation of some form of “universal” banks in the U.S. Lastly, despite the tendencies for convergence, Canadian and U.S. policies continue to exhibit distinctive characteristics in several key aspects of their respective policies. Particularly resistant to convergence are policy styles and institutional aspects – two realms that are deeply ingrained in the national and political cultures of the two countries, as well as conditioned by the respective sizes and structure of their political economies.

In regard to the dynamics of policy convergence and/or divergence, this study found that, first and foremost, not all bank merger policy change (convergence and/or divergence) is attributable to globalization or regionalism. Secondly, globalization and regionalism are not inexorable forces for convergence. They have both homogenizing and heterogenizing tendencies. As such, this study has demonstrated that although

globalization and regionalism are a potent source of institutional change and that while some of the pressures toward greater policy convergence are undeniable and significant, the convergence on the American model of the Canadian bank merger policy is far from being a foregone conclusion. The transformation of the Canadian bank merger policy is a contested process and a contingent one that is shaped by, among other factors, its respective national capitalist institutions. To the extent that these institutions generate uneven economic outcomes across sectors, individuals and social groups, the policy transformation process and the institutions themselves are necessarily subject to political contestation. Lastly, preference for U.S. institutions and practices has been indicated by a diversity of actors depending on a particular aspect in question. In other words, it is not only the business community that has been in favour of U.S. model. Canadian civil society organizations (both on the right and the left) have also been in favour of some (albeit different) aspects of U.S. policy on bank mergers; hence they have tended to advocate for the emulation (convergence) on the U.S. model. A case in point is the Canadian Community Reinvestment Coalition's advocacy for the adoption in Canada of some elements of the U.S. Community Reinvestment Act in order to promote the Canadian banking sector's sensitivity to community needs.

This study, therefore, helps to highlight at least three significant aspects that orthodox analyses seem to miss. First, is the realization that neoliberal strategies and corporate interests/preferences and politics may not always prevail, notwithstanding the claims by the proponents of globalization about the erosion of sovereignty and policy autonomy and hence the professed passivity and impotence of the nation-state. For instance, as it turned out, the case of Canadian bank merger proposals in 1998 demonstrates that the state does indeed still have room for manoeuvre. Second, it helps to challenge the

expectation rooted in orthodox analyses that pressures of globalization necessarily lead to policy convergence. Thus, it helps to reiterate the argument that globalization affects countries/societies differentially and that even where common pressures exist, it does not necessarily follow that common responses will be pursued as differences in resource endowments, capabilities, and power as well as path-dependence help to shape the different paths states may take. Lest we forget, while it is true that globalization and regionalism may limit policy choices, they may in other respects open up new dimensions and choices and hence may lead to policy divergence. In short, this study challenges the notion that convergence due to globalization is inevitable. And, perhaps most importantly, a study of bank merger policy convergence/divergence helps to reveal that policy processes are not free of contradiction and contestation; nor are they irreversible. As such, in spite (and perhaps because) of globalization national politics still matters (Berger, 1996; Boyer, 1996; Wade, 1996). Even in the most globalized domain (i.e., finance), policies are ultimately political choices. And as such, policy and institutional convergence are far from being a foregone conclusion. Moreover, the persistence of national specificities does reflect, *inter alia*, the role and significance of collective choice. And as Crouch and Streeck have cogently stated, "technologies and markets were far from fully determinative of social life under capitalism, and that societies had non-trivial alternatives with respect to how they wanted to run their respective capitalisms and, by implication, what kind of society they wanted to be" (Crouch & Streeck, 1997:1).

In conclusion, two notions underpin this study's main thesis. First, is that globalization contains both homogenizing and heterogenizing tendencies. Second, each country (even when highly integrated and within the same capitalist model such as Canada and the U.S. -- i.e. the Anglo-Saxon model) has unique economic, political, legal,

sociological, and institutional conditions, all of which may (in varying degrees and at different historical moments) influence and shape the evolution, patterns, and directions of a particular country's financial regulatory regime. As such, convergent trends and outcomes are just one of a number of possible (non-automatic, non-inexorable, and potentially reversible) institutional and policy outputs, outcomes and trajectories that are historically contingent. Consequently, it is quite reasonable not to see substantial convergence around the American model of bank merger (and financial system) governance.

