Has the European Commission had a policy of taking stability into consideration when making horizontal merger decisions in the commercial banking sector?

Christopher Johnson

Thesis submitted for assessment with a view to obtaining the degree of Master in Comparative, European and International Laws (LL.M.) of the European University Institute

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Chapter 1 – Introduction

1.1 The economic importance of commercial banks and the implications of their failure

The fundamental activity of commercial banks is the distribution of deposited capital through loans to firms and individuals. For a number of reasons, this role confers on commercial banks a degree of economic importance far in excess of a comparable firm in a relatively isolated market.

The most significant reason for this heightened economic importance is that commercial banks increase the efficiency of capital allocation. The position of commercial banks enables them to carefully evaluate whether or not a firm or individual should be in receipt of capital.

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1 Thomas M Hoenig and Charles S Morris, ‘Restructuring the Banking System to Improve Safety and Soundness’ in Viral V Acharya and others (eds), The Social Value of the Financial Sector: Too Big to Fail or Just Too Big? (World Scientific Publishing Company 2013) 401.
in the form of a loan, and then to coordinate low worth firms and individuals to lend to them².

This function is of particular importance to small and medium sized enterprises who are unable to raise additional capital through the issue of corporate bonds (and may find it difficult to obtain financing through other avenues due to, for example, the relative deficiencies of the European venture capital markets³), as well as to individuals making significant purchases. For firms in particular, the ready availability of capital has two major functions: facilitating investments in a firm’s future success; and allowing a firm to meet its obligations during temporary liquidity shortages.⁴

Other reasons for the economic importance of commercial banks include: their role in facilitating financial transactions without requiring direct interaction, and cash exchange, between individuals⁵; as well as commercial banks’ role in transmitting changes to monetary and fiscal policies⁶.

Disruption to the commercial banking sector is likely to prevent the efficient allocation of credit amongst firms in the real economy. Therefore, firms will have difficulty investing for future success, and temporary liquidity shortages may become fatal. This is likely to have extremely damaging implications for the economy as a whole⁷.

The potentially drastic implications for the real economy of disruptions in the banking sector are illustrated by a study conducted by the IMF. The study considers 42 banking sector crises across 23 countries during the period 1970 – 2007. It concludes that the average cost of resolving only the banking sector crisis amounts to 13 percent of GDP, whereas, the

⁵ Admati and Hellwig (n 2) 49; Imad A Moosa, *The Myth of Too Big to Fail* (Palgrave Macmillan 2010) 11.
⁷ Savvides and Antoniou (n 2) 358.
average cost of the resulting recession is 20 percent of GDP in the first four years alone\(^8\) (with some studies placing this figure even higher)\(^9\).

Because of its crucial role in facilitating the smooth functioning of the real economy, policymakers are typically extremely keen to ensure the continued efficient operation of the commercial banking sector. This concern is, for example, evidenced by the prevalence of State aid measures to the banking sector in the period following the September 2008 bankruptcy of Lehman Brothers\(^10\).

1.2 The aims of this study

The purpose of this paper is to examine whether the European Commission has had a policy of considering banking sector stability when making commercial banking sector merger decisions (both before and after the crisis).

*The reasoning behind this investigation*

Because of the commercial banking sector’s macroeconomic importance, the attainment of stability in the sector is often targeted by policymakers. In some legal regimes, the promotion of banking sector stability is explicitly incorporated into the merger regime. One example of this is the United Kingdom.

Merger control in the United Kingdom is primarily governed by the Enterprise Act 2002\(^11\). Typically, any proposed merger falling within the jurisdiction of the Act will be assessed on the basis of its likely impact on competition\(^12\). However, under sections 42-46 of the Act, the Secretary of State is empowered to dispense with competitive review when certain,

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\(^11\) Enterprise Act 2002

\(^12\) Enterprise Act 2002, section 36(1)(b)
specified public interest criteria apply\textsuperscript{13}. These public interest considerations are contained in s58 of the Act\textsuperscript{14}. On 6 October 2008, the British Government utilised prerogative powers to amend section 58, creating a new public interest criterion: “The interest of maintaining the stability of the UK financial system”\textsuperscript{15}. On 31 October 2008, the Secretary of State utilised this new public interest criterion to approve the merger of Lloyds TSB Group plc and HBOS plc\textsuperscript{16}. In permitting the merger, the Secretary of State recognised its likely anticompetitive effects\textsuperscript{17}, but argued that these were outweighed by the benefits resulting from its stabilising impact on the UK financial system\textsuperscript{18}. Other national merger control regimes also contain public interest exemptions. For example, the relevant German legislation allows the Ministry for Economic Affairs to authorise a previously prohibited merger on the basis that the costs resulting from its anticompetitive effects are outweighed by “benefits to the economy”\textsuperscript{19}.

Unlike the situation in, for example, the UK, the EU rules on merger control do not explicitly allow the decision maker (in this case, the European Commission) to take stability into account (see section 2.2, below). However, as will be elaborated upon in section 2.3 (below), the EC Merger Regulation\textsuperscript{20} (which governs the assessment of those mergers within the Commission’s jurisdiction) is worded in such a way that the Commission retains a degree of discretion to take account of factors that are not specified in the Regulation without acknowledging that it has done so.

The aim of this study is, therefore, to establish if the Commission has utilised this discretion to adopt a policy of promoting stability in the commercial banking sector. Although situations of macroeconomic crisis provide an increased incentive to adopt such a policy (as

\textsuperscript{13} Enterprise Act 2002, sections 42-26
\textsuperscript{14} Enterprise Act 2002, section 58
\textsuperscript{15} The Enterprise Act 2002 (Specification of Additional Section 58 Consideration) Order 2008, section 2
\textsuperscript{17} ibid 10.
\textsuperscript{18} ibid 12.
\textsuperscript{19} Gesetz gegen Wettbewerbsbeschränkungen, section 42
with the UK example, above), this investigation will also explore the possibility that the Commission pursued a stabilising merger agenda prior to the 2008 financial crisis.

**The contribution of this study to the wider literature**

Broadly speaking, there are two strands within the literature on financial sector mergers. The first strand is largely explanatory, describing merger decisions and suggesting probable rationales. The second is normative, and comprises discussion of how banking mergers should be decided. This piece is situated in the first strand, and will, for the reasons set out below, take no position regarding the normative debate.

Certainly since the financial crisis, the focus of the normative strand has been on the extent to which financial sector merger decisions should incorporate stability concerns. The general approach is to weigh the long and short term costs and benefits of sectoral competition versus sectoral stability\(^2\). However, such an exercise is far from simple. It is, as Shelanski notes, a trade-off between factors that cannot be easily calculated or easily compared\(^2\).

This difficulty has not prevented speculation. For example, Cejnar and Duke are wary of any reduction in financial sector competition in pursuit of stability on the basis that a reduction in competition may have substantial long-term consequences for the entire economy\(^2\). On the other hand, Marsden and Kokkoris propose a less stringent application of the failing firm defence (a competition-oriented merger principle, see below) during times of financial crisis on the basis that the instability resulting from banks exiting the market is more problematic than the anticompetitive effects of saving them\(^2\).

In the absence of significant empirical investigation, the normative debate is limited to identifying the potential effects of a shift in emphasis in mergers policy, and then


\(^{22}\) ibid 238.


speculating on their relative magnitudes. It is not improbable that such speculation is informed by pre-existing prejudices. Therefore, it should perhaps be unsurprising that the majority of competition lawyers engaged in the debate advocate the retention of entirely, or almost entirely, unadulterated competition principles in mergers policy.

Due to the current limitations of the normative debate, I will refrain from making any normative proposals in this piece. Instead, this paper will focus solely on an explanatory issue: establishing whether or not the Commission has considered banking sector stability in its horizontal commercial banking merger decisions, a question that is not satisfactorily addressed in the literature as it stands.

There are examples in the existing literature of authors utilising thoroughly developed methodologies to establish whether or not the Commission has taken certain, specific factors into account in its mergers decisions. However, such a scientific approach has not yet been applied to the question of whether financial stability has been taken into account, rather, the issue has only been dealt with in passing. Some authors have asserted that such a Commission policy exists whilst leaving this assertion unsubstantiated, whereas others have readily accepted, for example, the Commission’s insistences that mergers policy is unaffected by the financial climate.

1.3 The structure of this study

Chapter 2 of this paper will outline the rules governing commercial banking mergers. The first part of the chapter will focus on the regulatory merger controls that are specific to the banking sector. The next section will contain a brief outline of the EC Merger Regulation. Finally, it will be argued that although the legal test for the Commission’s assessment of


26 For example, Mark Thatcher, ‘European Commission Merger Control: Combining Competition and the Creation of Larger European Firms’ (2014) 53 European Journal of Political Research 443.


28 Leela Cejnar, ‘After the Global Financial Crisis: Key Competition Law Developments in Australia, the United States, the EU and the UK’ 5 Law and Financial Markets Review 201, 207.
mergers is whether or not they would “significantly impede effective competition”\textsuperscript{29}, the Commission is, in practice, free to have regard to other non-competition considerations if it so wishes, one of which may be the stability of the commercial banking sector.

Chapter 3 will outline how this paper will attempt to answer the question of whether or not the Commission has had a policy of taking stability into account in its commercial banking merger decisions. The methodology involves answering two separate questions (which will be the focus of chapters 4 and 5 respectively) before combining the answers to reach an overall conclusion (chapter 6).

In concluding the investigation, pre-financial-crisis merger decisions will be assessed independently of post-financial-crisis merger decisions. This is in recognition of the possibility that the Commission may have altered its mergers policy in response the financial crisis as it did explicitly with its State aid rules\textsuperscript{30} (how the sample of merger decisions was selected and how other extraneous variables have been controlled will be considered in further detail in section 3.2, below).

**Chapter 2 – The rules governing commercial banking mergers**

**2.1 Banking sector specific merger control**

The power to control mergers in the banking sector does not rest solely with the European Commission. Two other bodies, national supervisors and the European Central Bank (ECB),

\textsuperscript{29} the EC Merger Regulation (n 20), Articles 2(2), 2(3)

also possess limited powers in this sphere. These powers are intended to ensure that the acquiring party is suitable to purchase a significant stake in a banking institution.\(^\text{31}\)

This section will begin by briefly summarising the acquisition-related powers of national supervisors and the ECB, before concluding with a discussion of how these powers may affect the appraisal of the Commission’s merger policy that is the focus of this paper.

The acquisition appraisal powers of national supervisors are contained in Capital Requirements Directive IV ("CRD IV")\(^\text{32}\). National supervisors have possessed similar powers for some time\(^\text{33}\). The ECB’s role in pre-acquisition appraisal, on the other hand, was introduced only in 2013\(^\text{34}\) and is contained in the SSM Regulation\(^\text{35}\).

Article 22 of CRD IV identifies the circumstances in which the acquisition appraisal powers are applicable. Article 22 instructs Member States to require that “any natural or legal person... who [has] taken a decision... to acquire directly or indirectly, a qualifying holding in a credit institution” notify that decision to the national supervisor for assessment\(^\text{36}\). “Credit institutions” are defined to include commercial banks\(^\text{37}\); and a “qualifying holding” is defined as “a direct or indirect holding in an undertaking which represents 10% or more of the capital or of the voting rights or which makes it possible to exercise a significant influence over the management of that undertaking.”\(^\text{38}\).

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\(^{34}\) The SSM Regulation (n 31), Article 33(3)

\(^{35}\) Ibid

\(^{36}\) Capital Requirements Directive IV (n 32), Article 22

\(^{37}\) Ibid Article 3(1); “credit institution means an undertaking the business of which is to take deposits or other repayable funds from the public and to grant credits for its own account”, Parliament and Council Regulation (EU) No 575/2013 of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 [2013] OJ L 176/1 ("Capital Requirements Regulation"), Article 4(1)(1)

\(^{38}\) Ibid Article 3(31); Capital Requirements Regulation (n 37), Article 4(1)(36)
Notably, these powers arise in a much wider set of circumstances than those that would trigger the Commission’s powers under the EC Merger Regulation. There are two main differences between the situations where the powers will arise. The first difference relates to the attributes of the acquiring party; the CRD IV acquisition appraisal powers arise when “any natural or legal person”\textsuperscript{39} acquires a qualifying holding. In contrast, the Commission’s powers under the Merger Regulation require that the acquisition is made by an undertaking, or “a person already controlling at least one undertaking”\textsuperscript{40}: a much narrower class. The second difference relates to the degree of control that must be acquired; the CRD IV appraisal is triggered through an acquisition of a holding representing 10% or more of the capital or voting rights or creating the possibility of “significant influence” over the undertaking. On the other hand, for a purchase to trigger the Commission’s powers under the Merger Regulation requires (at the very least) the acquisition of stake giving “direct or indirect control” over the acquired undertaking\textsuperscript{41} (a higher standard referring to “decisive” rather than “significant” influence\textsuperscript{42}).

Although the jurisdictional rules differ, they are drafted in such a way that any commercial banking merger that falls within the jurisdiction of the Commission will also be subject to pre-acquisition appraisal under CRD IV.

As a result of the Banking Union project and, in particular, the creation of the Single Supervisory Mechanism (SSM), the ECB has acquired a veto over the national supervisor’s pre-acquisition appraisal. Article 15 of the SSM Regulation\textsuperscript{43} requires that once the national supervisor is notified of a proposed acquisition, it forwards “the notification and a proposal for a decision to oppose or not to oppose the acquisition... to the ECB”\textsuperscript{44}. “The ECB shall decide whether to oppose the acquisition on the basis of the assessment criteria set out in relevant Union law”\textsuperscript{45} (essentially, the CRD IV criteria\textsuperscript{46}).

\textsuperscript{39} Ibid Article 22
\textsuperscript{40} The EC Merger Regulation (n 20), Articles 3(1)(a), 3(1)(b)
\textsuperscript{41} Ibid Article 3(1)(b)
\textsuperscript{42} Ibid (n X) Article 3(2)
\textsuperscript{43} The SSM Regulation (n 31), Article 15
\textsuperscript{44} Ibid Article 15(2)
\textsuperscript{45} Ibid Article 15(3)
\textsuperscript{46} Ibid Article 4(3)
The relationship between national/ECB prudential merger assessment and Commission merger assessment is governed by Article 21(4) of the Merger Regulation. Article 21(4) permits “Member States [to] take appropriate measures to protect legitimate interests other than those taken into consideration by [the] Regulation”\(^{47}\). “[L]egitimate interests” are specifically defined to include “prudential rules”\(^{48}\) (such as CRD IV). Therefore, a merger that fails to comply with the CRD IV prudential requirements will not be permitted, regardless of Commission approval on the basis of the Merger Regulation.

Article 23 of CRD IV requires that the national supervisor (and, following the SSM, the ECB) “assess the suitability of the proposed acquirer and the financial soundness of the proposed acquisition”\(^{49}\) in accordance with five criteria. These are:

“(a) the reputation of the proposed acquirer; (b) the reputation, knowledge, skills and experience... of any member of the management body and any member of senior management who will direct the business of the credit institution as a result of the proposed acquisition; (c) the financial soundness of the proposed acquirer... (d) whether the credit institution will be able to comply and continue to comply with [Union] prudential requirements... (e) whether there are reasonable grounds to suspect that... money laundering or terrorist financing... is being or has been committed or attempted.”\(^{50}\)

It may be suggested that the existence of this procedure, which explicitly aims to reduce the likelihood of financial crisis through the regulation of mergers, means that, either, the Commission would be unable to further increase banking sector stability through its merger policy, or would defer to the explicit mandate of national supervisors and the ECB, and not pursue a stability-oriented merger policy. The following paragraphs will explain that such contentions would be incorrect for two reasons. First, the pre-acquisition appraisal under

\(^{47}\) The EC Merger Regulation (n 20), Article 21(4)
\(^{48}\) Ibid Article 21(4)
\(^{49}\) Capital Requirements Directive IV (n 32), Article 23
\(^{50}\) Ibid Articles 23(1)(a) – (e)
CRD IV is far too limited in scope to prevent de-stabilising mergers from occurring. Second, (as will be discussed at greater length in section 5.1, below) the de-stabilising factors which a merger authority (such as the European Commission) would attempt to address differ from the de-stabilising factors addressed by CRD IV.

Section 5.1 (below), outlines a range of phenomena that reduce the ability of the commercial banking sector to continue to perform its functions regardless of shocks. These are referred to as destabilising factors. The CRD IV pre-acquisition assessment attempts to address just two of these, they are, first, insufficient competence or insufficient solvency of the acquirer; and, second, insufficient competence of the prospective management. As only two of many potential destabilising factors are addressed, an acquisition may be approved on the basis of CRD IV, but still have a destabilising effect.

Further, although I have been unable to find any literature on the point, it is speculated that the destabilising factors addressed by the CRD IV appraisal are relatively unlikely to be present in the case of a horizontal commercial banking merger. As noted above, although the pre-acquisition appraisal will apply in the case of those horizontal banking mergers falling under the scrutiny of the Commission, it will also apply in a much wide range of circumstances. It is suggested that the solvency of the acquirer or the competence of the acquirer/management is much more likely to pose a problem in the case of acquisitions by, for example, individuals, rather than mergers with other commercial banks.

A further reason why the Commission is still in a position to influence commercial banking sector stability through its mergers policy, despite the existence of the CRD IV pre-acquisition appraisal, is that the destabilising factor that would be addressed by a merger authority such as the Commission differs from the destabilising factors addressed by CRD IV. In section 5.1 (below), it will be argued that, if the Commission wishes to promote commercial banking sector stability, it is limited by the nature of its powers to dealing with a single issue, being the threat posed by systemically important banks. CRD IV does not allow national supervisors or the ECB to take systemic importance into account when making the pre-acquisition assessment. Therefore, even if a merger has been approved under CRD IV, the Commission could decide that it would still result in a reduction of sectoral stability and
prohibit it. Whether or not the Commission has taken such an approach will be the subject of the remainder of this paper.

2.2 The Regulation in brief

The EC Merger Regulation contains legal rules governing the appraisal of qualifying mergers by the European Commission. This section will provide an overview of the Regulation. The overview will be divided into three parts, concerning (i) the scope of the regulation; (ii) the substantive assessment of qualifying mergers; and (iii) the assessment process.

The scope of the Regulation

The EC Merger Regulation applies to “all concentrations with a Community dimension”.

Concentration

A concentration entails an operation resulting in a “change of control on a lasting basis.” This may be the result of either (a) “the merger of two or more previously independent undertakings”; (b) the acquisition, by an undertaking or a person already controlling an undertaking, of “control of the whole or parts of one or more other undertakings”; or (c) “[t]he creation of a joint venture performing on a lasting basis all the functions of an autonomous economic entity.”

Community Dimension

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51 the EC Merger Regulation (n 20)
52 Ibid Article 1(1)
53 Ibid Article 3(1)
54 Ibid Article 3(1)(a)
55 Ibid Article 3(1)(b)
56 Ibid Article 3(4)
A concentration will have a “Community dimension” if certain turnover thresholds are exceeded by the entities involved. The principle threshold is contained in Article 1(2). It requires the total combined turnover of the merging parties to exceed €5,000 million, and the EU-wide turnover of at least two of the undertakings to exceed €250 million. The threshold in Article 1(3) is lower, and is designed to encompass the situation where, but for the rule, the merger would fall to be assessed in several Member States.

