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# *Mergers and Acquisitions in the Banking Industry: the ACCC Perspective*

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## Introduction

I am pleased to have this opportunity to talk to you about competition issues in the financial services sector, in particular, the banking industry, and to discuss the Australian Competition and Consumer Commission's policy framework for consideration of mergers and acquisitions in the sector.

In today's talk I will comment on recent media reports in relation to the so-called "four pillars" policy. I also intend to outline the Commission's approach to mergers generally and to look at the legal framework in which the Commission conducts its mergers analyses and reaches decisions.

In recent years, the dynamic nature of the financial services sector, both domestically and internationally, has raised a number of issues which I would also like to consider briefly in this forum. On the domestic front, these include convergence between the various segments of the financial sector eg. Banking, superannuation, life insurance, investment funds management, etc. Internationally, globalisation, deregulation, convergence, technological change and big bank mergers have all been important issues, particularly in the wake of the Asian financial crisis and the formation of international trading blocks such as NAFTA and the European Union.

## The "four pillars" policy

I note with some interest that in recent weeks there has been mounting speculation in the press about the lifting of the four pillars policy if the Coalition is successful at the upcoming federal election.

However, the Coalition has also been reported to be "in no hurry" to permit mergers among the big four.[1] These reports suggest that the Coalition would want to see a significant improvement in competition among the majors before allowing mergers. Mr Howard has said that the Coalition would have to be satisfied there was further competition in relation to small business, across the whole range of services, before it could be satisfied that there was sufficient competition to allow mergers among the big four.

While the Coalition has left the door open for a later review of the four pillars policy, the ALP is reported as having ruled out mergers among the big four banks altogether if it wins government. Further, the media has suggested that the ALP may request the Commission to monitor bank fees if it is elected.[2] The Commission will of course undertake this work if it is given this role by an ALP government.

Government policy aside, the press has also been speculating that the Commission would allow big bank mergers if two well matched competitors emerge. I consider such speculation to amount to nothing more than premature extrapolations. It is simplistic to suggest that if two merged entities would be well matched as competitors this of itself will satisfy the Commission that the merger does not breach s. 50 of the *Trade Practices Act 1974* (the TPA). The competitive impact of a merger is assessed against a range of criteria and the Commission has a process which it follows in carrying out its assessment. I shall discuss this in more detail shortly, noting that the objective of the assessment is to assess the likelihood, not just of the exercise of

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[1] See eg. Grattan, M and Dodson, L "Takeovers by foreign banks 'not ruled out'" *Australian Financial Review* 16 September 1998, pg. 4; Aylmer, S and Cleary, P "Banks: three-year timelock" *The Sydney Morning Herald* 16 September 1998, pg 33.

[2] See eg Rogers, I "Fees spectre returns to haunt industry" *Australian Financial Review* 16 September 1998, pg 31.

unilateral market power, but also of co-ordinated market power arising from concentration.

At this stage, the issue of mergers between the big four banks is not one which the Commission has analysed in any detail or formed a prior view on. In any event the question of mergers among the big four banks is an academic one so long as the four pillars policy remains in place. The Commission will have to look at each case on its merits but only if the policy is lifted.

**Globalisation and the "National Champions" Argument**

Business people frequently raise the question of whether or not the merger provisions of the TPA prevent the mergers necessary for Australian businesses, including financial service providers, to reach the size necessary to take part in global markets.

The answer to this is rarely, if ever, and, if so, then in circumstances where it is on balance undesirable because of the anti-competitive effect in the Australian market. The fact is that the Commission has not in the last seven years opposed mergers where imports make up more than 10 per cent of the relevant market (this is not a rigid rule but it is a fact of history). In other words, the Commission has not opposed mergers in sectors already exposed to international competition. It is in this sector that the argument for firms needing to be large to take part in world markets is most relevant. Moreover, even where there is no import competition, the Commission opposes relatively few mergers, and where it does some of them can be resolved by undertakings (as was the case with the Westpac/Bank of Melbourne merger).

