STATEMENT OF DEBORAH A. GARZA

BEFORE THE UNITED STATES HOUSE OF REPRESENTATIVES
COMMITTEE ON THE JUDICIARY
SUBCOMMITTEE ON COURTS AND COMPETITION POLICY

OVERSIGHT HEARING ON

"'TOO BIG TO FAIL?' ": THE ROLE OF ANTITRUST LAW IN GOVERNMENT-FUNDED CONSOLIDATION IN THE BANKING INDUSTRY"

March 17, 2009
Room 2141, Rayburn House Office Building

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Committee Chairman Conyers, Subcommittee Chairman Johnson, Ranking Member Coble, and other distinguished members of the House Judiciary Committee's Subcommittee on Courts and Competition Policy, it is a privilege to be invited to speak to you today about the important question of the role of antitrust policy and enforcement in the current financial crisis. I am not appearing today on behalf of any organization. From 2004 to 2007, however, I served as Chair of the Antitrust Modernization Commission (AMC). From May 2007 to January 2009, I served first as Deputy Assistant Attorney General for Regulatory Affairs and then as Acting Assistant Attorney General in charge of the U.S. Justice Department Antitrust Division. I do not purport to express the views of either the AMC or the Justice Department today, although I will discuss several relevant recommendations of the AMC.

Before discussing the AMC's recommendations, I would like to make a few points in response to the Subcommittee's specific questions about what role antitrust should and can play in bank mergers today, particularly those funded by the Troubled Asset Relief Program (TARP), and whether the antitrust laws should be used to block mergers that would produce financial firms that would be "too big to fail" on that basis. Those points can be summarized as follows:

- Antitrust enforcement and sound competition policy remain as relevant in the current financial crisis as ever. Competitively operating financial markets drive economic growth and ensure that consumers benefit from lower prices, higher quality, innovation, and diversity of products. Although we urgently need to strengthen and protect the banking system in order to prevent further deterioration of the economy, we must also be mindful of the longer term, competitive effects of consolidation.

- There is no apparent conflict between current antitrust enforcement policy and achieving stability in interbank money markets. The Justice Department's Antitrust Division should continue to assess the likely competitive effects of mergers, including those funded through TARP or involving banks in which the U.S. Government has taken an equity interest.

- There is no evidence that the current economic crisis resulted from a failure of antitrust merger enforcement in the banking industry or that current merger law needs to be changed to address bank mergers. Antitrust enforcement should continue to focus on whether markets are functioning competitively, rather than on whether a bank or other financial firm is "too big" or "systemically significant" to fail, which presents political and regulatory issues better handled outside the realm of antitrust enforcement.

The Continued Relevance of Antitrust

The Subcommittee has asked specifically about the role of antitrust enforcement where bank consolidation is being encouraged by the U.S. government, perhaps facilitated by the provision of TARP funds or in lieu of a government takeover. I understand that the Justice Department has reviewed the likely competitive effects of such transactions in cooperation with the banking agencies and obtained structural relief where it deemed it appropriate in order to protect competition.

For example, with respect to the acquisition by PNC Financial Services Group of National City Corporation in December 2008, the parties agreed to sell 61 of National City's branch banking offices in western Pennsylvania, which had deposits of about $4.1 billion as of June 30, 2008.[1] The parties also agreed to divest about half of National City's lending and related businesses with middle market customers in the Pittsburgh area and virtually all of that business in the Erie area. The divestitures were designed to ensure the continued benefits of competition for consumers, small businesses, and middle-market businesses (generally, businesses with lending needs of more than $1 million). The merging firms committed to the Federal Reserve Board (FRB) to comply with the agreement with the Justice

[1] See Justice Department Requires Divestiture in Acquisition of National City Corporation by the PNC Financial Services Group, Press Release dated Dec. 11, 2008, available at http://www.usdoj.gov/atr/public/press_releases/2008/240315.htm.

Department, and those commitments were to be included in any order issued by the FRB approving the transaction.

