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TOO BIG TO MANAGE: A CASE FOR STRICTER BANK MERGER REGULATION

Peter Lim Felton*

“We have a new kind of bank. It is called too big to fail.¹
TBTF, and it is a wonderful bank.”

- Congressman Stewart McKinney²

“It is well enough that people of the nation do not
understand our banking and money system, for if they did,
I believe there would be a revolution before tomorrow
morning.”

- Henry Ford³

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* J.D./M.B.A. Candidate, Santa Clara University School of Law and
Leavey School of Business, 2012. This Comment is dedicated to “Grandpa”
Charles Taylor (January 31, 1927 – February 5, 2011) and “Granny” Lenora
Taylor, two of the best grandparents any person could wish for. The author’s
appreciation goes out to Professor Catherine Sandoval, Ms. Diana Ngo, Ms.
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flowing encouragement and belief in him and his Father’s love and support.

1. See *infra* Part II.A.

2. GARY H. STERN & RON J. FELDMAN, *TOO BIG TO FAIL: THE HAZARDS OF
BANK BAILOUTS* 13 (2d ed. 2004).

3. *The Victims of Culture Enslaved by the International Banking
Establishment*, MEN’S WEEKLY, [http://www.mensweekly.co.uk/finance/the-
victims-of-culture-enslaved-by-the-international-banking-establishment/](http://www.mensweekly.co.uk/finance/the-victims-of-culture-enslaved-by-the-international-banking-establishment/) (last
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INTRODUCTION

Bank failure lies at the center of the Great Recession, which has shaken the financial strength of the United States. Worse, there is a growing public distrust of government motives.⁴ Disagreement with policymakers' decisions has

4. See Beth Fouhy, *Democrats See Minefield in Occupy Protests*, BUSINESS

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fueled much of the American public's disapproval of the government, voiced most recently by the Tea Party and Occupy Movements. Many argue that the federal government's decision to bail out failing banks in 2008 during the Great Recession lies at the center of this public discontent.⁵ The government defended its action as the only feasible option because allowing the banks to fail would prove disastrous for America.⁶

The government's bailouts, however, should not be the focus of the public's frustration and outrage. The real culprits are the bank mergers that created mammoth banks causing the government to feel forced to save private banks with public money. How were banks allowed to merge and reach such unmanageable sizes? Should these mergers have even been allowed?

This Comment seeks to address these questions and discuss the soundness of the government's decision to sanction these mergers. Part I commences with delving into America's banking history by exploring the federal governments' initial regulation of the banking system, the subsequent deregulation, and relevant banking statutes.⁷ Part II provides an explanation of the first praised, and then denounced, concept of "Too Big to Fail" (TBTF)—which suggests that if banks were large enough, they would not fail.⁸ Part III conducts a crucial legal analysis of the mergers creating TBTF banks, evaluating their admissibility according to banking statutes and antitrust laws.⁹ Lastly, Part IV discusses and proposes necessary modifications to the current banking system in the hopes of preventing further creation of TBTF banks and provides a possible solution to America's current dilemma.¹⁰

WEEK (Nov. 17, 2011), <http://www.businessweek.com/ap/financialnews/D9R2J30G0.htm>; Russ Roberts, *Occupy Wall Street and Washington's History of Financial Bailouts: Why We Need More Capitalism, Not Less*, FOREIGN AFFAIRS (Oct. 21, 2011), <http://www.foreignaffairs.com/articles/136609/russ-roberts/occupy-wall-street-and-washingtons-history-of-financial-bailouts>.

5. Fouhy, *supra* note 4; Roberts, *supra* note 4.

6. CONG. BUDGET OFFICE, THE TROUBLED ASSET RELIEF PROGRAM: REPORT ON TRANSACTIONS THROUGH DECEMBER 31, 2008 1 (2009).

7. *See infra* Part I.

8. *See infra* Part II.

9. *See infra* Part III.

10. *See infra* Part IV.

I. OVERVIEW OF BANKING IN THE UNITED STATES

A. *Useful Definitions*

Banks are invaluable to our society. They provide both a location for people to (relatively) safely hold their money and a supply of money to persons or businesses. A bank's most basic function is to receive money from individuals and to then loan that money to other account holders.¹¹ A more encompassing definition of banks defines them as "public [financial] institutions, for the custody and loan of money, the exchange and transmission of the same by means of bills and drafts, and the issuance of [their] own promissory notes, payable to bearer, as currency, or for the exercise of one or more of these functions . . . regulated by the law."¹²

Two terms used in this Comment are *commercial banks* and *investment banks*.¹³ "[C]ommercial banks offer a full range of banking services, including demand accounts (i.e., checking accounts) for business and personal use, savings and time deposits, investment and loan services, trust department services, and the like."¹⁴ Investment banks, on the other hand, are "financial intermediaries whose business consists in underwriting and distributing securities and acting as brokers and dealers in securities already distributed."¹⁵ The distinction between these two types of banks is important because they receive dissimilar regulatory treatment. Commercial banking statutes are generally more stringent than investment banking.¹⁶

B. *Concept of Banking Regulation*

To better appreciate banking regulation, it is important to first understand why it is necessary. It is essential for basically two reasons: 1) banks hold a large amount of money

11. See M.J. DEVINE & P.A. ERNEST, MICHIE ON BANKS AND BANKING 7 (2011).

12. *Id.* at 7–8 (citations omitted).

13. MICHAEL P. MALLOY, THE REGULATION OF BANKING: CASES AND MATERIALS ON DEPOSITORY INSTITUTIONS AND THEIR REGULATORS 41 (Anderson Publishing Co. 1992).

14. *Id.*

15. *Id.*

16. See *Implications of the 'Volcker Rules' for Financial Stability: Hearing Before the S. Comm. on Banking, Housing, and Urban Affairs*, 111th Cong. 45–49 (2010) [hereinafter *Volcker Rules*] (statement of Simon Johnson).

that is not their own, and 2) banks are involved in the risky business of lending money to borrowers who may or may not pay the banks back. By holding and lending out money, banks impact the economy enormously. “[Banking’s] very nature . . . makes it peculiarly an object of legislative solicitude in order that depositors and stockholders may be protected.”¹⁷ Its business also strongly impacts public interest through its lending function, which has an innate level of risk not present in most other businesses.¹⁸ Banking is speculative and volatile in nature and opens the door for illegal and unscrupulous behavior.¹⁹

The justice system is not “eager to intrude into the business practices” of banks, but banking regulation is necessary for public welfare.²⁰ The following legal definition of a bank explains its status as a corporation and subordinate nature to the government: “A bank is wholly a creature of statute doing business by legislative grace, and the right to carry on a banking business through the agency of a corporation is a ‘franchise’ right dependent on a grant of corporate powers by the state.”²¹ Furthering the need for banking regulation is the function of a bank as a corporation whose aim is to make money for its shareholders.²² The Michigan Supreme Court in *Dodge v. Ford Motor Company* held that a corporation’s principal aim is to make money for its shareholders and the firm’s decision making should be catered to that end.²³ Some banks will take huge “risks that pay when times are good”²⁴ in order to increase stock prices and dividends for the satisfaction of their shareholders (and employees and directors).²⁵ However risk-taking banks that fail may require bailouts when their investments do not succeed and those bailouts become a heavy cost and burden for taxpayers.²⁶

17. DEVINE & ERNEST, *supra* note 11, at 18.

18. *Id.* at 7, 18.