8.3 Contributions of this Study

This study makes three important contributions: theoretical, empirical, and practical. From a theoretical standpoint, this study is significant in several ways. First and foremost, unlike most conventional studies on banking regulation and industrial structure, this study is distinctive in that it explicitly focuses attention on the issue of public policy on bank mergers per se. This is significant because a study of bank merger policy provides a unique window through which one can examine the state's relationship with the financial sector.

Second, this study, in its quest to articulate the contexts within which bank mergers are governed, facilitated the linkage of finance literature on the types of financial systems to the VoC perspective. This synthesis was then linked to regulation theories and literature on governance, including current discourse on multi-level governance. The analysis on how financial systems are governed is significant because most studies under the VoC approach tend to focus on the governance of non-financial firms and the role of the financial system in the governance of such firms; hence missing the opportunity to

study financial systems under the VoC approach. This oversight is unfortunate because the VoC perspective has the potential to improve a great deal our understanding of financial system governance. The analysis in this study is thus a modest contribution to this body of scholarship.

Third, a review of relevant literature reveals that the primary focus of conventional studies has been on understanding the motivations for financial firm mergers. Consequently, (except in some respect for the brief assessments of the policy impacts/implications of bank mergers, e.g., Dermine, 2000; Kashyap, 1999; Kwast, 1999; Santomero, 1999; Solomon, 1999), not much is understood about the policy implications of bank mergers or of bank merger policy transformation. This study is thus a modest attempt to fill this lacuna.

Fourth, a comparative study of bank merger policies is important because by examining national institutions we get an opportunity to better understand and appreciate how differences in national institutions are an important cause of variation across countries in political and economic performance.

Fifth, this study provides a framework that advances our conceptual and theoretical understanding of a number of ideas and notions pertaining to bank merger policy transformation in this era of increasing globalization and regionalism. Moreover, based on the premise that understands and accounts for the Canadian federal bank merger policy convergence and/or divergence from the American model as an outcome and a process of the interplay among interests, institutions/structures, ideas, and processes at various historical moments and space, this study will have contributed, in a modest way, to the multi-causal approach in the study of public policy transformation.

Lastly, by approaching the study of bank merger policy (financial regulatory transformation) through the convergence lens this study will also contribute towards a better understanding of the notion of convergence per se.

Empirically, this study provides an interesting and challenging empirical field to examine the changing role of the state, and its relation with finance especially because the financial sector is arguably one of the most "globalized" and "globalizing" social domains. Consequently, this study will help in refining research methodologies in the study of financial systems in general and bank merger policies in particular. Moreover, as noted above, this study offers an analytical framework that can best help us understand the patterns, dynamics and implications of bank merger policy convergence and/or divergence. As such, the study has offered a guide for those interested in studying one of the most exciting issues and empirical work being done today in public policy.

From a practical perspective, the study of contemporary financial policy transformation has several uses. In light of the special role financial institutions play -- domestically and internationally -- a better understanding of financial regulatory change (and shifts in the governance of financial institutions in general) is of particular concern to regulators, economic players, and citizens. An investigation of bank merger policy process, therefore, helps shed some useful light on the significance and implications of key issues pertaining to the intersection between prudential regulation, competition policy, monetary policy, and international trade concerns. Consolidation in the banking industry raises several public policy issues including concerns over: (a) risk -- as core banking is combined with other financial activities; (b) concentration of economic power in the multifunctional, multinational bank; (c) competition and antitrust concerns associated with multifunctional banks; (d) the challenges and difficulties of monitoring the

multifarious activities of the multinational, multifunctional banks; (e) banks which are too big or too important to fail that compound the problem of moral hazard and are a contingent liability on the public purse; and (f) the challenges of winding up problem banks. Indeed, banking consolidation raises issues pertaining to investor protection, systemic risk, access to credit, and international competitiveness. It also raises concerns due to the enhanced role and significance "market discipline" has acquired in the governance of markets and institutions and the resultant changing relationship between labour, capital, and the state. Moreover, as a comparative study, this research can aid in the process of mutual learning, at least among Canadian and American policymakers. Indeed, acknowledging and understanding institutional variety is not only intellectually interesting but can also significantly contribute to our ability to design, modify, adapt, and evaluate actual institutions. Praxis-wise, a study of bank merger policy process could also potentially highlight the contested terrain of bank merger policy, which in turn can assist in the enhancement of democratic governance in this era of increasing globalization and regionalism. Essentially, it could help illuminate the notion that there are alternatives to neo-liberal, Anglo-Saxon type policy choices; and that while globalization and regionalism may limit policy choices in some aspects they do in fact open up new dimensions and choices – both positive and negative.