The basic approach the Justice Department takes to bank mergers, as illustrated by PNC/National City, is set forth in Bank Merger Guidelines it developed with the FRB and Office of the Comptroller of the Currency in 1995 and the Department's own Horizontal Merger Guidelines. In general, the Justice Department focuses on localized geographic markets (for example, depending on the facts, counties or standard metropolitan statistical areas) and the provision of specific products and services to discrete groups of customers, such as the provision of lending and other services to middle market business customers. The Department's experience shows that middle market business customers may have fewer competitive alternatives than do retail consumers (who have fewer needs and often borrow on credit cards offered by geographically distant banks) and larger businesses (who are also often able to deal with out-of-market banks). According to the Department, middle market business customers typically require services such as payroll, collection, disbursement, international banking, and trade finance services that small banks may not be able to provide and that larger, out-of-market banks may have little interest in providing. Middle market business customers accordingly may be especially susceptible to the exercise of market power if a merger combines two of only a few competitive providers of service to middle market firms or eliminates competition between the closest competitors to provide such service. In PNC/National City, the Justice Department thus required the divestiture of a substantial part of National City's business with middle market customers in addition to the divestiture of banking branches.

The Department employs a Herfindahl-Hirschman Index (HHI) market concentration screen to identify transactions that merit additional scrutiny and those that do not. The screen identifies transactions where the post-merger HHI based on deposits exceeds 1800 (the bottom of the "highly concentrated" range, which runs to 10,000 for a monopoly) and increases as a result of the merger by

more than 200 points. The Department generally will not further examine transactions falling below these thresholds unless it has reason to believe that application of the screen may understate the competitive effects of the transaction, such as because the relevant geographic market in which competition occurs is likely significantly smaller than the market used for the purpose of the screen or where the screen includes thrift institutions that make no commercial loans, the merging banks both make loans to small and medium-sized businesses, and the HHIs approach 1800/200. (Thrift institutions in any event are counted at half their deposits.) If a transaction does not pass through the screens, then the Department will conduct a more full-blown, transaction-specific analysis of the extent to which the merging banks compete with each other, the likelihood of entry or expansion by competing banks, and evidence that the market shares of the merging banks and other market participants either understate or overstate the future competitive significance of those firms. The Department also considers data regarding loan originations to specific groups of customers.

In assessing the competitive significance of a firm, the Department will consider, for example, evidence that a firm is rapidly losing market share, is not competitively viable, or is operating under regulatory restrictions on its activities. The Department will also apply the failing firm doctrine where appropriate.

The failing firm doctrine applies where the Department has otherwise concluded that the merger would be anticompetitive, but the failing firm (1) would be unable to meet its financial obligations in the near future, (2) would not be able to reorganize successfully under Chapter 11 of the Bankruptcy Code, (3) has in good faith tried and failed to find an alternative buyer that would pose less of a competitive concern, and (4) the assets would exit the market but for the merger. Where all four conditions are met, the failing firm would cease to have any competitive significance in the market in any event. If a bank is liquidated or shut down, its operation is dismantled, deposits are returned to customers or transferred to the customer's designated bank, and the loan portfolio is sold off.

Others have observed that in the current crisis, the U.S. Government itself will likely influence the extent to which the failing firm doctrine applies insofar as the existence of alternative buyers will depend on whether and the extent to which the U.S. Government is willing to finance a deal by assuming or guaranteeing bad assets.[2] Jonathan Rich and Thomas Scriven note that, although several bidders were initially interested in purchasing Lehman Brothers, for example, those bidders ultimately dropped out because the Government declined to assume or guarantee any of Lehman's "toxic" holdings. Citigroup similarly was interested in buying Wachovia if the Government would assume some of its toxic assets, and JP Morgan Chase's interest in Bear Stearns was continent on the FRB assuming some its bad assets. Rich and Scriven observe that there may be alternative buyers only because the Federal Deposit Insurance Corporation (FDIC) is willing to finance the deal, but that the FDIC might prefer a buyer that creates competition issues because alternative bidders would require a greater commitment of FDIC insurance funds.[3] In such a situation, the Justice Department and banking authority would need to work together to arrive at the optimal result that achieves the Government's dual objectives of both stabilizing the financial systems and ensuring that banking markets remain competitive.