It is often argued that Australian businesses need to develop the "critical mass" necessary to compete internationally. However, I think it is important to point out that

obstacles to export growth may face industry participants of all sizes. It is not apparent that, simply by entering a collaborative arrangement like a merger or joint venture, a participant's ability to compete internationally is enhanced. Size is often not necessary to enhance the ability to compete on world markets. It has been convincingly argued that, in many cases, domestic rivalry rather than national dominance is more likely to breed businesses that are internationally competitive. A recent report to the government which reviewed business programs in the context of an increasingly competitive global market noted that a lack of domestic competition was one of a number of impediments to building globally sustainable businesses in Australia.[3]

If a merger is anti-competitive, authorisation is possible on public benefit grounds. Since 1993, the Act explicitly has stated that export generation, import replacement or contributions to the international competitiveness of the Australian economy are public benefits.

Clearly the framework of the Act is not an obstacle to allowing Australian businesses to merge to achieve the scale necessary for international competitiveness providing there is a sufficient public benefit. There are in fact many cases where authorisations have been permitted. Over half of all merger authorisation applications have in fact been successful. A number of them have related to cases where the merger would cause a substantial reduction in competition in Australia but would bring international type benefits. There are of course instances in which the trade off or loss of competition in the home market versus benefits to Australia from a firm playing a role in world markets is unfavourable in terms of the public interest and in some cases

[3] Porter, M.E. The Competitive Advantage of Nations, The MacMillan Press Ltd, London, 1990.

mergers create monopolies or 'home champions' in the home market. They are not necessarily firms well prepared to compete in world markets as Professor Michael Porter's study, The Competitive Advantage of Nations demonstrated.

**The Commission's approach to Mergers**

The Commission's role is to enforce s.50 of the TPA, which prohibits mergers or acquisitions that would have the effect of substantially lessening competition in a substantial market in a State or Territory. In 1996, the Commission published its Revised Merger Guidelines setting out the process for, and issues relevant to, its administration of the merger provisions. The guidelines do not bind the Commission, but rather provide parties with an indication of matters the Commission considers when investigating mergers. They also aim to guide industry in setting out submissions which will assist the Commission in its consideration of proposed acquisitions.

In the event that the Commission has concerns about a proposed merger or indicates that it will oppose a merger, the parties have a number of options other than abandoning a proposal. They may amend the proposal, usually by means of divestiture, to address the Commission's concerns. The parties can also apply for authorisation or offer s. 87B court enforceable undertakings to the Commission.

The Merger Guidelines set out a five stage process for the Commission's assessment of substantial lessening of competition. I intend to consider each of these in turn, focussing particularly on the issue of market definition.

**1. Market Definition**

In establishing the market boundaries, the Commission seeks to include all those sources of closely substitutable products, to which consumers would turn in the event that the merged firm attempted to exercise market power. Further, the Commission looks at the market at the time at which the merger proposal comes to it.

For example, in the case of the Westpac Challenge merger, the Commission took the view that the banking market was best viewed as a cluster of retail banking services which banks delivered to consumers as a bundle. However, in assessing the Westpac (WBC) takeover of the Bank of Melbourne (BML), the Commission took the view that the cluster approach was no longer appropriate. This is because a sufficient proportion of customers were then prepared to unbundle key components of the cluster and to shop around for the best price on those components - especially home loans. That is, enough customers were unbundling one or more components of the cluster to the extent that banks were having to compete on price for those individual components. In other words, the Commission in considering the WBC/BML proposal adopted a multi-product analysis for banking markets.

*Convergence: Mergers Involving Banks, Life Insurers and Fund Managers*

The degree of convergence between banks and fund managers, including insurance companies, is also one which may impact on the Commission's analysis of relevant markets in the financial services sector in coming years. The association between banks and insurance companies is not new.

The Commission has had some experience in considering the overlapping activities of banks and insurance companies. For example, in 1991, Westpac and AMP proposed a strategic alliance which would have the same effect as a merger in that it restrained

Westpac from entering the life insurance sector and AMP from entering retail banking for a ten year period. While the then Trade Practices Commission did not oppose the alliance, it did express concern at the nature of the restrictive covenants, particularly given that Westpac was emerging as a serious contender in the life insurance industry. Ultimately, the alliance was undone.

Before the then Treasurer, Paul Keating, announced his "six pillars" policy, the Commission considered a merger proposal to combine ANZ and National Mutual. The then Trade Practices Commission decided not to oppose this merger on the basis that this particular merger would not be likely to lead to dominance in any relevant market. But, given the test is now a substantial lessening of competition, the Commission would examine such large and important bank/funds management/life insurance mergers closely.