19. *See id.* at 18.

20. *Id.* at 23.

21. BLACK’S LAW DICTIONARY 165 (9th ed. 2009).

22. *Dodge v. Ford Motor Co.*, 170 N.W. 668, 684 (Mich. 1919).

23. *Dodge*, 170 N.W. at 684.

24. *Volcker Rules*, *supra* note 16, at 46 (statement of Simon Johnson).

25. *Id.*

26. *Id.*

Scholars make two primary counterarguments against banking regulation. First, it is posited that shareholders, directors, and employees who gain relatively large profits captured by risky investments will reinvest, boosting the American economy.²⁷ However, with a real and growing international market providing an avenue for people to place money overseas, more profits will flow outside of the country rather than being reinvested domestically.²⁸ The second, equally defunct, argument is that the economy's cyclical nature will neutralize the banks' losses and gains. In reality, the majority of gains stay with the rich²⁹ while the burden of losses—in the form of federal bank bailouts—is borne by all economic classes; forcing lower classes to bear the brunt of banks' risky and failed decisions without reaping any of the profits.

C. *History of Banking Regulation and Deregulation*

Banking regulation became a priority concern for the federal government after the Great Depression in 1933.³⁰ The government proceeded to pass multiple banking statutes, including one in the same year as the Glass-Steagall Act (GSA)³¹ discussed *infra*.³²

Following a strong start, banking regulation grew increasingly lenient over the decades.³³ Banks were deregulated to allow growth through increased latitude.³⁴ The aims of banking deregulation were “efficiency and coherence in the regulation of [banks]”³⁵ and materialized in three main areas of banking:

- (i) [T]he deregulation of products, including (*e.g.*, deposit interest rates and securities activities of banks);

27. *See id.* at 46–47.

28. DEVINE & ERNEST, *supra* note 11, at 20.

29. *Id.*

30. MALLOY, *supra* note 13, at 111.

31. Banking Act of 1933, c. 89, § 1, 48 Stat. 162 (codified as amended in scattered sections of 12 U.S.C.); MICHAEL P. MALLOY, CONCISE HORNBOOK SERIES: PRINCIPLES OF BANK REGULATION 206 (2d ed. 2003).

32. *See infra* Part I.D.1.

33. *See* MALLOY, *supra* note 13, at 111.

34. *See id.* Deregulation is a movement encompassing more than just banking and has affected all facets of the economy. Randall S. Kroszner, *The Motivations Behind Banking Reform*, 24 REG. 36, 36 (2001).

35. MALLOY, *supra* note 13, at 111.

- (ii) [D]eregulation of markets, allowing more freedom to banks to engage in banking on an interstate basis; and,
- (iii) [S]tructural deregulation, reforming the structure of bank regulation itself into a more coherent system.³⁶

This loosening of government control granted banks the necessary freedom to burgeon.³⁷ Banking statute modifications spanning the past eighty years, following the above-stated aims, exhibited the continuous deregulation of the banking industry. Five banking statutes are presented in the following section to portray the evolution of the history of banking history from regulation to deregulation.³⁸

D. Relevant Banking Statutes

1. The Glass-Steagall Act (GSA)

Congress passed the Glass-Steagall Act on June 16, 1933 as the Banking Act of 1933 in response to the securities fraud and deception at the root of the Great Depression.³⁹ The mandates of the GSA were two-fold. They extricated the regulatory treatment of investment banks from commercial banks, and limited commercial bank activity in securities markets.⁴⁰

The United States Supreme Court's reasoning in *Investment Company Institute v. Camp* describes the possible apprehension of a marriage still alive thirty-eight years after the GSA's enactment. Investment companies in *Investment Company Institute* argued for the freedom of national banks to operate mutual funds, in effect, granting them the power of investment banks.⁴¹ The Court, however, did not accord them such freedom. The resulting close relationship between commercial and investment banks would violate the GSA and the Court feared potential repercussions.⁴² Since commercial

36. *Id.*

37. *See id.* A subsequent analysis will employ parts of these statutes to evaluate TBTF bank mergers.

38. *See infra* Part I.D.

39. *Id.* at 207; Banking Act of 1933, c. 89, § 1, 48 Stat. 162 (codified as amended in scattered sections of 12 U.S.C.).

40. Banking Act of 1933, c. 89, § 1, 48 Stat. 162 (codified as amended in scattered sections of 12 U.S.C.); MALLOY, *supra* note 31, at 208.

41. *Investment Co. Inst. v. Camp*, 401 U.S. 617, 624–25 (1971).

42. *Id.* at 639.

banks hold public money, failure would have been ruinous. As a result, commercial banks were kept separate from institutions involved in more risky investments such as investment companies.⁴³ The passage of the Gramm-Leach-Bliley Financial Modernization Act in 1999 later nullified the Court's ruling.

2. *The Bank Holding Company Act (BHCA)*

The BHCA was passed on May 9, 1956 and required the Federal Reserve Board to approve the creation of bank holding companies (BHCs).⁴⁴ A BHC is defined within the statute as "any company which has control over any bank or over any company that is or becomes a bank holding company by virtue of this chapter."⁴⁵ Congress also installed a vital prohibition creating an inherent limitation on bank size. The BHCA prohibited banks established in different states from acquiring each other.⁴⁶

3. *The Bank Merger Act (BMA)*

The BMA, effective May 13, 1960,⁴⁷ "prohibit[ed] mergers, consolidations, and purchases of assets with assumption of liabilities, as between banks, unless . . . prior written approval of the appropriate federal bank regulatory agency ha[d] been obtained."⁴⁸ The BMA was not originally used to examine the anticompetitive nature of bank mergers;⁴⁹ the government instead used section 7 of the Clayton Act to analyze the potential risk. Section 7 stated,

No person engaged in commerce . . . shall acquire . . . the whole or any part of . . . another person engaged also in commerce . . . where in any line of commerce or in . . . any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create

43. *See id.* at 637–38.

44. Bank Holding Company Act of 1956, c. 240, § 1, 70 Stat. 133 (codified as amended in 12 U.S.C. §§ 1841–44, 1846–48, 1851–52 (1996)); *Important Banking Legislation*, FDIC, <http://www.fdic.gov/regulations/laws/important/index.html> (last updated May 15, 2007) (citing CONG. RESEARCH SERV., MAJOR STATUTES AFFECTING FINANCIAL INSTITUTIONS AND MARKETS (2004)).

45. 12 U.S.C. § 1841(a)(1) (2006).

46. *Id.*

47. Bank Merger Act of 1960, Pub. L. 86-463, 74 Stat. 129 (codified as amended at 12 U.S.C. § 1828 (2006)); MALLOY, *supra* note 31, at 133.

48. MALLOY, *supra* note 13, at 295 (citation omitted).

49. MALLOY, *supra* note 31, at 133.

a monopoly.⁵⁰

The BMA was later amended in 1966 to deal with bank merger antitrust analysis.⁵¹ In order to decide a bank merger's legality, the following factors are weighed:

(1) Monopolization. The agency cannot approve a proposed transaction that would result in a monopoly, or that would be in furtherance of any combination or conspiracy to monopolize or to attempt to monopolize the business of banking in any part of the United States.⁵²

(2) Anticompetitiveness. The agency cannot approve a proposed transaction the effect of which in any section of the country may be substantially to lessen competition, or to tend to create a monopoly, or that in any other manner would be in restraint of trade.⁵³

(3) Traditional Banking Factors. The agency must take into consideration the financial and managerial resources and the future prospects of the existing and proposed institutions, and the convenience and needs of the community to be served. In addition, the responsible agency must take into consideration in every case the effectiveness of any insured depository institution involved in the proposed merger in combating money laundering activities, including in overseas branches.⁵⁴

These factors are essential to deciding a bank merger's authorization. They are discussed *infra* to analyze the soundness of TBTF bank mergers.⁵⁵

4. *The Riegle-Neal Interstate Banking and Branching Efficiency Act (RNIA)*

The RNIA, passed by Congress on September 29, 1994, requires banks to hold no less than ninety percent of their

50. 15 U.S.C. § 18 (2006).