In general, I agree with the view expressed by the United States in a discussion note submitted in February to the Organization for Economic Cooperation and Development that antitrust remains relevant:

> Setting aside competition law during times of crisis has proven unwise. Indeed, doing so is likely contrary to the public interest. The experience of the United States in the Great Depression, in particular the use of rationalization cartels pursuant to the National Industrial Recovery Act, showed that such an approach is more likely to cause further harm to the economy than to help recovery. Competition is central to well-functioning markets. Our experience and that of others indicates that

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[2] Jonathan M. Rich and Thomas G. Scriven, "*Bank Consolidation Caused by the Financial Crisis: How Should the Antitrust Division Review 'Shotgun Marriages?,*" The Antitrust Source (Dec. 2008).

[3] *Id.* at 5.

> relaxing existing principles of competition laws, through such approaches as greater solicitude towards mergers in the financial industry, is unlikely to solve an economic crisis, whether in the short- or longer-term.[4]

"Too Big to Fail" is not a Question of Antitrust Enforcement

The "too big to fail" (TBTF) issue is critically important to understand and address, as is the general issue of when, how, and whether government should act to prevent the failure of private enterprises. But it should not be confused with the issues that are relevant to sound antitrust analysis.

With respect to the TBTF issue, policy makers have a strong incentive to prevent the failure of large, systemically significant financial firms in order to avoid immediate, potentially catastrophic, disruption in global financial markets that would cascade into the general economy. Yet committing to sustain failing firms on government life support presents its own problems.

Labeling a firm or firms as "too big to fail," for example, creates a significant moral hazard issue that diminishes the effects of market discipline. Large depositors in a TBTF bank have less incentive to monitor the bank's financial condition because they know they will be bailed out in the event of a failure. At least absent sufficient regulatory controls, moreover, the management of a TBTF firm is incentivized to take on excessive risk because it expects to realize most of any upside, while suffering little of any downside.

The TBTF commitment also distorts competition. A TBTF firm will have greater access to funds in the marketplace at lower cost than its competitors, who will be less able to compete and in the extreme cases may even exit the market.

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[4] *Competition and Financial Markets*, Note by the United States submitted to the Organization for Economic Cooperation and Development, Directorate for Financial and Enterprise Affairs, Competition Committee (for discussion at meeting Feb. 16-18, 2009), hereinafter cited as "*U.S. Note*."

Once a TBTF firm has technically failed, moreover, putting it on life support may fail to restore trust in the financial system, which the system needs to operate. It may also prolong the inevitable demise of the firm at great expense to the taxpayer and the economy. In addition, as the Subcommittee has suggested, the question could be whether in a given instance, it might be better for the economy in the longer run for smaller but sounder regional banks to acquire the market-based or devalued assets of technically failed larger banks, than for those TBTF banks to buy up healthy smaller banks using TARP funds.

But whether a bank is too big or too systemically significant to fail is not a question of antitrust enforcement. [5] Antitrust enforcers lack the tools and experience, as well as the statutory mandate, to address the issue.[6] Rather, it is a political and bank regulatory question properly (and historically) addressed by the Treasury Department and relevant bank regulators.

The question for antitrust enforcers is not whether a merged entity would be "too big to fail," but whether it would be able to exercise market power. Size, or market share, is a relevant consideration in answering the market power question. Indeed, it is the starting point of merger analysis. But it is only the starting point. A merger that increases the size of deposits and a loan portfolio of a bank may make it a healthier entity and stronger competitor by, for example, diversifying its investments across geographic areas and customer bases and allowing it to reduce its costs and offer innovative products. The merged firm may be unable to exercise market power due to competition from other banks. The relevant question for antitrust is not the absolute size of the merged entity, but whether the merger likely will enable the firm to exercise market power by reducing output and raising

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[5] *In accord*: Albert Foer, The American Antitrust Institute, "*Preserving Competition After the Banking Meltdown*," Global Competition Policy (Dec. 2008) at 6 ("[g]reat size is not a target of antitrust policy and antitrust enforcement does not provide a protection against the creation, by merger, of companies 'too big to fail.'"), hereinafter cited as "*Foer*."

