

Can Canada Still Compete — Don't Bank On It

.....
*By John F. Clifford and J. William Rowley, Q.C.
McMillan Binch*

Spurred by a wave of major bank consolidation in Europe and the US, four of Canada's five largest banks, the Royal Bank of Canada and the Bank of Montreal and the Canadian Imperial Bank of Commerce (CIBC) and Toronto Dominion (TD), proposed mergers early in 1998. By the end of the year, Finance Minister Paul Martin had said no to both. Since then, Canada has witnessed a second wave of merger activity abroad that, coupled with significant advances in technology and the rapid growth of Internet banking, suggests the time is ripe for Ottawa to rethink its position.

What Happened in 1998?

In Canada, authority to review bank mergers is split three ways, among the Competition Bureau and Tribunal, the Office of the Superintendent of Finance (OSFI), and the Minister of Finance. The Competition Bureau investigates whether mergers are likely to lessen or prevent competition substantially, while the OSFI addresses prudential considerations. But it is the Minister of Finance who has the final say, based on whether a merger, on the whole, is in the public interest.

The Minister denied the 1998 mergers because he felt they would reduce competition, concentrate economic power in the hands of a few, and reduce the government's ability to address potential instability the two resulting mega-banks might engender. The Minister's bottom line at the time was also made clear: the government would consider no new big bank mergers until it had instituted its planned new policy framework for the financial sector.

The 1998 proposed mergers also may have been dogged by procedural glitches. Even though the Royal Bank/Montreal merger was announced three months before the CIBC/TD merger, the two were reviewed concurrently. Moreover, because of the Minister of Finance's role in the process, the Competition Bureau bucked normal procedure and reported its preliminary conclusions without first having attempted to negotiate remedies with the parties, a step which facilitated a Ministerial rejection.

What Has Changed?

In 1998, the Bureau was sceptical of both the pace of technological change and the level of competition Canadian banks would face globally, two of the main drivers for the proposed mergers. The Minister did not take issue with the Bureau's conclusions. Since the Minister's decision, technological innovation and Internet banking have taken off in ways many had not anticipated. What is more, recent events make clear that Canadian banks will soon face competition from a growing breed of super-banks.

Throughout Europe, the US and Japan, consolidation has allowed big banks to cut their costs and create internationally competitive institutions. In the past few

months alone, some of the most significant merger activity has occurred.

In Japan, Sanwa Bank, Japan's fourth largest, announced a planned three-way merger with Tokai Ltd and Asahi Bank, to form what may be the world's second largest bank. Ultimately, Japan will boast the world's largest bank as well, when the planned merger of Industrial Bank of Japan, Fuji and Dai-Ichi is consummated sometime before 2005. Just before the Sanwa announcement, Germany's Deutsche Bank, the largest European bank, had announced its intention to merge with Dresdner Bank. The merged entity initially would have been the world's largest bank. Although the attempted merger surprisingly fell through because of cultural disagreements between the banks, it remains significant because of the consolidation it will likely still kindle in Germany and Europe.

These recent announcements are expected to ignite still more consolidation throughout the world. However, similar movement is not likely here at home, where banks are wary of taking any action until the government changes its stance. Thus, the prospect of Canada's banks competing successfully against these global giants is looking grim.

Why Change Now?

The Japanese mergers and similar mergers throughout Europe admittedly will cause substantial lay-offs. Even so, business analysts and political commentators alike embrace them. Despite job losses in Germany that would have followed the thwarted Deutsche merger, Chancellor Gerhard Schröder welcomed the announcement, emphasizing that the merger would have created new opportunities and allowed the banks to play a strong role in international financial markets. Notably, the job loss posed by the 1998 Canadian bank mergers would have been far less than that Germany would have faced. Today, Canada's situation is even better. The Canadian economy is operating at capacity; basically, anyone who wants a job can work. Arguably, then, this is the ideal time to restructure Canada's financial services.

Moreover, the popular wisdom now almost uniformly accepts that the Internet and e-banking are greatly reducing the importance of branch banks, an area that concerned the Bureau in 1998.

When the Canadian government issued its new policy framework in June 1999, it listed as one of its four principles providing Canadian financial institutions the flexibility to adapt to the changing marketplace and to compete and thrive both at home and abroad. The spate of merger activity anticipated in the coming months clearly indicates that the world today is not what it was in 1998, and that the government must reconsider its position now if Canadian banks are to compete successfully domestically and globally.