51. MALLOY, *supra* note 31, at 135.

52. *Id.* at 137; *see* 12 U.S.C. § 1828(c)(5)(A) (2006).

53. *Id.*; *see* 12 U.S.C. § 1828(c)(5)(B) (2006). However unlike *Philadelphia National Bank*, the BMA “permits approval of such a transaction if the agency finds that its anticompetitive effects ‘are clearly outweighed in the public interest by the probable effect of the transaction in meeting the convenience and needs of the community to be served.’” MALLOY, *supra* note 31, at 138.

54. *Id.*; *see* 12 U.S.C. § 1828(c)(5)(B) (2006).

55. For the three factors used to analyze TBTF bank mergers, *see infra* Part III.C.3.

total retail deposits.⁵⁶ It was designed to ensure banks would have adequate reserves available for a sudden run on the bank. “This cap was not related to antitrust concerns as ten percent of a national market is too low to imply pricing power. Rather this was a sensible macro-prudential preventive measure—do[] [not] put all your eggs in one basket.”⁵⁷

However, this law is ineffective and limited for two reasons: “(1) The growth of big banks was not fueled by retail deposits but rather by various forms of ‘wholesale’ financing, and (2) [t]he cap was not enforced by lax regulators, so that Bank of America, J.P. Morgan Chase, and Wells Fargo all received waivers in recent years.”⁵⁸ With banks outgrowing the statute’s safeguards, and lenient enforcement impeding efficacy, the RNIA has become dated and unworkable.

5. *The Gramm-Leach-Bliley Financial Modernization Act (GLBA)*

The GLBA, passed on November 12, 1999,⁵⁹ played a central role in bank deregulation because it “repealed [GSA] prohibitions on affiliations between commercial and investment banking enterprises”⁶⁰ It permitted banks to act as Financial Holding Companies, allowing them to “engage in activities, and acquire companies engaged in activities, that are ‘financial in nature’ or that are incidental to such activities.”⁶¹ This law opened the door for banks to

56. Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, Pub. L. 103-328, 108 Stat. 2338 (codified as amended in scattered sections of 7, 12, 31, 112 U.S.C.); *Volcker Rules*, *supra* note 16, at 46 (statement of Simon Johnson).

57. *Id.*

58. *Id.* Wholesale financing involves “[t]he sale of securities among broker-dealers and large institutional investors. Securities sold at wholesale go for slightly lower prices than those paid by individual investors.” *Wholesale*, THE FREE DICTIONARY, <http://financial-dictionary.thefreedictionary.com/wholesale> (last visited Apr. 17, 2012).

59. Gramm-Leach-Bliley Act of 1999, Pub. L. 106-102, 113 Stat. 1338 (codified as amended in scattered sections of 12, 15 U.S.C.); MALLOY, *supra* note 31, at 206–07.

60. *Id.* at 207.

61. *Id.* (citing 12 U.S.C.A. § 1843(k)(1) (1999)). An FHC is defined as “[a] financial institution engaged in nonbanking activities that offers customers a wide range of financial services, including the opportunity to purchase insurance products and invest in securities.” *Financial Holding Company (FHC)*, INVESTOPEdia, <http://www.investopedia.com/terms/f/financial-holding-company-FHC.asp#axzz1eYZy9AOv> (last visited Apr. 17, 2012).

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invest in home mortgages, which were problematic financial activities prominent in the Great Recession.

E. Evolution of Banking

Deregulation of banks, combined with overall market globalization, altered the nature of banking. Commercial banks merged with investment companies and invested in capital markets, taking full advantage of their privileges.⁶² Recognizing these changes is indispensable to understanding TBTF banks' construct and emergence.

1. Investment Companies as Bank Holding Companies

Goldman Sachs and Morgan Stanley, not BHCs until recently, generate profits from investments.⁶³ Bestowing the BHC designation upon investment companies, such as Goldman Sachs and Morgan Stanley, provides them with protection in the form of the Federal Deposit Insurance Corporation's (FDIC) deposit insurance. Credit extensions provided by the Federal Reserve Board are also made available to investment banks turned BHCs.⁶⁴ In return, BHCs subject themselves to additional government regulation, including increased government oversight over capitalization.⁶⁵

2. Bank Involvement in Capital Market Funding

The sizable amount of available assets in capital markets presents banks with a lucrative investment opportunity. A capital market is "any market where a government or a company [in this case a bank] can raise money (capital) to fund their operations and long term investment[s]."⁶⁶ Bond

62. Sewall Chan, *U.S.: Financial Debate Renews Scrutiny on Banks' Size*, CORPWATCH (Apr. 20, 2010), <http://www.corpwatch.org/article.php?id=15567>.

63. *Volcker Rules*, *supra* note 16, at 46 (statement of Simon Johnson) ("[A] bank such as Goldman Sachs now has full access to the Federal [Reserve's] discount window (as a bank holding company)—yet also retains the ability to make risky investments of all kinds anywhere in the world (as it did when it was an investment bank, before September 2008). In a very real sense, the US government is now backing the world's largest speculative investment funds—without any effective oversight mechanisms.").

64. See Board of Governors of the Federal Reserve System, *Press Release*, FEDERAL RESERVE BOARD, (Sept. 22, 2008), <http://www.federalreserve.gov/news/press/bcreg/20080921a.htm>.

65. *See id.*

66. Mike Moffatt, *What Are Capital Markets?*, ABOUT.COM,

and stock markets are the most widely known examples.⁶⁷

In *Too Big to Fail: The Hazards of Bank Bailouts*,⁶⁸ authors Gary Stern and Ron Feldman, posited the possible advantages of capital market funding:

[G]reater reliance on capital markets could reduce an institution's chance of failure. Capital market funding can be cheaper and allow for more effective and diversified management of liquidity. The more arenas in which a bank can raise funds, the more likely it can survive a cutoff from a single source.⁶⁹

Regardless of the ability to diversify funds and spread risks through capital markets, banks must be wary of the risk they present. The risk lying in these markets is their inherent volatility.⁷⁰ Capital market funding can "increase instability by quickening the pace of failure."⁷¹ Capital market companies cause this "quickened pace" because they are "quicker than other sources to restrict the quantity of funds they provide banks."⁷² The failure of the Continental Illinois National Bank and Trust Company of Chicago forewarns against relying too heavily on "extensive capital market funding."⁷³

Continental Illinois' failure lives on in bank infamy. Its failure was the biggest American bank failure to date in 1984.⁷⁴ At that time, it was the seventh largest bank in the nation with almost forty billion dollars in assets and over thirty billion dollars in deposits.⁷⁵ A run on the bank forced

http://economics.about.com/od/financialmarkets/fl/capital_markets.htm (last visited Apr. 17, 2012).