In section 5.1 (below), it will be argued that the Commission, if desirous of promoting stability, would, typically, prohibit mergers creating or enlarging systemically important banks, but permit other banking sector mergers. Therefore, the Commission’s ability (and, arguably, incentive) to promote commercial banking sector stability through merger policy depends on the extent to which it has jurisdiction over mergers creating or enlarging systemically important banks.

It is impossible to say definitively that the Commission will always have jurisdiction over mergers involving certain banks (because jurisdiction depends on combined turnover, and because turnover changes year on year). However, for a number of reasons, it can be argued that it will be highly likely that the Commission will have jurisdiction in any mergers involving systemically important banks. First, the threshold of a worldwide turnover of €5,000 million appears to be attained by the majority of systemically important banks on their own. Second, the Commission has, in the past, assessed mergers involving twenty-five of the thirty banks on the list of global systemically important banks produced by the Financial Stability Board (in many cases, assessing multiple mergers involving each bank).

57 Ibid Articles 1(2) and 1(3)
58 Ibid Article 1(2)(a)
59 Ibid Article 1(2)(b)
62 Financial Stability Board (n 61).
This permits the inference that the Commission will typically have jurisdiction to control such concentrations.

The substantive assessment

Prior to the enactment of the 1989 EC Merger Regulation\(^\text{63}\), there was intense debate regarding which policy objectives the substantive assessment should promote. Germany and the United Kingdom desired an assessment based solely on competition. However, France, amongst others, lobbied for a test that also incorporated social and industrial objectives\(^\text{64}\). Encouraged by successive Competition Commissioners Peter Sutherland and Leon Brittan, the competition-centric approach advocated by the UK and Germany was eventually accepted by Member States\(^\text{65}\). The 1989 Regulation retained only “the smallest nod” to other concerns\(^\text{66}\). This section will examine in turn the legal position of competition oriented and non-competition oriented considerations under the EC Merger Regulation.

*Competition oriented considerations*

Article 2 of the Merger Regulation contains the legal test to be applied by the Commission in conducting its appraisal of any proposed concentration. Proposed concentrations will be approved if “compatible with the common market”\(^\text{67}\). A concentration will be deemed compatible with the common market unless it “would significantly impede effective competition, in the common market or in a substantial part of it, in particular as a result of the creation or strengthening of a dominant position”\(^\text{68}\).

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\(^{67}\) the EC Merger Regulation (n 20), Article 2(1)

\(^{68}\) Ibid Articles 2(2), 2(3)
The Commission, in making this assessment, is instructed to have particular regard to a number of considerations, all of which are competition oriented save one (see below). These include: the structure of the relevant markets; the influence of both actual and potential competitors; the existence of barriers to market entry; trends in supply and demand; and the interests of consumers. In accordance with Recital 28 of the EC Merger Regulation, the Commission has published guidance indicating how it will carry out its assessment of concentrations in order to determine their compliance with the internal market. These guidelines will prove informative when assessing the Commission’s commercial banking merger decisions and will, therefore, be discussed in significant detail in Chapter 4 (below).

**Non-competition oriented considerations**

As noted above, Article 2(1)(b) of the EC Merger Regulation instructs the Commission to have regard to a number of considerations when appraising a proposed merger. Aside from one, all of these considerations reflect the promotion of competition. The exception is that the Commission is instructed to consider “the development of technical and economic progress provided that it is to consumers’ advantage and does not form an obstacle to competition”. This provision enables the Commission to take account of efficiencies resulting from a proposed transaction (albeit to a limited extent).

The proviso that the efficiencies must “not form an obstacle to competition” limits the manner in which they may be considered. The proviso prevents the Commission from directly weighing the gain in productive efficiency resulting from efficiencies against the loss in allocative efficiency resulting from any anticompetitive effects. Rather, efficiencies can only be considered in so far as they counteract the negative effects on competition that the

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69 Ibid Articles 2(1)(a), 2(1)(b)
71 the EC Merger Regulation (n 20), Article 2(1)(b)  
72 Ibid Article 2(1)(b)  
73 Ibid Article 2(1)(b)  
merger would otherwise have\textsuperscript{75}. This will be the case “when the Commission is in a position to conclude... that the efficiencies generated by the merger are likely to enhance the ability and incentive of the merged entity to act pro-competitively for the benefit of consumers”\textsuperscript{76}. Such a situation may occur in the case of vertical and conglomerate mergers\textsuperscript{77}, but is highly unlikely to effect the appraisal of horizontal concentrations\textsuperscript{78}.

Aside from efficiencies, various other non-competition concerns have been raised by various interested parties in relation to proposed mergers\textsuperscript{79}. These include, for example, data protection\textsuperscript{80}; plurality of the media/cultural diversity\textsuperscript{81}; the security of energy supply\textsuperscript{82}; and the protection of national champion firms\textsuperscript{83}. In all cases, the Commission has maintained that the non-competition concerns are legally irrelevant\textsuperscript{84} (although it will be argued in section 2.3, below, that a consideration being legally irrelevant does not prevent the Commission from actually taking it into account if it wishes).

**The assessment process**

All “concentrations with a Community Dimension”\textsuperscript{85} must be notified to the Commission for appraisal prior to their implementation\textsuperscript{86}.

**Phase 1**

Following the receipt of notification, Phase 1 proceedings are initiated. At this point the Commission will seek comments from interested parties, verify the information it has

\textsuperscript{75} the EC Merger Regulation (n 20), recital 29  
\textsuperscript{76} Horizontal Merger Guidelines (n 70), paragraph 77  
\textsuperscript{77} Monti (n 74) 294.  
\textsuperscript{78} Faull and Nikpay (n 60) 746.  
\textsuperscript{80} Google/Double Click Case M.4731 (2008)  
\textsuperscript{81} Sony/BMG Case M.3333 (2007)  
\textsuperscript{82} Suez/GDF Case M.4180 (2006)  
\textsuperscript{83} Ibid  
\textsuperscript{84} For further examples, see: Petit (n 79).  
\textsuperscript{85} Ibid Article 1(1)  
\textsuperscript{86} Ibid Article 4(1)
received and consult Member States\textsuperscript{87}. The Commission must then make three decisions\textsuperscript{88} (these must be made within 25 working days of the receipt of the notification\textsuperscript{89}): (i) does the notified transaction fall within the scope of the Regulation?\textsuperscript{90} (ii) If so, does the notified transaction “raise serious doubts as to its compatibility with the common market”?\textsuperscript{91} (iii) If so, can these doubts be allayed by modification of the proposed transaction?\textsuperscript{92}

Therefore, the potential outcomes of Phase 1 are: (i) the Commission issues a decision concluding that the concentration is not within the scope of the Regulation\textsuperscript{93}; (ii) the Commission issues a decision declaring the concentration is compatible with the Common Market\textsuperscript{94} (with or without modifications\textsuperscript{95}); or (iii) the Commission finds that the proposed transaction raises serious doubts as to compatibility with the Common Market and initiates Phase 2 proceedings\textsuperscript{96}.

For certain, specified categories of proposed concentration, the Commission will adopt “a short-form decision declaring [the] concentration compatible with the common market pursuant to the simplified procedure”\textsuperscript{97} (the simplified procedure essentially entails the publication of a short, standard-form decision in line with an expedited timescale)\textsuperscript{98}. For the purpose of this paper, the most important situation in which a concentration is deemed clearly not a threat to the common market and, thus, the simplified procedure can be utilised, is a merger or acquisition where the parties are operating in the same product and geographical market (a horizontal relationship), but “their combined market share is less

\textsuperscript{87} Monti (n 74) 249.
\textsuperscript{88} Ibid Article 6(1)
\textsuperscript{89} Ibid Article 10(1)
\textsuperscript{90} Ibid Article 6(1)(a)
\textsuperscript{91} Ibid Article 6(1)(b)
\textsuperscript{92} Ibid Article 6(2)
\textsuperscript{93} Ibid Article 6(1)(a)
\textsuperscript{94} Ibid Article 6(1)(b)
\textsuperscript{95} Ibid Article 6(2)
\textsuperscript{96} Ibid Article 6(1)(c)
\textsuperscript{98} Ibid paragraphs 2, 17, 18
than 15%”\textsuperscript{99}. The Commission is not permitted to utilise the simplified procedure “[w]here it is difficult to define the relevant markets or to determine the parties’ market shares”\textsuperscript{100}.

All the commercial banking sector merger decisions contained in the sample scrutinised by this paper were decided following a Phase 1 investigation.

\textit{Phase 2}

In general, Phase 2 proceedings must be completed within ninety days of their commencement\textsuperscript{101}. Phase 2 requires an in-depth appraisal of the notified concentration, wherein the Commission will utilise its investigative powers under the Regulation\textsuperscript{102}; conduct an oral hearing; and maintain regular contact with the parties\textsuperscript{103}.

Aside from the possibility of finding that the proposed concentration does not fall within the jurisdiction of the Merger Regulation, which may not be made following Phase 2, the possible outcomes are the same as after a Phase 1 investigation: the Commission may issue a decision declaring the notified merger to be compatible with the Common Market, with\textsuperscript{104} or without\textsuperscript{105} modification; or the Commission may find that the notified merger is incompatible with the internal market\textsuperscript{106}.

\textbf{2.3 The Commission’s decision making discretion}

In this section, it will be argued that, although the Commission appears legally constrained only to consider a merger’s likely effect on competition (albeit with minor exceptions, see section 2.1, above), the Commission is, in practice, free to take account of a wide array of factors when making merger decisions, one of which may be banking sector stability.

\begin{flushleft}
\textsuperscript{99} Ibid paragraph 5(c)(i) \\
\textsuperscript{100} Ibid paragraph 6 \\
\textsuperscript{101} Ibid Article 10(3) \\
\textsuperscript{102} Ibid Articles 11, 12, 13 \\
\textsuperscript{103} Monti (n 74) 249. \\
\textsuperscript{104} the EC Merger Regulation (n 20), Article 8(2) \\
\textsuperscript{105} Ibid Article 8(1) \\
\textsuperscript{106} Ibid Article 8(3)
\end{flushleft}
This idea is hardly novel, in fact, the Commission has long been accused of taking account of factors other than those permitted by the Merger Regulation when making its decisions. Factors suggested include not only financial stability\textsuperscript{107}, but also, for example, promoting the creation of larger European firms\textsuperscript{108}; the attainment of “regulatory” objectives in the energy and electronic communications sectors\textsuperscript{109}; and promoting the even distribution of “production benefits” between Member States\textsuperscript{110}.

This section will describe how the Commission is able to, surreptitiously and without exposing itself to legal challenge, found merger decisions on considerations not permitted in the Merger Regulation. It will be suggested that this wide in-practice discretion is the result of two interrelated factors: first, the nature of judicial review of merger decisions; second, the vagueness of “competition” as a legal test. These will be discussed in turn below.

When reviewing merger decisions, the European Courts are deferential to the Commission’s interpretation of “competition”. This deference (in combination with the many possible meanings of competition, see below) gives the Commission room to incorporate non-competition concerns into their decisions without leaving those decisions vulnerable to legal challenge.

The most important form of legal challenge to a Commission merger decision is the Article 263 TFEU action for annulment\textsuperscript{111}. Article 263 confers on the European Courts the jurisdiction to review the legality of merger decisions. This review may be based on any of four grounds listed in the Article, of which three are procedural. An applicant may challenge the Commission’s application of the substantive rules of the Merger Regulation (Articles 2(2) and 2(3)) by alleging “infringement of any rule of law”, the fourth ground for review.

\textsuperscript{107} Lane (n 27) 503.

\textsuperscript{108} Thatcher (n 26) 445.


\textsuperscript{110} Bagchi (n 64) 2.

\textsuperscript{111} Consolidated Version of the Treaty on the Functioning of the European Union [2012] OJ C 326/1
To reflect the constitutional allocation of competences within the Union\textsuperscript{112}, the Court will employ varying intensities of review depending upon the element of the Commission’s decision being scrutinised\textsuperscript{113}. When the Court is reviewing, for example, “assessments of an economic nature”\textsuperscript{114}, it will respect the discretion conferred on the Commission, and undertake only limited review\textsuperscript{115}. This entails (i) establishing “whether the evidence relied on is factually accurate, reliable and consistent”\textsuperscript{116}; (ii) establishing “whether that evidence contains all the information which must be taken into account”\textsuperscript{117}; and (iii) establishing “whether [the evidence] is capable of substantiating the conclusions drawn from it”\textsuperscript{118}. This test is, therefore, far from a mere formality (it, in fact, represents a higher level of scrutiny than previous formulations\textsuperscript{119}). However, the test allows the Commission to retain a degree of discretion in the situation where “a reasonable antitrust enforcer could draw a range of (roughly) equally plausible conclusions”\textsuperscript{120}. It is contended that this limited discretion is highly significant. This is because it allows the Commission to justify its decision on the basis of any reasonably plausible conception of competition. The variation between these reasonably plausible conceptions of competition permits the Commission to justify a range of outcomes in each case without risking legal challenge.

It will now be argued that the varied reasonably plausible conceptions of competition are sufficiently diverse in the merger outcomes that they would precipitate, that they allow the Commission to take account of non-competition considerations (for example, banking sector stability) without vulnerability to review\textsuperscript{121}.

\textsuperscript{113} Ibid 5.
\textsuperscript{114} Case C-12/03 P Commission v Tetra Laval [2005] ECR I-00987, paragraph 38
\textsuperscript{115} Ibid paragraph 39
\textsuperscript{116} Ibid paragraph 39
\textsuperscript{117} Ibid paragraph 39
\textsuperscript{118} Ibid paragraph 39
\textsuperscript{120} Mel Marquis, ‘Rules That Govern Rules: Evidence, Proof and Judicial Control in Competition Cases’ in Mel Marquis and Claus-Dieter Ehlermann (eds), European Competition Law Annual 2009: The Evaluation of Evidence and its Judicial Review in Competition Cases (Hart Publishing 2011) xxxvii. For a similar statement by Advocate General Kokott, see Case C-441/07 P Commission v Alrosa Company Ltd. [2010] ECR I-05949, paragraph 84
\textsuperscript{121} Thatcher (n 26) 446.
This argument will proceed by drawing upon an example from the United States. Section 7 of the United States’ Clayton Antitrust Act\textsuperscript{122} prohibits acquisitions where “the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly”.\textsuperscript{123} This test was subject to dramatically contrasting interpretation in the US Supreme Court as presided upon by two successive Chief Justices, Chief Justice Warren and Chief Justice Burger. The following paragraphs will outline the contrasting approaches to Section 7 of the Warren Court and the Burger Court, highlighting that although both Courts base their approaches upon “competition”, the merger outcomes resulting from each approach differ significantly.

That the example selected is from the United States, and not the EU, makes it none the less relevant to the present argument. The point being made is that “competition” (the test under both the US Clayton Act and the EU Merger Regulation\textsuperscript{124}) can plausibly by interpreted in dramatically different manners. This is well illustrated by the development of the American jurisprudence, in which the approach to interpreting the idea of “competition” changed dramatically in a short period of time.

The most radical\textsuperscript{125} Section 7 decision of the Warren Court was the ruling in Brown Shoe Co.\textsuperscript{126}. In Brown Shoe, the Supreme Court held the acquisition of one manufacturer and retailer of footwear, the G. R. Kinney Company, by another, the Brown Shoe Company, to be unlawful. The judgment of Justice Warren is obscure\textsuperscript{127}; on the one hand, stressing the role of statistics and a case-by-case analysis; but on the other, expressing a general fear of increasing concentration, and calling for the protection of small, locally owned businesses (even when to do so would result in higher costs)\textsuperscript{128}. However, the Court’s application of these principles to the case in hand indicated, without question, the arrival of a restrictive,

\textsuperscript{122} Clayton Antitrust Act, 1914, ("Clayton Antitrust Act")
\textsuperscript{123} Clayton Antitrust Act, section 7
\textsuperscript{124} the EC Merger Regulation (n 14), Articles 2(2), 2(3)
\textsuperscript{126} Brown Shoe Co., Inc. v. United States, 370 U.S. 294 (1962), ("Brown Shoe Co.")
\textsuperscript{127} Kauper (n 125) 328.
“antimerger” conception of competition. The merger was found to be illegal despite occurring in an extremely competitive market; the merged entity manufacturing only 4.5% of the national output of shoes and controlling less than 3% of shoe retail outlets nationally. Further, the vertical aspect of the merger would foreclose, at most, 1.6% of retailers’ need for shoes.\textsuperscript{130}

The restrictive approach adopted in \textit{Brown Shoe} was carried forward in subsequent Warren Court section 7 decisions. For example, in \textit{Philadelphia National Bank}\textsuperscript{131}, the Court, suggested an effective reversal of the burden of proof in merger cases resulting in a large market share:

\begin{quote}
"Specifically, we think that a merger which produces a firm controlling an undue percentage share of the relevant market, and results in a significant increase in the concentration of firms in that market, is so inherently likely to lessen competition substantially that it must be enjoined in the absence of evidence clearly showing that the merger is not likely to have such anticompetitive effects."\textsuperscript{132}
\end{quote}

The antimerger approach continued for the duration of the Warren Court\textsuperscript{133}.

The characteristics of the approach of the Warren Court to section 7 may be considered to include: a per se aversion to both concentration and size\textsuperscript{134}, including, in particular, a concern that the trend to concentration be stopped in its "incipiency"\textsuperscript{135}; a rejection of the idea that an otherwise problematic merger may be permitted on the basis of efficiencies\textsuperscript{136}; a desire to protect small business and local ownership\textsuperscript{137}.

\textsuperscript{129} Kauper (n 125) 326.
\textsuperscript{130} Brown Shoe Co. (n74)
\textsuperscript{131} United States v. Philadelphia National Bank, 374 U.S. 321 (1963)
\textsuperscript{132} United States v. Phiiladelphia National Bank, 374 U.S. 321 (1963)
\textsuperscript{134} Fox (n 128) 423.
\textsuperscript{135} For example, Brown Shoe Co. (n 126)
\textsuperscript{137} For example, Brown Shoe Co. (n 126)
Chief Justice Warren resigned on 23 June 1969, to be replaced by Chief Justice Burger\textsuperscript{138}. The Burger Court’s approach to section 7 can be seen in the case of *General Dynamics Corp.*\textsuperscript{139}; the approach differed significantly from that of the Warren Court. In *General Dynamics*, the government argued against the proposed merger primarily on the basis of (correct) evidence indicating increasing levels of concentration in the coal mining sector, and showing that the merger would significantly increase the market share of the post-merger firm\textsuperscript{140}. Despite accepting this evidence, the Court ruled the merger to be lawful. The Court adopted a “more economically-sophisticated approach”\textsuperscript{141}, in which they looked for actual anticompetitive effects. They found that competition in the coal mining industry was focussed around competition for long-term supply contracts. The target firm had already committed the majority of its available coal reserves to such contracts and, therefore, held less than 1% of the uncommitted coal supply. The Court concluded that because of this, the merger would have minimal actual impact on competition in the market.\textsuperscript{142} In significant contrast to the approach of the Warren Court, the approach seen in *General Dynamics* was characterised not by a series of preferences/prejudices, but by a requirement that the opposing party prove “measurable or objectively probable anticompetitive effects”\textsuperscript{143}

The considerable distance between the merger outcomes resulting from the approach of the Warren Court and those emerging from the approach of the Burger Court, despite both being based on the same test – “competition”, provides an effective illustration of the vagueness of “competition” as a legal criterion. When viewed in tandem with the stated policy of the European Courts to conduct highly deferential review of Commission economic decisions, this vagueness or ambiguity as to what “competition” requires in a particular case clearly equips the Commission with a significant in-practice discretion to take all manner of non-competition concerns into consideration if they so wish. It is possible that one such

\textsuperscript{138} Fox (n 128) 408.
\textsuperscript{139} United States v. General Dynamics Corp., 415 U.S. 486 (1974)
\textsuperscript{140} Wesley A Cann Jr., ‘Section 7 of the Clayton Act and the Pursuit of Economic Objectivity: Is There Any Role for Social and Political Values in Merger Policy’ (1985) 60 Notre Dame Law Review 273, 286.
\textsuperscript{141} ibid 276.
\textsuperscript{142} United States v. General Dynamics Corp., 415 U.S. 486 (1974)
\textsuperscript{143} Fox (n 128) 423.
concern may be a desire to ensure the stability of the commercial banking sector, this is the issue upon which the remainder of this paper will dwell.