8.4 Limitations of the Study

As a study focussed narrowly on the Canadian federal policy on bank mergers the researcher is acutely aware of the limitations of the study. First, the study may not be able to capture other dynamics within Canada's financial system and policy developments. Second, the study's findings may not be generalizable to other jurisdictions. These

shortcomings, notwithstanding, the study offers some valuable insights as discussed earlier. Thirdly, the scope and objectives of this study did not permit a deeper investigation of each of the key bank merger policy elements. Consequently, this leads to the need to conduct further studies.

8.5 Suggestions for Further Research

To the extent that this study has now charted the broader contours of bank merger investigation, we recommend that in-depth studies be conducted with respect to each of the key policy elements delineated in this study. Moreover, we recommend that the study be expanded to encompass the other NAFTA partner, namely, Mexico. Including Mexico (a middle-income developing country) would potentially enrich our theoretical and empirical understanding of comparative public policy transformation.

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Appendices

Appendix 1: Types of Mergers

Mergers among: (a) domestic firm; (b) cross border (inward); (c) cross border (outward)

Target firm Acquiring firm	Bank	Non-bank financial firm	Non-financial firm
Bank	(1) a big bank buying a small bank (2) a big bank buying a big bank	(1) a bank buying a securities firm (2) a bank buying an insurance firm	A bank buying a non-financial firm
Non-bank financial firm	(1) an insurance firm buying a bank (2) a securities firm buying a bank	(1) an insurance firm buying an insurance firm (2) an insurance firm buying a securities firm (3) a securities firm buying an insurance firm (4) a securities firm buying a securities firm	(1) an insurance firm buying a non-financial firm (2) a securities firm buying a non-financial firm
Non-financial firm	A non-financial firm buying a bank	(1) a non-financial firm buying an insurance firm (2) a non-financial firm buying a securities firm	A non-financial firm buying a non-financial firm

N.B. (a) Domestic mergers (target firm = domestic; acquirer = domestic); (b) Inward cross border merger (target = domestic; acquirer = foreign); (c) Outward cross border merger (target = foreign; acquirer = domestic).

Appendix 2: Canadian Bank Mergers – Pre-1960s and Post 1960s

Table 1: Bank Absorptions: 1867-1967

Date	Bank Absorbed	Purchasing Bank
1868, June 1	Commercial Bank of Canada, Kingston	Merchants Bank of Canada
1870, May 19	Gore Bank, Hamilton	The Canadian Bank of Commerce
1875, June 21	Niagara District Bank, St. Catharines	Imperial Bank of Canada
1883, October 1	Union Bank of Prince Edward Island, Charlottetown	The Bank of Nova Scotia
1900, December 31	Bank of British Columbia, Victoria	The Canadian Bank of Commerce
1901, September 12	Summerside Bank, Summerside, P.E.I	Bank of New Brunswick
1902, October 31	Commercial Bank of Windsor, Windsor, N.S.	Union Bank of Halifax
1903, May 30	Halifax Banking Company, Halifax	The Canadian Bank of Commerce
1903, August 13	Exchange Bank of Yarmouth,	Bank of Montreal
1905, June 27	People's Bank of Halifax, Halifax, N.S.	Bank of Montreal
1906, May 31	Merchants Bank of Prince Edward Island, Charlottetown	The Canadian Bank of Commerce
1906, October 13	Ontario Bank, Toronto, formerly at Bowmanville	Bank of Montreal
1907, April 15	People's Bank of New Brunswick, Fredericton	Bank of Montreal
1909, February 13	Western Bank, Oshawa, Ontario	Standard Bank of Canada
1910, November 1	Union Bank of Halifax, Halifax	The Royal Bank of Canada
1911, March 31	United Empire Bank, Toronto	Union Bank of Canada
1912, February 29	Eastern Townships Bank, Sherbrooke, Que.	The Canadian Bank of Commerce
1912, September 3	Traders Bank of Canada, Toronto	The Royal Bank of Canada
1913, February 15	Bank of New Brunswick, Saint John	The Bank of Nova Scotia