67. *Id.*

68. STERN & FELDMAN, *supra* note 2.

69. *Id.* at 68.

70. *See id.*

71. *Id.*

72. *Id.* at 69.

73. *Id.*

74. FED. DEPOSIT INS. CORP., MANAGING THE CRISIS: THE FDIC AND RTC EXPERIENCE 545 (1998). Washington Mutual's failure in 2009, later eclipsed Continental Illinois' failure. Francine McKenna, *What I Learned Working at the Original Too Big to Fail Bank*, AMERICAN BANKER (Dec. 23, 2011, 10:38 AM), <http://www.americanbanker.com/bankthink/Continental-Illinois-Too-Big-to-Fail-1045154-1.html>.

75. FED. DEPOSIT INS. CORP., *supra* note 74, at 546; U.S. GEN. ACCOUNTING OFFICE, GAO/GGD-97-96, STAFF STUDY: FINANCIAL CRISIS MANAGEMENT: FOUR FINANCIAL CRISES IN THE 1980S 36 (1997).

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the FDIC to seize Continental Illinois Bank.⁷⁶ During the bank's bailout, the forbidding term—Too Big to Fail—was first used.⁷⁷

II. TOO BIG TO FAIL

A. *TBTF Banks*

Part I began with an exploration of United States' banking history and its current state. Part II will tackle the task at hand, TBTF banks. These banks' failures would be so disastrous the government could not afford to let them fail.⁷⁸ The dilemma presented by TBTF banks' size initially went unnoticed by certain legislative members. During the bailout of the Continental Illinois Bank, Congressman Stewart McKinney praised these huge banks:

[W]e have a new kind of bank. And today there is another type [of bank] created. We found it in the thrift institutions, and now we have given approval for a \$1 billion brokerage deal to the Financial Corporation of America. Mr. Chairman, let us not bandy words. We have a new kind of bank. It is called too big to fail. TBTF, and it is a wonderful bank.⁷⁹

After the financial crisis of the late 2000s, politicians ceased touting them.⁸⁰

Both local and nationwide banks have failed in the recent financial collapse.⁸¹ "Some banks fail[ed] without notice. Other failing banks capture[d] the attention of policymakers, often because of the bank's large size and significant role in the financial system."⁸² The large nationwide TBTF banks, however, have raised the most alarm among economists, world leaders, and the public because of the extent of the possible detrimental effects they can have on the economy.⁸³

TBTF also represents a financial school of thought. "A TBTF regime is a policy environment in which uninsured

76. FED. DEPOSIT INS. CORP., *supra* note 74, at 547–63.

77. STERN & FELDMAN, *supra* note 2, at 13.

78. *See id.* at 11.

79. *Id.* at 13.

80. *See Volcker Rules*, *supra* note 16 (statement of Simon Johnson).

81. *Id.* at 45.

82. STERN & FELDMAN, *supra* note 2, at 1.

83. *Id.* at 2.

creditors expect the government to protect them from prospective losses [and prevent] the failure of a big bank; big banks are said to be too big to fail in countries following such a regime.”⁸⁴ Stern and Feldman wrote the TBTF doctrine included, “(1) [A] policy of protecting uninsured creditors at banks from the losses they might suffer and (2) a definition of big bank[s].”⁸⁵ If TBTF banks—such as Bank of America, J.P. Morgan Chase, and Wells Fargo—were allowed to collapse, it would affect America’s economy too drastically because of their dominance within it.⁸⁶ When these banks are bailed out uninsured creditors, investing more than the FDIC insured \$250,000,⁸⁷ are protected by the government.⁸⁸ The tax-generated bailout funding⁸⁹ essentially uses taxpayer money as a safety net for banks walking the tightrope of risky, leveraged investments.⁹⁰

B. Concerns

“[T]he largest [six] banks in our economy now have total assets in excess of [sixty-three] percent GDP [Gross Domestic Product]”⁹¹ as of September 30, 2010.⁹² These banks are: Bank of America, J.P. Morgan Chase, Citigroup, Wells Fargo, Goldman Sachs, and Morgan Stanley.⁹³ These large controllers of American assets evolved through a series of mergers between Bank of America and Merrill Lynch,⁹⁴ J.P.

84. *Id.* at 13.

85. *Id.*

86. *See id.* at 12–13; *infra* Part II.B.

87. FEDERAL DEPOSIT INSURANCE CORPORATION, <http://www.fdic.gov/> (last visited Apr. 17, 2012).

88. STERN & FELDMAN, *supra* note 2, at 12.

89. *See* Chan, *supra* note 62.

90. *See* STERN & FELDMAN, *supra* note 2, at 11. Leveraged is defined as using borrowed money “to increase potential return on investment.” *Leverage*, INVESTOPIA, <http://www.investopedia.com/terms/l/leverage.asp#axzz1pPY18jkJ> (last visited Apr. 17, 2012).

91. *Volcker Rules*, *supra* note 16, at 45.

92. *Id.*

93. Robert Lenzner, *Six Giant Banks Made \$51 Billion Last Year; The Other 980 Lost Money: An Oligopoly of Goldman, BofA, JPMorgan, Morgan Stanley, Citi, and Wells Fargo Is Flourishing*, FORBES (June 3, 2010, 1:25 PM) <http://www.forbes.com/2010/06/03/goldman-sachs-citigroup-markets-lenzner-morgan-stanley.html>. An up-to-date list is located at *Top 50 BHCs*, FED. FIN. INSTS. EXAMINATION COUNCIL: NAT’L INFO. CTR., <http://www.ffiec.gov/nicpubweb/nicweb/top50form.aspx> (last updated Mar. 31, 2012).

94. Chan, *supra* note 62.

Morgan Chase and Bear Stearns,⁹⁵ and Wells Fargo and Wachovia.⁹⁶ By “controlling” sixty-three percent of the United States’ GDP, these banks are vital to the U.S. economy.⁹⁷ Their dominance, conjuring up memories of the past powerful American car and steel industries, also brings fears of the possible failure which could have dire effects on job availability, domestic dollar power, and the strength of the dollar abroad.⁹⁸

C. Effects Felt During the Financial Crisis of the Late 2000s

The repercussions of the TBTF banks’ failed risky investments have been catastrophic.⁹⁹ “Revised data will likely show more than 8 million net jobs lost since December 2007, due to more than a decade of reckless risk-taking involving large financial institutions.”¹⁰⁰ The driving force behind the Financial Crisis of the late 2000s was the collapse of the housing and credit “bubble” within the United States.¹⁰¹ This “bubble” inflated to dangerous levels because America’s economy was following the economic trend of financialization.¹⁰² “The financialization of capitalism—the shift in gravity of economic activity from production (and even from much of the growing service sector) to finance—is thus one of the key issues of our time,” commented John Foster, Professor of Sociology at the University of Oregon.¹⁰³ As a result of the shift, economic success now primarily depends on the financial sector, including commercial and investment banks.¹⁰⁴

95. *Id.*

96. *Id.*

97. *See Volcker Rules, supra* note 16, at 45 (statement of Simon Johnson).

98. *See id.* at 45–46.

99. *See id.*

100. *Id.* at 46.

101. Ben S. Bernanke, *Four Questions about the Financial Crisis*, FED. RESERVE (Apr. 14, 2009), <http://www.federalreserve.gov/newsevents/speech/bernanke20090414a.htm>.