Chapter 3 – Methodology

3.1 How the Commission decisions will be assessed

This section will describe and justify the methodology that is employed in the subsequent chapters to assess Commission merger decisions in the commercial banking sector in order to establish whether or not they indicate that the Commission has had a policy of taking sectoral stability into consideration.

The chosen methodology entails asking two questions of the merger decisions under scrutiny before combining the answers to these questions in order to reach an overall conclusion. The two questions are:

1. Does the decision appear to reflect the Commission’s interpretation of the Merger Regulation as set out in the Commission’s horizontal merger guidelines\(^\text{144}\)?
2. Does the decision reflect the promotion of stability in the commercial banking sector?

Answering these questions will enable boxes A, B, C and D in Table 1 (below) to be completed. The distribution of decisions between these boxes will allow conclusions to be drawn regarding the Commission’s merger policy.

\(^{144}\) Horizontal Merger Guidelines (n 70)
Table 1 – The Assessment Framework

<table>
<thead>
<tr>
<th>Does the decision appear to reflect the Commission’s interpretation of the Merger Regulation?</th>
<th>YES</th>
<th>NO</th>
</tr>
</thead>
<tbody>
<tr>
<td>Does the decision reflect the promotion of stability in the commercial banking sector?</td>
<td>YES</td>
<td>Box A</td>
</tr>
<tr>
<td>NO</td>
<td>Box C</td>
<td>Box D</td>
</tr>
</tbody>
</table>

Regardless of whether or not it appears to be based upon the merger guidelines, if a Commission merger decision is found not to reflect the promotion of sectoral stability (an outcome reflected in boxes C and D of table 1), it can, of course, be concluded that the Commission did not take commercial banking sector stability into consideration when making that decision. Therefore, to reach a negative overall conclusion (to the question of whether or not the Commission considers sectoral stability in its commercial banking merger decisions), it would only be necessary to answer the second of the two questions posed above.

However, the answers to each question alone are insufficient to allow a positive conclusion to be made regarding the Commission’s merger policy – decisions based on the Merger Guidelines will not necessarily result in different outcomes to decisions based on the promotion of stability. Therefore, a finding simply that merger decisions tend to reflect the pursuit of stability cannot support the inference that stability is the basis for those merger decisions. Nor, of course, is it possible to infer simply from the fact that the Commission has
failed to follow its own merger guidelines, that the Commission is pursing any one alternative policy (such as stability).

The deficiencies of each question alone (in facilitating a positive conclusion) may be overcome through combing their answers. A finding that a Commission decision both appears to have departed from the merger guidelines and reflects the promotion of sectoral stability (an outcome reflected in box B of table 1) would enable an inference to be made that the decision in question was made for the reason of banking sector stability.

The only box that has not yet been discussed is box A. This represents the situation where the decision in question reflects both apparent compliance with the merger guidelines and the promotion of banking sector stability. Such a decision could be based on either competition or stability so does not lead to inferences on Commission merger policy.

Chapter 4 will focus on answering the first question posed, and chapter 5 on answering the second. Chapter 6 will use the analysis performed in chapters 4 and 5 to fill in boxes A, B, C and D in table 1. The distribution of decisions between these boxes will then be examined to enable overall conclusions to be drawn. As was noted in section 1.3 (above), a change in the Commission’s commercial banking merger policy may have been catalysed by the beginning of the financial crisis. Therefore, the merger decisions made before and after the start of the financial crisis will be analysed separately.

3.2 Justifying the selection of the decisions under scrutiny

The Commission merger decisions that will be analysed in this paper are listed in annex 1. The decisions selected are all those made between 1 May 2004 and 1 July 2015 that result in an increase in market share for the resulting entity in an area of traditional commercial banking activity.

The decision to focus on commercial banks was made because of their particular economic importance (as discussed in section 1.1, above). By including the criterion that the merger must result in an increased market share in an area of commercial banking activity (a
horizontal merger), the field of inquiry has been further narrowed so as to eliminate mergers involving the expansion of commercial banks into other areas. This decision was made to ensure that this study focusses on the type of mergers that are likely to have the clearest and most significant impact on commercial banking sector stability (see the discussion of systemic importance in chapter 5, below). In section 1.1 (above), the core activity of commercial banks was considered to be “the distribution of deposited capital through loans to firms and individuals”\textsuperscript{145}. Therefore, for the purpose of this study, activities that are considered to be within the domain of commercial banking are those that involve the taking of deposits and/or the provision of credit.

Although the first iteration of the EC Merger Regulation came into force in 1990\textsuperscript{146}, this study will only analyse decisions made following 1 May 2004. Selecting the temporal limits of this investigation requires balancing two competing considerations. The first consideration, which militates in favour of selecting an earlier temporal limit, is the increase in sample size that this would allow. A larger sample of decisions is beneficial as it decreases the impact of anomalous results on the conclusions that may be drawn. However, selecting an earlier temporal limit also has a downside. It is possible that the Commission’s approach to commercial banking mergers has changed over time. Therefore, the larger the time span considered, the more likely it is that the decisions under scrutiny do not represent homogenous Commission policy. It is hoped that only investigating the decisions made after 1 May 2004 draws an appropriate balance between these two competing considerations. Setting the temporal limit at 1 May 2004 has a further advantage; it allows another extraneous variable, the reform of the EC Merger Regulation, to be controlled. In 2004, the original EC Merger Regulation was replaced\textsuperscript{147}. “Most importantly”\textsuperscript{148}, the 2004 Regulation replaced the original substantive test, based on the creation or strengthening of a dominant position\textsuperscript{149}, with a wider test: “significant impediment of effective competition”\textsuperscript{150} (see

\textsuperscript{145} Hoenig and Morris (n 1) 401.


\textsuperscript{147} the EC Merger Regulation (n 20)

\textsuperscript{148} Faull and Nikpay (n 60) 542.


\textsuperscript{150} the EC Merger Regulation (n 20) Article 2(2)
section 2.2, above). Admittedly, this reform was designed only to be relevant to a subset of situations, and, in large, continuity was envisaged\textsuperscript{151}. However, controlling this variable can only increase the validity of this study.

As noted in section 1.3 (above), the merger decisions made by the Commission before and after the financial crisis will be analysed separately because there is a possibility that the Commission’s approach to mergers changed as a result of the crisis. For the purpose of this paper, a merger decision will be considered to be pre-crisis if it was made prior to 15 September 2008, when Lehman Brothers filed for bankruptcy. This date has been chosen as it is regarded by many as the beginning of the worst phase of the crisis\textsuperscript{152}; it appears to have kick-started DG Competition’s crisis response in other fields\textsuperscript{153}; and it is close to the point at which the UK government felt it necessary to amend the Enterprise Act to allow “the stability of the UK financial system” to be taken into consideration in merger decisions (See section 1.2, above).

**Chapter 4 – The first question: are the merger decisions consistent with the Commission’s stated interpretation of the Merger Regulation?**

This chapter will attempt to answer the first of two questions posed by the methodology outlined in chapter 3 (above), being whether or not the merger decisions in the sample appear to be consistent with the Commission’s stated interpretation of the Merger Regulation (as contained in the Commission’s merger guidelines\textsuperscript{154}).

This chapter will be divided into two parts. Section 4.1 will consider what the Commission’s merger guidelines require of mergers in the commercial banking context. Section 4.2 will utilise the insights gained in section 4.1 to assess the merger decisions in the sample for apparent compliance with the Commission’s merger guidelines.

\textsuperscript{151} the EC Merger Regulation (n 20) Recital 26
\textsuperscript{152} For example, Carl Baudenbacher and Frank Bremer, ‘European State Aid and Merger Control in the Financial Crisis—From Negative to Positive Integration’ (2010) 1 Journal of European Competition Law & Practice 267, 269.
\textsuperscript{153} the Banking Communication (n 30)
\textsuperscript{154} Horizontal Merger Guidelines (n 70), Non-Horizontal Merger Guidelines (n 70)
Although the issue will be approached as scientifically as is possible, the imprecise nature of the merger guidelines renders their interpretation inevitably subjective. Therefore, the answers to the question posed will be that a given merger possibly, rather than certainly, does or does not reflect the Commission’s interpretation of the Merger Regulation.

4.1 The Commission’s merger guidelines in the commercial banking context

The Commission has published numerous documents illustrating its interpretation of the Merger Regulation. For the purpose of this paper, two documents are of particular relevance: the Commission’s horizontal merger guidelines\(^{155}\), and the Commission’s notice on the definition of relevant markets\(^{156}\). This section will consider how the principles contained in these documents operate in the context of commercial banking.

As stated in section 2.2 (above), the Merger Regulation requires the Commission to permit a proposed concentration unless that concentration “would significantly impede effective competition, in particular as a result of the creation or strengthening of a dominant position, in the common market or a substantial part of it.”\(^{157}\) According to the horizontal merger guidelines, this assessment normally entails two stages: first, the “definition of the relevant product and geographic markets”; and second, the “competitive assessment of the merger”\(^{158}\). These stages will be considered in turn in the following sections.

Definition of the relevant product and geographic markets

The test in Articles 2(2) and 2(3) of the Merger Regulation requires the Commission to assess whether a merger will create or strengthen a dominant position.\(^{159}\) The assessment of dominance is undertaken in relation to the market - delineated by both geography and

\(^{155}\) Horizontal Merger Guidelines (n 70)
\(^{156}\) Commission Notice, Commission Notice on the definition of relevant market for the purposes of Community competition law, [2011] OJ C372/5 (“Notice on the Definition of Relevant Markets”)
\(^{157}\) the EC Merger Regulation (n 20), Articles 2(2), 2(3)
\(^{158}\) Horizontal Merger Guidelines (n 70), paragraph 10
\(^{159}\) the EC Merger Regulation (n 20), Articles 2(2), 2(3)
product - in which the merging firms operate. Therefore, defining the market is an exercise with an often “decisive influence on the assessment of a competition case”160.

In this section, it will be argued that the Commission’s actual approach to market definition in its commercial banking sector merger decisions is, *prima facie*, consistent with its stated approach as contained in the notice on the definition of relevant markets. Further, it is conceded that an in depth challenge to the Commission’s approach would require detailed investigation that is beyond the scope of the present paper.

This section will proceed by outlining, first, the approach to market definition contained in the Commission’s notice on the definition of relevant markets and, second, the approach to market definition adopted in commercial banking merger decisions. It will then be argued that the approach taken in the decisions is consistent with that outlined in the notice.

*How the notice defines the relevant markets*

The Commission’s notice on the definition of relevant markets defines “[r]elevant product markets” thus:

“A relevant product market comprises all those products and/or services which are regarded as interchangeable or substitutable by the customer, by reason of the products; characteristics, their prices and their intended use”161

And “[r]elevant geographic markets” thus:

“The relevant geographic market comprises the area in which the undertakings concerned are involved in the supply and demand of products or services, in which the conditions of competition are sufficiently homogenous and which can be

160 Notice on the Definition of Relevant Markets (n 156), paragraph 4
161 Ibid paragraph 7
distinguished from neighbouring areas because the conditions of competition are appreciably different in those areas”

After providing these technical definitions, the notice summarises the exercise of defining a market in simpler terms:

“Basically, the exercise of market definition consists in identifying the effective alternative sources of supply for the customers of the undertakings involved, in terms of both products/services and of geographic location of suppliers.”

How Commission commercial banking merger decisions define the relevant markets

The Commission splits the commercial banking sector into two segments, retail banking and corporate banking. “Retail banking generally comprises all banking services to private individuals and very small enterprises”. Corporate banking comprises banking services to large corporate customers (“LCCs”) as well as to SMEs.

In early decisions, the Commission tended to leave open the question of “whether individual retail banking products represent separate relevant product markets or whether several retail banking products may form part of a single relevant product market”. However, the Commission has since identified discrete markets in, for example, “deposits, lending, mortgage loans, payment transactions, credit card issuing, custody accounts and distribution of mutual funds”.

When identifying sub-markets, the Commission undertakes a detailed assessment of the factors influencing both supply of, and demand for, a product. For example, in its BNP

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162 Ibid paragraph 8
163 Ibid paragraph 13
164 For example, Deutsche Bank/ABN AMRO Case M.5296 (2008), paragraph 9
165 For example, BNP Paribas/Fortis Case M.5384 (2008), paragraph 9
166 For example, Deutsche Bank/ABN AMRO Case M.5296 (2008), paragraph 10
167 For example, BNP Paribas/Fortis Case M.5384 (2008), paragraph 9
168 Unicredito/HVB Case M.3894 (2005), paragraph 9
Paribas/Fortis\textsuperscript{169} decision, the Commission identified a distinct product market for the provision of card-based consumer credit. In doing so, the Commission noted that the flexibility of card-based credit (once the card is issued, borrowing requires no further authorisation, and repayment is flexible) meets a distinct demand: “allowing customers to borrow in order to finance short-term gaps in cash flow, regardless of the purchasing need or opportunity”\textsuperscript{170}. The Commission then went on to consider the supply side, noting that the provision of card-based consumer credit requires specific assets that are not common to other varieties of consumer finance, thus eliminating the possibility of short-term substitution from one market to another.\textsuperscript{171}

In corporate banking, the Commission has long held that the provision of services to LCCs and the provision of services to SMEs are distinct product markets\textsuperscript{172}. It has left open the question of whether the market may be further divided “into separate product markets for the provision of deposits, loans... and foreign trade finance”\textsuperscript{173}.

The Commission has consistently defined the product markets within the retail banking segment as national, for two reasons. First, the “different competitive conditions within individual Member States”\textsuperscript{174}, second, “the importance of a network of branches”\textsuperscript{175}. The Commission has also defined the corporate banking markets for SMEs as national (for similar reasons), but has tended to leave open the question of whether the corporate banking markets for LCCs should be defined more widely\textsuperscript{176}. As with product markets, the Commission’s identification of geographic markets entails detailed assessment. For example, when considering the geographic extent of the market for banking services to LCCs, the Commission considered, amongst other factors, on the demand side, the

\begin{flushleft}
\begin{footnotesize}
\textsuperscript{169} BNP Paribas/Fortis Case M.5384 (2008)
\textsuperscript{170} Ibid paragraph 44
\textsuperscript{171} Ibid paragraph 45
\textsuperscript{172} For example, Fortis/ABN AMRO Case M.5384 (2008), paragraph 14
\textsuperscript{173} Danske Bank/Sampo Bank Case M.4484 (2007), paragraph 9
\textsuperscript{174} BNP Paribas/Fortis Case M.5384 (2008), paragraph 71
\textsuperscript{175} Ibid paragraph 71
\textsuperscript{176} For example, Deutsche Bank/ABN AMRO Case M.5296 (2008), paragraph 11
\end{footnotesize}
\end{flushleft}
relationship between firm size and demand for branch proximity\textsuperscript{177}, and on the supply side, the importance of local presence in providing banks with “local market intelligence”\textsuperscript{178}.

Whether the approach to market definition in the decisions is consistent with the approach in the notice

The relevant academic commentary contains little suggestion that the Commission, when assessing proposed mergers in the commercial banking sector, has not followed its own guidance on market definition. One author who bucks this trend is Dr Andrea Lista\textsuperscript{179}, who criticises the Commission’s increasing tendency to regard each service provided by a commercial bank as a distinct relevant product market. Lista argues that this practice pays insufficient regard to potential substitutability between products which, whilst differentiated, are of a similar type\textsuperscript{180}. However, Lista’s opinion, which is unsupported by reference to any specific decision, seems at odds with the content of the Commission’s decisions in the area. The Commission does not assume that the relevant product market should be defined on a service-by-service basis, instead only adopting such a position following an apparently in-depth market investigation, which tends to explicitly include an examination of substitutability between similar banking products\textsuperscript{181}.

Throughout her article, Lista appears concerned that too few banking sector mergers are falling within the jurisdiction of the Commission\textsuperscript{182}. Lista also mistakenly conflates the distinct questions of jurisdiction and market definition, suggesting that a proposed merger will not fall within the jurisdiction of the Commission when the product market is narrowly defined\textsuperscript{183}. Therefore, Lista’s suggestion that the Commission is defining product markets too narrowly may be dismissed as a misguided attempt to explain what she regards as a lack of banking sector merger decisions made by the Commission.

\begin{footnotesize}
\begin{enumerate}
\item\textsuperscript{177} Fortis/ABN AMRO Case M.5384 (2008), paragraph 77
\item\textsuperscript{178} Fortis/ABN AMRO Case M.5384 (2008), paragraph 78
\item\textsuperscript{180} ibid 294.
\item\textsuperscript{181} For example, BNP Paribas/Fortis Case M.5384 (2008), paragraph 45
\item\textsuperscript{182} Lista (n 179) 301.
\item\textsuperscript{183} ibid 295.
\end{enumerate}
\end{footnotesize}
In my opinion, reading the Commission’s commercial banking merger decisions provides no indication that the Commission has done anything other than follow their stated approach from the Notice on the Identification of Relevant Markets\textsuperscript{184}, being to identify “the effective alternative sources of supply for the customers of the undertakings involved, in terms of both products/services and of geographic location of suppliers”\textsuperscript{185}. The Commission appears to undertake this task in an in-depth, thorough manner through market investigations (examples of which have been detailed above). To assess the Commission’s approach to market definition in any further detail would require a parallel market assessment, an exercise that is entirely beyond the scope of this paper.

**Competitive assessment of the merger**

Once the product and geographical markets have been defined, the Commission will “assess the foreseeable impact of a merger on the relevant markets”\textsuperscript{186}. This assessment entails the consideration of two groups of factors: the possible anticompetitive effects of the merger; and any possible countervailing effects\textsuperscript{187} (common instances of which are identified in the horizontal merger guidelines). In the sections that follow, the most relevant of these effects will be summarised, and their impact on mergers in the commercial banking market will be appraised.

Two metrics of a merger’s degree of anticompetitive effect are (i) the post-merger market share of the firm involved; and (ii) the post-merger concentration level in the market. The size of these metrics will depend on the specific merger that is being scrutinised; these are termed “merger-dependent effects”. Other anticompetitive or countervailing effects are characteristic of all mergers occurring within the same market; these are termed “market-dependent effects”. It will be argued that the market-dependent effects of mergers in the commercial banking market are predominantly anticompetitive. Because of this, there need

\textsuperscript{184} Notice on the Definition of Relevant Markets (n 156)
\textsuperscript{185} Ibid paragraph 13
\textsuperscript{186} Horizontal Merger Guidelines (n 70), paragraph 12
\textsuperscript{187} Ibid paragraph 12
only be smaller anticompetitive merger-dependent effects arising from any particular commercial banking sector merger in order for that particular merger to contravene the Merger Regulation as interpreted by the merger guidelines.