1913, April 15	La Banque Internationale du Canada, Montreal	Home Bank of Canada
1914, November 14	Metropolitan Bank, Toronto	The Bank of Nova Scotia
1917, January 2	Quebec Bank, Quebec	The Royal Bank of Canada
1918, July 2	Northern Crown Bank, Winnipeg	The Royal Bank of Canada
1918, October 12	Bank of British North America, Montreal	Bank of Montreal
1919, April 30	Bank of Ottawa, Ottawa	The Bank of Nova Scotia
1922, March 20	The Merchants Bank of Canada, Montreal	Bank of Montreal
1923, December 31	Bank of Hamilton, Hamilton	The Canadian Bank of Commerce
1924, April 30	La Banque Nationale, Montreal	La Banque d'Hochelaga (name later changed to Banque Canadienne Nationale)
1924, December 31	Sterling Bank of Canada, Toronto	Standard Bank of Canada
1925, August 31	Union Bank of Canada, Winnipeg (formerly Quebec)	The Royal Bank of Canada
1925, January 20	The Molson's Bank, Montreal	Bank of Montreal
1928, November 3	The Standard Bank of Canada, Toronto	The Canadian Bank of Commerce
1931, May 1	Weyburn Security Bank, Weyburn, Sask.	Imperial Bank of Canada

Source: Jamieson (1957:421)

Table 2: Bank Amalgamations (1867-1967)

Year	Banks involved
1908	The Northern Bank and the Crown Bank of Canada became the Northern Crown Bank
1955	The Bank of Toronto and the Dominion Bank became the Toronto-Dominion Bank
1956	Imperial Bank of Canada and Barclays Bank (Canada) amalgamated to continue as Imperial Bank of Canada

Source: Jamieson (1957:421)

Table 3: Failures of Federally Regulated Chartered Banks (1867-1967)

Year	Failed Bank
1868	Commercial Bank of New Brunswick, Saint John
1873	Bank of Acadia, Liverpool, Nova Scotia
1876	Metropolitan Bank of Montreal, Montreal
1879	Mechanics Bank, Montreal
1879	Bank of Liverpool, Liverpool, Nova Scotia
1879	Consolidated Bank of Canada, Montreal
1879	Stadacona Bank, Quebec
1881	Bank of Prince Edward Island, Charlottetown
1883	Exchange Bank of Canada
1887	Maritime Bank of Dominion of Canada, Saint John, New Brunswick
1887	Pictou Bank, Pictou, Nova Scotia
1887	Bank of London in Canada, London, Ontario
1887	Central Bank of Canada, Toronto
1888	Federal Bank, Toronto
1893	Commercial Bank of Manitoba, Winnipeg
1895	La Banque du Peuple, Montreal
1899	Banque Ville Marie, Montreal
1905	Bank of Yarmouth, Yarmouth, Nova Scotia
1906	Ontario Bank, Toronto
1908	Sovereign Bank of Canada
1908	Banque de St. Jean, St. Jean, Quebec
1908	Banque de St. Hyacinthe, St. Hyacinthe, Quebec
1910	St. Stephens Bank, St. Stephen, New Brunswick
1910	Farmers Bank of Canada, Toronto
1914	Bank of Vancouver, Vancouver
1923	Home Bank, Toronto

Source: Jamieson (1957)

Table 4: Post-1960s Bank Mergers and Acquisitions

Year	Acquired Bank/Trust	Acquiring Bank
1963	Mercantile Bank	First National City Bank of New York
1978	Credit Foncier Franco-Canadiene	Montreal City and District Savings Bank
1979	Provincial Bank of Canada	Bank Canadian National
1985	Mercantile Bank	National Bank of Canada
1986	Continental Bank of Canada	Llyods Bank
1988	Eaton Trust Company	Laurentian Bank of Canada
1988	Western & Pacific Bank of Canada merged with Bank of Alberta	to form Canadian Western Bank
1990	The Taiyo Kobe Bank (Canada)	The Mitsui Bank of Canada
1991	Lloyds Bank Canada	Hong Kong Bank of Canada
1992	Royal Trustco	Amex Bank of Canada
1992	La Financiere Cooperants Prets-Epargne Inc	Laurentian Bank of Canada
1992	Standard Trust Company and Standard Loan Company	Banque Laurentienne du Canada
1992	Chemical Banking Corporation	Chemical Bank of Canada and Manufacturers Hanover Bank of Canada
1992	Guardian Trust Company	Laurentian Bank of Canada
1993	General Trust Corporation of Canada	Laurentian Bank of Canada
1993	Morgan Trust Company of Canada	Canadian Imperial Bank of Commerce
1993	Midland Bank plc	HSBC Holdings plc
1993	General Trust of Canada	National Bank of Canada
1993	Royal Trust	Royal Bank of Canada
1993	Security Pacific Bank Canada	Bank of America Canada
1993	Central Guaranty Trust Company	National Bank of Canada
1994	Manulife Bank of Canada	Laurentian Bank of Canada
1994	Montreal Trust	Bank of Nova Scotia
1996	Prenor Trust Company of Canada	Laurentian Bank of Canada
1996	Trust Pret et Revenu du Canada	Laurentian Bank of Canada
1996	BC Bancorp	Canadian Western Bank
1996	Aetna Trust Company	Canadian Western Bank
1996	Family Trust Corporation (Ontario)	National Bank of Canada
1996	The Municipal Savings & Loans Corp.	National Bank of Canada
1997	National Trust	Bank of Nova Scotia
2000	Canada Trust	TD Bank
2004	Valiant Trust Company	Canadian Western Bank