[6] *Foer* and 12 (considering whether the Clayton Act might be modified to require the Antitrust Division to determine "whether a merger should be stopped on the theory that the resulting company will be too embedded to be allowed to fail," but recognizing that would be beyond the expertise of the Division).

the price of loans and other services or reducing the interest paid on deposits. That question, in turn, is addressed by the analysis set forth in the Horizontal Merger Guidelines issued by the Department of Justice and Federal Trade Commission.

Some commentators have asserted that U.S. merger policy should prevent companies from getting "too big" regardless of whether there is any evidence that a merged firm would have market power. One commentator, for example, has argued that "the original purpose of the antitrust laws was also to prevent companies from becoming too powerful . . . in that so many other companies depended on them, so many jobs turned on them, and so many consumers or investors or depositors needed them—that the economy as a whole would be endangered if they failed [or] that they could wield inordinate political influence—of a sort that might gain them extra favor from Washington." [7]

As explained further below, however, even accepting the existence of such populist sentiment at the time the antitrust laws were first enacted, enforcement of those laws has evolved to place them on a much sounder base of economic principles focused on the promotion of consumer welfare through the preservation of competition. That footing has made the antitrust laws more predictable, transparent, and analytically sound and thus given antitrust enforcement legitimacy as a cornerstone policy of the United States.

One has to ask, moreover, how proponents of turning back the clock to a "big is bad" philosophy would construct enforcement standards, and how they would ensure they were applied fairly across firms. How would they ensure the predictability and transparency that is essential to a sound enforcement regime and, indeed, to the rule of law? How would they ensure that whatever size standards were adopted did not unreasonably interfere with the ability of firms to achieve scale and scope that would enable them to offer better, more diverse, and better priced products to consumers or to compete in global markets? Would the antitrust laws be used to cap the growth of companies

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[7] Robert Reich, "If They Are Too Big to Fail, They're Too Big Period" (Oct. 22, 2008), available at http://www.rgemonitor.com/financemarkets-monitor/254109/if_they're_too_big.htm.

through business success? Would the enforcers be expected to break up banks already deemed to be too big to fail under the new standard? I submit that current standards, which focus on the ability to exercise market power, are most appropriately suited to preventing transactions that unreasonably retrain trade or lead to monopoly, as provided for in the antitrust laws.

Recommendations of the Antitrust Modernization Commission

The AMC made six recommendations relevant to the topic of today's hearing. First, the AMC advised that there is no need to revise the antitrust laws to apply different standards to different industries.[8] For example, we do not need one legislated standard for mergers in the financial industry, another for the energy industry, and still another for software industry. Current law, including the Horizontal Merger Guidelines applied by the Antitrust Division and merger policy developed by the enforcement agencies and courts, is sufficiently flexible to address the specific *competitive* circumstances in the banking (or any other) industry. As the AMC Report explained, "major changes in antitrust analysis in recent decades . . . has strengthened the economic foundations of antitrust [,] . . . increased its flexibility [, and] . . . improved the likelihood of an accurate assessment of competitive effects " [9] across industries. Of course, enforcement authorities must consider all relevant market dynamics and characteristics of an industry that may bear on a valid antitrust analysis in assessing competitive effects.

[8] *See* Antitrust Modernization Commission, Report and Recommendations (Apr. 2007) ("*AMC Report*"), Recommendation 1 ("There is no need to revise the antitrust laws to apply different rules to industries in which innovation, intellectual property, and technological change are central features.") and AMC Recommendations 4 and 4a ("No substantial changes to merger enforcement policy are necessary to account for industries in which innovation, intellectual property, and technological change are central features. Current law, including the Merger Guidelines, as well as merger policy developed by the agencies and courts, is sufficiently flexible to address features in such industries.") Although the AMC focused specifically on whether different standards were needed for so-called new economy industries characterized by rapid technology changes and issues such as network effects and winner-take-all contests, the basis of its recommendation applies broadly, whatever the characteristics of a particular industry.

[9] *AMC Report* at 31.