In addition, the Commission examined but did not oppose the Colonial Mutual Life acquisition of State Bank of NSW in January 1995. Market enquires at the time indicated that the two entities operated in separate markets and there were no cross-holdings or other interests which caused competition concerns. Nor did the Commission oppose the amalgamation of Metway Bank, Suncorp Insurance and Finance, and the Queensland Industry Development Corporation (QIDC) for similar reasons.

In the current business climate, I note that AMP has a banking licence and is using this to aggressively compete in the home loans market by lowering interest rates.[4] Further, banks have for some time been involved in funds management, including life

[4] See eg Lekakis, G "AMP enters home loan war" *Australian Financial Review* 18 September 1998, pg 1

insurance and superannuation.  They also appear to be increasing their focus on retail investment products.  In this context, Westpac is reported as having moved a significant proportion of customers funds from deposits to funds management. However, media reports also suggest that insurance companies are likely to encounter some difficulty making inroads into banking whereas banks are better placed to strengthen their funds management business due to ongoing relationships with customers.

Given that all these reports are anecdotal, it would be a bold leap to suggest the market has converged to a point where there is a single market encompassing banking and funds management.  There is a need to look at the supply and demand substitutability and the extent to which the behaviour of market participants justifies the view that the convergence has reached a point where the market can be considered a single one.

Therefore, as a provisional view, the Commission would start from the position that funds managers and banks operate in different markets.  However, such a view would be thoroughly tested as part of the Commission's response to any such merger proposal which might be put to it and would be determined by the climate of the industry at the time of the proposal.

In respect of the geographic dimension, the Commission concluded in the WBC/BML matter that the geographic dimension of most of these markets was still State-based, although the home loan market was becoming a national market.

Although the market for banking services is changing through the introduction of new technologies, these new distribution methods are considered by the Commission to

be, in many ways, complements to, rather than substitutes for, traditional channels, such as branches, especially for day to day banking products like transaction accounts. If customers' use of phone banking and internet channels lead to a significant level of cross-border banking which obviates the necessity for a local presence, that would lead to a reconsideration of the geographical dimension.

## 2 The Level of Market Concentration

When assessing a merger proposal under section 50 of the TPA, the Commission first examines the level of concentration in relevant markets to determine whether the merger crosses certain thresholds. Usually, if:

- the market share of the merged entity is above 40%; or
- the combined market shares of the four largest market participants is above 75% and the share of the merged entity is above 15%;

then the merger is likely to merit detailed consideration.

If the market concentration ratio falls outside the thresholds, the Commission will generally determine that substantial lessening of competition is unlikely. However, given the importance of a competitive financial services sector to the well-being and efficiency of the Australian economy, the Commission may be minded to look closely at a merger between two large financial service providers even if the concentration thresholds are not triggered.

In the case of the National Mutual/Lend Lease proposal, the Commission examined a number of possible markets in the financial services industry and found that, even if narrow market definitions were to be adopted, the concentration thresholds would not

be crossed as a result of the merger. On the basis of these concentration figures, the Commission found that the proposal would be unlikely to substantially lessen competition in any relevant market. As it turned out, this proposal did not proceed for commercial reasons.

The Commission has also recently examined AMP's bid for GIO. In that case, the Commission was conscious that, in the broad, the companies were not involved in overlapping activities. AMP is essentially a funds management, life insurance and superannuation company and GIO is essentially a general insurance and re-insurance company. There is, nevertheless, some overlap. For example, the acquisition consolidates AMP's number one position in life insurance and elevates it to second in retail investment products and third in general (non-life) insurance. In all these areas, however, there were a substantial number of strong competitors and there did not appear to be any problems with concentration.

**3 Import Competition**

Both potential and real import competition are assessed. If import competition is an effective check on the exercise of domestic market power, it is unlikely that the Commission will intervene in a merger. In the case of retail banking services, however, there is little evidence of overseas suppliers constraining domestic participants.

**4 Barriers to Entry to the Relevant Market**

If the market is not subject to significant barriers to new entry, incumbent firms are likely to be constrained by the threat of potential entry, to behave in a manner consistent with competitive market outcomes. A concentrated market is often an indication that

there are high barriers to entry. In the financial services markets, such as banking and funds management, economies of scale and sunk costs to establish a reputation, meet prudential requirements, etc are substantial barriers to entry.