Source: Estey Commission (1986); Extracts from Stanbury (1988) "Appendix 1 List of Large Mergers and Acquisitions in Canada 1978 to 1987", in R. S. Khemani, D. M. Shapiro and W.T. Stanbury (eds), *Mergers, Corporate Concentration and Power in Canada*: 583-601;

Annual Reports of the Director of Investigations and Research - Competition Bureau
(various years).

Table 5: Post-1970s Acquisition of Trusts by other Trusts

Year	Acquired Trust	Acquiring Trust
1981	Canadian Permanent Mortgage Corp	Genstar Corp
1983	Royal Trustco Ltd (42%)	Trilon Financial Corp
1984	Fireman's Fund Co. of Canada	Trilon Financial Corp
1984	Victoria and Grey Trust Co. – amalgamation to create National Victoria & Grey Trust later National Trust	National Trust Co.
1984	Canada Trustco Mortgage Co	Genstar Corp
1986	Genstar Corp. (100%)	Imasco Ltd
1986	Eaton Financial Services Ltd	Laurentian Group Corp
1986	Credit Foncier (100% owned by Montreal City and District Savings Bank)	Montreal Trustco Inc.
1990	Canwest Trustco Limited	Atlantic Trust Company of Canada

Source: Extracts from Stanbury (1988) "Appendix 1 List of Large Mergers and Acquisitions in Canada 1978 to 1987", in R. S. Khemani, D. M. Shapiro and W.T. Stanbury (eds), *Mergers, Corporate Concentration and Power in Canada*: 583-601; Competition Bureau Annual Reports

Table 6: Post-1987 Bank Acquisitions of Securities Dealers

Year	Acquired Firm	Acquiring Firm
1987	Nesbitt Thomson Deacon Inc. (75 %)	Bank of Montreal
1987	McLeod Young Weir (100%)	Bank of Nova Scotia
1987	Dominion Securities Ltd (75%)	Royal Bank of Canada
1987	Gordon Capital (creation of a joint venture merchant bank)	Canadian Imperial Bank of Commerce
1988	Wood Gundy	Canadian Imperial Bank of Commerce
1993	BLC Rousseau	Laurentian Bank of Canada

Source: Extracts from Stanbury (1988) "Appendix 1 List of Large Mergers and Acquisitions in Canada 1978 to 1987", in R. S. Khemani, D. M. Shapiro and W.T. Stanbury (eds), *Mergers, Corporate Concentration and Power in Canada*: 583-601.

Table 7: Post-1967 Bank Failures

Year	Bank
1985	Canadian Commercial Bank
1985	Northland Bank

Source: Estey Commission (1986); Economic Council of Canada (1987: 47)

Table 8: Failures: Trusts and Loan Companies

	Year	Trust and Loan Company
Federally incorporated	1980	Astra Trust Company
	1981	Dial Mortgage Loan Company
	1983	The Fidelity Trust Company
	1983	AMIC Mortgage Investment Corporation
	1983	Greymac Mortgage Corporation
	1983	Seaway Mortgage Corporation
	1984	Northguard Mortgage Corporation
	1985	Pioneer Trust Company
	1985	Western Capital Trust Company
	1985	Continental Trust Company
Provincially incorporated	1983	Greymac Trust Co.
	1983	Seaway Trust Co.
	1983	Crown Trust Co.
	1985	London Loan Co.