Second, the AMC advised that there is no need to revise Section 7 of the Clayton Act or the general framework used by the enforcement agencies and courts to assess mergers.[10] Merger policy has evolved substantially and for the better. It has evolved away from simplistic and ill-founded or baseless assumptions based on the mere size of a company toward a more sophisticated assessment based on sound economic principles designed to protect the interests of U.S. consumers while not unreasonably preventing firms from obtaining the scale and scope needed to compete effectively in domestic and global markets. [11] The AMC found broad based consensus that merger antitrust enforcement policy has become increasingly predictable, transparent, and analytically sound.[12] As a result, there is substantial support for current policy, which has become the leading paradigm for competition policy throughout the world. Several witnesses testified that merger enforcement policy has become more stable and bipartisan, creating, in the words of one witness, "a sense of gravity that previously was lacking" in merger enforcement.[13] No witness or commentator proposed abandoning the focus on consumer welfare and affects on market price, output, and innovation that characterizes current enforcement policy.

Third, the AMC recommended that the Antitrust Division and Federal Trade Commission (FTC) endeavor to increase understanding of the basis for and efficacy of U.S. merger enforcement policy by further studying the relationship between concentration and other market characteristics and market

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[10] *See AMC Recommendation* 3 and 3.a: "No statutory change is recommended with respect to Section 7 of the Clayton Act. There is a general consensus that, while there may be disagreement over specific merger decisions, and U.S. merger policy would benefit from continued empirical research and examination, the basic framework for analyzing mergers followed by the U.S. enforcement agencies and courts is sound."

[11] *See AMC Report* at 54-56.

[12] *AMC Report* at 54-55.

[13] *See AMC Report* at 54, n.32 (citing and quoting William J. Baer, Statement at AMC Merger Enforcement Hearing, Nov. 17, 2005) at 5-6.

performance.[14] Notwithstanding the general consensus that exists in support of current policy, the empirical basis supporting assumptions about the effect of concentration and ease of entry, for example, is arguably limited. In particular, although one of the central assumptions of current policy is that increasing concentration in a market potentially leads to decreased competition, there is limited economic knowledge about the levels of concentration at which market power emerges or becomes a problem. Although a number of studies (Including some in the banking industry) appear to suggest that there is a relationship between concentration and market power, there is substantially less sense about the level at which "antitrust should bite."[15]

The AMC concluded that "[f]ocused study to increase understanding of how these important characteristics of the competitive landscape affect a merger's impact could improve the enforcement authorities' understanding and ability to enforce the antitrust laws in a manner that maximizes benefits for U.S. consumers."[16] It may be an appropriate time for antitrust and banking regulators to review the empirical data and existing studies bearing on questions such as whether increased concentration in local and national banking markets has affected the cost and availability of loans and other services or interest paid on deposits; whether ordered divestitures appear to have been effective in preventing anticompetitive effects; the impact of bank competition on efficiency, stability, and the access to funds by small and medium-sized businesses; and/or the impact of state ownership and other regulatory

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[14] *See AMC Recommendations* 10, 10.a. and 10.b: "The Federal Trade Commission and the Antitrust Division of the Department of Justice should seek to heighten understanding of the basis for U.S. merger enforcement policy. U.S. merger enforcement policy would benefit from further study of the economic foundations of merger policy and agency enforcement activity. The Federal Trade Commission and the Antitrust Division of the U.S. Justice Department should conduct or commission further study of the relationship between concentration, as well as other market characteristics, and market performance to provide a better basis for assessing the efficacy of current merger policy. The Federal Trade Commission and the Antitrust Division of the Department of Justice should increase their use of retrospective studies of merger enforcement decisions to assist in determining the efficacy of merger policy."

[15] *See AMC Report* at 62.

[16] *Id.*

policies on bank competition. Although such a review may well not lead to any change in enforcement policy, periodic review is important to assuring the continued relevancy and efficacy of that policy.