## 5 Merger Factors in s. 50(3) of the TPA

Section 50(3) of the TPA also contains a non-exhaustive list of factors that the Commission may take into consideration in assessing a merger. These include whether the merged firm will face countervailing power in the market; whether the merger will result in the removal of a vigorous and effective competitor; or whether the merger is pro-, rather than anti-competitive.

### Opposition to Mergers

The Commission rarely opposes mergers. Nevertheless, if parties decide to proceed with a merger in spite of Commission opposition, the Commission would normally seek an urgent interlocutory or interim injunction. However, the Commission is not the final arbiter. Ultimately it must prove to the satisfaction of a court that the merger would substantially lessen competition.

In January this year, the Commission published a detailed statistical analysis of mergers. The statistics show that in the latest year available 1996-97 that only about five per cent of mergers were opposed and opposition was lifted in respect of some of them once satisfactory undertakings had been given. In some respects the five per cent figure overstates the extent of the Commission's opposition because many mergers do not raise competition issues at all and are not considered by the Commission. On the other hand, there may be some mergers that are not brought forward to the Commission because the nature of the section 50 prohibitions is well

known.  However it is not the Commission's impression that business people are shy in coming forward to sound it out about possible mergers, even impossible looking mergers,  There have not been many of these.

**Authorisation**

The Commission must be satisfied that the benefits to the public are such that the merger proposal ought to proceed in order to grant authorisation.  Authorisation is a public process which allows all interested parties, as well as the participants themselves, to make submissions to the Commission.  The Commission has a time limit of 30 days to consider a merger authorisation application after the parties provide sufficient information for the application to be assessed.  For complex matters, the time limit can be extended to 45 days.  If it is sufficiently concerned about the detriment  which may flow from an acquisition if it were to proceed, the Commission can grant conditional authorisation if it sees that there are ways the parties can address its concerns.  If the Commission denies the application for authorisation, the parties may apply to the Australian Competition Tribunal to have the determination reviewed.

**Section 87B Undertakings**

Parties may also offer s 87B court enforceable undertakings to alleviate the Commission's concerns about the merger. I note in this context that the Commission has been accused in some quarters of using undertakings for the purposes of market re-engineering.  In deciding whether to accept undertakings offered to it by the parties, the Commission consciously strives to ensure that the undertakings are necessary to remedy the problem created by the merger.  It also looks at whether the

undertakings are proportionate in the product, geographic and temporal dimensions to remedy the competition problems. Any such undertakings to the Commission must also be effective in that they are enforceable and they must be transparent.

For example, in the case of the WBC/BML merger, Westpac acknowledged the Commission's concerns about the anti-competitive impact of the merger in the Victorian transaction accounts market. As a result, the parties offered to provide undertakings under s. 87B of the TPA aimed at remedying the likely substantial lessening of competition in the Victorian transaction accounts market.

The undertakings recognise that a key requirement for institutions to compete successfully in the transaction accounts market is the ability to issue EFTPOS and ATM cards with wide acceptance at competitive costs. They provide for EFTPOS and ATM access arrangements to WBC's electronic networks for the Victorian customers of existing and new financial institutions carrying on business in the Victorian transaction accounts market.

In addition, the undertakings make specific provisions, for a period of three years post-merger, in relation to the level of 'autonomy' of the management of the merged entity's Victorian operations in order to allow the merged entity to compete as vigorously with its rivals as BML had done in the past by offering competitive products, prices and customers service.

**Liberalisation of access to the payments system**

As noted above, the Commission's analysis of the market for the provision of transaction accounts services in Victoria in regard to the WBC/BML merger led it to the conclusion that access to electronic payments systems can present a potential

barrier to entry and expansion for new and smaller players in this market. The Commission has already had considerable involvement in various clearing systems via the authorisation of APCA's memorandum and articles of association and the regulations and procedures for the paper and bulk electronic clearing systems.

On the 20th August 1998, the Commission issued a draft determination proposing to deny authorisation to APCA in respect of its proposed industry self-regulatory rules for the Consumer Electronic Clearing System (CECS). These proposed rules relate to the clearing of debit card transactions effected on the ATM and EFTPOS networks and the issue of access to these networks, and were agreed by banks, building societies and credit unions under the umbrella of APCA.