_Possible anticompetitive effects – merging firms have large market shares_

A key indicator that a given merger will be considered by the Commission to be incompatible with the Merger Regulation is a large post-merger market share. As noted in the preceding section, post-merger market share is a merger-dependent effect.

Large market shares tend to be anticompetitive because “[t]he larger the increase in the sales base on which to enjoy higher margins after a price increase, the more likely it is that the merging firms will find such a price increase profitable despite the accompanying reduction in output.” The anticompetitive impact of large market shares is particularly pronounced in the banking sector, where customers face substantial switching barriers (see below).

_Possible anticompetitive effects – customers have limited possibilities of switching supplier_

Customers with limited abilities to switch supplier are vulnerable to post-merger price increases by the merged entity. The horizontal merger guidelines suggest two reasons why customers of the merging parties may have difficulties in switching to other suppliers: (i) because there are few alternative suppliers, and (ii) because switching entails substantial costs.

The first of these depends on the number of competitors in the market, or the concentration level. As noted in the introduction to this section (above), this is a merger-dependent effect.

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188 Ibid paragraph 27
189 Ibid paragraph 27
190 Fortis/ABN AMRO Case M.5384 (2008), paragraph 102
191 Horizontal Merger Guidelines (n 70), paragraph 31
192 Ibid paragraph 31
The second reason that customers may face limited possibilities of switching supplier is that switching supplier entails substantial cost. Incurring such cost is likely in a market where the barriers to switching supplier are high. The Commission has found that “substantial switching barriers”\(^{193}\) exist in the commercial banking market. These barriers include administrative burden, contractual lock in, and asymmetric information\(^ {194}\).

*Possible anticompetitive effects – merging firms are close competitors*

“The higher the degree of substitutability between the merging firms’ products, the more likely it is that the merging firms will raise prices significantly.”\(^ {195}\)

This anticompetitive effect reflects the possibility of product differentiation within a given market. If the products offered by the merging entities are highly substitutable, then pre-merger competition between them will have been a more significant competitive constraint than if they had been more differentiated. Therefore, the larger the degree of substitutability, the more significant the competitive loss resulting from the merger. It will be argued that, because of the Commission’s approach to market definition in commercial banking decisions, in cases where there is overlap between the merging firms in relevant product markets, the services on offer will tend to be highly substitutable.

As discussed above, the Commission is increasingly tending to adopt a narrow, service-by-service approach to product market definition in the commercial banking sector (with some exceptions). Naturally, the more narrowly a product market is defined, the higher the degree of substitutability between the products within that market, and, therefore, the greater the competitive loss resulting from a merger affecting that market. Therefore, in cases where there is overlap in a given product market between the merging parties, the products of the merging firms are likely to be close substitutes. All merger decisions in the sample are reasoned decisions (see section 3.3, above). In order for the Commission not to

\(^{193}\) Fortis/ABN AMRO Case M.5384 (2008), paragraph 102

\(^{194}\) Ibid paragraph 102

\(^{195}\) Horizontal Merger Guidelines (n 70), paragraph 28
clear the proposed merger using the standard form, simplified procedure, there must be overlap within a relevant product market (see above). Thus, the mergers assessed in the decisions in the sample will all be subject to the anticompetitive effect caused by the merging firms being close competitors.

Possible anticompetitive effects – coordination

It is possible that a merger may facilitate anticompetitive coordination between competitors. This may take various forms, including fixing prices above the competitive level, controlling output, or dividing the market\(^{196}\).

In assessing the likelihood of post-merger anticompetitive coordination, the Commission will consider four factors: the ease of establishing terms of coordination; whether the coordinating firms are able to monitor adherence to the terms of coordination; whether deviation can be deterred; and whether outsiders are able to jeopardise the results of the coordination\(^{197}\). How these factors operate in the commercial banking market will be analysed below. It will be argued that although the characteristics of the commercial banking market are not ideal for anticompetitive coordination, it remains a distinct possibility, particularly in highly concentrated markets.

The first requirement is that competitors are able to reach terms of coordination\(^{198}\). This is particularly facilitated by markets for relatively homogenous products\(^{199}\) (although the Commission has previously found that the “varying degrees of product differentiation”\(^ {200}\) in the commercial banking markets do not pose an obstacle to reaching terms of coordination). Reaching terms of coordination is also facilitated by a high level of concentration. As noted above, the post-merger concentration level will depend on the merger in question (it is a merger-dependent effect).

\(^{196}\) Ibid paragraph 40
\(^{197}\) Ibid paragraph 41
\(^{198}\) Ibid paragraph 44
\(^{199}\) Ibid paragraph 45
\(^{200}\) Fortis/ABN AMRO Case M.5384 (2008), paragraph 128
The second requirement is that firms should be able to monitor deviations by their competitors from the terms of coordination\textsuperscript{201}. This is closely linked to the third requirement, that there is a “credible threat of timely and sufficient retaliation”\textsuperscript{202}. Monitoring deviations requires that the market is relatively transparent. The Commission has found, in relation to the retail banking subset of commercial banking, that the market “is sufficiently transparent... prices are easy to monitor at least for certain products and... competitors tend to monitor other operator’s prices.”\textsuperscript{203} Market transparency is further increased by the merger-dependent effect of high levels of concentration\textsuperscript{204}. If a deviation from the terms of coordination is detected, the market structure characterised by large numbers of small transactions allows swift retaliation\textsuperscript{205}.

The final requirement is that the actions of non-coordinating firms, potential competitors and customers cannot jeopardise the outcome of the coordination\textsuperscript{206}. It will be argued below that customers (through countervailing buyer power) and potential competitors have little ability to counter anticompetitive conditions in the banking market. The ability of non-coordinating firms to effect the outcome of coordination will vary from merger to merger, depending on the levels of concentration, and the market shares of the coordinating firms.

To conclude, coordination is a potential market-dependent anticompetitive effect of mergers in the commercial banking market. However, the likelihood of coordination is significantly influenced by a merger-dependent effect, the degree of concentration in the market post-merger.

\textit{Possible countervailing effects – countervailing buyer power}

“Countervailing buyer power in this context should be understood as the bargaining strength that the buyer has vis-à-vis the seller in commercial negotiations due to its...
size, its commercial significance to the seller and its ability to switch to alternative suppliers.”

If buyers in a given market have significant countervailing buyer power, this will exert a competitive pressure on suppliers, and will operate to constrain the anticompetitive effects of mergers in that market. In this section it will be argued that, in the commercial banking market, buyer power is insufficient to significantly limit the anticompetitive effects of mergers.

The horizontal merger guidelines suggest three possible sources of buyer power: a credible threat to resort to an alternative source of supply; a credible threat to vertically integrate into the upstream market; and a credible threat to sponsor upstream expansion or market entry. The Commission has found that none of these options are likely to be open to individuals or SMEs who, on the contrary, depend on their bank for obtaining credit. Further, even larger corporate customers will struggle to leverage buyer power through these mechanisms due to significant informational asymmetries.

Even if buyer power is found to exist, a second consideration that the Commission will have regard to is the distribution of buyer power across the customer base of the merged entity:

“Countervailing buyer power cannot be found to sufficiently off-set potential adverse effects of a merger if it only ensures that a particular segment of customers, with particular bargaining strength, is shielded from significantly higher prices or deteriorated conditions after the merger.”

This would be the case in the commercial banking market. Even if any buyer power is found to exist, that power would be exclusively held by LCCs. SMEs and individuals would be left to

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207 Ibid paragraph 64
208 Ibid paragraph 64
209 Ibid paragraph 65
210 Fortis/ABN AMRO Case M.5384 (2008), paragraph 123
211 Ibid, paragraph 123
212 Horizontal Merger Guidelines (n 70), paragraph 67
endure deteriorated conditions. Therefore, the possible countervailing effect of buyer power is not operative in the commercial banking context.

Possible countervailing effects – entry

In appropriate market conditions, the anticompetitive effect of a merger will be constrained by potential market entrants. In this section, however, it will be argued that this potential countervailing effect has little role to play in constraining the anticompetitive effects of mergers in the commercial banking sector, due to the existence of significant barriers to entry.

Before entry may be considered a competitive constraint, the Commission requires that entry is “shown to be likely, timely and sufficient to deter or defeat any potential anticompetitive effects of the merger.” The likelihood of entry (as well as its timeliness and scope) is dependent on its probable profitability. In turn, probable profitability is affected by the existence of barriers to entry (which influence the risks and costs associated with entry).

“Barriers to entry are specific features of the market, which give incumbent firms advantages over potential competitors. When entry barriers are low, the merging parties are more likely to be constrained by entry. Conversely, when entry barriers are high, price increases by the merging firms would not be significantly constrained by entry.”

It is argued that the commercial banking market is characterised by high barriers to entry, and, therefore, potential entry has a relatively minor countervailing effect on the anticompetitive impact of commercial banking sector mergers. Barriers to entry in the commercial banking market have been identified by the Commission. The most significant of

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213 Ibid paragraph 68
214 Ibid paragraph 68
215 Ibid paragraph 69
216 Ibid paragraph 70
217 Ibid paragraph 70
these are “the sunk costs involved in setting up a branch network and... asymmetric information problems”218. Further barriers to entry include: demand that banking institutions offer a complete range of services219; and the importance of reputation to customers choosing a bank220. As a result of these entry barriers, the possible countervailing effect of potential competition has little impact in the commercial banking market.

Possible countervailing effects – efficiencies

The ability of post-merger efficiencies to counteract the anticompetitive effects of a merger were discussed above, where it was noted that they have little role to play in the assessment of horizontal concentrations.

Possible countervailing effects – failing firm

The failing firm defence amounts to an argument that the anticompetitive effects of a merger cannot be said to have been caused by that merger. “This will arise where the competitive structure of the market would deteriorate to at least the same extent in the absence of the merger.”221

There are three criteria that must be fulfilled for the defence to be invoked:

“First, the allegedly failing firm would in the near future be forced out of the market because of financial difficulties if not taken over by another undertaking. Second, there is no less anti-competitive alternative purchase than the notified merger. Third, in the absence of a merger, the assets of the failing firm would inevitably exit the market.”222

218 Fortis/ABN AMRO Case M.5384 (2008), paragraph 118
219 Ibid paragraph 119
220 Ibid paragraph 120
221 Horizontal Merger Guidelines (n 70), paragraph 89
222 Ibid paragraph 90
Whether these criteria will be satisfied will depend on the circumstances of the merger in question. However, the Commission did not consider the defence to be applicable to any of the decisions in the sample, therefore, it will not be discussed further.

Conclusions

The preceding paragraphs considered various anticompetitive and countervailing effects of mergers as identified by the Commission in its horizontal merger guidelines\(^\text{223}\). These included effects the magnitude of which would depend on the specific attributes of the merger (merger-dependent effects), and effects which would apply similarly to all mergers in the commercial banking market (market-dependent effects).

It was suggested that the market-dependent effects of horizontal mergers in the commercial banking sector are predominantly anticompetitive. This is a result of the presence of market-dependent anticompetitive effects, including: barriers to switching supplier; coordination between competitors; and the high degree of substitutability of services within relevant product markets. As well as the absence, in the commercial banking context, of the potential market-dependent countervailing effects identified by the Commission in its guidance.

When assessing proposed mergers, the Commission will also consider factors that are specific to the merger in question. Two such characteristics, identified above, are market share and post-merger concentration level. Below, it will be suggested that the predominantly anticompetitive nature of the market-dependent effects of commercial banking mergers means that the Commission, based on its guidance, would require a lower degree of market share or post-merger concentration before considering a proposed merger to be anticompetitive.

Recital 32 of the Merger Regulation\(^\text{224}\) instructs the Commission generally not to regard as problematic, mergers where the resulting entity holds a market share that does not exceed

\(^{223}\) Horizontal Merger Guidelines (n 70), paragraph
\(^{224}\) the EC Merger Regulation (n 20), Recital 32
25%\(^{225}\). At the other end of the scale, in the instance of mergers resulting in market shares exceeding 50%, market share alone may regarded as sufficient evidence of the existence of a dominant position\(^{226}\) (both these figures are, of course, generalities and there will be exceptions). In situations where the post-merger market share falls between 25% and 50%, the level of market share to be accepted will be dictated by the magnitude of market-dependent effects and the second merger-dependent effect, post-merger concentration level.

In the interest of preserving commercial secrecy, in its published decisions, the Commission does not disclose exact market shares, instead identifying only that the market share is somewhere within a ten percentage point band. For example, 0-10%, 10-20% and so on. Because many of the anticompetitive market-dependent effects, and few of the countervailing effects, identified in the horizontal merger guideline are present in relation to commercial banking mergers, it is possible to speculate that the guidelines would label any merger (as approved) resulting in a concentrated market and a post-merger market share of 30-40% as incompatible with the EC Merger Regulation.

This method of establishing whether or not a given merger decision can be regarded as being consistent with the Commission’s horizontal merger guidelines is, of course, imperfect. The most compelling criticism is that it fails to take into account any factors affecting the competitive impact of a merger that are not contained in the guidelines, as the Commission would do\(^{227}\). Therefore, the test will be modified to admit that a merger will not be regarded as potentially incompatible with the guidelines if the Commission can present a compelling and atypical account of why the high concentration would not be anticompetitive.

Even with this caveat, the imperfections of the test are not entirely alleviated. In recognition of this, the test does not claim to identify precisely whether a given decision is in

\(^{225}\) Further, the simplified procedure will apply to, amongst others, horizontal mergers resulting in a post-merger market share of less than 15%. Notice on a Simplified Procedure (n 97), paragraph 5(c)(i)

\(^{226}\) Horizontal Merger Guidelines (n 70), paragraph 17

\(^{227}\) Faull and Nikpay (n 60) 697.
compliance with the merger guidelines or not, rather, the test aims to identify those decisions that are potentially not in line with the guidance. This paper’s approach, at the very least, represents a significant improvement when compared to the approaches used in previous studies. For example, Robert Lane asserts boldly that a number of Commission merger decisions made in the wake of the financial crisis were approved when they might otherwise have been modified or prohibited. A second example is Mark Thatcher, who assumes that because, on the basis of market-dependent effects, the mergers in the commercial banking sector are predominantly anticompetitive, the Commission, in approving all proposed mergers in the sector (although some following modifications), must, by simple probability, have failed to follow its guidance in some instances.

4.2 Are the merger decisions in the sample consistent with the Commission’s stated interpretation of the Merger Regulation?

This section will consider the decisions made by the Commission in relation to proposed horizontal mergers in the commercial banking market, to establish whether or not those decisions can be regarded as consistent with the Commission’s stated interpretation of the EC Merger Regulation, as contained in the Commission’s horizontal merger guidelines.

In the conclusion to section 4.1 (above) it was argued that the Commission’s horizontal merger guidelines indicate that a commercial banking merger resulting in a post-merger market share of at least between 30 and 40% in a concentrated market, is potentially incompatible with the EC Merger Regulation, unless the Commission is able to provide a compelling and atypical explanation to the contrary.

In the paragraphs that follow, the merger decisions in the sample will be grouped on the basis of the highest post-merger market share that the merger (as approved) would create in a commercial banking market. The decisions that would result in a post-merger market share of at least 30-40% will then be discussed in detail.

228 Lane (n 27) 503.
229 Thatcher (n 26) 449, 450.
A post-merger market share in a commercial banking market of 0-10% was identified in a single case from the sample, Banco Santander/Abbey National\(^{230}\).

Five decisions from the sample: Santander/Bradford & Bingley Assets\(^{231}\); BNP Paribas/BNL\(^{232}\); Santander Consumer Finance/El Corte Inglés/Financiera El Corte Inglés\(^{233}\); Credit Mutuel/Monobanq\(^{234}\); and Credit Mutuel/Cofidis\(^{235}\), would have resulted in post-merger market shares in commercial banking markets of 10-20%.

In a further eight decisions from the sample, the maximum post-merger market share in a commercial banking market would have been 20-30%. These decisions were: Deutsche Bank/ABN AMRO Assets\(^{236}\); BNP Paribas/Fortis\(^{237}\); Danske Bank/Sampo Bank\(^{238}\); RZB/RBSPK/RWBB\(^{239}\); Barclays Bank/Egg Credit Card Assets\(^{240}\); Erste Bank/ASK\(^{241}\); Banco Santander/Rainbow\(^{242}\); and Credit Agricole/Casse Di Risparmio Della Spezia/Agences Intesa Sanpaolo\(^{243}\).

The remaining four decisions (as approved) would result in a post-merger market share of at least 30-40% in at least one relevant market. These are: Fortis/ABN AMRO Assets\(^{244}\) (the Dutch market for private banking, the Dutch market for mutual funds); Unicredito/HVB\(^{245}\) (the Polish market for mutual funds); Barclays/ABN AMRO\(^{246}\) (various UK corporate banking markets); and RBS/ABN AMRO Assets\(^{247}\) (in the UK market for SME corporate banking). As noted in section 4.1 (above), these decisions will be regarded as potentially inconsistent.

\(^{230}\) Case M.3547 (2004)  
\(^{231}\) Case M.5363 (2008)  
\(^{232}\) Case M.4155 (2006)  
\(^{233}\) Case M.7078 (2014)  
\(^{234}\) Case M.5605 (2009)  
\(^{235}\) Case M.5432 (2009)  
\(^{236}\) Case M.5296 (2008)  
\(^{237}\) Case M.5384 (2008)  
\(^{238}\) Case M.4484 (2007)  
\(^{239}\) Case M.7007 (2013)  
\(^{240}\) Case M.6164 (2011)  
\(^{241}\) Case M.5811 (2010)  
\(^{242}\) Case M.5948 (2010)  
\(^{243}\) Case M.5960 (2010)  
\(^{244}\) Case M.4844 (2007)  
\(^{245}\) Case M.3894 (2005)  
\(^{246}\) Case M.4692 (2007)  
\(^{247}\) Case M.4843 (2007)
with the Commission’s Merger Guidelines unless the text of the decision contains a compelling and atypical justification for permitting a merger resulting in such a large market share. These decisions will be discussed in turn below.

In the Unicredito/HVB decision, the Commission approved a proposed merger between Unicredito, an international bank based in Italy, and HVB, an international bank based in Germany. Pre-merger, both parties offered “a wide range of banking and financial services in several European countries”\(^248\). It was proposed that the merger would take place through a public exchange share-for-share offer made by Unicredito for the whole share capital of HVB.

The proposed merger would result in a post-merger market share of at least 30-40% in a single commercial banking market, the Polish market for the distribution of mutual funds. The Commission offers two explanations for permitting a transaction resulting in such a significant market share. First, mutual funds tend to be sold by banks to their existing customer base. Therefore, a high share of the market for mutual funds does not represent a dominant position in that market, rather it represents a high proportion of the deposits within a particular commercial bank being held in mutual funds. Second, the market for mutual funds in Poland is underdeveloped, and there are no significant barriers to market entry by established international fund managers. Therefore, the behaviour of the post-merger entity will be constrained by potential competition.