102. John Bellamy Foster, *The Financialization of Capitalization*, 58 MONTHLY REVIEW, Apr. 2007, at 1, available at <http://www.greeneconomics.net/Financialization.pdf>; John Bellamy Foster, SOCIOLOGY.UOREGON.EDU, <http://sociology.uoregon.edu/faculty/foster.php> (last visited Apr. 13, 2012).

103. Foster, *supra* note 102, at 1.

104. *Economic Crisis and Market Upheavals*, N.Y. TIMES (Oct. 3, 2011), http://topics.nytimes.com/top/reference/timestopics/subjects/c/credit_crisis/index.html?offset=0&s=newest.

Both types of banks, taking advantage of consequent freedoms due to deregulation, undertook unwise risks.¹⁰⁵ Investment banks, not being subject to the same regulations as commercial banks, amassed huge amounts of debt while still lending to people and corporations.¹⁰⁶ They then lacked the reserves to cover massive losses resulting from defaulted loans.¹⁰⁷ The shortage prevented banks from making further loans and halted the economy.¹⁰⁸

D. Bailout Money: Troubled Asset Relief Program (TARP)

In 2008, the government made the difficult but necessary choice to bailout multiple banks, including TBTF banks, in order to avoid total financial collapse.¹⁰⁹ Secretary of the Treasury Henry Paulson presented TARP to the nation TARP, the most memorable bank bailout, on September 19, 2008.¹¹⁰ It allowed the “Department of the Treasury to purchase or insure up to \$700 billion of troubled assets.”¹¹¹ Congress defined troubled assets as:

(1) Residential or commercial mortgages and any securities, obligations, or other instruments that are based on or related to such mortgages, that in each case was originated or issued on or before March 14, 2008, the purchase of which the Secretary determines promotes financial market stability; and

(2) [A]ny other financial instrument that the Secretary, after consultation with the Chairman of the Board of Governors of the Federal Reserve System, determines the purchase of which is necessary to promote financial market stability, but only upon transmittal of such determination, in writing, to the appropriate committees of Congress.¹¹²

The Treasury infused capital into failing banks by buying their assets and bad debt.¹¹³ It has bought twenty-five billion dollars worth of assets and bad debt of Citigroup, J.P. Morgan

105. See *Volcker Rules*, *supra* note 16, at 46 (statement of Simon Johnson).

106. See *Economic Crisis and Market Upheavals*, *supra* note 104.

107. See *id.*

108. See *id.*

109. See CONG. BUDGET OFFICE, *supra* note 6, at 1.

110. ANDREW ROSS STORKIN, *TOO BIG TO FAIL* 446 (2009).

111. CONG. BUDGET OFFICE, *supra* note 6, at 1.

112. *Id.*

113. See *id.*

Chase, and Wells Fargo; fifteen billion dollars of Bank of America; and ten billion dollars of Goldman Sachs.¹¹⁴

E. Viability

Before analyzing TBTF banks, it is important to contemplate their overall feasibility. Arguments of Simon Johnson, the Chief Economist of the International Monetary Fund from August 2007 to August 2008, and Edward Kane, renowned Professor of Finance at Boston College, debunking the theories of advantageous economies of scale displayed by TBTF banks, global competitiveness, and efficiency are presented.¹¹⁵ An investigation of a bank merger's effects on a loan offering, providing real evidence of the sensibility in these bank mergers, concludes this section.

1. Economies of Scale

Large banks would be expected to offer economies of scale, but there is little supporting evidence of them exhibiting this financial advantage.¹¹⁶ Economies of scale is defined as “a situation in which a firm can increase its output more than proportionally to its total input cost.”¹¹⁷ If a large bank follows the economic theory it should be able to more efficiently serve (at lower production costs) its consumers as it increases its number of services and account holders. Simon Johnson wrote, “There is no evidence for economies of scale in banking over \$100 billion of total assets.”¹¹⁸ This absence is caused by the bank's assets becoming so large that its dealings became unmanageable. The bank can then no longer consider the welfare of its customers.¹¹⁹ “[U]nprecedented consolidation in the financial sector over the previous decade ha[s] led to no significant efficiency gains, no economies of scale beyond a low threshold, and no

114. *Id.* at 2.

115. Simon Johnson, MIT.EDU, http://mitsloan.mit.edu/faculty/detail.php?in_spseqno=198 (last visited Apr. 17, 2012); Edward J. Kane, BC.EDU, <https://www2.bc.edu/~kaneeb/> (last visited Apr. 17, 2012).

116. See *Volcker Rules*, *supra* note 16, at 46–47 (statement of Simon Johnson).

117. EDGAR K. BROWNING & MARK A. ZUPAN, *MACROECONOMICS: THEORY & APPLICATIONS* 220 (John Wiley & Sons, Inc. 9th ed. 2006).

118. *Volcker Rules*, *supra* note 16, at 46 (statement of Simon Johnson).

119. *Id.*

evident economies of scope.”¹²⁰

Edward Kane disclaimed large banks enjoying economies of scale:

Since large banks exhibit constant returns to scale (they are no more or less efficient as they grow larger), and we know that large banks enjoy a subsidy due to being too big to fail, “offsetting diseconomies must exist in the operation of large institutions”—that is without the “too big to fail subsidy,” large banks would actually be less efficient than midsize banks.¹²¹

Large banks increasing in size do not evidence rising efficiency,¹²² rather there must be increasing inefficiencies within larger banks offsetting the economies of scale efficiencies they should be experiencing.¹²³ Kane finds the involution and magnitude of TBTF banks to be culpable for the apparent lack of economies of scale.¹²⁴ The cumbersome internal structure of TBTF banks offsets their would-be relative efficiency advantage.¹²⁵

“[B]ig banks [are able to] provide benefits to the economy that cannot be provided by smaller banks.”¹²⁶ Large banks possess a quasi-national system enabling them to provide services to account holders spanning the entire country. Nationwide Automated Teller Machines (ATMs) exemplify a benefit of this system.¹²⁷ Large banks also have increased networks and cash reserves enabling them, in theory, to give larger loans.¹²⁸ These increased offerings to customers

120. *Id.* (citing ROGER W. FERGUSON JR. ET AL., INTERNATIONAL FINANCIAL STABILITY 93–94 (2007)). “Economies of scope” is defined as “a case where it is cheaper for one firm to produce products jointly than it is for separate firms to produce the same products independently.” BROWNING & ZUPAN, *supra* note 117, at 229.

121. *Volcker Rules*, *supra* note 16, at 47 (statement of Simon Johnson) (citing Edward J. Kane, *Extracting Nontransparent Safety Net Subsidies by Strategically Expanding and Contracting a Financial Institution’s Accounting Balance Sheet*, 36 J. OF FIN. SERVICES RES. 161–68 (2009)). Diseconomies of scale describes the opposite situation where a firm produces less efficiently as increases its production. BROWNING & ZUPAN, *supra* note 117, at 220. Large banks display diseconomies of scale rather than desired economies of scale.

122. Kane, *supra* note 121, at 162.

123. *See id.*

124. *Id.*

125. *See id.*

126. *Volcker Rules*, *supra* note 16, at 46 (statement of Simon Johnson).

127. *See id.*

128. *Id.* For a case of a merged and subsequently larger bank offering a

evidence big banks “enjoy[ing] [] economies of scale” enabled by increased efficiency.¹²⁹ Regardless, the TBTF banks’ risks still outweigh these above-discussed benefits.¹³⁰ The simple adage of “the bigger the bank, the bigger the gains”¹³¹ no longer holds true.