The Commission considered that the proposed CECS self-regulatory rules were substantially incomplete in terms of specifying the standards and procedures relevant to participation in the ATM and EFTPOS networks and the effective clearing and settlement of debit card transactions generated within those networks.

The Commission also considered that APCA could play a role in ensuring that access to the ATM and EFTPOS networks is available on fair and reasonable commercial terms.

In its draft determination the Commission indicated that should APCA further develop and amend the proposed CECS rules along the lines outlined in the draft, it is likely that the rules would result in net public benefit so that authorisation may be granted by the Commission. Such enhanced CECS rules, addressing both the technical and commercial terms of access to the ATM and EFTPOS networks, would also be an appropriate industry self-regulatory response. APCA is now working towards

addressing the Commission's concerns and a revised version of the CECS rules are expected by the end of 1998.

**The Commission's Role in the Financial Services Industry**

The financial services industry is a complex one which is overseen by a number of regulatory bodies. In order to co-ordinate its role in this industry, the Commission has recently signed two agreements with complementary regulatory bodies. The first, a cooperation agreement with the Australian Securities and Investment Commission, was signed on 17 July 1998. ASIC is now responsible for consumer protection in the areas of deposit accounts, securities, futures contracts, insurance (both general and life) contracts, retirements savings accounts, and superannuation interests. The Commission is responsible for consumer protection in the area of credit and foreign exchange contracts, as well as financial services which come within the small business amendments to the TPA. Under the Agreement, ASIC and the Commission will refer complaints to the most appropriate agency, exchange information where permitted by law and if required, undertake joint responses to problems in the market.

The second, a Memorandum of Understanding with the Reserve Bank of Australia was signed on 9 September 1998. This Memorandum seeks to ensure that there is no regulatory overlap as the Reserve Bank is now charged with promoting competition and efficiency in the payments system. The Commission and the RBA will work closely together to ensure that a consistent approach is taken to regulatory policy in the payments system. The Memorandum sets out the information-sharing and other consultation arrangements that have been established to achieve this.

**INTERNATIONAL DEVELOPMENTS**

As you would be aware, there has recently been a spate of mergers and acquisitions occurring between large financial institutions in North America and Europe. Some local commentators and industry analysts have argued that these mergers have had some very direct and salient implications for the banking industry in Australia.

Circumstances such as the formation of large trading blocs in both Europe and North America may be driving such mergers but they do not exist in Australia. Further, some of these mergers cannot be regarded as *fait accompli*. For example, in Canada, the four big banks which are currently proposing to merge must still obtain regulatory approval from the Canadian Competition Bureau on competition grounds, the Office of the Superintendent of Financial Institutions on prudential grounds and, the Canadian Minister of Finance.

Another example is the Asian financial crisis which may well lead to further bank mergers in various Asian countries: but they are likely to be related more to prudential considerations than to achieving efficiency gains from rationalisation, although the latter could well be a result.

Indeed, I believe that the factors driving merger activity overseas are as much about specific regulatory, cyclical and institutional issues pertaining to particular jurisdictions as they are about the wider commercial imperatives impacting on financial institutions at home and abroad. In this context, the implications for local financial institutions of merger activity overseas needs to be interpreted carefully and with regard to a full set of information about the precise context in which merger activity is occurring in other jurisdictions.

**Conclusion**

By way of conclusion, I would like to stress that the financial services sector has proved to be extremely dynamic in recent years. Many factors are combining to create conditions for change in banking markets - new technology, globalisation of markets, the introduction of far reaching regulatory reforms, changes in consumer behaviour and the emergence of new products and industry players.

As such, the Commission cannot give an *ex ante* assessment of any merger proposal and will continue to assess mergers as and when they arise on a case-by-case basis.

The Commission will look at any mergers between the big four banks on a case by case basis at the time that they take place. In so doing, it will obviously have regard to the markets in which the merged entity will operate, the degree of convergence between banking and insurance activities and other dynamic characteristics and developments in the marketplace. Beyond this the Commission has no prior view on such mergers.

In any merger analysis, the Commission relies heavily on objective data and in this context I would suggest that analysis is a two way street. Industry assistance in the provision of meaningful data will enable the Commission to make informed decisions about the outcome of any merger proposal.

Thank you for your attention.