It is suggested that neither of these arguments is sufficiently atypical or compelling to make the proposed transaction a special case where a high post-merger market share should be permitted. The Commission’s first argument, that a high market share cannot be equated with dominance as mutual funds tend to be sold to existing customers is far from atypical. Rather, as the Commission has acknowledged in past decisions\(^249\), customers purchasing new products from the firm with which they have an existing relationship is a trait of many banking markets. The Commission’s second argument, that potential competition will be able to constrain anticompetitive behaviour in the market, is also insufficiently compelling.

\(^{248}\) Case M.3894 (2005)
\(^{249}\) Fortis/ABN AMRO Case M.5384 (2008), paragraph 102
The Commission argues that the market for mutual funds is such that it is unnecessary for a firm to establish a branch network, thus removing a significant barrier to market entry. It is accepted that the entry barriers in this market will be lower than in other banking markets. However, the barriers to entry will still be substantial. As noted in section 4.1 (above), these barriers result not only from the necessity of establishing a branch network, but also from, for example, asymmetric information and the importance of firm reputation to customers. As the Commission’s explanations for permitting a merger resulting in such high market share are neither atypical nor compelling, this merger should be regarded as potentially incompatible with the merger guidelines.

Barclays/ABN AMRO concerned the proposed acquisition by Barclays, a global financial service provider which, within the EU, is predominantly active in the UK, of ABN AMRO, an international banking group predominantly active in the Netherlands. Barclay’s proposed to conduct the acquisition by way of purchase of the entire issued share capital of ABN AMRO. Barclay’s proposal faced competition from a rival proposal made by an international consortium (see below).

Barclays’ acquisition of ABN AMRO would create a post-merger entity holding a market share that (potentially) exceeds 30-40% in three UK markets: SME current accounts; SME deposit accounts; and SME loans. However (unusually), the Commission’s decision does not provide a market share figure for the combined entity, instead only providing pre-merger figures for both parties. These are: SME current accounts, Barclays 15-25%, ABN AMRO 0-10%; SME deposit accounts, Barclays 20-30%, ABN AMRO 0-10%; SME loans, Barclays 20-30%, ABN AMRO 0-10%. Combining these figures allows us to calculate that there is a 33% chance that the post-merger market share in SME current accounts exceeded the 30% threshold established in section 4.1 (above), and a 50% chance that the 30% threshold was exceeded by the post-merger market share in SME deposit accounts or SME loans.

The Commission’s explanation for allowing a transaction resulting in such significant market shares is twofold. First, the accretion of market share is modest; second the affected markets all contain strong competitors. It is suggested that this explanation is not so atypical or compelling that it renders the high post-merger market share unproblematic. The
Commission’s first argument, that the accretion of market share is modest, is far from convincing. The horizontal merger guidelines do not indicate that the magnitude of the gain in market share is a relevant consideration. This is supported by the legal test which prohibits the creation or strengthening of a dominant position without specifying a degree of magnitude by which it must be created or strengthened. The Commission’s second argument, that the post-merger firm would be constrained by strong competitors has two problems. First, the assertion is not supported by any figures or even anecdotal evidence regarding competitor behaviour. Second, it may be inferred from this statement that the market in question is a concentrated one, which, as highlighted repeatedly in section 4.1 (above), is an anticompetitive trait. As the Commission’s explanations for permitting the large post-merger market shares are not compelling or atypical, the Barclays/ABN AMRO merger decision must be regarded as potentially incompatible with the horizontal merger guidelines.

The remaining decisions, RBS/ABN AMRO Assets and Fortis/ABN AMRO Assets, concern the rival proposal for the acquisition of ABN AMRO made by a consortium composed of the Royal Bank of Scotland, Fortis and Santander. As with Barclay’s proposal, this purchase was proposed to occur through the acquisition of the entire issued share capital of ABN AMRO. However, in contrast to the Barclay’s bid, the assets of ABN AMRO would then be divided amongst the members of the consortium.

In the RBS/ABN AMRO Assets decision, the Commission approved the acquisition of certain ABN AMRO assets by RBS. RBS was based in the UK, and was “one of the world’s largest banking and financial services groups”\(^{250}\).

The proposed acquisition would result in a post-merger market share of over 30-40% in a single market: the SME subset of the UK corporate banking market. The explanation offered by the Commission for permitting an acquisition resulting in such a significant market share is the same as that offered in the Barclays/ABN AMRO decision (see above): first, that the accretion of market share is modest, and, second, that the market contains strong

\(^{250}\) Case M.4843 (2007)
competitors. For the same reasons as given in relation to the Barclays/ABN AMRO decision, the justifications offered by the Commission should not be regarded as sufficiently atypical or compelling, and the decision must be considered to be potentially incompatible with the horizontal merger guidelines.

In Fortis/ABN AMRO Assets, the Commission approved the proposed acquisition by Fortis of certain ABN AMRO assets. Fortis is a financial services group operating in particular in Belgium and the Netherlands.

Fortis’ acquisition of ABN AMRO assets (as approved) would result in post-merger market share exceeding 30-40% in two markets: the Dutch market for mutual funds and the Dutch market for private banking.

In the Dutch market for mutual funds, the post-merger entity would have a market share of 30-40% (calculated by value of funds). The Commission gives four reasons why it does not regard this large market share as problematic. First, the accretion of market share is small. Second, one particular competitor, ING/Postbank, is particularly innovative. Finally, the regulatory architecture obliges retail banks to provide access to third party funds, thus reducing the barriers to entry faced by those firms.

The first reason given by the Commission, that the gain in market share is minor, has been discussed in relation to the Barclays/ABN AMRO decision (see above), where it was not regarded as compelling. A second reason given by the Commission for allowing the high post-merger market share is that ING/Postbank is a particularly innovative competitor. Although this is a relevant consideration, in this instance it is unconvincing as no empirical or anecdotal evidence is given for the assertion. The Commission’s final justification is that the lower barriers to entry in the market for mutual funds mean that the post-merger entity will be constrained by potential competition. This argument is the same as that found in the Unicredito/HVB decision (discussed above), and is not compelling for the same reasons. Although it is accepted that the barriers to entry will be less in this market, they will still be substantial enough to hinder effective competition by potential entrants.
“In private banking, the merger would combine two significant players and create the largest player in the market”\textsuperscript{251}. The market share of the post-merger entity would be 30-40%. However, the Commission argues that such a high post-merger market share will be unproblematic because the market in question is “only modestly concentrated”\textsuperscript{252}. It is argued that the Commission’s explanation is clearly not sufficiently atypical or compelling to justify permitting such a large post-merger market share. In fact, although the Commission regards the market as only modestly concentrated, 70-80% of the market is still held by only seven firms. Therefore, the Fortis/ABN AMRO Assets merger may be regarded as potentially incompatible with the Commission’s merger guidelines.

To conclude, in section 4.1 (above), it was suggested that a commercial banking merger decision will not be consistent with the Commission’s stated policy if it results in a post-merger market share of at least 30-40% in a commercial banking market and the Commission cannot provide an atypical and compelling justification for this. In this section, the merger decisions in the sample which result in such high market shares were identified, and the explanations given by the Commission were analysed in detail. On the basis of this analysis it was concluded that four decisions were potentially incompatible with the Commission’s horizontal merger guidelines. These are: Unicredito/HVB; Barclays/ABN AMRO; RBS/ABN AMRO Assets; and Fortis/ABN AMRO Assets.

Chapter 5 – The second question: are the merger decisions consistent with the promotion of commercial banking sector stability?

The methodology outlined in chapter 3 (above) requires two questions concerning the sample of merger decision to be answered. The first of these questions was addressed in chapter 4 (above). This chapter will focus on the second question posed: whether or not the merger decisions in the sample are consistent with the promotion of stability in the commercial banking sector.

\textsuperscript{251} Case M.4844 (2007)
\textsuperscript{252} Case M.4844 (2007)
The question will be addressed in two stages. Section 5.1 will utilise the literature on the determinants of banking sector stability in order to establish what decisions would be made within a merger policy with the sole aim of promoting commercial banking stability. Section 5.2 will enlist the framework developed in section 5.1, using it to assess the merger decisions in the sample.

5.1 How could merger policy be used to stabilise the commercial banking sector?

This section will consider the decisions which would be made by a hypothetical merger authority that, in its decision making process, absolutely prioritises the stability of the commercial banking sector.

The first part of this section will discuss the meaning of stability. It will then be argued that, although instability in the commercial banking sector has a range of disparate causes, the threat with which a stability minimising merger policy would be concerned is the threat posed by the presence in the market of systemically important institutions. Next, it will be suggested that this conclusion has three implications for the hypothetical authority. First, typically, the hypothetical authority would not allow mergers that create or enlarge a systemically important institution. However, second, in a limited range of circumstances, the hypothetical authority would allow mergers to prevent a systemically important bank from failing. Third, mergers not creating or enlarging a systemically important bank would be permitted.

The definition of stability

Although there is a reasonably large body of literature focussing on how “financial stability” should be defined253, there is a relative dearth of literature regarding the specific, narrower issue with which this paper is concerned: that of commercial banking sector stability. This section will, therefore, analyse the financial stability literature to identify the principles

underlying the common conceptions of stability. These principles will then be used to produce a definition of commercial banking sector stability.

Alawode and Al Sadek compile and review a multitude of definitions of financial stability/instability as produced by both academics and central banks\textsuperscript{254}. Possibly as a result of their brevity, there is a remarkable degree of homogeneity between the definitions produced by the central banks (although differences remain). A definition that appears to typify those produced by the central banks is that of the Deutsche Bundesbank:

“\textit{The Bundesbank defines financial stability as the financial system's ability to perform its key macroeconomic functions, and particularly so in periods of stress and upheaval}^\textsuperscript{255}.”

This definition possesses three characteristics identified by Alawode and Al Sadek as epitomising those definitions produced by central banks: stability (as opposed to instability) is defined; emphasis is placed on the performance of the key functions of the financial system; and further emphasis is placed on resilience to shocks\textsuperscript{256}.

There appears to be much more diversity amongst the definitions produced in academia. However, it is suggested that, upon closer inspection, prima facie disagreement belies significant conceptual similarity. The first area of discrepancy identified by Alawode and Al Sadek is whether a given paper elects to define stability or instability\textsuperscript{257}. However, it is suggested that this choice should not be regarded as indicating conceptual differences between authors as to what stability/instability is; rather, they are defining different, but related, ideas. This is well explained by Schinasi who regards financial stability as a continuum where stability and instability are independent phenomena occurring

\textsuperscript{254} Alawode and Al Sadek (n 253).
\textsuperscript{256} Alawode and Al Sadek (n 253) 14.
\textsuperscript{257} ibid 4.
increasingly as you move towards either end\textsuperscript{258} (a view apparently shared by the ECB\textsuperscript{259}).

Further, for the purpose of this paper, principles garnered from both definitions of stability and definitions of instability are equally relevant because both the promotion of stability and the reduction of instability can be conceptualised as an attempt to shift a banking system in the same direction along the same continuum.

Two seemingly disparate examples of how stability/instability is defined by academics are presented below:

Davis defines financial instability as “a heightened risk of a financial crisis”. Financial crisis is itself defined as “a major collapse of the financial system, entailing inability to provide payments services or to allocate credit to productive investment opportunities”\textsuperscript{260}.

Foot, on the other hand, defines financial stability as a situation where there is: “(a) monetary stability... (b) employment levels close to the economy’s natural rate... (c) confidence in the operation of the generality of the key financial institutions and markets in the economy... and (d) no relative price movements of either real or financial assets within the economy that will undermine (a) or (b)”\textsuperscript{261}.

Although the two definitions appear to differ significantly, it is argued that these differences do not reflect disagreement as to the meaning of stability/instability, rather, they reflect differing conceptions of the financial system and its macroeconomic role. For example, Davis and Foot appear to agree that stability requires a financial system to continue to perform its economic functions. However, Davis views these functions narrowly (the provision of payment services and the appropriate allocation of credit), whereas Foot conceives of them much more broadly (adding monetary stability, appropriate employment


levels and price stability). Looking beyond this example, it is possible to explain the differences between the vast majority of definitions as differences only in respect of how the role of the financial sector is conceptualised, differences that mask a shared emphasis on the ability of the financial system to continue to fulfil its role in the wider economy.\textsuperscript{262}

As with the definitions provided by central banks, an emphasis on resilience to shocks is a shared aspect of many of the definitions of stability produced by academics.\textsuperscript{263}

On the basis of the analysis above, it is possible to extract two principles that underpin the idea of stability. The first principle is that stability reflects the relative ability of a system to continue to perform its functions. The second principle is that the system must continue to perform its functions regardless of shocks. Therefore, commercial banking sector stability is the relative ability of the commercial banking sector to continue to perform its functions regardless of shocks. The macroeconomic functions of the commercial banking sector were discussed in section 1.1 (above). They include, but are not limited to, efficient capital allocation; facilitating payments; and transmitting changes to monetary and fiscal policies.

**The de-stabilising character of systemically important banks**

Any phenomenon that reduces the ability of the commercial banking sector to continue to perform its functions regardless of shocks will be referred to as a destabilising factor. Destabilising factors are many and varied. However, this section will argue that the sole destabilising factor with which a merger authority attempting to promote stability would be concerned is the existence of systemically important commercial banks. The second part of this section will provide a brief introduction to the idea of systemic importance.

**Why focus on systemic importance?**

Broadly speaking, a merger authority has the power to permit or prohibit non-organic firm growth. When considering how a merger authority would act if attempting to promote stability.

\begin{footnotesize}
\textsuperscript{262} Alawode and Al Sadek (n 253) 14.
\textsuperscript{263} ibid.
\end{footnotesize}
commercial banking sector stability, the constraints of this power must be borne in mind. Therefore, one must consider how the power to permit or prohibit non-organic growth may be utilised to achieve the aim of stability. The following paragraphs will provide an overview of destabilising factors in the commercial banking sector. It will then be argued that the only destabilising factor that it is possible to limit or reduce through the control of non-organic growth is the threat posed by systemically important banks.

It is a common feature of the literature on banking crises for an author to attempt to group destabilising factors by type. Such typologies differ between papers (for example, Llewellyn264 offers eight categories, whereas Ingves265 offers only two). However, it appears that a sufficiently comprehensive account of destabilising factors may be provided under four headings: macroeconomic circumstances266; banking behaviour267; microeconomic policies268; and banking sector structure269.

Macroeconomic destabilising factors include “low GDP growth, high real interest rates and high inflation”270, as well as “a sharp... fall in the exchange rate”271, or “a collapse of asset prices”272. These factors reduce stability by damaging the value of the assets on a bank balance sheet273. These factors cannot be directly influenced through the control of non-organic growth, so will not be the concern of a merger authority seeking to promote stability. Rather, as their name suggests, these factors should be controlled through broad economic policy.

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265 Stefan Ingves, ‘Banking Crisis from an International Perspective’ (Seminar on Financial Safety Nets, Buenos Aires, 8 April 2003).
267 Llewellyn (n 264) 154; Latter (n 266) 21; Demirgüç-Kunt and Detragiache (n 266) 6.
268 Ingves (n 265); Latter (n 266) 21.
270 Demirgüç-Kunt and Detragiache (n 266) 3.
271 Latter (n 266) 21.
272 ibid.
273 Demirgüç-Kunt and Detragiache (n 266) 7.
The second group of destabilising factors represents poor bank behaviour. Such behaviour includes negligent practises such as insufficient screening of loan applicants274 and amassing overly concentrated loan portfolios275, as well as deliberate misconduct, for example, bank managers diverting money for personal use276. Although there is speculation that such a link exists277, this study has found no evidence that behavioural problems can be linked to firm size278. Therefore, behavioural destabilising factors would not be the focus of a merger authority attempting to promote stability. Rather, destabilising behaviour should be addressed through regulation and supervision, although, as discussed in the paragraph below, this must itself be appropriate. An example of regulation/supervision that is intended to prevent specific aspects of destabilising bank behaviour is the CRD IV pre-acquisition appraisal that was discussed in section 2.1 (above).

Microeconomic destabilising factors are those relating to State control over the banking sector. They include, but are not limited to, insufficient supervision279; (potentially) deregulation280; and government interference in banking activities281, including the provision of financial support to struggling institutions282. As with the macroeconomic and behavioural destabilising factors, these factors cannot be influenced through the control of organic growth, and, therefore, will not be the target of a merger authority pursuing stability. Rather, these factors are controlled by the legislative framework for, as well as the operational and policy decisions of, the relevant regulatory and supervisory authorities.

274 ibid 6.
275 ibid.
276 ibid 8.
278 Although there are numerous studies investigating the link between firm size and firm performance, these indicate a lack of consensus, and, in any case, the available data does not easily facilitate the identification of any particular explanatory variables. For example, JL Stimpert and Judith A Laux, ‘Does Size Matter? Economies Of Scale In The Banking Industry’ (2011) 9 Journal of Business & Economics Research 47, 53.
279 Latter (n 266) 22.
280 ibid 23.
281 ibid.
282 ibid.
The final category of destabilising factor is structural destabilising factors. This category concerns the presence in the market of banks that are destabilising as the result of one or more attributes, in particular, their size and their level of interconnectivity with other market participants (see below). Such banks are described as systemically important. Unlike the macroeconomic, behavioural or microeconomic destabilising factors, which cannot be controlled by regulating non-organic growth, systemic importance is, at the very least (see below), highly correlated with bank size. For this reason, it is unique amongst the destabilising factors discussed, as it is the only one the occurrence or level of which can be directly affected by mergers policy. The two sections that follow will address, respectively, the nature of, and the determinants of, systemic importance.

*What is systemic importance?*

In a typical market, the exit of a single firm is an economically insignificant event. The exiting firm’s more efficient competitors will rapidly move to supply former customers, and the market will continue to function as normal. Conversely, in the commercial banking market (as well as other, similar financial markets) the exit of a single firm, dependant on the particular attributes of that exiting firm, may have severe negative consequences for competitors remaining in the market. This is the phenomenon of systemic importance. The potential for the exit of a single firm to negatively affect the whole market arises from two attributes that are peculiarly concentrated in the financial markets: interconnectivity and intra-market contagion.

The most significant cause of interconnectivity in the market for commercial banking is the existence of an inter-bank credit market allowing banks to lend to, and borrow from, one another in response to temporary fluctuations in demand. This market creates counterparty risk amongst commercial banks, meaning that the failure (and the default that this entails)

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283 Hans Genberg, ‘Data Requirements For Assessing the Health of Systemically Important Financial Institutions (SIFIs): A Perspective from Hong Kong’ (2009) 1.
284 Moosa (n 5) 1.
of a single institution, will negatively impact its creditor institutions in the same market. As Maes and Kiljanski observe, “[t]he position of these banks may in turn be weakened and entail losses for their own creditor banks.” Thus, interconnectivity through counterparty risk may result in a domino-effect of defaults across the market.

The second mechanism through which the exit of a single firm may be capable of negatively affecting the entire commercial banking market is informational contagion. There is an important disparity within the balance sheet of a commercial bank. Whereas the liabilities side is based on deposits which can be realised, if not instantly, at short notice; the assets side is formed of loans, the value of which is only ascertainable and realisable in the long run. The operation of this model is absolutely reliant on the continued confidence of depositors, as, at any one moment, a commercial bank only holds sufficient liquidity to satisfy a small percentage of its creditors. The failure of a single commercial bank may cause a loss of confidence in the system as a whole, causing depositors to withdraw their funding from other banks (particularly those perceived to be in a similar position to the defaulting institution) and the crisis to escalate. The potency of informational contagion is enhanced as depositors are likely to be well aware of sectoral interconnectivity and will, therefore, equate the failure of any one institution with an increased likelihood of failure for all others.