Fourth, the AMC recommended that the Antitrust Division and FTC increase the transparency of their decision-making to enhance public understanding of the agencies' merger enforcement policy.[17] Transparency enables firms considering a merger to predict the legal consequences. It also increases the enforcement efficiency to the extent that firms either choose not to proceed with anticompetitive transactions or are prepared to restructure them. Ultimately, transparency increases public confidence in the ability of the antitrust laws to promote competition.[18] The Antitrust Division and the FTC both have taken many steps to provide transparency, including the issuance of merger guidelines and commentary explaining them, speeches, testimony, and reports. It may be a good time for the Antitrust Division to focus such efforts specifically on bank mergers.[19] The Division might also consider a symposium and report on mergers in the banking industry similar to its symposium and report on competition in the telecommunications industry[20] or reports the FTC and Antitrust Division jointly issued in the healthcare and real estate industries.[21]

Fifth, the AMC recommended that Congress should not displace free-market competition absent extensive, careful analysis and compelling evidence that either competition cannot achieve important

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[17] *See AMC Recommendations* 11 and 11.a: "The Federal Trade Commission and the Antitrust Division of the Department of Justice should work toward increasing transparency through a variety of means. The agencies should issue 'closing statements,' when appropriate, to explain the reasons for taking no enforcement action, in order to enhance public understanding of the agencies' merger enforcement policy."

[18] *AMC Report* at 63.

[19] In her Senate confirmation hearing, President Obama's nominee for Assistant Attorney General in charge of the Antitrust Division, Christine Varney, expressed an interest in reviewing the Division's bank merger enforcement policy.

[20] *Voice, Video, and Broadband: The Changing Competitive Landscape and its Impact on Consumers*, a Report by the U.S. Department of Justice (Nov. 2008).

[21] *Improving Healthcare: A Dose of Competition*, a Report by the Federal Trade Commission and U.S. Department of Justice (Jul. 2004); *Competition in the Real Estate Broker Industry*, a Report by the Federal Trade Commission and U.S. Department of Justice (Apr. 2007).

societal goals that trump consumer welfare, or a market failure requires the regulation of prices, costs, and entry in place of competition.[22] The antitrust laws stand as a bulwark to protect free-market competition that in general does the best job of promoting consumer welfare and economic growth. As noted above, failing to enforce the antitrust laws where they would otherwise be enforced under current policy is unlikely to resolve the current economic crisis, but could cause further harm to the economy in the future, after the markets are stabilized. A case has not yet been made that applying antitrust principles to acquisitions of troubled institutions will undermine efforts to restore stability.

Finally, the AMC recommended that even in industries subject to economic regulation, the antitrust agencies should have full merger enforcement authority under the Clayton Act; the antitrust agency should perform the competition analysis, which should be accepted by the regulatory agency; the antitrust and regulatory agency should consult on the effect of regulation on competition and those effects should be considered in the competitive analysis; and mergers in regulated industries should be subject to the requirements of the HSR Act or comparable notification requirements, as under the banking statutes.[23] It also recommended that Congress should periodically review all instances in which a regulatory agency reviews mergers under a public interest standard to determine whether such review is necessary or can be accommodated by the antitrust agencies under Section 7.[24]

The banking merger review regime closely fits the model proposed by the AMC. Although recent reviews have been greatly expedited pursuant to the terms of the banking statute to account for

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[22] *See AMC Recommendation* 56: "Congress should not displace free-market competition absent extensive, careful analysis and strong evidence that either (1) competition cannot achieve societal goals that outweigh consumer welfare, or (2) a market failure requires the regulation of prices, costs, and entry in place of competition." *See also* AMC Recommendation 62: "Public policy should favor free-market competition over industry-specific regulation of process, costs, and entry. Such economic regulation should be reserved for the relatively rare cases of market failure, such as the existence of natural monopoly characteristics in certain segments of an industry or where economic regulation can address an important societal interest that competition cannot address. In general, Congress should be skeptical of claims that economic regulation can achieve an important societal interest that competition cannot achieve."

[23] *AMC Recommendations* 69-73.

[24]*AMC Recommendation*74.

exigent circumstances, the banking agencies have respected the views of the Justice Department on competition issues. Where TARP funds are involved, moreover, it may be possible for the Government to have more time to conduct its merger review if necessary.