Source: Estey Commission (1986); Economic Council of Canada (1987: 47); House of Commons (1985)

Appendix 3: Bank Mergers in the U.S.

Table 1: The Number of Bank Mergers in the U.S. (1980-2003)

Year	Rhoades (2000) Number of mergers	Pilloff (2004) Number of Mergers
1980	190	
1981	359	
1982	420	
1983	428	
1984	441	
1985	475	
1986	573	
1987	649	
1988	468	
1989	365	
1990	366	
1991	345	
1992	401	
1993	437	
1994	446	475
1995	345	475
1996	392	446
1997	384	422
1998	518	493
1999		333
2000		255
2001		231
2002		203
2003		184

Source: Pilloff (2004) and Rhoades (2000) – figures differ due to differences in definitions used.

Appendix 4: Canadian Royal Commissions and Task Forces on Banking

Table 1: Canadian Royal Commissions and Task Forces (Banking and Finance)

Name	Date established	Date reported	Mandate
Royal Commission on the Matters of the Farmers Bank (Meredith Commission)	February 12, 1912	February 21, 1913	Affairs surrounding the failure of Farmers Bank
Royal Commission on the Failure of the Home Bank (McKeown Commission)	February 23, 1924	June 10, 1924	Inquire into the failure of the Home Bank
Royal Commission on Banking and Currency (Macmillan Commission)	July 31, 1933	September 22, 1933	Broad mandate but focussed on central banking
The Royal Commission on Banking and Finance (Porter Commission)	October 18, 1961	February 5, 1964	Broad mandate
Royal Commission on Corporate Concentration (Bryce Commission)	May 1, 1975	March 17, 1978	Concentration of corporate power in Canada
Commission of Inquiry on Certain Banking Operations (Estey Commission)	September 29, 1985	August 27, 1986	Examine the state of affairs surrounding the failure of CCB and Northland Bank
Task Force on the Future of Canadian Financial Services Sector (MacKay Taskforce)	December 19, 1996	September 14, 1998	Broad mandate

Sources: Compiled from Henderson (1967); Bryce Commission (1978); Estey Commission (1986); MacKay Task Force (1998)

Appendix 5: International Bank Rankings – Canada vs. U.S. Banks

Table 1: World Ranking of Canadian Top 6 Banks

Bank	1970	1980	1987	1997	2001	2005
Royal Bank of Canada	12	34	45	46	44	49
Canadian Imperial Bank of Commerce	19	41	63	50	54	59
Bank of Montreal	23	54	55	72	52	55
Bank of Nova Scotia	47	62	78	58	45	46
Toronto-Dominion Bank	54	74	87	81	69	57
National Bank of Canada	143	118	151	186	132	159

Source: The Banker (various years)

Table 2: World Rankings: U.S. Banks (some selected years)

Name of Bank	1970	1980	1987	1997	2001	2005
BankAmerica Corp	1	2 (1)	24 (9)	7 (12)	3 (2)	4 (4)
First national City Corp (CitiCorp/Citi Group)	2	3 (3)	6 (1)	5 (4)	1(1)	1 (1)
Chase Manhattan Corp	3	12 (10)	30 (19)	4 (35)	Merged with J.P Morgan in 2000	
Manufacturers Hanover Corp	5	24 (30)	40 (27)	Merged in 1993		
J. P. Morgan & Co. (Morgan Guaranty) J. P Morgan Chase	6	29 (34)	38 (31)	23 (30)	4 (5)	2 (5)
Wells Fargo	42	82 (76)	76 (87)	49 (100)	20 (31)	16 (14)
Wachovia	130	245 (230)	156 (131)	92 (96)	68 (71)	18 (19)

Source: The Banker (several Years); figures in brackets are rankings for the previous year.

Appendix 6: Bank Numbers and Bank Branching in Canada

Table 1: Branches of Chartered Banks, by Province, as at Dec.31 for Certain Years 1868-1966
(Number of Branches for Each Year)