If the negative externality generated by the failure of a commercial bank, through both interconnectivity and intra-market contagion, is sufficiently large to cause severe disruption to the operation of the market as a whole, then that bank is categorised as a systemically important institution (adopting Genberg’s definition of systemic importance).

An example of the damage that can be caused by a systemically important institution exiting the market is the bankruptcy of Lehman Brothers in 2008 (although an investment bank and not a commercial bank, the principles are transferable). When Lehman Brothers collapsed,

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286 Maes and Kiljanski (n 25) 13.
287 Lyons (n 4) 28; Frédéric Jenny, ‘The Economic and Financial Crisis, Regulation and Competition’ (2009) 32 World Competition 449, 449.
288 Genberg (n 283) 1.
the impact of this was felt immediately by firms with exposure to Lehman’s debt (an example of interconnectivity), and even firms who had no direct exposure to Lehman suffered (an example of domino-effect interconnectivity and intra-market contagion). The result of Lehman Brothers’ bankruptcy was the sharpest downturn in economic activity since the Great Depression.\textsuperscript{289}

Further, although the destabilising effects of the failure of a systemically important bank may be avoided through government intervention preventing such failure, this cannot occur without itself inducing instability. In an effort to prevent the catastrophic economic fallout associated with the failure of a systemically important institution, the EU Member States and the United States appear to have adopted a policy of implicitly and unlimitedly guaranteeing against the default of financial institutions that are deemed “too big to fail”.\textsuperscript{290}

Aside from the problem that size is an imperfect analogue for assessing whether or not an institution is systemically important (an issue which will be addressed in detail below), there are two arguments that lead to the conclusion that using “too big to fail” policy as a solution to the instability problem caused by systemically important institutions may itself result in a degree of sectoral instability.

First, “too big to fail” policy distorts the cautionary effect of incentives. The unlimited and unconditional guarantee implicit in “too big to fail” does not reprimand firms for the behaviour which led them into trouble, and does not, as a necessary corollary, dis-incentivise the pursuit of similar conduct in the future.\textsuperscript{291} Essentially, to paraphrase Timothy Geithner, “too big to fail” policy rewards the arsonists who set the system on fire in the first place.\textsuperscript{292}

Second, if one firm is able to invoke “too big to fail”, other similarly situated firms may believe that they too will have access to the government safety net should they begin to

\textsuperscript{289} Admati and Hellwig (n 2) 11.
\textsuperscript{290} Moosa (n 5) 1.
\textsuperscript{291} ibid 130; Savvides and Antoniou (n 2) 348; Commission communication on the return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the State aid rules 2009 (2009/C 195/04) 28.
flounder. Therefore, “too big to fail” is capable not only of distorting the incentives of the firm in receipt of assistance, but also the incentives of all firms in analogous positions\textsuperscript{293}.

The very presence of systemically important institutions in the commercial banking market poses a significant threat to sectoral stability. The damage that such institutions are capable of inflicting on competitors by exiting the market is unacceptably high, but guaranteeing against this failure distorts incentives and itself jeopardises market stability.

**Reducing the risk posed by systemically important banks through merger policy**

As discussed above, the hypothetical merger authority prioritising banking sector stability over all other considerations will be focussed on addressing the threat posed by systemically important banks. It will be suggested that this threat can be reduced by the adoption of three policies:

1. Typically, a merger creating or enlarging a systemically important institution should be prohibited;
2. however, a merger designed to prevent a systemically important institution from failing will be permitted if State assistance is unavailable;
3. a merger that does not create or enlarge a systemically important institution should be permitted.

When deciding which of these policies to invoke, the hypothetical authority must decide whether or not certain institutions are systemically important or will become so post-merger. Therefore, before moving to consider each of these ideas in detail, it is important to consider what attributes render a particular bank systemically important or not.

**Factors influencing systemic importance**

\textsuperscript{293} Moosa (n 5) 133; Savvides and Antoniou (n 2) 348; Commission communication on the return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the State aid rules (n 167).
The level of threat that the failure of an institution poses to the smooth functioning of the entire market - that institution’s systemic importance - is dependent on a number of factors. This section will describe the most commonly cited factors and discuss how they effect a commercial bank’s degree of systemic importance.

The first factor capable of influencing a firm’s level of systemic importance is that firm’s degree of connection to other firms in the market. This is a straightforward application of the interconnectivity mechanism through which damage spreads in the commercial banking market on the back of counterparty risk.\(^\text{294}\)

A second factor to consider when assessing whether a firm should be regarded as systemically important or not is the prevailing market condition. If the market is prosperous, competitors will be better able to withstand the negative externalities resulting from any institution’s exist from the market, therefore, fewer firms will be classed as systemically important. However, if the market is struggling, even the exit of a relatively small and unconnected firm may cause significant disruption to the financial system.\(^\text{295}\) For example, Moosa compares the US Government’s assistance to JP Morgan in their purchase of the failing Bear Stearns at the beginning of the financial crisis, to the US Government’s failure to intervene in the bankruptcy of Drexel Burnham Lambert in 1990. He suggests that the only reason why it was considered necessary to save Bear Stearns, but not the similar firm 18 years earlier, is that Bear Stearns had become systemically important as a result of the poor state of the market at the time.

A further factor that has been touted as affecting a commercial bank’s level of systemic importance is the extent to which its activities are homogeneous with those of its competitors. The rationale behind this is that if one institution fails, others with highly correlated risk profiles are also likely to be at threat.\(^\text{296}\) Although correlation may be an important consideration in assessing the strength of the market as a whole, the fact that

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\(^{295}\) Moosa (n 5) 119.

\(^{296}\) Loutskina (n 294) 8.
one bank’s activities are correlated to those of other banks cannot be used to label that first bank as systemically important. For example, the bank may fail for reasons entirely unrelated to its correlated risk profile, such as mismanagement, and not cause any significant disruption to the operation of the banking system.

A literal interpretation of the “too big to fail” idea would seem to imply that size alone is capable of determining an institution’s level of systemic risk. However, the consensus amongst academics appears to be that although there may be a correlation between the size of a commercial bank and whether it is systemically important, that relationship is not likely to be causative. To Loutskina, the size of an institution is only relevant as it implies information about that institution’s degree of interconnectedness with other firms in the market (a risk factor discussed above). Despite opinion to the contrary, a degree of causality between size and systemic importance may be present through the intra-market contagion mechanism. This hypothesis is based on the assumption that the level of concern felt by depositors when a bank collapses is more significant when that bank is larger. However, it has been difficult to find evidence to support this effect.

Moosa and Loutskina both suggest that an institution’s market share may act as an indicator of its level of systemic importance. Both authors appear to view market share in a similar manner as they view size, not in itself causative of systemic importance, but correlated with other factors that result in systemic risk. As with the size criterion, it is arguable that market share may have some direct effect on an institution’s systemic importance as the collapse of a dominant firm may have a larger effect on depositor confidence than the collapse of a firm with a smaller market share.

To conclude, the hypothetical merger authority, making decisions solely based on how they affect market stability, would designate a commercial bank as systemically important or not based primarily on two factors that directly and significantly relate to the level of systemic

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297 ibid 4; Moosa (n 5) 121.
298 Loutskina (n 294) 4.
299 ibid; Moosa (n 5) 121.
300 Moosa (n 5) 118.
301 Loutskina (n 294) 10.
risk posed by that institution: its level of interconnectedness and the prevailing market conditions. Two further factors, bank size and bank market share, could also be considered as they are certainly indicative of systemic importance (although imperfectly), and may have some direct impact on a bank’s level of systemic importance.

**Identifying systemically important institutions**

In order to be able to use the framework developed in this section to assess the actual merger decisions made by the Commission, a test that labels a specific commercial bank as systemically important or not must be selected. In the preceding section, the factors influencing the degree of systemic risk posed by the failure of a commercial bank were discussed and it was suggested that the hypothetical merger authority would place most emphasis on two considerations: how interconnected a bank is with other firms in the market; and the overall strength of the market. Therefore, the ideal test will take both these considerations into account. For the purposes of this study, it is also important that either the results of the test are available in the form of a list of systemically important banks, or that the test can be easily applied to readily available data to produce such a list.

In the discussion above, the definition of a systemically important institution as one whose failure would pose significant risk to the smooth functioning of the financial system was adopted. The problem with translating this theoretical definition into a test capable of labelling individual banks as systemically important is its highly subjective nature. The definition begs the question – what level of risk should be regarded as significant? Because of this subjectivity, an inescapable difficulty with the chosen methodology is selecting a test where the level of risk deemed significant by that test aligns with the level of risk that the hypothetical authority would deem significant. Although it is important to critically assess the thresholds selected by the various tests, it is acknowledged that it may be necessary to assume, for the purposes of creating an implementable framework for

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302 Genberg (n 283) 1.
assessment, that the level of risk that would be regarded as significant by the hypothetical authority is the same as the level of risk deemed significant by the chosen test.

Various tests for systemic importance have been proposed. These can largely be grouped into single factor and multi-factor tests. The following section will consider which test is the most appropriate to adopt when implementing this framework and assessing Commission merger decisions in the field of commercial banking.

*Single-factor tests*

Of the possible single-factor tests, one based on a measure of interconnectivity has the most theoretical attraction. This is because interconnectivity is a direct cause of systemic importance. However, there are no lists of banks ranked by degree of interconnectivity, and to measure a bank’s level of interconnectivity with other banks on the market would be a complex exercise requiring access to data on bank activities that is not publically available. For these reasons, tests based on proxies of interconnectivity (in particular bank size and market share) may be more appropriate for the purposes of implementing this framework.

The most considerable advantage of single-factor tests of systemic importance based on proxy measures of interconnectivity is the availability of data for assessing the systemic importance of individual banks. Data on bank size is readily available, and information on the market share of merging banks can be found in the merger decisions themselves.

However, there are difficulties with such tests. As discussed above, the size or market share of a commercial bank, although correlated with systemic risk, is not likely to be significantly causative of that risk. Therefore, any test based on size or market share is liable to produce false positives and false negatives (although tests may be tailored to be predominantly over or under-inclusive depending on the specific threshold chosen). By requiring a degree

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304 Loutskina (n 294) 4. Gives the example of two banks of equal size, one of which is highly active in the intra-bank credit market, and the other of which is not. She notes that both banks would be caught (or not) by a sized based test of systemic importance, despite their actual levels of systemic importance differing considerably.
of correlation between a number of proxy measures of interconnectivity, multi-factor tests (As discussed below) are able to reduce the number of false positives or false negatives produced, and are, therefore, attractive.

A significant problem with all the single factor tests discussed is that unless the thresholds for systemic importance are regularly updated to take this into account (and this does not appear to be the case)\textsuperscript{305}, no regard is given to the prevailing market conditions. As a result, the chosen threshold will be over or under-inclusive depending on the strength of the market when the test is carried out.

Although imperfect, using either size or market share as the measure of systemic importance when implementing this framework has the advantage that the necessary data is readily accessible. However, if the data is equally accessible, the use of a multi-factor test is to be preferred as this will limit the impact of the false positives and false negatives produced by individual proxy measures.

\textit{Multi-factor tests}

As there are multiple factors that affect a bank’s level of systemic importance, a system of assessment that takes multiple variables into consideration possesses considerable attraction. The Basel Committee on Banking Supervision has proposed a system of tiered capital buffer regulation. Under the proposed system, banks posing the highest level of systemic risk are required to have higher capital reserves than less systemically important banks\textsuperscript{306}. To facilitate the implementation of these recommendations, the Basel Committee has published two documents providing guidance on the categorisation of banks as systemically important or not. These documents relate respectively to banks regarded as


\textsuperscript{306} ibid 4.
having global systemic importance (G-SIBs)\textsuperscript{307} and banks with only domestic systemic importance (D-SIBs)\textsuperscript{308}.

The G-SIB methodology incorporates five indicators which reflect “the size of banks, their interconnectedness, the lack of readily available substitutes or financial institution infrastructure for the services they provide, their global (cross-jurisdictional) activity and their complexity” (emphasis not added)\textsuperscript{309}. The incorporation of these five indicators allows the G-SIB assessment to reduce the possibility of over or under-inclusiveness that was noted to be a potential pitfall of using single-factor tests (see above). The criteria created by the Basel Committee are used annually by the Financial Stability Board to create a list of G-SIBs. Therefore, it is very simple to categorise a bank as G-SIB or not. This is a significant point in favour of adopting this test when implementing the framework set out in this chapter.

The list of G-SIBs has been made based on largely similar criteria since 2011. The 2011 survey utilised banks’ year-end 2009 data. The marked similarity between the list produced in 2011\textsuperscript{310} and the list produced in 2014\textsuperscript{311} illustrates the most significant issue with the criteria created by the Basel Committee. In the period between year-end 2009 and year-end 2013 there have been significant shifts in the strength of the global financial markets\textsuperscript{312}. Despite this, because market conditions are not taken into consideration in the assessment criteria, there have been markedly few alterations to the institutions on the list.

Whereas the G-SIB framework sets out five factors and then gives detailed guidance on how these are to be measured, the D-SIB framework devolves to national authorities the responsibility of establishing an assessment methodology, stipulating only that regard should be had to size, interconnectedness, substitutability and complexity\textsuperscript{313}. As the

\textsuperscript{307} ibid 1.
\textsuperscript{308} Basel Committee and on Banking Supervision, ‘Consultative Document A Framework for Dealing with Domestic Systemically Important Banks’ 1.
\textsuperscript{309} Basel Committee on Banking Supervision (n 170) 5.
\textsuperscript{311} Financial Stability Board (n 61) 3.
\textsuperscript{312} FT Reporters, ‘Eurozone Crisis: The Road to Bailouts’ \textit{Financial Times} (17 October 2012) \url{http://www.ft.com/intl/cms/s/0/66717ac-c9a9-11e1-bf00-00144feabdc0.html#axzz3U8IFHkC5> accessed 12 March 2015.
\textsuperscript{313} Basel Committee and on Banking Supervision (n 308) 3.
assessment is carried out on a local basis, there is currently no published list of domestic systemically important banks. Therefore, this assessment method cannot be used when applying this framework to evaluate Commission merger decisions.

A potential further criticism of adopting the G-SIB test to identify systemically important banks when applying the framework is that it may be regarded as under-inclusive as it does not identify banks that have systemic importance on a domestic level. However, it is suggested that, if concerned about stability, the Commission would be concerned about stability at the EU level, not the domestic level and there is likely to be a significant level of correlation between banks posing a systemic risk to the European market, and banks posing a global systemic risk.

Unfortunately, none of the available tests (either single or multi-factor) is entirely reflective of how it has been suggested that the hypothetical merger authority would make its decisions (by emphasising both interconnectivity and market conditions). However, in order to apply the framework developed in this section to assess Commission merger decisions, it is necessary to select a test of systemic importance. The assessment in section 5.2 (below) will, therefore, utilise the list of G-SIBs created by the Financial Stability Board. This has the advantage that the list is readily accessible, created based on parameters set by experts, and incorporates multiple factors, thus limiting the potential for over and under-inclusiveness. Its unavoidable limitations are its failure to account for the condition of the financial markets and the subjectivity of threshold selection.

The approach to mergers creating or enlarging a systemically important institution

In this section and the two that follow, the three suggestions for how the hypothetical merger authority would attempt to limit the destabilising effect of systemically important commercial banks are discussed. To reiterate, these suggestions are:

1. Typically, a merger creating or enlarging a systemically important institution should be prohibited;
2. however, a merger designed to prevent a systemically important institution from failing will be permitted if State assistance is unavailable;

3. a merger that does not create or enlarge a systemically important institution should be permitted.

Turning to the first proposal. It was argued above that the very existence of systemically important banks poses a threat to market stability. Therefore, the hypothetical merger authority would attempt to prevent the level of systemic risk from increasing by blocking mergers which, if allowed, would create systemically important banks\(^{314}\). In such a situation, aspects of the proposed merger may be permitted using the modification process, but only if the post-modification proposals would not render the post-merger entity systemically important. Further, it was noted above that the size of commercial banks is highly correlated to the level of systemic risk that they pose. Therefore, the hypothetical merger authority would also attempt to prevent increases in the size of a systemically important commercial bank by absolutely prohibiting any merger that would entail its enlargement.

The only exception to this general rule is where the merger is capable of preventing the collapse of an established systemically important bank and there is no less-destabilising alternative to the merger. In this situation, the stabilising effect of the merger outweighs its potential to destabilise the market. This exception will be discussed in detail in the following section.

**The approach to mergers rescuing systemically important institutions**

The collapse of a systemically important commercial bank is an inherently destabilising occurrence. Therefore, it is something which the hypothetical merger authority (prioritising sectoral stability over all other considerations) would wish to prevent. It may be possible to save a commercial bank from failure by allowing it to merge with another firm, or by

\[^{314}\text{Moosa (n 4) 142 "Preventing financial institutions from growing too big" is one of three policy suggestions Moosa makes for dealing with the problem caused by too big to fail; Moura e Silva (n 12) 131. Moura e Silva recognises the capacity of merger policy to constrain the rise of systemically important financial institutions, although he argues that this is not the proper role of such policy.}\]**
providing it with State funds. However, these “solutions” also have potentially destabilising implications. This section will argue that the hypothetical merger authority would allow a merger to rescue a failing systemically important bank, but only when State assistance is not available. The argument will proceed by considering the extent to which each of the three possible outcomes (bank failure, survival by merger or survival by bailout) impact upon commercial banking sector stability.

Bailouts and rescue mergers are potentially destabilising because they increase the risk of bank failure or increase the level of damage that such a failure would likely cause to the market. In contrast, if a struggling systemically important commercial bank is permitted to fail, the effect of this is certain disruption of the commercial banking sector’s ability to perform its economic functions. It is this contrast between the certain destabilising effect of bank failure and the potential destabilising effect of bank rescues that means the worst possible decision (from a pure stability perspective) is to allow a systemically important commercial bank to fail.

As previously discussed, State support to struggling systemically important banks has a potentially destabilising effect on the market through two varieties of moral hazard: the first is the distortion of the incentives operating on the bank in receipt of State support; the second is the distortion of the incentives operating on similar firms in the market. Both varieties of moral hazard increase the likelihood that commercial banks will pursue overly-risky business practices which may result in their failure.

A rescue merger is a merger capable of preventing a firm, which would otherwise leave the market, from collapsing. If a systemically important commercial bank is permitted to engage in a rescue merger, this constitutes an exception to the general rule that the hypothetical merger authority would not permit mergers enlarging systemically important banks. Therefore, such a merger would, like direct State assistance, result in potentially destabilising moral hazard. However, rescue mergers have further potentially destabilising implications on top of the moral hazard shared with direct State assistance. For this reason,

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315 Riss and McGrath (n 11) 45.  
316 Maes and Kiljanski (n 25) 15.
rescue mergers should only be permitted when a failing systemically important commercial bank is unable to obtain State assistance.