2. *Global Competition*

Simon Johnson presents the following argument for large banks: “global competitiveness of U.S. corporations requires American banks to be at least as big as the banks in any other country.”¹³² While partially true, the financial collapse was suffered worldwide¹³³ and operating well in a defunct system does not alter (or improve) the state of being defunct. Other countries, England for example, admitted their banking systems demand drastic overhaul.¹³⁴ The Bank of England termed the bailing out of increasingly bigger banks as the “doom loop.”¹³⁵ Andy Haldane, Bank of England’s Executive Director for Financial Stability, and Pier Giorgio Alessandri, Bank of England Economist,¹³⁶ argued governments’ repeated bank bail outs cripple their stance of “never again[,] . . . add[ing] to the cost of future crises. And the larger these costs, the lower the credibility of ‘never again’ announcements. This is a doom loop.”¹³⁷

Large international corporations spanning multiple countries do have “global financing needs.”¹³⁸ However, one bank does not exclusively provide all of a Multinational

smaller loan amount post merger than the two prior individual banks, see *supra* Part II.E.4.

129. *Id.*

130. See *supra* Part II.B.

131. *Volcker Rules*, *supra* note 16, at 46 (statement of Simon Johnson).

132. *Id.*

133. *Id.*

134. See *id.* at 45.

135. Edmund Conway, *Bank of England Says Financiers are Fuelling an Economic ‘Doom Loop,’* THE TELEGRAPH (Nov. 6, 2009, 11:50 PM), <http://www.telegraph.co.uk/finance/financetopics/financialcrisis/6516579/Bank-of-England-says-financiers-are-fuelling-an-economic-doom-loop.html>.

136. *Andy Haldane - Executive Director Financial Stability*, BANK OF ENGLAND, <http://www.bankofengland.co.uk/about/Pages/people/biographies/haldane.aspx> (last visited Apr. 17, 2012); *Piergiorgio Alessandri*, BANK OF ENGLAND, http://www.bankofengland.co.uk/research/Pages/economists/staff/piergiorgio_alessandri_publications.aspx (last visited Apr. 17, 2012).

137. Conway, *supra* note 135.

138. *Volcker Rules*, *supra* note 16, at 47 (statement of Simon Johnson).

Corporation's (MNC) services.¹³⁹ Instead, MNCs rely on "syndicates of banks for major offerings of equity or debt."¹⁴⁰ Most corporations would prefer not to rely on a single bank.¹⁴¹ They wish to capitalize on each bank's specializations, as well as protect themselves from bank failure.¹⁴² Simon Johnson wrote, "U.S. corporations already benefit from competition between U.S. and foreign banks, which can provide identical financial products; there is no reason to believe that the global competitiveness of our non-financial sector depends on our having the world's largest banks."¹⁴³ That being said, U.S. banks must be large enough to compete with the large foreign banks to provide this "global competitiveness" for corporations.

3. *What Is This Really About?: Competition v. Efficiency*

Arguments regarding big banks can be boiled down to the timeless tug-of-war between competition and efficiency. Competition, in theory, protects the buyer by discouraging monopolies, enabling sellers to charge higher prices. Efficiency, a by-product of bank mergers, spreads fixed costs, decreases costs due to competition, and offers greater economies of scale, the benefits of which are theoretically passed on to the buyer. Previously, the efficiency consideration was heavily favored because larger banks' positive effects were narrowly considered. Now, current economic reality is driving the promotion of competitiveness.

4. *Coca-Cola Enterprises (CCE) Case*

CCE's experience reveals bank mergers' potential consequences for borrowers.¹⁴⁴ CCE held separate credit lines with NationsBank and Bank of America.¹⁴⁵ The two banks decided to combine.¹⁴⁶ Following the banks' merger, CCE could only acquire a loan amounting to half of what the pre-

139. *Id.*

140. *Id.*

141. *Id.*

142. *See id.*

143. *Id.*

144. Jathon Sapsford & Paul Sherer, *Deals & Deal Makers: Fewer Banks Mean Costlier Credit Lines*, WALL ST. J., Mar. 14, 2001, at C1.

145. *Id.*

146. *Id.*

merger banks had previously offered.¹⁴⁷ The amalgamation reduced—and with regards to these two banks removed—CCE’s ability to procure a larger credit line by initiating loan relationships with multiple banks.¹⁴⁸ CCE was formerly able to benefit from the bank competition.

Depending from whose viewpoint you are looking, CCE’s loan outcome is either encouraging or discouraging. On one hand, the banks were able to reduce a risk they possibly should not have taken previously. Banks had the opportunity to accurately assess a borrower’s viability instead of muddling numbers to extend an ill-advisedly large loan in hopes of defeating the competition. Conversely, the borrower had fewer options for procurement of the loan and received a reduced loan.

III. ANALYSIS OF TBTF BANK MERGERS

A. *TBTF Bank Mergers*

During 2008, multiple nationwide TBTF banks merged: Bank of America “swallowed” Merrill Lynch, J.P. Morgan Chase bought Bear Stearns and joined Washington Mutual, and Wells Fargo purchased Wachovia.¹⁴⁹ Permitting these mergers only augmented the risks posed by TBTF banks as their increased size heightened the consequences of prospective failure. An analysis of the TBTF bank mergers will help answer the question posed at the beginning of this comment—should the government have allowed them to take place?

B. *Tools Used in Analysis*

Antitrust law and BMA factors are the analytic tools used to evaluate the government sanction of these TBTF bank mergers. Antitrust law protects competition by preventing agreements unreasonably restraining trade¹⁵⁰ and can be used to assess TBTF bank mergers’ legality. The Warren Court in *Brown Shoe Company v. United States*¹⁵¹

147. *Id.*

148. *Id.* It is important to note a market shift could have contributed to the altered credit line offer as well.

149. Chan, *supra* note 62.

150. *Texaco Inc. v. Dagher*, 547 U.S. 1, 5 (2006).

151. *Brown Shoe Co. v. United States*, 370 U.S. 294, 294 (1962).

explained the test for antitrust analysis: whether the effect of the merger may substantially lessen competition in any line of commerce in any section of the country.¹⁵² Congress later codified this test in section 7 of the Clayton Act.¹⁵³ In *United States v. Philadelphia National Bank* the same Warren Court applied antitrust laws to bank mergers.¹⁵⁴

A bank merger is judged by BMA factors in order to assess its possible anticompetitive nature. Its authorization turns on the result of that analysis.¹⁵⁵ The factors of monopolization,¹⁵⁶ anticompetitiveness,¹⁵⁷ and traditional banking factors are weighed by the court.¹⁵⁸ Applying these factors to TBTF bank mergers will determine whether they violated the BMA and if they discourage competition.¹⁵⁹

C. Analysis

An analysis of whether these TBTF bank mergers violate antitrust laws begins with first determining whether antitrust laws apply to the banks or if the banks are shielded by antitrust immunity. If antitrust laws do apply, it is essential to determine the relevant market for banks, including both their product and geographic markets. Ultimately, BMA factors are employed to evaluate the mergers' potential anticompetitive nature.