Province or Territory	1868	1902	1905	1920	1926	1930	1940	1950	1960	1962	1963	1964	1965	1966
Newfoundland								39	71	81	88	90	104	107
Prince Edward Island		9	10	41	28	28	25	23	27	27	26	26	29	29
Nova Scotia	5	89	101	169	134	138	134	144	173	178	180	183	189	189
New Brunswick	4	35	49	121	101	102	97	100	113	118	121	123	126	133
Quebec	12	137	196	1150	1072	1183	1083	1164	1427	1489	1515	1539	1580	1604
Ontario	100	349	549	1586	1326	1409	1208	1257	1785	1916	1967	2022	2055	2078
Manitoba		52	95	349	224	239	162	165	234	248	255	261	271	279
Saskatchewan		30	87	591	427	447	233	238	296	299	303	308	317	321
Alberta				424	269	304	172	246	394	417	431	445	457	462
British Columbia	2	46	55	242	186	229	192	294	514	545	546	563	580	588
Yukon and N.W.T			3	3	3	4	5	9	17	14	15	15	16	17
Canada	123	747	1145	4676	3770	4083	3311	3679	5051	5332	5447	5575	5724	5806

Source: Statistics Canada (1967:1128); Table 8.

Table 2: Canadian Bank Branches to Population (1868-2004)

Year	Number of Branches	Population Estimate (millions)	Ratio of population per branch	Ratio of branches per million people
1868	123	3.5	28,455	35.1
1902	747	5.5	7,363	135.8
1905	1,145	6.0	5,240	190.8
1920	4,676	8.6	1,839	543.7
1926	3,770	9.5	2,520	396.8
1930	4,083	10.2	2,498	400.3
1940	3,311	11.4	3,443	290.4
1950	3,679	13.7	3,724	268.5
1960	5,051	17.9	3,544	282.2
1962	5,332	18.6	3,488	286.7
1963	5,447	18.9	3,470	288.2
1964	5,575	19.3	3,462	288.9
1965	5,724	19.6	3,424	292.0
1966	5,806	20.0	3,445	290.3
1967	5,879	20.4	3,470	288.2
1970	6,199	21.3	3,436	291.0
1972	6,481	22.2	3,425	291.9
1973	6,664	22.5	3,376	296.2
1974	6,850	22.8	3,328	300.4
1975	7,018	23.1	3,292	303.8
1976	7,189	23.5	3,269	305.9
1977	7,324	23.7	3,236	309.0
1978	7,405	24.0	3,241	308.5
1979	7,457	24.2	3,245	308.1
1980	7,414	24.5	3,305	302.6
1981	7,366	24.8	3,367	297.0
1982	7,200	25.1	3,486	286.9
1983	7,074	25.4	3,591	278.5
1984	7,060	25.6	3,626	275.8
1985	7,019	25.8	3,676	272.1
1986	6,971	26.1	3,744	267.1
1987	6,958	26.5	3,809	262.6
1988	7,176	26.8	3,735	267.8
1989	7,307	27.3	3,736	267.7

1990	7,410	27.7	3,738	267.5
1991	7,523	28.0	3,722	268.7
1993	7,880	28.7	3,642	274.6
1994	8,045	29.0	3,605	277.4
1995	8,301	29.3	3,530	283.3
1996	8,125	29.6	3,643	274.5
1997	8,119	29.9	3,683	271.5
1998	8,182	30.2	3,691	270.9
1999	8,259	30.4	3,681	271.7
2000	8,348	30.7	3,678	271.9
2001	8,923	31.0	3,474	287.8
2002	8,944	31.4	3,511	284.8
2003	9,015	31.7	3,516	284.4
2004	9,028	32.0	3,545	282.1

Source: Statistics Canada, Canada Year Book (several years);
 Statistics Canada, Financial Institutions, Financial Statistics (Several Years);
 Department of Finance, Canada (several years);
 Bank of International Settlements (several years)
 Statistics Canada, Population Census (Several Years);

Table 3: Number of Banks and Trusts (Selected Years)

Year	Number of Banks					Number of Trusts		
	Domestic		Foreign		Total	Federally incorporated	Provincially incorporated	Total
1967					8	9	53	62
1974	10				10			
1979	11				11	25	70	95
	Schedule A (I)	Schedule B (II) Domestic	Schedule B (II) Foreign subsidiaries					
1984	13		59		72	36	64	100
1993	10		56		68			98
1997	8		48		61			36
1998	11		44		49			36
	Schedule I		Schedule II	Schedule III				
2000	14		33	16	63			38
2001	13		37	9	64			38
2002	14		33	20	67			39
2004	18		29	22	67			30

Sources:

Statistics Canada, Canada Year Book (several years);

Statistics Canada, Financial Institutions, Financial Statistics (several years);

Department of Finance, Canada (several years);

Annual Reports Office of the Superintendent of Financial Institutions Canada (several years)

Bank of International Settlements (several years)