In the case of direct State assistance to a failing systemically important commercial bank, the State is able to exert a significant degree of control over the structure and operations of the bank, to curtail its overly risky practices and ensure long-term viability\(^{317}\). In contrast, if the bank is stabilised by a rescue merger, the State will not obtain any continuing managerial influence. Instead, its ability to achieve changes to internal structure and behaviour will be limited to what can be secured by commitments at the time the merger is approved.

Further, rescue mergers, inherently, increase the size of the systemically important bank being rescued\(^{318}\). As discussed earlier, this increase in bank size is likely to correlate to an increase in interconnectivity and, therefore, the level of systemic risk posed by the bank in question. These two destabilising factors, lack of direct control and increase in bank size, make rescue mergers more destabilising than State assistance, and mean that such mergers would only be permitted by the hypothetical merger authority if direct State assistance cannot be obtained.

It has been suggested that the hypothetical merger authority, prioritising stability over all other considerations, would allow a merger to prevent a systemically important commercial bank from exiting the market, but only where direct State assistance is unavailable. This proposal has a number of similarities to the failing firm defence (discussed in section 4.1, above). However, there are also important differences between the two. The following paragraph will compare the failing firm defence with the proposed stability-promoting approach.

Section 4.1 outlines the three criteria (as stipulated by the horizontal merger guidelines) that must be fulfilled before the failing firm defence may be invoked. The first criterion is that, without the proposed merger, the allegedly failing firm would be forced out of the

\(^{317}\) ibid; Baudenbacher and Bremer (n 152) 283.

\(^{318}\) Maes and Kiljanski (n 25) 15.
market. This is also a requirement of the stability oriented approach to rescue mergers outlined above. A further criterion for failing firm is that, but for the merger, the assets of the firm will inevitably exit the market. This is not a requirement of the stability oriented approach; the damage to stability that results from a bank failure is not caused by the assets leaving the market, but through the two mechanisms, interconnectivity and intra-market contagion, described above. The final criterion for the failing firm test is that there is no less anticompetitive alternative to the merger. In the stability oriented approach, this criterion also applies, only the term “anticompetitive” would be replaced with the term “destabilising”. However, whichever term is used, both tests tend to prioritise State intervention and, if that is not available, settle for the least damaging possible merger (see section 4.1, above).

The approach to mergers not creating or enlarging a systemically important institution

In the preceding sections it was argued that the hypothetical merger authority prioritising sectoral stability over all other considerations would attempt, when making commercial banking merger decisions, to prevent any merger where the resulting entity would be a systemically important institution (aside from the narrow exception of a merger designed to prevent a systemically important institution from leaving the market where State assistance is unavailable). This section will consider how the hypothetical merger authority would act if the proposed merger would not result in the creation or enlargement of a systemically important institution. It will be suggested that such mergers would be allowed because there is no sufficiently conclusive body of evidence (theoretical or empirical) that indicates that the increased concentration resulting from the merger has any effect on market stability.

Although the envisaged merger will not create or enlarge a systemically important institution, it will have the effect of increasing the level of concentration within the geographic market for commercial banking; the result of this increased concentration is

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319 Horizontal Merger Guidelines (n 70), paragraph 76
320 Ibid
321 Ibid
likely to be a decrease in the level of competition in the market\textsuperscript{322}. In order to establish how a merger authority prioritising stability would act, it will, therefore, be necessary to consider the relationship between competition and stability in the commercial banking sector.

*Competition and stability – the theoretical perspective*

Early theoretical work suggested that competition may have a negative impact on banking sector stability. Cejnar and Duke\textsuperscript{323} summarise the two main reasons given for this hypothesis.

“First, the monopoly rents that come with market power may provide a buffer against adverse shocks. Secondly, banks with market power are less likely to take excessive risks... because the opportunity cost of going bankrupt is higher for such banks”\textsuperscript{324}

There are problems with each of these arguments. The first argument, that commercial banks making monopoly rents will use these to absorb adverse shocks, is premised upon the unsubstantiated assumption that banks receiving monopoly rents will use this revenue to increase their capital buffers. The second argument, that competition incentivises dangerous risk taking in the banking sector is particularly pervasive\textsuperscript{325}, but also problematic. Boyd and de Nicolo\textsuperscript{326} challenge this idea by considering the effect of increasing concentration on incentives from a different perspective. Boyd and de Nicolo argue that increased concentration allows commercial banks to issue loans at higher rates of interest. They suggest, for two reasons, that this will result in a higher rate of default by borrowers and, therefore, a tendency towards decreased stability in the sector. The first reason is


\textsuperscript{323}Cejnar and Duke (n 23) 583.

\textsuperscript{324}ibid 584.


increased default as a necessary corollary of higher interest rates. The second reason is that higher interest rates will create a moral hazard on borrowers who will “optimally increase their own risk of failure.”

The theoretical evidence regarding the effect of competition on banking sector stability is unclear. The argument that monopoly rents create a buffer against unexpected shocks is unsubstantiated, and the idea that competition incentivises destabilising risk taking by commercial banks is potentially nullified by the mechanism described by Boyd and de Nicolo through which decreased competition in the banking market increases the rate of defaults. Therefore, empirical evidence on the subject must be taken into account. Unfortunately, the available empirical evidence is equally conflicting.

*Competition and stability – the empirical perspective*

Boyd and de Nicolo loosely categorise studies on the effect of competition on banking stability into three groups. In the first group, the effect of banking deregulation on proxies for stability is considered. These studies assume that the relaxation of branching restrictions in the US has resulted in an increase in competition in the affected markets. They then compare proxy measures for stability before and after deregulation. Keeley finds that deregulation increases banking instability. Jayaratne and Strahan, however, reach the opposite conclusion.

The second group of studies utilise more defensible indicators of stability, but use bank size as a proxy for the level of competition in the given market. Within this group, Boyd and

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327 ibid 1329, 1330.
328 ibid 1333.
331 Boyd and De Nicolo (n 326) 1333.
Runkle\textsuperscript{332} find no relationship between competition and stability, contrasting sharply with the finding of de Nicolo that the relationship is positive and significant\textsuperscript{333}.

The final set comprises two more recent, but methodologically diverse studies\textsuperscript{334}. Beck, Demiruc-Kunt and Levine\textsuperscript{335} consider the levels of concentration in national banking markets subject to crises during the period 1980-1997. They find that there is a negative and significant relationship between concentration levels and the likelihood of a banking crisis. De Nicolo et al\textsuperscript{336} compare competition levels, as determined by a concentration ratio, with a measure of stability based on the probability of failure for the five largest national banks. On this basis, they find a positive and significant relationship between concentration and instability.

The grouping of studies by Boyd and de Nicolo illustrates that, even amongst methodologically comparable surveys, there is a fundamental lack of consensus regarding the effect of competition on banking sector stability.

\textit{Competition and stability - conclusions}

In conclusion, the available theoretical and empirical evidence on the relationship between banking sector competition and stability is insufficiently clear to draw a reliable conclusion either way (a sentiment shared by recent reviews of the literature)\textsuperscript{337}. Therefore, there is no reason why a merger authority absolutely prioritising sectoral stability would wish to interfere in a commercial banking merger which does not create or enlarge a systemically important institution, and, therefore, such mergers would be permitted.

\textsuperscript{334} Boyd and De Nicolo (n 326) 1334.
\textsuperscript{337} Jenny (n 287) 451; Cejnar and Duke (n 23) 584.
5.2 Are the merger decisions in the sample consistent with the promotion of commercial banking sector stability?

This section will employ the framework developed in section 5.1 (above) to assess the merger decisions in the sample. In section 5.1, it was argued that a merger authority desirous of promoting stability in the commercial banking sector would adopt three policies. To reiterate, these are:

1. Typically, a merger creating or enlarging a systemically important institution should be prohibited;
2. however, a merger designed to prevent a systemically important institution from failing will be permitted if State assistance is unavailable;
3. a merger that does not create or enlarge a systemically important institution should be permitted.

If a merger decision is consistent with these policies, then it will be regarded as consistent with the promotion of stability. In order to make this assessment, a series of questions must be asked of each merger decision in the sample. These questions can be presented as a dichotomous key (figure 1).

For the mergers in the sample, the answers to each of the questions in the key are displayed in Table 2 and Table 3 (below). Providing answers to two questions (first, whether the merger created or enlarged a G-SIB; and, second, whether the merger was designed to prevent a G-SIB exiting the market and State assistance was unavailable) posed some relative difficulty. The approach taken to answer these questions will, therefore, be discussed in the following paragraphs.
Did the merger create or enlarge a G-SIB?

In section 5.1 (above), it was argued that, for the purpose of this paper, a bank should be regarded as systemically important if present on the Financial Stability Authority’s list of global systemically important banks (G-SIBs). The list has been produced annually since 2011, when it was produced using year-end 2009 data (see section 5.1, above).

Therefore, in the case of merger decisions made during or after 2009, it is relatively simple to establish if the merger created or enlarged a G-SIB by looking to see if any one of the merging banks is on the list of G-SIBs produced in the year prior to the merger (this indicates a merger enlarging a G-SIB); or looking to see if the merged entity appears on the list of G-SIBs produced the year following the merger (this indicates a merger creating a G-SIB).

Applying this test, four of eight post-2009 merger decisions shall be regarded as enlarging a G-SIB. These are Santander Consumer Finance/El Corte Ingles/Financiera El Corte Ingles \(^{338}\),

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\(^{338}\) Case M.7078 (2014)
Barclays Bank/Egg Credit Card Assets\textsuperscript{339}; Banco Santander/Rainbow\textsuperscript{340}; and Credit Agricole/Casse Di Risparmio Della Spezia/Agences Intesa Sanpaolo\textsuperscript{341}.

The remaining four decisions, RZB/RBSPK/RWBB\textsuperscript{342}; Erste Bank/ASK\textsuperscript{343}; Credit Mutuel/Monobanq\textsuperscript{344}; and Credit Mutuel/Cofidis\textsuperscript{345}, neither created nor enlarged a G-SIB.

Because the FSA's list of G-SIBs has only been produced since 2011 (although on the basis of 2009 data), categorising pre-2009 merger decisions as creating/enlarging a G-SIB or not poses a problem. The chosen solution to this problem has been to extrapolate from the 2011 list when necessary.

Although, as discussed in section 5.1 (above), the size of a commercial bank is not a comprehensive indicator of its systemic importance, size (as measured by total asset value) is the attribute that forms the basis of the extrapolation exercise. This decision was made because, of the five indicators used by the Financial Stability Authority to create the G-SIB list (size; interconnectedness, the availability of substitutes; global activity; and complexity, see section 5.1, above), size is the only one for which historical data is easily obtainable for all of the banks in the sample. Although this is admittedly imperfect, it is defensible as size tends to be correlated to the other indicators used.

Therefore, a commercial bank will be regarded as having been systemically important at any point prior to 2009 if, at that moment, its total assets exceeded a threshold level. For reasons discussed below, the threshold level will be set at €800,000 million (as adjusted). Because the G-SIB criteria focus on the relative size of a bank, the threshold level will be adjusted to take into account the level of total assets in the market at the time of the merger\textsuperscript{346}. So, for example, if, at the time of the merger, the level of total assets was 50% of

\textsuperscript{339} Case M.6164 (2011)
\textsuperscript{340} Case M.5948 (2010)
\textsuperscript{341} Case M.5960 (2010)
\textsuperscript{342} Case M.7007 (2013)
\textsuperscript{343} Case M.5811 (2010)
\textsuperscript{344} Case M.5605 (2009)
\textsuperscript{345} Case M.5432 (2009)
\textsuperscript{346} Basel Committee on Banking Supervision (n 170) 5; Board of Governors of the Federal Reserve System (US), ‘Total Assets, All Commercial Banks’ (\textit{FRED, Federal Reserve Bank of St. Louis})
its 2009 level, a bank would be classed as a G-SIB if its total assets exceeded €400,000 million.

The threshold of €800,000 million was selected following an examination of the 2009 size (by total assets) of the banks on the 2011 G-SIB list (made using year-end 2009 data). The examination focused on the 11 banks headquartered in a Eurozone country (and thus releasing financial statements in euros). Of these banks, three have assets exceeding €1,500,000 million (Credit Agricole, BNP Paribas, Deutsche Bank). A further three banks had assets of between €1,000,000 million and €1,500,000 million (Banque Populaire, Société Générale, Banco Santander). Of the remaining five banks, three had assets of between €800,000 million and €1,000,000 million (ING Bank, Commerzbank, Unicredito), whilst two outliers, Dexia and Nordea, had assets of €577,630 million and €507,544 million respectively.

An €800,000 million threshold reflects the fact that the nine out of 11 of the Eurozone banks on the G-SIB list, in 2009, had total assets exceeding this figure. Admittedly, two of 11 banks had total assets below €800,000 million, therefore, the threshold may be under-inclusive. However, it would be wrong to simply set the threshold at the lowest level of total assets exhibited by the 2009 G-SIBs, because in these cases, the bank may be considered systemically important on the weight of other factors.

Information on banks’ total assets is contained in their annual reports. The reports containing the information related above, as well as any information required by the process detailed below, are listed in annex 2 (below).

As with the post-2009 decisions, a merger will be taken to have enlarged a G-SIB where either of the merging parties would have been considered to be a G-SIB prior to the merger. A merger will be considered to have created a G-SIB where, although neither party would

<https://research.stlouisfed.org/fred2/series/TLAACBQ158SBOG/> accessed 29 June 2015. Unfortunately, no data is available on the level of total commercial banking assets within the EU during the period in question. Therefore, data on total US commercial banking assets will be used on the assumption that the same general trends will be replicated in the EU.
have been considered a G-Sib before the merger, the merged entity would be regarded as a G-SIB. The difference to the exercise conducted in relation to the post-2009 decisions is that prior to conducting this analysis, the G-SIB list must be extrapolated. In the following paragraphs, the pre-2009 decisions that create a G-SIB, enlarge a G-SIB, or do neither, will be grouped, and a worked example for each will be provided.

Of the 11 merger decisions in the sample that were made before 2009, eight appear to have enlarged G-SIBs. These are: Deutsche Bank/ABN AMRO Assets\textsuperscript{347}; BNP Paribas/Fortis\textsuperscript{348}; Santander/Bradford and Bingley Assets\textsuperscript{349}; RBS/ABN AMRO Assets\textsuperscript{350}; Fortis/ABN AMRO Assets\textsuperscript{351}; Barclays/ABN AMRO\textsuperscript{352}; Deutsche Bank/Berliner Bank\textsuperscript{353}; and BNP Paribas/BNL\textsuperscript{354}. Of these, Deutsche Bank/Berliner Bank has been selected at random as a worked example.

The commercial banking market, as measured by total assets, was 1.20 times larger in 2009 than it was at the time of the Deutsche Bank/Berliner Bank merger\textsuperscript{355}. Prior to the merger, Deutsche Bank (the significantly larger of the merging institutions) had assets of €928,760 million. Adjusting for the change in the size of the market, Deutsche Bank’s assets were equivalent to €1,114,512 million in 2009. As €1,114,512 million exceeds the €800,000 million threshold, Deutsche bank should be regarded as having been a G-SIB prior to the merger, and the merger will, therefore, be categorised as having enlarged a G-SIB.

Two of the 11 pre-2009 decisions in the sample appear to have created a G-SIB. These are: Unicredito/HVB\textsuperscript{356} and Banco Santander/Abbey National\textsuperscript{357}. Of these, Unicredito/HVB will now be examined in detail as a worked example. In 2009, the commercial banking market, as measured by total assets, was 1.36 times larger than it was at the time of the merger\textsuperscript{358}. Prior to the merger, HVB (the larger of the merging institutions) had total assets of €467,400

\textsuperscript{347} Case M.5296 (2008)  
\textsuperscript{348} Case M.5384 (2008)  
\textsuperscript{349} Case M.5363 (2008)  
\textsuperscript{350} Case M.4843 (2007)  
\textsuperscript{351} Case M.4844 (2007)  
\textsuperscript{352} Case M.4692 (2007)  
\textsuperscript{353} Case M.4356 (2006)  
\textsuperscript{354} Case M.4155 (2006)  
\textsuperscript{355} Board of Governors of the Federal Reserve System (US) (n 346).  
\textsuperscript{356} Case M.3894 (2005)  
\textsuperscript{357} Case M.3547 (2004)  
\textsuperscript{358} Board of Governors of the Federal Reserve System (US) (n 346).
million. When multiplied by 1.36 to adjust for the change in the size of the market, this comes to €635,700 million. As this figure is less than the €800,000 million threshold, then HVB was not a G-SIB prior to the merger, and, therefore, the merger cannot be considered to have enlarged a G-SIB. Following the merger, the merged entity had total assets of €787,000 million. Adjusting for the change in the size of the market, this would be equivalent to €1,070,320 million in 2009. As this is above the €800,000 million threshold, the merged entity would be considered a G-SIB and, therefore, the merger should be regarded as having created a G-SIB.

The final decision, Danske Bank/Sampo Bank\(^\text{359}\), neither created nor enlarged a G-SIB. In 2009, the banking market was 1.19 times larger than it was at the time of the merger\(^\text{360}\). Prior to the merger, Danske Bank (the larger of the parties to the merger) had assets of €367,622 million (2,739,361 DKr m)\(^\text{361}\), equivalent to €437,470 million in 2009. As €437,470 million is less than the €800,000 million threshold, Danske Bank was not a G-SIB prior to the merger. The post-merger entity had total assets of €448,837 million (3,349,530 DKr m)\(^\text{362}\). This is equivalent to €534,116 million in 2009. As this is still less than the €800,000 million threshold, the post-merger entity would not be considered to be a G-SIB, and the merger cannot be regarded as either enlarging or creating a G-SIB.

*Merger designed to prevent the G-SIB from exiting the market and State assistance unavailable?*

If a merger is considered to have either created or enlarged a systemically important bank, then a further question will be considered. This question is whether or not the merger was designed to prevent the G-SIB from exiting the market and State assistance was unavailable. The question may be split into two sub-questions, the first one being: was the merger designed to prevent a G-SIB from exiting the market? If this first sub-question is answered

\(^{359}\) Case M.4484 (2007)  
\(^{360}\) Board of Governors of the Federal Reserve System (US) (n 346).  
\(^{361}\) [http://www.x-rates.com/average/?from=DKK&to=EUR&amount=1&year=2006](http://www.x-rates.com/average/?from=DKK&to=EUR&amount=1&year=2006)  
\(^{362}\) [http://www.x-rates.com/average/?from=DKK&to=EUR&amount=1&year=2007](http://www.x-rates.com/average/?from=DKK&to=EUR&amount=1&year=2007)
affirmatively, then a second sub-question must be answered: was State assistance unavailable?

The question of whether or not the merger was designed to prevent a G-SIB from exiting the market was answered by looking for indications of this fact in the decision itself, as well as any indications in reliable, contemporaneous media reports. For the sample of mergers investigated in this paper, the question was universally answered in the negative. Therefore, how the second sub-question would be approached need not be discussed.

Two merger decisions, Santander/Bradford & Bingley Assets\textsuperscript{363} and Banco Santander/Rainbow involved the purchase from the state of the assets of a bank that was nationalised to prevent its failure. Although these mergers occurred following and because of banks experiencing distress, it is argued that neither decision can be regarded as being designed to prevent the failure of the G-SIB. Essentially, it is argued that the State acted to promote stability when initially nationalising the banks, but the subsequent asset sales were independent of any systemic risk considerations. In the following paragraphs, each decision will be discussed in turn.