1. Do Banks Have Implied Antitrust Immunity for Merger Analysis?

i. Philadelphia National Bank Court Says No

United States v. Philadelphia National Bank is the hallmark case involving bank mergers.¹⁶⁰ The Court ruled against a merger of two banks, Philadelphia National Bank and Girard Trust Corn Exchange, because the merger would discourage competition, violating section 7 of the Clayton

152. *Id.* at 328; 15 U.S.C. § 12(a) (2011); *United States v. Phila. Nat'l Bank*, 374 U.S. 321, 356 (1963).

153. *See* 15 U.S.C. § 18 (2006).

154. *Phila. Nat'l Bank*, 374 U.S. at 338–43.

155. *Brown Shoe Co.*, 370 U.S. at 316–23.

156. 12 U.S.C. § 1828(c)(5)(A) (2006); *see supra* Part I.D.3.

157. § 1828(c)(5)(B); *see supra* Part I.D.3.

158. § 1828(c)(5)(B); *see supra* Part I.D.3.

159. *See infra* Part III.C.3.

160. *United States v. Phila. Nat'l Bank*, 374 U.S. 321, 321 (1963).

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Act.¹⁶¹ The banks claimed section 7 relief because of burdensome government banking regulation.¹⁶² But the Court held government regulation did not grant them immunization.¹⁶³

ii. Antitrust Savings Clause

The BHCA contains an antitrust savings clause—“[N]othing in this Act shall exempt any [BHC] involved in such a transaction from complying with the antitrust laws after the consummation of such transaction.”¹⁶⁴ This further confirms the application of antitrust laws to bank mergers. This same reasoning is applied to the antitrust savings clause in the telecommunications industry.

Verizon Communications Inc. v. Law Offices of Curtis V. Trinko, LLP is the seminal telecommunications case regarding the implementation of the antitrust savings clause.¹⁶⁵ The Rehnquist Court held industry regulation did not bar application of antitrust laws.¹⁶⁶ An antitrust savings clause within the applicable 1996 Telecommunications Act preserved application.¹⁶⁷ The savings clause was as follows: “Nothing in this Act or the amendments made by this Act shall be construed to modify, impair, or supersede the applicability of any of the antitrust laws.”¹⁶⁸

The prior stated BHCA antitrust savings clause expressed similar language and intent.¹⁶⁹ The BHCA required bank mergers to comply with antitrust laws in addition to its guidelines.¹⁷⁰ Refusal of antitrust immunity was in accordance with Federal Reserve Chairman at the time William Martin’s belief that the Attorney General, the government body that enforces antitrust provisions, should retain full authority under the Clayton Act.¹⁷¹ Martin

161. *Id.* at 371–72.

162. *Id.* at 368.

163. *Id.* at 350, 354.

164. 12 U.S.C. § 1849(b) (2006).

165. *Verizon Commc’n Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398, 398 (2004).

166. *Id.*

167. *Id.*

168. *Id.* at 406.

169. § 1849(b).

170. *See id.*

171. *See Current Antitrust Problems: Hearing Before the Antitrust Subcomm. (Subcomm. No. 5) of the H. Comm. on the Judiciary*, 84th Cong. 2173 (1955)

granted government permission to analyze bank mergers according to BMA factors.¹⁷²

2. *The Relevant Market*

Defining the relevant market is the first stage in antitrust analysis.¹⁷³ The relevant market is defined as “a product or group of products and a geographic area in which [two or more businesses’ products are] produced or sold.”¹⁷⁴ It can be broken down into the product and the geographic market.¹⁷⁵ Designating the product market determines substitutability between the companies’ goods.¹⁷⁶ The court decides the product market by assessing the potential change in a consumer’s purchasing habits in reaction to “a small but significant and non-transitory increase in price.”¹⁷⁷ As mentioned *supra*, the geographic market comprises the area in which the businesses produce or sell their products.¹⁷⁸

The present relevant market is composed of the TBTF banks’ product and geographic markets. Their product market must now include loans and investments made by both commercial and investment banks. TBTF banks would argue the geographic market should be worldwide because of their international clientele. This international market would suggest the banks are competing internationally and hence lessen the impact of a merger’s anticompetitive effects. A narrower, national market is more precise. While acting in their commercial banking capacity American TBTF banks serve primarily domestic customers. The BMA analysis conducted below will assume a national market.

(statement of William Martin, Federal Reserve Board Chairman).

172. *Id.* at 2170.

173. *United States v. E.I. du Pont de Nemours & Co.*, 351 U.S. 377, 404 (1956).

174. AM. BAR ASS’N SECTION OF ANTITRUST LAW, BANK MERGERS AND ACQUISITIONS HANDBOOK 113 (2006); DEPT. OF JUSTICE AND FED. TRADE COMM’N, HORIZONTAL MERGER GUIDELINES 4 (1992, rev. 1997), available at <http://www.justice.gov/atr/public/guidelines/hmg.pdf>.

175. AM. BAR ASS’N SECTION OF ANTITRUST LAW, *supra* note 174, at 113.

176. *See* DEPT. OF JUSTICE AND FED. TRADE COMM’N, HORIZONTAL MERGER GUIDELINES 7–8 (2010), available at <http://www.justice.gov/atr/public/guidelines/hmg-2010.pdf>.

177. *Id.* at 9.

178. AM. BAR ASS’N SECTION OF ANTITRUST LAW, *supra* note 174, at 113.

3. BMA Factors

i. Monopolization

There is no American banking monopoly,¹⁷⁹ nor is there an oligopoly,¹⁸⁰ as there are still numerous distinctly owned banks in the United States. Though an attempt to monopolize the banking industry is conceivable in the near future as large banks grow increasingly stronger, making it ever more difficult for smaller banks to compete. “Undersized” banks cannot contend with expanding TBTF banks because the larger banks offer credit card deals, national ATMs, and loans the smaller banks cannot provide.¹⁸¹ At present, however, there is no monopolization created by TBTF bank mergers.

ii. Anticompetitiveness

Mergers creating large national banks generate anti-competitiveness. They lessen the number of competing banks in the United States. Further, large banks are evolving into national banks and only other like-sized institutions can truly contend. These national banks presently vie for customers, but diminished rivalry will result as TBTF banks’ continue their amalgamation. The merged institutions have created a highly concentrated American bank market, fostering unhealthy competition. “The big four [banks] have half of the market for mortgages and two-thirds of the market for credit cards. Five banks have over [ninety-five] percent of the market for over-the-counter derivatives. Three U.S. banks have over [forty] percent of the global market for stock underwriting.”¹⁸² The market power of TBTF banks, in the words of Simon Johnson, is “dangerous.”¹⁸³

Several arguments support the creation of large banks. Arguably, the increased market power allows TBTF banks to accomplish more because they spend less resources, time and money, competing. The increased productivity of these banks

179. A monopoly would involve a single bank meeting all of the country’s banking needs. See BROWNING & ZUPAN, *supra* note 117, at 312.

180. A bank oligopoly would involve a few banks providing all of the banking services for the entire nation. See *id.* at 375.

181. See sources cited *supra* notes 126–29; *supra* Part II.E.1.

182. *Volcker Rules*, *supra* note 16, at 46 (statement of Simon Johnson).

183. *Id.* at 45.

benefits the whole country because these are American banks.¹⁸⁴ Randall Kroszner, Professor of Economics at the University of Chicago's Booth School of Business,¹⁸⁵ stated,

Branching deregulation tends to reduce banks' local market power and improves conditions for borrowers. Although not without controversy, a number of studies have shown that lending to small businesses increases on average when banking organizations purchase small banks, and credit availability to small businesses increases in the years following banking organizations' takeover of small banks.¹⁸⁶

However, large bank mergers also have negative effects on customers. Some of these negative effects are explored below.

Bank mergers enable the unified entities to raise loan rates because of less inter-bank competition for customers.¹⁸⁷ The resulting decreased loan amount in the *CCE* Case, discussed *supra*, illustrates another possible negative effect of these unions.¹⁸⁸ "Bank mergers lead to higher interest rates and diminished economic conditions."¹⁸⁹ Increased prices for bank customers and reduced competition between banks worsen economic conditions. People become less likely to procure bank loans and then reinvest that money into the economy by starting new businesses or buying products.

"[H]igher real estate loan rates [are] associated with bank mergers"¹⁹⁰ and "bank mergers influence deposit rates to the detriment of depositors."¹⁹¹ As a result of decreased competition, banks face a reduced risk of losing customers as a consequence of increasing their real estate loan rates.¹⁹² Bank mergers result in diminished bank "operating efficiency"¹⁹³ evidencing a lack of economies of scope. Banks display economies of scope when they can provide services

184. *See id.* at 46–47.

185. Randall S. Kroszner, CHICAGOBOOTH.EDU, http://www.chicagobooth.edu/faculty/bio.aspx?person_id=12825212928 (last visited Nov. 23, 2011).

186. Kroszner, *supra* note 34, at 38.

187. Donald R. Fraser et al., *Market Power, Bank Megamergers, and the Welfare of Bank Borrowers*, 34 J. FIN. RES. 641, 646 (2011).

188. *See* Part II.E.4.

189. Fraser et al., *supra* note 187, at 646.

190. *Id.*

191. *Id.* at 647.

192. *See id.* at 646–47.

193. *Id.* at 647.

more efficiently (at less cost) “jointly” than separately.¹⁹⁴ Actually diseconomies of scope¹⁹⁵ are revealed, “lead[ing] to higher loan rates and/or lower deposit rates.”¹⁹⁶ Convincing evidence exists pointing to TBTF bank mergers discouraging competition.

iii. Traditional Banking Factors

The BMA considers “the financial and managerial resources and the future prospects of the existing and proposed institutions and the convenience and needs of the community to be served.”¹⁹⁷ These traditional banking factors are indispensable to the analysis of TBTF banks. Banks investing in risky markets and then receiving government bailouts when they fail do not benefit the community for two reasons. First, taxpayers bear the burden of expensing that bailout. Second, a very real incentive pressuring these banks to make safer investments is eliminated. TBTF banks may lose customers due to unwise investments, but they do not face a *bona fide* threat of failure. Moral hazard—“[t]he tendency to incur risks that one is protected against”—is bred.¹⁹⁸ Bank bailouts have in effect removed an extremely effective incentive for banks to make safer investments.¹⁹⁹ TBTF banks pose an indisputable threat to the United States economy and to the interests of the American people. Furthermore, they lack a legitimate incentive to lessen that threat.

4. Final Analysis

There is no current monopolization created by the TBTF bank mergers; however, there is compelling evidence they discourage competition. Applying the TBTF bank mergers to the traditional banking factors illuminates that they are not serving the community’s—that is the United States’—

194. See BROWNING & ZUPAN, *supra* note 117, at 229.

195. Banks experience diseconomies of scope when separate banks can provide services more efficiently (at less cost) separately than “jointly.” See *id.*

196. Fraser et al., *supra* note 187, at 647.

197. 12 U.S.C. § 1828(c)(5) (2006); see *supra* Part I.D.3.

198. ALAN C. SHAPIRO & ATULYA SARIN, FOUNDATIONS OF MULTINATIONAL FINANCIAL MANAGEMENT 527 (John Wiley & Sons, Inc. 6th ed. 2009).

199. “Capitalism without failure is like religion without sin. It doesn’t work. Bankruptcies and losses concentrate the mind on prudent behavior.” *Id.* at 68 n.1 (quoting economist Allan H. Meltzer).

interests. Their potential failure greatly encumbers the public in the form of taxes for bailout money and detrimental effects on the economy. TBTF bank mergers violate the BMA and should not have been allowed.

IV. PROPOSED CHANGES

Because these bank mergers violated antitrust laws, stark changes must be made to their product, the TBTF banks. This revamping could be achieved through the enforcement of an additional BMA traditional banking factor. Currently the traditional banking factors do not expressly account for future ramifications. Foreseeing future adverse effects, such as the dire economic effects, manifest clearly that the “needs of the community” are not best served by TBTF bank mergers. Further, TBTF banks must be divided to create smaller and hence more manageable banks.

The “needs of the community” factor can be utilized to determine a reasonable and enforceable bank size restriction. In the interests of the community, the government must create and implement this cap size. Determination of an appropriate cap size is a complex issue beyond this Comment’s breadth, but a system of regional banks, apportioned by time zone, would be a sensible start. This crucial restriction will limit bank size and increase competition in an effort to save the American economy from future disasters. “Without a size cap on individual bank size, [the United States] will move towards the highly dangerous situation that prevails in some parts of Western Europe—where individual banks hold assets worth more (at least on paper, during a boom) than their home country’s GDP.”²⁰⁰ This is valid cause for worry because this power gives banks the ability to take immense, perilous risks.²⁰¹ These institutions’ growth must be confined, particularly considering the government and, ultimately, taxpayers fund their risk and potential failure.

The GLBA needs to be retracted, and the GSA should be reinstated. Separating commercial banks from investment banks would be both physically and legally prudent. It will advance their regulation by constructing more transparent

200. *Volcker Rules*, *supra* note 16, at 45 (statement of Simon Johnson).

201. *See id.* at 45–46.

and effective distinct controlling statutes. An absolute separation may be untenable, given the current global marketplace demands, but efforts must be made to distinguish two banks serving contradictory needs and requiring divergent laws.

The RNIA must be expanded considering the evolution of “wholesale financing.” Precise enlargement will predicate upon GSA reinstatement that will, as stated above, disentangle commercial banks from investment banks. Currently, the RNIA’s ten percent deposit holding requirement is inept at controlling TBTF banks in their current construct. The improved restriction must encompass money TBTF banks receive from wholesale financing.

CONCLUSION

Mergers creating TBTF banks violate the BMA. They are anticompetitive and clearly not in the community’s best interests.²⁰² TBTF banks, through deregulation, have grown beyond what the United States’ economy can safely sustain.²⁰³ Curtailing bank cap size is paramount to creating a more manageable bank.²⁰⁴ The Legislature must revert to stricter banking statutes. To not do so would evidence, borrowing language from the Roberts Court, “systemic negligence”²⁰⁵ on the government’s part. The Great Recession elucidated the TBTF dilemma, and the Legislature’s failure to take corrective and preventive action would be “grossly negligent conduct”²⁰⁶ considering another economic collapse could only be described as “circumstances recurring.”²⁰⁷

Increased regulation and restriction will help revive the public’s trust in its government and banking system. With the rise of globalization and increasing foreign competition,²⁰⁸ strengthened confidence in America’s political and economic structure will be of the utmost importance. Improved banking regulation is a step towards stabilizing the future of America’s economy and avoiding future financial collapse.

202. *See supra* Part III.C.4.

203. *See supra* Part II.B.

204. *See supra* Part IV.

205. *Herring v. United States*, 555 U.S. 135, 144 (2009).

206. *Id.*

207. *Id.*

208. SHAPIRO & SARIN, *supra* note 198, at 4.