From September 2008, Bradford and Bingley was experiencing significant financial difficulty. As a result of this, the bank was nationalised by the British government on 29 September 2008\textsuperscript{364}. The British Government decided to retain Bradford and Bingley’s (primarily) mortgage assets, and to sell its viable retail deposits and branch network\textsuperscript{365}. The Santander/Bradford & Bingley Assets\textsuperscript{366} decision concerned the purchase by Santander of these retail deposits and the branch network of Bradford and Bingley\textsuperscript{367}. Although the origin of this purchase was the financial difficulties of Bradford and Bingley, it is suggested that, for two reasons, the merger cannot be regarded as having been designed to prevent Bradford and Bingley from failing. First, Bradford and Bingley was already in the hands of the British

\textsuperscript{363} Case M.5363 (2008)
\textsuperscript{364} the European Commission, ‘State Aid: Commission Approves UK Rescue Aid Package for Bradford & Bingley’ 1 <file:///C:/Users/Christopher/Downloads/IP-08-1437_EN.pdf>.
\textsuperscript{365} The Treasury, ‘Memorandum from Bradford and Bingley’ <http://www.publications.parliament.uk/pa/cm200809/cmselect/cmtreasy/144/144w119.htm>.
\textsuperscript{366} Case M.5363 (2008)
\textsuperscript{367} Ibid
government, so was no longer at risk of collapse. Second, the assets purchased were independently viable.

The Banco Santander/Rainbow\textsuperscript{368} merger occurred as a result of mandatory divestments required of RBS in return for permitting State aid to the bank\textsuperscript{369}, designed to prevent its collapse\textsuperscript{370}. The purpose of requiring the divestment was twofold. First, it would generate resources that limit the need for further aid; second, it would limit the moral hazard resulting from the grant of State aid\textsuperscript{371}. Therefore, although the divestment and, thus, the merger arose out of the stabilisation of RBS, it cannot be said that the purpose of the merger was to prevent RBS from failing.

Table 2 – Do pre-crisis mergers reflect the promotion of stability?

<table>
<thead>
<tr>
<th>Merger Name?</th>
<th>Merger permitted without modification?</th>
<th>Merger permitted following modification?</th>
<th>Merger denied?</th>
<th>Did the merger create or enlarge a G-SIB?</th>
<th>Merger designed to prevent the G-SIB from failing and State assistance unavailable?</th>
<th>The merger reflects banking sector stability?</th>
</tr>
</thead>
<tbody>
<tr>
<td>DEUTSCHE BANK / ABN AMRO ASSETS\textsuperscript{372}</td>
<td>✓</td>
<td>X</td>
<td>X</td>
<td>Enlarged</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>BNP PARIBAS / FORTIS\textsuperscript{373}</td>
<td>X</td>
<td>✓</td>
<td>X</td>
<td>Enlarged</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>SANTANDER / BRADFORD &amp; BINGLEY ASSETS\textsuperscript{374}</td>
<td>✓</td>
<td>X</td>
<td>X</td>
<td>Enlarged</td>
<td>X</td>
<td>X</td>
</tr>
</tbody>
</table>

\textsuperscript{368} Case M.5948 (2010)
\textsuperscript{369} Case M.5948 (2010); State aid No N 422/2009; State aid N 621/2009
\textsuperscript{371} ibid.
\textsuperscript{372} Case M.5296 (2008)
\textsuperscript{373} Case M.5384 (2008)
\textsuperscript{374} Case M.5363 (2008)
<table>
<thead>
<tr>
<th>Merger Name</th>
<th>Merger permitted without modification?</th>
<th>Merger permitted following modification?</th>
<th>Merger denied?</th>
<th>Did the merger create or enlarge a G-SIB?</th>
<th>Merger designed to prevent the G-SIB from failing and State assistance unavailable?</th>
<th>The merger reflects banking sector stability?</th>
</tr>
</thead>
<tbody>
<tr>
<td>DANSKE BANK / SAMPO BANK</td>
<td>✓</td>
<td>X</td>
<td>X</td>
<td>Neither</td>
<td>N/A</td>
<td>✓</td>
</tr>
<tr>
<td>RBS / ABN AMRO ASSETS</td>
<td>✓</td>
<td>X</td>
<td>X</td>
<td>Enlarged</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>BARCLAYS / ABN AMRO</td>
<td>✓</td>
<td>X</td>
<td>X</td>
<td>Enlarged</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>FORTIS / ABN AMRO ASSETS</td>
<td>X</td>
<td>✓</td>
<td>X</td>
<td>Enlarged</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>DEUTSCHE BANK / BERLINER BANK</td>
<td>✓</td>
<td>X</td>
<td>X</td>
<td>Enlarged</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>BNP PARIBAS / BNL</td>
<td>✓</td>
<td>X</td>
<td>X</td>
<td>Enlarged</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>UNICREDITO / HVB</td>
<td>✓</td>
<td>X</td>
<td>X</td>
<td>Created</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>BANCO SANTANDER / ABBEY NATIONAL</td>
<td>✓</td>
<td>X</td>
<td>X</td>
<td>Created</td>
<td>X</td>
<td>X</td>
</tr>
</tbody>
</table>

Table 3 – Do post-crisis mergers reflect the promotion of stability?

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375 Case M.4484 (2007)  
376 Case M.4843 (2007)  
377 Case M.4692 (2007)  
378 Case M.4844 (2007)  
379 Case M.4356 (2006)  
380 Case M.4155 (2006)  
381 Case M.3894 (2005)  
382 Case M.3547 (2004)
In chapter 6 (see below), the results displayed in tables 2 and 3 (above) will be combined with the results of the investigation contained in chapter 4 (above) to enable final conclusions to be drawn.

### Chapter 6 – Conclusions

**6.1 Conclusions**

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383 Case M.7078 (2014)
384 Case M.7007 (2013)
385 Case M.6164 (2011)
386 Case M.5811 (2010)
387 Case M.5948 (2010)
388 Case M.5960 (2010)
389 Case M.5605 (2009)
390 Case M.5432 (2009)
This paper is attempting to establish whether or not the European Commission has taken stability into consideration when making horizontal merger decisions in the commercial banking sector. The methodology outlined in chapter 3 (above) suggested that to provide a defensible answer to this question, it would be necessary to first address two sub-questions, the answers to which would then be combined to allow overall conclusions to be drawn.

These sub-questions were:

1. Does the decision appear to reflect the Commission’s interpretation of the Merger Regulation as set out in the Commission’s horizontal merger guidelines?
2. Does the decision reflect the promotion of stability in the commercial banking sector?

The questions were addressed in chapters 4 and 5 respectively (see above).

The methodology outlined in chapter 3 proposed that the answers to these two questions be combined using an assessment framework (table 1), with the distribution of Commission merger decisions between the squares of the framework allowing inferences to be drawn regarding the Commission’s merger policy. The completed assessment framework is shown in table 4 (below).
Table 4 – The Completed Assessment Framework

<table>
<thead>
<tr>
<th>Does the decision appear to reflect the Commission’s interpretation of the Merger Regulation?</th>
<th>YES</th>
<th>NO</th>
</tr>
</thead>
<tbody>
<tr>
<td>Does the decision reflect the promotion of stability in the commercial banking sector?</td>
<td>YES</td>
<td>5</td>
</tr>
<tr>
<td>NO</td>
<td>10</td>
<td>4</td>
</tr>
</tbody>
</table>

The potential implications of the distribution of decisions between the boxes of Table 4 will now be discussed.

Of the 19 decisions in the sample, only five were considered to have reached the same outcome that would have been reached if the decision had been taken on the basis of criteria aimed at ensuring the stability of the commercial banking sector. Taken alone, this low figure indicates that the Commission has not, during the entire period 2004-2015, had a general policy of making commercial banking merger decisions to increase stability in the sector.

The top right-hand box of Table 4 represents the situation where the Commission both departs from its own merger guidelines, and the resulting decision reflects commercial banking sector stability. Had this box been populated, it may have been possible to infer that the Commission, in certain circumstances, departed from its guidelines with the aim of promoting sectoral stability. However, none of the decisions from the sample have been placed in this box.
Therefore, two conclusions can be drawn from Table 4. First, it is evident that, between 2004 and 2015, the Commission did not have a general policy of taking stability into consideration when making commercial banking sector merger decisions. Second, the Commission did not, during the same period, make any individual merger decisions on the basis of stability. Thus Table 4 allows the research question with which this paper is concerned to be answered firmly in the negative.

However, two questions remain. First, as noted in section 3.2 (above), it is possible that the Commission’s approach to commercial banking sector mergers was affected by the financial crisis that began in 2008. Therefore, the pre and post-2008 commercial banking sector merger decisions will be analysed separately to see if any distinct trends may be discerned. Second, in four instances (as represented by the bottom right-hand box of Table 4) the Commission potentially departed from its merger guidelines for some reason other than a desire to promote banking sector stability. These decisions will be briefly considered, and possible reasons why the Commission disregarded its guidelines in each case will be discussed.

**Commission merger policy before and after the financial crisis**

In Tables 5 and 6 (below), the information contained in Table 4 (above) has been divided on the basis of whether the merger decision was made before or after the commencement of the financial crisis. As noted in section 3.2 (above), for the purpose of this investigation, the financial crisis is considered to have commenced on 15 September 2008, when Lehman Brothers filed for bankruptcy.
Table 5 – The Completed Assessment Framework, pre-crisis

<table>
<thead>
<tr>
<th>Does the decision appear to reflect the Commission’s interpretation of the Merger Regulation?</th>
<th>YES</th>
<th>NO</th>
</tr>
</thead>
<tbody>
<tr>
<td>Does the decision reflect the promotion of stability in the commercial banking sector?</td>
<td>YES</td>
<td>1</td>
</tr>
<tr>
<td>NO</td>
<td>6</td>
<td>4</td>
</tr>
</tbody>
</table>

Table 5 (above) contains the distribution of those commercial banking merger decisions made before the commencement of the financial crisis. The implications of the distribution will be considered in the following paragraphs.

Of the 11 decisions in Table 5, 10 result in an outcome that differs from that which would have been reached had the decision been based on a desire to promote stability in the commercial banking sector. Further, the one decision that is in line with stability is also consistent with the Commission’s merger guidelines. This overwhelmingly indicates that the Commission did not adopt a comprehensive policy of making decisions on the basis of promoting sectoral stability during this period.

In the discussion regarding Table 4 (above), it was noted that on four occasions during the period 2004-2015 the Commission made decisions that were not in compliance with their merger guidelines (and also not reflective of a desire to promote banking sector stability). As can be seen from the bottom right-hand box of Table 5, all of these instances occurred prior to the commencement of the financial crisis.
Therefore, a number of conclusions may be made regarding the Commission merger policy prior to the financial crisis. First, the Commission certainly did not base its decisions on a desire to promote banking sector stability. Second, the Commission did not adhere religiously to its merger guidelines (with four of 11 cases departing from the result that would have been reached had the guidelines been followed). Although it is evident that the Commission did not depart from the guidelines through a desire to ensure sectoral stability, it is unclear why they were not followed. This question will be further explored below.

Table 6 – The Completed Assessment Framework, post-crisis

<table>
<thead>
<tr>
<th>Does the decision appear to reflect the Commission’s interpretation of the Merger Regulation?</th>
<th>YES</th>
<th>NO</th>
</tr>
</thead>
<tbody>
<tr>
<td>Does the decision reflect the promotion of stability in the commercial banking sector?</td>
<td>YES</td>
<td>4</td>
</tr>
<tr>
<td>NO</td>
<td>4</td>
<td>0</td>
</tr>
</tbody>
</table>

Table 6 (above) contains the distribution of those commercial banking merger decisions made after the beginning of the financial crisis. The implications of this distribution will be considered below.

The most striking feature of the distribution is that all eight decisions appear to be consistent with the Commission’s merger guidelines. This contrasts with the pre-crisis distribution (Table 5), where four of 11 decisions appeared to reach results other than those mandated by the guidelines (these decisions will be further analysed below).
Of the eight post-crisis merger decisions, four appear to reach the same result that would have been reached had the decision been taken on the basis of criteria aimed at ensuring stability in the commercial banking sector (the top left-hand box of Table 6), whereas the other four do not (the bottom left-hand box of Table 6). This implies that, during the period 2008-2015, the Commission has had a policy of following its merger guidance, regardless of how this will impact on commercial banking sector stability.

In section 1.3 (above), it was suggested that following the commencement of the recent financial crisis, the Commission may have altered its mergers policy to take into account stability concerns as it did explicitly with its State aid policy. It was also observed that some commentators (including Robert Lane\textsuperscript{391}) have suggested that the Commission has made such a change. The conclusions that have been drawn from Table 6 show that these suggestions are incorrect. Rather, Neelie Kroes’s assertion that the Commission would continue to apply the existing merger rules during the crisis\textsuperscript{392} has proven to be correct.

**Why has the Commission departed from its merger guidelines?**

It was observed in the preceding sections that on four occasions prior to the commencement of the financial crisis, the Commission appears to have made merger decisions that depart from the merger guidelines for reasons other than a desire to ensure stability in the commercial banking sector. In this section, those decisions will be briefly discussed, and potential reasons why the guidelines were not followed in each instance will be suggested. However, a comprehensive examination of this question is beyond the scope of this paper.

The four merger decisions in question are Unicredito/HVB\textsuperscript{393}; Barclays/ABN AMRO\textsuperscript{394}; RBS/ABN AMRO Assets\textsuperscript{395}; and Fortis/ABN AMRO Assets\textsuperscript{396}. Unicredito/HVB concerned the

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\textsuperscript{391} Lane (n 27) 503.
\textsuperscript{393} Case M.3894 (2005)
\textsuperscript{394} Case M.4692 (2007)
\textsuperscript{395} Case M.4843 (2007)
\textsuperscript{396} Case M.4844 (2007)
proposed merger of Unicredito, based in Italy, and HVB, based in Germany. The merger was
permitted without modification and created a G-SIB (see section 5.2, above). Barclays/ABN
AMRO related to the proposed purchase of Dutch banking group ABN AMRO by Barclays, an
international banking group based in the UK. The proposed purchase was permitted without
modification and would have enlarged a G-SIB (see section 5.2, above). RBS/ABN AMRO
Assets and Fortis/ABN AMRO Assets both relate to aspects of a rival bid for the purchase of
ABN AMRO made by a consortium composed of RBS (based in the UK), Fortis (based in
Belgium) and Santander (based in Spain). The purchase of ABN AMRO Assets by RBS was
allowed without modification. The purchase would have enlarged a G-SIB (see section 5.2,
above). The purchase of ABN AMRO Assets by Fortis was permitted only following
modifications. The merger as permitted would have enlarged a G-SIB (See section 5.2,
above). For further detail on each of the decisions, see section 4.2 (above).

There are a number of potential explanations why these cases were decided in a manner
that does not appear to accord with the merger guidelines. Some potential explanations
may be immediately dismissed. For example, it is possible to speculate that decisions may
display differing levels of compliance with the guidelines dependent upon whether they
were made at phase 1 or at phase 2. However, this potential explanation is clearly
inapplicable to the present situation, because all decisions in the sample were made
following a phase 1 investigation (see section 2.2, above).

Other potential explanations appear plausible, but would require further detailed
investigation before they could be confirmed. For example, Thatcher suggests that the
Commission is using its merger decisions to pursue a policy of creating “larger European
firms” through cross-border mergers. Thatcher even makes specific reference to the
RBS/ABN AMRO Assets and Fortis/ABN AMRO Assets decisions as potential examples
of this policy. It was observed above that each of the transactions which the Commission
permitted in apparent breach of its guidelines would result in the creation or enlargement

397 Thatcher (n 26) 460.
398 ibid 456.
399 ibid 457.
of G-SIBs. As G-SIBs would likely constitute “larger European firms”, Thatcher’s explanation seems tenable.

A further potential explanation for the Commission’s disregard of the merger guidelines in these instances is that the transactions in question may have had an unusual degree of political support. The purchase of ABN AMRO was Europe’s largest ever banking takeover\(^{400}\). As such, it may have had a level of prestige, generating political support. However, it has been difficult to find any real suggestion of unusual political encouragement for any of the deals in question, rather, any retrospective analysis of the ABN AMRO deals, for example, focuses on the driving influence of personalities within the relevant institutions\(^{401}\). However, more research would be needed before this potential explanation could be dismissed.

Aside from the explanations considered above, there are probably many further potential reasons why the Commission failed to follow its merger guidelines in some instances. This is a question that would benefit from significant further research, that is, unfortunately, beyond the scope of the present piece.

**Conclusions and implications**

This paper has established that, between 2004 and 2015, the European Commission did not base its commercial banking merger decisions on considerations aimed at ensuring sectoral stability. Not only did the Commission not have a *general* policy of promoting stability through its merger decisions, it also failed to take stability into account in any individual instances. This conclusion remains the same when the Commission’s pre and post-crisis decisions are considered separately.

This paper has, however, identified four merger decisions made prior to the financial crisis where the Commission does not appear to have followed its merger guidelines. In the


preceding section, potential reasons why the guidelines were not followed in these instances were suggested. However, without detailed investigation (which would be beyond the scope of this piece), the reasons remain unclear. This is a potential area for further research. Such research may be carried out using a modified version of the methodology adopted by this paper.

This paper utilised a three-stage methodology. First, the merger decisions in the sample were examined to establish whether or not they appeared to be consistent with the Commission’s merger guidelines. Second, the merger decisions were again scrutinised, to determine whether they reflected a desire on the part of the Commission to promote stability. Finally, the results of the first two stages were combined, allowing conclusions to be drawn. It is suggested that this is a compelling and scientific method resulting in defensible results. If carefully modified, the method may be adapted by other studies seeking to identify whether or not a particular consideration has taken into account by the European Commission when making merger decisions.

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Annex 1 – Merger Decisions

Post-crisis merger decisions

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RZB / RBSPK / RWBB Case M.7007 (2013)
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ERSTE BANK / ASK Case M.5811 (2010)
BANCO SANTANDER / RAINBOW Case M.5948 (2010)
CREDIT AGRICOLE / CASSA DI RISPARMIO DELLA SPEZIA / AGENCES INTESA SANPAOLO Case M.5960 (2010)
CREDIT MUTUEL / MONABANQ Case M.5605 (2009)
CREDIT MUTUEL / COFIDIS Case M.5432 (2009)

Pre-crisis merger decisions

DEUTSCHE BANK / ABN AMRO ASSETS Case M.5296 (2008)
BNP PARIBAS / FORTIS Case M.5384 (2008)
SANTANDER / BRADFORD & BINGLEY ASSETS Case M.5363 (2008)
DANSKE BANK / SAMPO BANK Case M.4484 (2007)
RBS / ABN AMRO ASSETS Case M.4843 (2007)
BARCLAYS / ABN AMRO Case M.4692 (2007)
FORTIS / ABN AMRO ASSETS Case M.4844 (2007)
DEUTSCHE BANK / BERLINER BANK Case M.4356 (2006)
BNP PARIBAS / BNL Case M.4155 (2006)
UNICREDITO / HVB Case M.3894 (2005)
BANCO SANTANDER / ABBEY NATIONAL Case M.3547 (2004)

Annex 2 – Bank Annual Reports
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